



IRS MAY USE MORTGAGE INTEREST DATA TO FIND NON-FILERS AND UNDER-REPORTERS



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Any time a mortgage is paid to a financial institution, it is required that the lender reports the interest expense to the IRS and taxpayer on Form 1098. In August of 2009 the Treasury Inspector General for Tax Administration (TIGTA) issued a report that recommends that the IRS use Form 1098 to expose taxpayers who erroneously do not file tax returns or whose reported interest expense is not in line with the amount of income they report. For instance, a tax return for a family of five may have \$30,000 of mortgage interest on Form 1098 but report income of only \$35,000. This would raise questions as to how the family pays for other living expenses such as food, clothing, cars, taxes and the like.

The IRS has used computer matching in the past to uncover unreported income items such as interest, dividends and capital gains. If the IRS accepts this recommendation they may attempt to find people who pay mortgage interest but do not file a tax return or who claim more interest and other expenses than their reported income.

Statistical samples of Form 1098 matching have already been analyzed by the IRS. According to the TIGTA report, they used “two statistically valid samples of 100 individuals with combined Forms 1098 totaling \$20,000 or more of mortgage interest...for 2005.” The results of the analyses of these samples are, with 95% confidence level:

- The number of potential non-filers will be between 28,500 and 63,729 with amounts owed ranging between \$350,000,000 and \$900,000,000 in collections.
- Projections for individuals who may be under-reporting income are between 67,501 and 114,195 with amounts owed ranging between \$550,000,000 and \$1,050,000,000 in collections.

The top-end forecasted range approaches nearly two billion dollars in taxes, penalties and interest that may be collected if this program goes through!

TIGTA emphasizes that “The role and benefits of third-party information reporting, such as Form 1098, are central to the success of our nation’s tax system.”

While the IRS has used Form 1098 to identify issues in the past, it now says it will likely expand this program nationwide. The IRS indicated that they are going to form a task force to determine if the Small Business/Self Employed Division can also use Form 1098 to uncover unreported income.

While each return chosen under this system would still need to be reviewed by the IRS to determine if there is a non-compliance or under-reporting issue, this is in line with a new wave of technology-driven tools the IRS can use to better assure that all proper taxes are being collected.

About the Author

Lynne Broza, CPA, ABV, CFF, Director, is an expert in the financial aspects of matrimonial litigation and the valuation of closely-held businesses. With nearly 30 years of experience in public accounting, Ms. Broza has been retained as an expert witness in litigation matters including divorce proceedings, personal injury claims, shareholder disputes, and estate and business valuations. She can be contacted at 732-741-2624 or lbroza@cowangunteski.com.