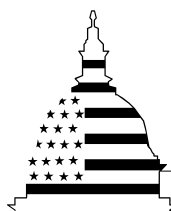


December 2003

# TAX ADMINISTRATION

## More Can Be Done to Ensure Federal Agencies File Accurate Information Returns



G A O

Accountability \* Integrity \* Reliability



Highlights of [GAO-04-74](#), a report to congressional requesters

## Why GAO Did This Study

The Internal Revenue Service (IRS) matches information returns filed by third parties, including federal agencies, with taxpayers' income tax returns to determine whether taxpayers have filed a return and/or reported all of their income. A correct taxpayer identification number (TIN) is necessary to enable IRS to match these returns. Prior GAO reviews have shown that federal agency payment records often include invalid TINs, particularly for vendors. GAO was asked to study federal agencies' compliance with filing information returns for service payments made to vendors, IRS's efforts to improve agencies' compliance, and whether additional measures could improve their compliance.

## What GAO Recommends

To improve federal agency compliance with annual information reporting requirements for vendor payments, GAO is making recommendations to ensure that (1) IRS identifies and follows up with federal agencies that fail to file annual information returns for vendor service payments and (2) IRS and the Office of Management and Budget (OMB) ensure that vendor TINs are validated using IRS's online TIN-matching program.

IRS and OMB agreed to implement our recommendations.

[www.gao.gov/cgi-bin/getrpt?GAO-04-74](http://www.gao.gov/cgi-bin/getrpt?GAO-04-74).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Michael Brostek at (202) 512-9110 or [brostekm@gao.gov](mailto:brostekm@gao.gov).

# TAX ADMINISTRATION

## More Can Be Done to Ensure Federal Agencies File Accurate Information Returns

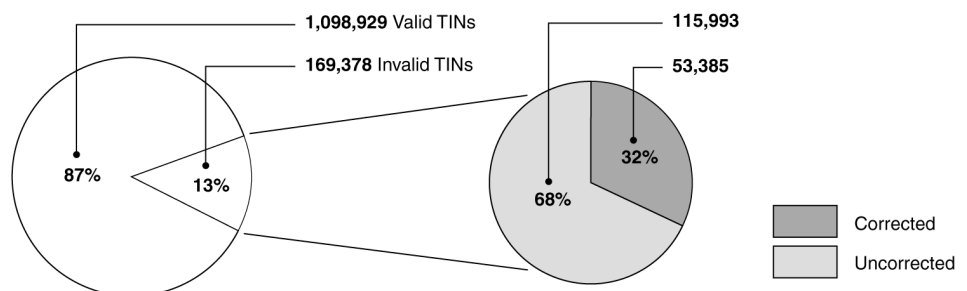
### What GAO Found

Federal agencies do not always adhere to information return reporting requirements. About \$5 billion in payments to 152,000 payees made during 2000 and 2001 by agencies within three federal departments were not reported to IRS. About 8,800 of these payees had received \$421 million in payments, yet had failed to file a tax return for these years. In addition, about \$20 billion in payments that were reported to IRS on 170,000 information returns for 2000 and 2001 included invalid vendor TINs. This was due in part to the fact that few federal agencies use IRS's TIN-matching program, as use of this program is optional.

IRS has acted to aid federal agencies in complying with annual information return filing requirements. In August 2003, IRS notified federal agencies about information returns filed for 2001 that included invalid vendor TINs and the need for agencies to withhold a portion of future payments if the vendors fail to provide a valid TIN. IRS is also in the process of making the TIN-matching program available online.

IRS does not currently have a program to identify and follow up with federal agencies that fail to file required annual information returns for vendor payments. Improvements to IRS's Payer Master File, which contains general information on all payers who file information returns, would be necessary for such a program. In addition, although the Central Contractor Registration is intended for use as a central source of valid vendor information by all federal agencies, it contains some invalid TINs. Due to statutory restrictions, all vendor TINs in this database cannot currently be validated through the IRS TIN-matching program, but options exist to address this problem.

**Forms 1099 MISC Submitted to IRS by Federal Agencies for Vendor Payments, Including Those with Invalid Vendor Taxpayer Identification Numbers That IRS Was Unable to Correct - Tax Years 2000 and 2001 Combined**



Source: IRS.

Note: GAO analysis of IRS data.

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United States General Accounting Office  
Washington, D.C. 20548

December 5, 2003

The Honorable Bill Thomas  
Chairman, Committee on Ways and Means  
House of Representatives

The Honorable Amo Houghton  
Chairman, Subcommittee on Oversight  
Committee on Ways and Means  
House of Representatives

Federal agencies pay billions of dollars each year to vendors for services, such as compensation paid to individuals that are not employees and medical and health care payments. At the same time, some vendors fail to pay their taxes and have accrued billions of dollars in delinquent federal taxes. The Internal Revenue Service's (IRS) ability to ensure vendors are properly paying their taxes hinges on having complete and accurate reports from federal agencies on their vendor payments.

The Internal Revenue Code requires any service recipient, including federal agencies, to report service payments to IRS if the services total \$600 or more during a calendar year. An IRS Form 1099 MISC (Miscellaneous Income) information return is used to report service payments to IRS and must include the vendor's name, address, and taxpayer identification number (TIN).<sup>1</sup>

IRS matches information returns with income tax returns to determine whether taxpayers have filed a return and/or reported all of their income. For fiscal year 2002, IRS used information returns to detect about 1.5 million taxpayers that underreported their income by about \$2.5 billion and also identified about 2 million taxpayers with tax liabilities of \$2.4 billion that failed to file tax returns. However, when the TIN on an information return is invalid<sup>2</sup> and IRS cannot ascertain the correct TIN, IRS is unable to match the information return data with tax return data and is thus unable

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<sup>1</sup> The TIN is a unique nine-digit number, usually a social security number (SSN) for an individual, an employer identification number (EIN) assigned by IRS for a partnership or corporation, and either an SSN or EIN if the vendor is a sole proprietor.

<sup>2</sup> In this report, an invalid TIN refers to a missing TIN, a TIN with more or less than nine numeric characters, a TIN that includes an alpha character, or a TIN/name combination that does not match or cannot be found in IRS's records.

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to detect either whether a taxpayer underreported income or failed to file a tax return.

To help federal agencies identify whether vendor TINs are valid, in 1997 IRS initiated a TIN-matching program that agencies can use, prior to filing their information returns, to determine whether vendors have provided a correct TIN/name combination. If a vendor either fails to provide a TIN or provides a TIN/name combination that does not match information in IRS's records, and the vendor subsequently fails to provide a correct TIN/name combination upon request, the federal agency is required to initiate backup withholding<sup>3</sup> of future payments for services.

Despite these efforts, our reviews of IRS's Federal Payment Levy Program<sup>4</sup> showed that federal agency payment records often contained invalid or missing TINs and, therefore, could not be used to levy vendors' federal payments to recover delinquent federal taxes.<sup>5</sup> As a result, you asked us to assess whether federal agencies in general have been submitting complete and accurate annual information returns to IRS for service payments to vendors. Specifically, our objectives were to determine (1) the extent to which federal agencies file required Forms 1099 MISC, take steps to ensure that information on the returns, particularly TINs, are valid, and initiate backup withholding if vendors provide invalid TINs; (2) recent actions IRS has taken to help improve federal agency Form 1099 MISC filing compliance; and (3) whether any additional measures could further improve federal agency compliance with Form 1099 MISC filing requirements.

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<sup>3</sup> Section 3406 of the Internal Revenue Code requires that payers withhold and forward to IRS a predetermined percentage of certain payments if a payee fails to provide the payer with a correct TIN; this is known as backup withholding.

<sup>4</sup> The Federal Payment Levy Program, authorized by the Taxpayer Relief Act of 1997 and conducted jointly by IRS and the Department of the Treasury's Financial Management Service, enables IRS to levy up to 15 percent of certain federal payments to collect delinquent federal taxes, including payments made to vendors.

<sup>5</sup> U.S. General Accounting Office, *Tax Administration: IRS' Levy of Federal Payments Could Generate Millions of Dollars*, [GAO/GGD-00-65](#) (Washington, D.C.: Apr. 7, 2000) and *Tax Administration: Millions of Dollars Could Be Collected If IRS Levied More Federal Payments*, [GAO-01-711](#) (Washington D.C.: July 20, 2001).

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To meet our objectives, we requested and obtained vendor payment information for service payments made by the agencies and bureaus within the 14 federal departments<sup>6</sup> for calendar years 2000 and 2001 and compared this information to vendor payment information included in IRS's Payer Master File and Information Returns Master File for the same 2-year period. We also surveyed the 14 federal departments on their policies and practices for obtaining vendor TINs and filing required Forms 1099 MISC. In addition, we discussed with IRS officials actions recently taken or pending for assisting federal agencies in filing complete and accurate Forms 1099 MISC for service payments to vendors. Finally, we discussed with both IRS and Office of Management and Budget (OMB) officials additional measures that could further improve federal agency compliance with Form 1099 MISC filing requirements. Our work was done from June 2002 through September 2003 in accordance with generally accepted government auditing standards. (App. I describes our overall objectives, scope, and methodology.)

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## Results in Brief

Federal agencies are not always filing required Forms 1099 MISC or taking steps to ensure that information on the returns is valid. For example, we found that about \$5 billion in payments to about 152,000 payees made by agencies within three federal departments during 2000 and 2001 were not reported to IRS on Forms 1099 MISC, and about 8,800 of the payees failed to file an income tax return for these years. In addition, about \$20 billion in service payments on almost 170,000 Forms 1099 MISC—13 percent of the information returns filed by agencies within the 14 federal departments for 2000 and 2001 combined—included invalid TINs. IRS was unable to correct the TINs on about 116,000 of these returns (68 percent) valued at almost \$9 billion, thus rendering them unusable for determining whether the vendors had reported this income. In response to our survey, only two federal departments indicated that their agencies were either using IRS's TIN-matching program to validate vendor TINs or initiating backup withholding if vendors failed to provide valid TINs departmentwide. While officials from some federal departments said they were unaware of IRS's TIN-matching program, others thought the program was currently unavailable. The main reason cited for not initiating backup withholding was the lack of a process in place within their respective financial

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<sup>6</sup> The Department of Homeland Security had not been established at the time this review began.

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management systems for accomplishing backup withholding of vendor payments if vendors failed to provide valid TINs.

IRS has taken recent action and has other actions planned to assist federal agencies in complying with Form 1099 MISC filing requirements. For example, in August 2003 IRS sent a specific notice to federal agencies for the first time, identifying Forms 1099 MISC filed by the agencies for 2001 that included invalid vendor TINs and reminding the agencies of their responsibility to ensure that valid vendor TINs are provided and to initiate backup withholding of subsequent payments for vendors who fail to provide a valid TIN. Also, in late 2003 IRS plans to expand its TIN-matching program to enable federal agencies to submit online up to 100,000 TIN/name combinations at one time and to receive a response from IRS within 24 hours concerning whether these combinations match the TIN/name combinations in IRS's records.

IRS does not identify agencies that fail to file Forms 1099 MISC and IRS and OMB have not taken steps to realize the potential of the Central Contractor Registration (CCR)—a Department of Defense (DOD) database of vendors that have registered to do business with DOD—to better ensure that agencies include accurate TINs on their Forms 1099 MISC for federal vendors. IRS does not currently have a program to identify and follow up with federal agencies that fail to file Forms 1099 MISC. Although such a program would be beneficial, it would require that IRS's Payer Master File, which IRS could use to identify federal agencies that do not file Forms 1099 MISC, be complete, accurate, and up to date. We found that 96 out of 147 federal agencies for which we had requested information from IRS were not specifically identified as federal payers in the Payer Master File. Further, although IRS's online TIN-matching program has the potential to assist federal agencies in reducing the number of Forms 1099 MISC submitted to IRS with invalid TINs, as of October 2003 OMB began requiring all federal agencies to use the CCR as the single validated source of information about vendors doing business with the federal government. However, TINs recorded in the CCR are not validated via IRS's TIN-matching program, there are no current plans to require such validation, and our work has raised concerns about the validity of TINs contained in the CCR. Having DOD validate vendor TINs recorded in the CCR through IRS's TIN-matching program would eliminate the need for each individual federal agency to do so and would further OMB's goal of having the CCR be a central source of valid vendor data. DOD cannot validate all vendor TINs under current law, but could if vendors gave it permission to do so or if the law was changed.



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We are making recommendations to ensure that IRS identify and follow up with federal agencies that fail to file annual information returns for vendor service payments and that IRS and OMB ensure that vendor TINs are validated using IRS's TIN-matching program. Both IRS and OMB generally agreed with our recommendations. DOD also indicated that actions were underway that should eventually enable vendor TINs in the CCR to be validated via IRS's TIN-matching program.

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## Background

Section 6041A of the Internal Revenue Code requires any service recipient, including federal agencies, to file an annual information return with IRS for payments made to any person for services totaling \$600 or more during a calendar year. Payments to corporations for certain services provided must also be reported, such as attorneys' fees and medical and health care payments. In addition, federal executive agencies must report all payments for services provided by vendors, including payments made to corporations. Specific information required on the annual information return—an IRS Form 1099 MISC—includes the name, address, and TIN of both the payer and payee, as well as the total amounts paid during the year for the various types of services provided. The purpose of the Form 1099 MISC filing requirement is to enable IRS to identify taxpayers who fail to file an income tax return as well as those who fail to report all of their income on their tax return for the related year.

IRS enters Form 1099 MISC information in both a Payer Master File (PMF) and an Information Returns Master File (IRMF). The PMF is a database that includes all entities that make payments subject to information return reporting. The PMF includes general information on the total number and dollar value of information returns, including Forms 1099 MISC, filed by each payer for each year. The IRMF is a database that includes specific information on the type and amount of payments made to each payee, including whether the payee TIN was valid upon receipt of the information return and if the TIN was invalid, whether it was subsequently corrected by IRS. Both the PMF and IRMF include the payer's TIN.

Upon receipt of a Form 1099 MISC, basic information is entered into a temporary IRS database. IRS compares the payee TIN/name combination with TIN/name combinations in its records to determine if there is a match. If there is a match, the information is entered in the IRMF without the need for additional action. If there is not a match, IRS will try to validate the TIN/name combination via a TIN "validation" process, which entails matching the TIN and name control—the first four characters of an

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individual's last name or the first four characters of a business name—on the Form 1099 MISC with (1) a file which contains all social security numbers ever issued and all name controls ever associated with them and (2) a file that contains all employer identification numbers ever issued and all name controls ever associated with them. If IRS is able to match the TIN and name control through this process, the information is entered in the IRMF with a code indicating that the TIN was corrected and is valid. If IRS is unable to match the TIN and name control, the information is entered in the IRMF with a code indicating that the TIN is invalid.

If the vendor TIN included on the Form 1099 MISC is initially valid or subsequently corrected by IRS, and the vendor files a tax return for the corresponding year, IRS can electronically match the TIN, name control, and amount entered in the IRMF with the amount reported on the vendor's tax return via the Document Matching Program.<sup>7</sup> This enables IRS to determine whether the vendor has reported all of the income on the tax return. Alternatively, if there is no corresponding return with the same TIN and name control as that entered in the IRMF, IRS can determine that the vendor is a potential nonfiler. However, if the TIN entered in the IRMF is invalid, IRS is unable to use the information to detect either underreporting or nonfiling on the part of a vendor.

Since 1997, IRS has had a TIN-matching program that federal agencies can use to verify the accuracy of TIN/name combinations furnished by federal payees. This program was intended to reduce the number of notices of incorrect TIN/name combinations issued for backup withholding by allowing agencies the opportunity to identify TIN and name discrepancies and to contact payees for corrected information before issuing an annual information return, such as a Form 1099 MISC. Monthly, federal agencies can submit a batch of TIN/name combinations to IRS for verification. IRS then matches each record submitted and informs the agency whether the TIN and name combination submitted matches its records.<sup>8</sup>

In order to encourage vendors to provide a valid TIN and to ensure that taxes are paid when they do not, Internal Revenue Code Section 3406

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<sup>7</sup> The Document Matching Program matches information on selected tax issues (usually income) reported on tax returns by individual taxpayers and reported on information returns by third parties, such as employers, banks, and other payers of income.

<sup>8</sup> IRS cannot tell an agency what the correct TIN, name, or both TIN and name should be if the records do not match, as to do so would violate tax disclosure laws.

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requires payers, including federal agencies, to initiate backup withholding of a federal payment if a payee, including a vendor, fails to provide a TIN or provides an invalid TIN, and upon notice fails to provide a correct TIN. IRS considers a TIN to be missing if it is not provided, has more or less than nine numbers, or has an alpha character in one of the nine positions. IRS considers the TIN to be invalid if it is in the proper format, but the TIN/name combination doesn't match or cannot be found in IRS or Social Security Administration files. Payments subject to backup withholding include various types of income reportable on a Form 1099 MISC, including compensation paid to individuals that are not employees. The current rate for backup withholding is 30 percent of the payment.

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## Not All Federal Agencies File Required Information Returns or Take Steps to Ensure That Information Provided Is Valid

Federal agencies are not always adhering to Form 1099 MISC filing requirements. For 2000 and 2001, about 152,000 information returns for federal payments totaling about \$5 billion were not filed with IRS, while about 170,000 information returns, including \$20 billion in federal payments that were filed, included invalid TINs. Few agencies are taking advantage of IRS's TIN-matching program to validate vendor TINs prior to submitting information returns to IRS. Similarly, few agencies are initiating backup withholding on payments made to vendors that have provided invalid TINs.

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## With Some Exceptions, Federal Agencies File Forms 1099 MISC

While most federal agencies filed information returns for vendors, some did not. For both 2000 and 2001, the 14 federal departments collectively filed over 600,000 Forms 1099 MISC in which they reported over \$100 billion in payments each year. (See app. II for the number and dollar value of Forms 1099 MISC filed individually by the 14 federal departments.)

Although the 14 federal departments collectively filed a substantial number of Forms 1099 MISC over this 2-year period, we found some significant exceptions, as the following examples illustrate.

- About \$5 billion in payments to about 152,000 payees made collectively by the Departments of Agriculture, Commerce, and Justice for 2000 and 2001 combined were not reported to IRS on Forms 1099 MISC. About 8,800 of these payees who collectively received payments totaling about \$421 million dollars—an average of about 48,000 each—failed to file an income tax return for these 2 years, according to IRS's records. If information returns had been filed and IRS had this information, it

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would have provided a basis for IRS to assess the appropriate taxes against these payees.

- Almost \$3.0 billion in payments made via purchase cards by DOD between 2000 and 2001 had not been reported to IRS due to incorrect or missing vendor TINs. DOD officials indicated that obtaining vendor information needed for Forms 1099 MISC from payment card companies has been a long-standing problem. They estimated that they could have filed as many as 40,000 additional Forms 1099 MISC for 2000 and 2001 if they had received the necessary vendor information from payment card companies.
- According to the Department of Transportation, Forms 1099 MISC were not filed for services if the vendor was a corporation that provided both goods and services, as their vendor payment system cannot distinguish between the two for the purpose of issuing Forms 1099 MISC. As a result, only about \$8 million of \$92 million in service payments for tax years 2000 and 2001 were reported to IRS on Forms 1099 MISC.
- One Department of Housing and Urban Development agency that made payments to vendors for services totaling over \$73 million for 2000 and 2001, failed to file any Forms 1099 MISC for these 2 years. According to a Department of Housing and Urban Development official, because the agency is a wholly owned corporation within HUD and is therefore quasi-federal, agency officials were not aware that they were required to file Forms 1099 MISC. They further indicated that the agency had subsequently issued Forms 1099 MISC to its vendors for payments made for 2002.

In response to our survey of departmental policies and practices for filing Forms 1099 MISC, department officials cited various reasons for not filing a Form 1099 MISC for vendor payments. Not having a valid vendor TIN was the foremost reason cited. Other reasons included the inability to distinguish between goods and services provided by a vendor,<sup>9</sup> as cited above, and problems obtaining necessary vendor information, namely TINs, from payment card companies for vendors that are paid via government purchase cards.

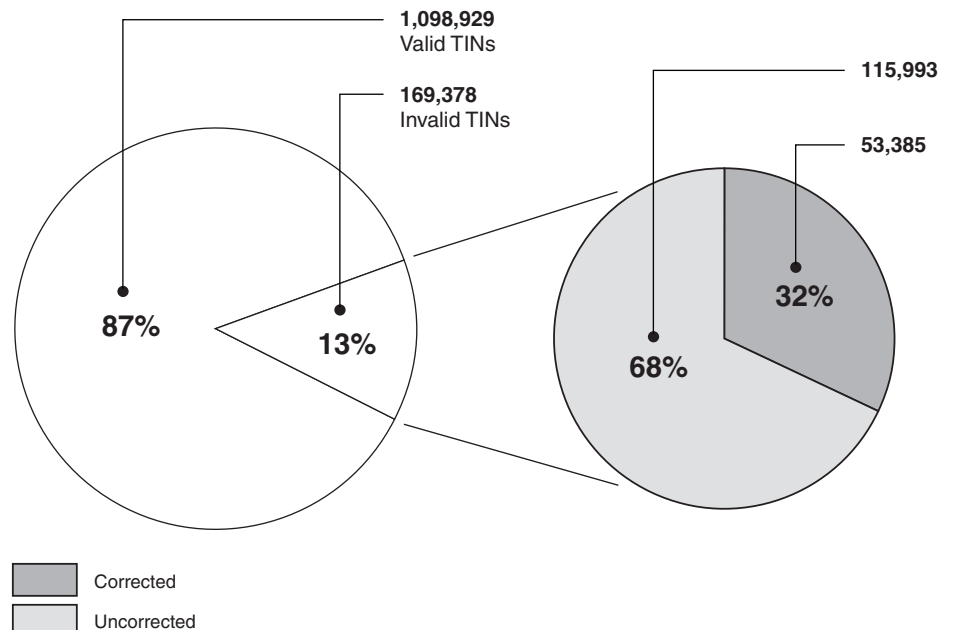
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<sup>9</sup> We did not review the capabilities of individual agency and department vendor payment systems to distinguish between goods and services, as this was beyond the scope of our review.

## Forms 1099 MISC Often Include Missing or Incorrect TINs

Even when federal agencies do file Forms 1099 MISC, they often include an invalid vendor TIN. As a result, IRS has to expend resources in an attempt to identify a correct TIN via its TIN validation process and, in most cases, IRS is unable to use the information returns to determine whether vendors had either underreported their income or failed to file a tax return. As shown in figure 1, the 14 federal departments filed almost 170,000 Forms 1099 MISC with invalid vendor TINs for tax years 2000 and 2001 combined. Almost \$20 billion in vendor payments were included on these information returns. Overall, for the 2 years combined, about 13 percent of all Forms 1099 MISC filed by the 14 federal departments included an invalid TIN when they were submitted to IRS. (See app. III for the number and percentage of Forms 1099 MISC filed individually by the 14 federal departments with invalid TINs.)

**Figure 1: Forms 1099 MISC Submitted to IRS by Federal Agencies for Vendor Payments, Including Those with Invalid Vendor TINs That IRS Was Unable to Correct - Tax Years 2000 and 2001 Combined**



Source: IRS.

Note: GAO analysis of IRS data.

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As also shown in figure 1, IRS was subsequently able to correct about 32 percent of the invalid vendor TINs through its TIN validation process. However, IRS was unable to correct the invalid TINs included on about 116,000 of the Forms 1099 MISC filed by the 14 departments, which were valued at almost \$9 billion, an average of about \$77,000 per return. As a result, IRS would be unable to match this income with income reported on income tax returns for the same period to determine whether these vendors had either underreported the income or failed to file a tax return.

One reason cited by department officials for filing Forms 1099 MISC with invalid TINs was the lack of a means for validating vendor TINs. This was cited, in particular, by those departments whose agencies were not using IRS's existing TIN-matching program.

In addition to negatively affecting IRS's ability to ensure that vendors report all required income on their tax returns, invalid vendor TINs also impede the Department of the Treasury's ability to offset federal tax debts through the Federal Payment Levy Program, as well as its ability to offset other debts through the Treasury Offset Program.<sup>10</sup> Each program requires a match of the payee's TIN and name control on both the payment record submitted to the Financial Management Service (FMS) and the debt information included in the FMS database, in order for the payment to be offset against the debt.

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## Federal Agencies Do Not Consistently Use IRS's TIN-Matching Program

Although the TIN-matching program is available, most federal agencies do not consistently use this program to ensure that the TINs included on information returns are valid. From our survey of federal department policies and practices for obtaining vendor TINs and filing required Forms 1099 MISC we found the following.

- Officials from only 2 of the 14 federal departments—Labor and Housing and Urban Development—said their agencies were currently using IRS's TIN-matching program departmentwide. Even so, we noted that according to IRS's records, agencies within both departments had filed

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<sup>10</sup> The Debt Collection Improvement Act of 1996 requires federal agencies to obtain a valid TIN from federal payees, including vendors, to facilitate federal debt collection via the Treasury Offset Program. The Treasury Offset Program involves a centralized database of delinquent federal nontax debts that have been referred by federal agencies for offset against federal payments processed by the Department of the Treasury's Financial Management Service.

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some Forms 1099 MISC for tax years 2000 and 2001 with invalid vendor TINs.

- Three other federal departments—Health and Human Services, Interior, and Justice—indicated that IRS’s TIN-matching program is used, but only by some of the agencies or bureaus within the respective departments.

While officials from some federal departments said they were unaware of the TIN-matching program, others thought the program was currently unavailable. DOD officials stated that they rely on the CCR for validating vendor TINs and thus do not use the IRS TIN-matching program. A Department of the Interior official indicated that it is in the process of implementing use of the CCR by its bureaus and agencies as of October 2003 at the direction of OMB.

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## In General, Federal Agencies Do Not Initiate Backup Withholding as Required

Although backup withholding is required if vendors fail to provide a valid TIN to a federal payer, most federal agencies do not initiate backup withholding. From our survey of federal department policies and practices for obtaining vendor TINs and filing required Forms 1099 MISC we found the following.

- Officials from only 2 of the 14 federal departments—Energy and Transportation—said that their agencies initiate backup withholding departmentwide.
- Three other federal departments—Health and Human Services, Interior, and Justice—indicated that backup withholding is initiated only by some of the agencies or bureaus within the respective departments.

The main reason cited by officials from several of the federal departments for not initiating backup withholding was the lack of a process in place within their respective financial management systems for accomplishing backup withholding of vendor payments.<sup>11</sup> Some department officials also indicated that they had no way of knowing when a vendor’s TIN is invalid and therefore subject to backup withholding. An official with one of the agencies within the Department of Health and Human Services indicated

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<sup>11</sup> As indicated earlier, we did not review the capabilities of individual agency and department vendor payment systems, as this was beyond the scope of our review.

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that they deny payment to vendors who fail to provide a valid TIN in lieu of backup withholding.

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## IRS Has Acted to Improve Form 1099 MISC Reporting Compliance

IRS has taken some recent actions and has other actions planned to assist federal agencies in complying with Forms 1099 MISC filing requirements, as the following examples illustrate.

- In August 2003, for the first time, IRS sent a specific notice (Notice 1313) to federal agencies identifying Forms 1099 MISC filed for 2001 in which the vendor's TIN was invalid and reminding the agencies of their responsibility to ensure that TINs are valid and to initiate backup withholding for any vendors who subsequently fail to provide the agency with a correct TIN upon notification by the agency. Sending these notices annually may address agency concerns about not having a way to determine that a vendor's TIN is invalid and that backup withholding should be initiated.
- By the end of 2003, IRS plans to expand its TIN-matching program to enable federal agencies to submit online up to 100,000 TIN/name combinations at a time and to receive a response from IRS within 24 hours concerning whether the TIN/name combinations submitted match the TIN/name combinations in IRS's records. As an interim step, IRS plans to have an interactive computer application available that will allow federal agencies to submit up to 25 TIN/name combinations and receive feedback within 5 seconds on whether these match the TIN/name combinations in IRS's records. As with the existing TIN-matching program, IRS will not be able to provide an agency with the correct TIN or name if they do not match IRS's records due to the disclosure laws. Instead, the agencies will continue to be responsible for contacting a vendor for the correct TIN/name combination. However, the online TIN-matching program should make it easier for federal agencies to identify vendors that are to be contacted to obtain a valid TIN and thus prevent the agencies from filing Forms 1099 MISC that include invalid TINs.
- In February 2003 IRS issued a proposed revenue procedure that would enable payment card companies to act on behalf of cardholders/payers, such as federal agencies, in soliciting, collecting, and validating vendor information, including TINs. This procedure would enable payment card companies to use IRS's TIN-matching program to validate the TIN/name combinations provided by vendors for which a Form 1099



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MISC is to be filed. Once adopted, this procedure may help to eliminate some of the problems agencies have experienced in getting necessary vendor information related to purchase card payments.

In addition, IRS has initiated meetings with various federal agencies, including the Departments of Defense and Agriculture, to identify specific problems associated with obtaining valid vendor TINs and filing accurate Forms 1099 MISC, particularly problems related to purchase card payments. In November 2003, IRS plans to present a federal agency seminar covering various topics related to filing Forms 1099 MISC, including use of the TIN-matching program, information reporting requirements, and the previously mentioned proposed revenue procedure.

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## **IRS Has No Program to Identify Federal Agencies That Fail to File Forms 1099 MISC and the CCR Does Not Now Serve as a Central Source of Valid TINs**

Although IRS can identify whether Forms 1099 MISC filed by federal agencies include a valid TIN, IRS does not have a program to identify and follow up with agencies that fail to file Forms 1099 MISC. In addition, the CCR does not, as OMB intends, serve as a central source of valid TIN data that federal agencies can use.

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## **At Present, IRS Has No Program to Detect Federal Agencies That Do Not File Forms 1099 MISC**

IRS does not have a program to periodically identify and follow up with federal agencies that fail to file Forms 1099 MISC for vendor payments. IRS officials indicated that their emphasis has been on identifying Forms 1099 MISC filed with invalid TINs by nonfederal payers. This is because Internal Revenue Code section 6721 authorizes IRS to assess a penalty of \$50 against a nonfederal payer for each information return filed with an invalid TIN, up to a maximum penalty of \$250,000 per calendar year. IRS proposed just over \$204 million in penalties against nonfederal payers for information returns with invalid TINs for tax years 2000 and 2001 combined. IRS estimated that an additional \$6.9 million in penalties could

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have been proposed against federal agencies for filing information returns with invalid TINs, if IRS had the authority to do so.<sup>12</sup>

A complete and accurate Payer Master File, which includes general payer information, such as the payer name and TIN, as well as the total number and dollar value of various types of Forms 1099 filed by each payer, would enable IRS to identify federal agencies that fail to file Forms 1099 MISC. IRS could then contact these agencies to ascertain why these returns were not filed. IRS initially indicated to us that federal payers are specifically coded as such in the Payer Master File to distinguish them from nonfederal payers. However, we found that 96 of 147 federal agencies and bureaus for which we needed information concerning Forms 1099 MISC they filed with IRS for 2000 and 2001 were not coded as federal payers in the Payer Master File. IRS officials agreed that there is a need to update the Payer Master File to ensure that all federal payers are properly coded as federal. Conducting a survey of all payers included in this file would be a way for IRS to update this information, thus ensuring that all federal payers are correctly coded as federal in the Payer Master File.

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## TINs in the CCR Are Not Validated

OMB has instructed federal agencies to begin using the CCR as of October 2003, as the single validated source of information about vendors doing business with the federal government, but CCR vendor TINs are not validated with IRS's TIN-matching program. The CCR, which is maintained by DOD, includes information on over 234,000 vendors that have registered to do business with DOD, including the vendors' TIN and name. The accuracy and completeness of information listed in this database is the responsibility of the individual vendors and must be updated annually. According to CCR officials, vendor TINs are not validated via IRS's TIN-matching program. Instead, CCR does an edit check to ensure that a vendor's TIN is in the correct format, namely that it contains nine numbers.

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<sup>12</sup> IRS Policy Statement P-2-4 states "penalties and interest will not be assessed against agencies or instrumentalities of the United States."

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At the time of our review and resulting July 2001 report<sup>13</sup> mentioned earlier, we found that there were a substantial number of invalid vendor TINs in the CCR. In addition, during our current review, we found that the CCR included about 7,000 vendor employer identification numbers that were not included in IRS's Business Master File.<sup>14</sup>

Due to the lack of validated TINs in the CCR, agencies' use of this centralized database as a source of TINs for vendors in and of itself would not ensure that the agencies include valid TINs on Forms 1099 MISC submitted to IRS. As noted earlier, in line with OMB's expectations, DOD relies on the CCR as a source of valid TINs and therefore does not use IRS's TIN-matching program; Interior officials say they also plan to use the CCR.

If the name and TIN of vendors recorded in the CCR were validated by DOD initially and then periodically thereafter through IRS's TIN-matching program, the CCR could become a central source of valid vendor TINs for all agencies to use for their Forms 1099 MISC submitted to IRS. However, because agencies are restricted to using the TIN-matching program only for validating TINs for which an information return is required, DOD would not be able to validate all vendor TINs included in the CCR because not all vendors in the CCR actually receive DOD contracts to provide services. This restriction could be addressed through a change to the disclosure laws, thus authorizing DOD to use the TIN-matching program for all vendors that have registered with the CCR. Alternatively, individual vendors could be asked to agree to have their TIN and name matched to IRS data when they apply to do business with the government. Section 6103 of the Internal Revenue Code protects taxpayer information, including TINs, from disclosure. However, taxpayers can waive this protection. This would enable IRS to provide more information than can currently be provided under the TIN-matching program, such as the correct TIN/name combination.

Given that the CCR is not currently a valid source of vendor TINs, agencies cannot rely on the CCR as OMB intends. Therefore, each agency would need to use IRS's online TIN-matching program as the only way to independently verify vendor TINs necessary to include on their Forms 1099

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<sup>13</sup> [GAO-01-711](#).

<sup>14</sup> The Business Master File is an IRS database that contains tax return filing histories for business entities.

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MISC. However, at the present time agency use of the TIN-matching program is optional.

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## Conclusions

Some federal agencies' failure to file required annual Forms 1099 MISC and other agencies' failure to file returns with valid vendor TINs adversely affects IRS's efforts to detect unreported vendor income and vendors that fail to file income tax returns. In addition, invalid TINs in federal agency payment records negatively affect Department of the Treasury efforts to offset federal tax debts through the Federal Payment Levy Program and other federal debts through the Treasury Offset Program.

Although IRS has taken some positive actions to improve federal agency compliance with Form 1099 MISC filing requirements, additional steps could be taken. IRS could identify and follow up with federal agencies that fail to file required Forms 1099 MISC if it had a complete and accurate Payer Master File. In addition, the CCR could become, as OMB intends, a central source for valid vendor information, including TINs. Currently, CCR TIN data are not always accurate. Except for current statutory restrictions on the use of IRS's TIN-matching program, the CCR's administrator, DOD, could use IRS's new online TIN-matching program to routinely verify the TINs of all vendors as they are added to the CCR and then periodically thereafter. This would carry out OMB's desire for the CCR to be a central source of valid vendor information and would thereby avoid each agency independently verifying TINs for some of the same vendors. Asking vendors to permit DOD to routinely verify their TINs when they register to do business with the federal government would be one option to enable DOD to verify TINs in the CCR against IRS's records. Alternatively, OMB and IRS could determine whether an exception to section 6103 of the Internal Revenue Code should be requested.

In the absence of the CCR as a valid source of TINs, agencies must individually and voluntarily use IRS's TIN-matching program to validate vendor TINs. Agencies have not consistently used the TIN-matching program in large part because they say they were unaware of it. IRS's new online TIN-matching program and publicity IRS plans as it launches the new system later this year may make officials more aware of the program and increase their use of it. However, until OMB is able to realize its intent of having the CCR be a valid source of information for federal vendors, additional assurance could be gained that agencies would use the matching program if OMB required them to do so. Because IRS has made the system

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available online, fulfilling such a requirement should now be easier than in the past.

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## Recommendations for Executive Action

To ensure that federal agencies file Forms 1099 MISC for payments to vendors for services provided, we recommend that the Commissioner of Internal Revenue

- ensure the accuracy of identification information concerning federal payers in IRS's Payer Master File and
- develop a program to periodically identify federal agencies that fail to file Forms 1099 MISC and follow up to determine why the forms were not filed.

To minimize duplicate agency effort in validating vendors' TINs and to reinforce the anticipated role of the Central Contractor Registration as the single validated source of vendors doing business with the federal government, we also recommend that the Commissioner of Internal Revenue and the Director of the Office of Management and Budget consider options to routinely validate all vendor TINs in the CCR and to then require all agencies to use vendor and TIN information from the CCR for their Forms 1099 MISC. If this proves to be infeasible, OMB should require each agency to validate TINs for vendors who provide services through IRS's TIN-matching program.

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## Agency Comments and Our Evaluation

We received written comments on a draft of this report from the Commissioner of Internal Revenue (see app. IV) and the Under Secretary of Defense (Comptroller) (see app. V).

The Commissioner agreed with our recommendations. However, he also emphasized that agencies may not wish to spend the resources to effectively use IRS's TIN-matching program and that IRS cannot compel agencies to meet their Form 1099 MISC reporting responsibilities.

To ensure the accuracy of identification information concerning federal payers included in IRS's Payer Master File, the Commissioner agreed to perform periodic reviews of the database to ensure its accuracy. In addition, as part of an education-compliance program geared to federal agencies that IRS is in the process of developing, the Commissioner stated

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that IRS plans to contact federal agencies to identify and verify that all TINs used by each agency have been properly identified, thus compiling an accurate list of all federal agency payer TINs.

To identify federal agencies that fail to file Forms 1099 MISC and the reasons why the forms were not filed, the Commissioner agreed to compare the above mentioned list of federal agency payer TINs to the Payer Master File to identify agencies that did not file Forms 1099 MISC and to then contact the agencies to determine if Forms 1099 MISC were required.

To minimize duplicate agency effort in validating vendors' TINs and to reinforce the role of the CCR as the single validated source of vendors doing business with the federal government, the Commissioner agreed that IRS will work with DOD to ensure that vendor TINs on the CCR are accurate, to include exploring the expanded use of the TIN-matching program to validate all TINs included in the CCR.

In addition to commenting on the report recommendations, the Commissioner pointed out that IRS Policy Statement P-2-4, which provides that federal agencies are not subject to penalties and interest for failure to comply with Form 1099 MISC filing requirements, is based on a 1978 GAO Comptroller General Decision (B-161457). This decision states that agency appropriations are not available for payment of interest and penalties. The Commissioner noted that if an agency does not wish or is unable to comply with its Form 1099 MISC reporting responsibilities, there is nothing that IRS can do but rely on voluntary compliance on the part of the agency.

Although we agree that IRS cannot compel agencies to meet their Form 1099 MISC reporting responsibilities, we believe implementing our recommendations will better ensure that agencies do so. For instance, by bringing to agencies' attention that they are not filing the required information returns, IRS can help educate agencies about their reporting responsibilities. Further, by improving the validity of TINs in the CCR, IRS, working with OMB, can make it easier for agencies to comply.

The Commissioner also stated that a number of federal agencies indicated that they have been unable to use IRS's TIN-matching program because their financial reporting systems were incompatible with the TIN-matching program and that the cost to make agency systems compatible would be prohibitive. If IRS and DOD are able to arrange validation of TINs included in the CCR via the TIN-matching program as we recommend, this would

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eliminate the need for individual agencies to use the TIN-matching program. In the event that IRS and DOD are unable to work out such an arrangement, IRS's online TIN-matching program, which can be accessed via the Internet using a desk-top workstation, may be an effective alternative to agencies making substantial changes to their financial accounting systems.

The Under Secretary of Defense (Comptroller) did not directly say he agreed with our recommendation, but indicated that efforts currently underway to improve the accuracy of TINs in the CCR for both DOD and all other federal agencies mirror our recommendation for IRS and OMB to consider options to routinely validate all vendor TINs in the CCR and to require all agencies to use vendor and TIN information from the CCR for their Forms 1099. The Under Secretary pointed out that the mandated use of the CCR throughout the federal government coupled with IRS's online TIN-matching program should enable DOD to establish a basic level of validation in the near term, perhaps as soon as the second quarter of fiscal year 2004.

The Under Secretary also pointed out that the Defense Finance and Accounting Service has been working with payment card companies, such as VISA and Master Card, to improve the process for reporting payments made via payment cards. As a result, DFAS expects a significant increase in the number and dollars reported for the card programs on Forms 1099 for calendar year 2003. We commend these efforts to address the long-standing problem of obtaining necessary vendor information from payment card companies. Coupled with IRS's proposal to enable payment card companies to act on behalf of cardholder/payers in soliciting, collecting, and validating vendor information, including TINs, these efforts should go a long way in addressing this problem.

On November 26, 2003, we also received oral comments from representatives of OMB's Offices of Federal Procurement Policy and Federal Financial Management. OMB generally agreed with our recommendation. Accordingly, OMB agreed to develop and issue a memorandum to federal agencies directing them to validate TINs by using the TIN-matching program or the CCR. In addition, OMB agreed to work with IRS and the CCR to ensure agencies are provided the necessary information to use either of the methods recommended. Although we believe that either using IRS's TIN-matching program or validating TINs in the CCR can be effective means for ensuring that agencies include valid TINs on their Forms 1099 MISC, using the CCR as the primary source of

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valid TINs would reinforce OMB's intention that the CCR become the government's central source of contractor data and would minimize duplicate effort among agencies in validating TINs. Therefore, we encourage OMB to pursue use of the CCR as the primary option for agencies to obtain valid TINs.

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We are sending copies of this report to the Ranking Minority Member, House Committee on Ways and Means; Ranking Minority Member, Subcommittee on Oversight, House Committee on Ways and Means; and the Chairman and Ranking Minority Member, Senate Committee on Finance. We will also send copies to the Commissioner of Internal Revenue, the Director of the Office of Management and Budget, the Secretary of Defense, and other interested parties. Copies of this report will also be made available to others upon request. The report will also be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you have any questions concerning this report, please contact me at (202) 512-9110 or Ralph Block at (415) 904-2150. Key contributors to this report are listed in appendix VI.



Michael Brostek  
Director, Tax Issues



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# Objectives, Scope, and Methodology

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Our objectives were to determine (1) the extent to which federal agencies file required Forms 1099 MISC, take steps to ensure that information on the returns, particularly Taxpayer Identification Numbers (TIN), are valid, and initiate backup withholding if vendors provide invalid TINs; (2) recent actions the Internal Revenue Service (IRS) has taken to help improve federal agency Form 1099 MISC (Miscellaneous Income) filing compliance; and (3) whether any additional measures could further improve federal agency compliance with Form 1099 MISC filing requirements.

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## Scope and Methodology

To determine whether federal agencies annually file required Forms 1099 MISC with IRS, we requested and obtained vendor service payment information from the 14 federal departments for calendar year 2000 and 2001. We specifically asked for the vendor name, TIN, and total dollar value of all payments made by the various agencies and bureaus within these departments for services provided during calendar years 2000 and 2001. However, we were unable to verify whether they fully complied with our request, such as only providing payments for services and not for goods. We compared the information we obtained from the 14 federal departments with vendor payment information included in IRS's Payer Master File (PMF) and Information Returns Master File (IRMF) for the same 2-year period. On the basis of our review of IRS's procedures for processing information returns and our testing of database extracts obtained from IRS's Payer Master File and Information Returns Master File, we determined that the data were sufficiently reliable to enable us to determine whether Forms 1099 MISC had been filed by the agencies and bureaus within the 14 federal departments and, if so, whether they included valid vendor TINs.

We obtained vendor payment information from the following federal departments:<sup>1</sup>

Agriculture  
Commerce  
Defense  
Education  
Energy  
Health and Human Services

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<sup>1</sup> The Department of Homeland Security had not been established at the time this review began.

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Housing and Urban Development  
Interior  
Justice  
Labor  
State  
Transportation  
Treasury  
Veterans Affairs

In an effort to gauge the potential result of not filing Forms 1099 MISC, we selected payment information provided to us by the agencies within 3 of the 14 federal departments for 2000 and 2001 and identified the amounts paid to individual payees that were not included on IRS's IRMF, thus indicating that a Form 1099 MISC had not been filed. We then compared the payee information to an IRS file of nonfilers to determine whether the individual payees had filed federal income tax returns for the comparable years.

To determine whether Forms 1099 MISC filed with IRS by federal agencies include valid vendor TINs, we analyzed IRS's IRMF for calendar years 2000 and 2001. We identified the number and dollar value of Forms 1099 MISC filed by the 14 federal departments that, according to the IRMF, contained invalid TINs. Of these, we further identified the number and dollar value associated with invalid TINs that IRS was able to correct via its TIN validation program, as well as those that remained invalid because IRS was unsuccessful in correcting them.

To determine whether federal agencies take steps to ensure that information on the returns, particularly TINs, is valid, by using IRS's TIN-matching program to validate vendor TINs or initiate backup withholding on future payments to vendors that have submitted invalid TINs, we sent a survey to the 14 federal departments about their policies and practices for obtaining vendor TINs and filing Forms 1099 MISC. We asked whether they validate vendor TINs through IRS's TIN-matching program and if not, why not. We also asked whether they initiate backup withholding if it is determined that a vendor has provided an invalid TIN. We then summarized the overall department responses.

To identify recent actions IRS has taken to help improve federal agency Form 1099 MISC filing compliance, we discussed with IRS officials any actions that were either recently implemented or pending. We also tracked

the progress of IRS's pending on-line TIN-matching program, which is expected to be available to federal agencies in the latter part of 2003.

To identify any additional measures that could further improve federal agency compliance with Form 1099 MISC reporting requirements, we discussed this issue with IRS and the Office of Management and Budget (OMB) officials and analyzed both recent and pending actions that would affect such compliance.

We did our work at IRS and OMB headquarters in Washington, D.C., from June 2002 through September 2003 in accordance with generally accepted government auditing standards.

We obtained written comments on a draft of this report from the Commissioner of Internal Revenue (see app. IV) and the Secretary of Defense (see app. V). We also obtained oral comments from representatives of the Office of Management and Budget.

# Forms 1099 MISC Filed by 14 Federal Departments for Tax Years 2000 and 2001

This appendix provides details concerning the specific number and dollar value of Forms 1099 MISC filed by each of the 14 federal departments for tax years 2000 and 2001.

As table 1 shows, the Department of Defense filed the greatest number and dollar value of Forms 1099 MISC each year, while the Department of Transportation filed the least. With a few exceptions, most departments filed more Forms 1099 MISC in 2001 than in 2000.

**Table 1: Number and Dollar Value of Forms 1099 MISC Filed with IRS for Tax Years 2000 and 2001**

Dollars in millions (rounded)

Department	Number filed for 2000	Amount filed for 2000	Number filed for 2001	Amount filed for 2001
Agriculture	32,617	\$1,183.1	42,440	\$1,579.0
Commerce	7,369	1,370.6	7,601	962.2
Defense	245,917	49,944.3	257,382	60,974.1
Education	2,428	906.1	2,686	1,068.4
Energy	3,587	6,066.4	3,381	7,250.0
Health & Human Services	8,464	41,735.4	8,859	40,312.8
Housing & Urban Development	17,347	1,118.5	15,522	1,065.9
Interior	23,394	1,292.5	26,197	1,549.3
Justice	21,241	1,705.5	22,868	2,146.6
Labor	66,285	965.4	66,245	1,126.5
State	6,345	1,195.6	6,411	1,552.2
Transportation	93	7.7	4	<sup>a</sup>
Treasury	5,846	1,537.1	7,481	1,767.7
Veterans Affairs	173,988	6,301.1	186,309	6,953.1
<b>Total</b>	<b>614,921</b>	<b>\$115,329.3</b>	<b>653,386</b>	<b>\$128,307.8</b>

Source: GAO analysis of IRS's Information Returns Master File.

<sup>a</sup>Less than \$1 million rounded.

# Forms 1099 MISC Filed with IRS with Invalid TINs for Tax Years 2000 and 2001

This appendix provides details concerning the specific number and percentage of Forms 1099 MISC filed by each of the 14 federal departments for tax years 2000 and 2001 that included invalid TINs when received by IRS.

As table 2 shows, the Departments of Defense and Veterans Affairs filed the greatest number of Forms 1099 MISC with invalid TINs each year, while the Departments of Transportation and Education filed the least. The Departments of Transportation and Agriculture filed the greatest percentage of Forms 1099 MISC with invalid TINs each year, while the Department of Health and Human Services filed the least.

**Table 2: Number and Percent of Forms 1099 MISC Filed with Invalid TINs for Tax Years 2000 and 2001**

Department	Number of invalid TINs 2000	Percent of invalid TINs 2000	Number of invalid TINs 2001	Percent of invalid TINs 2001
Agriculture	6,820	20.9	9,518	22.4
Commerce	510	6.9	788	10.4
Defense	27,246	11.1	26,006	10.1
Education	352	14.5	313	11.7
Energy	469	13.1	531	15.7
Health & Human Services	503	5.9	493	5.6
Housing & Urban Development	3,397	19.6	2,916	18.8
Interior	2,986	12.8	3,319	12.7
Justice	3,949	18.6	4,005	17.5
Labor	9,086	13.7	9,555	14.4
State	1,021	16.1	1,053	16.4
Transportation	20	21.5	1	25.0
Treasury	999	17.1	1,132	15.1
Veterans Affairs	25,781	14.8	26,609	14.3
<b>Totals</b>	<b>83,139</b>	<b>13.5</b>	<b>86,239</b>	<b>13.2</b>

Source: GAO analysis of IRS's Information Returns Master file.

# Comments from the Internal Revenue Service



COMMISSIONER

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

November 25, 2003

Mr. Michael Brostek  
Director, SI/Tax Issues  
United States General Accounting Office  
Washington DC 20548

Dear Mr. Brostek:

We appreciate the opportunity to review and provide comments on the draft report, titled "Tax Administration – More Can Be Done to Ensure Federal Agencies File Accurate Information Returns." We value the input of the General Accounting Office on the information return reporting issues affecting federal agencies. As you know, we are working to improve compliance by federal agencies. However, as noted below, we lack the means to enforce effectively these provisions due to a lack of compliance tools. Along with the general comments we provided your staff, we would like to address your recommendations.

Under "Recommendations for Executive Action," you suggest that the IRS take the following steps to ensure that federal agencies file appropriate informational returns for payments to vendors who provide services to the respective agency:

**RECOMMENDATION:** Ensure the accuracy of identification information concerning federal payers in the IRS's Payer Master File (PMF).

We agree that the entity coding in the PMF needs to be accurate, and we will make every effort to ensure its accuracy by performing periodic reviews of the database. Prior to your recommendation, we were in the process of developing an education-compliance program to address specifically federal agencies as taxpayers. As part of this initiative, we will contact federal agencies to identify and verify that all Taxpayer Identification Numbers (TINs), used by each agency, have been properly identified. This list of TINs will be used to identify federal agencies that do not file Forms 1099-MISC, as described below.

**RECOMMENDATION:** Develop a program to identify periodically federal agencies that fail to file Forms 1099-MISC and follow up to determine why the forms were not filed.

Currently, there is an annual extract of the PMF to identify those taxpayers who have filed incorrect Forms 1099-MISC. As mentioned in your report, starting in August 2003, federal agencies are now notified of any erroneous TINs and are requested to get the correct TINs for their vendors. We will also compare the list of TINs obtained from the federal agencies to the PMF and identify agency TINs that did not file Forms 1099-MISC. We will then contact the federal agency to determine if Forms 1099-MISC were required for those TINs with no reported Forms 1099-MISC filings.

**RECOMMENDATION:** Consider using the Department of Defense (DOD) Central Contractor Registry (CCR) as the central depository for all vendor Taxpayer Identification Numbers (TIN) and require all federal agencies to use vendor and TIN information from the CCR for Forms 1099-MISC. The IRS and Office of Management and Budget (OMB) should annually validate all vendor TINs on the CCR. Alternatively, OMB should require that all federal agencies use the IRS TIN matching program to validate vendor TINs.

We will work with the DOD to ensure that the vendor TINs on the CCR are accurate. If the DOD agrees, we will explore expanding use of our TIN matching program to validate all of the TINs on the CCR, and notify the DOD when a vendor TIN is invalid. As you mentioned in your report, we can only notify the DOD that a vendor TIN is invalid, and cannot give them the correct TIN without violating tax disclosure laws. We will also explore expanding the TIN matching program in connection with the CCR to cover all vendors in the database and not just those who are currently receiving payments.

Two additional items mentioned in your report need to be emphasized.

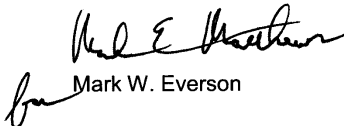
First, a number of federal agencies have told us that they cannot identify all the taxpayers that should receive Forms 1099-MISC. They are also unable to use the IRS TIN matching program because their financial reporting systems are incompatible with the TIN matching program. The cost and resources involved in making the agencies' financial accounting systems compatible with the TIN matching program could run into the tens of millions of dollars. Even though our TIN matching program seems to be a reasonable solution to the problem of incorrect TINs, the agencies may not wish to spend the resources necessary to accomplish this work.

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Finally, IRS Policy Statement P-2-4 provides that federal agencies are not subject to interest and penalties if they fail to file Forms 1099-MISC. This policy statement is based on Comptroller General's Opinion Federal Agency Payment of Penalties and Interest on Federal Employment Taxes, B-161,457, 1978 WL 9910 that provides that federal agencies do not have the authority to assess penalties or interest against one another. If an agency does not wish to or is unable to comply with its tax responsibilities, including Forms 1099-MISC reporting responsibilities, there is nothing the IRS can do. Voluntary compliance is the only way to get federal agencies to file Forms 1099-MISC for vendors who provide services to the agencies.

If you need any additional information, please contact me or a member of your staff may contact Floyd Williams, Director, Office of Legislative Affairs, at (202) 622-3720.

Sincerely,

  
Mark W. Everson



# Comments from the Department of Defense



COMPTROLLER

UNDER SECRETARY OF DEFENSE  
1100 DEFENSE PENTAGON  
WASHINGTON, DC 20301-1100

NOV 26 2003

Mr. Michael Brostek  
Director, Tax Issues  
U.S. General Accounting Office  
Washington, DC 20548

Dear Mr. Brostek:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) Draft Report (04-74), "TAX ADMINISTRATION: More Can be Done to Ensure Federal Agencies File Accurate Information Returns," dated November 3, 2003, (GAO Code 440132). Our comments are at the enclosure.

The Department appreciates the opportunity to comment on the subject report. Mr. Summers will be available to help resolve the issue outlined in this report. He may be contacted by e-mail: [tom.summers@osd.mil](mailto:tom.summers@osd.mil) or by telephone at (703) 697-3193.

Sincerely,

A handwritten signature in black ink, appearing to read "D. S. Zakheim", is written over the typed name.

Dov S. Zakheim

Enclosure:  
As stated

GAO DRAFT REPORT DATED NOVEMBER 7, 2003,  
GAO-04-74 (GAO CODE 440132)

“TAX ADMINISTRATION: MORE CAN BE DONE TO  
ENSURE FEDERAL AGENCIES FILE ACCURATE  
INFORMATION RETURNS”

DEPARTMENT OF DEFENSE COMMENTS

Since its operational implementation in 1998, the Central Contractor Registration (CCR) program office has endeavored to work with the Internal Revenue Service (IRS) to accomplish an automated validation of the Taxpayer Identification Numbers (TINs) for vendors that register in the database. However, the IRS has not allowed any type of validation to be performed, as it would not accept that the CCR could act as an authorized system to perform this function on behalf of the Department. Additionally, the IRS has not been able to support, until very recently, the automation necessary to accomplish these validations without manual intervention.

The effort to validate TINs was revived as a part of the Federal eGov Integrated Acquisition Environment (IAE) initiative, under which the CCR program now is mandated for use throughout the federal government. The Office of Management and Budget (OMB) and the IAE program office were able to facilitate CCR becoming an authorized system to perform these validations with IRS. As IRS' on-line TIN matching program now appears robust enough to handle the automation necessary, the two programs are working to establish a basic level of validation in the very near term (anticipated in the second quarter of fiscal year 2004). This will improve the accuracy of TINs not only for DoD, but all Federal Agencies, as they now incorporate the use of CCR information for their contract vendor payment activities. These efforts mirror the GAO's recommendation that the IRS and the OMB consider options to validate all vendor TINs in the CCR routinely, and for the OMB to then require all agencies to use the CCR vendor and TIN information for their Form 1099s.

The obligation to obtain TINs from card accepting merchants resides with the banks that accept and process the merchants' transactions. VISA has a relationship with these banks and the processor of the transactions as does MasterCard. Working with these organizations, the Defense Finance and Accounting Service (DFAS) has improved the card program reporting process. Further, the DFAS' efforts have resulted in a better mutual understanding of data file formats which, in turn, has assisted the Department in helping to locate the data needed to comply with the IRS reporting requirements. While the DFAS expects a significant increase in both the number of Form 1099s produced and the related dollars for the card programs, the actual impact will not be known until the Form 1099s for calendar year 2003 are produced in January 2004.

Enclosure

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# GAO Contacts and Staff Acknowledgments

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## GAO Contacts

Michael Brostek, (202) 512-9119  
Ralph T. Block, (415) 904-2150

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## Acknowledgments

In addition to those named above, Tom Bloom, Janet Eackloff, Evan Gilman, Shirley Jones, Bob McKay, and James Ungvarsky made key contributions to this report.

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