



Treasury Inspector General for Tax Administration Office of Audit

MORTGAGE INTEREST DATA COULD BE USED TO PURSUE MORE NONFILERS AND UNDERREPORTERS

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Highlights

Highlights of Report Number: 2009-40-112 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Individuals who fail to file required returns and/or underreport their income can create unfair burdens on honest taxpayers and diminish the public's respect for the tax system. TIGTA recognizes that, given the current state of the economy, many individuals are struggling to meet their mortgages and other financial obligations. Nevertheless, a large number of individuals are paying a significant amount of mortgage interest and are either not filing tax returns or are filing tax returns reporting income that is not sufficient to cover their mortgage obligations and basic living expenses. The considerable difference between income and expenditures on these returns raises serious questions about whether additional income should have been reported.

WHY TIGTA DID THE AUDIT

The objective of this review was to determine how effectively the Internal Revenue Service (IRS) uses Mortgage Interest Statements (Forms 1098) to identify unreported income. The review was initiated as part of our planned Fiscal Year 2009 audit coverage under the major management challenge of Tax Compliance Initiatives.

WHAT TIGTA FOUND

To its credit, the IRS recognizes the potential benefits of incorporating Forms 1098 into its compliance efforts and is using these documents in its Return Delinquency Program. While this Program is experiencing success in identifying potential nonfilers, our samples of Forms 1098 show the documents may also provide some good audit leads for use in the IRS Examination function.

TIGTA evaluated 2 statistically valid samples of 100 individuals with combined Forms 1098 totaling \$20,000 or more of mortgage interest that were filed with the IRS for Tax Year 2005. For the first sample,

Email Address: inquiries@tigta.treas.gov
Web Site: <http://www.tigta.gov>

TIGTA matched the taxpayer identification numbers on Forms 1098 meeting our criteria to accounts in the IRS Individual Return Transaction File and found 219,593 individuals without a corresponding tax return. From the 219,593 potential nonfilers, TIGTA randomly selected 100 for review and identified 21 individuals who appeared to have a filing requirement for Tax Year 2005, but had yet to be contacted by the IRS. TIGTA estimated that the 21 individuals may owe as much as \$177,715 in delinquent taxes and \$107,209 in penalties and interest. When projected to our population of 219,593 potential nonfilers, our results indicate that 46,115 potential nonfilers may collectively owe \$625 million in delinquent taxes, penalties, and interest for Tax Year 2005.

In the second sample, TIGTA matched the taxpayer identification numbers on Forms 1098 meeting our criteria to the accounts in the IRS Individual Return Transaction File and identified 245,535 individuals who reported less adjusted gross income on their Tax Year 2005 returns than the amount of mortgage interest reflected on their Forms 1098. After randomly selecting 100 of the 245,535 individual returns for review, TIGTA used the IRS' cash transaction analysis process and identified 37 individuals who may have underreported their income because their mortgage interest and basic living expenses appear to exceed their income. Overall, based on our sample results, TIGTA estimated that these 37 individuals may owe \$265,018 in additional taxes and \$61,233 in penalties and interest. When projected to our population of 245,535 filers, our results indicate that 90,848 taxpayers may owe \$801 million in additional taxes, penalties, and interest for Tax Year 2005.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Director, Examination, Small Business/Self-Employed Division, explore the feasibility of making greater use of mortgage interest data to pursue additional nonfilers and underreporters for audit.

IRS management agreed with our recommendation and plans to expand an existing Area-wide Compliance Initiative Project on the mortgage interest deduction to a Nationwide Compliance Initiative Project. Management also plans to form a task team to study the existing processes for identifying nonfiler workload to ensure that mortgage interest is appropriately considered in selecting nonfiler cases for delivery to examiners.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2009reports/200940112fr.pdf>

Phone Number: 202-622-6500