TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Additional Actions to Enforce Payment Card Reporting Requirements Could Reduce the Tax Gap

September 25, 2015

Reference Number: 2015-40-089

Redaction Legend:
1 = Tax Return/Return Information
2 = Risk Circumvention of Agency Regulation or Statute

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ADDITIONAL ACTIONS TO ENFORCE PAYMENT CARD REPORTING REQUIREMENTS COULD REDUCE THE TAX GAP

Issued on September 25, 2015

Highlights

Highlights of Report Number: 2015-40-089 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Congress enacted legislation in an effort to narrow the Tax Gap (the estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time) and increase voluntary compliance of businesses through information reporting. The legislation required information returns to be filed for reportable payment card transactions starting in Calendar Year 2012. The Department of the Treasury estimated that this new law would result in the additional collection of almost $10 billion over 10 years.

WHY TIGTA DID THE AUDIT

In Calendar Year 2012, the IRS committed to a multiyear, multi-treatment stream compliance pilot initiative leveraging Form 1099-K, *Payment Card and Third Party Network Transactions,* information to reduce the Tax Gap. This audit continues our assessment of the IRS's implementation of payment card reporting requirements.

WHAT TIGTA FOUND

The IRS recognizes the challenges associated with using Forms 1099-K to identify noncompliance with income reporting. To address these challenges, the IRS implemented pilot initiatives to identify payment card noncompliance. These initiatives include new processes and changes to existing processes, treatment streams, and capabilities. The IRS continues to use the results from these pilot initiatives to refine the criteria used to identify underreporting of payment card income. **********************2******************************* ********************2**********************. TIGTA found that payers are not compliant with backup withholding requirements which require a payer to immediately withhold 28 percent of amounts reported on Forms 1099-K for payees that failed to provide a valid Taxpayer Identification Number (TIN). For example, TIGTA's review of Calendar Year 2013 Forms 1099-K identified 10,216 Forms 1099-K with a missing TIN. These Forms 1099-K reported gross transactions totaling over $10.6 billion. As such, payers were required to withhold almost $3 billion from these payees, yet no backup withholding was taken.

TIGTA also identified that the TIN Matching Program used by payers to verify a payee TIN does not alert the payer when the TIN of a deceased individual is used. TIGTA's review of Calendar Year 2013 Forms 1099-K found that the IRS received 2,933 Forms 1099-K with gross transactions totaling $543.9 million for which the payee TIN was that of a deceased individual.

Finally, Form 1099-K information should be included in the IRS's nonfiler identification efforts. Review of Calendar Year 2013 Forms 1099-K identified 84,107 individuals for whom payers reported gross transactions on Forms 1099-K totaling nearly $9.1 billion and 443,528 businesses for which payers reported gross transactions on Forms 1099-K totaling over $164.5 billion that did not file a tax return.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Small Business/Self-Employed Division, **2** *************************2************************; ensure that a business case analysis is performed when making decisions to grant transitional relief; assess penalties on certain payers that do not comply with reporting requirements; and use Form 1099-K information as part of the IRS's nonfiler program.

The IRS agreed with six of the seven recommendations. The IRS did not agree to implement a computer programming change because it could not guarantee changes will be implemented due to budgetary constraints and limited resources. However, TIGTA believes this change should be a priority.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 25, 2015

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Additional Actions to Enforce Payment Card Reporting Requirements Could Reduce the Tax Gap
(Audit # 201440005)

This report presents the results of our review to assess the Internal Revenue Service's efforts to implement an effective process to match reportable payment card transaction amounts reported by payment settlement entities on Forms 1099-K, *Payment Card and Third Party Network Transactions*,[1] to income reported on participating merchants tax returns. This audit was included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Achieving Program Efficiencies and Cost Savings.

Management's complete response to the draft report is included in Appendix VII.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have questions, please contact me or Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services).

[1] The 2011 Form 1099-K was titled "*Merchant Card and Third Party Network Payments*." All subsequent years for this form are titled "*Payment Card and Third Party Network Transactions*."

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Abbreviations

CY	Calendar Year
EIN	Employer Identification Number
I.R.C.	Internal Revenue Code
IRDM	Information Reporting and Document Matching
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
SSA	Social Security Administration
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number

Background

Congress enacted legislation in an effort to narrow the Tax Gap[1] and increase voluntary compliance of businesses through information reporting. Specifically, the Housing and Economic Recovery Act of 2008,[2] Section (§) 3091, *Returns Relating to Payments Made in Settlement of Payment Card and Third Party Network Transactions*, added § 6050W to the Internal Revenue Code (I.R.C.). The legislation required information returns to be filed for reportable payment transactions. The Internal Revenue Service (IRS) developed Form 1099-K, *Payment Card and Third Party Network Transactions*,[3] to be submitted to the IRS starting in Calendar Year (CY) 2012 for CY 2011 reportable payment transactions. Each year, payers are required to provide Forms 1099-K to the IRS by February 28 if submitted by paper and by March 31 if electronically submitted. The Department of the Treasury estimated that enactment of this law would result in the additional collection of almost $10 billion over 10 years.

In January 2012, the IRS published a study that estimated the gross Tax Gap for Tax Year[4] 2006 at about $450 billion. The IRS reported in March 2014 that a significant portion ($140 billion) of the Tax Gap was attributed to noncompliance in the reporting of business income earned by entities other than large corporations. The IRS also concluded that compliance with reporting of income is higher when the income is subject to third-party reporting or withholding.

Form 1099-K requirements

The Form 1099-K reporting requirements were enacted to assist the IRS in comparing payee gross proceeds from card sales to gross receipts reported on the taxpayer's return. The law requires payment settlement entities (payers) to report annual gross payment transactions to the IRS and send a written statement containing the same information to participating payees that received these payments. For example, a business or individual (payee) that accepts payment cards will enter into a contract with a bank or organization (payer) that has the contractual obligation to make payments to the payee in settlement of reportable payment card transactions. All payers making one or more payments to a payee in settlement of reportable payment transactions are required to file Form 1099-K annually with the IRS.

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[1] The estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.
[2] Pub. L. No. 110-289, 122 Stat. 2654 (2008).
[3] See Appendix V for an example of this form. The CY 2011 Form 1099-K was titled "*Merchant Card and Third Party Network Payments*." All subsequent years are titled "*Payment Card and Third Party Network Transactions*."
[4] A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

The payer reports the gross amount of such reportable payment transactions for the calendar year and for each month within that calendar year. The payer must also report the payee name, address, and Taxpayer Identification Number (TIN)[5] on Form 1099-K. A written statement must be furnished to the payee containing the same information as on the Form 1099-K as well as the name, address, and phone number of the person required to prepare the return. The two types of reportable payment card transactions are:

1. Payment Card Transactions – a reportable payment card transaction involves a bank or other entity that makes a payment to a merchant or other business, in settlement of reportable payment card transactions, which includes credit cards, debit cards, and store-valued cards. The entity that transfers funds to the merchant's account is responsible for preparing and furnishing Form 1099-K to the merchant and to the IRS.
2. Third-Party Network Transactions – a third-party network transaction involves a third-party settlement organization. A third-party settlement organization is the organization that has the contractual obligation to make payments to participating payees in a third-party payment network. The most common example of a third-party settlement organization is an online auction payment facilitator, like PayPal,[6] which operates as an intermediary between a buyer and seller by transferring funds between accounts in settlement of an auction/purchase. Third-party settlement organizations charge sellers a fee for facilitating the transaction. Under the new reporting requirements, third-party settlement organizations must complete Form 1099-K when there are more than 200 transactions and payment to a payee exceeds $20,000.

Figure 1 provides the volume of Forms 1099-K filed for CY 2013.

[5] A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the TIN can include an Employer Identification Number (EIN), a Social Security Number (SSN), or an Individual TIN.
[6] PayPal gives individuals and businesses a way to send money without sharing financial information and with the flexibility to pay using bank accounts and credit cards.

Figure 1: Form 1099-K Volumes, Calendar Year 2013

	Payee TIN Type			
	Social Security Number	Employer Identification Number	Missing/ Incorrect TIN[7]	Total
Number of Forms 1099-K	1.8 million	7.5 million	0.4 million	9.7 million
Gross Amount of Transactions Reported	$91.9 billion	$5.2 trillion	$117.0 billion	$5.4 trillion

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of the Information Returns Master File[8] as of December 31, 2014.

Information reporting and document matching pilot initiatives

The IRS established the Information Return Document Matching (IRDM) Program in the Small Business/Self-Employed (SB/SE) Division to create the infrastructure needed to implement legislation related to third-party reporting. This law requires new information reporting to the IRS for three issues that contribute to the Tax Gap. The three transaction types involve payment cards, cost basis for securities, and certain government payments made to contractors. In CY 2012, the IRS committed to a multiyear, multi-treatment stream compliance pilot initiative to use Form 1099-K information to reduce the Tax Gap. The IRS uses various systems (*e.g.*, the Automated Underreporter system[9] and IRDM system[10]) to identify potential underreporter payment card compliance cases. The IRDM Program includes the following payment card pilot initiatives:

1. Alternative Notice – Compliance cases are identified by the Office of Compliance Analytics for Form 1040, *U.S. Individual Income Tax Return*, and Form 1120, *U.S. Corporation Income Tax Return*, with an associated Form 1099-K. This is considered an underreporter notice pilot and is designed to determine gross receipts that should have been reported on the tax return. Notices are sent to individuals and businesses with potential underreporting of income to verify income reported on their tax return.

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[7] A payee TIN is considered to be missing if it is not provided, has more or less than nine numbers, or has an alpha character as one of the nine positions. A payee TIN is considered incorrect if it is in the proper format but the payee Name/TIN combination does not match or cannot be found on IRS or Social Security Administration (SSA) records.
[8] Creates a master file of current tax year information returns and maintains access to nine prior years.
[9] Works underreporter cases in campuses that were identified by matching information returns (Forms 1099 (various types of U.S. information returns); Form W-2, *Wage and Tax Statement*; *etc.*) against data reported on individual tax returns.
[10] An SB/SE Compliance function application that compares information returns to tax returns to identify discrepancies in tax return money amounts and create a universe of potential underreported cases. It also applies decision analytics to score and select cases.

2. Technical Audit – Compliance cases are identified by the Office of Compliance Analytics for Form 1040 and Form 1120 with an associated Form 1099-K. This is considered an audit pilot to test the efficiency of working cases selected based on payment card data in a correspondence setting. The taxpayer's books and records are requested to verify the gross receipts reported on the income tax return.

3. Field Audit – Compliance cases are identified by the Office of Compliance Analytics for Form 1040; Schedule C (Form 1040), *Profit or Loss from Business (Sole Proprietorship)*; Form 1120; Form 1120S, *U.S. Income Tax Return for an S Corporation*; and Form 1065, *U.S. Return of Partnership Income*, with an associated Form 1099-K. This is considered an audit pilot that works complex tax returns in an office or field exam setting by tax compliance officers or revenue agents.

4. Individual Master File Automated Underreporter and Business Master File Automated Underreporter – Compliance cases are identified by the Automated Underreporter system when the gross receipts reported on Form 1040; Schedule C (Form 1040); Schedule E (Form 1040), *Supplemental Income and Loss*; Schedule F (Form 1040), *Profit or Loss From Farming*; or Form 1120 are less than the aggregate amount reported on third-party documents submitted to the IRS including Form 1099-K.

5. Collection – Compliance cases are identified when a Form 1099-K has been submitted to the IRS and an associated tax return has not been filed or has a balance due. Cases include taxpayers with and without a past filing history of tax returns. This initiative employs Form 1099-K information to identify and pursue nonfilers the IRS was unable to locate and test the value as a levy source for the Automated Collection System[11] on balance due accounts.

Figure 2 provides a timeline of activities associated with the IRS's implementation of payment card reporting requirements.

[11] A telephone contact system through which telephone assistors collect unpaid taxes and secure tax returns from delinquent taxpayers that have not complied with previous notices.

Figure 2: Payment Card Reporting Timeline

Effective Date	Description
July 2008	Legislation enacted requiring payers to submit returns to the IRS in settlement of reportable payment transactions.
April 2009	The initial IRDM Program was launched by the IRS to define and size the area, develop the approach, and organize the function.
January 2012	• CY 2011 Forms 1099-K were required to be submitted to the IRS. • External stakeholders expressed concerns related to the IRS requiring reconciliation of Form 1099-K amounts to the tax returns. • Backup withholding requirements and payer penalties were applied to Forms 1099-K with missing and incorrect Name/TIN combinations reported. However, an initial year of transitional relief was granted.
March 2012	The IRS performed testing and analysis by obtaining a test sample of data from merchant acquirers[12] to test data quality, conduct preliminary analysis, and develop a new approach for identifying and quantifying a business's potential income underreporting.
October 2012	Compliance pilot initiatives were initiated to process potential underreporting of income on CY 2011 tax returns using Forms 1099-K.
January 2013	Backup withholding commenced on missing TINs submitted on Forms 1099-K.
March 2014	Compliance pilot initiatives were approved for expanded temporary staffing.
September 2014	The IRS began issuing notices to payers for incorrect TINs on CY 2013 Forms 1099-K.

Source: The I.R.C. and IRS management.

Backup withholding requirements for payees with missing or incorrect TINs

Once Forms 1099-K are received, the IRS verifies that a payee TIN is listed on the Form 1099-K and the TIN is valid (*i.e.*, matches either the SSA's or IRS's records). Backup withholding provisions require payers to withhold 28 percent of amounts reported on Forms 1099-K associated with payees that do not provide a payer with a TIN or that provide an incorrect TIN. After TIN validation, the IRS sends notices to payers that submit information documents with missing and/or incorrect payee TINs. Once the payer receives the notice of a missing and/or incorrect payee TIN, the payer is required to obtain valid TIN information for the payee or withhold tax from future payments if a valid TIN cannot be obtained.

[12] Acquirers enable businesses to accept card payments.

Backup withholding requirements apply to information returns as follows:

- Missing TIN – considered to be missing if it is not provided, has more or less than nine numbers, or it has an alpha character as one of the nine positions. Payers are required to ***immediately*** backup withhold on payments to the payee, and this occurs at the time the payee refuses or neglects to provide a TIN to the payer.
- Incorrect TIN – considered incorrect if it is in the proper format but the Name/TIN combination does not match or cannot be found on IRS or SSA files. Backup withholding is applied on payments to payees 30 days after the IRS has notified the payers of the incorrect TIN. These notices go out in the fall of the year following when the TIN was incorrect, and backup withholding occurs on payments made after that time. For example, payers that submitted CY 2013 Forms 1099-K (due by March 2014) with incorrect TINs would not be notified until September 2014, and backup withholding would start 30 days following the notice (assuming that the payee does not at that time provide a correct TIN).

I.R.C. § 3406, *Backup Withholding*, states (selected portions omitted so as to focus on sections relevant to this discussion):

> *(a) Requirement to deduct and withhold*
>
> *(1) In general*
>
> *In the case of any reportable payment, if—*
>
> *(A) the payee fails to furnish his TIN to the payer in the manner required,*
>
> *(B) the Secretary notifies the payer that the TIN furnished by the payee is incorrect,*
>
> *then the payer shall deduct and withhold from such payment a tax equal to the product of the fourth lowest rate of tax applicable.*
>
> *(b) Reportable payment, etc.*
>
> *(3) Other reportable payment*
>
> *The term "other reportable payment" means any payment of a kind, and to a payee, required to be shown on a return required under—*
>
> *(F) section 6050W (relating to returns relating to payments made in settlement of payment card transactions).*

A prior TIGTA review identified deficiencies with payment card reporting

In CY 2011, TIGTA reported that the IRS's redesign of Tax Year 2011 income tax forms may not facilitate a direct match between sales reported on Forms 1099-K and amounts reported on tax returns.[13] Based on this finding, the IRS immediately made adjustments to one tax form and planned to revise other forms to make similar improvements.

TIGTA also reported that because of the increased volume of Forms 1099-K resulting from payment card reporting requirements, there is a risk that Name/TIN combination mismatches might not be resolved before backup withholding becomes mandatory. TIGTA found that the IRS's risk assessment and implementation plan did not contain adequate details regarding these risks as well as appropriate contingencies and also lacked other details. TIGTA made five recommendations to which the IRS agreed and for which it ultimately closed the corrective actions as completed. See Appendix VI for the July 2011 prior TIGTA report recommendations, IRS responses, and planned corrective actions.

This review was performed with information obtained from the SB/SE Division located in Lanham, Maryland, during the period August 2014 through June 2015. 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. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

[13] TIGTA, Ref. No. 2011-40-065, *Plans for the Implementation of Merchant Card Reporting Could Result in Burden for Taxpayers and Problems for the Internal Revenue Service* (July 2011).

Results of Review

Processes Were Developed to Identify Underreporting of Reportable Payment Card Transactions

The IRS recognizes the challenges associated with using Forms 1099-K to identify noncompliance with income reporting. For example, one significant challenge is that gross receipts reported on Forms 1099-K do not directly correspond to any line on an income tax return. To address this and other challenges, the IRS implemented pilot initiatives in an effort to identify payment card noncompliance.

Receipt and use of Forms 1099-K to identify underreporting of income

Prior to receipt of the initial CY 2011 Forms 1099-K, the IRS obtained data from payers to test the quality of the data, conduct preliminary analysis, and develop an approach for identifying and quantifying potential underreporting of income. The IRS analyzed underreporting among different types of businesses including variations by industry, tax form type, size, and demographics. They also developed a Payment Mix Methodology that compares the ratio of cash and payment card revenues of similar businesses to identify potential underreporting when unusually high ratios are identified. The Payment Mix Methodology is a selection methodology that is being tested as an indirect method to identify underreported income.

As a result of these initial efforts, the IRS added specific lines to Form 1099-K to better identify underreporting, such as the Merchant Category Code (which is an industry classification assigned by merchants), number of transactions, and dollar amount of 'card not present' transactions[14] to identify online businesses. Furthermore, the IRS expanded its information technology infrastructure to incorporate the Form 1099-K data needed to support initial pilot initiatives.

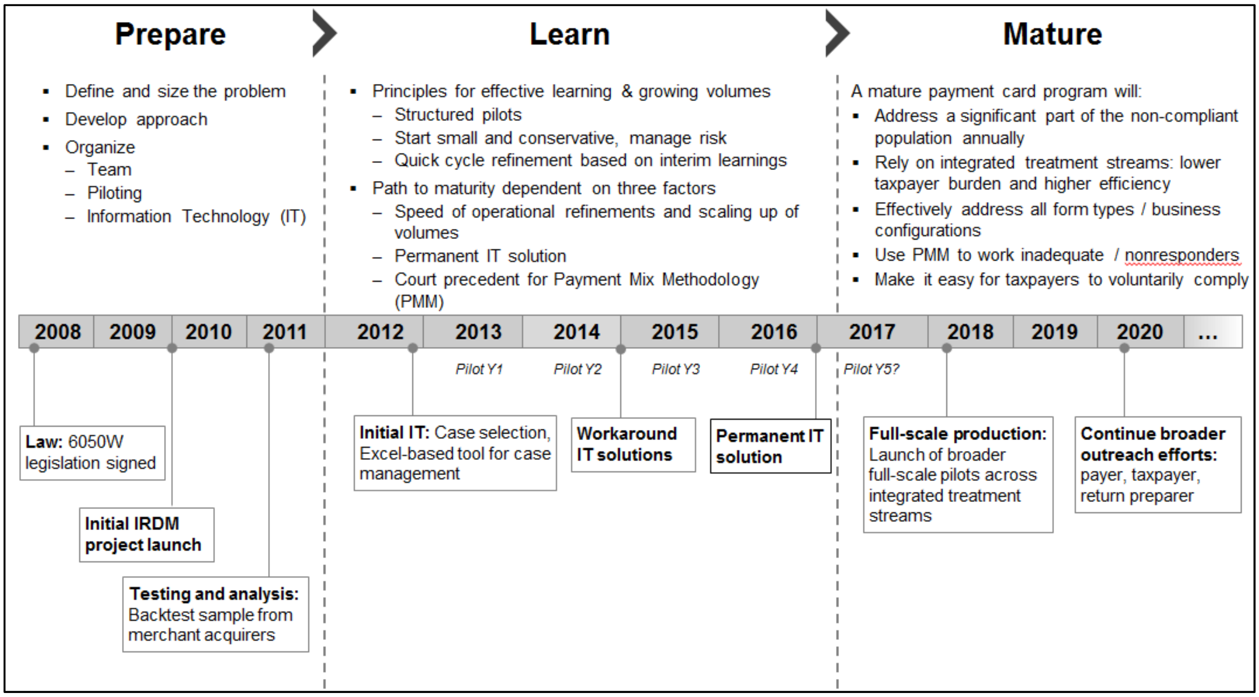
Multiyear and multi-treatment stream compliance program developed

In CY 2012, the IRS Commissioner and representatives from the SB/SE Division and the Office of Compliance Analytics committed to a multiyear, multi-treatment stream compliance program leveraging Form 1099-K information to reduce the Tax Gap. The program included new processes and changes to existing processes, treatment streams, and capabilities. A small first-year enforcement footprint and rapid "test and learn" approach helped minimize risk and taxpayer burden while quickly influencing voluntary compliance. Key program principles

[14] Transactions for which the card was not present at the time of the transaction or the card number was keyed into the terminal. Typically, this relates to online sales, phone sales, or catalogue sales.

included addressing both cash and payment card underreporting, testing multiple treatment streams, and leveraging outreach to drive voluntary compliance. Figure 3 depicts the IRS's actions taken and planned for the implementation of the Form 1099-K compliance program.

Figure 3: Pilot Initiatives Timeline



Source: *March 31, 2014, Operational and Strategic Update.* IT = Information Technology. PMM = Payment Mix Methodology. Y# = Year 1, Year 2, *etc.*

Results from pilot initiatives are being used to continually refine efforts to better identify payment card income underreporting

The IRS continues to use the results from its payment card pilot initiatives to refine the criteria it uses to identify underreporting of payment card income. For example, the initiatives identified that:

- The law requiring the reporting of payment card gross transactions on Forms 1099-K has led to significant voluntary compliance. Forty-eight percent of taxpayers that received a Form 1099-K reported more gross receipts relative to payment card receipts. Only 13 percent reported less.
- Twenty-five percent of pilot cases in which there was no change to the tax return were the result of data errors such as instances in which the gross transactions reported on the Form 1099-K did not belong to the taxpayer. In response, the IRS plans to conduct payer outreach/education in an effort to improve the accuracy of Form 1099-K reporting.

- The Payment Mix Methodology successfully identifies underreporting of cash sales. The first year it was used, the IRS identified twice as many revenue underreporters as a random sample, and 98 percent of the cases identified would not have been selected through normal examination classification processes.
- Sixty-two percent of the taxpayers that were part of the pilot selection process reported more gross receipts relative to payment card receipts in the following tax year. Only 8 percent reported less.

Payers Are Not Compliant With Backup Withholding Requirements, Resulting in Billions of Dollars in Tax Not Being Collected

Backup withholding requirements were effective beginning with CY 2012. However, the IRS postponed the implementation of backup withholding until CY 2013. Under backup withholding, payers are required to immediately withhold 28 percent of amounts reported on Forms 1099-K for payees that fail to provide a TIN. Our review of CY 2013 Forms 1099-K[15] identified 10,216 Forms 1099-K for which the payee TIN was missing. These Forms 1099-K reported gross transactions totaling over $10.6 billion. As such, payers were required to withhold almost $3 billion[16] from these payees, yet no backup withholding was reported. The $3 billion in backup withholding is 28 percent of the gross amount of transactions reported.

Once the payee files a tax return, the gross amount would be reduced by non-income items such as cash back, cost of goods sold/sales, returns and allowances, expenses, credits, exemptions, and other reductions and most of the withholding amount would be refunded with a filed return. However, the amount that may be refunded, if any depending on if a return is filed and withholding is claimed, cannot be determined at the time a Form 1099-K with a missing TIN is filed.

***********************************2***2*************************. The IRS noted that:

> *I.R.C. Section 3406(h)(10) provides that payments that are subject to the backup withholding under Section 3406 are treated as if they were wages paid by the employer to an employee. Section 3403 provides that the employer shall be liable for the payment of the tax required to be deducted and withheld under chapter 24 (collection of income tax at source on wages).*

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[15] CY 2013 was chosen for analysis because backup withholding provisions commenced from transitional relief.
[16] The $3 billion is the amount of tax required to be withheld from the gross transactions. The $3 billion represents the amount of revenue the Government could protect in relation to the income paid to payees. The net tax effect is unknown until a payee files a tax return.

When we brought payers' ************************2************************** **2*********************************** ********************2*******************.

Incorrect payee TINs

Our review of CY 2013 Forms 1099-K found that the IRS received 362,573 Forms 1099-K with over $106 billion of gross transactions reported with an incorrect payee TIN. Just as with a missing TIN, receipt of a Form 1099-K with an incorrect TIN prevents the IRS from ensuring that the payee correctly reported the gross transactions. Unlike with payees that do not provide a TIN (which requires payers to immediately withhold), the amount of tax that payers could potentially withhold on the 362,573 Forms 1099-K cannot be determined until payees have the opportunity to respond to notices.

Backup withholding requirements were also effective for CY 2012 Forms 1099-K with incorrect payee TINs, and the IRS also postponed these requirements. However, the IRS did identify and send payers that submitted CY 2013 Forms 1099-K with an incorrect TIN a notice informing them of the incorrect TIN. Valid payers were sent notices starting in September 2014 for CY 2013 reportable payment card transactions. The notice alerts payers that they may be responsible for backup withholding. The notice is accompanied by a list of Forms 1099-K with missing or incorrect payee TINs.

A TIN Matching System is available to payers to reduce reporting errors

To assist payers with TIN reporting errors and reduce the number of backup withholding notices, the IRS established a TIN Matching System for payers submitting information returns (*e.g.*, Forms 1099-K). To participate in the TIN Matching Program, authorized users must complete an application and meet certain requirements. The TIN Matching Program is a free tool, and its use is completely voluntary. Prior to filing an information return, a payer can check the TIN furnished by the payee against the Name/TIN combinations contained in IRS databases to verify the validity of the TIN. TIN matching does not divulge a taxpayer's SSN or a business's EIN. It only verifies whether or not the TIN and name combination furnished by the payee matches a combination in the IRS's records.

The purpose of backup withholding is to make sure that the Government is able to collect taxes on all appropriate income, particularly income that is not usually subject to withholding. Payer noncompliance associated with Forms 1099-K could be resulting in a significant loss to the Government because the IRS is unable to associate payees with missing or incorrect TINs to a specific payee tax return. As such, unreported income will go undetected and contribute to the Tax Gap. We are planning a separate review of the IRS's backup withholding program based on our identification of the lack of an IRS process to fully address significant payer noncompliance relative to the Form 1099-K backup withholding requirements.

Recommendations

The Commissioner, SB/SE Division, should:

Recommendation 1: *****************************2**************************
************************************2*************************************.

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS will evaluate existing policies and procedures in place for backup withholding requirements on information returns, determine if there are changes needed in the guidance relating to backup withholding requirements, and identify the next steps including consideration of programming needs.
>
> Management, however, did not agree with our outcome measure. The IRS stated that our outcome measure of $2.9 billion in potential revenue protected is overstated. The IRS noted that the outcome measure is based on the potential assessment of backup withholding on missing TINs. The IRS also added that backup withholding is based on a gross amount of Forms 1099-K reportable transactions and that a majority of the withholding amount would likely be refunded with the filed return.
>
> ***Office of Audit Comment:*** The actual amount of the $2.9 billion in potential revenue protected is based upon the gross receipts amount of Form 1099-K reportable transactions and is dependent upon the IRS implementing an effective process to enforce compliance with the backup withholding provisions. Our report acknowledges situations that could reduce the actual outcome realized, including the potential that withholding amounts may be refunded with filed returns. However, the amount that may be refunded, **if any**, is dependent on whether a return is filed and withholding claimed. Because these taxpayers did not submit a TIN to the payer, the IRS has no way of identifying if these taxpayers filed a tax return to report the income. As such, payee nonreporting of this income will continue to go undetected and contribute to the Tax Gap.

Recommendation 2: Ensure that the payers that submitted the 10,216 Forms 1099-K we identified with missing TINs are held liable for the backup withholding that was not withheld from the payees.

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS will perform a match of these records with the data file of Forms 1099-K from the subsequent year. From that match, the IRS will select a judgmental sample of the Forms 1099-K identified with missing TINs to determine the nature and extent of the issue and whether any further action is required, taking into consideration the potential benefits to be derived. The IRS will also review its current resources applied to the program and determine if additional resources are needed to support the compliance efforts.

A Comprehensive Business Case Analysis Was Not Conducted to Support the Decision to Grant Transitional Backup Withholding and Penalty Relief

The IRS decided to grant payers transitional relief for CY 2012 from backup withholding requirements and assessment of penalties against payers that do not comply with Form 1099-K reporting requirements.[17] Because of this decision, over $4.7 billion was not withheld and over $26.5 million in penalties were not assessed in CY 2012. Figure 4 details the backup withholding and payer penalty requirements and relief granted by the IRS.

Figure 4: Backup Withholding and Payer Penalty Requirements and Relief

TIN Reporting Error	I.R.C. § 3406 – Backup Withholding (BWH)	Transitional Backup Withholding Relief	I.R.C. § 6721 and § 6722 – Penalty	Form 1099-K Transitional Penalty Relief
Incorrect If a TIN is in the proper format but the Name/TIN combination does not match or cannot be found on the IRS's or SSA's files. Missing If a TIN is not provided, has more or less than nine numbers, or has an alpha character in one of the nine positions.	Deduct and withhold for any reportable payment if: a) the payee fails to furnish his or her TIN to the payer in the manner required, or b) the Secretary notifies the payer that the TIN furnished by the payee is incorrect.	Notice 2011-88, *Postponement of Backup Withholding Requirement for Payment Card and Third Party Network Payments Made Under Section 6050W*, postponed backup withholding for CY 2012 reportable payments. Backup withholding commenced for CY 2013 reportable payments for missing TINs and after notice is issued by the IRS in Fall 2013 for incorrect TINs.	Imposes penalties on a person for, among other things, failing to include all required information or including incorrect information on an information return or payee statement. Penalty of $100 for each return with respect to which such a failure occurs, not to exceed $1.5 million per payer.	Notice 2011-89, *Transitional Penalty Relief for Information Reporting Relating to Payment Card and Third Party Network Transactions*, provided transitional relief from penalties for filers reporting incorrect information on information returns and payee statements for reportable payments made in CY 2011. Notice 2013-56, *Transitional Penalty Relief and Schedule for Notices of Incorrect Name/TIN Combinations for Information Returns Relating to Payment Card and Third Party Network Transactions*, provided transitional relief from penalties for filers for the following: • CY 2012 transactions – missing and incorrect TINs. • CY 2013 transactions – incorrect TINs. Penalties will commence for information returns and payee statements for CY 2014 transactions.

Source: I.R.C. §§ 3406, 6721, and 6722; Notices 2011-88, 2011-89, and 2013-56; Publication 1281.

The IRS stated that backup withholding and penalty relief was granted based on concerns raised by external stakeholders suggesting that payers were unfamiliar with information reporting and

[17] I.R.C. §§ 6721 and 6722 impose penalties on a payer that fails to include all required information or includes incorrect information on a return or payee statement; the penalty is $100 for each return, not to exceed $1.5 million.

backup withholding requirements. However, limited analysis (*e.g.*, the IRS provided assistance in using the TIN Matching Program and sent notices to payers to assist with obtaining accurate TINs) was performed by the IRS to confirm concerns raised by the stakeholders or to identify the potential monetary impact of providing transitional relief from backup withholding and penalties.

Our review of CY 2012 Forms 1099-K identified that the top 10 payers that most frequently submitted missing or incorrect TINs on Forms 1099-K also submitted other income information returns which could indicate that these payers were in fact familiar with information reporting and backup withholding requirements. For example, these 10 payers submitted 316,594 other income information returns. These same 10 payers were responsible for submitting 464,707 (80.1 percent) of the Forms 1099-K with missing or incorrect TINs. Figure 5 provides a breakdown of the Forms 1099-K filed with a missing or incorrect TIN along with the volume of other types of income information returns filed by this payer.

Figure 5: **********************1**1******************

Payer Name	Number of Forms 1099-K With Missing/Incorrect Payee TINs	Total Gross Transactions Reported on Forms 1099-K	Total Amount of Tax That Should Have Been Withheld[18]	Total Payer Penalties That Could Have Been Assessed	Total Information Returns Filed Excluding Forms 1099-K[19]
****1****	*****1*****	*****1*****	*****1*****	*****1*****	*****1*****
****1****	*****1*****	*****1*****	*****1*****	*****1*****	*****1*****
****1****	*****1*****	*****1*****	*****1*****	*****1*****	*****1*****
****1****	*****1*****	*****1*****	*****1*****	*****1*****	*****1*****
****1****	*****1*****	*****1*****	*****1*****	*****1*****	*****1*****
****1****	*****1*****	*****1*****	*****1*****	*****1*****	*****1*****
****1****	*****1*****	*****1*****	*****1*****	*****1*****	*****1*****
****1****	*****1*****	*****1*****	*****1*****	*****1*****	*****1*****
****1****	*****1*****	*****1*****	*****1*****	*****1*****	*****1*****
****1****	*****1*****	*****1*****	*****1*****	*****1*****	*****1*****
****1****	*****1*****	*****1*****	*****1*****	*****1*****	*****1*****

*************1*********************************.

[18] Amounts only include Forms 1099-K with missing payee TINs.
[19] Includes all information returns subject to payer penalties. However, not all information returns are subject to backup withholding.

Recommendations

The Commissioner, SB/SE Division, should:

Recommendation 3: Ensure that a comprehensive business case analysis is performed to support decisions to grant transitional relief from legislative reporting and penalty requirements.

> ***Management's Response:*** The IRS agreed with this recommendation. If a similar situation arises in the future, the IRS will use its Risk Acceptance Form and Tool to ensure that a comprehensive business case analysis is performed to support decisions to grant transitional relief from legislative reporting and penalty requirements. Because the IRS does not anticipate this situation occurring regularly, with this commitment, the IRS considers this action to be implemented.

Recommendation 4: Assess penalties on payers that do not comply with Form 1099-K reporting requirements.

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS will conduct an assessment of its processes to determine what factors contribute to the gap and identify any needed improvements. The IRS will also review its current resources applied to the program and determine if additional resources are needed to support the compliance efforts.

The Systemic Validation Process Does Not Always Correctly Identify Forms 1099-K With an Incorrect Taxpayer Identification Number

Our review identified instances in which a Name/TIN combination reported on Form 1099-K was an incorrect EIN, but the number matched a valid SSN. This results in the IRS incorrectly identifying the TIN used on this Form 1099-K as being valid. The incorrect verification of the TIN results from the IRS's systemic process of using the TIN and *the first four characters of the business or individual's name* (the IRS refers to this as the name control). As a result, if a business's EIN listed on Form 1099-K does not match the IRS's EIN–Name Control file but there is an SSN in the SSA file that it does match to, the system would process the Form 1099-K as having a valid TIN. The following hypothetical example illustrates this point:

> *A payer submits a Form 1099-K for Johnson Company that has an incorrect EIN of 12-3456789 and a name control of JOHN. As a result, the payee Name/TIN combination will not match the IRS's EIN–Name Control file. However, there is a valid SSN with the same number assigned to a David Johnson (i.e., SSN of 123-45-6789 and name control of JOHN). Since the payee Name/TIN combination matches the SSA file, the IRS's systemic program is erroneously setting a valid SSN indicator on the Form 1099-K even though the Form 1099-K was filed under an incorrect EIN.*

We are unable to identify the volume of Forms 1099-K with an incorrect TIN that may have been inaccurately coded as having a valid TIN. However, our comparison of active EIN's issued by the IRS to SSN's issued by the SSA identified over 1.7 million records for which the EIN and name control matches an SSN and name control (*i.e.*, same 9-digit number and four-letter name control). In addition, we found that for the population of CY 2013 Forms 1099-K, a total of 15,135 active EINs matched an SSN and name control. According to the IRS, currently 63 percent of EINs are equivalent to SSNs, but less than 0.2 percent of them share a name control. When the IRS receives a payee TIN that validates to both files, the IRS will rely on the payer identifying the type of TIN on the Form 1099-K as the deciding factor. If the payer does not indicate the type of TIN, the system will default to an SSN.

When information returns are not correctly coded as having an incorrect TIN, the IRS will incorrectly associate any income reported with the wrong individual or business. Furthermore, the IRS will also incorrectly identify the payer as submitting an accurate information return. When we provided IRS management with examples of this issue, they indicated that any system changes in this area would be subject to budget and resource availability.

Recommendation

Recommendation 5: The Commissioner, SB/SE Division, should consider initiating a computer programming request to ensure that information returns are accurately identified as having a valid TIN.

> ***Management's Response:*** The IRS agreed with this recommendation. While the IRS agrees with the recommendation and the value it would add, the IRS cannot commit to implementing it at this time because computer programming is subject to the availability of limited funding and resources and its completion cannot be reasonably assured.
>
> ***Office of Audit Comment:*** When information returns are not correctly coded as having an incorrect TIN, the IRS will incorrectly associate any income reported with the wrong individual or business. As such, we believe that the IRS should make this programming change a priority.

The Taxpayer Identification Number Matching Program Does Not Include Notification When a Taxpayer Identification Number for a Deceased Individual Is Used

Our review of CY 2013 Forms 1099-K found that the IRS received 2,933 Forms 1099-K with gross transactions totaling $543.9 million for which the payee TIN was that of a deceased individual. These individuals were deceased at least two years prior to the issuance of the Form 1099-K. The TIN Matching Program available to payers does not alert the payer that the payee TIN they are attempting to verify belongs to a deceased individual. Figure 6 shows the current indicators returned to payers when they use the TIN Matching Program.

Figure 6: Summary of Indicators Returned by the TIN Matching Program

Indicator	Definition
0	Name/TIN combination matches IRS records.
1	Missing TIN (*i.e.*, contains alphas, special characters), TIN not a 9-digit numeric, or TIN not provided.
2	TIN not currently issued.
3	Name/TIN combination **does not** match IRS records.
4	Incorrect.
5	Duplicate request.
6	Matched on SSN when the TIN type is unknown and a matching TIN and name control is found only on the SSA data.
7	Matched on EIN when the TIN type is unknown and a matching TIN and name control is found only on the IRS's EIN–Name Control file.
8	Matched on SSN and EIN when the TIN type is unknown and a matching TIN and name control is found both on the SSA's file and the IRS's EIN–Name Control file.

Source: Publication 2108A, On-Line TIN Matching Program.

Recommendation

Recommendation 6: The Commissioner, SB/SE Division, should add an indicator on the TIN Matching Program alerting a payer of a payee's use of a deceased taxpayer TIN (*e.g.*, an indicator stating that a TIN is not currently in use).

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS will first evaluate if a general indicator can be added to the TIN Matching Program without violating the disclosure rules. If such an indicator is legally permissible, it will evaluate the cost/benefit of programming changes and take the appropriate actions.

Nonfiler Identification Efforts Do Not Include the Use of Form 1099-K

The IRS's overall individual and business nonfiler identification processes do not include the use of Forms 1099-K. Our match of CY 2013 Forms 1099-K to tax return filings identified 84,107 individuals[20] for whom payers reported gross transactions on Forms 1099-K totaling nearly $9.1 billion but who did not file a tax return under the SSN listed on the Forms 1099-K. We also identified 443,528 businesses for which payers reported gross transactions on Forms 1099-K totaling over $164.5 billion that did not file a tax return under the EIN listed on the Forms 1099-K. The IRS reviewed and agreed with the methodology we used to identify and quantify the individual and business nonfilers. Business nonfilers could have claimed the income on related entities' income tax returns; we were unable to identify these instances.

The IRS recognizes the impact these individuals and businesses have relative to the Tax Gap and has initiated pilot initiatives that identify individual nonfilers using Forms 1099-K. The objective of these pilot initiatives is to determine how to use Form 1099-K in nonfiler identification, prioritization, and calculation of potential income tax liabilities for certain nonfilers. To address business nonfilers, the IRS is working three pilot initiatives that include identifying business nonfilers using Forms 1099-K. The IRS's analysis of the results to date from these pilot initiatives has shown that there is merit in using Forms 1099-K information to identify nonfilers. When we discussed using Form 1099-K as part of the IRS's overall nonfiler identification program, IRS management agreed that Form 1099-K should be used as part of the program.

Recommendation

Recommendation 7: The Commissioner, SB/SE Division, should incorporate Form 1099-K information as part of the IRS's nonfiler program for both individuals and businesses.

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS Collection function piloted the use of Form 1099-K data to identify unfiled returns and, based on the finding in the pilot, the IRS has incorporated the Form 1099-K information as part of its nonfiler program.

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[20] Analysis was done using the IRS's payee TIN-type field set as valid individuals. This could include incorrect businesses that were erroneously set as valid individuals.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to assess the IRS's efforts to implement an effective process to match payment card transaction amounts reported by payment settlement entities on Forms 1099-K, *Payment Card and Third Party Network Transactions*,[1] to income reported on participating merchants tax returns. To accomplish our objective, we:

I. Determined the effectiveness of the IRS's actions to facilitate a direct match of amounts reported on Forms 1099-K to income on tax returns.

   A. Reviewed prior TIGTA reports to determine if planned corrective actions have been implemented.

      1. Determined if the IRS is monitoring the amounts reported for payment card and third-party payments and communicating challenges to taxpayers and practitioners filing Forms 1099-K.

      2. Determined if the IRS is effectively instructing taxpayers as to where payment card transactions including cash back are to be reported on tax returns.

      3. Reviewed the payment card reporting risk assessment and implementation plan to determine if it includes the identification of risk mitigation and impact analysis and tracks expected production delivery dates and financial reporting of costs.

   B. Determined if the IRS is effectively implementing the legislation as intended by automating the matching of data reported on legislatively mandated information returns to the data submitted on tax returns.

      1. Interviewed IRS management to determine the impact on tax administration and identify the barriers to redesigning tax returns and Forms 1099-K.

      2. Interviewed external stakeholders to determine the impact and identify the barriers to redesigning tax returns and Forms 1099-K.

   C. Identified the estimated revenue that was expected to be generated by implementing the payment card reporting legislation.

[1] See Appendix V for an example of this form. The CY 2011 Form 1099-K was titled "*Merchant Card and Third Party Network Payments*." All subsequent years for this form are titled "*Payment Card and Third Party Network Transactions*."

II. Assessed the effectiveness of the IRS's ability to identify and adequately address noncompliance.

A. Assessed the effectiveness of the IRS's IRDM Program pilot initiatives through the use of Forms 1099-K.

1. Identified the payment card pilot initiatives that were created to resolve potential underreporting of income and assessed the effectiveness of those programs.

2. Determined if the IRS is effectively assessing the pilot results to make qualified decisions on whether to progress into a compliance program.

B. Assessed the effectiveness of the IRS's ability to identify potential underreporting of income through the use of Forms 1099-K in its other compliance efforts by reviewing the IRS's Office of Compliance Analytics methodology that is used to identify tax returns with potential underreporting of gross receipts or sales through the use of Forms 1099-K.

III. Assessed the effectiveness of the IRS's ability to identify individuals and businesses with amounts reported on Forms 1099-K that did not file income tax returns.

A. Identified CY 2013 individuals and businesses with reported Form 1099-K amounts with no associated tax return (*i.e.*, nonfilers) and compared the results to the IRS's compliance efforts.

B. Identified the amounts reported on Forms 1099-K for nonfilers and quantified the impact on tax administration.

IV. Assessed the effectiveness of the IRS's ability to identify incorrect payee Name/TIN combinations to ensure backup withholding is occurring as required.

A. Determined if the IRS is accurately validating payee Name/TIN combinations on submitted Forms 1099-K.

B. Determined if the IRS is effectively identifying individuals and businesses subject to backup withholding.

1. Determined the accuracy and assessed the effectiveness of the IRS's payee Name/TIN validation processes and procedures.

2. Identified Tax Years 2012 and 2013 Forms 1099-K that were submitted to the IRS with incorrect or missing TINs.

3. Ensured that the IRS properly notified payers subject to backup withholding.

Data validation methodology

During this review, we relied on data stored at TIGTA's Data Center Warehouse and performed analysis of data extracted from the Information Returns Master File[2] for Tax Years 2012 and 2013. To assess the reliability of computer-processed data, programmers within TIGTA's Data Center Warehouse validated the data files we extracted while we ensured that each data extract contained the specific data elements we requested and that the data elements were accurate. For example, we reviewed judgmental samples of the data extracts and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System.[3] As a result of our testing, we determined the data used in our review were reliable.

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: 1) processes and procedures to implement the payment card reporting program as intended and 2) processes and procedures to ensure that nonfilers and those subject to backup withholding requirements are identified and that appropriate actions are taken. We evaluated the controls by reviewing the IRS's Internal Revenue Manuals used by various business operating divisions; interviewing IRS management; reviewing relevant I.R.C. sections and Treasury Regulations applicable to the payment card reporting program, nonfilers, and backup withholding; and evaluating applicable documentation and management information reports.

[2] Creates a master file of current tax year information returns and maintains access to nine prior years.
[3] IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.

Appendix II

Major Contributors to This Report

Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services)
Diana M. Tengesdal, Director
Larry Madsen, Audit Manager
Steve Elix, Lead Auditor
David Robben, Senior Auditor
Jack Laney Jr., Auditor

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Director, Office of Compliance Analytics OCA
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Director, Collections SE:S:C
Director, Examination SE:S:E
Director, Campus Exam SE:S:E:CE
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Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Director, Office of Audit Coordination OS:PPAC:AC
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Commissioner, Small Business/Self-Employed Division SE:S

Appendix IV

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:

- Revenue Protection – Potential; assessment of $2,969,109,626[1] in backup withholding if the IRS held payers liable (as allowed by the I.R.C.) when submitting Forms 1099-K, *Payment Card and Third Party Network Transactions*, with missing payee TINs (see page 10).

Methodology Used to Measure the Reported Benefit:

Our review of CY 2013 Forms 1099-K found that the IRS received 10,216 Forms 1099-K totaling over $10.6 billion with missing payee TINs. After further analysis, we found that almost $3 billion was subject to backup withholding. However, no backup withholding was taken of the almost $3 billion subject to backup withholding. The $3 billion in backup withholding is based on the gross amount reported. Once a tax return is filed, the gross amount would be reduced by non-income items such as cash back, cost of goods sold/sales, returns and allowances, expenses, credits, exemptions, and other reductions and most of the withholding amount would be refunded with a filed return. However, the amount that may be refunded, if any, depending on if a return is filed and withholding is claimed, cannot be determined at the time a Form 1099-K with a missing TIN is filed.

We received an Information Returns Master File[2] extract for CY 2013 Forms 1099-K. We then identified Forms 1099-K with missing payee TINs by analyzing certain data fields from the extract. We also removed Forms 1099-K not subject to backup withholding (*e.g.*, foreign payers).

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 2,933 Forms 1099-K could have been identified and corrected from being submitted with deceased individuals' TINs as payee TINs (see page 16).

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[1] The $3 billion is the amount of tax required to be withheld from the gross transactions. The $3 billion represents the amount of revenue the Government could protect in relation to the income paid to payees. The net tax effect is unknown until a payee files a tax return.
[2] Creates a master file of current tax year information returns and maintains access to nine prior years.

Methodology Used to Measure the Reported Benefit:

Our review of CY 2013 Forms 1099-K found that the IRS received 2,933 returns totaling $543.9 million for deceased individuals who were deceased two years prior to the Form 1099-K reportable transactions; therefore, the income likely does not belong to the taxpayer.

We received an Information Returns Master File extract for CY 2013 Forms 1099-K. We then identified Forms 1099-K with payee TINs of deceased individuals by analyzing the Social Security Administration file that includes dates of death. We filtered for individuals who were deceased two years prior (on or before December 31, 2012) to the Form 1099-K reportable payment card transactions.

Appendix V

2014 Form 1099-K, Payment Card and Third Party Network Transactions

☐ CORRECTED (if checked)

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.	2014	
	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 (optional) $	2 Merchant category code	**Copy B For Payee**
	3 Number of payment transactions	4 Federal income tax withheld $	This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported.
PAYEE'S name	5a January $	5b February $	
Street address (including apt. no.)	5c March $	5d April $	
	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)	6 State	7 State identification no.	8 State income tax withheld $ $

Form **1099-K** (Keep for your records) www.irs.gov/form1099k Department of the Treasury - Internal Revenue Service

Appendix VI

Status of Prior TIGTA Report Recommendations[1]

TIGTA Report No. 2011-40-065 *"Plans for the Implementation of Merchant Card Reporting Could Result in Burden for Taxpayers and Problems for the Internal Revenue Service"*		
TIGTA Recommendation	**IRS Response**	**Status of Corrective Action Taken**
The IRS should ensure that changes similar to those drafted for Schedule C are made to Schedules E and F (Form 1040), and Forms 1065, 1120, and 1120S to confirm that there is no confusion about where to enter cash back on the income tax return to arrive at taxable income and that the amounts entered on the tax return can be matched with amounts on Forms 1099-K. The IRS should monitor the merchant card and third-party network payment amounts that taxpayers enter on their income tax returns to ensure that taxpayers and preparers understand how to properly report gross receipts and cash-back amounts. If warranted, the income tax returns should be changed to include a specific line for cash back.	The IRS agreed with Part 1 of this recommendation. The IRS has revised Schedule C (Form 1040) and will revise Forms 1065, 1120, and 1120S to inform taxpayers of where to enter cash back on their tax returns. Since cash-back transactions for Schedules E and F (Form 1040) filers are infrequent, the IRS will include the information in the instructions for these forms. The IRS will monitor the amounts reported for merchant card and third-party payments and communicate to taxpayers and practitioners any challenges identified in the filing of the new Form 1099-K.	The IRS closed this corrective action as completed noting that Forms 1065, 1120, 1120S, and Schedule C (Form 1040) were revised to specifically accept merchant card and third-party payments. The "What's New" section of the instructions for Schedules E and F (Form 1040) was revised to include language concerning merchant card and third-party payment reporting requirements. However, subsequent IRS meetings with industry representatives for both large and small businesses confirmed that business accounting systems currently do not permit businesses to separate Form 1099 and non–Form 1099 income. Requiring all taxpayers to do so would be costly and burdensome. As a result, the IRS decided not to require the reconciliation of reported Form 1099-K income on income tax returns.

[1] Forms and schedules used in this chart include: Form 1040, *U.S. Individual Income Tax Return*. Form 1065, *U.S. Return of Partnership Income*. Form 1099 series (various types of U.S. information returns). Form 1099-K, *Payment Card and Third Party Network Transactions*. Form 1120, *U.S. Corporation Income Tax Return*. Form 1120S, *U.S. Income Tax Return for an S Corporation*. Schedule C (Form 1040), *Profit or Loss from Business (Sole Proprietorship)*. Schedule E (Form 1040), *Supplemental Income and Loss*. Schedule F (Form 1040), *Profit or Loss From Farming*.

TIGTA Report No. 2011-40-065 *"Plans for the Implementation of Merchant Card Reporting Could Result in Burden for Taxpayers and Problems for the Internal Revenue Service"*

TIGTA Recommendation	IRS Response	Status of Corrective Action Taken
The IRS should ensure that the risk assessment and implementation plan adequately address the issue of mismatched TINs and names and the initiation of backup withholding.	The IRS agreed with this recommendation. TIN matching is an existing service offered to certain Form 1099 filers. The IRS submitted a computer programming request to add Form 1099-K to the TIN Matching System.	The IRS closed this corrective action as completed, noting that TIN matching is an existing service offered by the IRS to certain Form 1099 filers. The IRS also submitted a computer programming request to add Form 1099-K to the TIN Matching System.
The IRS should ensure that it adds sufficient detail to this and future risk assessments to address the full scope of the project.	The IRS agreed with this recommendation. The program has a well-documented risk assessment process that has been implemented to include identification of risk mitigation and impact analysis. The risk assessment process ensures that all risks and mitigation strategies are documented and approved by governance.	The IRS closed this corrective action as completed, noting that the program has a well-documented risk assessment process that has been implemented.
The IRS should ensure that it adds sufficient detail to this and future implementation plans to indicate the full scope of the project and expected or estimated due dates.	The IRS agreed with this recommendation. Detailed work breakdown structures have been developed that cover the full scope of the program, including expected production delivery dates.	The IRS closed this corrective action as completed, noting that detailed work breakdown structures have been developed.
The IRS should ensure that financial reporting is added to the risk assessment and implementation plan to help ensure that costs and schedules are tracked and reported timely. Accumulation of costs should begin when resources are first used on the project, as in preparing the risk assessment.	The IRS agreed that financial reporting should be tracked and monitored. IRDM costs are being tracked and monitored.	The IRS closed this corrective action as completed, noting that IRDM costs are being tracked and monitored.

Source: Analysis of recommendations and corrective actions from a prior TIGTA report.

Appendix VII

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

SEP 17 2015

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Karen Schiller
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – *Additional Actions to Enforce Payment Card Reporting Requirements Could Reduce the Tax Gap* (Audit #201440005)

Thank you for the opportunity to review the subject draft report regarding the IRS's efforts to implement payment card reporting requirements. We appreciate your acknowledgement of the challenges associated with using Forms 1099-K to identify noncompliance with income reporting and our effort to include new processes and changes to existing processes, treatment streams, and capabilities.

As noted in your report, Congress enacted legislation in an effort to narrow the Tax Gap and increase voluntary compliance of businesses through information reporting. IRS strives to implement the Internal Revenue Code Section 6050W (6050W) reporting requirements through administrative policies and procedures resulting in the least amount of unnecessary burden to taxpayers by carefully weighing taxpayer burden against compliance risk.

Our approach to implementation of the payment card reporting requirements allowed IRS to design a program, with significant external stakeholder input, ensuring balance between taxpayer burden and compliance risk. For instance, while payers were accustomed to information reporting requirements, 6050W introduced the first reporting requirements on these types of payments. Payers shared the challenges they faced in trying to obtain valid TIN's and requested a delay in implementing backup withholding on these payments to allow them to better prepare. Recognizing that withholding of 28% of the gross payments would have a significant impact on the working capital of small businesses, transitional relief was provided and backup withholding on 6050W transactions was delayed. We assisted payers with the use of eServices TIN Matching, provided a "stuffer" that the payers could include in subsequent mailings to try to obtain valid TIN's and sent interim soft notices to payers to assist with obtaining accurate TINs and names.

2

We appreciate your careful review of this robust program and your insight, as we are always seeking ways to improve upon our programs. And we agree that your recommendations would indeed provide additional opportunities to further strengthen our program. However, our current constrained budget resources make it difficult for us to know when we will be able to fund and implement some of your recommendations. We have noted specific concerns related to some of the recommendations in the attachment.

Finally, we note that the Revenue Protection Outcome Measure in the report is based on the potential assessment of back-up withholding on missing TINs. As reflected in your report, backup withholding is based on a gross amount of 1099-K reportable transactions and a majority of the withholding amount would likely be refunded with the filed return. As such, the amount of revenue protection cited in the report is overstated. We do not agree with the Reliability of Information Outcome Measure regarding deceased taxpayers. Internal Revenue Code Section 6103 prohibits us from disclosing the death of a taxpayer to a payer, so creating a new indicator that is only for deceased taxpayers could be problematic. In addition, the deceased taxpayer's income could be taxable to the estate or trust, so an information return would need to be filed for that taxpayer.

If you have any questions, please contact me, or a member of your staff may contact Shenita Hicks, Director, Examination Operations, Small Business/Self Employed Division at (240) 613-2849.

Attachment

Attachment

RECOMMENDATION 1:
The Commissioner, SB/SE Division, should *****************2******************************* ***2*** ************2************************.

CORRECTIVE ACTION
The IRS will evaluate existing policies and procedures in place for backup withholding requirements on information returns, determine if there are changes needed in the guidance relating to backup withholding requirements, and identify next steps including consideration of programming needs.

IMPLEMENTATION DATE:
December 15, 2016

RESPONSIBLE OFFICIAL:
Director, Examination Operations, Small Business/Self-Employed

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

RECOMMENDATION 2:
The Commissioner, SB/SE Division, should ensure that the payers that submitted the 10,216 Forms 1099-K we identified with missing TINs are held liable for the backup withholding that was not withheld from the payees.

CORRECTIVE ACTION:
We will perform a match of these records with the data file of Forms 1099-K from the subsequent year. From that match, we will select a judgmental sample of the Forms 1099-K identified with missing TINs to determine the nature and extent of the issue and whether any further action is required, taking into consideration the potential benefits to be derived. We will also review our current resources applied to the program and determine if additional resources are needed to support our compliance efforts.

IMPLEMENTATION DATE:
September 15, 2016

RESPONSIBLE OFFICIAL:
Director, Examination Operations, Small Business/Self-Employed

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

RECOMMENDATION 3:
The Commissioner, SB/SE Division, should ensure that a comprehensive business case analysis is performed to support decisions to grant transitional relief from legislative reporting and penalty requirements.

CORRECTIVE ACTION:
If a similar situation arises in the future, we will utilize our Risk Acceptance Form and Tool to ensure a comprehensive business case analysis is performed to support decisions to grant transitional relief from legislative reporting and penalty requirements. Because we do not anticipate this situation occurring regularly, with this commitment, we consider this action to be implemented.

IMPLEMENTATION DATE:
Completed

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A

RECOMMENDATION 4:
The Commissioner, SB/SE Division, should assess penalties on payers that do not comply with Form 1099-K reporting requirements.

CORRECTIVE ACTION:
We agree that the assertion of penalties on payers who do not comply with Form 1099-K reporting requirements is important. We will conduct an assessment of our processes to determine what factors contribute to the gap and identify any needed improvements. We will also review our current resources applied to the program and determine if additional resources are needed to support our compliance efforts.

IMPLEMENTATION DATE:
September 15, 2016

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RESPONSIBLE OFFICIALS:
Director, Examination Operations, Small Business/Self-Employed and Director, Servicewide Operations, Small Business/Self-Employed

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

RECOMMENDATION 5:
The Commissioner, SB/SE Division, should consider initiating a computer programming request to ensure that information returns are accurately identified as having a valid TIN.

CORRECTIVE ACTION:
While we agree with the recommendation and the value it would add, we cannot commit to implementing it at this time because computer programming is subject to the availability of limited funding and resources and its completion cannot be reasonably assured.

IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A

RECOMMENDATION 6:
The Commissioner, SB/SE Division, should add an indicator on the TIN Matching Program alerting a payer of a payee's use of a deceased taxpayer TIN (e.g., an indicator stating TIN not currently in use).

CORRECTIVE ACTION:
We will first evaluate if a general indicator can be added to the TIN Matching Program without violating the disclosure rules. If such an indicator is legally permissible, we will evaluate the cost/benefit of programming changes and take the appropriate actions.

IMPLEMENTATION DATE:
October 15, 2016

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RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A

RECOMMENDATION 7:
The Commissioner, SB/SE Division, should incorporate Form 1099-K information as part of the IRS's nonfiler program for both individuals and businesses.

CORRECTIVE ACTION:
Our Collection function piloted the use of Form 1099-K data to identify non-filed returns and, based on our findings in the pilot, we have incorporated the Form 1099-K information as part of the IRS's nonfiler program.

IMPLEMENTATION DATE:
Completed

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A