



*Trends in Compliance Activities
Through Fiscal Year 2005*

March 2006

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This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 27, 2006

MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND
ENFORCEMENT

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Trends in Compliance Activities Through Fiscal
Year 2005 (Audit # 200630021)

This report presents the results of our review of statistical information that reflects activities of the Collection and Examination functions. The overall objective of this review was to provide statistical information requested by the Internal Revenue Service (IRS) Oversight Board and provide trend analyses of that information.

Synopsis

Overall, compliance activities increased and results improved during Fiscal Year (FY) 2005. Since FY 2000, the IRS has been reversing many of the downward trends in compliance activities that had occurred in prior years. In FY 2005, most of these activities continued to increase even though Collection and Examination function field staffing decreased slightly. The FY 2006 budget for tax law enforcement provided a 7 percent increase over the FY 2005 budget, and both the Collection and Examination functions plan to hire enforcement personnel during FY 2006.

Specifically, the level of compliance activities and the results obtained in many Collection function areas in FY 2005 showed a continued increase. The use of levies and seizures (collection enforcement tools) was greater in FY 2005 than in FY 2004, but it has not returned to pre-1998 levels. It is unlikely the use of seizures will ever return to those pre-1998 levels. Enforcement revenue collected increased substantially in FY 2005, and the total dollar amount of uncollected liabilities decreased. However, the gap between new delinquent accounts and account closures increased slightly.



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The Collection function collected 15.5 percent more in FY 2005 than in FY 2004, and the number of taxpayers and the amount owed on accounts in the Queue¹ decreased slightly. While this inventory is now a source of work for Collection Field function employees, a significant amount may never be worked. In addition, a significant number of accounts were shelved (removed) from collection inventory and may never be worked. A larger part of these inventories may be able to be worked in the future. The IRS received authority to use private collection agencies to work some cases² and plans to begin testing of this concept later in FY 2006.

During FY 2005, the overall percentage of tax returns examined increased 22 percent even though the number of examiners decreased by almost 1 percent. However, the overall percentage of tax returns examined is still 45 percent lower than it was in FY 1996.

Overall, the number of examinations of individual tax returns increased during FY 2005. Correspondence examinations accounted for 88 percent of the examinations of individuals with incomes under \$100,000 in FY 2005 and 67 percent of those with incomes of \$100,000 and over. Correspondence examinations are usually not as comprehensive as face-to-face examinations. Additionally, the dollar yield per hour increased for individual income tax return examinations.

The number of examinations of corporate tax returns increased almost 71 percent in FY 2005, after decreasing since FY 1997. However, the percentage examined is still almost 59 percent less than it was than in FY 1997. The total number of tax returns examined decreased from 1 out of 37 returns filed in FY 1997 to 1 out of 80 returns filed in FY 2005. Large increases in the percentage of tax returns examined occurred for larger corporations, those with assets of \$10 million and over. Yield indicators for examinations of corporate tax returns improved again in FY 2005. While there was a decrease in the amount of the tax adjustments on those returns, there was also a decrease in the hours spent examining those returns for the year. As a result, the dollar yield per hour increased.

Some of the positive changes noted in this report might be attributed to management emphasis on the Collection and Examination programs. Over the last few years, the IRS has implemented reengineering suggestions aimed at increasing the effectiveness of enforcement efforts. In addition, the Small Business/Self-Employed Division reorganized the Compliance organization along functional lines. This allowed the Collection and Examination functions to leverage specialized knowledge and created more direct accountability for accomplishments within each function.

Despite actions the IRS has taken to improve its enforcement efforts, the Government Accountability Office regarded enforcement of tax laws (collection of unpaid taxes and earned

¹ The Queue is a holding file for unassigned inventory. Some of the inventory is considered low priority, but other inventory is placed in the file until it can be assigned as workload for Collection function employees.

² American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004).



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income credit noncompliance) as 1 of the 25 high-risk areas in the Federal Government in its January 2005 update.³ However, as our report points out, the IRS has moved toward reversing many of the enforcement declines in both the Collection and Examination functions.

Continued effort to improve compliance is important to the integrity of the voluntary compliance system. The IRS' recently revised figures show the tax gap⁴ for Tax Year 2001 to be \$345 billion, which is at the high end of the \$312 billion to \$353 billion range per year estimate released last March.⁵

Recommendations

We made no recommendations in this report. However, key IRS management officials reviewed it prior to issuance.

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

³ *HIGH-RISK SERIES – An Update* (GAO-05-207, dated January 2005).

⁴ The tax gap is the difference between what taxpayers should have paid and what they actually paid timely.

⁵ *IRS Updates Tax Gap Estimates* (IRS News Release IR-2006-28, dated February 14, 2006).



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Background

We initiated this review of nationwide compliance statistics for examination and collection activities at the request of the Internal Revenue Service (IRS) Oversight Board. Our data analyses were performed in the Treasury Inspector General for Tax Administration Chicago, Illinois, office during the period January through February 2006 using national Management Information System reports. The audit was conducted in accordance with *Government Auditing Standards*. However, because we relied on information accumulated by the IRS in established reports, we did not verify the accuracy of the data.

Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II. A Glossary of Terms is included in Appendix IV. Detailed charts and tables referred to in the body of this report are included in Appendix V. Many of the calculations throughout the report and Appendix V are affected by rounding. All initial calculations were performed using the actual numbers rather than the rounded numbers that appear in the report.

Much of the data included in this report update prior Treasury Inspector General for Tax Administration audit reports on compliance trends. See Appendix VI for a list of these reports.



Results of Review

Overall, compliance activities increased and results improved during Fiscal Year (FY) 2005. Since FY 2000, the IRS has been reversing many of the downward trends in compliance activities that had occurred in prior years in both the Collection and Examination functions. In FY 2005, most of these activities continued to increase, while others fell slightly from the prior year.

Even though the IRS has started to reverse many of the downward trends in compliance activities, the Collection and Examination functions enforcement staffing level is not much higher than the 10-year low experienced in FY 2003. The combined Collection and Examination functions enforcement personnel¹ declined from approximately 22,200 at the beginning of FY 1996 to 14,500 at the end of FY 2005, a 35 percent decrease. After increasing 5 percent during FY 2004, staffing decreased 1 percent during FY 2005. The FY 2006 budget was a 7 percent increase over the FY 2005 budget for tax law enforcement; the Collection and Examination functions plan to hire enforcement personnel during FY 2006. While the President's FY 2007 proposed budget for tax law enforcement is a slight increase over the FY 2006 budget, the difference would be needed to maintain the same level of service as provided for in the FY 2006 budget.

Overall, Compliance Activities Increased and Results Improved

For some time, the total number of tax returns filed and the total dollars the IRS received (gross collections) increased annually with the growing economy. In the past 9 years, the total number of tax returns filed grew 12 percent, from 155 million in Calendar Year 1995 to 174 million in Calendar Year 2004. From FYs 1996 to 2001, IRS gross collections grew from \$1.49 to \$2.13 trillion but then fell a total of 8 percent during FYs 2002 and 2003, to \$1.95 trillion. These were the first decreases in total revenue since FY 1983. During FY 2004, there was a slight increase to \$2.02 trillion. However, during FY 2005, gross collections increased 12 percent, reaching a new record high of \$2.27 trillion.²

After remaining relatively constant for FYs 1999 through 2002, the amount of enforcement revenue collected increased 39 percent in the last 3 years. During FY 2005 alone, enforcement revenue collected increased 10 percent to \$47.3 billion.³ This amount (not adjusted for inflation) is 24 percent higher than the FY 1996 level.⁴

¹ Collection and Examination function staff located in field offices, excluding management and overhead staff.

² See Appendix V, Figure 1.

³ See Appendix V, Figure 3.

⁴ See Appendix V, Figure 2.



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Despite work the IRS is doing to improve its enforcement efforts, the Government Accountability Office regarded enforcement of tax laws (collection of unpaid taxes and earned income credit noncompliance) as 1 of the 25 high-risk areas in the Federal Government in its January 2005 update.⁵ The Government Accountability Office noted, “The Commissioner of Internal Revenue has made strengthening enforcement a high priority, but [the] IRS has not yet materially reversed enforcement declines.” However, as our report points out, the IRS has moved toward reversing many of the enforcement declines in both the Collection and Examination functions.

Continued effort to improve compliance is important to the integrity of the voluntary compliance system. According to the IRS’ recently revised figures, the tax gap for Tax Year 2001 is \$345 billion, which is at the high end of the estimated \$312 billion to \$353 billion released last March.⁶

Collection Function Compliance Activities Increased and Results Improved

The Collection Field function (CFf) revenue officer personnel assigned delinquent cases decreased slightly in FY 2005; there were 3,680 field revenue officers as of the end of the fiscal year.⁷ Since the start of FY 1996, revenue officer staffing is down almost 38 percent. Results from many Collection function activities continued to show improvement during FY 2005, while the results of other activities were not positive.

Many Collection function operations showed improvement

Many activities showed positive results for the Collection function during FY 2005.

- Total dollars collected on Taxpayer Delinquent Accounts (TDA) by the Automated Collection System (ACS) and the CFf employees during FY 2005 was \$5.8 billion, an increase of 15.5 percent from FY 2004.⁸ The FY 2005 amount is up 62 percent from the 10-year low that occurred in FY 2000.
- The average amount collected per CFf staff year on TDAs increased 113 percent to \$576,777 in FY 2005, from a low of \$271,110 in FY 1999.⁹ The increase from FY 2004 to FY 2005 alone was \$125,677 (28 percent).

⁵ *HIGH-RISK SERIES – An Update* (GAO-05-207, dated January 2005).

⁶ *IRS Updates Tax Gap Estimates* (IRS News Release IR-2006-28, dated February 14, 2006).

⁷ See Appendix V, Figure 5.

⁸ See Appendix V, Figure 9.

⁹ See Appendix V, Figure 8.



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- The amount of gross accounts receivable decreased just over 9 percent during FY 2005, the first significant decrease in 10 years.¹⁰ This occurred with increases in gross collections and enforcement revenue collected.
- The number of TDAs closed, excluding shelved accounts, and the number closed by full payment increased 5.5 percent and 7.5 percent, respectively, from FY 2004 to FY 2005.¹¹ The FY 2005 volumes are the highest since FY 1997.
- The number of Taxpayer Delinquency Investigations (TDI) closed by the ACS and the Cff because delinquent tax returns were received by the IRS increased 25 percent from FY 2004 to FY 2005.
- As shown in Figure 1, the use of levies and seizures (collection enforcement tools)

increased substantially from lows experienced in FY 2000. Levies increased 1,148 percent and seizures increased 592 percent.¹² However, the numbers are still substantially lower than they were before 1998. It is unlikely the IRS' use of seizures will ever return to the pre-1998 volumes.

Figure 1: Use of Levies and Seizures

	Levies	Seizures
FY 1996	3,108,926	10,449
FY 1997	3,659,417	10,090
FY 1998	2,503,409	2,307
FY 1999	504,403	161
FY 2000	219,778	74
FY 2001	674,080	234
FY 2002	1,283,742	296
FY 2003	1,680,844	399
FY 2004	2,029,613	440
FY 2005	2,743,577	512

Source: Collection Report 5000-23, Customer Service Activity Report, and IRS manual reconciliation of seizure logs.

Some of the positive changes noted in this section might be attributed to management emphasis on the collection programs. For example:

- Changes recommended by the Collection Reengineering initiatives and subsequent revisions to the recommendations have been implemented over the last few years. We have issued audit reports on some of these changes including the case prioritization, case selection process, and group manager involvement initiatives. See Appendix VI for a list of these audit reports.
- The Small Business/Self-Employed Division realigned the Compliance organization along functional lines at the beginning of FY 2005. This allowed the Collection function to leverage specialized knowledge and created a more direct accountability for accomplishments within the function.

¹⁰ See Appendix V, Figure 3.

¹¹ See Appendix V, Figures 14 and 15.

¹² See Appendix V, Figures 17 and 18.



Some Collection function operations showed mixed results

Some indicators were not positive for Collection function compliance activity during FY 2005.

- There were more TDA receipts than closures during FY 2005, and the gap between TDA receipts and TDA closures widened during the fiscal year after narrowing during the prior 2 fiscal years.¹³ The gap increased 41 percent to 1,218,465 accounts as of the end of FY 2005. Except for FY 2004, this volume is still lower than at the end of any fiscal year since FY 1998. However, according to IRS calculations, when all balance-due modules are considered (those resolved by sending balance-due notices to the taxpayer and those resolved during the TDA process), the IRS has resolved more balance-due modules than it received in inventory the last 3 fiscal years.
- The total number of liens issued by the CFf and the ACS decreased in FY 2005 by about 2 percent, which is similar to the decrease in FY 2004.¹⁴ The IRS attributes the decrease in the total number of liens filed to a policy change that resulted in fewer liens being refiled since FY 2003.

While the number of liens issued by the ACS decreased 6 percent, the number issued by the CFf increased 1 percent. However, the total number of liens issued in FY 2005 was still 211 percent higher than the low experienced in FY 1999. As we recently noted, there should be an increase in the number of liens filed on accounts with large balance-due amounts based on procedural changes being made by the Collection function.¹⁵

An inventory of unassigned collection cases is maintained in the Queue. Except for some slight dips, the number of taxpayers with unpaid accounts in the Queue and the amount owed on these accounts steadily increased from FYs 1996 through 2004.¹⁶ During FY 2005, both dropped slightly. The number of taxpayer accounts decreased 3 percent to 607,114. At the same time, the amount owed decreased 5 percent to \$20.3 billion. The number of taxpayers with unfiled tax returns decreased 15 percent to 716,315 in FY 2005, and there was a large (just over 46 percent) decrease in the number of these accounts that were shelved or surveyed (removed from inventory) during the year.¹⁷ Although many of the cases in the Queue may be assigned to be worked, a significant amount may never be worked.

While there were positive results for the Queue inventory during FY 2005, the inventory figures do not include the millions of tax periods for unpaid accounts and unfiled return investigations

¹³ See Appendix V, Figure 12.

¹⁴ See Appendix V, Figure 16.

¹⁵ *High-Risk Work Is Selected From the Unassigned Delinquent Account Inventory, but Some Unassigned Accounts Need Management's Attention* Reference Number 2006-30-030, dated February 2006).

¹⁶ See Appendix V, Figure 13.

¹⁷ See Appendix V, Figures 10 and 11.



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shelved or surveyed (removed) from Collection function inventory during the last few years. From FYs 2001 through 2005, approximately 6.2 million TDAs¹⁸ (with balance-due amounts totaling more than \$26 billion) were removed from Collection function inventory. During the same period, more than 14.1 million TDI tax periods were removed. However, the pace for removal of both TDAs and TDIs slowed during FY 2005. These cases were removed from Collection function inventory because they were potentially less productive than other available inventory and may never be worked.

The Collection function is unable to work all of the existing accounts in the Queue with current staffing, and, as noted above, the number of TDA receipts is outpacing closures. If changes do not occur, a significant number of cases will continue to not be worked. This reinforces the need for additional resources to work the cases. As previously noted, the Collection function will be hiring during FY 2006. The President's FY 2007 proposed budget has only a slight increase over the FY 2006 budget for tax law enforcement; the difference is needed to maintain the same level of service as provided for in the FY 2006 budget. In addition, a larger part of the Queue inventory may be able to be worked in the future. Legislation was passed¹⁹ allowing the IRS to use private collection agencies to work some cases, and the IRS plans to begin testing the concept later in FY 2006.

Examination Function Compliance Activities Increased and Results Improved

Overall, the number of field Examination function personnel that conduct examinations of tax returns decreased by about 1 percent during FY 2005. The number of revenue agents (RA) decreased to 9,682, while the number of tax compliance officers (TCO) (formerly referred to as tax auditors) declined slightly to 981 as of the end of FY 2005.²⁰ However, there has been an almost 34 percent decrease in the number of examiners in field offices²¹ since the start of FY 1996.

Compared to FY 2004, the percentage of tax returns examined increased for every type of tax return during FY 2005. At the same time, examination yield per hour (the amount of the tax adjustments on tax returns divided by the number of hours spent examining those returns) also increased for individual, corporate, and other types of tax returns.²²

¹⁸ See Appendix V, Figure 11.

¹⁹ American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004).

²⁰ See Appendix V, Figure 4.

²¹ Examiners in field offices include RAs, TCOs, tax examiners, and revenue officer examiners.

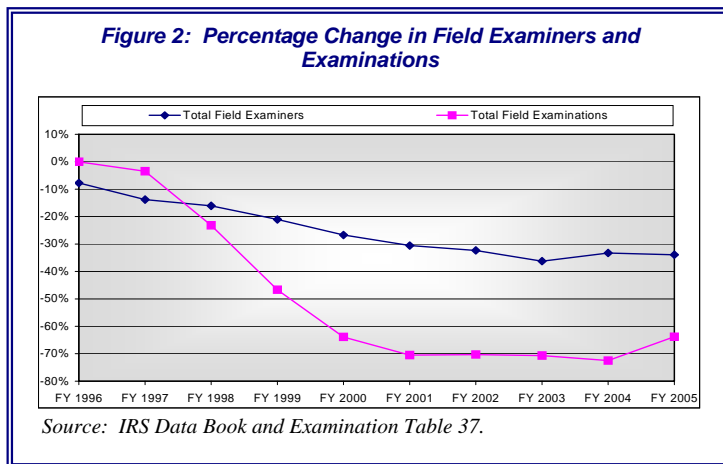
²² See Appendix V, Figures 20 through 23.



The number of tax returns examined increased, but many examinations were conducted via correspondence

When analyzing examination coverage rates, it is important to recognize differences in the types of contacts that are counted in Examination function statistics. Examinations range from an IRS notice asking for clarification of a single tax return item that appears to be incorrect (correspondence examination) to a full face-to-face interview and review of the taxpayer's records. Face-to-face examinations are generally more comprehensive and time consuming for the IRS and the taxpayers, and they typically result in higher dollar adjustments to the tax amounts. Thus, caution should be used when combining statistics from the various Examination function programs into overall examination rates. In addition, the IRS uses several computer-matching and automated error-checking routines in the Computing Centers to check the accuracy of tax returns. The running of these routines often results in adjustments to tax liabilities; however, these adjustments are not included in the traditional "audit rates" and are not generally reported separately as enforcement efforts.

The overall percentage of tax returns examined (including face-to-face and correspondence examinations) increased 22 percent²³ from FY 2004 to FY 2005 and has increased 76 percent since FY 2000. However, the rate is still 45 percent lower than it was in FY 1996. The largest



increase in the examination rate from FY 2000 was for individual tax returns. Examinations of other types of tax returns did not increase as significantly or decreased.

Examination staffing decreased slightly during FY 2005. However, the FY 2006 budget for tax law enforcement is a 7 percent increase over the FY 2005 budget, and the Examination function plans to hire during FY 2006.

Figure 2 compares the change in field Examination function staffing to the change in examinations for all types of tax returns by field employees from the beginning of FY 1996 through FY 2005. The chart line for the number of field examiners does not start at zero because the number of examiners conducting examinations during FY 1996 decreased by almost 8 percent during the year.

²³ The IRS has traditionally calculated the percentage of examination coverage by dividing the number of returns examined in the current fiscal year by the number of returns filed in the preceding calendar year.



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A continued effort to increase the examination coverage is important to the effectiveness of the voluntary compliance system. Studies of taxpayer attitudes show continued improvement in attitudes about cheating on taxes. In 2005, 10 percent of taxpayers felt it was acceptable to cheat on their tax returns. This is down from 12 percent in 2004 and 17 percent in 2003.²⁴ Also, fear of examination is an increasing factor in influencing taxpayers to report taxes honestly. In 2002, 54 percent of taxpayers surveyed cited fear of examination as a factor that influenced their voluntary compliance. This increased to 60 percent in 2004 and 62 percent in 2005.

The following paragraphs summarize examination coverage for various types of tax returns.

- *Individual Income Tax Examinations* – Overall, the number of examinations of all types of individual income tax returns decreased from FY 1997 through FY 2000. However, the downward trend was reversed in FY 2001 when the number of examinations in most categories increased from the prior years. During FY 2000, only 617,765 (1 in 202) individual income tax returns were examined. Since then the number examined has continuously increased and 1,215,308 (1 in 107) were examined in FY 2005, with 84 percent of those being done by correspondence.²⁵
 - The number of examinations of individual income tax returns with income under \$100,000 increased from 518,218 (1 in 221 tax returns filed) in FY 2000 to 996,100 (1 in 117 tax returns filed) in FY 2005.²⁶ This increase was entirely due to an increase in the number of correspondence examinations, which accounted for 88 percent of the examinations in this income category. The number of face-to-face examinations decreased 2 percent. Only 1 in 976 individual income tax returns filed with income under \$100,000 received a face-to-face examination, while 1 in 133 received a correspondence examination.
 - The number of examinations of individual income tax returns with income of \$100,000 and over increased from 99,547 (1 in 104 tax returns filed) in FY 2000 to 219,208 (1 in 64 tax returns filed) in FY 2005.²⁷ Most (86 percent) of this increase was due to an increase in the number of correspondence examinations, which accounted for 67 percent of the examinations in this income category. Only 1 in 193 individual income tax returns filed with income of \$100,000 and over received a face-to-face examination, while 1 in 95 received a correspondence examination.

The Earned Income Tax Credit issues made up between 67 and 83 percent of the individual income tax examinations of tax returns with income under \$25,000 for FYs 2000 through 2005 and accounted for about 37 percent of the examinations of

²⁴ *IRS Oversight Board 2005 Taxpayer Attitude Survey.*

²⁵ See Appendix V, Figure 24.

²⁶ See Appendix V, Figures 24 and 25.

²⁷ See Appendix V, Figures 24 and 25.



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individuals overall during FY 2005. Excluding examinations in which the Earned Income Tax Credit was an issue, the number of examinations of individuals with income under \$100,000 increased 122 percent from 250,248 in FY 2000 to 555,456 in FY 2005, and the number with income of \$100,000 and over increased 118 percent from 98,983 in FY 2000 to 215,305 in FY 2005.

- *Corporate Income Tax Examinations* – The number of examinations of corporate income tax returns (excluding returns for foreign and S Corporations) increased 71 percent in FY 2005 after decreasing since FY 1997. Even with the increase in FY 2005, the number of examinations has still decreased 59 percent since FY 1997. The total number of tax returns examined decreased from 69,295 (1 out of 37 returns filed) in FY 1997 to 28,687 (1 out of 80 returns filed) in FY 2005.²⁸

The majority of the increase in examinations during FY 2005 was due to an increase in examinations of corporate tax returns with assets of under \$10 million. The number of those tax returns examined increased 145 percent in FY 2005. During the same period, the number of corporate tax returns with assets of \$10 million and over increased 14 percent. However, these larger corporations had a greater increase in the percentage of tax returns examined due to the decrease in the number of tax returns filed in this category.

- *S Corporation Return Examinations* – The number of S Corporation tax returns examined increased 63 percent in FY 2005. Since FY 1998, the number of S Corporation returns filed has increased 44 percent while the number of examinations has decreased 59 percent. From FY 1998 to FY 2005, the number of tax returns examined decreased from 1 out of 96 returns filed to 1 out of 338 returns filed.²⁹ The IRS is starting a research project to study the compliance of S Corporation entities in which the income flows through to other entities. The results of this project could lead to changes in the selection of these tax returns for examination.
- *Partnership Return Examinations* – The number of partnership returns examined increased 36 percent in FY 2005, resulting in a 30 percent increase since FY 2000. The number of returns filed also increased at about the same rate between FYs 2000 and 2005.³⁰ About 1 out of every 300 returns filed in FYs 2000 and 2005 was examined. The IRS had planned to include partnership tax returns in the research project of tax returns in which the income flows through to other entities but decided to concentrate on only S Corporations as mentioned above. Compliance of partnerships may be studied in a future project.

²⁸ See Appendix V, Figures 37, 38, and 50 for coverage by size of corporation.

²⁹ See Appendix V, Figures 40 and 50.

³⁰ See Appendix V, Figures 41 and 50.

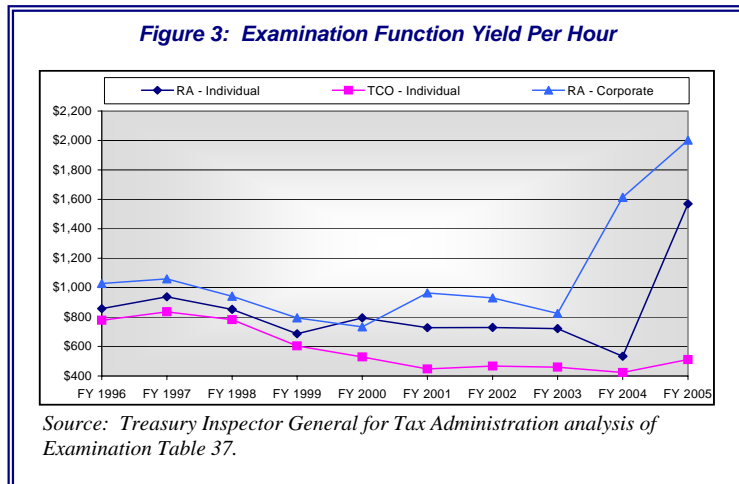


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- *Other Tax Types Examinations (Fiduciary, Employment, Excise, Estate, and Gift Taxes)* – The overall number of examinations in these 5 classes increased 51 percent during FY 2005 and was up 36 percent from FY 2000. The ratio of tax returns examined to tax returns filed was higher for each class in FY 2005 compared to FY 2000 except fiduciaries. However, the ratio for fiduciaries increased from FY 2004 to FY 2005.³¹

Examination function dollar yield per hour improved

The dollar yield per hour improved for individual and corporate income tax return examinations during FY 2005. Figure 3 shows the impact on the dollar yield per hour from FY 1996 to FY 2005 for RAs and TCOs on individual and corporate tax returns.



The Examination function dollar yield per hour for individual income tax return examinations was lower in FY 2004 than in FY 1996.³² However, during FY 2005, yield increased significantly for RAs and slightly for TCOs, but only the yield for RAs increased above the level in FY 1996. While the dollar results from examinations per tax return examined fluctuated during the period, the number of hours used to examine each tax return increased substantially through FY 2004, then decreased in FY 2005.

The dollar yield per hour spent examining corporate tax returns increased in both FYs 2004 and 2005. The increase for the 2 years was 143 percent; the net increase since FY 1996 was 95 percent.³³ The average hours spent examining each tax return increased each year from FYs 1998 through 2004, then decreased in FY 2005. This decrease in hours outpaced the decrease in assessments on corporate tax returns during the same time period, resulting in the net effect of the increase in the dollar yield per hour during FY 2005. While there was an overall decrease in average assessments per return, there was a large increase in average assessments for larger corporations (those with assets of \$10 million and over).

³¹ See Appendix V, Figures 42 through 46 and 50.

³² See Appendix V, Figures 20 and 23.

³³ See Appendix V, Figure 21.



Examination initiatives had a positive impact

Over the last few years, the Small Business/Self-Employed Division has implemented some changes that could have had a positive impact in some of the areas noted above within the Examination function. For example:

- The Examination function implemented changes from the Examination Reengineering initiative. We have issued reports on some of these initiatives including the field examination reengineering pilot, office audit redesign pilot, and high income tax strategy. See Appendix VI for a list of these audit reports.
- As previously noted, the Small Business/Self-Employed Division Compliance functions were realigned along functional lines at the beginning of FY 2005. Just as it did for the Collection function, the realignment allowed the Examination function to leverage specialized knowledge and created a more direct accountability for accomplishments within the function.



Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to provide statistical information requested by the Internal Revenue Service Oversight Board and trend analyses of that information.

To accomplish our objective, we analyzed information obtained from the Internal Revenue Service's management information reports to determine the trends and changes in the major areas of compliance. Because we relied on information accumulated by the Internal Revenue Service in established reports, we did not verify its accuracy. The major issues we focused on included:

- Enforcement revenue and gross accounts receivable.
- Collection and Examination function staffing.
- Collection and Examination function direct time.
- Collection function delinquent account inventories and unfiled return investigations.
- Collection function enforcement actions (liens, levies, and seizures).
- Examination function coverage of individual and business tax returns compared to the number of returns filed in each category.
- Examination function productivity results for individual and business tax returns.
- Other activity resulting in improving the accuracy of filed tax returns and the filing of delinquent returns.



Appendix II

Major Contributors to This Report

Curtis W. Hagan, Assistant Inspector General for Audit (Small Business and Corporate Programs)

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Amy L. Coleman, Audit Manager

Joseph P. Snyder, Lead Auditor

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Commissioner, Large and Mid-Size Business Division SE:LM
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Appendix IV

Glossary of Terms

Automated Collection System (ACS) – A telephone contact system through which telephone assistants collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.

Automated Lien System – A comprehensive database that prints Notices of Federal Tax Lien and lien notices, stores taxpayer information, and documents all Federal tax lien activity.

Automated Substitute for Return (ASFR) system – Designed to assess taxes on wage earners who fail to file tax returns. It analyzes information submitted to the Internal Revenue Service (IRS) and historical tax returns information.

Balance Sheet – A statement of the financial assets and liabilities of a business at a given date filed with a corporate income tax return; it is used by the IRS to group businesses by the size of their assets.

Collection Field function (Cff) – The unit in the field offices consisting of revenue officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled tax returns.

Computing Center – IRS Computing Centers support tax processing and information management through a data processing and telecommunications infrastructure.

Corporate Income Tax Returns – U.S. Corporation Income Tax Returns (Form 1120) are returns used by corporations to report the corporate income tax.

Earned Income Tax Credit – A tax credit for certain people who work and have income under established limits.

Employment Tax Returns – Various Form 940 return series (primarily Employer's Annual Federal Unemployment (FUTA) Tax Return (Form 940) and Employer's QUARTERLY Federal Tax Return (Form 941)) filed by businesses to report things such as Employer's Federal Unemployment Taxes and Federal Taxes Withheld.

Enforcement Revenue – This is any tax, penalty, or interest received from a taxpayer as a result of an IRS enforcement action (usually an examination or a collection action).

Estate Tax Return – United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706) is the form to be filed on certain estates of deceased persons.

Examination (Face-to-Face) – Field examinations of individuals, partnerships, and corporations that occur either at the taxpayer's place of business or through interviews at an IRS office.



Trends in Compliance Activities Through Fiscal Year 2005

Excise Tax Return – Quarterly Federal Excise Tax Return (Form 720) is used to report and pay certain taxes such as those on transportation and fuel.

Fiduciary Income Tax Returns – Income tax returns filed for estates and trusts.

Gift Tax Return – United States Gift (and Generation-Skipping Transfer) Tax Return (Form 709) is used to report transfers subject to the Federal gift taxes and to calculate the tax due on those transfers.

Gross Accounts Receivable – Includes all unpaid tax, with accrued penalties and interest, on taxpayers' delinquent accounts.

Individual Income Tax Returns – U.S. Individual Income Tax Returns (Form 1040 series) are annual income tax returns filed by citizens or residents of the United States.

Math Error – A program with which the IRS contacts taxpayers through the mail or by telephone when it identifies mathematical errors or mismatches of taxpayer information that would result in a tax change.

National Research Project – Research conducted by the IRS to determine filing, payment, and reporting compliance by taxpayers for different types of taxes.

Partnership Return – U.S. Return of Partnership Income (Form 1065) is used to report the income and expenses of domestic partnerships and the share distributed to each partner.

Queue – An automated holding file for unassigned inventory of delinquent cases that the Collection function does not have enough resources to immediately assign for contact.

Revenue Agent – Employees in the Examination function that conduct face-to-face examinations of more complex tax returns such as businesses, partnerships, corporations, and specialty taxes (e.g., excise tax returns).

Revenue Officer – Employees in the CFF who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by the IRS campuses (formerly known as service centers) or the ACS.

Revenue Officer Examiner – Revenue officers that have been trained to conduct examinations of employment tax returns.

S Corporation Tax Return – U.S. Income Tax Return for an S Corporation (Form 1120S) is filed by qualifying small business corporations and includes amounts distributed to shareholders.

Service Center Collection Branch (SCCB) – Mails the balance-due and return delinquency notices to taxpayers and analyzes and responds to taxpayer correspondence.

Shelved or Surveyed Cases – These are delinquent unpaid accounts or investigations of unfiled tax returns that have been taken out of Collection function inventory because they are lower priority than other available inventory.



Trends in Compliance Activities Through Fiscal Year 2005

Tax Compliance Officer/Tax Auditor – Employees in the Examination function that conduct mostly examinations of individual taxpayers through interviews at IRS field offices. The position title was changed in 2002 from tax auditor to tax compliance officer.

Tax Examiner – Employees in field offices that conduct examinations through correspondence.

Taxpayer Delinquent Account (TDA) – A balance-due account of a taxpayer.

Taxpayer Delinquency Investigation (TDI) – An unfiled tax return for a taxpayer.

Tax Gap – The difference between what taxpayers should have paid and what they actually paid timely.

Tax Period – Refers to each tax return filed by the taxpayer for a specific period (year or quarter) during a calendar year for each type of tax.

Total Gross Receipts (TGR) – The categories used for individual income tax returns with Profit or Loss From Business (Schedule C) or Profit or Loss From Farming (Schedule F) income based on the total receipts reported.

Underreporter – The Underreporter Program matches items reported on an individual's income tax return to information supplied to the IRS from outside sources (such as from employers, banks, and credit unions) to determine if the taxpayer's tax return reflected the correct amounts, ensuring the tax amount is correct.



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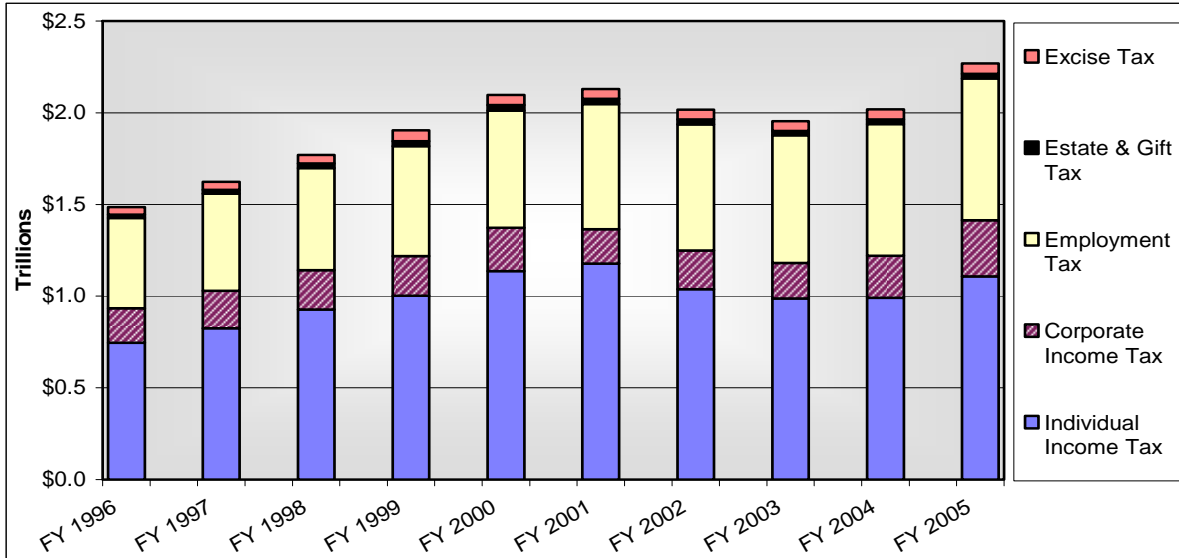
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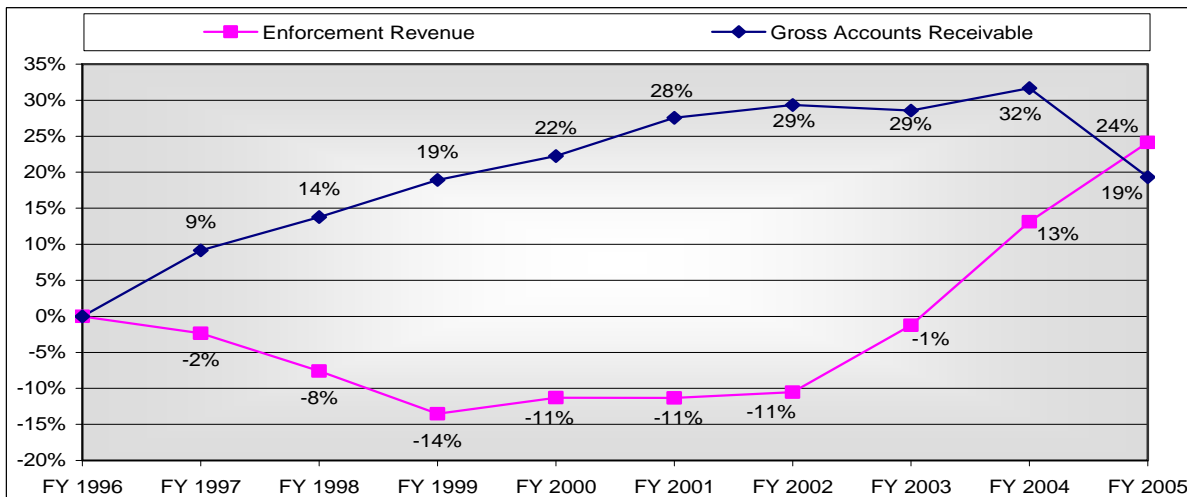
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Figure 1. Gross Collections by Type of Tax Since Fiscal Year (FY) 1996. Overall gross tax collections rose in FY 2005 to the highest level of the 10-year analysis. Since a low experienced in FY 2003, corporate income tax collections increased by 58 percent, individual income tax collections increased by 12 percent, and employment tax collections increased by 11 percent.



Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of Internal Revenue Service (IRS) Data Book.

Figure 2. Change in Enforcement Revenue and Gross Accounts Receivable – Percentage Change From FY 1996. Enforcement revenue has been increasing sharply since FY 2002; for FY 2005, it was 24 percent higher than it was for FY 1996. Gross accounts receivable showed a sharp decrease in FY 2005, to a level only 19 percent higher than that in FY 1996.

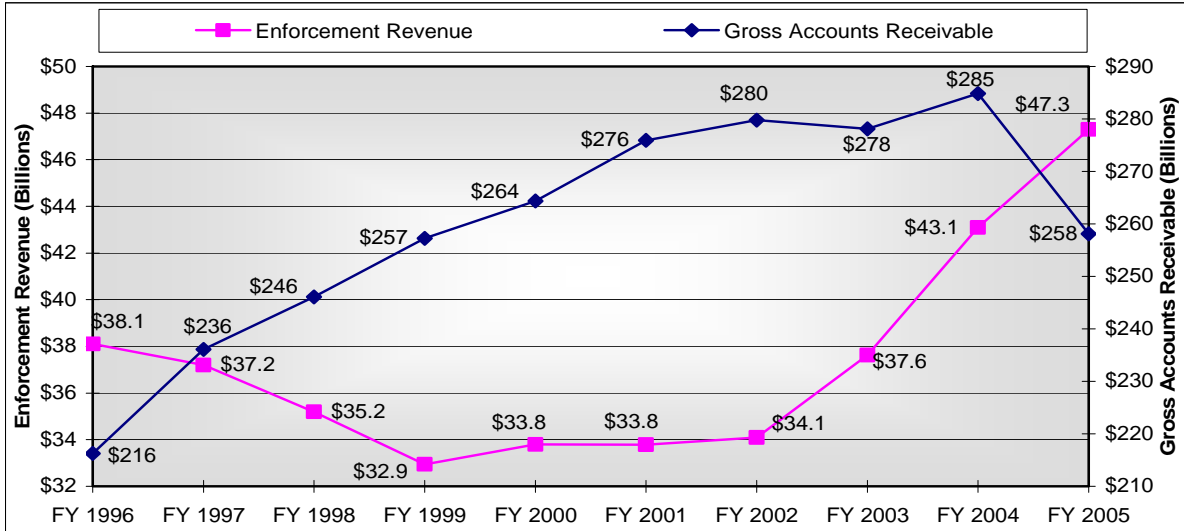


Source: TIGTA analysis of Tax Analysts Document Service Doc. 2005-22508 and Chief Financial Officer information.



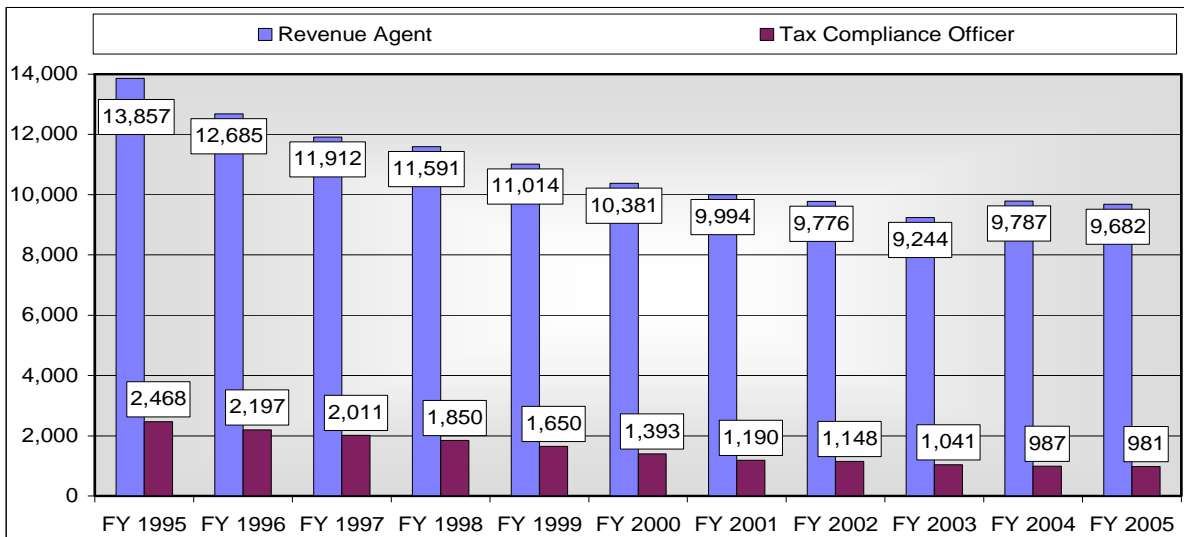
Trends in Compliance Activities Through Fiscal Year 2005

Figure 3. Amounts of Enforcement Revenue Collected Compared to Growth in Gross Accounts Receivable. After several years of remaining relatively constant, enforcement revenue collected has increased 39 percent since FY 2002. Gross accounts receivable, after reaching a 10-year high in FY 2004, decreased just over 9 percent during FY 2005.



Source: Tax Analysts Document Service Doc. 2005-22508 and Chief Financial Officer information.

Figure 4. Examination Function Staffing at the End of Each Fiscal Year. The numbers in this chart represent the number of Examination function staff conducting examinations of tax returns (excludes management and overhead staff). During FY 2005, revenue agent and tax compliance officer (formerly referred to as tax auditor) staffing decreased, and the combined total is now almost 35 percent lower than it was at the beginning of FY 1996.

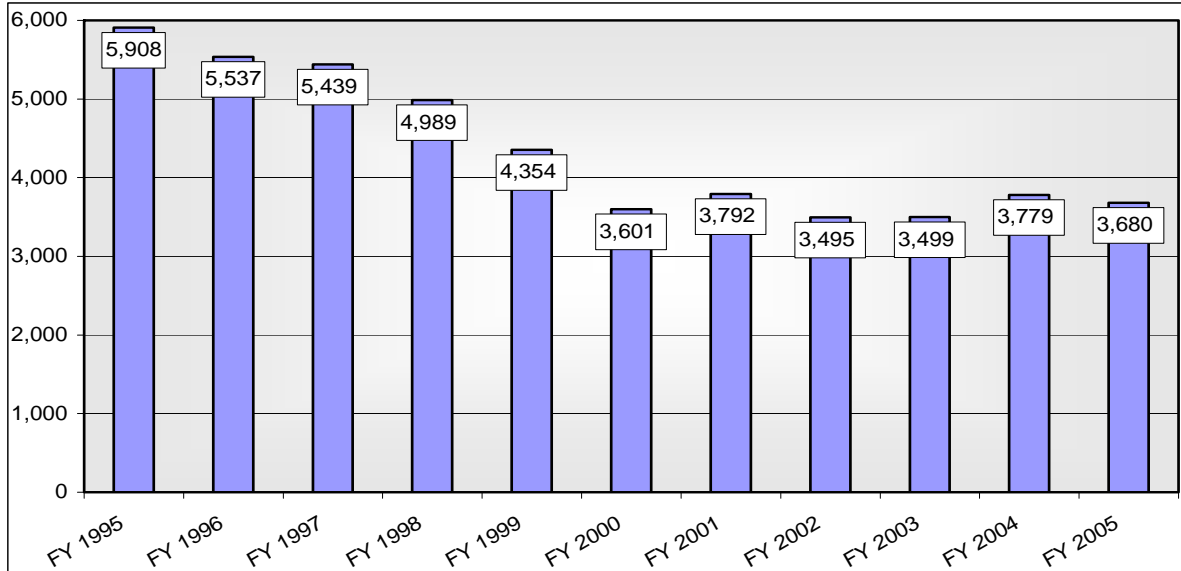


Source: TIGTA analysis of Examination Table 37.



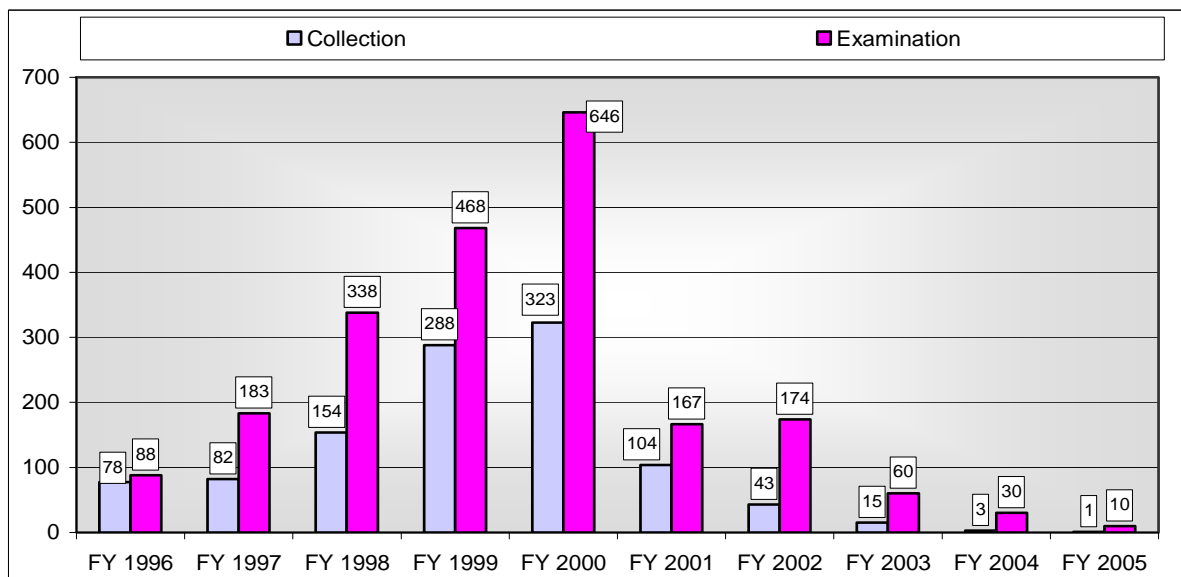
Trends in Compliance Activities Through Fiscal Year 2005

Figure 5. Collection Field function (CFF) Staffing at the End of Each Fiscal Year. The number of revenue officers working assigned delinquent cases (excludes management and overhead staff) decreased slightly during FY 2005 and is almost 38 percent fewer than at the start of FY 1996.



Source: Collection Report 5000-23.

Figure 6. Staff Years Detailed to Customer Service. The number of staff years detailed to customer service dropped off again in FY 2005 and remains lower than the number detailed during FY 1996.

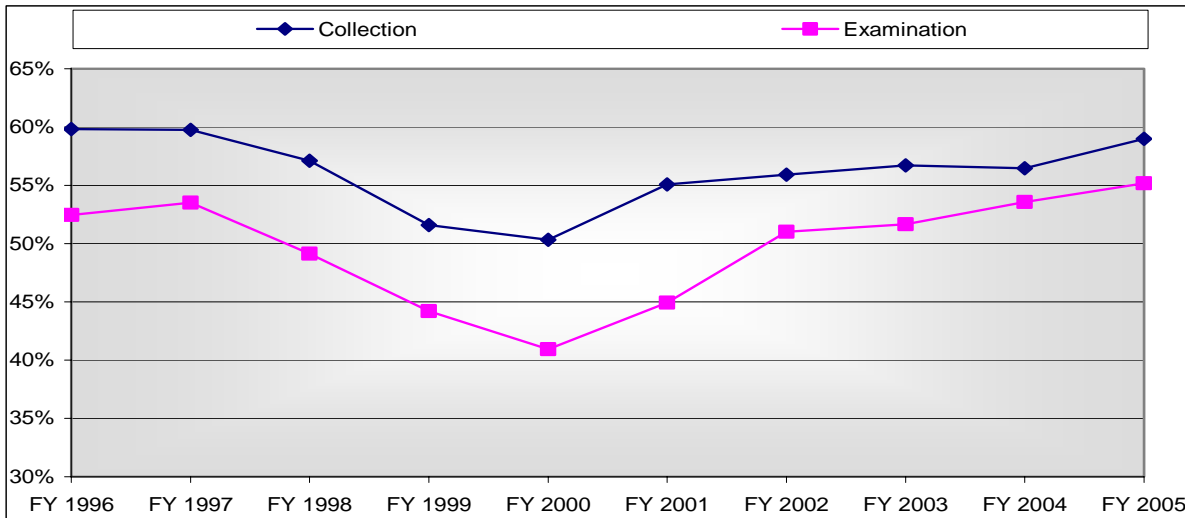


Source: TIGTA analysis of Collection Report 5000-23 and Examination Table 37.



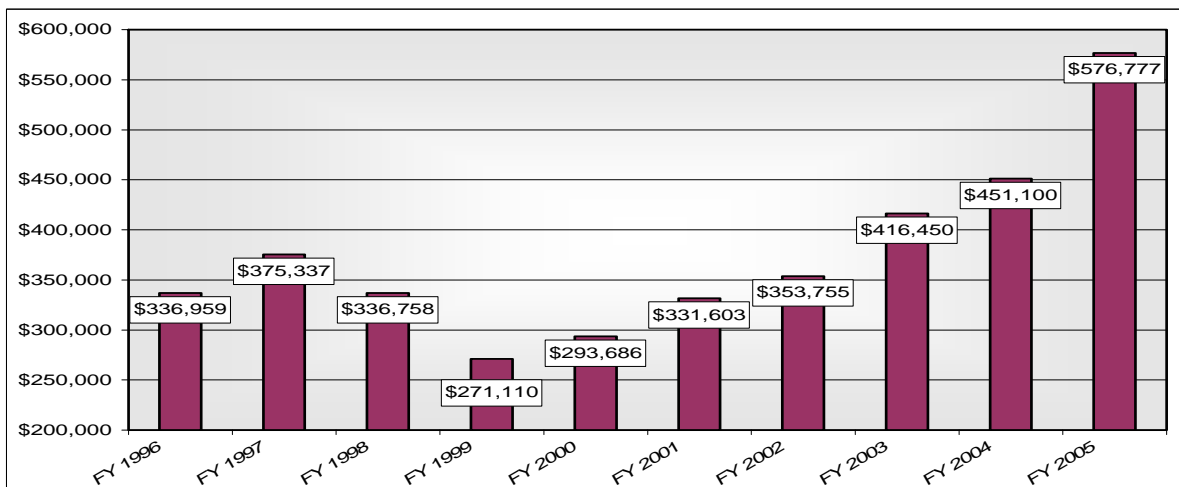
Trends in Compliance Activities Through Fiscal Year 2005

Figure 7. Changes in Direct Time Percentages. The Collection and Examination functions have both increased the percentage of overall time charged to their tax-related responsibilities (collecting taxes, securing tax returns not timely filed, and examining tax returns) since FY 2000. The Examination and Collection functions changed what types of time they capture as direct and indirect in recent years, including capturing some of the previous indirect time as direct time. The graph below depicts our recalculation of direct time based on direct time categories from prior years, to present consistent data for the 10 years included in the graph.



Source: TIGTA analysis of Collection Report 5000-23 and Examination Table 37.

Figure 8. Average Dollars Collected per Staff Year on Taxpayer Delinquent Accounts (TDA) by the CFf. The average amount collected by the CFf for each staff year has increased significantly, by almost 28 percent from FY 2004 to FY 2005 and almost 113 percent since FY 1999.

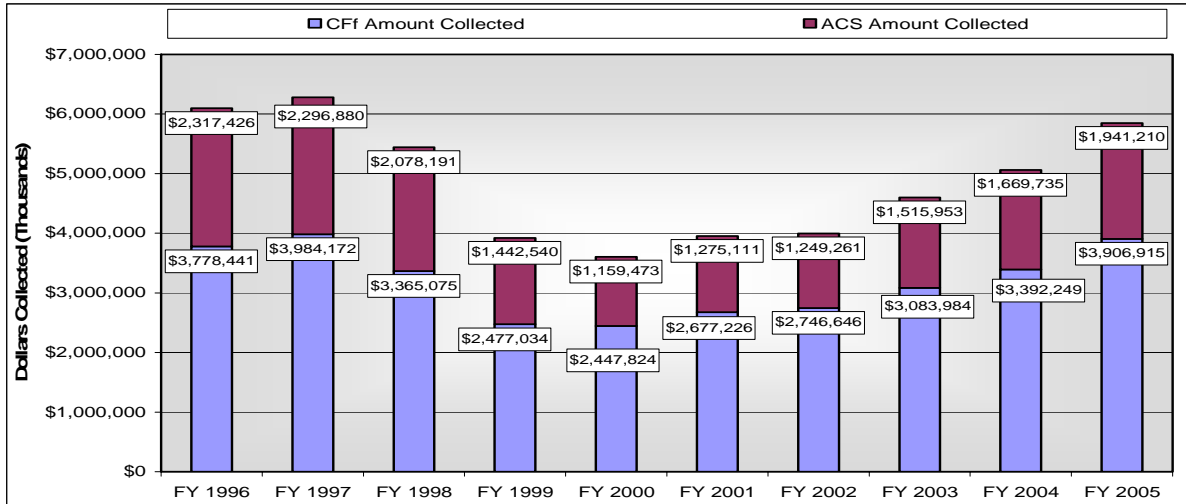


Source: TIGTA analysis of Collection Reports 5000-2 and 5000-23.



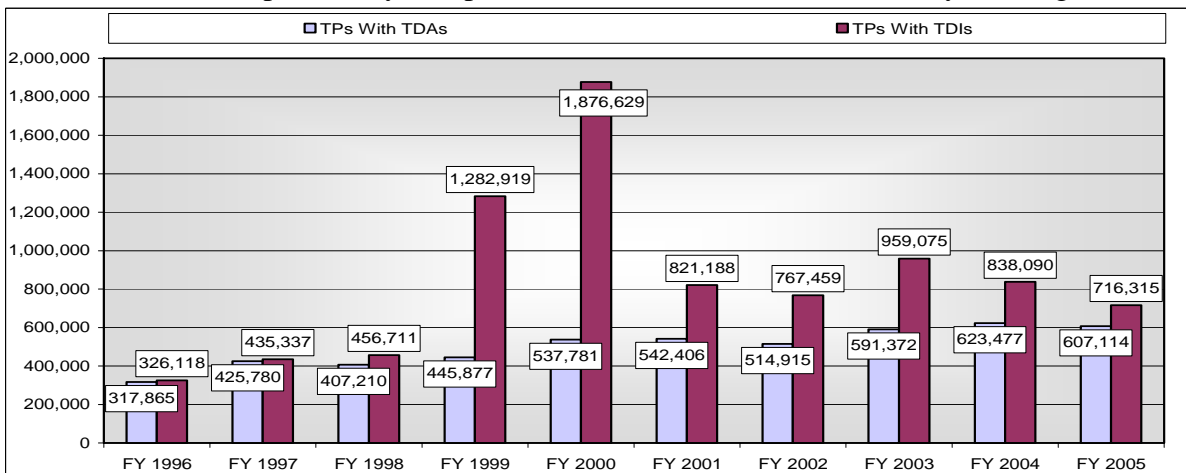
Trends in Compliance Activities Through Fiscal Year 2005

Figure 9. Total Dollars Collected on TDAs by the Cff and the Automated Collection System (ACS). Except for FY 2002, when the amount collected by the ACS decreased slightly, the amounts collected by the ACS and Cff have increased constantly since FY 2000. Since then, the ACS amount collected increased by just over 67 percent, while the amount collected by the Cff increased by almost 60 percent.



Source: Collection Report 5000-2.

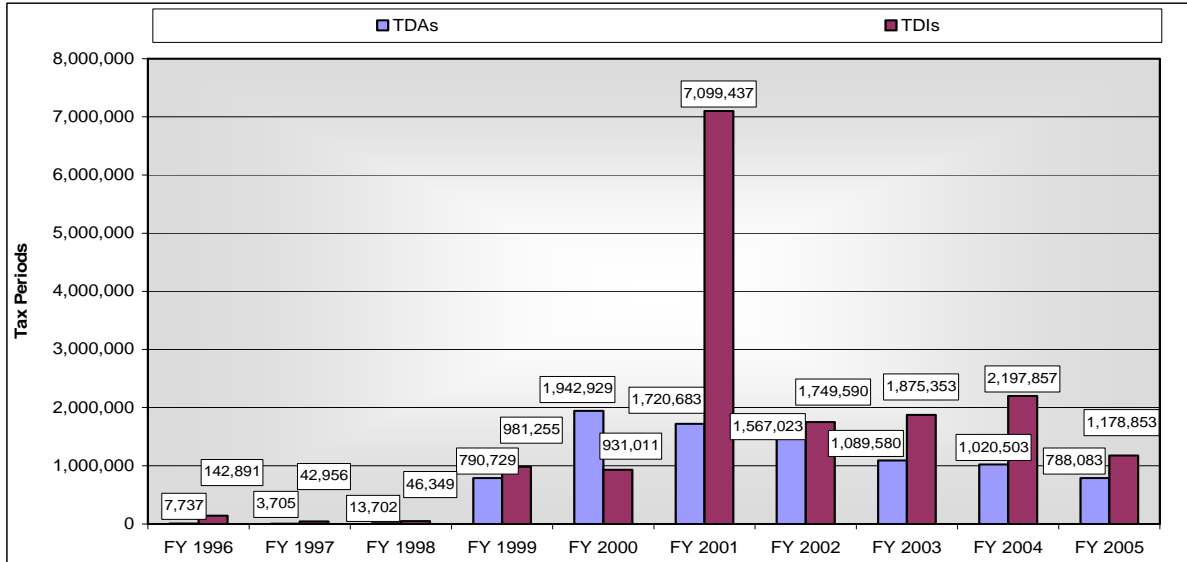
Figure 10. Delinquent Accounts in the Queue. The number of taxpayers (“TPs” in the chart) with Taxpayer Delinquency Investigations (TDI) in the Queue inventory increased from FY 1996 to FY 2000, with significant spikes during FYs 1999 and 2000, then decreased to remain at relatively constant levels. Except for a couple of slight dips, the number of taxpayers with TDAs increased from FYs 1996 to 2004, then dropped slightly during FY 2005. However, from FY 1999 through FY 2005, the IRS removed a large number of cases from the Queue that were considered to be potentially less productive than other Queue inventory (see Figure 11).



Source: Collection Reports 5000-2 and 5000-4.

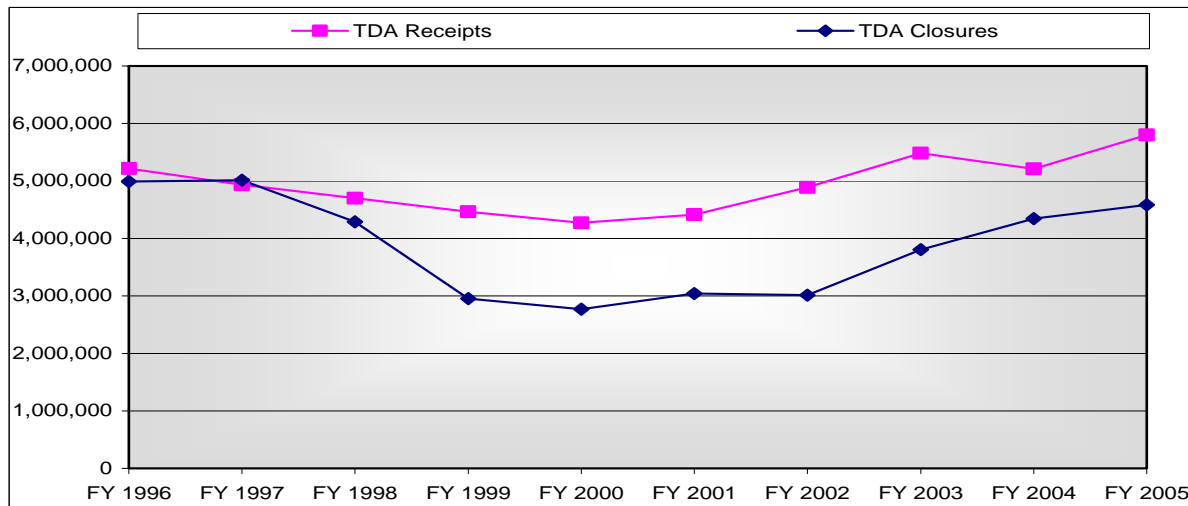


Figure 11. Delinquent Accounts and Unfiled Return Investigations Shelved or Surveyed Each Year. Since FY 1999, the IRS has removed millions of unpaid tax periods and unfiled return investigations from the Queue inventory. However, the total volume shelved or surveyed decreased significantly (by almost 39 percent) from FY 2004 to FY 2005.



Source: TIGTA analysis of Collection Reports 5000-2 and 5000-4.

Figure 12. Gap Between New Delinquent Accounts and Account Closures. The gap between unpaid account receipts and closures increased for FY 2005 after decreasing in FYs 2003 and 2004. The number of receipts has been greater than the number of closures each year after FY 1997. The closures shown here do not include the unpaid accounts shelved, shown above in Figure 11.

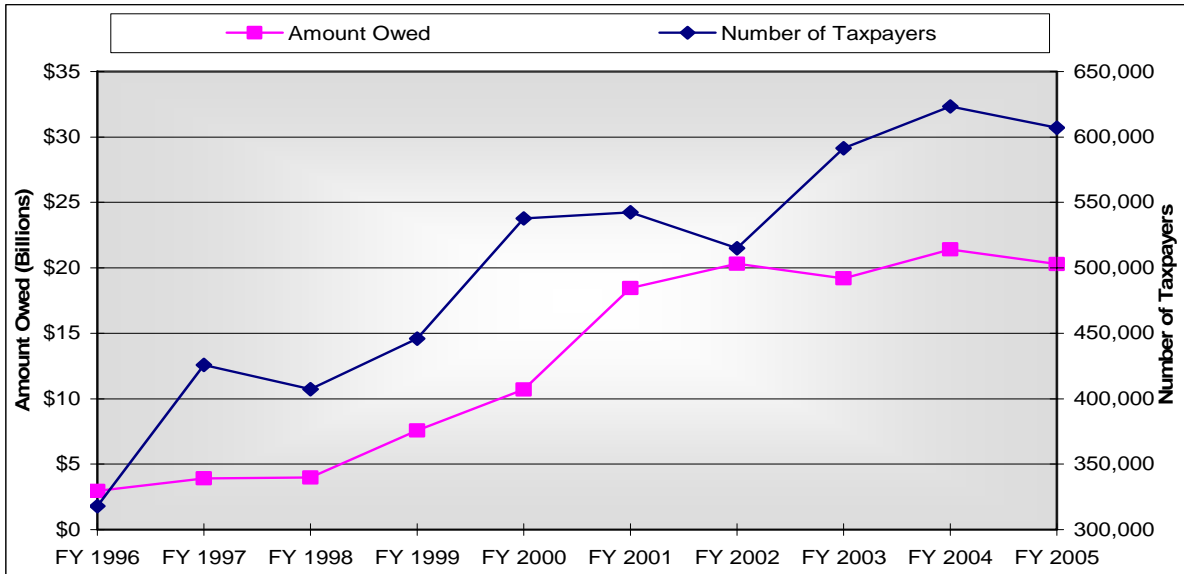


Source: TIGTA analysis of Collection Report 5000-2.



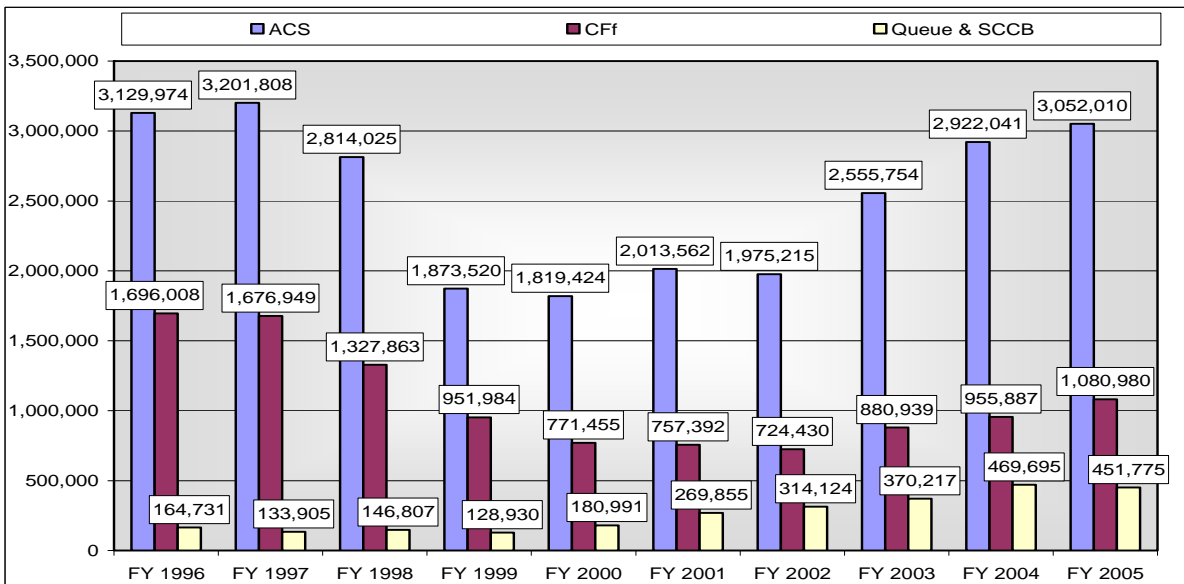
Trends in Compliance Activities Through Fiscal Year 2005

Figure 13. Number of Taxpayers and Amounts Owed in the Queue. The number of taxpayers with unpaid accounts in the Queue inventory decreased by almost 3 percent, while the amount owed decreased by just over 5 percent from FY 2004 to FY 2005.



Source: Collection Report 5000-2.

Figure 14. Number of Delinquent Accounts Closed, Excluding Shelved Accounts. The number of delinquent unpaid accounts closed by the ACS and CFf increased again in FY 2005, while the number closed from the Queue and Service Center Collection Branch (SCCB) inventory decreased slightly.

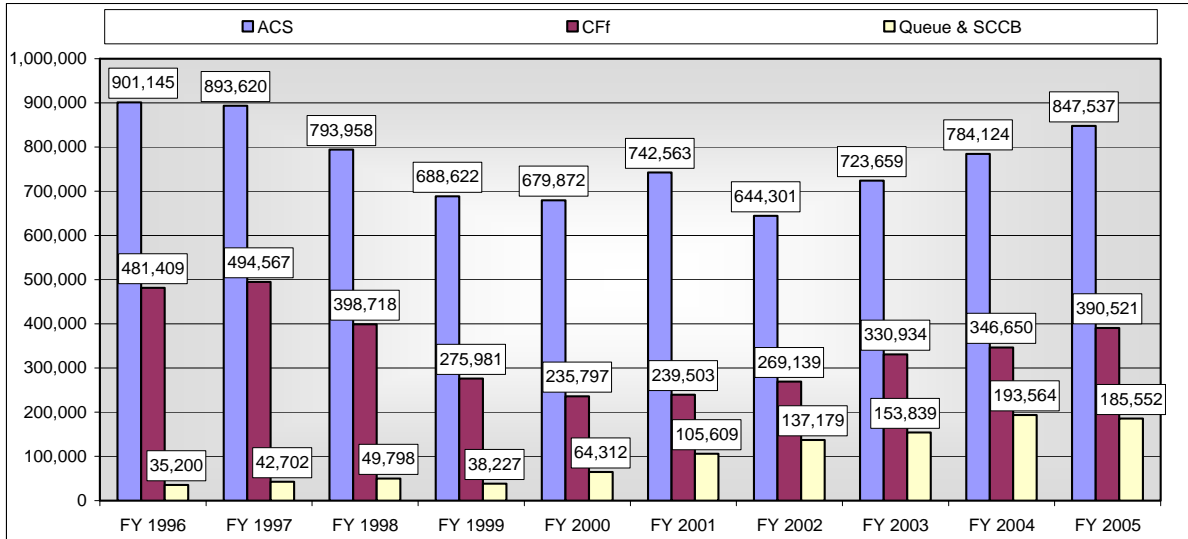


Source: TIGTA analysis of Collection Report 5000-2.



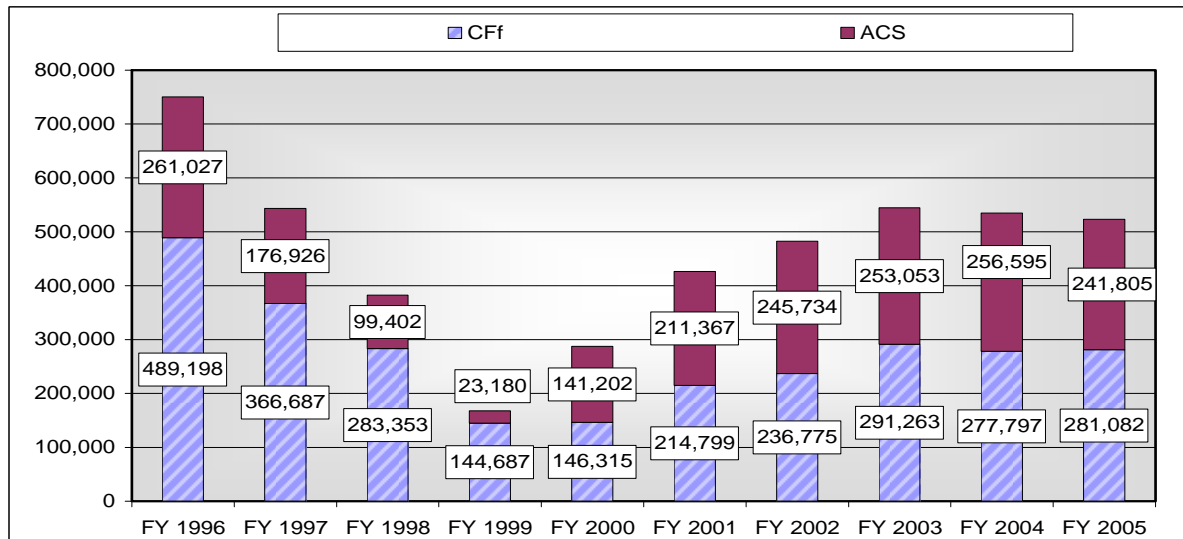
Trends in Compliance Activities Through Fiscal Year 2005

Figure 15. Number of Delinquent Accounts Closed by Full Payment. The total number of accounts closed by full payment increased by 7.5 percent in FY 2005. Since FY 2002, there has been a steady increase in the number of accounts closed by full payment by the ACS and the CFf.



Source: TIGTA analysis of Collection Report 5000-2.

Figure 16. Liens Filed by the CFf and ACS. The total number of liens filed in FY 2005 decreased by just over 2 percent. This follows a similar drop in FY 2004. The IRS attributes this decrease to a policy change that resulted in fewer liens being refiled since FY 2003. During FY 2005, the number of liens filed by the ACS decreased 6 percent, but those filed by the CFf increased 1 percent.

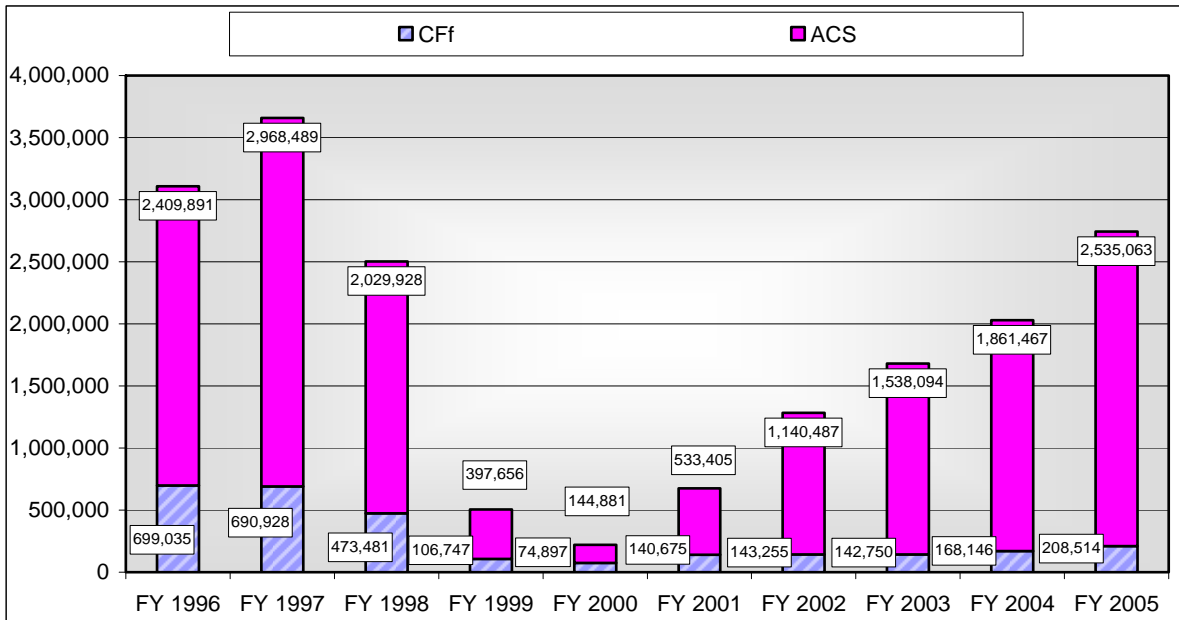


Source: Collection Report 5000-23 and the Automated Lien System.



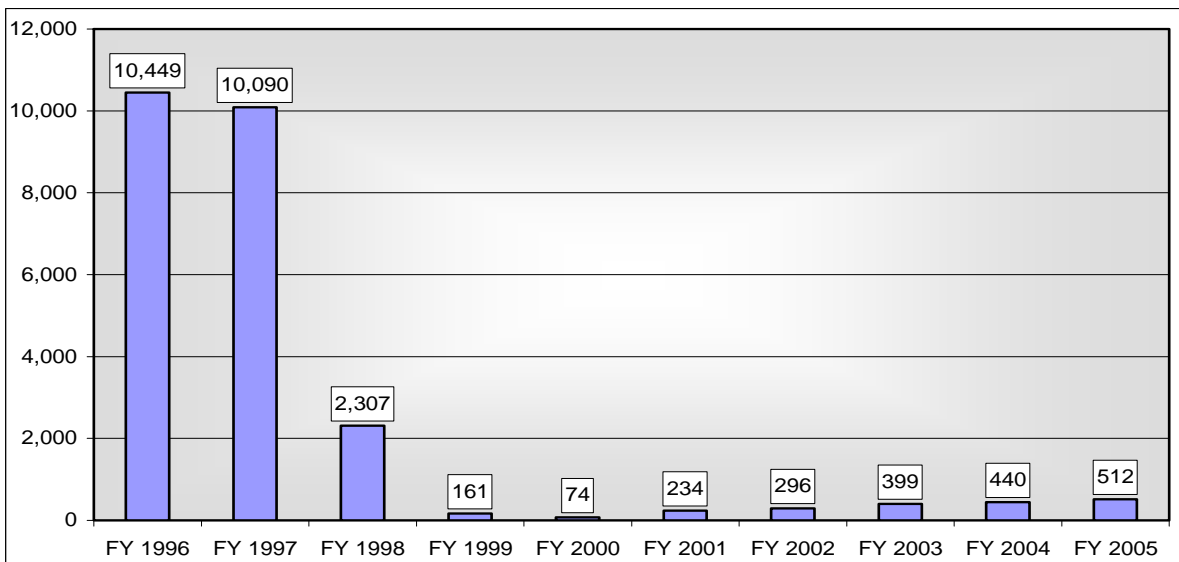
Trends in Compliance Activities Through Fiscal Year 2005

Figure 17. Levies Issued by the Cff and ACS. An increasing number of levies have been issued by the ACS and the Cff since FY 2000. Compared to FY 2004, the total number of levies issued during FY 2005 increased by slightly over 35 percent.



Source: Collection Report 5000-23 and Customer Service Activity Report.

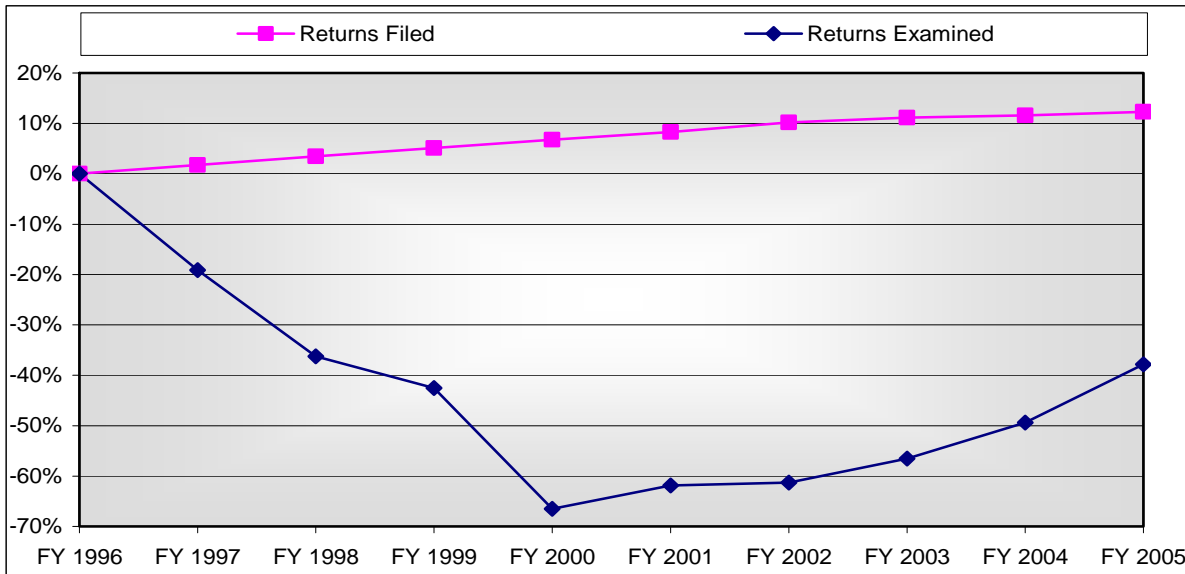
Figure 18. Number of Seizures Made Each Fiscal Year. The number of seizures made in FY 2005 continued the upward trend that has occurred since FY 2000, but it is still only about 5 percent of the seizures made in FY 1996.



Source: Collection Report 5000-23 and IRS manual reconciliation of seizure logs.

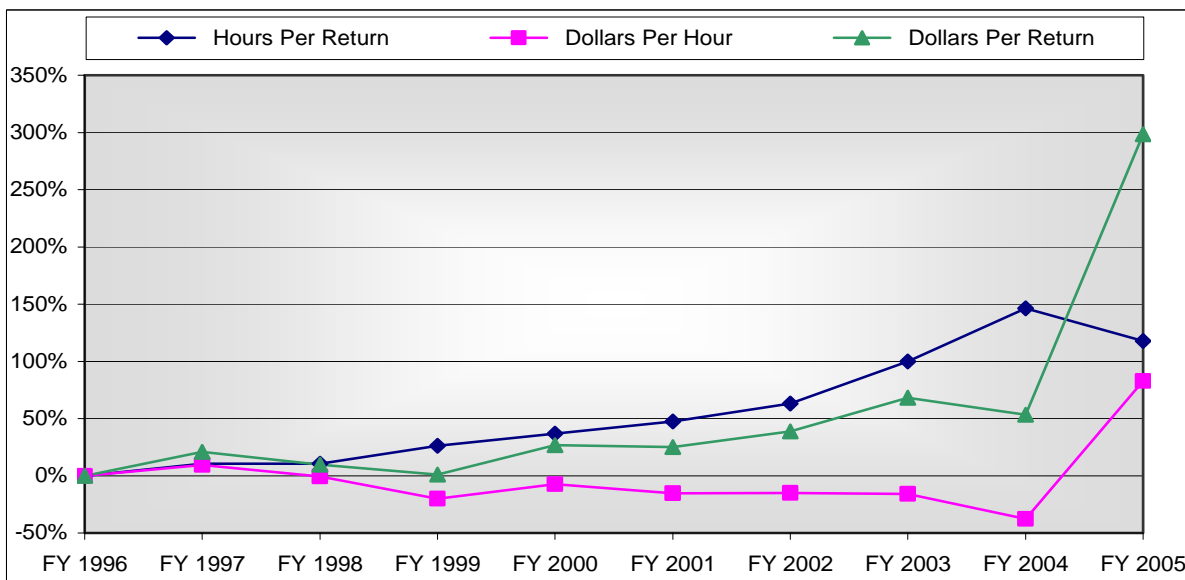


Figure 19. Examination Coverage of All Tax Returns – Percentage Change From FY 1996. While the examination coverage of tax returns is still below the level in FY 1998, the growth in examination coverage again outpaced the growth in returns filed during FY 2005.



Source: TIGTA analysis of IRS Data Book.

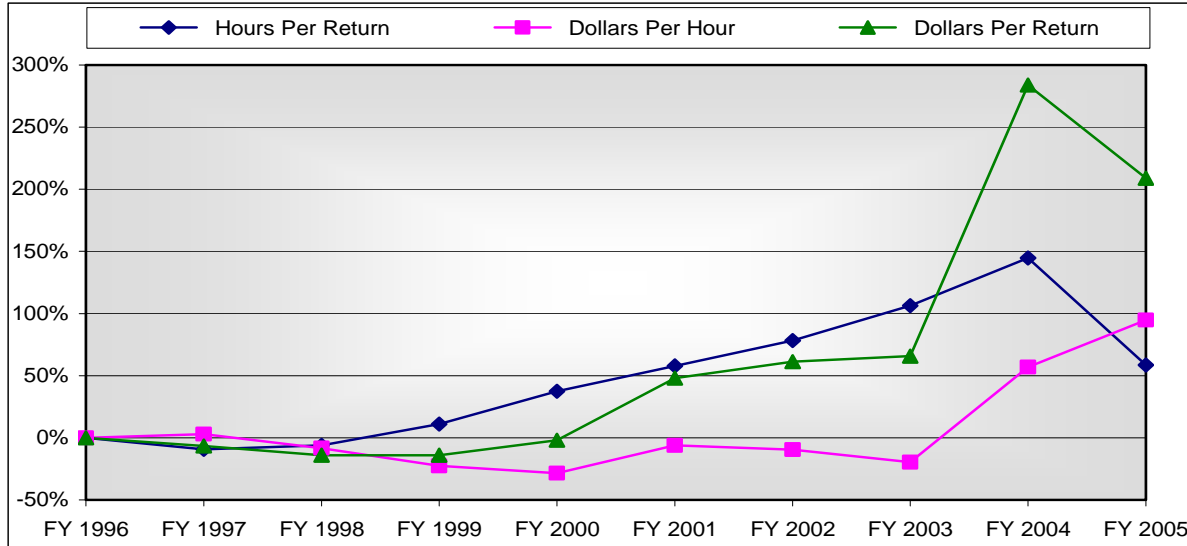
Figure 20. Revenue Agent Results on U.S. Individual Income Tax Returns (Form 1040), Excluding Training Returns – Percentage Change From FY 1996. The hours per return decreased and dollars per return increased significantly, resulting in an increase of 194 percent in dollars per hour for FY 2005.



Source: TIGTA analysis of Examination Table 37.

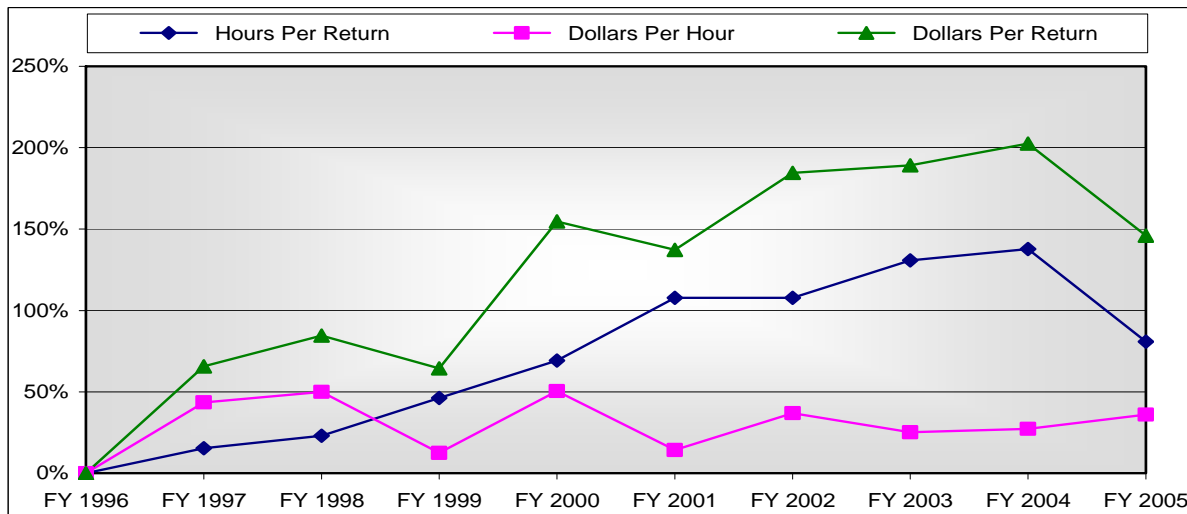


Figure 21. Revenue Agent Results on Corporate Income Tax Returns, Excluding Training Returns – Percentage Change From FY 1996. The hours and dollars per return both decreased during FY 2005. However, the decrease in hours per return was substantial enough that the combined effect resulted in an increase in dollars per hour of just over 24 percent for FY 2005.



Source: TIGTA analysis of Examination Table 37.

Figure 22. Revenue Agent Results on Other Types of Tax Returns, Excluding Training Returns – Percentage Change From FY 1996. The hours and dollars per return both decreased during FY 2005. However, since the hours per return decrease was greater, the combined effect was that dollars per hour increased by almost 7 percent for FY 2005.

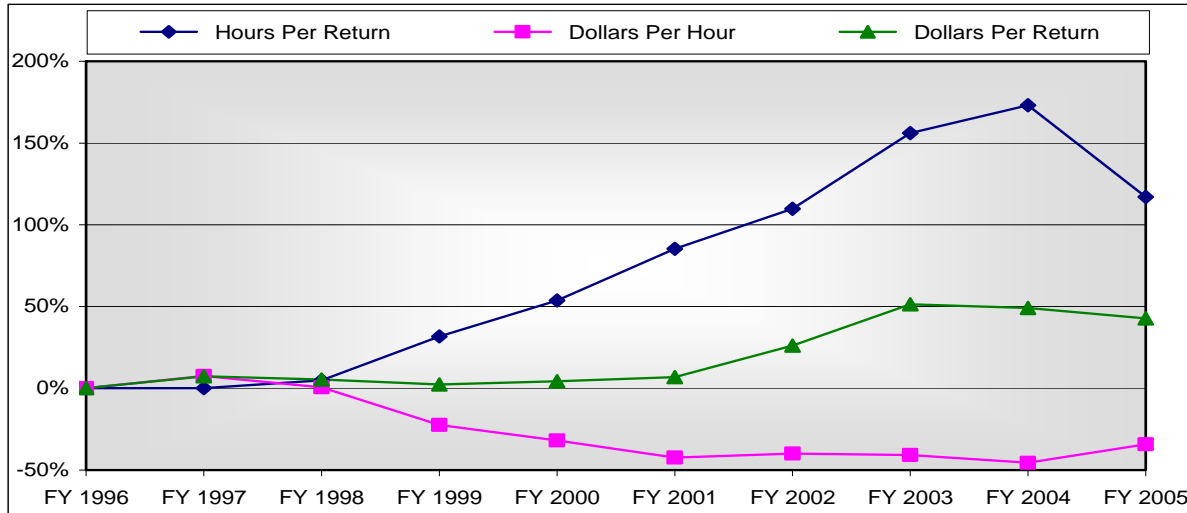


Source: TIGTA analysis of Examination Table 37.



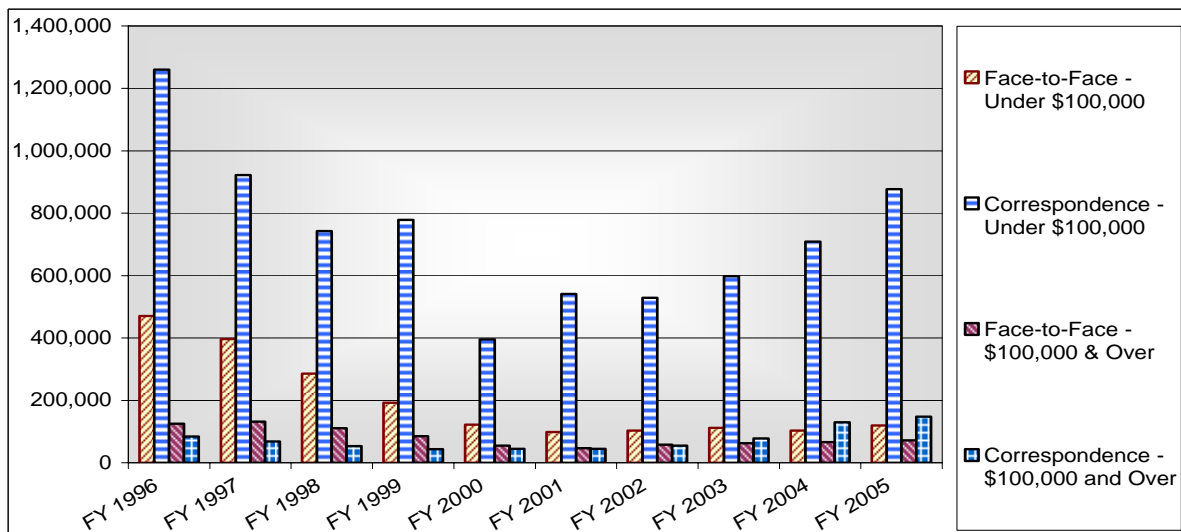
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Figure 23. Tax Compliance Officer Results on Forms 1040, Excluding Training Returns – Percentage Change From FY 1996. The hours and dollars per return both decreased during FY 2005. However, the decrease in hours per return was significant. Therefore, the combined effect was that dollars per hour increased by almost 21 percent for FY 2005.



Source: TIGTA analysis of Examination Table 37.

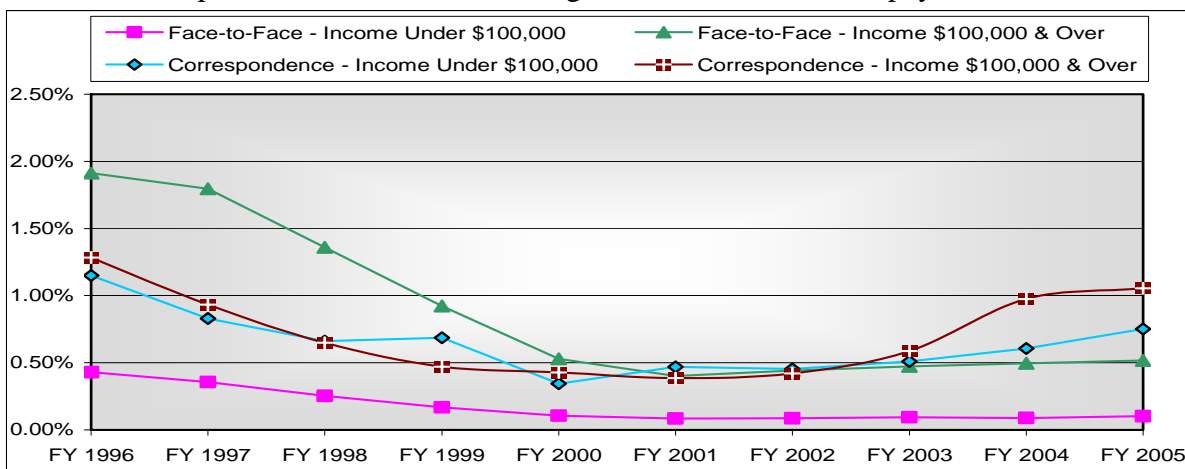
Figure 24. Number of Forms 1040 Examined Face-to-Face or Through Correspondence. The total number of face-to-face examinations of individuals increased by just over 13 percent, and those conducted through correspondence increased by just over 22 percent in FY 2005. A slightly greater percentage of change occurred for individuals with income of under \$100,000; those increased over 15 percent for face-to-face examinations and almost 24 percent for correspondence examinations.



Source: TIGTA analysis of Examination Table 37.

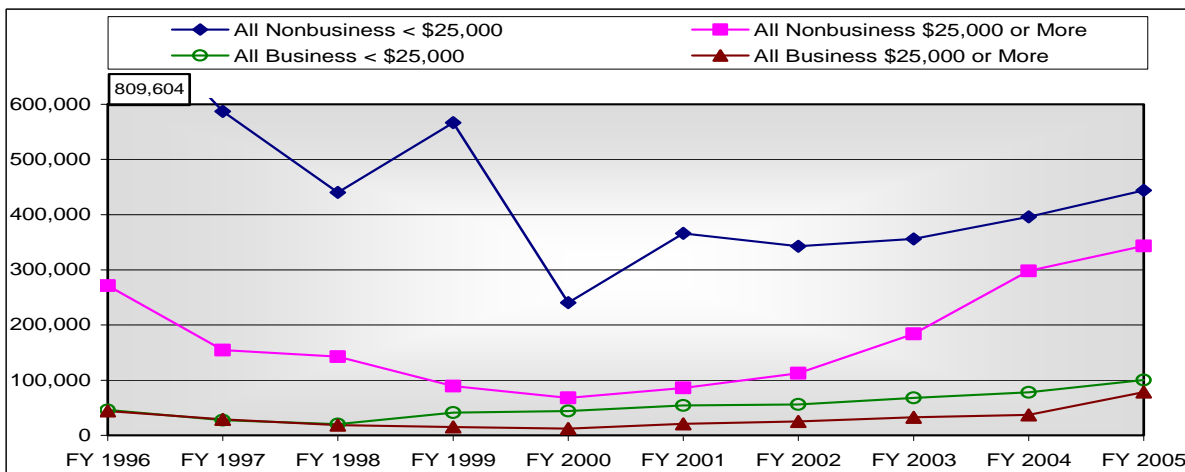


Figure 25. Percentage of Forms 1040 Examined Face-to-Face or Through Correspondence. During FY 2005, the coverage rate for face-to-face examinations of nonbusiness and business individual income tax returns increased for many of the income categories. The overall face-to-face coverage rate for individual income tax returns with farm income decreased. The coverage rate for correspondence examinations of individual income tax returns increased for all categories except for nonbusiness Forms 1040 with high income (\$100,000 and over). However, the rate increased substantially for business Forms 1040 with high income, resulting in a slight increase in correspondence examinations of high-income individual taxpayers overall.



Source: TIGTA analysis of Examination Table 37.

Figure 26. Number of Forms 1040 Examined by Correspondence Examination. During FY 2005, the number of examinations conducted by correspondence examination increased for all categories of tax returns except nonbusiness with income over \$100,000. The fluctuation in examinations of nonbusiness tax returns with income under \$25,000 was largely based on fluctuations in the number of Earned Income Tax Credit examinations.

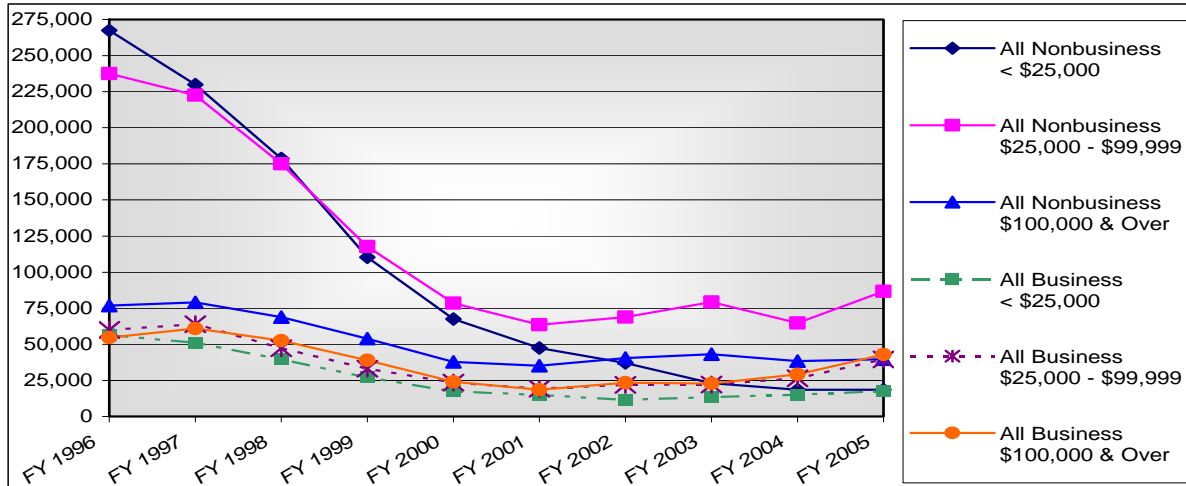


Source: TIGTA analysis of IRS Data Book.



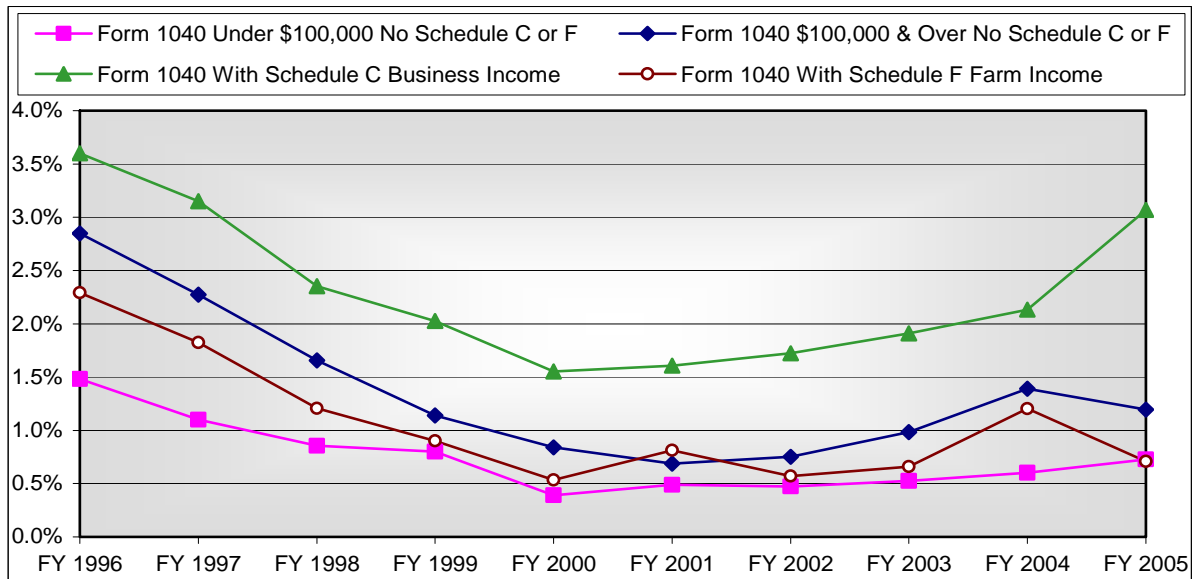
Trends in Compliance Activities Through Fiscal Year 2005

Figure 27. Number of Forms 1040 Examined by Field Offices (Excluding Those With Farm Income). Field offices conduct a combination of face-to-face and correspondence examinations. During FY 2005, the number of examinations conducted by field offices increased for all categories of tax returns.



Source: TIGTA analysis of IRS Data Book.

Figure 28. Percentage of Forms 1040 Examined. This shows the comparison in examination rates (total correspondence and face-to-face) for tax returns with business or farm income and those with incomes of under \$100,000 and \$100,000 and over without business or farm income. During FY 2005, the percentage examined decreased for Forms 1040 with farm income and for those with incomes of \$100,000 and over on which the income was not from a business or farm.

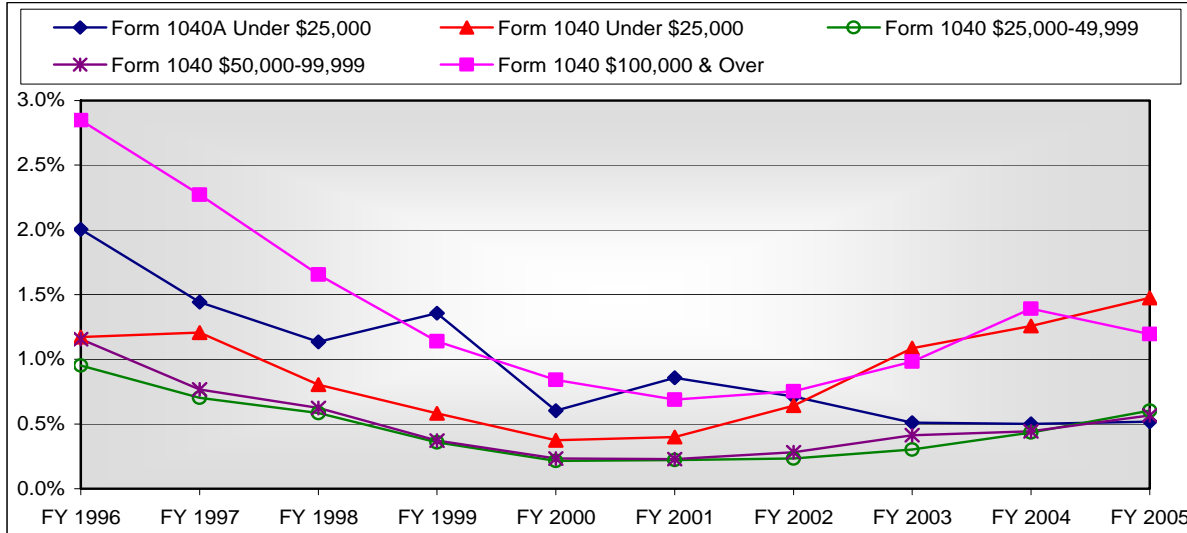


Source: TIGTA analysis of IRS Data Book.



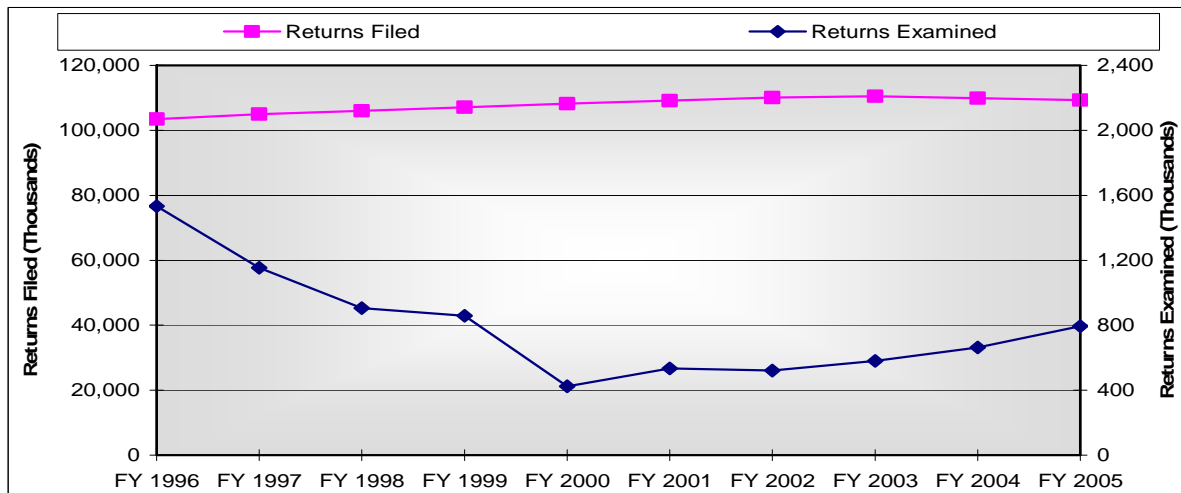
Trends in Compliance Activities Through Fiscal Year 2005

Figure 29. Percentage Examined – Forms 1040 With No Business or Farm Income. The percentage of Forms 1040 examined increased during FY 2005 for all income categories except those with income of \$100,000 and over. The increases were largely due to increases in the percentage of Forms 1040 examined by compliance center employees by correspondence.



Source: TIGTA analysis of IRS Data Book.

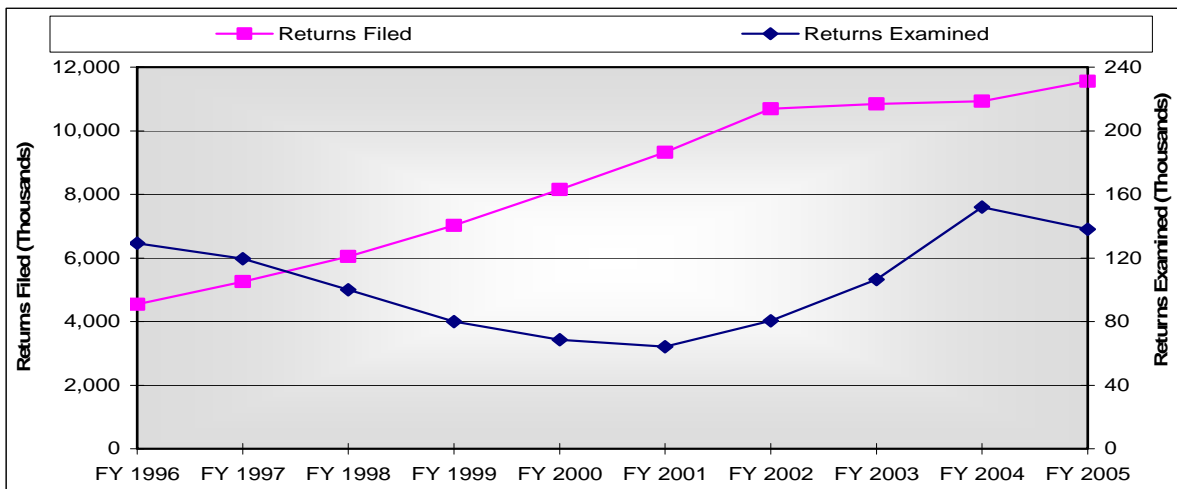
Figure 30. Examination Coverage of Nonbusiness Forms 1040 – Under \$100,000. The number of nonbusiness tax returns filed with income of under \$100,000 dropped off slightly in FYs 2004 and 2005 after steadily increasing since FY 1996. During FY 2005, the examination coverage rate for these returns increased by just over 20 percent. This increase was almost entirely due to an increase in compliance center correspondence examinations, which accounted for slightly over 83 percent of the increase in the number of examinations in this category.



Source: TIGTA analysis of IRS Data Book.

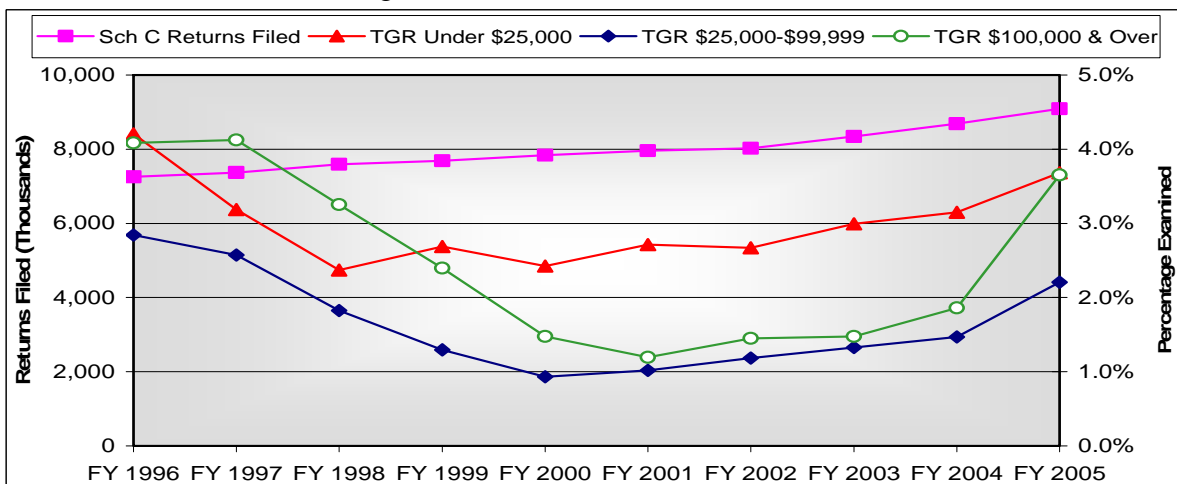


Figure 31. Examination Coverage of Nonbusiness Forms 1040 – \$100,000 and Over. The number of nonbusiness tax returns filed with income of \$100,000 and over increased slightly in FY 2005 after being relatively constant since FY 2002. During FY 2005, the examination coverage rate for these returns decreased by just over 14 percent. While the number of examinations by field employees increased slightly, there was a large decrease in the number of correspondence examinations conducted by compliance center employees in this category.



Source: TIGTA analysis of IRS Data Book.

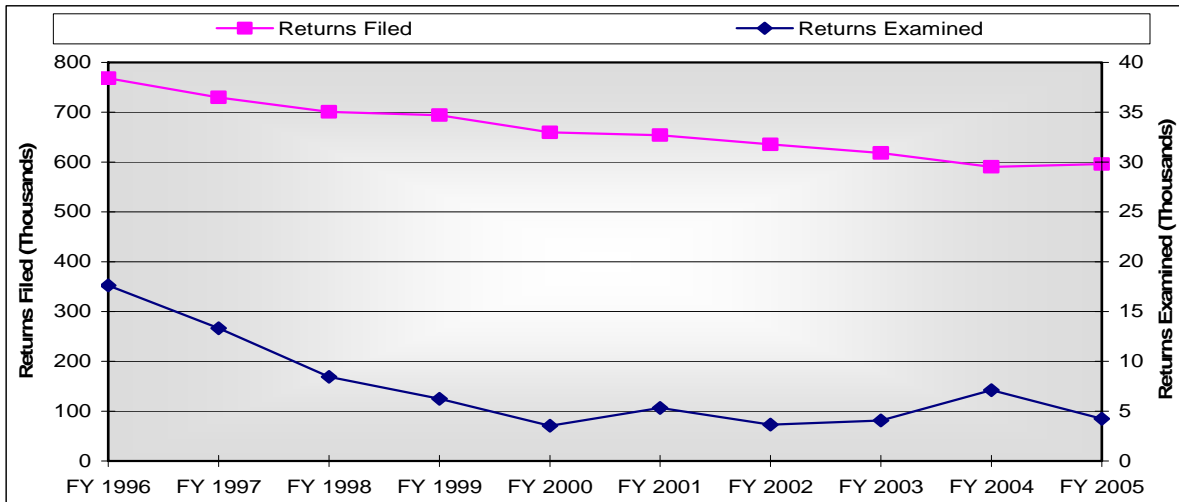
Figure 32. Examination Coverage of Forms 1040 With Business Income (Excluding Farms). During FY 2005, the total number of individual income tax returns filed with business income increased, as did the percentage examined in each of the categories. While there were increases in examination coverage by both field and compliance center employees, compliance center employees who conduct correspondence examinations accounted for a larger portion of the increases in each of the categories.



Source: TIGTA analysis of IRS Data Book. TGR = total gross receipts.

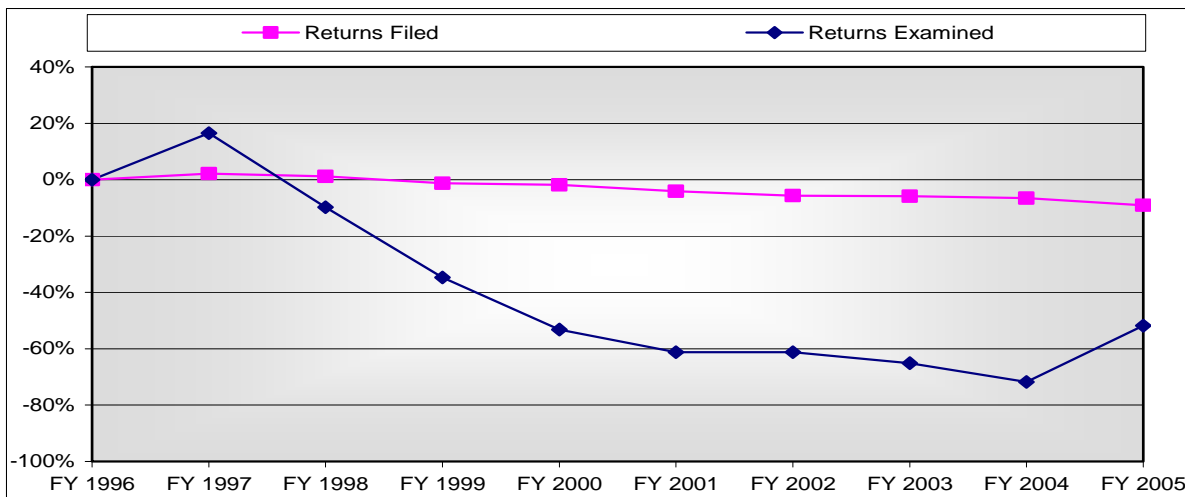


Figure 33. Examination Coverage of Forms 1040 With Farm Income. The number of Forms 1040 filed with farm income increased slightly in FY 2005. There was a slight increase in examinations of Forms 1040 with farm income by compliance center employees and a large decrease in those examinations by field employees. This, combined with the increase in filing of these tax returns, resulted in a 41 percent decrease in examination coverage in this category.



Source: TIGTA analysis of IRS Data Book.

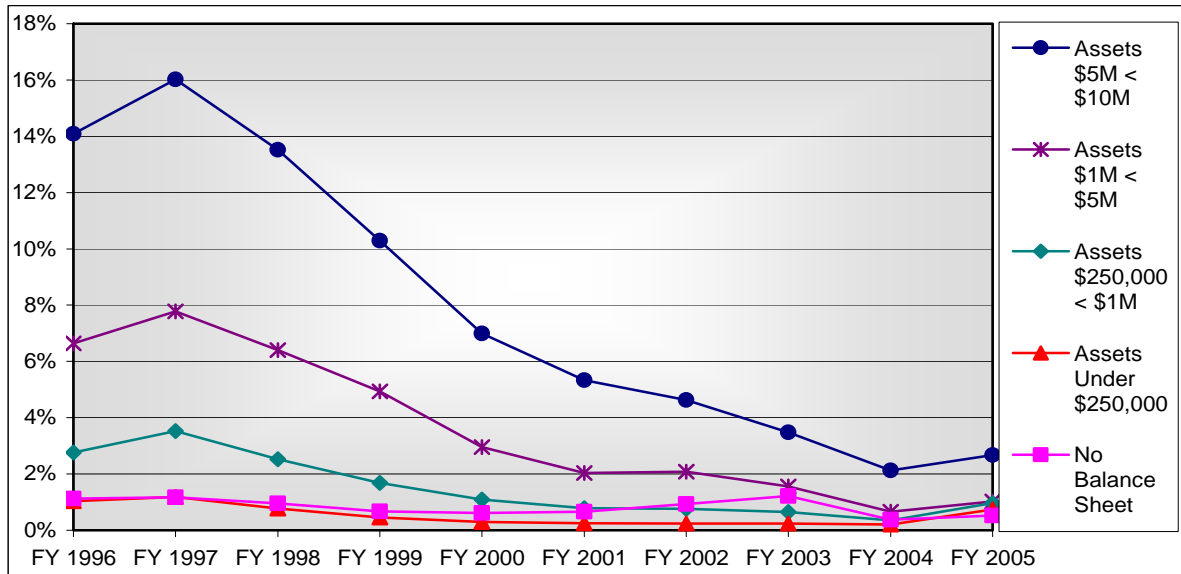
Figure 34. Examination Coverage of Corporate Income Tax Returns – Percentage Change From FY 1996. The number of corporate tax returns (excluding U.S. Income Tax Return for an S Corporation (Form 1120S) and U.S. Income Tax Return for a Foreign Corporation (Form 1120-F)) filed continued the steady decrease during FY 2005. The percentage of tax returns examined increased for all corporate tax return categories. Overall, 1 in 80 corporate tax returns was examined in FY 2005.



Source: TIGTA analysis of IRS Data Book.

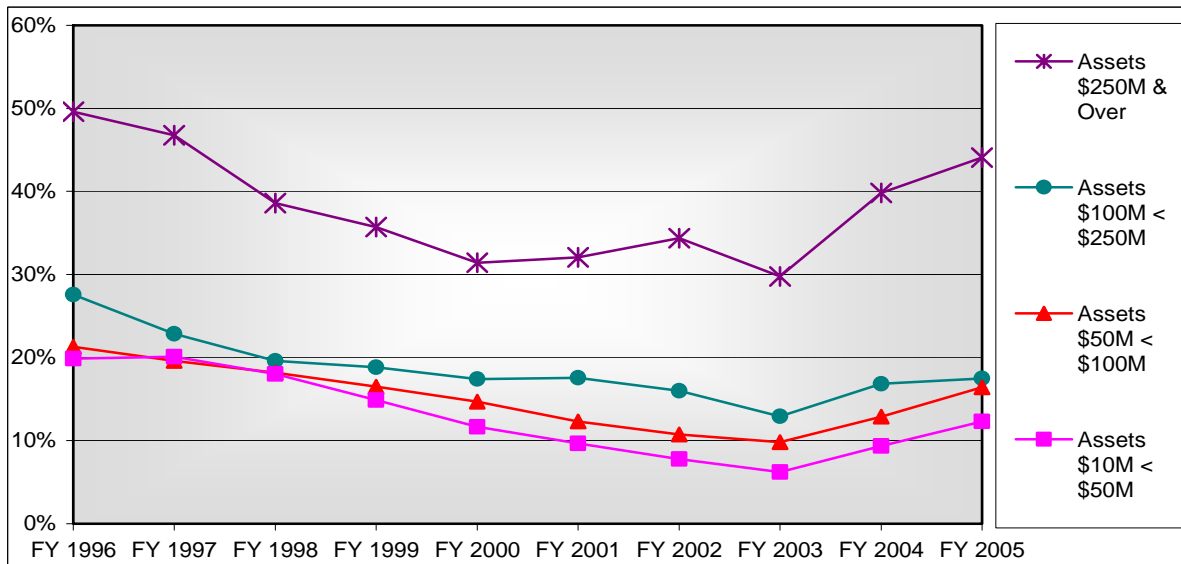


Figure 35. Percentage of Corporate Income Tax Returns Examined – Corporations With Assets of Under \$10 Million. During FY 2005, the examination coverage rate for corporate tax returns with no balance sheet or asset classes of under \$10 million increased by 151 percent.



Source: TIGTA analysis of IRS Data Book.

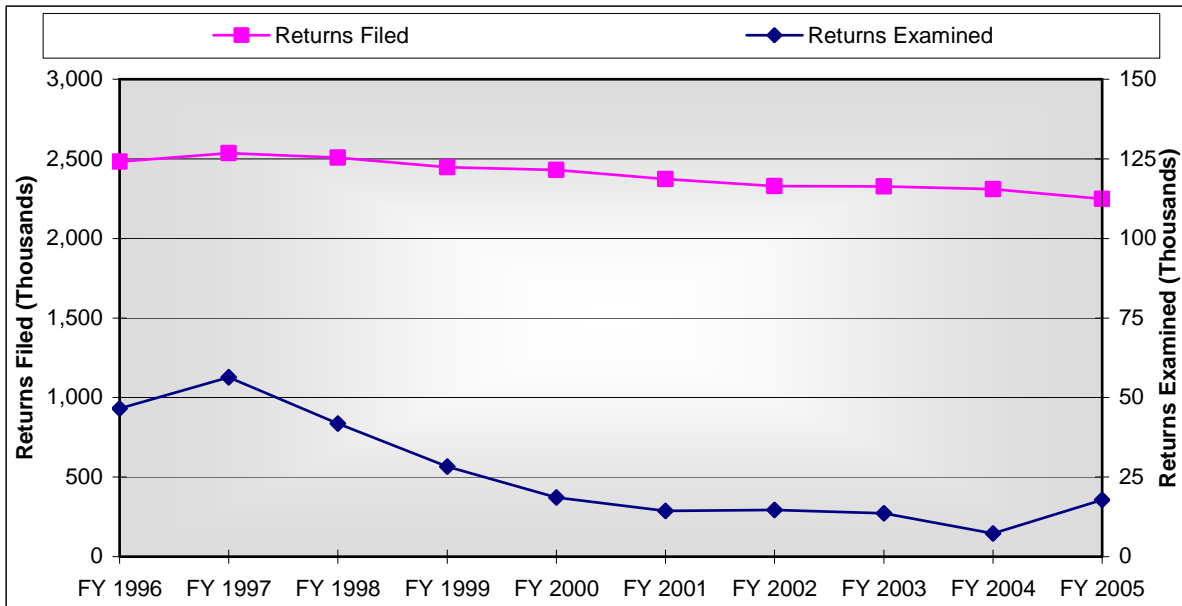
Figure 36. Percentage of Corporate Income Tax Returns Examined – Corporations With Assets of \$10 Million and Over. During FY 2005, the examination coverage rate for corporate tax returns with assets of \$10 million and over increased by 20 percent.



Source: TIGTA analysis of IRS Data Book.

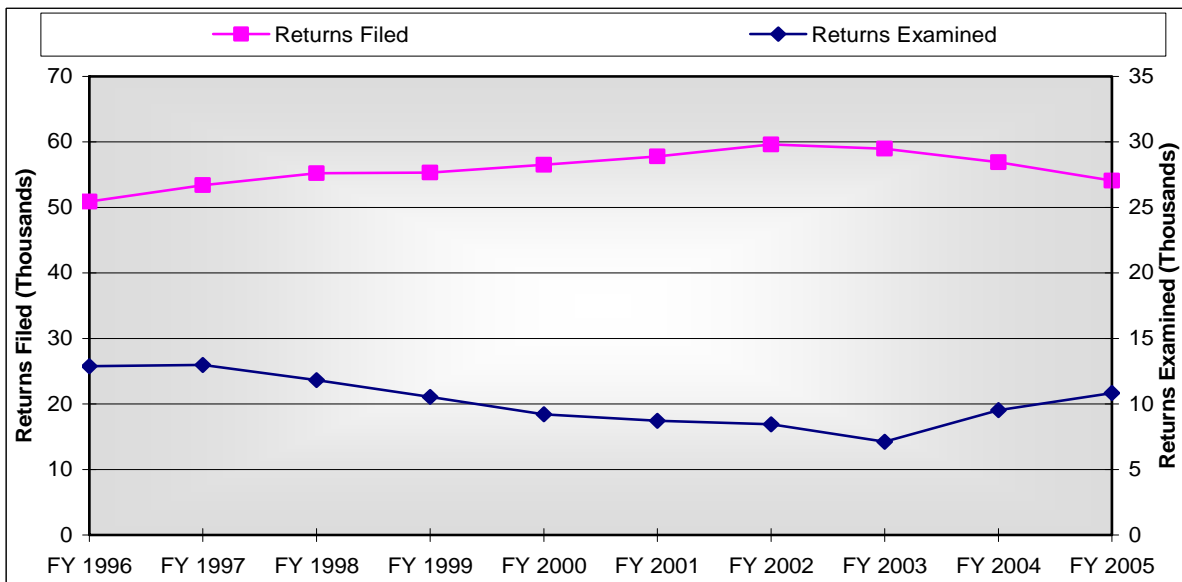


Figure 37. Examination Coverage of Corporations With Assets of Under \$10 Million. The number of corporate tax returns filed with assets of under \$10 million dropped by almost 3 percent during FY 2005, but the number of tax returns examined increased 145 percent.



Source: TIGTA analysis of IRS Data Book.

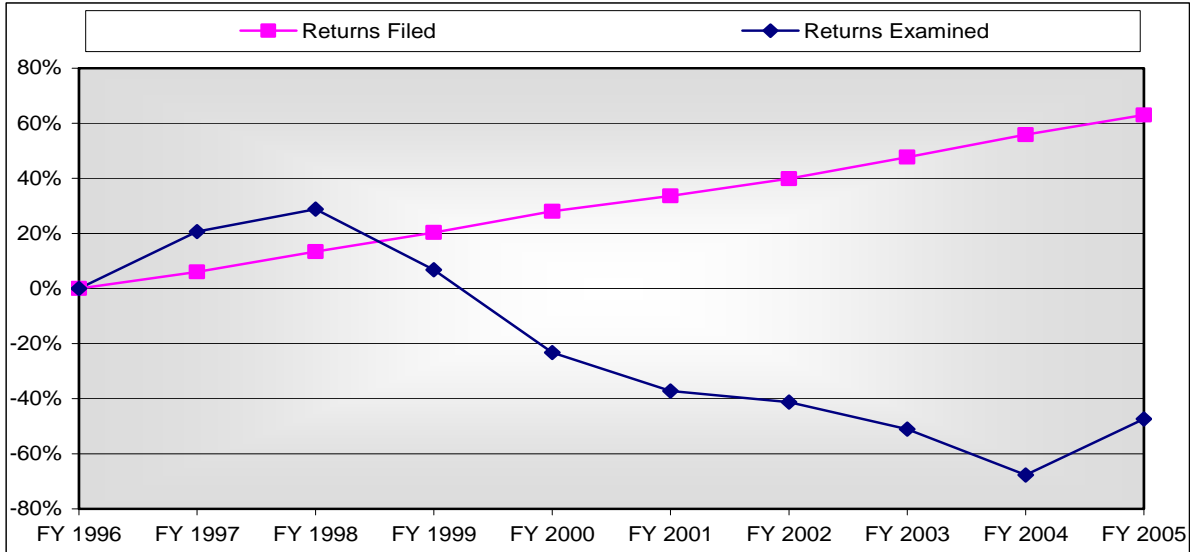
Figure 38. Examination Coverage of Corporations With Assets of \$10 Million and Over. During FY 2005, the number of corporate tax returns filed with assets of \$10 million and over decreased almost 5 percent, while the number of returns examined increased almost 14 percent.



Source: TIGTA analysis of IRS Data Book.

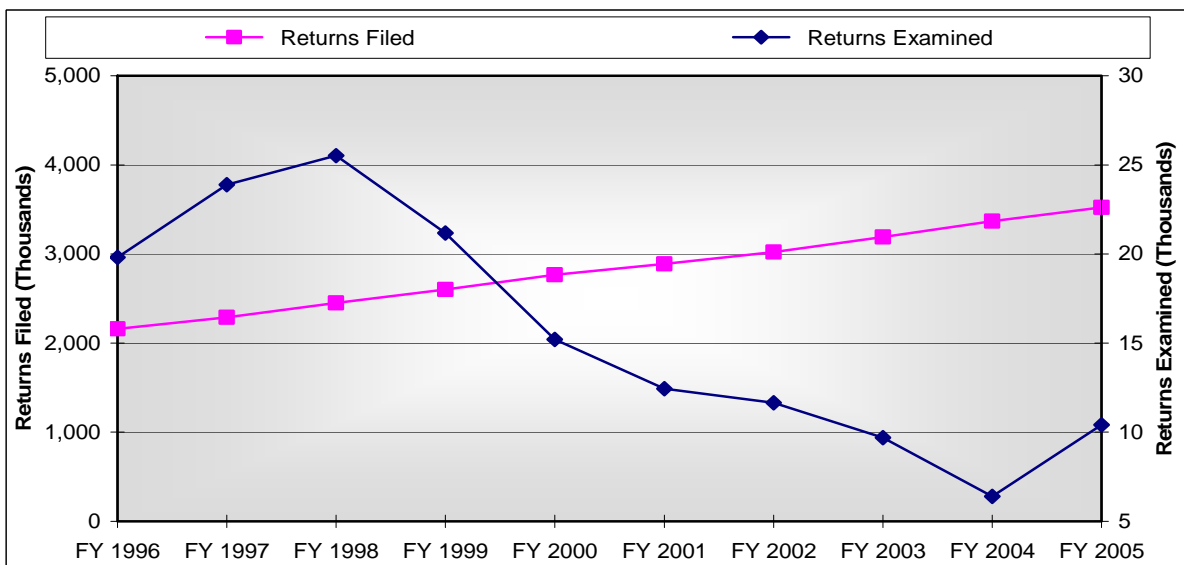


Figure 39. Examination Coverage of Forms 1120S – Percentage Change From FY 1996. After decreasing each year since FY 1998, the percentage of Forms 1120S examined increased 56 percent during FY 2005. Additional examinations of Forms 1120S are expected during the next few years as they are part of an ongoing National Research Project studying tax compliance.



Source: TIGTA analysis of IRS Data Book.

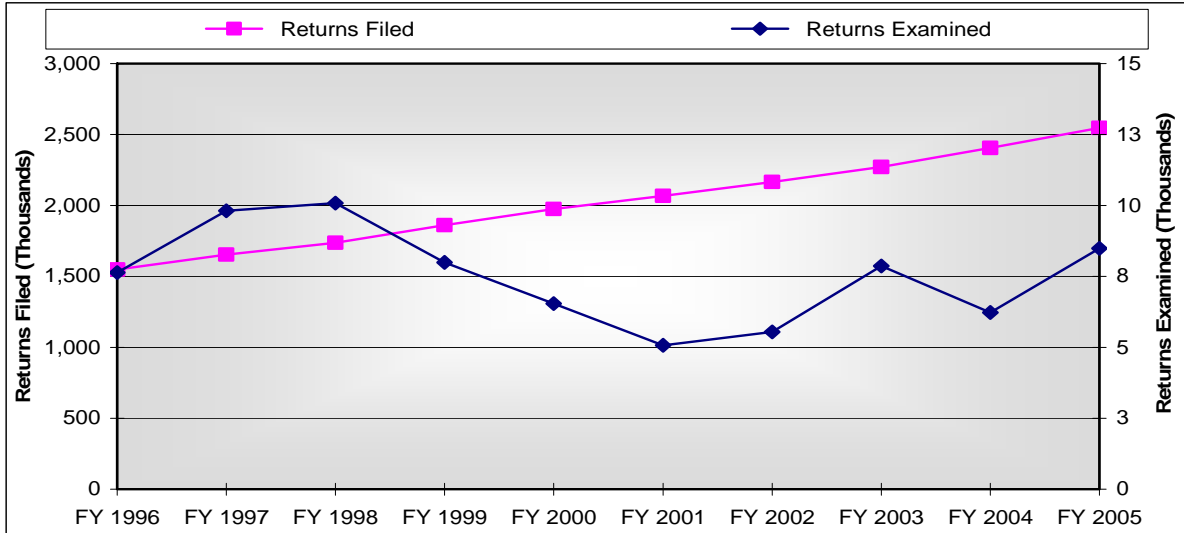
Figure 40. Examination Coverage of Forms 1120S. The number of Form 1120S tax returns filed has increased at an average rate of about 150,000 per year since FY 1996, to just over 3.5 million in FY 2005. During FY 2005, the number of examinations increased, but only about 1 out of every 338 Form 1120S returns was examined.



Source: IRS Data Book.

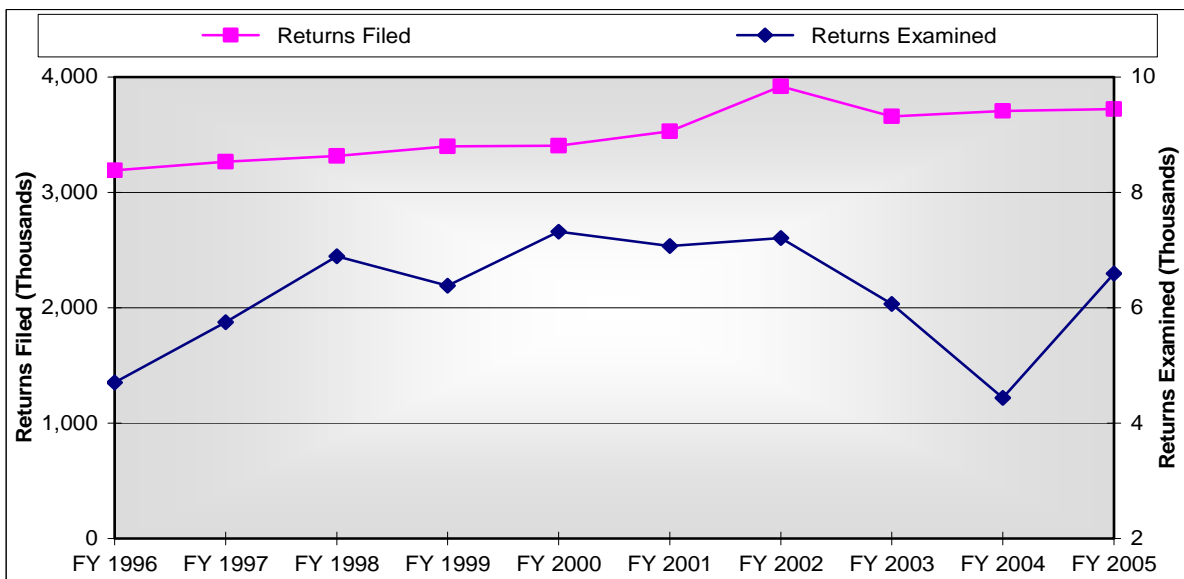


Figure 41. Examination Coverage of Partnership Income Tax Returns. The number of partnership tax returns filed has increased at an average rate of about 110,000 per year since FY 1996, to just over 2.5 million in FY 2005. During FY 2005, the number of returns examined increased by just over 36 percent, but only 1 out of every 300 partnership returns was examined.



Source: IRS Data Book.

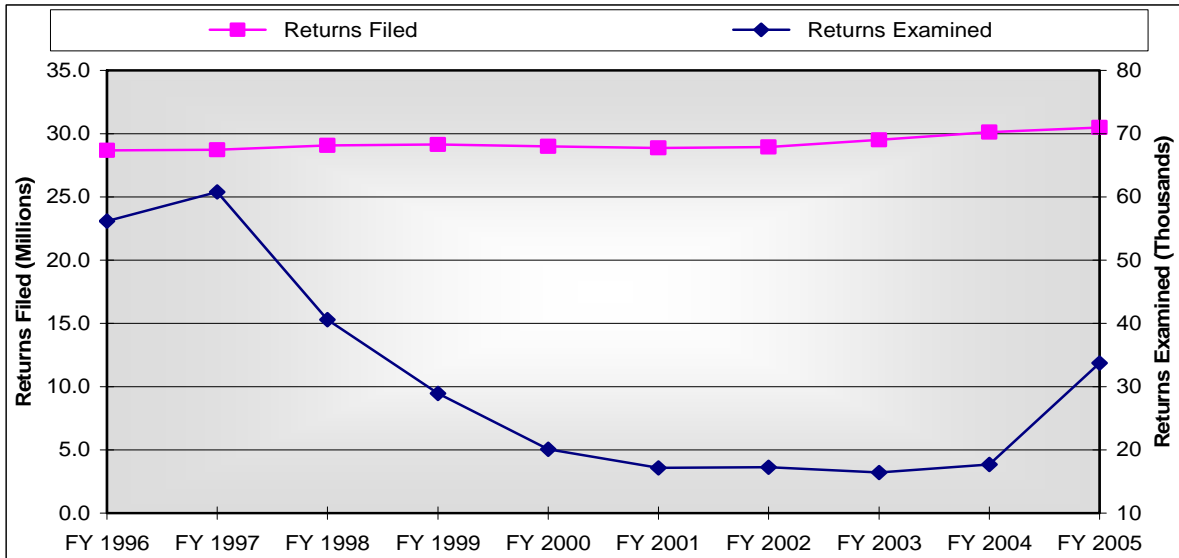
Figure 42. Examination Coverage of Fiduciary Income Tax Returns. During FY 2005, the number of income tax returns filed by estates and trusts increased slightly, but the number of tax returns examined increased by almost 49 percent. Only 1 out of every 565 fiduciary income tax returns was examined.



Source: IRS Data Book.

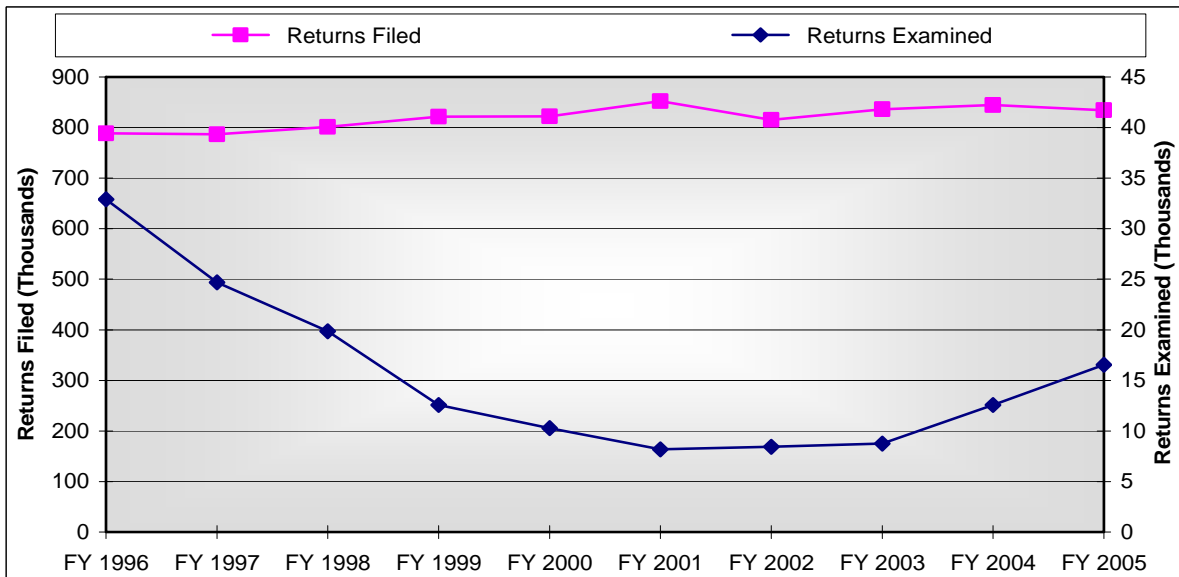


Figure 43. Examination Coverage of Employment Tax Returns. During FY 2005, the number of employment tax returns filed increased by just over 1 percent, but the number of tax returns examined increased by almost 91 percent. One out of every 904 employment tax returns was examined.



Source: IRS Data Book.

Figure 44. Examination Coverage of Excise Tax Returns. The number of excise tax returns filed remained relatively steady, but the number of returns examined increased by almost 32 percent during FY 2005.

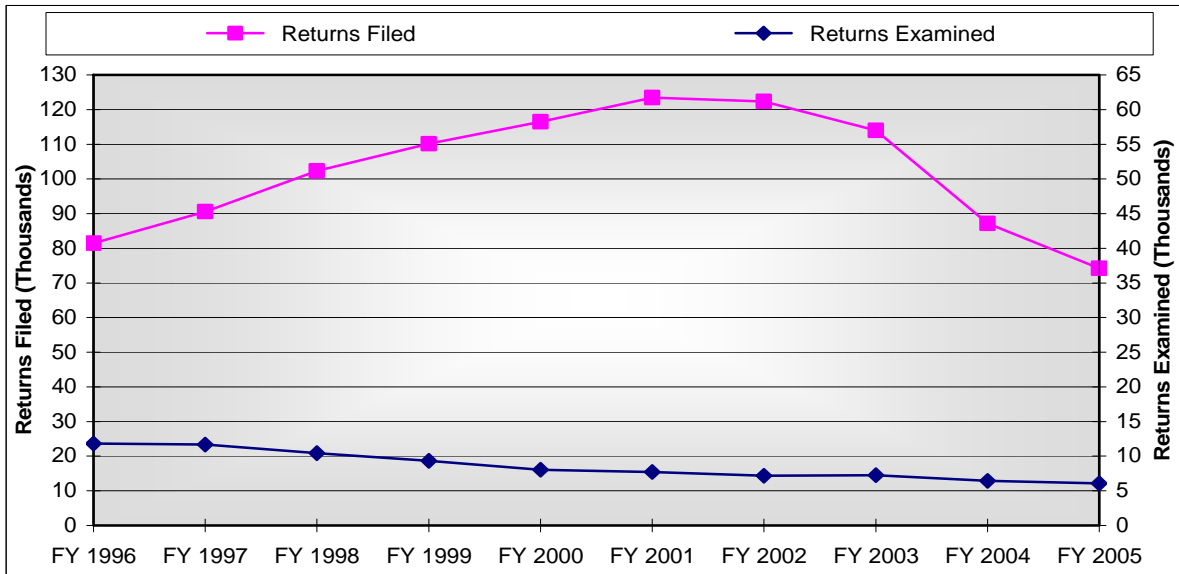


Source: IRS Data Book.



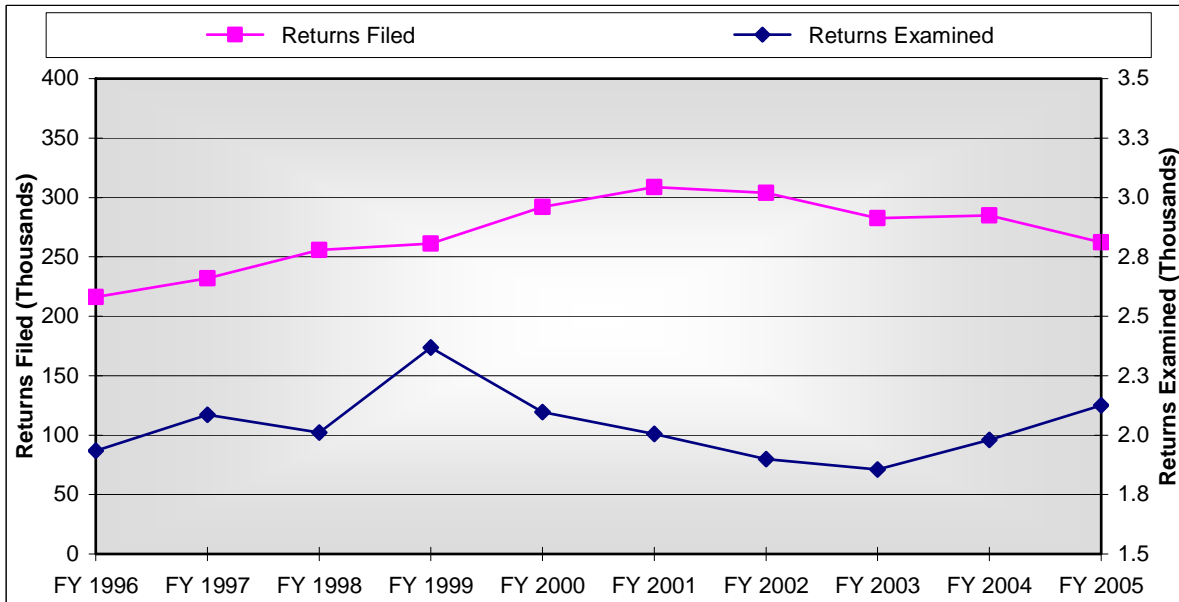
Trends in Compliance Activities Through Fiscal Year 2005

Figure 45. Examination Coverage of Estate Tax Returns. During FY 2005, the number of estate tax returns filed decreased by almost 15 percent, and the number of returns examined decreased by almost 6 percent. One out of every 12 estate tax returns was examined.



Source: IRS Data Book.

Figure 46. Examination Coverage of Gift Tax Returns. In FY 2005, the number of gift tax returns filed decreased by almost 8 percent, but the number of returns examined increased by just over 7 percent.

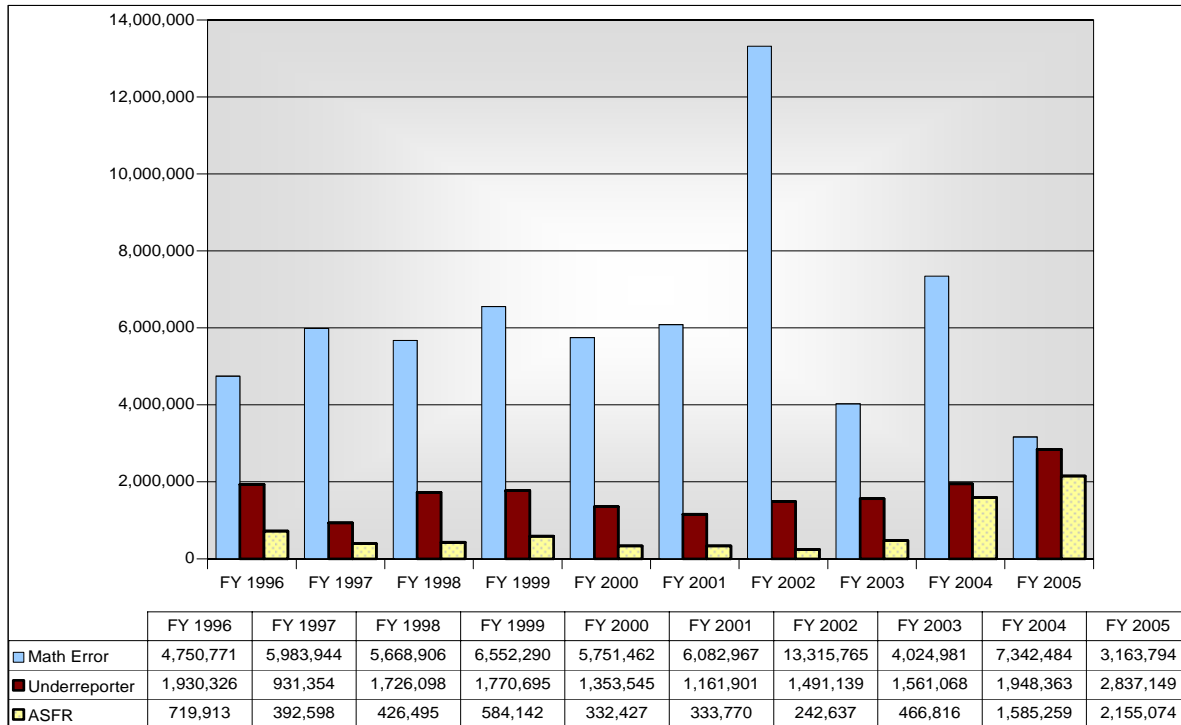


Source: IRS Data Book.



Trends in Compliance Activities Through Fiscal Year 2005

Figure 47. Other Compliance Contacts on Forms 1040. The number of contacts decreased for math error cases during FY 2005 but increased for the other types of compliance contacts. The spike in math error cases for FY 2002 was the result of taxpayer confusion over the Rate Reduction Credit. Much of the spike in FY 2004 was due to Child Tax Credit issues.



Source: IRS Data Book.

Figure 48. Other Compliance Contacts – Percentage of Coverage on Forms 1040. The levels of coverage decreased for math error cases during FY 2005 and increased for the other types of compliance contacts. The math error aberrations in FY 2002 and 2004 were explained in Figure 47.

	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY2003	FY 2004	FY 2005
Math Error	4,750,771	5,983,944	5,668,906	6,552,290	5,751,462	6,082,967	13,315,765	4,024,981	7,342,484	3,163,794
Coverage Rate	4.01%	4.97%	4.63%	5.25%	4.53%	4.70%	10.22%	3.08%	5.59%	2.38%
Underreporter	1,930,326	931,354	1,726,098	1,770,695	1,353,545	1,161,901	1,491,139	1,561,068	1,948,363	2,837,149
Coverage Rate	1.66%	0.79%	1.43%	1.44%	1.08%	0.91%	1.15%	1.20%	1.49%	2.16%
ASFR	719,913	392,598	426,495	584,142	332,427	333,770	242,637	466,816	1,585,259	2,155,074
Coverage Rate	0.62%	0.33%	0.35%	0.48%	0.27%	0.26%	0.19%	0.36%	1.21%	1.64%

Source: TIGTA analysis of IRS Data Book.



Trends in Compliance Activities Through Fiscal Year 2005

Figure 49. Numbers and Percentages of Examinations on Forms 1040. This chart shows the numbers and percentages of examination coverage.

	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Forms 1040A – < \$25,000										
Returns Examined	921,820	659,094	515,015	600,949	256,650	357,954	289,136	182,222	168,887	170,317
Coverage Rate	2.00%	1.44%	1.14%	1.36%	0.60%	0.86%	0.71%	0.51%	0.50%	0.52%
Forms 1040 – Nonbusiness										
Returns Examined < \$25,000	155,125	157,978	104,050	76,215	51,567	55,624	90,781	197,005	245,470	292,033
Coverage Rate	1.17%	1.21%	0.81%	0.58%	0.37%	0.40%	0.64%	1.09%	1.26%	1.48%
Returns Examined \$25,000 & < \$50,000	259,794	196,489	165,168	103,340	63,742	67,109	71,966	94,825	135,041	185,965
Coverage Rate	0.95%	0.70%	0.58%	0.36%	0.21%	0.22%	0.23%	0.30%	0.43%	0.60%
Returns Examined \$50,000 & < \$100,000	196,582	140,330	121,384	77,698	51,954	53,433	69,620	105,400	113,944	145,641
Coverage Rate	1.16%	0.77%	0.62%	0.37%	0.23%	0.23%	0.28%	0.41%	0.44%	0.57%
Returns Examined \$100,000 and over	129,320	119,575	100,079	80,038	68,616	64,259	80,483	106,565	151,969	138,085
Coverage Rate	2.85%	2.27%	1.66%	1.14%	0.84%	0.69%	0.75%	0.98%	1.39%	1.19%
Forms 1040 – Schedule C										
Returns Examined < \$25,000	102,558	78,553	60,023	68,450	61,695	69,332	67,876	81,541	92,855	117,999
Coverage Rate	4.21%	3.19%	2.37%	2.69%	2.43%	2.72%	2.67%	3.00%	3.15%	3.68%
Returns Examined \$25,000 & < \$100,000	87,691	80,861	58,877	42,391	31,226	34,650	40,530	46,927	53,477	82,542
Coverage Rate	2.85%	2.57%	1.82%	1.30%	0.93%	1.02%	1.18%	1.33%	1.47%	2.21%
Returns Examined \$100,000 and over	71,050	73,049	59,728	44,945	28,781	24,080	29,848	30,738	39,124	78,497
Coverage Rate	4.09%	4.13%	3.25%	2.40%	1.48%	1.20%	1.45%	1.47%	1.86%	3.65%
Forms 1040 – Schedule F										
Returns Examined < \$100,000	7,944	5,868	3,949	2,832	1,384	2,104	1,709	1,997	3,104	1,603
Coverage Rate	1.59%	1.28%	0.93%	0.68%	0.35%	0.55%	0.47%	0.57%	0.91%	0.48%
Returns Examined \$100,000 and over	9,662	7,446	4,507	3,415	2,150	3,211	1,932	2,076	4,003	2,626
Coverage Rate	3.61%	2.75%	1.63%	1.23%	0.80%	1.18%	0.72%	0.78%	1.61%	1.01%

Source: TIGTA analysis of IRS Data Book.



Trends in Compliance Activities Through Fiscal Year 2005

Figure 50. Numbers and Percentages of Examinations on Business Tax Returns. This chart shows the numbers and percentages of examination coverage.

	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Corporations – Assets < \$10 Million	46,568	56,323	41,818	28,268	18,623	14,332	14,655	13,608	7,294	17,858
Coverage Rate	1.88%	2.22%	1.67%	1.16%	0.77%	0.60%	0.63%	0.58%	0.32%	0.79%
Corporations – Assets \$10 Million and Over	12,891	12,972	11,830	10,537	9,212	8,718	8,443	7,125	9,523	10,829
Coverage Rate	25.33%	24.29%	21.43%	19.05%	16.30%	15.08%	14.17%	12.08%	16.74%	20.02%
Form 1120S	19,809	23,898	25,522	21,169	15,200	12,437	11,646	9,695	6,402	10,417
Coverage Rate	0.92%	1.04%	1.04%	0.81%	0.55%	0.43%	0.39%	0.30%	0.19%	0.30%
Partnership	7,636	9,811	10,082	7,991	6,539	5,070	5,543	7,871	6,226	8,489
Coverage Rate	0.49%	0.59%	0.58%	0.43%	0.33%	0.25%	0.26%	0.35%	0.26%	0.33%
Fiduciary	4,701	5,753	6,890	6,382	7,318	7,070	7,206	6,068	4,438	6,591
Coverage Rate	0.15%	0.18%	0.21%	0.19%	0.22%	0.20%	0.18%	0.17%	0.12%	0.18%
Employment	56,195	60,799	40,595	28,898	20,074	17,163	17,252	16,408	17,698	33,748
Coverage Rate	0.20%	0.21%	0.14%	0.10%	0.07%	0.06%	0.06%	0.06%	0.06%	0.11%
Excise	32,900	24,701	19,858	12,562	10,294	8,169	8,426	8,756	12,560	16,563
Coverage Rate	4.17%	3.14%	2.48%	1.53%	1.25%	0.96%	1.03%	1.05%	1.49%	1.98%
Estate	11,794	11,686	10,451	9,319	8,024	7,707	7,151	7,265	6,455	6,081
Coverage Rate	14.47%	12.90%	10.22%	8.46%	6.89%	6.24%	5.84%	6.38%	7.41%	8.20%
Gift	1,934	2,085	2,010	2,369	2,097	2,005	1,899	1,855	1,979	2,125
Coverage Rate	0.89%	0.90%	0.79%	0.91%	0.72%	0.65%	0.63%	0.66%	0.69%	0.81%

Source: TIGTA analysis of IRS Data Book.



Appendix VI

Related Treasury Inspector General for Tax Administration Audit Reports

Prior Compliance Trends Reports:

- *Management Advisory Report: Evaluation of Reduction in the Internal Revenue Service's Compliance Activities* (Reference Number 2000-30-075, dated May 2000).
- *Management Advisory Report: Tax Return Filing and Examination Statistics* (Reference Number 2001-30-175, dated September 2001).
- *Management Advisory Report: Analysis of Trends in Compliance Activities Through Fiscal Year 2001* (Reference Number 2002-30-184, dated September 2002).
- *Trends in Compliance Activities Through Fiscal Year 2002* (Reference Number 2003-30-078, dated March 2003).
- *Trends in Compliance Activities Through Fiscal Year 2003* (Reference Number 2004-30-083, dated April 2004).
- *Trends in Compliance Activities Through Fiscal Year 2004* (Reference Number 2005-30-055, dated March 2005).

Collection Reengineering Reports:

- *The New Risk-Based Collection Initiative Has the Potential to Increase Revenue and Improve Future Collection Design Enhancements* (Reference Number 2004-30-165, dated September 2004).
- *The Revised Collection Case Selection Criteria That Expedites Trust Fund Workload to the Field Appears Effective* (Reference Number 2004-30-173, dated September 2004).
- *Implementation of the Collection Field Function Consultation Initiative Was Carefully Coordinated, but Some Aspects Could Be Enhanced* (Reference Number 2005-30-011, dated November 2004).

Examination Reengineering Reports:

- *The Office Audit Redesign Pilot Was Effective in Meeting Its Goals, but Its Implementation Needs to Be Monitored* (Reference Number 2004-30-033, dated January 2004).



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- *Many Aspects of the Field Examination Reengineering Pilot Were Effectively Implemented; However, Continued Monitoring Is Needed During the Nationwide Rollout* (Reference Number 2004-30-116, dated June 2004).
- *The High Income Taxpayer Strategy Was Effectively Implemented, Although Its Success Still Needs to Be Determined* (Reference Number 2005-30-012, dated November 2004).