

PD-17 JT-904

1.2M-46180

AUDIT OF
AID'S COMPLIANCE WITH INTERNAL
REVENUE SERVICE REGULATIONS ON REPORTING
TAXABLE NONEMPLOYEE COMPENSATION


Audit Report No. 86-08

August 11, 1986

Office of the
Deputy Inspector General

August 11, 1986

MEMORANDUM FOR AA/M, R. T. Rollis, Jr.

FROM: D/IG, James B. Durnil 

SUBJECT: Audit Report No. 86-08
Audit of AID's Compliance with Internal Revenue
Service Regulations on Reporting Taxable
Nonemployee Compensation

This report presents the results of an audit of AID's compliance with Internal Revenue Service regulations on reporting taxable nonemployee compensation. The compliance audit was made to: (i) evaluate AID's compliance with IRS regulations on reporting taxable nonemployee compensation; (ii) determine if AID's written procedures, accounting records and contract documents facilitated accurate and expeditious reporting; and (iii) ascertain if AID program fund recipients reported to the IRS nonemployee compensation to third parties.

The audit showed that AID partially complied with the IRS reporting requirements. For tax years 1983 through 1985, AID filed 1,137 nonemployee compensation information returns totaling \$8.5 million. Although the Agency's level of compliance improved significantly during the above period, estimated unreported compensation totaled \$9.5 million for tax years 1984 and 1985. AID's written procedures did not provide clear and comprehensive guidelines defining and illustrating taxable nonemployee compensation. Contract documents utilized for identifying recipients of nonemployee compensation did not include information on the contractor's legal status for tax purposes to facilitate identifying such recipients. A review of AID program fund recipients showed that they reported to the IRS nonemployee compensation paid to third parties.

The report contains three recommendations to correct the above deficiencies. AID should: (i) strengthen its implementation procedures to ensure that all AID reporting units comply with Form 1099 reporting requirements; (ii) issue revised guidelines that define and illustrate nonemployee compensation; and (iii) provide the required information in the contract documents to enable AID reporting units to identify all recipients of nonemployee compensation.

The draft audit report was discussed with officials in the Office of Financial Management and the Office of Procurement. Their oral and written comments were taken into consideration in preparing this report. Management agreed to notify AID reporting units annually of the Form 1099 filing requirements. They stated that further clarifications from AID's General Counsel and the IRS would have to be obtained before revised guidelines could be issued. Management also agreed to include additional information in the contract documents in order to facilitate the task of identifying recipients of nonemployee compensation. We believe that the proposed actions, when implemented, should considerably improve AID's compliance with IRS regulations on reporting nonemployee compensation. I appreciate the courtesies and cooperation extended to my staff during the audit.

Please advise this office within 30 days of the actions taken or planned to clear the recommendations.

AUDIT OF
AID'S COMPLIANCE WITH INTERNAL
REVENUE SERVICE REGULATIONS ON REPORTING
TAXABLE NONEMPLOYEE COMPENSATION

TABLE OF CONTENTS

PART I -	INTRODUCTION	<u>Page</u> 1
	A. Background	1
	B. Objectives and Scope	2
PART II -	RESULTS OF AUDIT	3
	A. Findings and Recommendations	4
	1. AID Needs to Improve Compliance on Filing Form 1099 Information Returns	4
	2. Improved Guidelines Are Needed to Facilitate Complete and Accurate Reporting of Nonemployee Compensation	6
	3. Contract Documents Could Enhance Compliance with Form 1099 Reporting If Modified	8
	B. Compliance and Internal Controls	10
	1. Compliance	10
	2. Internal Controls	10
	C. Other Pertinent Matters	10
PART III -	EXHIBITS AND APPENDICES	
	EXHIBITS	
	1. Summary of Form 1099 Filings by Forty-five AID Reporting Units for Tax Years 1983, 1984 and 1985	
	2. Estimated Unreported Nonemployee Compensation for Tax Years 1984 and 1985	
	APPENDICES	
	1. Management Comments by the Office of Financial Management	
	2. Management Comments by the Office of Procurement	
	3. Report Distribution	

EXECUTIVE SUMMARY

In October 1985, the President's Council on Integrity and Efficiency initiated a government-wide audit of Federal agencies' compliance with Section 6041 of the Internal Revenue Code. The Code requires Federal agencies to report to the Internal Revenue Service on Form 1099 information returns nonemployee compensation of \$600 or more paid to individuals, partnerships and medical corporations. Prior studies had shown a general noncompliance by Federal agencies with these reporting requirements. This audit was made to determine AID's compliance as part of a government-wide review. AID's nonemployee compensation was comprised of consultant and professional fees for services performed in the United States and overseas. Responsibility for reporting was dispersed among 49 AID offices worldwide.

The compliance audit was made to: (i) evaluate AID's compliance with Internal Revenue Service regulations on reporting taxable nonemployee compensation on Form 1099; (ii) determine if AID's written procedures, accounting records and contract documents facilitated accurate and expeditious reporting; and (iii) ascertain whether AID program fund recipients reported to the Internal Revenue Service nonemployee compensation to third parties.

The audit showed that AID partially reported nonemployee compensation on Form 1099 to the Internal Revenue Service. For tax years 1983 through 1985, approximately \$8.5 million was reported by AID (Exhibit 1). Although the agency's level of compliance improved significantly during the above period, estimated unreported nonemployee compensation totaled \$9.5 million for tax years 1984 and 1985 (Exhibit 2). AID, therefore needs to strengthen its implementation procedures to ensure full compliance with the reporting requirements. Management stated that they will establish procedures whereby AID reporting units will be advised annually of Form 1099 filing requirements.

AID's written procedures did not define and illustrate nonemployee compensation reportable on Form 1099. AID should issue revised guidelines that define and illustrate such payments. Management stated that they will have to seek clarification from AID's General Counsel as well as the Internal Revenue Service in order to issue revised guidelines.

Contract documents utilized for preparing Form 1099 did not indicate the contractors' legal status for tax purposes, which is essential to identify recipients of nonemployee compensation. AID should modify these documents so that the necessary

information is readily available. Management stated that they will issue written instructions requiring additional information on the contract documents that will facilitate identifying recipients of nonemployee compensation.

A review of AID program fund recipients showed that they reported to the Internal Revenue Service on nonemployee compensation paid to third parties.

Office of the Inspector General

AUDIT OF
AID'S COMPLIANCE WITH INTERNAL
REVENUE SERVICE REGULATIONS ON REPORTING
TAXABLE NONEMPLOYEE COMPENSATION

PART I - INTRODUCTION

A. Background

Government departments as well as private enterprises are required to report taxable nonemployee compensation to the Internal Revenue Service (IRS) on Form 1099 information return. Examples of such payments are consultant and professional fees, rent, service payments, commissions and interest. Form 1099 is to be filed for payments totaling \$600 or more to individuals, partnerships and medical corporations. Payments to other types of corporations are exempt from reporting.

IRS studies disclosed that unreported income caused by nonsubmission of Form 1099 resulted in significant losses of tax revenues to the Government. For example, in 1981, unreported nonemployee compensation was estimated by the IRS to total \$29.8 billion. Since October 1980, the Office of Management and Budget and the IRS have expressed their concerns to government agencies on not fully complying with the reporting requirements. Also, General Accounting Office (GAO) studies and congressional testimony have shown general noncompliance by federal government agencies with the information return reporting requirements.

On October 21, 1985, the President's Council on Integrity and Efficiency (PCIE) initiated a government-wide audit of Federal agencies' compliance with Form 1099 reporting requirements. The audit was initiated as a result of a proposal submitted by the Department of the Treasury to the PCIE in August, 1985.

Section 6041 of the Internal Revenue Code states the regulations for reporting nonemployee compensation and is supplemented by instructions issued annually by the IRS. The regulations were designed to enable the IRS to identify nonemployee compensation for which no taxes are withheld at the source. AID guidelines on reporting such payments are stated in the USAID Mission Controllers Guidebook and the Internal Procedures Manual, issued by the Office of Financial Management.

AID's nonemployee compensation is comprised of consultant and professional fees for services performed in the United States and overseas. AID has 49 reporting units, 2 in Washington, D.C., and 47 overseas, which have responsibility for reporting such payments to the IRS. The reporting information should be

obtained from AID's accounting records and contract documents. For tax years 1983 through 1985, AID reported approximately \$8.5 million of nonemployee compensation to the IRS (Exhibit 1).

B. Objectives and Scope

The compliance audit was made to

- evaluate AID's compliance with IRS regulations on reporting taxable nonemployee compensation on Form 1099;
- determine if AID's written procedures, accounting records and contract documents facilitated accurate and expeditious reporting; and
- ascertain if AID program fund recipients reported to the IRS nonemployee compensation to third parties.

The detailed review was conducted in Washington, D.C., from February 1 through April 30, 1986, and covered Form 1099 information returns reported by AID to the IRS for tax years 1983 through 1985. Our work included: (i) analyzing responses to a questionnaire cabled to 47 AID reporting units located overseas; (ii) reviewing Form 1099 filings by the two reporting units in Washington D.C.; (iii) inspection of AID accounting records and contract documents in Washington, D.C.; (iv) visiting the offices of four AID program fund recipients to review their reporting to the IRS on nonemployee compensation to third parties; and (v) interviewing officials in AID's Office of Financial Management and Office of Procurement, as well as IRS officials. The audit was made in accordance with generally accepted government auditing standards.

Our findings and recommendations were discussed with AID officials and a draft audit report was submitted for their review. Comments provided by AID officials were considered in preparing this report. A full text of their comments is presented in Appendices I and II.

AUDIT OF
AID'S COMPLIANCE WITH INTERNAL
REVENUE SERVICE REGULATIONS ON REPORTING
TAXABLE NONEMPLOYEE COMPENSATION

PART II - RESULTS OF AUDIT

AID has partially complied with Internal Revenue Service (IRS) regulations to report taxable nonemployee compensation on Form 1099. A review of 45 of the 49 AID reporting units showed that between 33 to 47 percent complied with the reporting requirements for tax years 1983 through 1985. Nonemployee compensation reported to the IRS by these units totaled \$8.5 million for the above period (Exhibit 1). Based on an analysis of the information provided by the 45 reporting units, AID's unreported nonemployee compensation is estimated to be \$9.5 million for tax years 1984 and 1985 (Exhibit 2).

AID's written procedures for reporting nonemployee compensation were not fully effective because the instructions did not define and illustrate the elements that constitute such compensation. Contract documents utilized for preparing Form 1099 did not include information on the contractor's legal status for tax purposes, which is essential to identify recipients of nonemployee compensation. Consequently, AID reporting units experienced problems in identifying all recipients, particularly partnerships and medical corporations.

AID programs have a high potential for generating third party nonemployee compensation because several recipients of AID program funds hire consultants to perform subcontract work. A review of four program fund recipients showed that they reported such payments to the IRS.

AID therefore needs to: (i) strengthen its implementation procedures to ensure that all AID reporting units comply with Form 1099 reporting requirements; (ii) issue revised guidelines that define and illustrate nonemployee compensation; and (iii) provide the required information in the contract documents to enable AID reporting units to identify all recipients of nonemployee compensation.

A. Findings and Recommendations

1. AID Needs to Improve Compliance on Filing Form 1099 Information Returns

The Internal Revenue Service (IRS) regulations and AID internal procedures required AID financial offices to report nonemployee compensation to the IRS on Form 1099 information returns. AID partially complied with this requirement. For tax years 1983 through 1985, AID reported \$8.5 million of such payments to the IRS. During this period, AID's level of compliance with the reporting requirements improved from 33 to 47 percent. Reasons for not fully complying were attributable to: management oversight, not being aware of the IRS regulations, and lack of response from the IRS to AID overseas offices' requests for tax forms. Estimated nonemployee compensation not reported by AID on Form 1099 was \$9.5 million for tax years 1984 and 1985.

Recommendation No. 1

We recommend that the AID Office of Financial Management establish procedures whereby AID reporting units are reminded annually of the requirement to report nonemployee compensation to the Internal Revenue Service on Form 1099.

Discussion

AID is required under Section 6041 of the IRS regulations to report on Form 1099 information returns taxable nonemployee compensation of \$600 or more paid to individuals, partnerships, and medical corporations. Each return should show the payee's tax identification number (TIN). In case a TIN is not submitted by the recipient, AID is required to withhold 20 percent of the payment reported to the IRS. To assist in complying with IRS regulations, AID had issued to its financial management personnel written guidelines on the filing requirements.

To evaluate AID's compliance with the filing requirements, a questionnaire was cabled to 47 AID overseas reporting units requesting Form 1099 data and related information for tax years 1983 through 1985. Forty-three units responded to the questionnaire. The same information was obtained from the two reporting units in Washington, D.C.

An analysis of the information provided by the 45 reporting units showed that AID reported \$8.5 million in nonemployee compensation to the IRS for tax years 1983 through 1985 (Exhibit 1). During this period, the rate of compliance improved from 33 to 47 percent of the 45 reporting units. Of those that complied, several reporting units stated that they had no taxable nonemployee compensation and were, therefore, not required to report to the IRS. One unit did not submit the requested information and the remaining did not file Form 1099. Based on

the above filing data, estimated taxable nonemployee compensation not reported by AID to the IRS totaled \$9.5 million for tax years 1984 and 1985 (Exhibit 2).

Of the 29 reporting units that did not file Form 1099 in tax year 1984, 10 were either not aware of the filing requirements or did not follow AID's written instructions, two were unable to file because the IRS did not respond to their requests for Form 1099; and 17 did not provide an adequate response. Of the last group, 14 stated that they reported to the IRS on Form W-2 (Wage and Tax Statement). That form is for reporting employee wages for which taxes are withheld at source. It is not the proper form for reporting nonemployee compensation.

Had all reporting units fully complied with the filing requirements, the amount of nonemployee compensation reported by AID to the IRS would have been substantially higher than what was actually reported. Therefore, AID needs to strengthen its implementation procedures to ensure full compliance.

The two reporting units in Washington, D.C., filed 745 Form 1099 returns totaling \$4.9 million for tax years 1983 through 1985. Of these, 77 totaling \$428,860 did not include the recipients' tax identification numbers. These two units had not withheld 20 percent of the payments, or \$85,800, as required by IRS filing instructions. AID officials attributed the omission to an oversight.

Management Comments

Officials in AID's Office of Financial Management felt that Recommendation No. 1 was not necessary. Nevertheless, they agreed to establish a system whereby AID reporting units will be advised annually of Form 1099 filing requirements.

Office of Inspector General Comments

We believe that the above recommendation is necessary because several AID reporting units were either not aware of Form 1099 filing requirements or did not follow AID's written instructions set forth in the USAID Controller's Guidebook (Exhibit 1). Actions proposed by the Office of Financial Management, when implemented, should considerably improve AID's reporting of nonemployee compensation to the IRS.

2. Improved Guidelines Are Needed to Facilitate Complete and Accurate Reporting of Nonemployee Compensation

AID's instructions should clearly explain the Internal Revenue Service (IRS) regulations for reporting nonemployee compensation, describe reporting conditions, and provide guidance on how to comply with the regulations. However, AID officials experienced problems in identifying payments subject to Form 1099 reporting because AID's instructions did not define and illustrate the elements of nonemployee compensation. Therefore, inadequate guidelines contributed to AID's noncompliance with the IRS regulations.

Recommendation No. 2

We recommend that the Office of Financial Management revise its instructions on Form 1099 reporting by defining and illustrating the elements of nonemployee compensation such as: housing, travel, educational allowances and service payments.

Discussion

AID's instructions for reporting nonemployee compensation to the IRS are included in Chapter 5 of the USAID Mission Controllers Guidebook and Chapter 4 of the AID/Washington Internal Procedures Manual, issued by the Office of Financial Management. These provide a general summary of the IRS regulations and instructions for completing and filing Form 1099 information returns.

Officials in 17 of the 45 AID reporting units stated that the above guidelines were either inadequate or could be improved. A review of the guidelines showed that clarification and definition of nonemployee compensation within the specific context of AID's operations were not provided. For example, three reporting units stated that they were not certain whether payments such as travel, housing allowances, and educational allowances should be reported on Form 1099. Moreover, the AID instructions did not highlight a 20 percent tax withholding requirement on payments to recipients who had not provided AID their tax identification numbers.

AID officials responsible for issuing and updating the instructions stated that they were not told of the above deficiencies by the AID reporting units and were, therefore, unaware of the need to issue more comprehensive instructions to meet the requirements of the end users. Inadequate internal guidelines on reporting nonemployee compensation contributed to AID's noncompliance with IRS regulations.

Management Comments

AID officials in the Office of Financial Management stated that the IRS instructions on Form 1099 reporting were not clear and clarifications from AID's General Counsel as well as the IRS would have to be obtained before AID could issue more clear and comprehensive instructions on Form 1099 reporting. The Office of Financial Management has no tax or legal experts on its staff who could interpret the law.

Office of Inspector General Comments

We concur that IRS guidelines do not provide clear and definitive instructions on what constitutes nonemployee compensation. However, AID has the responsibility to report such payments to the IRS. Therefore, AID should seek written clarification and interpretation from the IRS on Form 1099 reporting requirements so that clear and comprehensive internal guidelines can be issued to AID reporting units on Form 1099 reporting.

3. Contract Documents Could Enhance AID Compliance with Form 1099 Reporting If Modified

Contract documents utilized for preparing Form 1099 should provide the required information to facilitate accurate and complete reporting. AID officials responsible for Form 1099 reporting experienced difficulties in identifying and reporting nonemployee compensation, particularly for partnerships and medical corporations, because the recipient's legal status for tax purposes was not included in the contract documents. This information gap contributed to AID's noncompliance with the reporting requirements. Only two of the 45 AID reporting units complied fully with IRS regulations by reporting nonemployee compensation to partnerships and medical corporations.

Recommendation No. 3

We recommend that the Office of Procurement coordinate with the Office of Financial Management to: (i) either modify contract documents forwarded to AID reporting units or provide an alternative notation so that information on the contractors' legal status for tax purposes can be readily identified; and (ii) advise all AID reporting units that the additional information in the contract documents be utilized for Form 1099 reporting to the IRS.

Discussion

Information for preparing Form 1099 is obtained by the AID reporting units from their accounting records and contract documents which are forwarded to them by the AID contracting offices located either in the United States or overseas. Information needed to complete the Form includes: amount of nonemployee compensation paid in the tax year, the recipient's tax identification number and tax status, that is, whether the recipient is an individual, a partnership or a medical corporation. While the amount of compensation could be readily obtained from the accounting records, contract documents forwarded to the AID reporting units did not normally include information on the tax status of the recipients and sometimes did not provide the tax identification numbers.

According to officials in the Office of Procurement, information on the contractors' legal status for tax purposes is obtained by contracting officials in negotiating a contract and is recorded in the contract negotiation files. However, purchase orders and unsolicited proposals are processed by utilizing standard forms as prescribed by the Federal Acquisition Regulations. These forms do not require the user to specify whether the contractor is an individual, partnership or a medical corporation. In order

to include the additional information, a government-wide revision of the standard forms would have to be initiated. AID cannot take unilateral action to bring about this change.

Officials in the two AID reporting units in Washington stated that, because of the information gap in the contract documents that are forwarded to the reporting units, identifying and reporting nonemployee compensation paid to recipients, particularly partnerships and medical corporations, was difficult as well as time consuming. Only two of the 45 AID reporting units stated that they reported such payments to the IRS.

According to officials in the AID Office of Financial Management in Washington, the number of partnerships and medical corporations who received nonemployee compensation were insignificant. However, in order to ensure full compliance with the reporting requirements, AID contracting officers should record the contractors' tax status on the final contract documents that are forwarded to the AID reporting units.

Management Comments

The Office of Procurement will issue a Contract Information Bulletin requiring that all contract documents contain a contract identification number (DUNS) and, in case the contractor is an individual, his social security number. In addition, contracting officers will be required to annotate the cover sheet of each contract document if the contractor is a partnership. Office of Procurement officials stated that the number of medical corporations doing business with AID is very small and suggested that the AID Office of Financial Management assume the responsibility of identifying such entities.

Office of the Inspector General Comments

The proposed actions, when implemented, should considerably facilitate the task of AID reporting units in identifying recipients of nonemployee compensation. However, in order to ensure full compliance with Form 1099 reporting requirements, the Office of Procurement should coordinate with the Office of Financial Management to identify medical corporations in addition to individuals and partnerships.

B. Compliance and Internal Controls

1. Compliance

As described on pages 4 and 5, AID's level of compliance with IRS regulations on reporting nonemployee compensation ranged from 33 to 47 percent of the 45 reporting units. The Agency, therefore, needs to strengthen its implementation procedures so that all AID reporting units comply with the IRS regulations. Otherwise, nothing came to our attention which would indicate that AID was not in compliance with applicable rules and regulations.

A review of AID program fund recipients showed that they reported on Form 1099 to the IRS nonemployee compensation paid to third parties.

2. Internal Controls

AID's written procedures did not provide clear and comprehensive instructions to Agency officials responsible for IRS reporting (pages 6 and 7). Contract documents utilized for preparing Form 1099 did not provide the information on contractor's legal status for tax purposes, which is required to identify recipients of nonemployee compensation (pages 8 and 9). These deficiencies in internal controls prevented AID from identifying and reporting all taxable nonemployee compensation to the IRS.

C. Other Pertinent Matters

Forty-seven of the 49 AID reporting units are located overseas. Nonemployee compensation paid by the overseas units was comprised of fees for services performed by U.S. contractors at those locations. Contracts for overseas work usually provided for allowances such as: housing, transportation, children's education and utilities. IRS Form 1099 reporting regulations did not provide clear and definitive instructions whether these allowances were taxable income. Consequently, AID officials at the overseas reporting units were not certain whether to report these payments on Form 1099. Also, seven AID overseas units stated that the IRS did not send the required tax forms (Form 1099) despite several requests. Lack of clarity in the tax regulations and IRS failure to respond to requests for supply of tax forms prevented some AID overseas reporting units from complying with the reporting requirements. When AID improves its internal procedures, these matters should be resolved.

AUDIT OF
AID'S COMPLIANCE WITH INTERNAL
REVENUE SERVICE REGULATIONS ON REPORTING
TAXABLE NONEMPLOYEE COMPENSATION

PART III - EXHIBITS AND APPENDICES

EXHIBIT 1

SUMMARY OF FORM 1099 FILINGS BY FORTY-FIVE AID REPORTING UNITS
FOR TAX YEARS 1983, 1984 and 1985

	<u>1983</u>		<u>1984</u>		<u>1985</u>	
	<u>No. of Reporting Units</u>	<u>%</u>	<u>No. of Reporting Units</u>	<u>%</u>	<u>No. of Reporting Units</u>	<u>%</u>
<u>Filed Form 1099 Returns</u>	10	22%	12	27%	18	40%
<u>Did Not File Form 1099:</u>						
Inadequate Response	17	38%	17	38%	13	29%
Management oversight	8	18%	8	18%	7	16%
Not aware of filing requirements	3	7%	2	4%	1	2%
Unable to obtain tax forms from the IRS	1	2%	2	4%	2	4%
<u>No Reportable Payments</u>	5	11%	3	7%	3	7%
<u>No Information Submitted</u>	<u>1</u>	<u>2%</u>	<u>1</u>	<u>2%</u>	<u>1</u>	<u>2%</u>
TOTAL	<u>45</u>	<u>100%</u>	<u>45</u>	<u>100%</u>	<u>45</u>	<u>100%</u>

<u>Tax Year</u>	<u>No. of Form 1099's Filed</u>	<u>Nonemployee Compensation Reported</u>
1983	235	\$1,625,135
1984	356	2,598,576
1985	<u>546</u>	<u>4,301,147</u>
TOTAL	<u>1,137</u>	<u>\$8,524,858</u>

EXHIBIT 2

ESTIMATED UNREPORTED NONEMPLOYEE COMPENSATION
FOR TAX YEARS 1984 AND 1985

<u>Tax Year</u>	<u>A</u> <u>Compensation</u> <u>Reported</u>	<u>B</u> <u>Rate of</u> <u>Compliance</u>	<u>C</u> <u>Rate of Non-</u> <u>compliance</u>	<u>D</u> <u>Estimated</u> <u>Total</u> <u>Compensation</u> <u>(A ÷ B)</u>	<u>E</u> <u>Estimated</u> <u>Unreported</u> <u>Compensation</u> <u>(C x D)</u>
1984	\$2,598,576	34%	64%	\$7,642,870	\$4,891,437
1985	4,301,147	47%	51%	9,151,376	<u>4,667,202</u>
		.			<u>\$9,558,639</u>

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20548

MEMORANDUM

DATE: July 28, 1986

TO: RIG/A/W, Mervin F. Sover, Jr.

FROM: FM/DC, Bruce K. Birnberg

SUBJECT: Draft Audit Report: AID's Compliance with the Internal Revenue Service Regulations on Reporting Taxable Nonemployee Compensation

REFERENCE: Copy of Subject Transmitted Under Cover Memorandum Dated July 14, 1986

We have reviewed the referenced draft audit report and find that while some of the changes we suggested during our meeting with your staff on June 10 were included, others were not.

The estimated figure of \$11.6 million for nonemployee compensation not reported by AID to the Internal Revenue Service is still a concern. We are unable to determine how this figure was derived. It shows up five different times in the Draft Report and once in the Executive Summary. Once, on page four, it isn't preceded by the word "estimated". I understand that your staff has further reviewed this calculation and downward adjusted it to \$9.5 million. If your calculations could be included in the Exhibit at the end of the report, it would help clarify the presentation.

Recommendation No. 1

"We recommend that the AID Office of Financial Management establish procedures whereby AID reporting units are reminded annually of the Form 1099 filing requirements."

While we don't feel this should be necessary, M/FM/ASD will establish a system whereby we annually advise them of the requirements set forth in the FM Controller's Guidebook.

Recommendation No. 2

"We recommend that the Office of Financial Management revise its instructions on Form 1099 reporting by: (i) defining and illustrating the elements of nonemployee compensation such as: housing, travel, educational allowances and service payments; and (ii) describing how to identify the payments subject to Form 1099 reporting."

Responding to the first part of this Recommendation will be difficult at best. We used the information provided to us by the I R S. That their directive isn't clear is unfortunate, but shouldn't really be a surprise. M/FM has no tax or legal experts on its staff who could interpret the law. We will contact both the I R S and the GC to gain additional clarification, but are concerned that the Recommendation, as written, will hold us accountable until such time as we can provide clear, understandable and accurate definitions. I am not sure that this will ever be possible!

- 2 -

As for the second part of the Recommendation, M/FM can not fulfill these requirements at this time, but should be able to once the Office of Procurement completes Recommendation No. 3. Therefore, I propose that this part of Recommendation No. 2 be moved and No. 3 be revised to read as follows:

We recommend that the Office of Procurement coordinate with the Office of financial Management to either modify contract documents forwarded to the AID reporting units or provide an alternative notation so that information on the contractors' legal status for tax purposes can be readily identified and that all reporting units be advised of the action taken.

This would place the recommendation where it best fits chronologically.

If you have any questions concerning the above please call me on 632-0162

cc: M/FM/C, Curtis Christensen
M/SER/OP, Robert Halligan
AA/M, Ain H. Kevimae
IG/PPO, E. John Eckman
RIG/A/W, Dev Sen
M/FM/SSD, George Smith
M/FM/PAFD, E. S. Owens

1986 JUL 30 12:12

MEMORANDUM

JUL 30 1986

TO: RIG/A/W, Mr. Mervin F. Boyer, Jr.
FROM: M/SER/OP, Robert Halligan *RH*
SUBJECT: Draft Audit Report: AID's Compliance
with the Internal Revenue Service
Regulations on Reporting Taxable
Nonemployee Compensation

We have reviewed the draft audit report including Recommendation No. 3 which is directed to the Office of Procurement. We agree that the most direct method of collecting the needed information on the contractor's legal status for tax purposes would be to modify the standard contracting forms being used. As you recognize on page 7 of the draft report, AID cannot take unilateral action to bring about this change since the forms are standard forms prescribed for use government-wide. It is suggested that your office, in responding to the request from the President's Council on Integrity and Efficiency (PCIE), recommend that they initiate the appropriate changes to the standard forms.

Pending a future change to the standard forms this office proposes the following actions. As discussed with your auditors, SER/OP has previously agreed with the Office of Financial Management (M/FM) to prepare a Contract Information Bulletin which will emphasize the requirement that all contract and grant documents contain a DUNS number and that all PSC's and contracts/purchase orders with individuals must also contain the Social Security number. This should identify most of the individuals to whom the IRS requirement applies. In the case of partnerships we propose to expand the provisions of the CIB to include a requirement that contracting offices annotate the cover sheet of each obligating document when a partnership is involved.

It is our understanding from your auditors that very few medical corporations are doing business with AID. In light of the small numbers and the esoteric definition of

-2-

firms in this category we will propose that M/FM assume the responsibility of identifying the qualifying firms and providing this information to the AID reporting units.

cc: SER/OP, R. Dangler
AAA/SER, K. Burke
M/FM, C. Christensen

Report Distribution

Assistant Administrator, Bureau for Management, AA/M	5
Office of Procurement, M/SER/OP	5
Office of Financial Management, M/FM/ASD	5
Audit Liaison Office, M/SER/AAM	1
Office of Procurement, Policy, Planning and Evaluation, M/SER/PPE	2
Director, Office of Legislative Affairs, LEG	1
Assistant Administrator Bureau for External Affairs, AA/XA	2
Office of Press Relations, XA/PR	1
Office of the General Counsel, GC	1
Center for Development Information and Evaluation, PPC/CDIE	3
Office of the Inspector General, IG	1
RIG/A/Cairo	1
RIG/A/Dakar	1
RIG/A/Manila	1
RIG/A/Nairobi	1
RIG/A/Tegucigalpa	1
RIG/A/Singapore	1
D/IG	1
IG/PPO	2
IG/LC	1
IG/EMS/C&R	16
IG/II	1