United States Government Accountability Office

GAO

Report to the Committee on Finance, U.S. Senate

May 2009

TAX GAP

Requiring Information Reporting for Charitable Cash Contributions May Not Be an Effective Way to Improve Compliance

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GAO-09-555

May 2009

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Highlights

Highlights of GAO-09-555, a report to the Committee on Finance, U.S. Senate

TAX GAP

Requiring Information Reporting for Charitable Cash Contributions May Not Be an Effective Way to Improve Compliance

Why GAO Did This Study

Individual taxpayers who misreport charitable cash contributions they deduct on their tax returns contribute to the tax gap, the difference between tax amounts taxpayers report and pay voluntarily and on time and the amounts they should pay under the law. The Internal Revenue Service (IRS) most recently estimated a gross tax gap of $345 billion for tax year 2001. One approach that tends to result in high levels of taxpayer compliance is information reporting to IRS by third parties on taxpayer transactions.

GAO was asked to (1) provide information on characteristics of individual taxpayer misreporting of charitable cash contributions, (2) provide information on actions that IRS takes to address misreporting, and (3) evaluate potential benefits and challenges associated with requiring information reporting for charitable cash contributions.

To meet its objectives, GAO used data from IRS's tax year 2001 National Research Program (NRP) compliance study of individual taxpayers, reviewed IRS guidance and enforcement data, and interviewed IRS officials and representatives from charities or organizations that represent charities.

GAO made no recommendations in this report. In email comments on a draft of this report, IRS agreed with GAO's overall conclusion that requiring information reporting for charitable cash contributions may not be an effective way to improve compliance.

View GAO-09-555 or key components.
For more information, contact Michael Brostek at (202) 512-9110 or brostekm@gao.gov.

What GAO Found

For tax year 2001, an estimated 46 percent of taxpayers who deducted cash contributions misreported, resulting in an estimated $13.8 billion in underreported net income. Since this amount is in income, and not tax dollars, the tax gap from the misreported cash contributions was much less than $13.8 billion. About 79 percent of misreporting taxpayers overstated a total of $16 billion in contributions while about 21 percent of misreporting taxpayers understated a total of $2.2 billion in contributions.

Distribution of Estimated Net Misreported Cash Contribution Amounts by Individual Taxpayers, Tax Year 2001

Net misreported amount per taxpayer	Number of misreporting taxpayers (in millions)	Percentage of misreporting taxpayers	Total net misreported contributions (dollars in billions)
Overstated contributions			
Less than $1,000	9.1	53	$3.2
$1,000 to $4,999	3.9	23	8.1
$5,000 or greater	0.5	3	4.7
Understated contributions			
Less than $1,000	3.2	19	-0.6
$1,000 or greater	0.4	2	-1.6
Total	**17.1**	**100**	**$13.8**

Source: GAO analysis of IRS data.

IRS attempts to ensure charitable cash contribution reporting compliance through enforcement and taxpayer service efforts. Cash contributions are one of the areas IRS examines most frequently for individual taxpayers. For fiscal year 2008, IRS examined about 175,000 taxpayers who potentially misreported cash contributions, out of about 1.4 million individual taxpayers it examined that fiscal year, and adjusted cash contribution amounts by $593 million in net terms. Through its taxpayer service programs, IRS provides publications and instructions to tax forms to help taxpayers comply with cash contribution reporting and recordkeeping requirements.

Requiring information reporting for charitable cash contributions may not be an effective way to improve compliance. Charities could incur substantial costs and burdens if they were required to file information returns with IRS and taxpayers on the cash contributions they receive. Exempting some cash contributions, such as those below a certain dollar amount or those made to small or religious charities, from information reporting could reduce the burden on some charities. However, exempting some cash contributions from information reporting would reduce the effect that the reporting would have on improving compliance, in part because IRS may not be able to match information returns against tax returns without complete information reporting. Also, the extent to which information reporting would improve voluntary compliance is unclear. Since the 2001 NRP study, more stringent requirements for the documentation taxpayers must keep to substantiate their cash contributions have gone into effect. It is not yet known whether the requirements have improved taxpayer reporting compliance, although an ongoing NRP study of individual taxpayers could show this.

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United States Government Accountability Office
Washington, DC 20548

May 14, 2009

The Honorable Max Baucus
Chairman
The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate

Based on Internal Revenue Service (IRS) data, individual taxpayers overstated the deductions they took for donating cash to charities by an estimated $13.8 billion, in net terms, for tax year 2001.[1] By overstating their cash contributions, these taxpayers contributed to the gross tax gap, estimated most recently at $345 billion for tax year 2001.[2] The tax gap is the difference between the taxes that taxpayers report and pay voluntarily and on time and the amounts they should pay under the law. Given the magnitude of the tax gap, even small improvements in taxpayer compliance could result in substantial revenue. Also, increasing compliance could improve the fairness of the tax system, as misreporting taxpayers increase the burden of funding the nation's commitments for those taxpayers who accurately pay their taxes.

One approach that tends to lead to high levels of taxpayer compliance is information reporting, through which third parties, such as employers or banks, file returns with IRS and taxpayers that provide information on a variety of taxpayer transactions. IRS tries to match information from information returns filed by third parties against taxpayers' income tax returns to see if taxpayers have filed returns and reported all their income. Currently, information reporting is not required for cash contributions to

[1]Individual taxpayers overstated about $16 billion and understated about $2.2 billion in cash contributions, resulting in a net overstatement of $13.8 billion. The $13.8 billion includes charitable contributions made by cash, check, credit card, electronic funds transfer, or payroll deduction, but does not include donations of property, such as stocks or bonds, vehicles, or household items, which individual taxpayers report separately on their tax returns. IRS estimated that individual taxpayers overstated their deductions for these noncash contributions by about $4 billion, in net terms, for tax year 2001.

[2]IRS estimated that it would eventually collect about $55 billion of the gross tax gap through late payments and IRS enforcement actions, leaving a net tax gap of around $290 billion. Unless otherwise noted, references to the tax gap refer to the gross tax gap.

charities.[3] Given your long-standing interest in addressing the tax gap, you asked us to (1) provide information on characteristics of individual taxpayer misreporting of charitable cash contributions, (2) provide information on actions that IRS takes to address individual taxpayer misreporting of charitable cash contributions, and (3) evaluate potential benefits and challenges associated with requiring information reporting for charitable cash contributions.

To provide information on the characteristics of individual taxpayer misreporting of charitable cash contributions, we used data from IRS's National Research Program (NRP) study of individual taxpayers for tax year 2001. Through this study, IRS examined about 46,000 randomly selected individual tax returns and used the results of the examinations to estimate misreporting of income and taxes for all individual tax returns. We also reviewed data from IRS's Statistics of Income (SOI) individual files for tax years 2001 through 2006, the most recent year for which data are available. SOI is a widely used database consisting of a sample of unexamined income tax returns. Since the estimates we provide using these data sources are based on samples, they involve margins of error. Unless otherwise noted, all percentage estimates have margins of error of 2 percentage points or less; value estimates have margins of error of 10 percent or less. We assessed both sources of IRS data and determined that they were sufficiently reliable for the purposes of this report.

To provide information on the actions that IRS takes to address individual taxpayer misreporting of charitable cash contributions and any challenges that it faces with these actions, we reviewed IRS forms, publications, and taxpayer guidance on deducting cash contributions to charities and reviewed documents and data from IRS's enforcement programs including the Examination Operational Automation Database of IRS taxpayer examinations. We assessed this data source and determined that it was sufficiently reliable for the purposes of this report. We also interviewed officials from IRS's Wage and Investment; Small Business/Self Employed; Tax Exempt and Government Entities; and Research, Analysis, and Statistics Divisions and the Office of the Chief Counsel who have knowledge of cash contribution compliance issues.

[3]Information reporting is required for some other types of charitable contributions, such as the donation of motor vehicles, airplanes, or boats resulting in gross proceeds of more than $500.

To evaluate the potential benefits and challenges associated with requiring information reporting for charitable cash contributions, we reviewed requirements of the Paperwork Reduction Act of 1995[4] under which federal agencies, such as IRS, must obtain approval from the Office of Management and Budget that the benefits of collecting new information outweigh the costs. We also examined IRS's policies and procedures relating to information reporting. For example, IRS generally requires that each information return include a taxpayer identification number for purposes of matching information returns with tax returns. We also reviewed prior GAO reports related to information reporting and interviewed IRS officials from the divisions previously listed. In addition, we interviewed representatives from the tax return preparation industry and from charities or organizations that represent charities. The briefing in appendix I provides details on the charitable organizations we interviewed.

We conducted this performance audit from September 2008 through May 2009 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

On March 3, 2009, we briefed your staff on the results of our work. This report, including the information in appendix I conveys an update to the information provided during that briefing.

Results

For tax year 2001, an estimated 46 percent of individual taxpayers who deducted cash contributions misreported, resulting in an estimated $13.8 billion in underreported net income. Since this amount is in income, and not tax dollars, the tax gap from the misreported cash contributions was much less than $13.8 billion. About 79 percent of misreporting taxpayers overstated a total of $16 billion in contributions, while about 21 percent of misreporting taxpayers understated a total of $2.2 billion[5] in contributions.

[4] 44 U.S.C. §§ 3501-3520.

[5] Estimate has a margin of error of 34 percent.

We also found that

- about two-thirds of taxpayers who overstated their cash contributions overstated less than $1,000,
- about 70 percent of the $16 billion in overstated contributions were from taxpayers who overstated less than $5,000,
- most taxpayers who overstated cash contributions overstated at least half of the amount they deducted on their tax returns, and
- taxpayers who deducted cash contributions and used paid tax return preparers misreported about as often as those who deducted cash contributions and prepared their own tax returns.

Taxpayers misreport cash contributions, for example, when they are unable to substantiate with required documentation the contribution amounts they deducted on their tax returns.

IRS attempts to ensure charitable cash contribution reporting compliance through enforcement and taxpayer service efforts. As part of its enforcement efforts, IRS examines tax returns that include potential misreporting of cash contributions. Cash contributions are one of the areas IRS examines most frequently for individual taxpayers. For fiscal year 2008, IRS examined about 175,000 individual taxpayers who potentially misreported cash contributions out of about 1.4 million individual taxpayers it examined that fiscal year. IRS adjusted cash contribution amounts for about 76 percent of the taxpayers it examined that year for a net total of $593 million (IRS reduced overstated cash contributions by about $760 million and increased understated cash contributions by about $167 million). The $760 million of overstated contributions IRS reduced in fiscal year 2008 would have represented less than 5 percent of the $16 billion in estimated overstated contributions from tax year 2001. Through its taxpayer service programs, IRS provides publications and instructions to tax forms to help taxpayers comply with cash contribution reporting and recordkeeping requirements.[6]

Requiring information reporting for charitable cash contributions may not be an effective way to improve compliance. Charities could incur substantial costs and burdens if they were required to file information

[6]In addition to the instructions to Schedule A of the individual tax return, on which taxpayers itemize their deductions, including those for charitable cash contributions, IRS produces two publications that cover charitable cash contribution reporting and recordkeeping requirements—Publication 526, *Charitable Contributions*, and Publication 1771, *Charitable Contributions – Substantiation and Disclosure Requirements*.

returns with IRS and taxpayers on the cash contributions they receive. Exempting some cash contributions, such as those below a certain dollar amount or those made to small or religious charities, from information reporting could reduce the burden on some charities. However, exempting some cash contributions from information reporting would reduce the effect that the reporting would have on improving compliance, in part because IRS may not be able to match information returns against tax returns without complete information reporting. Also, the extent to which information reporting would improve voluntary compliance is unclear. The Pension Protection Act of 2006 included more stringent requirements for the documentation taxpayers must keep to substantiate their cash contributions, starting in tax year 2007.[7] It is not yet known whether the enhanced substantiation requirements have improved taxpayer recordkeeping and reporting compliance, although an updated NRP study of individual taxpayers could show whether compliance improved following the passage of the act. Finally, requiring information reporting could result in reduced charitable cash contributions from taxpayers, for example, because taxpayers may not want the federal government to know to which charities they donate, particularly for donations to religious organizations.

Agency Comments

In an e-mail commenting on a draft of this report, the Director of Compliance from IRS's Wage and Investment Division agreed with our overall conclusion that requiring information reporting for charitable cash contributions may not be an effective way to improve compliance. IRS noted that information reporting could impose substantial costs and burdens on charities, especially smaller charities. In terms of exempting some contributions from a reporting requirement to reduce the burden on smaller charities, IRS noted that exempting some contributions and not others would lead to an incomplete process of matching information returns to tax returns, which would reduce the impact that reporting would have on improving compliance and produce disparate treatment of taxpayers.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to the Chairman and Ranking

[7]Pub. L. No. 109-280, § 1217, 120 Stat. 780, 1080 (Aug. 17, 2006), 26 U.S.C. § 170(f)(17).

Member, House Committee on Ways and Means; the Secretary of the Treasury; the Commissioner of Internal Revenue; and other interested parties. The report also will be available at no charge on GAO's Web site at http://www.gao.gov.

If you or your staffs have any questions, please contact me at (202) 512-9110 or brostekm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report were Charlie Daniel, Assistant Director; Jeff Arkin; Crystal Bernard; Sara Daleski; John Mingus; Melanie Papasian; and Andrew Stephens.

Michael Brostek
Director, Tax Issues
Strategic Issues Team

Appendix I: Congressional Briefing on Charitable Cash Contribution Reporting Compliance

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Requiring Information Reporting for Charitable Cash Contributions May Not Be an Effective Way to Improve Compliance

Briefing for the Senate Committee on Finance

Engagement Objectives

- Provide information on the characteristics of individual taxpayer misreporting of charitable cash contributions
- Provide information on actions the Internal Revenue Service (IRS) takes to address individual taxpayer misreporting of charitable cash contributions
- Evaluate potential benefits and challenges associated with requiring information reporting for charitable cash contributions

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Background: Misreporting of Cash Contributions and the Tax Gap

- For tax year 2001, individual taxpayer misreporting of cash contributions resulted in an estimated $13.8 billion in underreported net income
  - This estimate includes contributions made by cash, check, credit card, electronic funds transfer, or payroll deduction
  - The estimate does not include donations of property, such as stocks or household items, which individual taxpayers report separately on their tax returns
  - The tax gap from misreported cash contributions was much less than $13.8 billion
- Misreporting of cash contributions contributes to the gross tax gap, which IRS most recently estimated to be $345 billion for tax year 2001
  - The tax gap is the difference between the taxes that taxpayers report and pay voluntarily and on time and the amounts they should pay under the law
  - IRS estimated $55 billion of the tax gap would eventually be recovered

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Background: Charitable Cash Contribution Reporting Requirements

- Individual taxpayers must itemize deductions to deduct charitable contributions
- Taxpayers who receive a benefit from a contribution can only deduct the amount of the contribution that exceeds the value of the benefit received
  - For example, a taxpayer who contributes $65 to a fund raising event that includes a meal valued at $25 can only deduct $40
  - Taxpayers do not have to exclude the value of token items, such as mugs bearing the logos of charitable organizations
- Taxpayers can deduct certain out-of-pocket expenses, such as car expenses, directly related to giving services to a charitable organization

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Background: Charitable Cash Contribution Recordkeeping Requirements

- Taxpayers must keep records to substantiate all charitable cash contributions they deduct
- The type of documentation that taxpayers must keep changed with the passage of the Pension Protection Act of 2006 (Pub. L. No. 109-280)
  - Prior to the passage of the act, acceptable documentation included bank records (e.g., canceled checks or credit card statements), written records from charities, or other written records (e.g., taxpayer-prepared logs)
  - For contributions of $250 or more, taxpayers had to have statements from the recipient charities (per contribution rather than for cumulative contributions) that showed whether the charities did or did not provide goods or services in return for contributions and a description and estimated value of any goods or services provided, among other requirements

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Background: Charitable Cash Contribution Recordkeeping Requirements (Cont.)

- Following the passage of the Pension Protection Act, beginning with tax year 2007, taxpayers must have a bank or written record from charities to substantiate their cash contributions
- Taxpayers can no longer use other written records to substantiate their contributions
- Taxpayers still must have written records from charities for contributions of $250 or more

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Background: Taxpayers Who Deducted Charitable Cash Contributions

- For tax year 2001 through tax year 2006
  - From 28 percent and 30 percent of all individual taxpayers were estimated to have deducted cash contributions
  - Total deducted cash contributions increased from an estimated $105 billion to an estimated $144 billion
  - From 79 percent to 85 percent of taxpayers who were estimated to have itemized their deductions were estimated to have reported deductions for cash contributions

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Background: Information Reporting

- Information reporting involves third parties, such as employers or banks, filing returns with IRS and taxpayers that provide information on a variety of taxpayer transactions
- Information reporting helps ensure compliance
  - Taxpayer voluntary compliance tends to be high for items subject to information reporting, in part because of the deterrent effect that information reporting can have on taxpayers who might otherwise misreport intentionally
  - Generally, IRS matches amounts that third parties report on information returns against amounts that taxpayers report on tax returns to help identify potential misreporting and address it through enforcement actions (for example, through its Automated Underreporter program)

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Scope and Methodology

- To provide information on characteristics of individual taxpayer misreporting of charitable cash contributions, we analyzed data from two sources:
  - IRS's tax year 2001 National Research Program (NRP) study of individual taxpayer compliance (the latest year available)
  - IRS Statistics of Income individual taxpayer data from tax years 2001 through 2006 (the latest year available)
- Estimates from these data sources are based on samples and involve margins of error, and unless otherwise noted
  - percentage estimates have margins of error of 2 percentage points or less and
  - value estimates have margins of error of 10 percent or less

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Scope and Methodology (Cont.)

- To provide information on actions that IRS takes to address individual taxpayer misreporting of charitable cash contributions, we
  - reviewed documents and data from IRS's enforcement programs,
  - reviewed IRS guidance on deducting charitable cash contributions, and
  - interviewed officials from IRS's Wage and Investment; Small Business/Self Employed; Tax Exempt and Government Entities; and Research, Analysis, and Statistics divisions and the Office of Chief Counsel who have knowledge of cash contribution compliance issues

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Scope and Methodology (Cont.)

- To evaluate the potential benefits and challenges associated with requiring information reporting for charitable cash contributions, we
  - reviewed the requirements of the Paperwork Reduction Act of 1995 (Pub. L. No. 104-13), under which federal agencies, such as IRS, must get Office of Management and Budget approval that the benefits of collecting any new information outweigh the costs;
  - examined IRS's policies and procedures relating to information reporting (for example, IRS generally requires that each information return include a taxpayer identification number for purposes of matching information returns with tax returns);
  - reviewed prior GAO reports related to information reporting;
  - interviewed IRS officials from the divisions listed previously; and
  - interviewed representatives of the American Institute of Certified Public Accountants to obtain information on how information reporting of cash contributions might affect its members in preparing tax returns for taxpayers

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Scope and Methodology (Cont.)

- We also interviewed representatives from the following organizations that represent different types of charitable organizations accounting for substantial amounts of cash contributions:
  - Independent Sector is a leadership forum for a diverse group of charities, foundations, and corporate-giving programs, whose members include some of the largest charities
  - The National Council of Churches and the Evangelical Council for Financial Accountability are membership organizations that represent various religious organizations and denominations (religious organizations receive substantial amounts of cash contributions)
  - The United Way of America and the Combined Federal Campaign are conduits for large amounts of cash contributions collected for charities, some of which are given via payroll deduction
  - The Council on Foundations is an association of grant-making foundations and corporations (individuals mostly make large contributions to foundations)
  - The National Council of Nonprofits and Independent Charities of America represent a diverse group of charities and nonprofit organizations, many of which are of small or medium size

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Characteristics of Individual Taxpayer Misreporting of Charitable Cash Contributions

- For tax year 2001, an estimated 46 percent of taxpayers deducting cash contributions misreported, resulting in an estimated $13.8 billion in underreported net income
- About 79 percent of misreporting taxpayers overstated their contributions
  - Overstated contributions resulted in an estimated $16 billion in underreported net income
  - The estimated median overstated contribution amount was $504
- About 21 percent of misreporting taxpayers understated their contributions
  - Understated contributions resulted in an estimated $2.2 billion in overreported net income (estimate has a margin of error of 34 percent)
  - The estimated median understated contribution amount was $132 (estimate has a margin of error of 11 percent)

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Characteristics of Individual Taxpayer Misreporting of Charitable Cash Contributions (Cont.)

- Types of misreporting of cash contributions could include the following:

  Overstated deductions

  - Taxpayers being unable to substantiate with required documentation the cash contributions they deducted on their tax returns
  - Taxpayers deducting cash contributions to organizations that were not qualified charitable organizations
  - Taxpayers deducting portions of cash contributions for which they received benefits

  Understated deductions

  - Taxpayers who during the course of IRS's examinations identified cash contributions that they did not initially deduct on their tax returns

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Characteristics of Individual Taxpayer Misreporting of Charitable Cash Contributions (Cont.)

- About two-thirds of overstating taxpayers (9.1 million out of 13.5 million overstating taxpayers) overstated less than $1,000
- About 70 percent of all overstated contributions ($11.3 billion out of $16.0 billion in overstated contributions) were from taxpayers who overstated less than $5,000

Distribution of Estimated Net Misreported Cash Contribution Amounts by Individual Taxpayers, Tax Year 2001

Net misreported amount per taxpayer	Number of misreporting taxpayers (in millions)	Percentage of misreporting taxpayers	Total net misreported contributions (dollars in billions)
Overstated contributions			
Less than $1,000	9.1	53	$3.2
$1,000 to $4,999	3.9	23	8.1
$5,000 or greater	0.5[a]	3	4.7[a]
Understated contributions			
Less than $1,000	3.2	19	-0.6
$1,000 or greater	0.4[a]	2	-1.6[b]
Total	**17.1**	**100**	**$13.8**

Source: GAO analysis of IRS data
[a]Estimates have margins of error of 21 percent or less
[b]Estimate has a margin of error of 47 percent

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Characteristics of Individual Taxpayer Misreporting of Charitable Cash Contributions (Cont.)

- Most taxpayers who overstated cash contributions overstated at least half of the contribution amount they deducted on their tax returns

Distribution of Estimated Overstated Cash Contribution Amounts as a Percentage of Reported Cash Contribution Amounts for Individual Taxpayers, Tax Year 2001

Percentage of reported amount that was overstated	Number of taxpayers who overstated (in millions)	Percentage of taxpayers who overstated	Total overstated contributions (dollars in billions)
Less than 10 percent	2.0	15	$0.4[a]
10 percent to less than 25 percent	1.6	12	0.8[a]
25 percent to less than 50 percent	2.0	15	2.1[b]
50 percent to less than 75 percent	1.8	14	2.5[a]
75 percent or greater	6.1	45	10.3
Total	**13.5**	**100**	**$16.0**

Source: GAO analysis of IRS data

Note: Estimates for overstated contributions do not sum to totals because of rounding

[a]Estimates have margins of error of 15 percent or less

[b]Estimate has a margin of error of 24 percent

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Characteristics of Individual Taxpayer Misreporting of Charitable Cash Contributions (Cont.)

- For tax year 2001, taxpayers who deducted cash contributions used paid preparers more often than taxpayers who did not deduct cash contributions (63 percent to 53 percent, respectively)
- Taxpayers deducting cash contributions who used paid tax return preparers misreported about as often as those who deducted cash contributions and prepared their own tax returns

Estimated Number of Individual Taxpayers Deducting Cash Contributions, Misreporting Percentages, and Net Misreported Contributions by Tax Return Preparation Method, Tax Year 2001

Tax return preparation method	Number of taxpayers deducting cash contributions (in millions)	Percentage of taxpayers deducting cash contributions who misreported	Net misreported contributions (dollars in billions)
Self-prepared	14.1	45	$8.5[a]
Paid tax return preparer	23.1	46	5.3[b]
Total	**37.2**	**46**	**$13.8**

Source: GAO analysis of IRS data
[a]Estimate has a margin of error of 19 percent
[b]Estimate has a margin of error of 11 percent

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IRS Tries to Ensure Compliance through Enforcement and Taxpayer Services

Enforcement

- IRS examines tax returns that include potential misreporting of cash contributions
- Cash contributions is one of the most frequently examined areas for individual taxpayers (mostly through correspondence)
    - For fiscal year 2008, IRS examined about 175,000 taxpayers who potentially misreported cash contributions (IRS examined about 1.4 million individual taxpayers that fiscal year)
    - IRS adjusted cash contribution amounts for about 76 percent of these taxpayers for a total of about $593 million, in net terms
        - IRS reduced overstated cash contributions by about $760 million (the median reduced overstatement amount was $3,573)
        - IRS increased understated cash contributions by about $167 million (the median increased understatement amount was $1,416)
        - The $760 million of overstated contributions IRS reduced in fiscal year 2008 would have represented less than 5 percent of the $16 billion in estimated overstated contributions from tax year 2001

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IRS Tries to Ensure Compliance through Enforcement and Taxpayer Services (Cont.)

Taxpayer services

- IRS provides publications and instructions to tax forms to help taxpayers comply with cash contribution reporting requirements
  - Instructions to Schedule A (Itemized Deductions) of the individual tax return
  - Publication 526, *Charitable Contributions*
  - Publication 1771, *Charitable Contributions – Substantiation and Disclosure Requirements*

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Requiring Information Reporting for Charitable Cash Contributions May Not Be Effective

- Charities could incur costs and burdens if information reporting were required for cash contributions
- Exempting some cash contributions could reduce the burden on charities but would limit the effect that reporting would have on improving compliance
- The extent to which information reporting would improve compliance is unclear
- It is not known whether recently enhanced substantiation requirements have improved taxpayer reporting compliance
  - An updated NRP study of individual taxpayers, which is under way, could show any improvements
- Requiring information reporting could also result in reduced charitable cash contributions from taxpayers

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Requiring Information Reporting for Charitable Cash Contributions May Not Be Effective (Cont.)

- Charities could incur substantial costs and burdens if information reporting were required for cash contributions
  - Some administrative practices could be foreign to smaller charities, which may make up a large share of charitable organizations
  - Although some charities already collect and maintain information about their donors and donations, all charities would need to routinely employ this practice
  - Charities may need to bear costs to safeguard and ensure against stolen donor information (especially if Social Security numbers were required with reporting)
  - Charities would need to spend time filing information returns or pay to have the returns filed on their behalf
  - Charities are evaluated on having low overhead costs; information reporting would likely increase those costs

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Requiring Information Reporting for Charitable Cash Contributions May Not Be Effective (Cont.)

- Exempting some contributions from a reporting requirement could reduce the burden on charities associated with information reporting
- For example:
  - Exempting yearly contributions below a certain dollar threshold that a taxpayer makes to a single charity
  - Exempting contributions to charities with annual gross receipts of $25,000 or less and religious organizations, which generally do not have to report income and asset information to IRS as is required for other charities

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Requiring Information Reporting for Charitable Cash Contributions May Not Be Effective (Cont.)

- <u>However, exempting some cash contributions from information reporting would reduce the effect that reporting would have on improving compliance</u>
  - Partial reporting likely would not have the same impact on taxpayer voluntary compliance as full information reporting
  - Exempting certain contributions would make it more difficult for IRS to effectively use information returns in its enforcement efforts
    - Many taxpayers could deduct cash contributions for which IRS would not receive a corresponding information return
    - As such, IRS may not be able to address misreporting through its Automated Underreporter program for cash contributions, and might only be able to use information returns for examinations
    - IRS contacts many more potentially noncompliant taxpayers through the Automated Underreporter program than through examinations
  - Also, with a dollar threshold exemption, charities would likely need to collect information for all donors upon first receiving donations because charities would not know if their donors' gifts would eventually exceed the established threshold

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Requiring Information Reporting for Charitable Cash Contributions May Not Be Effective (Cont.)

- For taxpayers who misreport in that they cannot substantiate their cash contributions, information reporting could improve voluntary compliance without increasing tax revenue
  - Some misreporting taxpayers IRS examined through NRP may have made the contributions they were unable to substantiate
  - For these taxpayers, information reporting should improve compliance in that they should be able to substantiate the cash contributions they deduct
  - However, for these taxpayers, information reporting would not likely change the amount of cash contributions they deduct, resulting in improved compliance without increased tax revenue
  - It was not possible to determine from the NRP data the extent to which taxpayers misreported their cash contributions because of a lack of substantiating documentation (or whether taxpayers without documentation actually made the cash contributions they deducted)

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Requiring Information Reporting for Charitable Cash Contributions May Not Be Effective (Cont.)

- It is not known whether the requirement that taxpayers now must maintain records from banks or charities for all cash contributions has improved taxpayer recordkeeping
  - IRS has not studied the impact the recordkeeping requirements from the Pension Protection Act have had on compliance
  - IRS is implementing a new NRP study through which it examines individual taxpayers on an annual basis and will use the results of 3 years of examinations to estimate compliance
  - The results of examinations from tax year 2007 through tax year 2009 could identify whether misreporting decreased with the new recordkeeping requirement
  - If IRS finds a decrease in taxpayer misreporting compared to tax year 2001, it could be, in part, because of the more stringent recordkeeping requirement

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Requiring Information Reporting for Charitable Cash Contributions May Not Be Effective (Cont.)

- Requiring information reporting could result in reduced cash contributions
  - Taxpayers may reduce giving because they are reluctant to provide Social Security numbers to charities given concerns over identity theft
    - Social Security numbers are generally required on information returns and IRS uses Social Security numbers to match information returns to tax returns
    - Donors may perceive that charities will not adequately safeguard their Social Security numbers
    - Many charities rely on volunteers, to whom donors may not want to provide their Social Security numbers
    - An alternative means to uniquely identify donors, that is, for IRS to provide separate, unique numbers for this purpose, could alleviate donor concerns about identity theft but could be burdensome to implement

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Requiring Information Reporting for Charitable Cash Contributions May Not Be Effective (Cont.)

- With information reporting, taxpayers may reduce their contributions because of privacy concerns
  - Taxpayers may not want the federal government to know to which charities they donate
  - Privacy concerns may be particularly relevant for donations to religious organizations
- Information reporting could lead to a reduction in spontaneous giving (such as at a fund-raising event) or onetime gifts (such as a memorial gift) if taxpayers perceived information reporting to be too burdensome
- Information reporting could inhibit anonymous giving
  - Currently, anonymous donors can receive substantiation letters from recipient charities through representatives on the donors' behalf
  - It may not be possible for taxpayers to deduct anonymous donations if information reporting were required

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Requiring Information Reporting for Charitable Cash Contributions May Not Be Effective (Cont.)

- Other challenges to using information reporting with charitable cash contributions exist
  - Information reporting would have to account for contributions for which the taxpayer received a benefit (i.e., gross versus net contributions)
  - Information reporting would not be possible for taxpayers who deduct out-of-pocket expenses (such as car expenses directly related to giving services to a charitable organization), which are classified as cash donations for tax purposes, because of the lack of a third-party document for substantiation

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Concluding Observations

- Information reporting generally results in high levels of voluntary taxpayer compliance and provides IRS with an effective enforcement tool to address misreporting
- The costs and burden that information reporting for cash contributions could pose for charities could be mitigated to some extent by exempting some contributions from reporting
- However, exempting some cash contributions would likely limit improvements in voluntary compliance and the effectiveness of information reporting as an enforcement tool for IRS
- Also, both the extent to which misreporting is because of taxpayers’ lack of documentation and whether a more stringent recordkeeping requirement that went in effect for tax year 2007 has improved taxpayer recordkeeping are unclear
- The results of an ongoing NRP study could identify whether and to what extent reporting compliance improved following the new recordkeeping requirement

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