The Internal Revenue Service Needs a Coordinated National Strategy to Better Address an Estimated $30 Billion Tax Gap Due to Non-filers

November 2005

Reference Number: 2006-30-006

Phone Number | 202-927-7037
Email Address | Bonnie.Heald@tigta.treas.gov
Web Site | http://www.tigta.gov

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

November 22, 2005

MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Internal Revenue Service Needs a Coordinated National Strategy to Better Address an Estimated $30 Billion Tax Gap Due to Non-filers (Audit # 200530011)

This report presents the results of our review of the Internal Revenue Service's (IRS) implementation of initiatives under the Non-filer Strategy for current and past fiscal years.

Synopsis

According to a study released by the IRS in March 2005,[1] individual, estate, and gift tax non-filers accounted for about 10 percent of the total tax gap[2] for Tax Year (TY) 2001. The IRS study, together with previous IRS studies, indicates the tax gap for individual non-filers tripled from $9.8 billion in TY 1985 to over $30 billion[3] in TY 2001.

In the past, the IRS had several strategies for reducing the tax gap attributable to individual non-filers. The most recent National Non-filer Strategy, which was developed for Fiscal Years (FY) 2001 through 2003, was made obsolete in July 2002 when the IRS was reorganized. Since then, each IRS business division has been responsible for tracking and monitoring

---

[1] The IRS National Headquarters Office of Research released results of a study in March 2005 providing tax gap estimates for Tax Year (TY) 2001. The non-filer population data were from TY 1988.
[2] The non-filer tax gap is the dollar amount of taxes not paid timely on delinquent and non-filed returns.
[3] The estimated tax gap of $30 billion in TY 2001 was comprised of $28 billion for individual income tax non-filing and $2 billion associated with estate and gift tax. The estimate is developed from other tax gap data sources and is not derived from direct data sources. So, the growth in the dollar amounts in the estimate track the increases in other tax gap estimates.

completion of its own action items. Consequently, there has been no formal system in place for coordinating and tracking all actions across all IRS divisions.

As increasing voluntary compliance remains a Service-wide effort, the individual business divisions within the IRS have taken steps to improve efficiency in working non-filer cases. The actions taken by business divisions include:

- Consolidation of the Automated Substitute for Return Program[4] into one campus.[5]
- Computer programming changes to enhance automated processing of returns created by the IRS for non-filing businesses, as authorized under Section 6020(b) of the Internal Revenue Code.[6]
- Refinement of the processes for selection and modeling of non-filer cases each year through risk-based compliance approaches. The intention is to identify and select the most productive non-filer work and to apply appropriate compliance treatments to high-priority cases.
- Increased outreach efforts by the Small Business/Self-Employed (SB/SE) Division through its Taxpayer Education and Communication function.
- Increase in the number of cases recommended for prosecution by the Criminal Investigation Division from 269 in FY 2001 to 317 in FY 2004 (an increase of 17.8 percent).

However, these are not coordinated activities that have been planned and controlled within the framework of a comprehensive strategy. Since FY 2001, each business division has independently directed its own non-filer activities. Currently, the IRS does not have a comprehensive, national non-filer strategy or an executive who is charged with overseeing each business division's non-filer efforts. The IRS needs better coordination among its business divisions to ensure resources are being effectively used to bring non-filers into the tax system and ensure future compliance. The Executive Steering Committee that was previously established to monitor and coordinate activities among the business divisions last met in August 2002; coordinated meetings involving all business divisions were not conducted between September 2004 and April 2005.

---

[4] The Automated Substitute for Return Program focuses on high-income taxpayers who have not filed individual income tax returns but appear to owe significant income tax liabilities based on available Information Reporting Program information.
[5] The campuses are the data processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
[6] Internal Revenue Code Section 6020(b) (2005) provides the IRS with the authority to prepare and process certain returns for a non-filing business taxpayer if the taxpayer appears to be liable for the return, the person required to file the return does not file it, and attempts to secure the return have failed.

The IRS also needs an organization-wide tracking system to monitor the progress of each business division's actions. The IRS does not have a formal system in place for monitoring progress or changes to each business division's non-filer plans (e.g., a decision to eliminate or discontinue an action item).

In addition to better coordination and an organization-wide tracking system, the IRS also needs measurable program goals. For example, three measurable goals that could be established are:

- The number of returns secured from non-filers.
- Total payments received.
- The recidivism (repeater) rate.

Without such measurable program goals, management is unable to determine whether efforts to improve program efficiency and effectiveness are achieving desired results.

Finally, according to the National Taxpayer Advocate,[7] the IRS needs to know whether its current outreach and education activities are maximizing voluntary compliance and minimizing the tax gap. The IRS needs to have information to support whether the outreach and education programs are effective in bringing non-filers into compliance and reducing the recidivism rate.

Recommendations

We recommended the IRS Commissioner establish a Non-filer Program Office with a position for a Non-filer Executive or a permanent multidivisional group with responsibilities for developing strategy, implementing management control systems, and providing accountability for all the IRS non-filer efforts.

The Deputy Commissioner for Services and Enforcement should ensure each business division develops measurable program goals to determine the success of its non-filer efforts and creates a decision support system for aggregating data concerning the effectiveness of non-filer programs to improve the voluntary compliance levels of non-filers. Consideration should be given to the development of an organization-wide tracking system to monitor the progress of each business division's non-filer strategy action items. Additionally, a schedule for future meetings for the Non-filer Summit group needs to be established to address non-filers.

The Director, Communications, Liaison, and Disclosure (CLD), SB/SE Division, should ensure research is conducted on the indirect effect of outreach and education activities on voluntary compliance to determine whether education and outreach are effective tools to combat non-filing. Finally, a study should be considered to devise an effective outreach and education strategy.

[7] IRS National Taxpayer Advocate's testimony to Congress on April 14, 2005.

Response

IRS management agreed with the recommendations presented. IRS management has established a multidivisional executive group, the Collection Governance Council (CGC), whose responsibilities include developing initiatives, implementing management control systems, and providing accountability for all IRS non-filer efforts. The Council is meeting regularly to provide oversight for non-filer initiatives and to discuss emerging non-filer issues. A Non-filer subteam, which consists of representatives from each division and reports to the CGC, has been formed to ensure planned actions are accomplished. The subteam is also meeting on a regular basis.

For FY 2006, the IRS developed its first comprehensive non-filer work plan. The CGC will partner with the SB/SE Division Office of Research to identify sources and types of data, gather the data and standardize the metrics, and develop a methodology for decision making. A cross-functional action plan has been developed that includes the responsible individuals and status of completion. Actions are being completed, with results and activity monitored by the Non-filer subteam and the CGC. The CGC will evaluate the effectiveness of the current monitoring system and make changes as necessary to ensure adequate oversight and control.

The CLD function will partner with the SB/SE Division Office of Research to analyze and summarize existing research on the effect of outreach and education activities on voluntary compliance. Based upon study findings, the CLD function will develop appropriate outreach and education strategies. Management’s complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Curtis Hagan, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

Table of Contents

Background

Section (§) 6012 of the Internal Revenue Code (I.R.C.)[1] requires individuals, businesses, and other taxable entities with income over certain threshold amounts to file income tax returns. Most individuals and businesses comply with this requirement. However, an estimated 7.4 million individual taxpayers did not voluntarily file a tax return in Tax Year (TY) 2003.[2]

The timely filing of required tax returns is critical to the United States (U.S.) system of voluntary compliance.

Individual non-filers are defined as individuals who are legally required to file and for whom returns have not been filed by the due date of the return or extended due date. For businesses, non-filers are defined as entities that have a filing requirement and for which returns have not been received by the due dates of the returns, or extended due dates, and are usually 90 days past due.

The Internal Revenue Service (IRS) considers non-filing to be an egregious problem because it can cause compliant taxpayers to lose faith in the fairness of the tax system. When taxpayers pay their taxes, they want to be confident that their neighbors and competitors are doing the same. One of the goals in the IRS Strategic Plan for 2005 through 2009 is to discourage and deter noncompliance with emphasis on corrosive activity by corporations, high-income individual taxpayers, and other contributors to the tax gap.

The IRS identifies individual non-filers by using historical filing information and third-party data. For example, the IRS requires employers, financial institutions, and other business entities to submit income and various other types of tax-related information to the IRS. These third-party data are then matched with filed returns. Non-filers are identified when third-party data for a tax year cannot be matched with a return for that tax year.

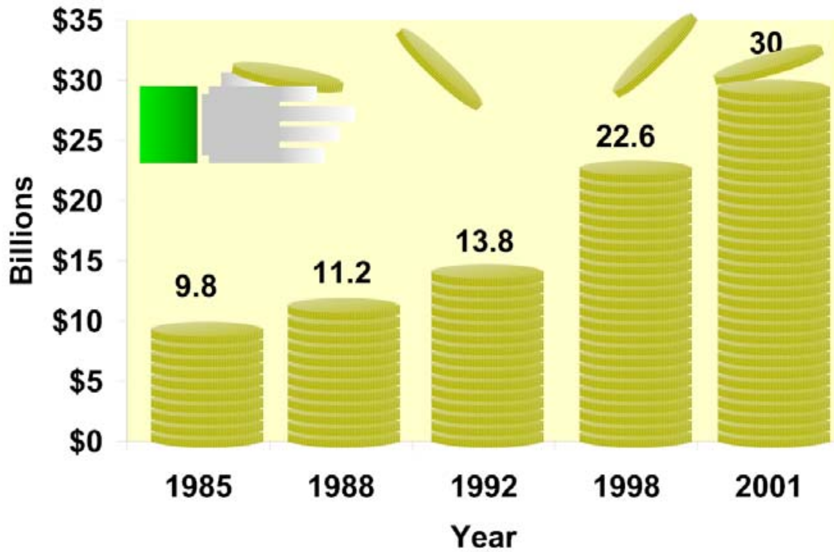
In March 2005, the IRS reported[3] that individual non-filers accounted for an estimated $30 billion[4] of the total tax gap[5] for Fiscal Year (FY) 2001. This report, together with previous

[1] I.R.C. § 6012 (2004).
[2] An Internal Revenue Service (IRS)-sponsored study in 1999 estimated that the IRS could identify about 57 percent of individual non-filers but concluded that these taxpayers would provide the preponderance of collectible income tax.
[3] This study, conducted by the IRS National Headquarters Office of Research, Analysis, and Statistics and released in March 2005, provided numbers estimated for TY 2001. The non-filer population data were from TY 1988. The estimate is developed from other tax gap data sources and is not derived from direct data sources. So, the growth in the dollar amounts in the estimate track the increases in other tax gap estimates.
[4] The estimated individual non-filer tax gap of $30 billion in TY 2001 was comprised of $28 billion for individual income tax non-filing and $2 billion associated with estate and gift taxes.
[5] The non-filer tax gap is the dollar amount of taxes not paid timely on delinquent and non-filed returns.

IRS studies, indicates the tax gap for individual non-filers tripled from $9.8 billion in TY 1985 to over $30 billion in TY 2001.

The rate of growth accelerated from TYs 1998 to 2001 as the individual non-filer tax gap grew from $22.6 billion to $30 billion, an increase of 33 percent over 3 years. These estimates are based on other tax gap estimates and track along with the growth in those areas. The estimates are not the result of direct identification of non-filer taxes owed. This is illustrated in Chart 1.

Chart 1: Tax Gap Amounts Attributable to Individual Non-filers



Source: IRS Tax Gap Estimated Statistics for Tax Years 1987-2001.

Note: These amounts do not take into account the amount owed by the cash or underground economy.[6] According to a January 2005 study conducted by Bear Stearns Asset Management, Inc.,[7] the U.S. may be foregoing $35 billion a year in income tax collections because of the number of jobs that are now off the books. Additionally, the study estimates that approximately 5 million illegal workers are collecting wages on a cash basis and avoiding income taxes.

We conducted our audit during the period March through May 2005 at the Small Business/ Self-Employed (SB/SE) Division Headquarters in New Carrollton, Maryland; Large and Mid-Size Business Division Headquarters in Washington, D.C.; Wage and Investment (W&I)

---

[6] Schemes using such items as nominees, currency, multiple bank accounts, wire transfers, and international tax havens to avoid detection, which ultimately erode public confidence in the tax system.
[7] Research conducted by Robert Justich and Betty Ng, Bear Stearns Asset Management Inc., New York, New York, January 3, 2005.

Division Headquarters in Atlanta, Georgia; Criminal Investigation (CI) Division in Washington, D.C.; and Tax Exempt and Government Entities Division Headquarters in Washington, D.C. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

The Internal Revenue Service Has Taken Steps to More Efficiently Deal With Individual Non-filers

The IRS has estimated that 2,183 Full-Time Equivalents (FTE)[8] were directed to the identification and working of non-filer cases in FY 2004. As illustrated in Chart 2, this was a net increase of 10 percent from 1,982 FTEs in FY 2003.

Chart 2: Estimated FTEs Expended for Non-filer Cases by Business Division

Division	FTEs in FY 2003	FTEs in FY 2004	Percentage Change From 2003 to 2004
CI	540.00	554.00	2.59%
Large and Mid-Size Business	13.35	11.50	-13.86%
SB/SE	1,108.64	1,251.12	12.85%
Tax Exempt and Government Entities	1.00	1.00	0.00%
W&I	318.95	365.75	14.67%
Totals	1,981.94	2,183.37	10.16%

Source: IRS business divisions.

Since FY 2001, the IRS has taken steps to more efficiently deal with individual non-filers. Actions taken by business divisions include:

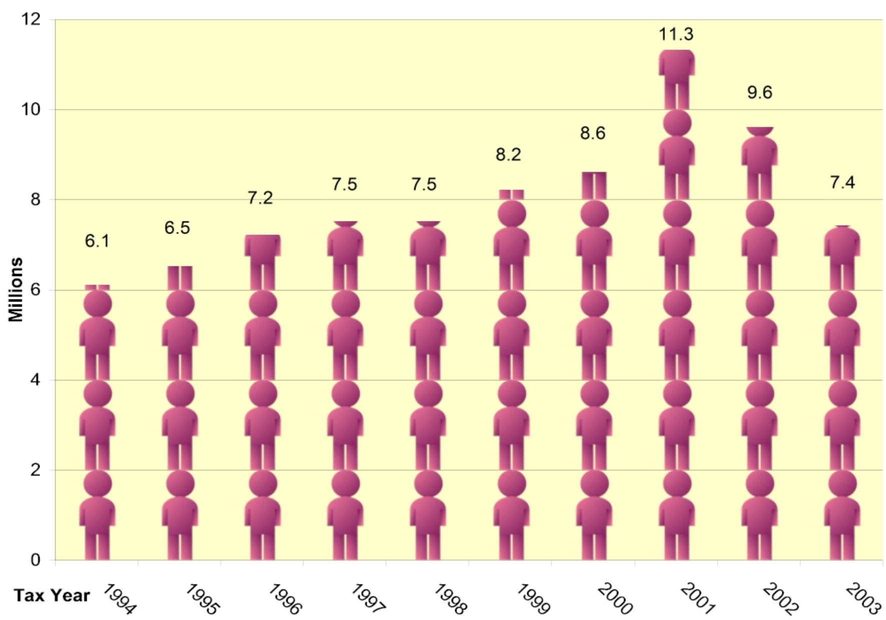
- Consolidation of the Automated Substitute for Return Program[9] into one campus.[10]
- Computer programming changes to enhance automated processing of returns created by the IRS for non-filing businesses, as authorized under I.R.C. § 6020(b).[11]

[8] An FTE is a measure of labor hours. One FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year. For FY 2004, 1 FTE was equal to 2,096 staff hours.
[9] The Automated Substitute for Return Program focuses on high-income taxpayers who have not filed individual income tax returns but appear to owe significant income tax liabilities based on available Information Reporting Program information.
[10] The campuses are the data processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
[11] I.R.C. § 6020(b) (2005) provides the IRS with the authority to prepare and process certain returns for a non-filing business taxpayer if the taxpayer appears to be liable for the return, the person required to file the return does not file it, and attempts to secure the return have failed.

- Refinement of the processes for selection and modeling of non-filer cases each year through risk-based compliance approaches. The intention is to identify and select the most productive non-filer work and to apply appropriate compliance treatments to high-priority cases.
- Increased outreach efforts by the SB/SE Division through its Taxpayer Education and Communication (TEC) function.
- Increase in the number of cases recommended for prosecution by the CI Division from 269 in FY 2001 to 317 in FY 2004 (an increase of 17.8 percent).

As illustrated in Chart 3, these actions may have resulted in fewer non-filers since 2001. This is not certain because IRS methods for identifying this population change yearly.[12] The apparent decrease in non-filers since 2001 could be due to a change in estimating methods.

Chart 3: National Inventory of Identified Individual Non-filers[13]



Source: IRS Case Creation for Individual Non-filer Program.

---

[12] The IRS could not provide a population for business non-filers.

[13] Year-to-year comparisons cannot be made because the methodology used to identify the non-filer population changes yearly.

To Address the Ongoing Non-filer Problem, the Internal Revenue Service Has Employed a Variety of Strategies

During the 3-year period from FYs 1993 through 1995, a multifunctional, National Non-filer Strategy focused on using the Collection function's open inventory. The IRS had a large non-filer population and used higher grade Examination function staff to eliminate a backlog in the non-filer inventory. The IRS considered this a success because of the reduction in the non-filer inventory, elimination of unproductive cases, and increase in the number of returns filed. However, there was no measure of the effect on voluntary compliance, and there were no cost data for determining the return on investment.

Another national non-filer strategy was developed for FYs 2000 and 2001. However, it was terminated because of the IRS reorganization. Subsequently, the National Non-filer Strategy for FYs 2001 through 2003 was developed. This Strategy was updated yearly based on the overall strategic business plan. It relied on a combined approach of outreach and compliance efforts. While the SB/SE Division had overall responsibility for its implementation, the National Non-filer Strategy was a coordinated, Service-wide effort to improve filing compliance. Extensive studies by the SB/SE Division Office of Research contributed to development of the Strategy.

Key elements of the Strategy included improved and reengineered processes and work streams, expanded/centralized compliance/enforcement activities, and outreach and education. The effort was to focus on the most egregious, high-risk, and highly productive segments of the population, including Business Master File (BMF)[14] trust fund, high-income individual, abusive trust/tax schemes, and criminal non-filers.

The Internal Revenue Service Needs Better Coordination to Ensure Resources Are Effectively Used to Bring Non-filers Into Compliance

While the IRS has taken steps to improve efficiency in dealing with individual non-filers, these are not coordinated activities that have been planned and controlled within the framework of a comprehensive strategy. Since FY 2002, each business division has independently directed its own non-filer activities. Currently, the IRS does not have a comprehensive, national non-filer strategy or an executive who is charged with overseeing each business division's non-filer efforts.

Individual, estate, and gift tax non-filers are attributed with $30 billion of the tax gap for TY 2001.

[14] The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

The IRS needs better coordination among its business divisions to ensure resources are being effectively used to bring non-filers into the tax system and ensure future compliance.

In the fiscal years up to 2002, the IRS had an Executive Steering Committee (ESC) that was broadly tasked with both developing an integrated strategy that addressed non-filers and overseeing the activities of an Implementation Team. An executive was in charge and had authority over all non-filer operational and analytical resources. In July 2002, the IRS determined that its National Non-filer Strategy was obsolete. Since then, each business division has been responsible for developing its own non-filer strategy and action items (embedding them in annual strategy and program plans) and tracking results.

The last meeting of the ESC was held in August 2002. There is no longer a single executive in charge. As a result, there is no longer any overall coordination of action items or monitoring, tracking, and analysis of the efforts of all the business divisions. While increasing compliance is a Service-wide effort, there is no regular and comprehensive Service-wide assessment of results so resources can be strategically directed in the most effective and efficient manner.

The ESC was responsible for coordinating meetings with all business divisions to establish information sharing. Since the last meeting of the ESC in August 2002, coordination meetings have not been held regularly. An IMF/BMF[15] Council held several meetings in 2004, but we were unable to obtain documents indicating which business divisions participated or the topics discussed. During the period September 2004 to April 2005, no meetings were held involving all business divisions. In April 2005, a Non-filer Summit group meeting was held with all business divisions to share information. At that meeting, the IRS discussed formation of a Collection Governance Board. The Board is in the design phase because a charter on the scope and responsibilities of the Board has not been established. A second Non-filer Summit meeting was held in July 2005.

The IRS needs a Service-wide tracking system for monitoring progress of efforts to bring non-filers into compliance

In addition to better coordination among its business divisions, the IRS needs an organization-wide tracking system to monitor the progress of each business division's non-filer strategy action items. The IRS does not have a formal system in place for monitoring progress or changes to each business division's non-filer plans (e.g., a decision to eliminate or discontinue an action item).

[15] The Individual Master File (IMF) is the IRS database that maintains transactions or records of individual tax accounts.

For example, we previously reported in March 2002[16] that the IRS' State Employment Wage Data[17] third-party matching project was underway. At that time, IRS management indicated there would be an evaluation of the results of testing, a cost/benefit analysis, and confirmation of test results for each activity before proceeding to the next step. Three years later, the project is still in the testing phase and IRS management could not provide us with any cost/benefit information for test results. Until August 2004, the SB/SE Division had been monitoring the results of its non-filer strategy actions on the Service Wide Action Plan system. Use of this system was suspended in 2004.

The IRS needs measurable program goals for bringing non-filers into compliance

In addition to better coordination and an organization-wide tracking system, the IRS needs measurable program goals. For example, three measurable goals that could be established are:

- The number of returns secured from non-filers.
- Total payments received.
- The recidivism (repeater) rate.

Without such measurable program goals, management is unable to determine whether efforts to improve program efficiency and effectiveness are achieving desired results.

The Government Performance and Results Act of 1993 (GPRA)[18] requires that plans have general goals and objectives, including outcome-related goals and objectives. It also requires a description of how the goals and objectives will be achieved, skills and technology required, human capital information, and other resources required.

According to the IRS, it did not establish a system to measure aggregate business results for its non-filer efforts because (a) it was too difficult to determine the cost or resource allocation for specific non-filer strategy action items and (b) these measures could only be associated with each function's filing compliance program area.

Under the GPRA, performance measurement is the ongoing monitoring and reporting of program accomplishments.

In measuring business results, the IRS needs a non-filer measurement system that would provide an aggregate measure of the effectiveness of IRS programs to improve the voluntary compliance levels of non-filers across the business divisions.

[16] *Improvements Are Needed to Enable the National Non-filer Strategy to Achieve Its Objectives* (Reference Number 2002-30-060, dated March 2002).
[17] Now known as the Employer Wage Data Match according to SB/SE Division management.
[18] Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

This would be consistent with Office of Management and Budget Circular A-123[19] requirements for effective internal controls to ensure programs operate, and resources are used, efficiently and effectively to achieve desired objectives.

In summary, with better coordination among its business divisions, an organization-wide tracking system, and measurable program goals, the IRS would be better positioned to strategically address an estimated $30 billion tax gap attributable to individual, estate, and gift tax non-filers.

Recommendations

Recommendation 1: To ensure adequate accountability and oversight, the IRS Commissioner should establish a Non-filer Program Office with a position for a Non-filer Executive or a permanent multidivisional group with responsibilities for developing strategy, implementing management control systems, and providing accountability for all the IRS non-filer efforts.

> ***Management's Response*:** During July 2005, the IRS convened a Non-filer Summit to elevate and discuss non-filer issues. At this Summit, it established a multidivisional executive group, the Collection Governance Council (CGC), whose responsibilities include developing initiatives, implementing management control systems, and providing accountability for all IRS non-filer efforts. The Council is meeting regularly to provide oversight for non-filer initiatives and to discuss emerging non-filer issues.

Recommendation 2: To determine the results achieved for each function involved in increasing filing compliance, the Deputy Commissioner for Services and Enforcement should ensure each business division develops measurable program goals for determining the success of its non-filer program activities.

> ***Management's Response*:** For FY 2006, the IRS has developed its first comprehensive non-filer work plan. Since each compliance function will be accountable for achieving the plan, the non-filer initiatives are incorporated in each division's program plan. Each compliance function will monitor results on a regular basis, and the CGC will ensure coordination among divisions.

Recommendation 3: To obtain reliable data for measuring filing compliance, the Deputy Commissioner for Services and Enforcement should ensure a decision support system is created for aggregating data on the effectiveness of non-filer programs in improving voluntary compliance.

---

[19] Circular A-123, *Management's Responsibility for Internal Control* (revised December 2004).

Management's Response: The CGC will partner with the SB/SE Division Office of Research to identify sources and types of data, gather the data and standardize the metrics, and develop a methodology for decision making.

Recommendation 4: For continuity and program emphasis, the Deputy Commissioner for Services and Enforcement should ensure the Non-filer Summit group continues to meet by establishing a schedule of future meetings for coordination and information sharing among the business divisions.

Management's Response: The CGC is meeting regularly to provide oversight for non-filer initiatives and to discuss emerging non-filer issues. A Non-filer subteam, which consists of representatives from each division and reports to the CGC, has been formed to ensure planned actions are accomplished. The subteam is also meeting on a regular basis.

Recommendation 5: To ensure effective coordination, monitoring, and successful completion of each business division's non-filer strategy objectives, the Deputy Commissioner for Services and Enforcement should consider the development of an organization-wide tracking system. Detailed information for each business division should include actions taken, status, results, and contact information for the individual responsible for each action.

Management's Response: A cross-functional action plan has been developed that includes responsible individuals and status of completion. Actions are being completed, with results and activity monitored by the Non-filer subteam and the CGC. The CGC will evaluate the effectiveness of the current monitoring system and make changes as necessary to ensure adequate oversight and control.

Information on Outreach and Education Efforts Is Needed to Determine the Effect on Recidivism

The IRS needs to have information to support whether the outreach and education programs are effective in bringing non-filers into compliance and reducing the recidivism rate. The SB/SE Division has increased outreach efforts through its TEC function. A similar function, Stakeholder Partnerships, Education, and Communication (SPEC), is part of the W&I Division. In January 2005, the SB/SE and W&I Divisions reorganized as a result of a 2004 study[20] that assessed whether the IRS could accomplish its prefiling and outreach objectives more effectively. The study clearly validated that the TEC and SPEC functions are vital to the accomplishment of the IRS' mission by

The IRS needs to know whether its current outreach and education activities are maximizing voluntary compliance and minimizing the tax gap.

[20] The study was conducted in the fall of 2004 by the Office of Program Evaluation and Risk Analysis. The SB/SE Division is in the process of implementing the results of the study.

delivering quality assistance to the American public through a variety of services. A decision was made to realign the SB/SE Division TEC function with the Communications and Liaison function, creating a Communications, Liaison, and Disclosure (CLD) function. Also, the Communications function in the W&I Division merged with the SPEC function, retaining the SPEC function title.

The CLD and SPEC functions are aimed at proactively addressing the needs of taxpayers and their representatives to improve overall compliance early in the process and to support a risk-based compliance strategy. These functions also have taxpayer education programs that reach out to customers based on specific, documented needs. A wide variety of published products, including electronic and interactive media, will be produced to better respond to customer needs and to keep pace with services available through the private sector. The goals for these activities are to reduce taxpayer burden and increase tax compliance by making it easier for taxpayers to understand and comply with their tax responsibilities.

According to the National Taxpayer Advocate,[21] the IRS needs to know whether its current outreach and education activities are maximizing voluntary compliance and minimizing the tax gap. These activities may not be adequate to achieve the objectives and goals and develop data for decision support. Although research has been conducted on a select group of non-filers[22] to determine the recidivism rate, the IRS needs to consistently calculate a recidivism rate for all non-filers. Also, the IRS cannot determine whether outreach efforts have been effective in reaching repeat non-filers treated by the Automated Substitute for Return Program. The IRS expends resources preparing returns for these individuals, only to have many stop filing 1 or more years later. When these taxpayers are identified as non-filers again, the IRS must spend additional resources and restart the enforcement cycle.

According to the GPRA, performance measurement is the ongoing monitoring and reporting of program accomplishments. However, in some programs, outcomes are not quickly achieved. In such cases, program evaluations may be needed to examine the extent to which a program is achieving its objectives. The GPRA requires program activities that have objectives, goals, and data for decision support. The IRS has not conducted a study on the effect of outreach and educational activities on non-filers. The IRS is missing opportunities to educate those taxpayers who are not complying with their filing requirements and to deter future noncompliance.

[21] IRS National Taxpayer Advocate's testimony to Congress on April 14, 2005.
[22] *Report on International Non-filers in Puerto Rico and U.S. Virgin Islands (Form 1040PR and Form 1040SS)*, SB/SE Division Research function, dated October 2003.

Recommendations

Recommendation 6: To ensure the IRS' outreach and education programs are effective in bringing non-filers into the system and combating recidivism, the Director, CLD, SB/SE Division, should ensure research is conducted on the indirect effect of outreach and education activities on voluntary compliance and use this research to determine which outreach and education activities to pursue.

> **Management's Response:** The CLD function will partner with the SB/SE Division Office of Research to analyze and summarize existing research on the effect of outreach and education activities on voluntary compliance. The CLD function will use the findings to determine the next steps, if applicable.

Recommendation 7: To ensure the IRS is not missing opportunities to educate those taxpayers who are not complying with their filing requirements and to deter future noncompliance, the Director, CLD, SB/SE Division, should consider a study to devise an effective outreach and education strategy. This strategy must (a) be based on research, (b) explain the causes of noncompliance, (c) target the appropriate taxpayer segments for each particular cause of noncompliance, and (d) reduce opportunities for noncompliance.

> **Management's Response:** Based upon study findings, the CLD function will develop appropriate outreach and education strategies.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Internal Revenue Service (IRS) effectively implemented the initiatives of its Non-filer Strategy. Specifically, we reviewed the IRS' current proposed actions for Fiscal Years (FY) 2004 – 2005 and followed up on the proposed actions for the FYs 2001 – 2003 National Non-filer Strategy that were to be implemented in response to the recommendations made in a prior Treasury Inspector General for Tax Administration report.[1] Specifically, we:

I. Determined the effectiveness of IRS programs for identifying non-filers, securing the returns, receiving payments, and reducing the recidivism (repeater) rate.

   A. Obtained FYs 2004 – 2005 Strategy and Program Plans for the following IRS business divisions: Small Business/Self-Employed (SB/SE), Wage and Investment (W&I), Large and Mid-Size Business (LMSB), Tax Exempt and Government Entities (TE/GE), and Criminal Investigation (CI).

   B. Interviewed IRS analysts and management for each business division to obtain the status of the action items pertaining to non-filers. For items completed, we discussed the results of the action items.

   C. Discussed with IRS analysts and management their plans, based on available budget levels, and how decisions are made to allocate resources to the highest risk aspects of the non-filer program.

      1. Computed the total resources the IRS allocated to working all aspects of the Non-filer Strategy.

      2. Obtained information on how the IRS determined risk-based priorities for non-filers and how the budget is allocated to these high-risk areas.

      3. Obtained information on program accomplishments for each fiscal year since FY 2001 and statistical information tracked for FYs 2003 and 2004.

   D. Interviewed IRS analysts and management to determine whether the IRS had quantified the cost to the Department of the Treasury of not pursuing known non-filers because of budget constraints.

[1] *Improvements Are Needed to Enable the National Non-filer Strategy to Achieve Its Objectives (*Reference Number 2002-30-060, dated March 2002).

E. Interviewed IRS analysts and management from the SB/SE, W&I, and LMSB Divisions to obtain information on the programs used to identify potential non-filers. For these programs, we obtained information on how the IRS measures success.

F. Interviewed IRS analysts and management from each business division to determine whether the actions taken by the IRS since FY 2001 have resulted in any substantial reductions in the numbers of individual and business non-filers.

G. Interviewed and obtained information from IRS analysts in the Taxpayer Education and Communication function; Stakeholder Partnerships, Education, and Communication function; and CI Division to determine whether the IRS effectively communicated with taxpayers to reduce the non-filer population.

1. Obtained information on outreach efforts conducted to encourage taxpayer compliance.

2. Ascertained how the IRS measures the effectiveness of outreach efforts.

3. Determined whether the IRS computed the non-filer recidivism rate and what actions were taken to reduce it.

II. Determined whether the proposed actions for the FYs 2001–2003 National Non-filer Strategy were implemented in accordance with IRS responses to our previous recommendations.[2]

A. Interviewed SB/SE Division analysts and management, obtained the status of the state matching of employment data project, and obtained plans for implementation.

B. Obtained information from IRS analysts and management from the SB/SE, W&I, LMSB, TE/GE, and CI Divisions on the action items completed from the FYs 2001–2003 National Non-filer Strategy and the effectiveness of these actions.

C. Requested documentation of meetings held by the Executive Steering Committee to oversee and monitor the Implementation Team's activities since its first scheduled meeting in January 2002.

D. Requested documentation for measuring the overall success of the Non-filer Strategy that was to be developed by the Implementation Team to measure the return on investment for the Non-filer Strategy activities.

[2] *Improvements are Needed to Enable the National Non-filer Strategy to Achieve its Objectives* (Reference Number 2002-30-60, dated March 2002.)

Appendix II

Major Contributors to This Report

Curtis Hagan, Assistant Inspector General for Audit (Small Business and Corporate Programs)
Preston Benoit, Acting Director
Philip Shropshire, Director
Timothy Greiner, Acting Audit Manager
Michael Howard, Acting Audit Manager
Donna Saranchak, Lead Auditor
Carole Connolly, Senior Auditor
Debra Mason, Auditor

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Assistant Deputy Commissioner for Services and Enforcement SE
Commissioner, Large and Mid-Size Business Division SE:LM
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Tax Exempt and Government Entities Division SE:T
Commissioner, Wage and Investment Division SE:W
Chief, Communications and Liaison CL
Chief, Criminal Investigation SE:CI
Deputy Commissioner, Large and Mid-Size Business Division SE:LM
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Deputy Commissioner, Wage and Investment Division SE:W
Director, Campus Compliance Services, Small Business/Self-Employed Division SE:S:CCS
Director, Communications and Liaison, Large and Mid-Size Business Division SE:LM:CL
Director, Communications, Liaison, and Disclosure, Small Business/Self-Employed Division SE:S:CLD
Director, Compliance, Wage and Investment Division SE:W:CP
Director, Pre-Filing and Technical Guidance, Large and Mid-Size Business Division SE:LM:PFTG
Acting Chief, Performance Improvement, Wage and Investment Division SE:W:S:PI
Director, Campus Filing and Payment Compliance, Small Business/Self-Employed Division SE:S:CCS:CFPC
Director, Campus Reporting Compliance, Small Business/Self-Employed Division SE:S:CCS:CRC
Director, Filing and Payment Compliance, Wage and Investment Division SE:W:CP:FPC
Director, Stakeholder Partnerships, Education, and Communication, Wage and Investment Division SE:W:CAR:SPEC
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Management Controls OS:CFO:AR:M
Audit Liaisons:

Commissioner, Large and Mid-Size Business Division SE:LM

Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Tax Exempt and Government Entities Division SE:T
Commissioner, Wage and Investment Division SE:W
Chief, Communications and Liaison CL
Chief, Criminal Investigation SE:CI

Appendix IV

Management's Response to the Draft Report

DEPUTY COMMISSIONER

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

RECEIVED
OCT 28 2005

October 24, 2005

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Mark E. Matthews
Deputy Commissioner for Services & Enforcement

SUBJECT: Draft Audit Report – The Internal Revenue Service Needs a Coordinated National Strategy to Better Address an Estimated $30 Billion Tax Gap Due to Non-filers (Audit # 200530011)

We have reviewed your report and appreciate your acknowledgement of our ongoing Non-filer Strategy initiatives. Three themes form the foundation for the Internal Revenue Service (IRS) non-filer initiatives: identifying egregious non-filer cases, improving efficiencies in compliance activities, and enhancing education and outreach. Our recent achievements demonstrate that IRS initiatives have continued to evolve and address the diverse non-filer population.

Working collectively across the IRS business divisions, we are identifying and contacting more non-filers than ever before. By stratifying the non-filer population, we are prioritizing our inventory and applying resources more effectively. In particular, we have increased our focus on high income non-filers. For example, in Fiscal Year (FY) 2005, the IRS secured almost 3.5 million delinquent returns, a 26 percent increase over our FY 2003 results. Dollars collected with delinquent returns increased 7 percent from FY2003 to FY2005.

We recently held a Servicewide Non-filer Summit and established an executive group with responsibility for developing non-filer initiatives, implementing management control systems, and providing accountability for all IRS non-filer efforts. This executive group, the Collection Governance Council, is chaired by the Director, Collection, Small Business/Self-Employed (SB/SE) Division and is now meeting regularly to provide oversight for non-filer initiatives.

Filing compliance has always been a priority for all IRS business divisions. For example, under Criminal Investigation's (CI) compliance strategies, the non-filer initiatives have received a high investigative priority since FY 1999. During FY's 2001 through 2005, CI consistently devoted a significant proportion of its tax-related direct investigative time to time to non-filer initiatives. The IRS operating divisions contributed to these investigative efforts by referring 25 to 30 percent of the CI non-filer cases initiated over the past five years.

In FY 2006, the IRS will have its first corporate non-filer work plan in place, and each compliance function will be accountable for its commitments in this area. Our current leadership team is focused on the non-filer challenge and is committed to aligning resources to this area of non-compliance in order to achieve performance targets.

To complement our non-filer enforcement initiatives, the IRS has implemented multi-faceted communications efforts to address non-filer issues. During FY 2005, the IRS achieved widespread publicity for its non-filer cases, as a direct result of extensive IRS media and outreach efforts on non-filer initiatives. Throughout the year, we continually educate citizens on their tax filing obligations and provide helpful information to assist them in filing their tax returns. For example, we routinely distribute outreach material to national and state practitioner organizations, and to small business and industry associations, which they share with their members. We also conduct small business workshops and practitioner liaison meetings in partnership with state tax agencies to reach business taxpayers. The IRS prominently includes information on filing requirements in its forms and publications, and taxpayers are regularly reminded, via the web and media statements, to file tax returns. In addition, we provide information to taxpayers about how to resolve non-filing issues and get back into compliance with filing requirements.

An integral component of IRS communications is the IRS.gov Website, which provides extensive information to the public. The Website includes fraud alerts and a page dedicated to IRS non-filer initiatives. Non-filer cases also are prominently mentioned on IRS Web pages concerning Employment Tax Fraud, Abusive Trusts, and Bankruptcy Fraud. The information contained on these Web pages educates taxpayers and practitioners about tax evasion schemes and warns them of severe consequences that can result from intentionally violating the law.

Our comments on your recommendations are as follow:

RECOMMENDATION 1

To ensure adequate accountability and oversight, the IRS Commissioner should establish a Non-Filer Program Office with a position for a Non-Filer Executive or a permanent multi-divisional group with responsibilities for developing strategy, implementing management control systems and providing accountability for all of the IRS non-filer efforts.

CORRECTIVE ACTION
During July 2005, we convened a Non-filer Summit to elevate and discuss non-filer issues. At this Summit, we established a multi-divisional executive group, the Collection Governance Council (CGC), whose responsibilities include developing initiatives, implementing management control systems, and providing accountability for all IRS non-filer efforts. The Council is now meeting regularly to provide oversight for non-filer initiatives and to discuss emerging non-filer issues.

IMPLEMENTATION DATE
Completed

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 2
To determine the results achieved for each function involved in increasing filing compliance, the Deputy Commissioner for Services and Enforcement should ensure that each business division develops measurable program goals for determining the success of its non-filer program activities.

CORRECTIVE ACTION
For FY 2006, the IRS has developed its first comprehensive non-filer work plan. Since each compliance function will be accountable for achieving the plan, the non-filer initiatives are incorporated in each division's program plan. Each compliance function will monitor results on a regular basis and the Collection Governance Council will ensure coordination between divisions.

IMPLEMENTATION DATE
Completed

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 3
In order to obtain reliable data for measuring filing compliance, the Deputy Commissioner for Services and Enforcement should ensure that a decision support

system is created for aggregating data on the effectiveness of non-filer programs in improving voluntary compliance.

CORRECTIVE ACTION
The Collection Governance Council will partner with the SB/SE Office of Research to identify sources and types of data, gather the data and standardize the metrics, and develop a methodology for decision making.

IMPLEMENTATION DATE
October 31, 2006

RESPONSIBLE OFFICIAL
Director, Collection, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN
The Director, Collection, SB/SE Division will advise the SB/SE Commissioner of any delays in implementing this corrective action.

RECOMMENDATION 4
For continuity and program emphasis, the Deputy Commissioner for Services and Enforcement should ensure the Non-filer Summit group continues to meet by establishing a schedule of future meetings for coordination and information sharing between the business divisions.

CORRECTIVE ACTION
The Collection Governance Council is now meeting regularly to provide oversight for non-filer initiatives and to discuss emerging non-filer issues. A Non-filer sub-team (which reports to the CGC) has been formed consisting of representatives from each division to ensure planned actions are accomplished. They, too, are meeting on a regular basis.

IMPLEMENTATION DATE
Completed

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 5
To ensure effective coordination, monitoring, and successful completion of each business division's non-filer strategy objectives, the Deputy Commissioner for Services

and Enforcement should consider the development of an organization-wide tracking system. Detailed information for each business division should include actions taken, status, results, and contact information for the individual responsible for each action.

CORRECTIVE ACTION
A cross-functional action plan has been developed that includes responsible individual and status of completion. Actions are being completed with results and activity monitored by the Non-filer sub-team and the CGC. The CGC will evaluate the effectiveness of the current monitoring system and make changes as necessary to ensure adequate oversight and control.

IMPLEMENTATION DATE
Completed

RESPONSIBLE OFFICIAL
Director, Collection, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN
Completed

RECOMMENDATION 6
To ensure the IRS' outreach and education programs are effective in bringing non-filers into the system and combating recidivism, the Director, Communications Liaison and Disclosure (CLD), Small Business/Self-Employed Division, should ensure research is conducted on the indirect effect of outreach and education activities on voluntary compliance and use this research to determine which outreach and education activities to pursue.

CORRECTIVE ACTION
CLD will partner with the SB/SE Office of Research to analyze and summarize existing research on the effect of outreach and education activities on voluntary compliance. CLD will use the findings to determine next steps, if applicable.

IMPLEMENTATION DATE
March 31, 2006

RESPONSIBLE OFFICIAL
Director, CLD, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN
Director, CLD, SB/SE Division will advise the SB/SE Commissioner of any delays in implementing this corrective action.

RECOMMENDATION 7

To ensure the IRS is not missing opportunities to educate those taxpayers who are not complying with their filing requirements and to deter future noncompliance, the Director, Communications Liaison and Disclosure, Small Business/Self-Employed Division, should consider a study to devise an effective outreach and education strategy. This strategy must (a) be based on research, (b) explain the causes of noncompliance, (c) target the appropriate taxpayer segments for each particular cause of noncompliance, and (d) reduce opportunities for noncompliance.

CORRECTIVE ACTION

Based upon study findings, CLD will develop appropriate outreach and education strategies.

IMPLEMENTATION DATE

June 30, 2007

RESPONSIBLE OFFICIAL

Director, CLD, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

Director, CLD, SB/SE Division will advise the SB/SE Commissioner of any delays in implementing this corrective action.

If you have any questions, please call me at (202) 622-0600 or Brady R. Bennett, Director, Collection, SB/SE Division, at (202) 283-7660.