TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Billions in Potential Taxes Went Unaddressed From Unfiled Returns and Underreported Income by Taxpayers That Received Form 1099-K Income

December 30, 2020

Reference Number: 2021-30-002

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HIGHLIGHTS: Billions in Potential Taxes Went Unaddressed From Unfiled Returns and Underreported Income by Taxpayers That Received Form 1099-K Income

Final Audit Report issued on December 30, 2020
Reference Number 2021-30-002

Why TIGTA Did This Audit

Internal Revenue Code Section 6050W was intended to help narrow the Tax Gap by increasing voluntary compliance through additional third-party information reporting. This audit was initiated to determine whether the IRS is identifying and addressing individual and business taxpayers with underreported income or unfiled returns related to Form 1099-K, *Payment Card and Third Party Transactions*, income. This report focuses on identifying the general population of individual and business taxpayers that received Form(s) 1099-K for Tax Year 2017, but underreported the income or did not file a tax return, and how the IRS is addressing this tax noncompliance.

Impact on Taxpayers

If taxpayers are not reporting or are underreporting Form 1099-K income, they are potentially not paying the appropriate taxes on the income. To help decrease the Tax Gap, promote fairness, and protect the integrity of the tax system, it is important the IRS identify and address taxpayers with the highest risk of noncompliance.

What TIGTA Found

For Tax Year 2017, numerous business and individual nonfiler taxpayers with Form 1099-K income were not identified and cases were not created by the IRS's nonfiler programs, and in other cases, they were identified but not worked by the IRS. TIGTA identified 314,586 business taxpayers with $335.5 billion in Form 1099-K income that appeared to have a filing obligation, but were not identified as nonfilers by the IRS. The problem is that the IRS cannot use third-party information returns, such as Form 1099-K data, to identify business nonfilers and create cases if the taxpayers' accounts are coded as not having an open filing requirement, or no tax account exists because the business has never filed a tax return.

The IRS also does not identify all individual nonfilers with significant Form 1099-K income. TIGTA identified 62,087 individual nonfilers with $575 million in Form 1099-K income who the IRS had not identified as nonfilers and nonfiler cases were not created. While the IRS cannot work all of the nonfiler cases it identifies due to resource limitations, TIGTA identified a significant number (325,060 business nonfilers and 103,991 individual nonfilers with $203 billion and $3 billion in Form 1099-K income, respectively) that were not selected to be worked.

For Tax Year 2017, numerous business and individual taxpayers with reporting discrepancies of at least $10,000 between the reported Tax Year 2017 income on the return and the Form 1099-K income were not identified by the IRS's underreporter programs, or were identified, but not worked. For example, the IRS does not identify fiscal year business underreporters. There were 3,314 Form 1120, *U.S. Corporation Income Tax Return*, fiscal year filer business nonfilers with $1.5 billion in underreported Form 1099-K income. Additionally, TIGTA identified a significant number of underreporter cases (45,169 business underreporter cases) not selected to be worked by the Field Case Selection unit, with $73 billion in potentially underreported Form 1099-K income.

TIGTA estimates that if the IRS identified, created, and worked just the nonfiler and underreporter cases with Form 1099-K income of $1 million or more for businesses (Form 1120) and $100,000 or more for individuals, the IRS could potentially assess an additional $5.723 billion in taxes.

What TIGTA Recommended

TIGTA made seven recommendations to help improve the case identification, creation, and work selection processes for the nonfiler and underreporter programs.

The IRS agreed with three of the seven recommendations and disagreed with four recommendations. The IRS plans to evaluate Start Date criteria for reviewing newly created entities, define high-income business nonfilers, and work a percentage of individual nonfiler cases TIGTA identified.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

December 30, 2020

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

M. Weir

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Billions in Potential Taxes Went Unaddressed From Unfiled Returns and Underreported Income by Taxpayers That Received Form 1099-K Income (Audit # 201930023)

This report presents the results of our review to determine whether the Internal Revenue Service is identifying and addressing taxpayers with unfiled or underreported Form 1099-K, *Payment Card and Third Party Transactions*, income. This review was part of our Fiscal Year 2020 Annual Audit Plan and addresses the major management and performance challenge of *Improving Tax Reporting and Payment Compliance*.

Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

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Appendices

Background

The Internal Revenue Service (IRS) defines the gross Tax Gap as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay in a tax year.[1] For Tax Years (TY) 2011 through 2013, the IRS estimated that the portion of the Tax Gap due to underreporters was $352 billion (80 percent), of this, 70 percent was from individual tax returns and 11 percent was from corporation income tax returns.[2] Additionally, the portion due to nonfilers was $39 billion (9 percent).[3] An important role of the Treasury Inspector General for Tax Administration (TIGTA) is to make recommendations to improve the efficiency and effectiveness of IRS programs, including its compliance and enforcement programs. TIGTA recommendations are intended to inform the IRS on actions needed to address areas of concern. IRS management is responsible for resource allocation decisions and may decide to leave problems unaddressed. The IRS cannot address all of the tax noncompliance that it identifies; however, in its efforts to reduce the Tax Gap, promote fairness, and protect the integrity of the tax system, it is important that the IRS identify and address taxpayers with the highest risk of noncompliance. In this report, we are highlighting noncompliance by taxpayers who earn income that is reported to the IRS on Form 1099-K, *Payment Card and Third Party Network Transactions*.[4]

Internal Revenue Code Section 6050W was intended to help narrow the Tax Gap by increasing voluntary compliance through additional third-party information reporting.

In Calendar Year 2008, the Housing and Economic Recovery Act of 2008 was enacted into law.[5] Among other provisions, this act created Internal Revenue Code Section (§) 6050W, which, effective in TY 2011, requires Form 1099-K to be filed in Calendar Year 2012 on payment card transactions by "merchant acquiring entities" and third-party network transactions by "third party settlement organizations." However, the law established annual thresholds of $20,000 and 200 transactions for third-party settlement organizations.[6] This legislation was intended to help narrow the Tax Gap by increasing voluntary compliance through additional third-party information reporting. Enhanced third-party information reporting aids enforcement by ensuring that taxable income is reported.

The IRS has several programs to address underreporting and nonfiling discrepancies for different types of income, including Form 1099-K. In addition, there are multiple potential enforcement actions that the IRS can take to address nonfilers and underreporters. The matter can be assigned to a revenue officer in the Collection Field function who may telephone the

[1] Hereafter the gross Tax Gap is referred to as the Tax Gap.

[2] See Appendix VII for a glossary of terms.

[3] Publication 1415, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011 – 2013* (Sept. 2019).

[4] See Appendix III for a copy of Form 1099-K. The Form 1099-K assists the IRS in matching gross payments to the gross sales/receipts reported on tax returns.

[5] Pub. L. No. 110-289, 122 Stat. 2654.

[6] Internal Revenue Code § 6050W(b)(2) provides that merchant acquiring entities include banks and other organizations that must fulfill credit card transaction payments. Internal Revenue Code § 6050W(b)(3) defines third-party settlement organizations as the central organizations that have the contractual obligation to make payment to participating payees of third-party network transactions.

taxpayer or make an in-person visit. The matter might also be assigned to a revenue agent in the Examination function who will attempt to secure the unfiled return and possibly subject the tax return for an audit to identify and assess the unreported income.[7] Because the intentional nonfiling of a tax return is a crime, the IRS might also assign the matter to a special agent in Criminal Investigation. Most often, however, the IRS starts the process by sending the taxpayer a letter.

In a prior report, we determined that neither the IRS's Automated Underreporter (AUR) program nor the Examination function addressed 134,089 individual taxpayers with potential Form 1099-K discrepancies totaling almost $11.9 billion.[8] All of these taxpayers received at least one Form 1099-K from one of nine gig economy payers in TYs 2012 through 2015. As a result, almost $481 million in self-employment taxes could have potentially been assessed if the IRS had a strategic plan to address gig economy taxpayer noncompliance.

This report expands on the Form 1099-K discrepancies identified in past TIGTA reports by focusing on identifying the general population of individual and business taxpayers that received a Form(s) 1099-K for TY 2017 but underreported the income or did not file a return, and how the IRS is handling those cases.[9] The Form 1099-K is required to be filed with the IRS and is furnished to the payee for all merchant cards and third-party network payments, which, for reporting purposes, include those made by credit cards, debit cards, and stored-value cards.[10] The gross amount of reportable payment transactions for the calendar year and its corresponding months are reported on the Form 1099-K for each payee.

Figure 1 identifies the populations of individual and business taxpayers that received TY 2017 Forms 1099-K.

Figure 1: TY 2017 Form 1099-K Recipients

	Form 1099-K Business Recipients	Form 1099-K Individual Recipients
Form 1099-K Documents	**6,371,901**	**3,354,329**
Unique Taxpayer Identification Numbers	**3,349,296**	**2,622,703**

Source: TIGTA analysis of Information Returns Master File (IRMF) Form 1099-K file data.

We matched the Form 1099-K individual and business recipients to their TY 2017 income tax returns to identify taxpayers that appeared to underreport their taxes or that did not file a TY 2017 tax return.[11] Taxpayers are generally required to file a tax return to report income and

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[7] Internal Revenue Manual (IRM) 4.1.27.6.3(1) and (2) (June 28, 2019).

[8] TIGTA, Ref. No. 2019-30-016, *Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance* (Feb. 2019).

[9] The terms taxpayer and case are used interchangeably in this report.

[10] IRM 21.7.4.4.23 (Oct. 1, 2019).

[11] For individual recipients, we matched the Form 1099-K income to their Form 1040, *U.S. Individual Income Tax Return*; Form 1040, Schedule C, *Profit or Loss From Business*; and Form 1040, Schedule F, *Profit or Loss From Farming*. For business recipients, we matched the Form 1099-K income to their Form 1120, *U.S. Corporation Income Tax Return*; Form 1120-S, *U.S. Income Tax Return for an S Corporation*; and Form 1065, *U.S. Return of Partnership Income*.

pay any required tax. When taxpayers do not file, or when they underreport their income, this results in a loss of tax revenue.

Nonfiler case creation programs

The IRS Small Business/Self-Employed (SB/SE) Division identifies individuals and businesses that did not timely file required tax returns (nonfilers). For individual taxpayers, the IRS uses the Information Return Program third-party information reporting to identify nonfilers who received income from an employer or business as reflected on information returns such as Form W-2, *Wage and Tax Statement*; Form 1099-MISC, *Miscellaneous Income*; and Form 1099-K. The IRS's Individual Master File (IMF) delinquency checks using the Information Return Program generally occur 10 months after the due date of the return.[12]

To identify potential individual nonfilers, the Nonfiler Inventory and Analysis group analyzes available data twice a year. The Nonfiler Inventory and Analysis group does this using the IMF Case Creation Nonfiler Identification Process (CCNIP), which is completed for each tax year on a stand-alone basis, *i.e.*, the process is performed two times a year for each tax year, but it only includes data from the applicable tax year being reviewed.

To identify potential business nonfilers, the Business Master File (BMF) identification process weekly identifies business taxpayers that have an open filing requirement for a return that is not filed. The BMF performs delinquency checks 16 weeks after the due date of each return and tax period.[13] The BMF CCNIP then prioritizes and identifies productive inventory using third-party data for BMF nonfiler cases.[14]

The IMF CCNIP and the BMF CCNIP are the IRS's main processes to score nonfilers and select them for treatment. Collection select codes are assigned to each module to identify and prioritize work selection and assignment.

However, it is not possible for the IRS to work all of the nonfiler inventory given its resource limitations. The Collection function determines the number of nonfiler cases from the nonfiler inventory that will be selected for delinquency notification depending on available resources. After the case is selected, a first delinquent return notice for individual taxpayers (Computer Paragraph 59, *First Notice - Return Delinquency, Unfiled Tax Return*) and for business taxpayers (Computer Paragraph 259, *BMF Generated - First Taxpayer Delinquency Investigation Notice*) is sent to the taxpayer. A second delinquent return notice is issued if the taxpayer fails to respond to the first notice. If the taxpayer fails to respond to the second notice, the taxpayer's case is placed into a Taxpayer Delinquency Investigation status and forwarded to a compliance inventory stream for collection actions.

In multiple recent reports, TIGTA has identified lapses in the IRS's nonfiler programs. However, IRS management stated that it is important to note that since Fiscal Year (FY) 2010, the IRS has lost nearly one-third of its enforcement personnel, which resulted in significant challenges affecting compliance programs, such as the nonfiler program. In one report, TIGTA found that the BMF CCNIP had been declining since FY 2011 and virtually stopped in October 2016 due to significant reductions in staffing at call sites, creating fewer nonfiler cases that resulted in a

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[12] IRM 5.1.11.2.1(2) (Jan. 15, 2010).
[13] IRM 5.1.11.2.1(3) (Jan. 15, 2010).
[14] IRM 5.1.11.2.1(4) (Jan. 15, 2010).

reduction of potential inventory for nonfiler programs.[15] In another report, TIGTA found that the vast majority of nonfilers with expired extensions were not identified or addressed in TY 2012 due to a programming error that was not fully investigated or timely corrected.[16] Additionally, in the same report, TIGTA found that in TY 2013, IRS management canceled this process for all taxpayers with expired extensions. As the nonfiler process is run on a stand-alone basis for each tax year, the majority of the nonfilers with expired extensions were not identified or addressed. In a third report, TIGTA determined that pursuing nonfilers is one of the IRS's most efficient enforcement strategies because issuing nonfiler notices can be a cost-effective tool that requires little more than automated notices.[17] In response to the prior TIGTA reports, the SB/SE Division has revised its Nonfiler Strategy, with the most recent revision on May 31, 2018.

Underreporter programs

The IRS SB/SE Division has two underreporter programs: the Business Underreporter program and the Individual Underreporter program. The AUR program is an individual underreporter program that began in the 1970s and became automated in the 1990s. The Business Underreporter (BUR) is a recent program that began with identifying TY 2012 Form 1120, *U.S. Corporation Income Tax Return*, underreporters and later started identifying Form 1120-S, *U.S. Income Tax Return for an S Corporation*, and Form 1065, *U.S. Return of Partnership Income*, underreporters; however, the BUR program does not have an automated case management system. These programs identify and address discrepancies between information returns and tax returns filed by taxpayers. The discrepancies are identified through a data assimilation process that identifies the link between tax returns and information returns filed for the same taxpayer, and a data correlation process that compares tax return and information return data and applies business rules to identify potential underreporter cases. These processes are conducted by the Information Technology organization Underreporter Group. It is not possible for the IRS to work all of the underreporter inventory given its resource limitations.

For individual underreporters, the Information Return Case Selection (IRCS) uses the Information Reporting and Document Matching Case Inventory Selection and Analytics (IRDM CISA) tool to select cases for AUR to work. Generally, three correlation cycles are conducted per tax year for AUR case selection in [redacted] and the volume of cases selected may be adjusted depending upon annual workplan needs. The IRCS shares IMF underreporter data that are generally outside the scope of the AUR with other functions for compliance consideration.

For business underreporters, the BMF Analytics (BMFA) system is the tool used for BUR case selection. Depending upon inventory needs, two or three correlations are conducted for BUR case selection per tax year, generally during the months of [redacted] and the volume of cases selected may also be adjusted depending upon annual workplan needs.

IRS management stated that although the BUR program identifies underreporter taxpayers for flow-through entities (Form 1120-S and Form 1065), [redacted] Underreporter data from these flow-through entities are shared with the Field Case Selection unit for compliance consideration. The data-sharing

[15] TIGTA, Ref. No. 2019-30-069, *Billions of Dollars of Nonfiler Employment Taxes Went Unassessed in the Automated 6020(b) Program Due Primarily to Resource Limitations* (Sept. 2019).
[16] TIGTA, Ref. No. 2016-30-085, *Improvements to the Nonfiler Program Could Help the Internal Revenue Service More Effectively Address Additional Nonfilers Owing Billions of Dollars in Taxes* (Sept. 2016).
[17] TIGTA, Ref. No, 2020-30-015, *High-Income Nonfilers Owing Billions of Dollars Are Not Being Worked by the Internal Revenue Service* (May 2020).

process in the Field Case Selection unit for Form 1120-S and Form 1065 returns has been and continues to be tested for improved case selection.[18] In addition, the BUR program shares Form 1120 returns with the Field Case Selection unit when these cases exceed the dollar threshold for the BUR program. [redacted]

Results of Review

Nonfilers With Form 1099-K Income Were Not Always Identified and Enforcement Action Was Not Taken, Resulting in Billions of Dollars of Potential Unassessed Taxes

The IRS uses the IMF CCNIP for individual taxpayers and the BMF nonfiler identification process for business taxpayers to create and identify nonfilers. Subsequently, the identified nonfiler cases are scored and prioritized for selection by the IMF CCNIP and the BMF CCNIP. Generally, the Collection function determines the number of cases from the nonfiler inventories to be selected for delinquency notification, which is based on available resources. We identified the population of individual and business taxpayers with Form 1099-K income to determine if the IRS is identifying and taking enforcement actions on these nonfiler taxpayers. Overall, our analysis showed that for TY 2017, there were 352,065 business and 62,087 individual nonfiler taxpayers that were not identified or no case was created by the BMF and IMF CCNIP, and there were 325,060 business and 103,991 individual nonfiler taxpayers that were identified, but no enforcement action was taken.[19]

Some business nonfilers were not identified

Most businesses must file an annual income tax return when they earn or receive income each year. The BMF nonfiler identification process occurs weekly and is based on the following criteria:[20]

- 16 weeks have lapsed beyond the tax return due date.
- The business has an open filing requirement for the tax return.
- There is not a satisfying condition on the tax module.

[18] The IRS has an open Compliance Initiative Project for Form 1120-S returns to determine whether changes can be made to improve case selection. The IRS also had a Compliance Initiative Project for Form 1065 returns which ended on December 31, 2017, and did not find a need to make changes to the Form 1065 case selection process.

[19] From the 352,065 business nonfilers not identified, there are 314,586 taxpayers with no open filing requirements and 36,028 taxpayers that did not meet Start Date criteria, and therefore did not meet the criteria to be identified as nonfilers.

[20] IRM 5.19.22.3.1 (July 7, 2016) and Programming Requirements Package 180, Section 17, Project 720 – Return Delinquency Check (Jan. 1, 2017).

- The tax period is available for selection by meeting the Start Date criteria.[21]

Third-party income and taxpayer account data are then used to score and assign codes to the business nonfiler inventory.

The IRS is unable to pursue some taxpayers with no open filing requirement.

From a population of 3,349,296 business taxpayers with Form 1099-K income received in TY 2017, we identified 1,057,017 taxpayers that did not file their 2017 tax return. We identified these taxpayers by comparing the population of businesses that received TY 2017 Form 1099-K income with businesses that filed their TY 2017 taxes on Forms 1120, 1120-S, or 1065, as of May 2019.

The nonfiler taxpayer data identified by the BMF are stored in the Integrated Production Model (IPM). From our population of 1,057,017 business nonfiler taxpayers, we determined that 690,227 were not found on the IPM. The BMF identification process uses various criteria to identify nonfilers; however, the IRS does not track the cases that do not meet those criteria. IRS management provided these criteria and we performed further research, which showed that 338,162 (49 percent) of these cases were not found on the IPM for various justifiable reasons. For example, the delinquent returns were satisfied or a delinquency letter was mailed to the taxpayer, the Form 1099-K income was reported on another tax return, or returns were filed through a subsidiary organization. We determined that 352,065 of the 690,227 cases were not found on the IPM for the following reasons:

- 314,586 (46 percent) cases, the taxpayers' accounts were coded as having no open filing requirement, or there is no tax account on file because the business has not previously filed a tax return.
- 36,028 (5 percent) cases, the taxpayers did not meet the nonfiler Start Date criteria.

However, based on our research of the remaining 1,451 (less than 1 percent) cases, we could not determine why these cases were not found on the IPM. IRS management could not determine the reason either, stating that these 1,451 cases might have met the Last Period Satisfied exclusion criteria, which is used during the BMF nonfiler identification process.[22] The Last Period Satisfied data are regularly updated based on the most current filing or nonfiler closing transaction. Therefore, the Last Period Satisfied data stored in the IPM may have changed since the prior update, making it difficult to determine whether the Last Period Satisfied criteria was applied during the identification process for these cases. Due to the small number of cases, we will not be making a recommendation at this time.

Accounts of some business nonfilers with substantial income are coded as not having an open filing requirement, or no tax account exists because the business has never filed a tax return

The BMF nonfiler identification process does not identify business taxpayers that do not have a tax account because they have never filed a tax return, or their account has been coded as not having an open filing requirement.[23] Our analysis identified 314,586 (46 percent) business

[21] The Start Date criteria uses particular dates associated with the start of the business to determine if the business was active at the time the return was due.

[22] The Last Period Satisfied is the tax module for the most recent tax period ending with a satisfying transaction posted, for example, when a tax return is filed or the taxpayer is no longer liable to file.

[23] IRM 5.19.22.3.1(3) (July 7, 2016).

taxpayers with these two scenarios that received TY 2017 Form 1099-K income. Figure 2 shows the number of taxpayers and the amount of Form 1099-K income they received.

Figure 2: Unidentified Business Taxpayers With Form 1099-K Income and No Open Filing Requirement

Range of Form 1099-K Gross Amount	Number of Nonfilers	Form 1099-K Gross Amount
$1 to $9,999	66,696	$215.75 Million
$10,000 to $49,999	76,471	$2.10 Billion
$50,000 to $99,999	42,315	$3.05 Billion
$100,000 to $499,999	77,855	$18.03 Billion
$500,000 to $999,999	20,607	$14.53 Billion
$1,000,000 or Greater	30,642	$297.57 Billion
Totals	**314,586**	**$335.49 Billion**

Source: TIGTA analysis of business Return Transaction File (RTF), IPM, and BMF data.

Of the 314,586, there are 30,642 (10 percent) business nonfilers that had Form 1099-K gross income of $1 million or greater, totaling almost $298 billion (89 percent) of the potential unreported income. Yet, these taxpayers were not identified by the IRS's nonfiler programs. Although these business taxpayers do not have an open filing requirement with the IRS, they earned substantial income, and therefore would appear to have a filing requirement. These business taxpayers should file tax returns to report this income and pay the appropriate tax.[24] We estimate that 8,008 of the 30,642 nonfilers that had Form 1099-K income of $1 million or greater should have filed a Form 1120 return (as opposed to a Form 1120-S or Form 1065), and that a potential $2.8 billion in Federal taxes could be assessed if these nonfilers were identified and worked.[25]

IRS management agreed that despite the large volume of BMF nonfilers identified, there are some BMF taxpayers that cannot be identified as nonfilers because they do not have an open filing requirement, even though they received a considerable amount of income. In the past, IRS management submitted a proposal for a project to release the second version of the BMF CCNIP process called "BMF CCNIP R2," which would have started on October 1, 2009, for TY 2011 nonfiler taxpayers. The proposed revision included enhanced and refined selection criteria for BMF taxpayers that have income but do not have an open filing requirement, and would include the ability to open their filing requirements when applicable. However, the proposal was never funded. The proposal IRS management submitted showed a total cost of $13.9 million to implement the BMF CCNIP R2 and estimated that the implementation would return $318.5 million of revenue collected. The project would break even in the first year and would continue to produce a significant return on investment annually. TIGTA's analysis resulted in a greater potential return of $2.8 billion in the first year, based only on estimated Form 1120 nonfilers with Form 1099-K income of $1 million or greater. To address the same

[24] We removed any identified subsidiary organizations' returns.
[25] See Appendix II for details on this calculation.

issue for Form 1099-K nonfilers, the IRS began a pilot program in April 2013 to use Form 1099-K information returns to identify business taxpayers without an open filing requirement that did not file a return but had third-party income information indicating a return may be due. However, the pilot program was shut down prior to completion due to budget constraints and was never restarted.

Start Date criteria results in some nonfilers not being pursued

As mentioned previously, the business's tax period needs to meet the IRS's Start Date criteria for the taxpayer to be identified as a nonfiler. The Start Date criteria is based on one of three dates associated with the start of the business, which is dependent upon what type of tax form the business files and whether they file calendar year or fiscal year returns. These dates are considered to determine whether the business was active at the time the return was due. For calendar year taxpayers, these dates should be at least 12 months prior to the end of the delinquent period. For example, a new business would not meet the Start Date criteria if it had been open for less than a year.[26]

We identified 36,028 business nonfiler taxpayers that had an open filing requirement but were not identified by the BMF nonfiler identification process because the establishment date for these taxpayers was between January 2017 and December 2017, and therefore did not meet the required period for selection per the Start Date criteria. If the business does not meet the Start Date criteria, the IRS drops these cases, and they are not pursued. Figure 3 shows the number of taxpayers and the Form 1099-K income they received.

Figure 3: Unidentified Business Nonfilers That Did Not Meet Start Date Criteria

Range of Form 1099-K Gross Amount	Number of Nonfilers	Form 1099-K Gross Amount
$1 to $9,999	13,240	$38.54 Million
$10,000 to $49,999	10,417	$278.40 Million
$50,000 to $99,999	4,645	$332.64 Million
$100,000 to $499,999	6,419	$1.37 Billion
$500,000 to $999,999	798	$545.45 Million
$1,000,000 or Greater	509	$1.41 Billion
Totals	**36,028**	**$3.97 Billion**

Source: TIGTA analysis of business RTF, IPM, and BMF data.

We found that 509, about 1 percent, business nonfilers were not identified by the IRS but had Form 1099-K gross income of $1 million or greater, totaling $1.4 billion of unreported income. We analyzed the 509 taxpayers and determined that 177 of them should have a filed Form 1120. We estimate that if the IRS worked these 177 cases, a potential $9.93 million in Federal taxes could be assessed.[27]

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[26] See Appendix IV for detailed Start Date criteria.
[27] See Appendix II for details on this calculation.

IRS management stated that the business Start Date criteria has been in place since 1994 and was implemented to lessen the number of notices issued for which the taxpayer was not liable. When the BMF CCNIP was developed, nonfiler analysts along with SB/SE Division Research function and other stakeholders agreed to keep the date rules intact. The IRS agreed that unlike with individual nonfilers, certain forms (for example, the Form 1120) are required to be filed regardless of income or how long the business has been operational.

Although the IRS does not identify new businesses as nonfilers unless they are in business for at least one full tax year, these businesses are still liable for taxes on the income earned. However, if the IRS does not identify them as nonfilers, then it will not pursue these businesses for the unassessed taxes. In addition, in some cases, the businesses may have made a Federal tax deposit, which will remain a credit on the account until a tax is assessed.

While some new businesses may not make substantial profit in their first year, they are still required to file their tax return to determine whether any amount is owed. If the IRS does not identify these nonfiler taxpayers, it will not pursue them for their delinquent returns. If these taxpayers are not filing their tax returns, they are potentially not paying the appropriate taxes on this income.

Most business nonfiler cases were not worked

During the BMF CCNIP process, collection select codes are assigned to each nonfiler tax module to identify and prioritize work selection and assignment. The inventory selection is made by Collection function Headquarters' analysts based on the Select Code, Master File Tax code, and the Collection function's inventory needs.[28]

From our population of 1,057,017 business nonfiler taxpayers, the IRS identified 366,790 using the IPM. We obtained status code data to determine whether the IRS was working these cases as of October 24, 2019, and determined that the IRS addressed 41,730 (11 percent) of the cases as follows:

- 30,510 cases with status codes indicating action was taken, such as a letter requesting the delinquent return was issued to the taxpayer or the delinquent return was secured from the taxpayer.
- 11,220 cases with transaction codes on the taxpayers' accounts indicating the delinquency was satisfied or the case was assigned in the Examination function.

For the remaining 325,060 (89 percent) business nonfiler taxpayers, there was no status or transaction code on the taxpayers' accounts indicating that the IRS did not select or address the nonfiler case.[29] Figure 4 shows the number of these taxpayers and the Form 1099-K income they received.

[28] IRM 5.19.22.3.1(2) (July 7, 2016).

[29] However, it is possible that this income could have been reported under a different partnership or subsidiary tax return.

Figure 4: Identified Business Nonfilers Not Being Worked

Range of Form 1099-K Gross Amount	Number of Nonfilers	Form 1099-K Gross Amount
$1 to $9,999	54,986	$188.99 Million
$10,000 to $49,999	76,284	$2.12 Billion
$50,000 to $99,999	48,701	$3.53 Billion
$100,000 to $499,999	100,683	$23.44 Billion
$500,000 to $999,999	23,190	$16.20 Billion
$1,000,000 or Greater	21,216	$157.82 Billion
Totals	**325,060**	**$203.30 Billion**

Source: TIGTA analysis of RTF, IPM, and BMF data.

We identified 21,216, about 7 percent, business nonfilers that were not worked by the IRS and had Form 1099-K income of $1 million dollars or greater, totaling almost $158 billion (78 percent) of the potentially unreported income. We determined that 4,807 of the 21,216 nonfiler taxpayers should have filed a Form 1120 (as opposed to a Form 1120-S or Form 1065). If the IRS worked just these 4,807 cases, a potential $1.2 billion in taxes could be assessed.[30]

IRS management stated that due to limited resources, the IRS is unable to work all of the business nonfiler cases. Cases are selected based on priority codes, and these cases were lower priority than the ones that were selected to be worked. Also, cases are kept in inventory for three years and may still be selected to be worked. For example, TY 2017 nonfilers were likely added to the inventory in FY 2018 and will be available for selection until FY 2021.

However, the chance of selection of these cases decreases each year as the cases age. This is because the nonfiler case selection criteria prioritizes newer cases. In addition, the IRS does not define high-income business nonfilers. The IRS's Nonfiler Strategy, issued in May 2018, includes criteria for high-income individual nonfilers, and the IRS has created a strategy to work them, but there is no definition for high-income business nonfilers. The IRS should define and include high-income business nonfilers in its Nonfiler Strategy.

Some individual nonfiler cases were not created

The IRS identifies individual nonfiler taxpayers using the IMF CCNIP system, which uses third-party income information and other IRS account data to identify potential individual nonfiler cases with the goal of increasing taxpayer compliance and maximizing dollars collected. Individual taxpayers who receive income (from Form 1099-K or otherwise) and meet certain criteria should be identified by the IMF CCNIP and created as potential individual nonfiler cases. Generally, the IMF CCNIP file keeps cases only if they meet the following criteria:

- [redacted]

[30] See Appendix II for more details on this calculation.

[redacted]

[redacted]

[redacted]

[redacted]

- [redacted]

From a population of 2,622,703 individual taxpayers with income reported on a TY 2017 Form 1099-K, we identified 373,562 taxpayers who did not file a tax return for 2017. We identified these taxpayers by comparing the population of individuals who received a Form 1099-K with TY 2017 income with individuals who filed their TY 2017 Form 1040, *U.S. Individual Tax Return*; Form 1040, Schedule C, *Profit of Loss From Business*; and/or Form 1040, Schedule F, *Profit or Loss From Farming*, as of June 2019.

From our population of 373,562 individual nonfiler taxpayers, we identified 113,692 who were not found on the IMF CCNIP file. Further research showed that 43,176 of these cases were not on the IMF CCNIP file because they did not meet some of the individual nonfiler criteria. For example, the taxpayer was deceased, the estimated tax owed was below the criteria, or the delinquent returns were satisfied or a delinquency letter was mailed to the taxpayer. We also removed 8,429 individual taxpayers for whom the Form 1099-K was issued with an Employer Identification Number.[31]

For the remaining 62,087 (17 percent) of the 373,562 individual nonfiler taxpayers, the IRS could not determine why these nonfilers were not identified and why the cases were not created. IRS management stated that the individual nonfiler system does not have the capability to track which cases do not meet the nonfiler criteria and are not created during the data assimilation process. The data assimilation and correlation processes to identify nonfiler taxpayers are complex processes, which only identify and retain cases meeting the nonfiler criteria. Cases that do not meet the criteria are not identified or tracked, due to the complexities of the process and high volume of data.

Figure 5 shows the number of TY 2017 individual nonfiler taxpayer cases that were not created by the IRS and the Form 1099-K income they received.

[31] We identified 8,429 of these 113,692 taxpayers for which the Form 1099-K income was issued with an Employer Identification Number. These taxpayers are likely sole proprietors who report their business income on their individual Form 1040, Schedule C tax return. These taxpayers should list their Employer Identification Number as a cross-reference on their individual return; however, if the cross-reference is listed incorrectly, then the cases are dropped from the nonfiler process. Due to the complexity of the cross-reference process and the possibility that these cases were dropped due to cross-reference mismatches, we removed these cases from our results.

Figure 5: Individual Nonfiler Cases Not Created

Range of Form 1099-K Gross Amount	Number of Nonfilers	Form 1099-K Gross Amount	Potential Tax Assessed Amount
$1 to $9,999	50,975	$213.37 Million	$8.12 Million
$10,000 to $49,999	9,954	$166.80 Million	$6.38 Million
$50,000 to $99,999	618	$43.06 Million	$2.10 Million
$100,000 or Greater	540	$151.32 Million	$11.75 Million
Totals	**62,087**	**$574.55 Million**	**$28.35 Million**

Source: TIGTA analysis of RTF, IMF CCNIP, and IMF data.

Just like with businesses, if the IRS does not identify and create individual nonfiler cases, then it will not pursue these taxpayers for their delinquent returns. The Internal Revenue Manual (IRM) defines a high-income nonfiler as any nonfiler with a total income greater than or equal to $100,000.[32] There were 540 nonfilers with Form 1099-K income of $100,000 or greater during TY 2017. The IRS should address high-income nonfilers as a priority. If these taxpayers are not filing their tax returns, they may also not be paying the appropriate taxes on this income resulting in loss of tax revenue. We estimate that if the IRS worked these 540 high-income individual nonfiler cases, a potential $11.75 million in Federal taxes could be assessed.[33]

Some individual nonfiler cases were not worked

Individual taxpayers identified through the IMF CCNIP are categorized based on a number of characteristics, such as the amount of third-party reported income and the estimated tax due. In addition, each case is assigned a selection code that is used to prioritize IMF CCNIP inventory, which is based on the potential the IRS has for securing a tax return. In addition to the selection code, the IRS estimates the potential balance due amount for each nonfiler case within each selection code category and applies a score that is also used to prioritize IMF CCNIP inventory.

From the population of 259,870 individual nonfiler taxpayers the IRS identified using the IMF CCNIP, we determined that there were 135,602 (52 percent) cases that the IRS had addressed or selected to be worked.[34] Of these, there were:

- 73,558 cases in a delinquency status.
- 39,744 cases in which a letter requesting the delinquent return was issued to the taxpayer.
- 15,606 cases in which the delinquent return was filed and an assessment made.
- 5,889 cases in which the nonfiler issue was addressed by the IRS or the taxpayer was determined to be no longer liable.

[32] IRM 5.19.2.8(1) (Nov. 6, 2015).
[33] See Appendix II for details on this calculation.
[34] We obtained status code data as of October 24, 2019, and transaction codes as of January 25, 2020, to determine whether the IRS is working these cases.

- 805 cases with transaction codes on the taxpayer's account indicating the delinquency was satisfied or the case was assigned to the Examination function.

In addition, we determined there were 20,276 (8 percent) cases in IMF CCNIP inventory that were not selected to be worked for the following reasons:

- 18,655 cases in which [redacted]
- 1,308 cases in which the taxpayers were deceased before the nonfiler period.
- 313 cases in which [redacted]

However, there were 103,991 cases remaining in the individual nonfiler inventory, representing $3.1 billion in Form 1099-K income that are available for selection to be worked.[35] IRS management stated there is still a chance for these cases to be selected; however, due to limited resources, the IRS is unable to work all of the individual nonfiler cases.

Figure 6 shows the number of TY 2017 individual nonfiler taxpayers not selected and the Form 1099-K income they received.[36]

Figure 6: Identified Individual Nonfilers Not Being Worked[37]

Range of Form 1099-K Gross Amount	Number of Nonfilers	Form 1099-K Gross Amount	Potential Tax Assessed Amount
$1 to $9,999	20,940	$98.70 Million	$3.76 Million
$10,000 to $49,999	66,207	$1.83 Billion	$70.50 Million
$50,000 to $99,999	16,074	$1.10 Billion	$52.60 Million
$100,000 or greater	770	$81.40 Million	$4.62 Million
Totals	**103,991**	**$3.10 Billion**	**$131.46 Million**

Source: TIGTA analysis of RTF, IMF CCNIP, and IMF data.

In a prior TIGTA report, the IRS stated that all individual high-income nonfilers for TYs 2016 through 2018 were selected to be worked.[38] However, we identified 770 high-income individual nonfiler taxpayers with Form 1099-K income of $100,000 or greater during TY 2017 who were not selected to be worked by the IRS. If these taxpayers are not filing their tax returns, they may also not be paying the appropriate taxes on this income resulting in loss of tax revenue. We estimate that if the IRS worked these high-income individual nonfiler cases, a potential $4.62 million in Federal taxes could be assessed.

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35 [redacted]

36 We did not consider whether taxpayers reported the Form 1099-K income on Form 1040, Schedule E, *Supplemental Income and Loss*. The IRS does not consider Schedule E income when identifying cases, but does consider it for the selection process, as it will affect the taxes assessed and whether taxpayers meet the selection criteria.

37 Totals may not sum due to rounding.

38 TIGTA, Ref. No. 2020-30-015, *High-Income Nonfilers Owing Billions of Dollars Are Not Being Worked by the Internal Revenue Service* (May 2020).

After reviewing a draft of this report, IRS management stated that they did not select the 770 high-income cases to be worked based on their estimate of the 770 nonfiler taxpayer's adjusted gross income (AGI), which they use to select high-income cases. IRS management performed additional analysis of these 770 taxpayers using Information Return Program third-party data to compute the AGI and determined that 756 of the 770 taxpayers had an AGI under $100,000. For the remaining 14 taxpayers, in most cases the taxpayers either had losses, which reduced their total income below $100,000, or they reported the Form 1099-K income under an Employee Identification Number.

However, our review of the IRS's estimates for the 756 individual nonfilers showed the AGIs were still greater than $92,000. If these taxpayers are not filing their tax returns, they may also not be paying the appropriate taxes on this income. The IRS should at least work a percentage of these 756 nonfiler cases with significant income.

The Commissioner, SB/SE Division, should:

Recommendation 1: Consider funding and implementing the "BMF CCNIP R2," which includes enhanced and refined selection criteria for BMF taxpayers that have income but do not reflect as having an open filing requirement, so that these cases will have the opportunity to be identified and worked.

> **Management's Response:** The IRS disagreed with this recommendation. In their response, IRS management stated that while they continue to support the programming that would be required, the ultimate approval and implementation of that programming is subject to Service-wide needs and priorities (including programming required for implementation of Coronavirus Disease 2019-related legislation).
>
> > **Office of Audit Comment:** Our audit shows that implementing the BMF CCNIP R2 programming has the potential to identify significant noncompliance of business taxpayers that received income, but had no open filing requirement, and are not identified as nonfilers by the IRS's current systems. Implementing this program would allow the IRS to identify hundreds of thousands of business nonfilers earning hundreds of billions of unreported income each year, and include not only Form 1099K income, but other types as well.
> >
> > We identified a potential $2.8 billion in Federal taxes that could be assessed for taxpayers that received $1 million or greater of Form 1099-K income in Tax Year 2017, but were not identified and worked. High-income business taxpayers that do not file tax returns should be identified and brought into compliance.

Recommendation 2: Evaluate the Start Date criteria for business nonfilers to determine whether it can be eliminated or revised, so that these cases will have the opportunity to be identified and worked.

> **Management's Response:** The IRS agreed with this recommendation. In their response, IRS management stated that they will evaluate the Start Date criteria for business nonfilers and will make a recommendation as to whether it can be eliminated or revised. However, if programming is required, it is possible there will be information technology considerations similar to those discussed in the IRS's response to Recommendation 1.

Recommendation 3: Define high-income business nonfilers and create a strategy to work these cases so that all high-income business nonfiler cases will have the opportunity to be selected and worked. Include the business high-income strategy in the IRS Nonfiler Strategy plan.

Management's Response: The IRS agreed with this recommendation. In their response, IRS management stated that under the umbrella of the 2018 SB/SE Division Nonfiler Strategic Plan, SB/SE Division Examination and Collection functions will partner to perform an analysis of business nonfilers to determine the feasibility of implementing a Service-wide definition of high-income business nonfilers and whether that type of designation is appropriate in the selection of business nonfiler cases.

Recommendation 4: Develop a process to identify high-income individual nonfilers who are not created during the information return data assimilation and correlation processes, so these cases will have an opportunity to be identified and worked.

Management's Response: The IRS disagreed with this recommendation. In their response, IRS management stated that the benefit of this recommendation to the IMF CCNIP process would be minimal, as the purpose of the process is to enhance case selection by identifying those nonfiler cases with higher potential tax assessments, while balancing coverage considerations and ensuring fairness in case selection. The IRS stated that the ability to select "all" cases currently identified in the program is not attainable due to resource and funding constraints.

Office of Audit Comment: This recommendation is meant to allow the IRS to determine the most feasible way to ensure that all high-income nonfilers are identified and worked, to the extent that resources allow. Our audit shows that there were more than 62,000 individual nonfiler cases that were not created during the IMF CCNIP process, which the IRS could not provide an explanation for because they do not identify or create those records. We identified 540 individual nonfilers in this population with $100,000 or greater in Form 1099-K income and a potential for $11.75 million in taxes that could be assessed. Because the IRS has committed to working all high-income individual nonfilers in their High Income Nonfiler Strategy, the IRS should develop a way to identify those high-income taxpayers that are not created during the IMF CCNIP process to ensure that they have a chance to be worked. If these cases are not identified, they cannot be worked.

Recommendation 5: Select and work a percentage of the 756 individual nonfilers who had significant income.

Management's Response: The IRS agreed with this recommendation. In their response, IRS management stated that they will analyze the 756 individual nonfiler cases and will refer the cases with a significant liability to the appropriate treatment stream.

Underreporters of Form 1099-K Income Were Not Always Identified and Enforcement Action Was Not Always Taken, Resulting in Billions of Dollars of Potential Unassessed Taxes

The AUR program for individual underreporters and the BUR program for business underreporters are responsible for developing document matching requirements to identify cases, selecting cases to be worked, and managing initiatives to improve compliance through notice treatments and programs. We identified the population of individual and business taxpayers with Form 1099-K income to determine if the IRS is identifying and working cases of taxpayers with underreported Form 1099-K income. Our overall underreporting analysis showed that 11,947 business taxpayers were not identified by the IRS, and 11,274 individual taxpayers were not found in IRDM CISA data.[39] In addition, 45,169 business taxpayers were not selected by the Field Case Selection unit, and 1,746 business taxpayers were not selected to be worked by the BUR program.

From a population of 2,290,046 business taxpayers with Form 1099-K income received in TY 2017 and that filed a tax return, we identified 160,425 (7 percent) taxpayers with a discrepancy of $10,000 or more between the reported income and the Form 1099-K income.[40] We identified these taxpayers by comparing the population of businesses that received a Form 1099-K with TY 2017 income with businesses that filed their 2017 business tax returns as of May 2019, using the gross receipts reported on each of the Forms 1120, 1120-S, and 1065 tax returns.[41]

In addition, from a population of 2,245,040 individual taxpayers with Form 1099-K income received in TY 2017 and who filed a tax return, we identified 226,739 (10 percent) taxpayers with a discrepancy of at least $10,000 between the reported income and the Form 1099-K income. We identified these taxpayers by comparing the population of individuals who received a Form 1099-K with TY 2017 income with individuals who filed their 2017 individual tax returns as of June 2019, using the income on the Form 1040 Schedule C and Schedule F tax returns.[42]

Some business underreporters were not identified

The data assimilation and correlation processes for BUR cases identify business underreporter taxpayers that file calendar year returns, but not fiscal year taxpayers. The discrepancies are identified by the Information Technology organization Underreporter Group. The data correlation process compares information return data with filed tax returns and applies business rules to determine whether taxpayers underreported their income. In addition, the

[39] There are 11,917 fiscal year business taxpayers. Fiscal year taxpayers are not within the scope of the BUR Campus Program, and therefore not identified as underreporters.

[40] We removed 2,233 records from the original population of filed returns because these taxpayers filed more than one business tax return, and we could not determine which return type was correct and corresponded to the Form 1099-K income. We also removed 25,405 records from the original population of filed returns because these taxpayers were not underreporters at the time that the IRS ran the first or second correlations.

[41] TY 2017 correlations and case selections were conducted prior to TIGTA's [redacted] data pull for this audit; therefore, due to the timing delay, the underreporter data do not reconcile exactly.

[42] We included income from gross receipts (Form 1040 Schedule C) and gross income (Form 1040 Schedule F). We also considered taxpayers to be underreporters if they filed a Form 1040, but did not file a Schedule C or F. In addition, TY 2017 correlations and case selections were conducted prior to TIGTA's [redacted] data pull for this audit; therefore, due to the timing delay, the underreporter data do not reconcile exactly.

underreporter process keeps a drop file for the identified underreported taxpayers that do not meet the case criteria. From the 160,425 business underreporter taxpayers that we identified, we determined that 148,508 (93 percent) business underreporter taxpayers filed on a calendar year basis.[43] Our analysis found that the IRS identified all but 30 of the 160,425 taxpayers as underreporters.

Although the BUR case identification process does not identify fiscal year business underreporters, we performed an analysis using monthly income reported on Form 1099-K to identify 11,917 (7 percent) fiscal year business underreporter taxpayers with a discrepancy of at least $10,000 between the reported income and the Form 1099-K income, totaling $55.2 billion. Of these, 419 (3.5 percent) cases had examination indicators, and the remaining 11,498 (96.5 percent) have not been selected to be worked. IRS management stated that fiscal year taxpayers are not within the scope of the BUR program and are worked in other programs, such as the General Examination Program. The General Examination Program does not specifically select underreporter taxpayers, but rather selects cases from tax returns that have been classified through a scoring system that weighs returns with certain characteristics. However, these taxpayers are underreporters and should be identified by the underreporter program to be worked by the BUR program or shared with other functions for compliance consideration.

IRS management also responded that in some cases they cannot identify fiscal year underreporter taxpayers because, while the Form 1099-K reports income separated by month, other third-party information returns do not report monthly income amounts; therefore, they cannot determine the taxpayer's fiscal year income using information returns that do not report income amounts monthly. Of the 11,917 fiscal year business underreporter taxpayers we identified, we determined that 3,314 filed a Form 1120 and had a discrepancy based solely on Form 1099-K income during the fiscal year, and no other annual information returns were reported to the IRS for the taxpayers.[44] These taxpayers also did not have any indicators that they were being worked by other programs.

A prior TIGTA review reported on this issue [redacted][45] This report did not include a recommendation because the scope of the review was Schedule K-1, which is not reported monthly.[46] However, TIGTA concluded that not considering fiscal year filers for underreporting is overlooking a potential noncompliance area that results in loss of tax revenue and inequitable taxpayer treatment that may diminish the public's perception that the tax system is fair. The report stated that the IRS should look for ways to overcome the barriers so that fiscal year taxpayers can be systemically checked for underreporting. This is also supported by our analyses of Forms 1099-K.

Our analysis focused on Form 1120 taxpayers with solely Form 1099-K discrepancies because the IRS can identify these taxpayers based on the monthly income data. These 3,314 Form 1120

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[43] This also includes taxpayers whose cases were already being worked in the Examination function.

[44] We removed taxpayers with annual information returns (Form 1099-MISC and Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*) from our population. [redacted] In addition, we considered other line income such as Other Income and Rental Income.

[45] TIGTA, Ref. No. 2019-30-078, *The Use of Schedule K-1 Data to Address Taxpayer Noncompliance Can Be Improved* (Sept. 2019).

[46] Schedule K-1 (Form 1041), *Beneficiary's Share of Income, Deductions, Credits, etc.*

fiscal year taxpayers received substantial Form 1099-K income totaling almost $4.13 billion. If these taxpayers are underreporting their income, they are potentially not paying the appropriate taxes on this income. Figure 7 shows the number of taxpayers and the Form 1099-K income they received.

Figure 7: Unidentified Form 1120 Fiscal Year Business Underreporters With Only Form 1099-K Income in TY 2017[47]

Range of Underreported Form 1099-K Income	Number of Taxpayers	Form 1099-K Gross Amount	Underreported Form 1099-K Income Amount
$10,000 to $24,999	620	$245.28 Million	$10.53 Million
$25,000 to $49,999	605	$290.31 Million	$21.81 Million
$50,000 to $99,999	609	$349.64 Million	$44.10 Million
$100,000 to $499,999	1,088	$1.19 Billion	$241.44 Million
$500,000 to $999,999	200	$401.34 Million	$136.30 Million
$1,000,000 or Greater	192	$1.65 Billion	$1.00 Billion
Totals	**3,314**	**$4.13 Billion**	**$1.46 Billion**

Source: TIGTA analysis of RTF and BMF data.

We identified 192 of the 3,314 Form 1120 taxpayers that underreported $1 million or greater (totaling more than $1.65 billion) of Form 1099-K income during TY 2017. We estimate that if the IRS worked the 192 cases, a potential $78.7 million in additional taxes could be assessed.[48] By not identifying fiscal year business underreporters during the BUR case selection process, the IRS is not pursuing these taxpayers for their underreported income.

Most business underreporters were not worked

The BUR program uses the BMFA, a case selection tool, to select the most productive cases to work by considering various factors such as taxpayer behavior (repeat underreporters), revenue protection, available resources, and prior document matching case results. The business rules that are applied to each case during the data correlation process determine which cases will be selected to be worked. The selection of cases is limited to two or three times per year, and the volume of cases selected are based on the BUR program workplan, which is primarily driven by available full-time equivalent (FTE) staffing and resources.[49] Figure 8 shows the IRS's BUR program workplan for FYs 2017 through 2019.[50]

[47] Totals may not sum due to rounding.
[48] See Appendix II for details on this calculation.
[49] These periods of selection activities are called correlation cycles and are based on tax reporting deadlines.
[50] The BUR program workplan includes Form 1041, *U.S. Income Tax Returns for Estates and Trusts*, and Form 1120 cases.

Figure 8: BUR Program Workplan for FYs 2017 Through 2019

BUR Program	FY 2017 Actual	FY 2018 Actual	FY 2019 Actual
FTE	71.76	39.26	17.76
Contact Closures	38,199	22,152	6,426
Contact Closures Per FTE	532	564	362
Starts	51,884	16,391	7,861

Source: IRS Examination function management.

FTEs for the BUR program decreased by 45 percent from FY 2017 to FY 2018 and decreased by another 55 percent from FY 2018 to FY 2019. In response to having fewer FTEs, the Planning and Performance Analysis function, which determines the workplan volumes by program and location, reduced the number of planned starts keeping the closures per FTE in a similar range; these reductions were done after the first correlation.

From the 148,478 business underreporter taxpayers identified by the IRS, we obtained BUR system data to determine whether the IRS is selecting these cases to be worked. We determined that 96,902 cases were not selected based on established criteria.[51] Of the remaining 51,576 cases, we identified:

- 45,169 cases that were identified during the first or second correlation and were not selected to be worked by the Field Case Selection unit for compliance consideration.
    - 30,766 taxpayers filed a Form 1120-S.
    - 13,859 taxpayers filed a Form 1065.
    - 544 taxpayers filed a Form 1120 and did not meet the BUR selection criteria.[52]
- 4,052 cases that were selected to be worked in the BUR program.
- 1,746 cases in which the taxpayers filed a Form 1120 that were identified during the first or second correlation and were not selected to be worked by the BUR program.
- 609 cases that were already being worked in the General Examination Program.

Some BUR Form 1120 cases were not selected to be worked

The BUR program only selects and works Form 1120 business underreporter cases when the underreported amount is under an established dollar threshold. Of the cases that meet the criteria, the BUR program creates an annual workplan based on staffing and resources.

There were 1,746 cases with more than $314.67 million in total unreported income that met the criteria and were identified, but were not selected to be worked by the BUR program. Figure 9 shows the TY 2017 Form 1120 business underreporter taxpayers not being worked by the BUR program and the Form 1099-K income they received.

[51] For example, cases are dropped when the tax change is below a certain amount or the taxpayer is [redacted]

[52] Cases that do not meet BUR case selection criteria are considered to be outside the scope of the BUR program. However, these Form 1120 cases did not have the treatment code indicating that they were shared with the Field Case Selection unit.

Figure 9: Identified Form 1120 Business Underreporters Not Being Worked by the BUR Program[53]

Range of Underreported Form 1099-K Income	Number of Taxpayers	Form 1099-K Gross Amount	Underreported Form 1099-K Income Amount
$10,000 to $24,999	307	$127.44 Million	$5.21 Million
$25,000 to $49,999	294	$143.23 Million	$10.73 Million
$50,000 to $99,999	317	$245.60 Million	$22.57 Million
$100,000 to $499,999	651	$943.76 Million	$148.89 Million
$500,000 to $999,999	177	$485.24 Million	$127.27 Million
Totals	**1,746**	**$1.95 Billion**	**$314.67 Million**

Source: TIGTA analysis of RTF, IRCS/BMFA, and BUR data.

According to IRS management, due to staffing constraints and the January 2019 furlough, the BUR program workplan for TY 2017 was adjusted to reduce the number of Form 1120 business underreporter cases to be selected and worked at the BUR campus. As result, when the second correlation to identify underreported cases was performed, the BUR program skipped selecting cases from it. Therefore, cases that were not selected from the first correlation, as well as cases identified during the second correlation, did not have a chance to be selected. As a result, these cases will not be worked.

IRS management stated that staffing constraints occurred after the first correlation selection was completed. Most of the BUR program staff were moved to work on the Employer Shared Responsibility Payment program. In addition, the January 2019 furlough further affected the IRS's ability to work all the cases.

Most large dollar underreporter cases were not selected to be worked by Field Examination

Form 1120 underreporter cases in which the potential tax adjustment and the underreporting amount exceeds an established dollar threshold and [redacted] These cases are generally outside the scope of the BUR campus environment and include cases in which the correspondence environment would not be effective or that are too complex for tax examiners to work. However, through the data-sharing process, the underreporter data identified for the BUR program are shared with the Field Case Selection unit for compliance consideration.

While the IRS cannot work all identified cases in the BUR program, our analysis showed that there are a significant amount of cases (45,169 cases) with more than $73.01 billion in total unreported income that were identified for Examination function consideration; however, these cases are not being worked by Field Examination. Figure 10 shows the TY 2017 business underreporter taxpayers not selected to be worked by Field Examination and the Form 1099-K income they received.

[53] Totals may not sum due to rounding.

Figure 10: Identified Business Underreporters Not Selected to Be Worked by Field Examination[54]

Range of Underreported Form 1099-K Income	Number of Taxpayers	Form 1099-K Gross Amount	Underreported Form 1099-K Income Amount
$10,000 to $24,999	3,200	$1.62 Billion	$54.83 Million
$25,000 to $49,999	3,685	$2.25 Billion	$134.04 Million
$50,000 to $99,999	4,774	$4.15 Billion	$350.25 Million
$100,000 to $499,999	22,788	$34.71 Billion	$5.21 Billion
$500,000 to $999,999	4,920	$12.73 Billion	$3.44 Billion
$1,000,000 or Greater	5,802	$120.72 Billion	$63.82 Billion
Totals	**45,169**	**$176.17 Billion**	**$73.01 Billion**

Source: TIGTA analysis of RTF, IRCS/BMFA, and BUR data.

We identified 5,802 business taxpayers that underreported $1 million or greater of Form 1099-K income during TY 2017, with the total underreported amount of more than $63.82 billion. These cases include Forms 1120, 1120-S, and 1065. We cannot determine the potential assessments on Form 1120-S and 1065 cases. However, we identified 540 business taxpayers that filed Form 1120 and underreported their Form 1099-K income by $1 million or greater, totaling $20.17 billion. We estimate that a potential $1.58 billion in additional taxes could be assessed if these cases were selected by the Field Case Selection unit and worked in the Examination function.[55]

Data we obtained from the IRS showed that these cases were identified during the first or second data correlation, and therefore were available to be selected by the Field Case Selection unit for compliance consideration. However, they were not selected to be worked in the Examination function. IRS management stated that the Field Case Selection unit considers various criteria when selecting cases to be worked [redacted] After applying elimination filters to account for these types of factors, the remaining cases are sorted by underreported amounts. The volume of the final delivery is then determined based on workplan needs. Once the delivery total is computed, the cases needed to achieve this [redacted] However, based on TIGTA's analysis, there are many large dollars cases not being worked with potentially billions of dollars in underreported Form 1099-K income. The IRS should reassess their case selection priorities to ensure that more of these high-dollar cases are worked.

[54] Totals may not sum due to rounding.
[55] See Appendix II for details on this calculation.

Some individual underreporter cases were not created

The IRS identifies individual underreporter taxpayers using a data assimilation and correlation process conducted by the Information Technology organization, which compares information return data with filed tax returns to determine whether taxpayers underreported their income. These cases are then loaded into the IRDM CISA tool for selection. From our population of 226,739 individual underreported taxpayers with Form 1099-K income, we identified 30,143 (13 percent) cases that were not found on the IRDM CISA.[56] Additionally, the majority of these underreported taxpayer cases were not selected to be worked by the General Examination Program.

IRS management stated that some of the 30,143 cases may have met the drop case criteria during the data correlation process, and therefore were not created and loaded to the IRDM CISA. Individual underreporters are identified with a legacy system that does not have the capability to track which cases meet the IRS's drop case criteria, and therefore, cases are dropped before they can be created and loaded in the IRDM CISA. IRS management stated they receive a report only with the volume of cases within each specific drop criteria, but not an actual list of the dropped cases. Drop criteria includes, for example, [redacted] or cases with a total tax change below a particular threshold.

IRS management provided us with a list of 30 criteria that are used to drop unproductive or unworkable underreporter taxpayer cases.[57] We analyzed the 30,143 underreporter taxpayer cases by applying 20 of these criteria. We determined that 18,446 met the drop criteria, explaining why they were not included on the IRDM CISA, leaving 11,697 for the IRS to review.[58] IRS management manually reviewed a judgmental sample of 423 cases and found that 386 cases met the drop criteria and 37 were found on the IRDM CISA. In addition, the IRS reviewed a statistically valid sample of 68 additional cases, which resulted in all cases having acceptable reasons for not being on the IRDM CISA; for example, there were cases in which the tax change was below the dollar threshold, and cases in which [redacted] These review results show that there is a high possibility that most of the remaining 11,206 cases would meet the drop case criteria.

Some individual underreporter cases were not worked

The AUR program uses the IRDM CISA tool to select the most productive cases to work. The tool scores cases by comparing cases in the current correlation to similar cases from past correlations and assigning each case an Estimated Potential Assessment value and a repeater code.[59] The IRDM CISA uses specific case selection criteria called business rules, along with case scores to optimize (balance) the inventory into subfile categories and determine which cases will be selected to be worked. AUR Case Selection shares specific IMF underreporter data that are

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[56] Further researched showed that in 70 cases, the Form 1099-K income was reported as "Other Income," and in 10 cases, the underreported amount was less than $10,000; therefore, we removed these from the cases not found on the IRDM CISA.

[57] See Appendix V for a list of the drop case criteria.

[58] We were unable to determine whether these taxpayers met the other 10 criteria. The IRS stated that some underreporter cases could have been identified during the data assimilation and then later dropped, for example, [redacted]

[59] The Estimated Potential Assessment value is an estimation of the assessment that each case will yield based on the behavior and characteristics of cases from past AUR correlations. The repeater code tells whether the taxpayer has underreported in the past.

outside of scope for the AUR campus with Campus Case Selection for compliance consideration. The volume of cases selected to be worked by the AUR program is based on the AUR program workplan, which is primarily driven by available FTE staffing and resources. Figure 11 shows the IRS's AUR workplan for FYs 2017 through 2019.

Figure 11: Individual AUR Program Workplan for FYs 2017 Through 2019

IMF AUR	FY 2017 Actual	FY 2018 Actual	FY 2019 Actual
FTE	1,505.48	1,365.88	1,328.59
Contact Closures	3,294,728	3,011,556	1,968,731
Contact Closures Per FTE	2,188	2,205	1,482
Starts	3,982,531	2,968,664	1,973,303

Source: IRS Examination function management.

AUR FTEs decreased by 9 percent from FY 2017 to FY 2018 and decreased by another 3 percent from FY 2018 to FY 2019. In response to fewer FTEs assigned to the program in FY 2018, the workplan reduced the number of planned starts.

Using the data from the AUR system, we determined the following from the 196,516 individual underreporter taxpayers identified by the IRS:

- 111,768 cases were not selected due to offset and nonselect rules.[60]
- 62,929 cases were selected to be worked by tax examiners in the AUR program.
- 5,957 cases were eliminated due to cases that met specific [redacted][61]
- 5,061 cases were not selected because [redacted][62]
- 4,825 cases were not selected due to [redacted]
- 120 cases did not meet the selection criteria.
- 4 cases were referred to the Examination function based on tax change criteria.

We determined that the remaining 5,852 cases were not selected by the AUR program during the correlation because they did not meet the FY 2017 Estimated Potential Assessment value selection criteria. IRS management stated that these cases [redacted][63] [redacted]

60 [redacted]

61 [redacted]

62 [redacted]

63 [redacted]

[redacted]

The Director, Examination, SB/SE Division, should:

Recommendation 6: Develop a process to identify Form 1120 fiscal year business underreporters so that these cases will have the opportunity to be identified and worked.

Management's Response: The IRS disagreed with this recommendation. In their response, IRS management stated that the BUR program does not have the capability to address fiscal year filers. IRS management further stated that information returns are filed on a calendar year basis, which would require the IRS to generate an estimate to calculate the potential fiscal year income.

Office of Audit Comment: The IRS should have a method to identify and work fiscal year business underreporter cases. Although the IRS examined 1,021 fiscal year tax returns of 2017 corporate taxpayers in other compliance work streams, we found 3,314 fiscal year taxpayers that were not identified or referred to the Examination function as underreporters. The current underreporter program does not have the capability to identify these taxpayers.

Recommendation 7: Consider adjustments to the Field Case Selection unit process that will allow for more high-dollar business underreporter cases to be examined.

Management's Response: The IRS disagreed with this recommendation. In their response, IRS management stated that TIGTA only considered the population of taxpayers with a discrepancy between Form 1099-K income and income reported on their return, and not the entire population of taxpayers with information return and tax return income discrepancies shared with the Field Case Selection unit. IRS management believes that with this limited analysis, it is difficult to determine if these returns would have been prioritized over the returns selected for examination.

Office of Audit Comment: The scope of our audit was specific to taxpayers who earned Form 1099-K income, not the entire population of taxpayers with information returns. In our analysis, we identified more than 5,800 business taxpayers with underreported Form 1099K income of $1 million or more (totaling almost $64 billion) that were not selected for examination. We estimate that a potential $1.58 billion in additional taxes could be assessed if these cases were selected by the Field Case Selection unit and worked in the Examination function. While we understand that the IRS has resource constraints, we maintain that it should consider adjustments to allow for more high-dollar cases to be selected and examined.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether the IRS is identifying and addressing taxpayers with unfiled or underreported Form 1099-K income. To accomplish our objective, we:

- Evaluated the adequacy of controls, requirements, and processes for identifying and addressing individual and business taxpayers with underreported Form 1099-K income or with Form 1099-K income that did not file a tax return.
- Identified the individual and business populations of TY 2017 Form 1099-K recipients from data obtained from the Data Center Warehouse IRMF Form 1099-K table. We requested the business population for TY 2018 Form 1099-K recipients for only fiscal year taxpayers.
- Identified the individual income reported from taxpayers with TY 2017 Form 1099-K income using the Data Center Warehouse RTF IMF for Processing Years 2017, 2018, and 2019 Forms 1040, and Form 1040 Schedules C and F return data.
- Identified the business income reported from taxpayers with TY 2017 Form 1099-K income using the Data Center Warehouse RTF BMF for Processing Years 2017, 2018, and 2019 Forms 1120, 1120-S, and 1065 return data.
- Conducted a data analysis on the individual and business populations to identify potential nonfiler taxpayers with Form 1099-K income that did not file a return.
- Determined whether the potential individual and business nonfiler taxpayers with Form 1099-K income that we identified were also identified by the IRS by reviewing the data on the IMF CCNIP and the IPM.
- Determined how potential individual and business nonfiler taxpayers with Form 1099-K income identified by the IRS are being addressed by reviewing data on the IMF CCNIP and the IMF/BMF Status History from the Compliance Data Warehouse.
- Conducted a data analysis on the individual and business populations to identify potential underreported taxpayers with a discrepancy between the reported income and the Form 1099-K gross receipts of $10,000 or more.
- Determined whether the potential individual and business underreported taxpayers with Form 1099-K income that we identified were also identified by the IRS by reviewing data on the IRDM CISA and the IRCS-BMFA.
- Determined how the potential individual and business underreported taxpayers with Form 1099-K income identified by the IRS are being addressed by reviewing data on the Individual AUR and BUR Form 1120.

Performance of This Review

This review was performed with information obtained from the SB/SE Division Examination and Collection functions at the IRS National Headquarters in Washington, D.C., during the period April 2019 through July 2020. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Major contributors to the report were Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations); Phyllis Heald London, Director; Autumn Macik, Audit Manager; Doris A. Cervantes, Lead Auditor, Heath Sollak, Senior Auditor; and Myriam Dolsaint, Auditor.

Validity and Reliability of Data From Computer-Based Systems

During this review, we obtained extracts from the IRMF Form 1099-K table for TYs 2016 and 2017, the RTF tables for IMF and BMF Processing Years 2017 through 2019, and the IMF and BMF tables in the TIGTA Data Center Warehouse. In addition, we obtained extracts from the IMF CCNIP and IMF/BMF Status History tables in the IRS Compliance Data Warehouse. We also relied on data received from the IRS underreporter and nonfiler programs, the IRDM CISA, AUR, the IRCS-BMFA, BUR Form 1120, and the IPM. Before relying on the data, we ensured that each file contained the specific data elements requested. We evaluated the data by 1) performing electronic testing of required data elements, 2) reviewing existing information about the data and the system that produced them, and 3) interviewing agency officials knowledgeable about the data. We also performed analysis to ensure the validity and reasonableness of our data, such as ranges of dollar values and obvious invalid values. Based on the results of our tests, we believe that the data used in our review were reliable for purposes of this report.

Internal Controls Methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: IRS policies, procedures, and practices to identify, select, and process work selection of individual and business underreporters and nonfilers with Form 1099-K income. We evaluated these controls and procedures by reviewing source material, interviewing IRS management, and performing analysis on IRS individual and business underreporter and nonfiler taxpayer data.

Appendix II

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $2.8 billion in assessed tax by addressing 8,008 business nonfilers (not identified) that should have filed a TY 2017 Form 1120 with Form 1099-K gross income of $1 million or greater (see Recommendation 1).

Methodology Used to Measure the Reported Benefit:

We analyzed data extracted from the business RTF, IPM data obtained from the IRS, the status history data extracted from the Compliance Data Warehouse, and taxpayers' records in the BMF. We determined that 314,586 business nonfilers with Form 1099-K gross income were not identified by the IRS. Of these, 30,642 taxpayers had Form 1099-K gross income of $1 million or greater, totaling $297,568,873,638 of potential unreported income. We conducted additional analysis to estimate how many of these taxpayers should have filed a Form 1120, as subsequently described. We then calculated the potential assessed tax as follows:

- We used the IRS's Statistics of Income (SOI) to determine a five-year average net income ratio of 7.15 percent to allow for potential business deductions of 92.85 percent.[1] We applied the 7.15 percent to the Form 1099-K gross income for each individual taxpayer to obtain an estimated net income used to determine the potential tax assessment.
- Of the 30,642 taxpayers, 523 had filed returns prior to TY 2017. We used the prior returns to determine that 110 of the 523 unidentified business nonfiler taxpayers had a Form 1120 filing requirement. We applied the 2017 Tax Rate Schedule to the Form 1099-K net income for each of the 110 taxpayers and obtained $44,553,093 in potential taxes assessed.
- Of the 30,642 taxpayers, 30,119 had not filed returns prior to TY 2017. We estimated that 7,898 of 30,119 unidentified business taxpayers with no open filing requirement should have potentially filed a Form 1120 tax return. We calculated this estimate as follows:
    - Identified the percentage of Form 1120 nonfilers from the total population of 344,252 identified BMF nonfilers that had Form 1099-K gross income of $1 million or greater. This was 26.22 percent (6,390 Form 1120 out of a total 24,367 Forms 1120, 1065, and 1120-S).

[1] SOI Tax Stats - Integrated Business Data. We used the C Corporation data from Table 1 for TY 2011 to TY 2015 to obtain a five-year average net income ratio (net income-to-business receipts).

            - Applied 26.22 percent to the 30,119 unidentified business nonfiler taxpayers and obtained an estimated 7,898 unidentified nonfilers that should have filed a Form 1120 tax return.
        - We then identified the percentage of taxes assessed from the total population of 344,252 identified BMF nonfilers that had Form 1099-K gross income of $1 million or greater. This was 39.99 percent ($47,374,690,927 Form 1120 out of a total $118,479,148,596 Forms 1120, 1065, and 1120-S).[2]
            - We applied the 39.99 percent to the $6,996,091,117 representing the total taxes assessed for the 30,119 taxpayers with no open filing requirement, and identified an estimated $2,797,434,471 in potential taxes assessed for taxpayers that should have filed a Form 1120 return.[3]
- We added the potential taxes assessed for the 110 taxpayers with a Form 1120 filing requirement to the potential taxes assessed for the estimated 7,898 taxpayers with a Form 1120 filing requirement and obtained $2,841,987,564 ($44,553,093 + $2,797,434,471) in total potential taxes assessed.

Management's Response: The IRS disagreed with the recommendation related to this outcome measure (Recommendation 1), but did not provide a response directly regarding the outcome measure.

Office of Audit Comment: The methodology used to quantify the outcome was appropriate and provides a reasonable estimate of the potential tax assessment for these taxpayers.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $9.9 million in assessed tax by addressing 177 business nonfilers (not identified) that should have filed a TY 2017 Form 1120 with Form 1099-K gross income of $1 million or greater (see Recommendation 2).

Methodology Used to Measure the Reported Benefit:

We analyzed data extracted from the business RTF, IPM data obtained from the IRS, the status history data extracted from the Compliance Data Warehouse, and taxpayers' records in the BMF. We determined that 36,028 business nonfilers with Form 1099-K gross income were not identified by the IRS. Of these, 509 taxpayers had Form 1099-K gross income of $1 million or greater, totaling $1,408,232,818 of potential unreported income.

- We used the IRS's SOI to determine a five-year average net income ratio of 7.15 percent to allow for potential business deductions of 92.85 percent. We applied the 7.15 percent to the Form 1099-K gross income for each individual taxpayer to obtain an estimated net income used to determine the potential tax assessment.

[2] We used the Form 1120 tax rate schedule for the Form 1120-S and Form 1065 tax computations because those forms are for flow-through entities that are not taxed at the entity level. Using this method could result in taxes that may potentially be higher or lower. However, we believe the tax computation is reasonable for determining our potential outcome for Form 1120 taxpayers.

[3] Numbers may not compute due to rounding the percentage

- We used the taxpayers' prior returns and determined that 177 of the 509 unidentified business nonfiler taxpayers had a Form 1120 filing requirement. We applied the 2017 Tax Rate Schedule to the Form 1099-K net income for each of the 177 taxpayers and obtained $9,927,653 in potential taxes assessed.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $1.2 billion in assessed tax by addressing 4,807 business nonfilers (identified, but not worked) that should have filed a TY 2017 Form 1120 with Form 1099-K gross income of $1 million or greater (see Recommendation 3).

Methodology Used to Measure the Reported Benefit:

We analyzed data extracted from the business RTF, the status history data extracted from the Compliance Data Warehouse, and taxpayer's records in the BMF. We determined that 325,060 business nonfilers were not worked by the IRS. Of these, 21,216 taxpayers had Form 1099-K income of $1 million dollars or greater, totaling $157,819,161,665 of potential unreported income.

- We applied the same 7.15 percent detailed previously to the Form 1099-K gross income for each business taxpayer to obtain an estimated net income, allowing for potential business deductions, totaling $11,284,070,058.[4]
- We determined that 4,807 of 21,216 nonfiler taxpayers had a Form 1120 filing requirement. We applied the 2017 Tax Rate Schedule to the Form 1099-K net income for each of the 21,216 taxpayers and obtained $1,197,629,572 in potential taxes assessed.

Management's Response: The IRS disagreed with this outcome measure, stating that the outcome measure does not reflect its resource constraints in the compliance environment. Due to the IRS's limited resources, it is unable to work every productive return. Its workplan is developed to affect multiple areas of noncompliance (*e.g.* geography) and is not driven solely by business results. Additionally, every change the IRS makes to its compliance activities could result in an opportunity cost. However, when the IRS is determining the feasibility of adding a definition of business nonfilers (see Recommendation 3), it will pursue the consideration of 100 examinations of the 4,807 taxpayers. If it assumes each of the 100 returns have unreported income of $1,000,000 and apply the maximum tax rate for TY 2017 of 39.6 percent, without consideration of any other factors other than opportunity cost, the maximum tax potential is $35,369,900.

Office of Audit Comment: The methodology used to quantify the outcome was appropriate and provides a reasonable estimate of the potential tax assessment for these taxpayers. TIGTA acknowledges that the IRS has resource constraints; however, that does not change the potential tax that could be assessed on these taxpayers if the cases were worked.

Additionally, the calculation that the IRS provided assumes that the 100 returns have only $1 million of unreported income each. The cases we identified have $1 million or greater of Form 1099-K income. The 21,216 taxpayers in the

[4] Numbers may not compute due to rounding the percentage.

outcome measure had almost $158 billion of total Form 1099-K income, which averages more than $7 million per taxpayer.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $11.7 million in assessed tax by addressing 540 individual nonfiler accounts (not created) with TY 2017 Form 1099-K gross income of $100,000 or greater (see Recommendation 4).

Methodology Used to Measure the Reported Benefit:

We analyzed IMF CCNIP data extracted from the Compliance Data Warehouse and taxpayers' records in the IMF, and determined that 62,087 individual nonfiler accounts with Form 1099-K income were not created by the IRS. Of these, 540 taxpayers had Form 1099-K gross income of $100,000 or greater, totaling $151,320,087 of potential unreported income.

- We used the IRS's SOI to determine a five-year net income ratio of 26.95 percent to allow for potential business deductions of 73.05 percent.[5] We applied the 26.95 percent to the Form 1099-K gross income for each individual taxpayer to obtain an estimated net income, allowing for potential business deductions, totaling $40,780,763.
- We calculated the potential taxes assessed for each taxpayer as follows:
  - We computed the self-employment tax for the Form 1099-K net income and obtained $4,888,129.[6]
  - We reduced the underreported Form 1099-K net income by the personal exemption, the standard deduction, and one-half of the self-employment tax deduction. Then we computed the income tax using the 2017 Tax Rate Schedule for single filing status and obtained $6,859,844.
  - We added the computed self-employment tax to the computed income tax and obtained $11,747,973 ($4,888,129 + $6,859,844) in total potential taxes assessed.

Management's Response: The IRS disagreed with this outcome measure, stating that it is not clear that the Form 1099-K income reported as paid to the 540 taxpayers was merged correctly. (Self-employed individuals typically have an Employer Identification Number that Form 1099-K income is reported to and file a Form 1040 under their Social Security Number. That information must be merged).

Office of Audit Comment: The methodology used to quantify the outcome was appropriate and provides a reasonable estimate of the potential tax assessment for these taxpayers. As stated in the report, in footnote 31, from the 113,692 taxpayers who were not found on the IMF CCNIP file, we removed the 8,429 taxpayers for which the Form 1099-K contained an Employer Identification Number due to the complexity of the cross-reference (merge) process. The remaining 62,087 taxpayers for whom we report on in this outcome measure received Form 1099-K income under their Social Security Number and therefore no merging is necessary.

[5] SOI Tax Stats - Integrated Business Data. We used the Nonfarm Sole Proprietorships data from Table 1 for TY 2011 to TY 2015 to obtain a five-year average net income ratio (net income to business receipts).
[6] Self-employment tax may not be required on some types of Form 1099-K income, such as rental income.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $4.6 million in assessed tax by addressing 770 individual nonfilers (identified, but not worked) with TY 2017 Form 1099-K gross income of $100,000 or greater (see Recommendation 5).

Methodology Used to Measure the Reported Benefit:

We analyzed IMF CCNIP data extracted from the Compliance Data Warehouse and taxpayers' records in the IMF, and determined that 103,991 identified high-income individual nonfilers were not worked by the IRS. Of these, 770 taxpayers had Form 1099-K gross income of $100,000 or greater, totaling $81,397,143 of potential unreported income.

- We applied the same 26.95 percent detailed previously to the Form 1099-K gross income to obtain an estimated net income, allowing for potential business deductions, totaling $21,936,530.
- We calculated the potential taxes assessed for each taxpayer as follows:
  - Computed the self-employment tax for the Form 1099-K net income and obtained $3,087,818.[7]
  - Reduced the underreported Form 1099-K net income by the personal exemption, the standard deduction, and one-half of the self-employment tax deduction. Then we computed the income tax using the 2017 Tax Rate Schedule for single filing status and obtained $1,531,699.
  - Added the computed self-employment tax to the computed income tax and obtained $4,619,517 ($3,087,818 + $1,531,699) in total potential taxes assessed.

Management's Response: The IRS disagreed with this outcome measure, stating that it uses AGI in its CCNIP analysis rather than Form 1099-K income alone; AGI is more accurate for case selection purposes as it can have the effect of reducing the net income amount and better indicating the expected tax due. The IRS asserts that most of the 770 taxpayers TIGTA identified in the report as high-income nonfilers did not technically qualify as high-income cases.

Office of Audit Comment: The methodology used to quantify the outcome was appropriate and provides a reasonable estimate of the potential tax assessment for these taxpayers. When IRS management raised this issue, we incorporated their concerns and our response into the report (page 14). As stated previously, these taxpayers' AGIs were still greater than $92,000 each.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $78.7 million in assessed tax by addressing 192 Form 1120 fiscal year business taxpayers (not identified) with underreported TY 2017 Form 1099-K gross income of $1 million or greater (see Recommendation 6).

[7] Self-employment tax may not be required on some types of Form 1099-K income, such as rental income.

Methodology Used to Measure the Reported Benefit:

We analyzed the taxpayer's records in the BMF. We determined that 3,314 Form 1120 fiscal year business taxpayers underreported Form 1099-K gross income and were not identified by the IRS. Of these, 192 taxpayers underreported Form 1099-K gross income of $1 million or greater, totaling $1,003,131,717 of potential unreported income.[8] We calculated the potential taxes assessed for each taxpayer as follows:

- We computed the corrected taxable income for the 192 taxpayers by adding the underreported Form 1099-K income discrepancy amount to the taxable income from the original return. Then we computed the corrected tax using the 2017 Tax Rate Schedule and obtained $343,902,641.
- We subtracted the tax from the original return from the computed corrected tax ($343,902,641 - $1,700,290) and obtained $342,202,351 as the estimated proposed tax change.
- The IRS later provided an analysis of TYs 2015 and 2016 Form 1120 business underreporter cases with only Form 1099-K income discrepancies. This analysis determined a two-year ratio of only 23 percent of the IRS's proposed tax changes on these cases were assessed.[9] Therefore, we applied the 23 percent to the estimated proposed tax change of $342,202,351 and obtained $78,706,541 in total additional potential taxes assessed.

Management's Response: The IRS disagreed with this outcome measure, stating that it reviewed a random sample of the full population of 3,314 total returns listed in Figure 7. The IRS asserts that of the 67 sample returns reviewed, 65 (95 percent) were considered either correctly filed or likely to result in no additional assessments.

Office of Audit Comment: The methodology used to quantify the outcome was appropriate and provides a reasonable estimate of the potential tax assessment for these taxpayers. Additionally, these cases are not identified as underreporters by the current IRS systems. If the cases are not identified, then they cannot be worked as underreporter cases.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $1.58 billion in assessed tax by addressing 540 Form 1120 business taxpayers (identified, but not selected by the Field Case Selection unit) that had TY 2017 underreported Form 1099-K gross income of $1 million or greater (see Recommendation 7).

Methodology Used to Measure the Reported Benefit:

We analyzed BUR Form 1120 data and determined that 2,290 Form 1120 business taxpayers underreported Form 1099-K gross income and were identified, but not selected to be worked. Of these, 540 Form 1120 business taxpayers underreported $1 million or greater of Form 1099-K

[8] Cases in which Form 1099-K income was the same amount reported on the Other Income and Rental Income lines were removed.

[9] This may be due to a number of reasons such as final case resolution or if the taxpayer claimed additional deductions.

gross income that were not selected to be worked by the Field Case Selection unit, totaling $20,168,723,316 of potential unreported income. We calculated the potential taxes assessed for each taxpayer as follows:

- We computed the corrected taxable income for the 540 taxpayers by adding the underreported Form 1099-K income discrepancy amount to the taxable income from the original return. Then we computed the corrected tax using the 2017 Tax Rate Schedule and obtained $7,812,726,614.
- We subtracted the tax on the original return from the computed corrected tax ($7,812,726,614 - $949,453,683) and obtained $6,863,272,932 for the estimated proposed tax change.[10]
- We then applied the same 23 percent as detailed previously and obtained $1,578,552,774 in total additional potential taxes assessed.[11]

Management's Response: The IRS disagreed with this outcome measure, stating that in addressing these concerns, the IRS reviewed a random sample of TIGTA's population of Form 1120 underreporters that were identified but ultimately not selected. At the time of the review, TIGTA indicated the total population in question equaled 2,290 returns. The results of the review showed that 24 of the 67 returns in the sample met established exclusion criteria. By projecting from its sample to the 2,290 returns, the IRS estimates that 820 (±352 for the 95% confidence interval) returns would meet an established exclusion criterion. Further, the IRS identified at least one Form 1065 and eight Forms 1120-S that were erroneously included in the subject population (*i.e.* Form 1120 underreporters that were identified but ultimately not selected).

Lastly, the IRS stated that this outcome measure does not consider resource constraints, workplan requirements, coverage considerations, fairness in case selection, or the opportunity costs of selecting more of these types of cases rather than working other high-priority cases.

Office of Audit Comment: The methodology used to quantify the outcome was appropriate and provides a reasonable estimate of the potential tax assessment for these taxpayers. The IRS has resource constraints; however, that does not change the potential tax that could be assessed on these taxpayers if the cases were worked.

[10] Numbers may not compute due to rounding.

[11] Tax assessments may be lower in some cases, when the Form 1099-K income may have been reported on lines such as Rental Income or Other Income, rather than Gross Receipts.

Appendix III

Form 1099-K, *Payment Card and Third Party Network Transactions*

1010 ☐ VOID ☐ CORRECTED

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.	FILER'S federal identification no.	OMB No. 1545-2205	Payment Card and Third Party Network Transactions
	PAYEE'S taxpayer identification no.	2017	
	1a Gross amount of payment card/third party network transactions $	Form 1099-K	
Check to indicate if FILER is a (an): Payment settlement entity (PSE) ☐ Electronic Payment Facilitator (EPF)/Other third party ☐ — Check to indicate transactions reported are: Payment card ☐ Third party network ☐	1b Card Not Present transactions $	2 Merchant category code	Copy A For Internal Revenue Service Center
	3 Number of payment transactions	4 Federal income tax withheld $	
PAYEE'S name	5a January $	5b February $	File with Form 1096.
Street address (including apt. no.)	5c March $	5d April $	For Privacy Act and Paperwork Reduction Act Notice, see the **2017 General Instructions for Certain Information Returns.**
	5e May $	5f June $	
City or town, state or province, country, and ZIP or foreign postal code	5g July $	5h August $	
PSE'S name and telephone number	5i September $	5j October $	
	5k November $	5l December $	
Account number (see instructions) — 2nd TIN not. ☐	6 State	7 State identification no.	8 State income tax withheld $ $

Form 1099-K Cat. No. 54118B www.irs.gov/form1099k Department of the Treasury - Internal Revenue Service

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Appendix IV

Start Date Criteria[1]

1. Master File Tax Account code 02 – Form 1120
   a. Start Date Criteria:

[redacted]

b) [redacted]

2. Master File Tax Account code 06 – Form 1065
   a. [redacted]

[1] Programing Requirements Package (PRP) 180, Section 17.02, Revision March 20, 2008.

Appendix V

Individual Master File Underreporter Drop Case Criteria[1]

[redacted]

[1] Programing Requirements Package (PRP) 404, Section 08, Revision April 18, 2018.

[redacted]

Appendix VI

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

November 30, 2020

MEMORANDUM FOR MICHAEL E. McKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Eric C. Hylton
Digitally signed by Darren J. Guillot
Date: 2020.11.30 15:26:55 -05'00'
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Report – Billions in Potential Taxes Went Unaddressed From Unfiled Returns and Underreported Income by Taxpayers That Received Form 1099-K Income (Audit # 201930023)

Thank you for the opportunity to review and comment on the above subject draft audit report. The IRS recognizes the impact proper utilization and analysis of 1099-K information has on our tax compliance activities. This information can be useful in identifying activity that may not be reported accurately on an income tax return, which may, in turn, help to uncover sources of unreported income. As such, we continue to utilize 1099-K information during the case building, examination, and collection phases for both filed and non-filed returns.

We believe the title of the report misrepresents the performance of our underreporter and non-filer programs. In fact, despite the title, the report itself describes the success of our nonfiler and underreporter programs. While there may be potential discrepancies that have not been addressed by the IRS it is not due to the failure of our programs but rather due to resource constraints.

In recognition of the importance of nonfiler programs in promoting overall compliance, the IRS created the SB/SE Nonfiler Strategic Plan and the Nonfiler Executive Steering Committee in Fiscal Year (FY) 2018 to ensure coordination among the various IRS functions involved in nonfiler efforts. SB/SE also increased the resources devoted to nonfiler programs. As a result, dollars collected from secured delinquent returns increased by 33% from FY 2018 to FY 2019.

Our existing Case Creation Nonfiler Identification Processes (CCNIP) are complex and effective. CCNIP considers 3.5 billion income information returns filed each year as reported on more than 41 different types of documents, including Forms W-2, 1098 and 1099. The system uses this information to identify nonfilers and estimate the potential tax that could be assessed. CCNIP analysis utilizes an aggregated adjusted gross income (AGI) figure as opposed to a single input such as 1099-K gross income because

AGI more accurately identifies potential tax assessments. IRS then issues delinquency notices to taxpayers based on the results of the CCNIP analysis. Nonfilers with high potential assessments are considered a high priority. Based on our analysis of the 756 taxpayers identified by TIGTA as high-income nonfilers, we determined that none of those nonfilers met our high-income case criteria. We do not agree that the potential increased revenue rises to the level indicated, but we plan to further review the sample and refer the ones with a significant liability to the appropriate treatment stream.

In addition to CCNIP, the IRS SB/SE Division has two separate underreporter programs dedicated to addressing discrepancies between the tax return and the information return: the Automated Underrporter (AUR) program and the Business Underreporter (BUR) program.

The AUR program focuses on individual taxpayers and considers more than 150 million filed tax returns on an annual basis. Through a series of complex filters and analysis, the AUR program successfully identifies taxpayers with reporting discrepancies and high potential assessments for further compliance action. As TIGTA noted in its report, there are justifiable business reasons for all non-selected individual underreporters, which supports the AUR program is functioning as intended.

The BUR program focuses on business taxpayers and annually considers more than 13 million filed tax returns using a series of complex filters and analysis. In the report, TIGTA focused on a subset of the Tax Year 2017 business taxpayer population: 2.29 million business taxpayers who received a Form 1099-K and, specifically, 160,425 (7%) of those taxpayers with a discrepancy of $10,000 or more between the income reported on a Form 1099-K and the income reported on the taxpayer's return. Of this population, TIGTA determined that all but 30 returns were properly identified, which means that the BUR program properly identified more than 99.98% of the population. The IRS has subsequently corrected the programming error contributing to the 30 missed returns. These findings and conclusions support the BUR program is functioning as intended. While the IRS recognizes the BUR program does have limitations, high potential returns that fall outside of the scope of this program are shared for consideration in other compliance workstreams, subject to additional filtering, prioritization, and resource constraints.

As we have stated previously in response to numerous TIGTA reports, we must make enforcement decisions based on resources, return on investment, coverage of all types of taxpayers, and other high priority work. TIGTA's recommendations in this report, as well as others issued to SB/SE on different topics[1], fail to fully consider the other

[1] Ref. No. 2020-30-015, *High-Income Nonfilers Owing Billions of Dollars Are Not Being Worked by the Internal Revenue Service* (May 29, 2020); and Ref. No. 2019-30-069, *Billions of Dollars of Nonfiler Employment Taxes Went Unassessed in the Automated 6020(b) Program Due Primarily to Resource Limitations* (September 16, 2019).

competing priorities of the SB/SE Division. SB/SE cannot act on competing recommendations in various reports that do not appropriately balance deployment of limited resources.

We are unable to commit to implementing “BMF CCNIP R2” since recent legislation has placed significant demands on our Information Technology resources. However, we will review our process for evaluating start date criteria for business nonfilers to determine if it can be eliminated or revised and will also determine if implementing a Service-wide definition and strategy for working high-income business nonfilers is feasible.

If you have any questions, please contact me or Scott E. Irick, Director, Examination Operations, Small Business/Self-Employed Division.

Attachment

Attachment

RECOMMENDATION 1:
The Commissioner, Small Business/Self-Employed (SB/SE) Division, should consider funding and implementing the "BMF CCNIP R2," which includes enhanced and refined selection criteria for BMF taxpayers that have income but do not reflect as having an open filing requirement, so that these cases will have the opportunity to be identified and worked.

CORRECTIVE ACTION:
While we continue to support the programming that would be required, the ultimate approval and implementation of that programming is subject to Service-wide needs and priorities (including programming required for implementation of COVID-related legislation).

IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A

RECOMMENDATION 2:
The Commissioner, SB/SE Division, should evaluate the Start Date criteria for business nonfilers to determine whether it can be eliminated or revised, so that these cases will have the opportunity to be identified and worked.

CORRECTIVE ACTION:
We will evaluate the Start Date criteria for business nonfilers and will make a recommendation as to whether it can be eliminated or revised. However, it is possible there will be information technology (IT) considerations similar to those discussed in our response to recommendation #1 if programming is required.

IMPLEMENTATION DATE:
February 15, 2022

RESPONSIBLE OFFICIAL:
Director, Collection Inventory Delivery & Selection, SB/SE

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 3:
The Commissioner, SB/SE Division, should define high-income business nonfilers and create a strategy to work these cases so that all high-income business nonfiler cases will have the opportunity to be selected and worked. The Commissioner, SB/SE Division, should include the business high-income strategy in the IRS Nonfiler Strategy plan.

CORRECTIVE ACTION:
Under the umbrella of the 2018 SB/SE Nonfiler Strategic Plan, SB/SE Examination and Collection will partner to perform an analysis of business nonfilers to determine the feasibility of implementing a Service-wide definition of high-income business nonfilers and whether that type of designation is appropriate in the selection of business nonfiler cases.

IMPLEMENTATION DATE:
October 15, 2022

RESPONSIBLE OFFICIALS:
Director, Examination Operations, SB/SE
Director, Collection Operations, SB/SE

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 4:
The Commissioner, SB/SE Division, should develop a process to identify high-income individual nonfilers who are not created during the information return data assimilation and correlation processes, so these cases will have an opportunity to be identified and worked.

CORRECTIVE ACTION:
The benefit of this recommendation to the IMF CCNIP process would be minimal, as the purpose of the process is to enhance case selection by identifying those nonfiler cases with higher potential tax assessments, while balancing coverage considerations and ensuring fairness in case selection. Moreover, the ability to select "all" cases currently identified in the program is not attainable due to resource and funding constraints. This process would require significant IT resources and programming, for little or no benefit

IMPLEMENTATION DATE:
N/A

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RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A

RECOMMENDATION 5:
The Commissioner, SB/SE Division, should select and work a percentage of the 756 individual nonfilers who had significant income.

CORRECTIVE ACTION:
We will analyze the 756 individual nonfiler cases and will refer the cases with a significant liability to the appropriate treatment stream.

IMPLEMENTATION DATE:
April 15, 2021

RESPONSIBLE OFFICIAL:
Director, Collection Inventory Delivery & Selection, SB/SE

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 6:
The Director, Examination, SB/SE Division, should develop a process to identify Form 1120 fiscal year business underreporters so that these cases will have the opportunity to be identified and worked.

CORRECTIVE ACTION:
The BUR program does not have the capability to address fiscal year filers. In general, information returns are filed on a calendar year basis, which would require the IRS to generate an estimate to calculate the potential fiscal year income. Addressing fiscal year filers within this compliance stream would significantly increase taxpayer burden, require form changes, and IT programming updates. However, fiscal year filers are currently addressed in other compliance work streams as evidenced by the 1,021 fiscal year 2017 corporate taxpayer examinations we have completed.

IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A

RECOMMENDATION 7:
The Director, Examination, SB/SE Division, should consider adjustments to the Field Case Selection process that will allow for more high-dollar business underreporter cases to be examined.

CORRECTIVE ACTION:
TIGTA only considered the population of taxpayers with a discrepancy between Form 1099-K income and income reported on their return, and not the entire population of taxpayers with information return and tax return income discrepancies shared with Field Case Selection. With this limited analysis, it is difficult to determine if these returns would have been prioritized over the returns selected for examination. The existing Field Case Selection process includes various elimination filters and specific criteria to prioritize all discrepant returns in a manner ensuring fairness in case selection. It also considers competing priorities, workplan needs, and resource constraints. TIGTA has not demonstrated that our current process is lacking and we do not plan to make any adjustments to our current processes.

IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A

OUTCOME MEASURE 1:
Increased Revenue – Potential; $2.8 billion in assessed tax by addressing 8,008 business nonfilers (not identified) that should have filed a TY 2017 Form 1120 with Form 1099-K gross income of $1 million or greater (see Recommendation 1).

IRS RESPONSE:
We disagree with recommendation 1, so a response is not applicable to this outcome measure.

OUTCOME MEASURE 2:
Increased Revenue – Potential; $9.9 million in assessed tax by addressing 177 business nonfilers (not identified) that should have filed a TY 2017 Form 1120 with Form 1099-K gross income of $1 million or greater (see Recommendation 2).

IRS RESPONSE:
We agree with this outcome measure.

OUTCOME MEASURE 3:
Increased Revenue – Potential; $1.2 billion in assessed tax by addressing 4,807 business nonfilers (identified, but not worked) that should have filed a TY 2017 Form 1120 with Form 1099-K gross income of $1 million or greater (see Recommendation 3).

IRS RESPONSE:
The outcome measure does not reflect our resource constraints in the compliance environment. Due to our limited resources we are unable to work every productive return. Our work plan is developed to impact multiple areas of non-compliance (e.g. geography) and is not driven solely by business results. Additionally, every change we make to our compliance activities could result in an opportunity cost. However, when we are determining the feasibility of adding a definition of business non-filers (see recommendation 3) we will pursue the consideration of 100 examinations of the 4,807 taxpayers. If we assume each of the 100 returns have unreported income of $1,000,000 and apply the maximum tax rate for tax year 2017 of 39.6, without consideration of any other factors other than opportunity cost, the maximum tax potential is $35,369,900.

OUTCOME MEASURE 4:
Increased Revenue – Potential; $11.7 million in assessed tax by addressing 540 individual nonfiler accounts (not created) with TY 2017 Form 1099-K gross income of $100,000 or greater (see Recommendation 4).

IRS RESPONSE:
We disagree with this outcome measure as it is not clear that the 1099-K income reported as paid to the 540 taxpayers was merged correctly. (Self-employed individuals typically have an Employer Identification Number that 1099-K income is reported to and file a Form 1040 under their Social Security Number. That information must be merged). We continue to research these cases.

OUTCOME MEASURE 5:
Increased Revenue – Potential; $4.6 million in assessed tax by addressing 770 individual nonfilers (identified, but not worked) with TY 2017 Form 1099-K gross income of $100,000 or greater (see Recommendation 5).

IRS RESPONSE:
We disagree with this outcome measure. We use adjusted gross income (AGI) in our CCNIP analysis rather than 1099-K income alone; AGI is more accurate for case selection purposes as it can have the effect of reducing the net income amount and better indicating the expected tax due. As a result, most of the 770 taxpayers TIGTA

identified in the report as high-income nonfilers did not technically qualify as high-income cases and we do not agree that the potential increased revenue rises to the level indicated. As noted in our corrective action for recommendation 5, we plan to analyze these nonfiler cases and will refer the cases with a significant liability to the appropriate treatment stream.

OUTCOME MEASURE 6:
Increased Revenue – Potential; $78.7 million in assessed tax by addressing 192 Form 1120 fiscal year business taxpayers (not identified) with underreported TY 2017 Form 1099-K gross income of $1 million or greater (see Recommendation 6).

IRS RESPONSE:
We disagree with this outcome measure. The IRS reviewed a random sample of the full population of 3,314 total returns listed in figure 7. Of the 67 sample returns reviewed, 65 (95%) were considered either correctly filed or likely to result in no additional assessments.

OUTCOME MEASURE 7:
Increased Revenue – Potential; $1.58 billion in assessed tax by addressing 540 Form 1120 business taxpayers (identified, but not selected by the Field Case Selection unit) that had TY 2017 Form 1099-K gross income of $1 million or greater (see Recommendation 7).

IRS RESPONSE:
We disagree with this outcome measure. In addressing these concerns, the IRS reviewed a random sample of TIGTA's population of Form 1120 underreporters that were identified but ultimately not selected. At the time of the review, TIGTA indicated the total population in question equaled 2,290 returns. The results of the review showed that 24 of the 67 returns in the sample met established exclusion criteria. By projecting from our sample to the 2,290 returns, we estimate that 820 (±352 for the 95% confidence interval) returns would meet an established exclusion criterion. Further, the IRS identified at least one Form 1065 and eight Forms 1120-S that were erroneously included in the subject population (i.e. 1120 underreporters that were identified but ultimately not selected).

Lastly, this outcome measure does not consider resource constraints, workplan requirements, coverage considerations, fairness in case selection, or the opportunity costs of selecting more of these types of cases rather than working other high priority cases.

Appendix VII

Glossary of Terms

Term	Definition
Automated Underreporter Program	The AUR program matches items reported on an individual's income tax return to information supplied to the IRS from outside sources to determine if the taxpayer's tax return reflected the correct amounts, ensuring that the tax amount is correct.
Business Master File	The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.
Business Master File Analytics System	The system is the tool used for BUR case selection. Users have the option to test the integrity of data, build rules to select cases, export data, and view various reports.
Business Master File Case Creation Nonfiler Identification Process	The process in which the Business Master File delinquency check assimilates third-party information in the case creation program to identify productive BMF nonfiler cases.
Business Underreporter Program	The BUR program matches items reported on a business's income tax return to information supplied to the IRS from outside sources to determine if the taxpayer's tax return reflected the correct amounts, ensuring that the tax amount is correct.
Calendar Year	A year that begins on January 1 and ends on December 31.
Case Inventory Selection and Analytics	The CISA provides IRCS analysts with the ability to define and execute logic for the intelligent selection of individual taxpayer case inventory.
Compliance Data Warehouse	An IRS repository of compliance, filing, and related databases that are used to support projects, analyses, and studies related to tax administration.
Correlation	A process that compares tax return and information return data, and applies business rules to identify potential underreporter cases.
Data Center Warehouse	A collection of IRS databases containing various types of taxpayer account information that is maintained by TIGTA for the purpose of analyzing data for ongoing audits.
Estimated Potential Assessment	An estimation of the assessment that each case will yield based on the behavior and characteristics of cases from past AUR correlations.
Field Case Selection Unit	The Field Case Selection unit provides policy guidance on selection of cases and delivery of inventory for examination.

Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Full-Time Equivalent	A measure of labor hours in which one FTE is equal to eight hours multiplied by the number of compensable days in a particular fiscal year.
Individual Master File	An IRS computer system that stores transactions or records of individual tax accounts.
Individual Master File Case Creation Nonfiler Identification Process	A program that identifies individual nonfilers by using IMF and IRMF data to determine if certain criteria are met for a specific tax year. Once the nonfiler cases are identified, the program also categorizes the cases and assigns selection codes.
Information Reporting and Document Matching	The IRDM is a SB/SE Division Compliance application. It consists of two subsystems: IRDM Data Correlation and IRDM BMFA.
Information Return Case Selection	A group of IRS employees who use the IRDM CISA tool to select cases for AUR to work.
Information Returns Master File	An IRS database that stores income and withholding data reported to the IRS from payers and employers.
Integrated Production Model	A consolidated source of core taxpayer data that is used by a wide range of projects and other business applications.
Internal Revenue Code	Federal statutes pertaining to taxes that are imposed by the Federal Government are compiled into Title 26 of the United States Code.
Nonfilers	Individual and business taxpayers that have been identified as liable to file a tax return but have not filed a tax return by the return due date or extended due date.
Small Business/ Self-Employed Division	The IRS organization that services self-employed taxpayers and small businesses by educating and informing them of their tax obligations, developing educational products and services, and helping them understand and comply with applicable tax laws.
Tax Year	The 12-month period for which tax is calculated. For most individual taxpayers, the tax year is synonymous with the calendar year.

Appendix VIII

Abbreviations

AGI	Adjusted Gross Income
AUR	Automated Underreporter
BMF	Business Master File
BMFA	Business Master File Analytics
BUR	Business Underreporter
CCNIP	Case Creation Nonfiler Identification Process
CISA	Case Inventory Selection and Analytics
FTE	Full-Time Equivalent
FY	Fiscal Year
IMF	Individual Master File
IPM	Integrated Production Model
IRCS	Information Return Case Selection
IRDM	Information Reporting and Document Matching
IRM	Internal Revenue Manual
IRMF	Information Returns Master File
IRS	Internal Revenue Service
RTF	Return Transaction File
SB/SE	Small Business/Self-Employed
SOI	Statistics of Income
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year