Filing Characteristics and Examination Results for Partnerships and S Corporations

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 28, 2006

MEMORANDUM FOR COMMISSIONER, LARGE AND MID-SIZE BUSINESS DIVISION
COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

FROM: (for) Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Filing Characteristics and Examination Results for Partnerships and S Corporations (Audit # 200530019)

This report presents the results of our review of statistical information reflected in the filings and examinations of partnership and S corporation[1] tax returns. Our overall objective was to analyze the filing characteristics and examination trends of these flowthrough entities.[2] We conducted the review at our own initiative to highlight the important role the National Research Program (NRP) study plays in understanding what the rapid growth in filings of partnership and S corporation returns means for tax compliance. It has been more than 20 years since the Internal Revenue Service (IRS) studied how well these entities comply with tax laws. Since that study, flowthrough entities have become the fastest growing segments filing income tax returns with the IRS and are annually passing hundreds of billions of dollars in income and losses to their partners and shareholders.

Synopsis

From a practical standpoint, partnerships and S corporations have long provided a popular way of protecting income from taxation by having the legal capacity to offset wages and

> ***We conducted the review at our own initiative to highlight the important role the NRP study plays in understanding what the rapid growth in filings of partnership and S corporation returns means for tax compliance.***

[1] An S Corporation has a limited number of shareholders and is a small business corporation that elects to be a flowthrough entity for income tax purposes.
[2] Flowthrough entities describe certain entities, such as partnerships and S corporations, because their income, losses, credits, and other tax items are generally distributed untaxed to their owners.

other income sources that partners and shareholders report on their tax returns. Changes in the legal and regulatory environment in the 1990s contributed to their popularity. Specifically, the legal and regulatory changes involved the creation of Limited Liability entities[3] and the issuance of so-called Check-the-Box Regulations[4] by the Federal Government. In 2004, the IRS processed approximately 1.19 million returns filed by Limited Liability entities, which was an 83 percent increase over the 650,000 returns from Limited Liability entities processed in 2000.

Like partnerships, S corporations have the legal capacity to offset income sources that shareholders report on their income tax returns. Additionally, S corporations provide their shareholders with the ability to save on the amount of employment taxes they would otherwise have to pay under most other types of business organizations. The prospect of offsetting income sources of shareholders and minimizing the amount of employment tax that must be paid can be particularly attractive benefits and could be reasons S corporations have become the most common type of corporate entity filing income tax returns with the IRS.

The IRS NRP study is fully underway studying the extent to which S corporations and their shareholders comply with the tax laws. From a compliance perspective, this effort and another one under consideration for partnerships are critically important for a number of reasons. Most important, perhaps, is that the study results are expected to enhance the IRS examination process that helps ensure taxes on the hundreds of billions of dollars of income and losses passing through these entities to shareholders and partners are reported and paid. The statistical validity and comprehensiveness of the NRP study is designed to provide the IRS with updated compliance data needed for deciding which partnership and S corporation returns should be examined and how best to focus millions of dollars of examination resources on the most significant areas of noncompliance.

The IRS last collected data on how well partnerships and S corporations comply with tax laws more the 20 years ago, and over time these data have become less reliable for examination workload selection. The IRS increasingly selects partnership and S corporation returns for examination under special projects to address specific types of noncompliance such as abusive tax schemes and transactions. Additionally, IRS executives have invested considerable efforts in various initiatives aimed at making the examination process more efficient.

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[3] Limited Liability entities are Limited Liability Companies and Limited Liability Partnerships. A Limited Liability Company is a business entity that offers its owners the advantage of limited liability (like corporations) and partnership-like taxation in which profits are passed through to the owners and taxed on their personal income tax returns. A Limited Liability Partnership is a business entity in which its participants are generally not responsible for the negligent acts committed by other partners. State statutes allow only certain types of professional businesses, such as law and accounting firms, to form this type of entity.

[4] Treasury Regulations allow most unincorporated businesses to elect by checking a box whether they will be taxed as a conventional corporation or as a partnership for Federal income tax purposes.

Although we did not measure the impact these various projects and initiatives have had on the examination process, IRS statistics show the numbers of partnership and S corporation examinations are increasing and examiners are spending less time on the examinations while making more adjustments to the tax returns. Despite these positive trends, the number of examinations that are closed with no adjustment continues to be high and could likely be reduced with NRP study data to assist in the identification, selection, and examination processes. In Fiscal Year 2005, 44 percent of partnership and 43 percent of S corporation examinations resulted in no adjustments. This no-change rate means a significant amount of resources are being devoted to unproductive examinations, and compliant partnerships and S corporations are being unnecessarily burdened.

Besides updating workload selection formulas, the NRP study data are expected to be used for other important tax administration activities such as identifying areas where instructions and prefiling taxpayer services could be improved, suggesting legislative changes, and refining estimates of the tax gap (i.e., the amount of taxes owed but not voluntarily paid). Because of these benefits, numerous stakeholders, including the Treasury Inspector General for Tax Administration, Government Accountability Office, and IRS Oversight Board,[5] support the program.

Recommendations

We made no recommendations in this report. However, key IRS management officials reviewed the report 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 Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-8500.

[5] The Oversight Board is a nine-member independent body created by the IRS Restructuring and Reform Act of 1998 (P.L. 105-206) to improve the IRS so it may better serve the public and meet the needs of taxpayers. It is charged to oversee the IRS in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws and to provide experience, independence, and stability to the IRS so it may move forward in a cogent, focused direction.

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Abbreviations

AIMS	Audit Information Management System
BRTF	Business Return Transaction File
FY	Fiscal Year
IRS	Internal Revenue Service
LLC	Limited Liability Company
LLP	Limited Liability Partnership
NRP	National Research Program
PY	Processing Year
TCMP	Taxpayer Compliance Measurement Program
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year

Background

We conducted this review at our own initiative to highlight the important role the National Research Program (NRP) study has in understanding what the rapid growth in filings of partnership and S corporation[1] returns means for tax compliance. The NRP study is fully underway studying the extent to which S corporations and their shareholders comply with the tax laws. The study involves the identification, selection, and examination of approximately 5,000 tax returns filed by S corporations and processed by the Internal Revenue Service (IRS) for Tax Years (TY) 2003 and 2004. Statistically valid sampling techniques are being used so the results from the examinations can reliably measure the level of compliance in the universe of S corporations filing tax returns.

From a compliance perspective, this effort and another one under consideration for partnerships are critically important for several reasons. Most important, perhaps, is that the study results are expected to improve the IRS examination process by helping ensure the taxes on hundreds of billions of dollars of income and losses passing through these entities are reported and paid properly. The statistical validity and comprehensiveness of the NRP study is designed to provide the IRS with updated compliance data needed for deciding which partnership and S corporation returns should be examined and how best to focus millions of dollars of examination resources on the most significant areas of noncompliance.

During the review, we relied on computer programs to obtain data from IRS databases. In testing the data, we noted there were some data elements missing from the databases. This can occur when information is not included on a tax return when it is filed. We also matched a database containing tax return information with one containing examination results. As part of this matching process, we were unable to match all records in the databases. Where information was missing or records were unable to be matched, we noted this by using the term "Unknown" in the figures presented throughout the report.

The review was performed at the Treasury Inspector General for Tax Administration (TIGTA) Office of Audit in Los Angeles, California, during the period August 2005 through July 2006. 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. Detailed figures referred to in the body of the report are included in Appendix IV. Many of the calculations throughout the report and

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[1] An S Corporation has a limited number of shareholders and is a small business corporation that elects to be a flowthrough entity for income tax purposes. Flowthrough entities describe certain entities, such as partnerships and S corporations, because their income, losses, credits, and other tax items are generally distributed untaxed to their owners.

Appendix IV are affected by rounding. All initial calculations were performed using actual numbers rather than the rounded numbers that appear in the report. The report does not include examination results from the Coordinated Industry Case Program[2] because relatively few entities are examined under this Program, and the examination procedures and techniques differ from the vast majority of other examinations conducted by the IRS.

[2] The Coordinated Industry Case Program uses a team approach to examine the largest business entities on a continuous basis.

Results of Review

Partnerships and S Corporations Are the Fastest Growing Segments of Taxpayers Filing Tax Returns With the Internal Revenue Service

From a practical standpoint, partnerships and S corporations have long provided a popular way of protecting income from taxation because they have the legal capacity to offset wages and other income sources that partners and shareholders report on their tax returns. Organizing a business as a partnership or an S corporation also allows these entities, as well as their partners and shareholders, to avoid double taxation on business profits. This treatment is unlike the traditional corporation that incurs a tax liability first at the corporate level and again when business profits are distributed to shareholders in the form of dividends. As illustrated in Appendix IV, operating as a partnership or S corporation can result in considerable tax savings.

Between January 2000 and December 2004, the number of partnership and S corporation tax returns processed annually by the IRS grew 21 percent, from 4.96 million to 6 million. By 2012, the IRS is projecting this number will increase another 42 percent to approximately 8.49 million.

Limited Liability entities[3] are a driving factor in the growth rate of partnerships filing tax returns

Changes in the legal and regulatory environment in the 1990s contributed to making partnerships the fastest growing segment of all filers of tax returns with the IRS. Specifically, the changes involved the creation of Limited Liability Companies (LLC) and Limited Liability Partnerships (LLP)[4] by State governments and the issuance of the so-called Check-the-Box Regulations[5] by the Federal Government. In 2004, the IRS processed approximately 1.19 million returns filed by Limited Liability entities. This was an 83 percent increase over the nearly 650,000 returns from Limited Liability entities processed in 2000 and represented 47 percent of partnership returns processed in 2004 (see Figure 1).[6]

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[3] When we refer to Limited Liability entities in this report, collectively we mean Limited Liability Companies (LLC) and Limited Liability Partnerships (LLP).
[4] An LLC is a business entity that offers its owners the advantage of limited liability (like corporations) and partnership-like taxation. An LLP is a business entity in which its participants are generally not responsible for the negligent acts committed by other partners. State statutes allow only certain types of professional businesses, such as law and accounting firms, to form this type of entity.
[5] Treasury Regulation 301.7701-3 (2006) allows most unincorporated businesses to elect by checking a box whether they will be taxed as a corporation or as a partnership for Federal income tax purposes.
[6] See Appendix IV, Figures 4 and 5.

Figure 1: Numbers and Types of Partnership Returns Processed in Processing Years (PY) 2000 – 2004

Type of Partnership	Processing Years[7]					Percentage Change
	2000	2001	2002	2003	2004	PYs 2000 - 2004
General Partnership	918,631	876,586	832,843	796,323	762,719	-16.97%
Limited Partnership (┼)	362,595	370,533	384,120	394,287	402,840	11.10%
LLC	606,760	714,048	832,268	962,894	1,106,678	82.39%
LLP (┼)	43,049	59,006	65,646	73,927	81,189	88.60%
All other (√)	134,093	143,662	151,057	165,656	170,463	27.12%
Totals	2,065,128	2,163,835	2,265,934	2,393,087	2,523,889	22.21%

(┼) A limited partnership is one with at least one general partner in which limited partners can purchase an interest and be liable only to the extent of their interests and not risk personal liability. In an LLP, each partner is fully liable for the debts of the partnership but not for acts of professional negligence or malpractice committed by the other partners.
(√) All other includes other partnerships and foreign partnerships for which the IRS began collecting data in PY 2001 and partnerships with no entity designation.
Source: TIGTA analysis of the IRS Business Return Transaction File (BRTF)[8] for PYs 2000 - 2004.

As with all partnerships, most LLC partnership returns processed in 2000 through 2004 were concentrated in the finance/insurance industry sector and real estate industry sector. During this 5-year period, these 2 industry sectors filed 52.25 percent of all partnership returns processed. They reported accumulating $7.3 trillion in assets and distributing $68 billion of income and $36 billion in losses to their partners. The $7.3 trillion in assets represented 74 percent of the total assets on all partnership returns processed in 2004.

Partnership returns in the finance/insurance industry sector and real estate industry sector also were more likely to be linked to other partnerships. These linkages are referred to as tiered partnerships and generally involve a partnership that owns or is owned by one or more other partnerships. Tiered partnership returns processed in 2000 through 2004 for the real estate industry sector grew at a rate of 27.36 percent, while those in the finance/insurance industry sector grew by more than 50 percent. Of those partnerships with less than $250,000 in total assets, only 11 percent were linked to other partnerships while 72.75 percent of those with over $250 million in assets were linked to other partnerships.

[7] A processing year includes all returns processed in a calendar year.
[8] The BRTF is a computer file of the transcribed line items on all business returns and their accompanying schedules or forms.

Most S corporations have less than $10 million in assets and only 1 shareholder

The growth in the number of S corporation returns processed from 2000 through 2004 continued a trend that was started in 1997 when they became the most common type of corporate entity filing income tax returns. In 2004, the IRS processed approximately 3.5 million S corporation returns. This was a 21 percent increase over the 2.89 million S corporation returns processed in 2000. S corporations with assets of less than $10 million represented over 99 percent of the S corporations filed in 2004 (see Figure 2).

Figure 2: Numbers and Types of S Corporation Returns Processed in PYs 2000 – 2004

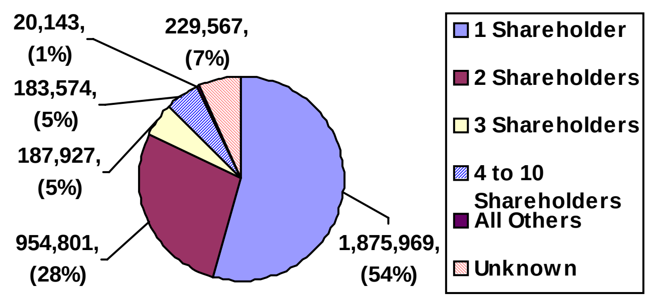
Asset Classification	Processing Years					Change	Percentage Change
	2000	2001	2002	2003	2004	PY 2000 to PY 2004	PY 2000 to PY 2004
Under $250,000	2,262,371	2,359,609	2,477,088	2,628,151	2,746,315	483,944	21.39%
$250,000 to under $1 million	404,521	425,186	446,401	463,983	478,266	73,745	18.23%
$1 million to under $5 million	173,570	182,275	191,358	197,359	202,867	29,297	16.88%
$5 million to under $10 million	27,180	29,076	29,898	31,073	31,952	4,772	17.56%
Totals less than $10 million	2,867,642	2,996,146	3,144,745	3,320,566	3,459,400	591,758	20.64%
$10 million to under $50 million	19,469	21,336	22,124	23,025	24,347	4,878	25.06%
$50 million to under $100 million	1,846	2,053	2,297	2,418	2,524	678	36.73%
$100 million to under $250 million	1,016	1,126	1,374	1,383	1,449	433	42.62%
$250 million and over	462	602	952	668	660	198	42.86%
Totals $10 million or more	22,793	25,117	26,747	27,494	28,980	6,187	27.14%
Grand Totals	2,890,435	3,021,263	3,171,492	3,348,060	3,488,380	597,945	20.69%

Source: TIGTA analysis of the S corporation BRTF for PYs 2000 - 2004.

Unlike partnerships, the S corporation filings were distributed over a wider variety of industries[9] although most S corporation tax returns processed in 2000 through 2004 were concentrated in a variety of service industry sectors. In 2004, the service industry sectors filed 31.26 percent of all S corporation returns processed. That same year, the service industry sectors reported holding $246 billion in assets and distributing $50 billion of income and $13.8 billion in losses to their shareholders. However, the $246 billion in assets represented only 11 percent of the total assets on all S corporation returns processed in 2004.

[9] See Appendix IV, Figures 7 and 9.

Figure 3: S Corporation Ownership



Source: TIGTA analysis of S corporation BRTF for PY 2004.

S corporations additionally provide shareholders with the ability to save on the amount of employment taxes they would have to pay if they were structured as sole proprietorships or partnerships. Continuing a trend that has existed for many years, S corporations owned by a sole shareholder dominated the data. Of the 3.45 million S corporation tax returns processed in 2004, approximately 54 percent had sole ownership (see Figure 3). As we have previously reported,[10] single ownership in an S corporation has the benefit of allowing owners to pay employment taxes on only the portion of profits they decide to pay themselves as a salary. This is very different from a sole proprietorship[11] that pays employment taxes based on a percentage of all profits. Single owners of S corporations annually paid themselves an average of $33,853 on returns filed in 2004. In contrast, these same S corporation returns reported average operating profits of $34,683 after taking deductions for officers' salaries. This permitted sole-shareholder S corporations to save nearly $8.4 billion in employment taxes in TY 2003, or $4,504 on average. The prospect of offsetting income sources of shareholders or minimizing the amount of employment taxes that must be paid can be particularly attractive benefits and may be a primary reason why S corporations have become the most common type of corporate entity filing income tax returns with the IRS.

National Research Program Results Are Critical to Understanding the Impact Partnerships and S Corporations Are Having on Compliance

The IRS last collected data on how well partnerships and S corporations comply with the tax law more the 20 years ago under its Taxpayer Compliance Measurement Program (TCMP).[12] As we reported in 2004,[13] these data are out of date and, accordingly, less reliable for identifying, selecting, and examining the tax returns that pose the greatest compliance risk. The IRS, as a result, increasingly selects partnership and S corporation returns for examination under special

[10] *Actions Are Needed to Eliminate Inequities Between Sole Proprietorships and Single Shareholder S Corporations* (Reference Number 2005-30-080, dated May 2005).

[11] A sole proprietorship is a business operated by one person who owns all assets and is responsible for all liabilities.

[12] The TCMP was a systematic program of tax return examinations conducted to facilitate the compilation of compliance data and estimate the tax gap prior to the National Research Program. The last Taxpayer Compliance Measurement Program process involved TY 1988 individual income tax returns.

[13] *Additional Efforts Could Further Improve the Execution of the National Research Program* (Reference Number 2004-30-044, dated January 2004).

projects to address specific types of noncompliance such as tax shelters. Additionally, IRS executives have invested considerable efforts in various initiatives aimed at making the examination process more efficient. Although we did not measure the impact these various projects and initiatives have had on the examination process, IRS statistics show the numbers of partnership and S corporation examinations are increasing and examiners are spending less time on the examinations while making more adjustments to the tax returns. Despite these positive trends, the number of examinations closed with no adjustment continues to be high and could likely be reduced with NRP data to assist in the identification, selection, and examination processes.

The numbers of partnership and S corporation examinations are increasing and will likely continue to do so in the future

Although the IRS has historically emphasized examining taxable entities, such as sole proprietorships, it is moving away from this emphasis and towards one that is focused on maintaining examination coverage across all filing segments and on areas presenting the highest compliance risk. This new focus will likely contribute to an increase in the numbers of partnership and S corporation tax returns examined if coverage is to be maintained over the growing number of tax returns expected to be filed by these entities. The IRS closed 37 percent more partnership examinations and 63 percent more S corporation examinations in Fiscal Year (FY) 2005 than it did in FY 2004 (see Figure 4). The increases occurred in nearly every size of partnership and S corporation but generally varied by industry segment.[14]

[14] See Appendix IV, Figures 14, 15, 16, and 17.

Figure 4: FYs 2004 and 2005 Partnership and S Corporation Examination Closures, by Total Assets

	Partnership Returns Examined			S Corporation Returns Examined		
Total Assets	**FY 2004**	**FY 2005**	**Percentage Change**	**FY 2004**	**FY 2005**	**Percentage Change**
Under $250,000	2,199	3,544	61%	3,473	5,737	65%
$250,000 to under $1 million	622	1,035	66%	616	1,189	93%
$1 million to under $5 million	838	1,243	48%	617	1,353	119%
$5 million to under $10 million	356	469	32%	282	569	102%
$10 million to under $50 million	982	935	-5%	795	1,063	34%
$50 million to under $100 million	272	286	5%	132	150	14%
$100 million to under $250 million	290	307	6%	91	106	16%
$250 million and over	348	409	18%	58	42	-28%
Unknown	254	187	-26%	336	201	-40%
Totals	6,161	8,415	37%	6,400	10,410	63%

Source: TIGTA analysis of the Audit Information Management System (AIMS)[15] for partnership and S corporation return examinations completed in FYs 2004 and 2005.

In terms of areas presenting the greatest compliance risk, the IRS has identified abusive tax schemes and transactions as a priority area for increased examination activity. This focus has increased and will likely continue to increase the numbers of partnership and S corporation returns that are examined. In 2000, the IRS published guidance on 10 transactions that could trigger an examination because they purportedly abuse the tax law, represent a significant loss of tax revenue, and undermine the public's confidence in the tax system. By 2004, there were 31 such transactions, 9 (29 percent) of which required the involvement of a partnership or an S corporation in the transaction.

Partnership and S corporation examinations are taking less time and generating more adjustments to items reported on the tax returns

IRS surveys have shown consistently that business taxpayers believe the examination process is too long and consumes too much time. To address this issue and better leverage its examination resources, IRS executives have invested considerable effort in developing and implementing work process changes focused on reducing the length of examinations. Although we did not measure the impact the efforts have had on examinations, IRS statistics show that both the number of hours and number of calendar days spent on partnership and S corporation

[15] The AIMS is a computer system used during examination and appeals activities to control returns, input assessments/adjustments to the Master File, and provide management reports. The Master File is an IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

examinations decreased between FYs 2004 and 2005. The average number of days decreased nearly 19 percent, and the number of hours decreased nearly 34 percent on partnership examinations (see Figure 5).[16] Similar trends existed for S corporations during the period.[17]

Figure 5: Comparison Between the Numbers of Calendar Days and Hours Spent on Partnership Examinations in FYs 2004 and 2005, by Total Assets

	Average Number of Days			Average Number of Hours		
Total Assets	**FY 2004**	**FY 2005**	**Percentage Change**	**FY 2004**	**FY 2005**	**Percentage Change**
Under $250,000	495	456	-7.88%	43.80	38.99	-10.98%
$250,000 to under $1 million	530	350	-33.96%	48.69	36.13	-25.80%
$1 million to under $5 million	551	386	-29.95%	55.95	34.49	-38.36%
$5 million to under $10 million	511	521	1.96%	79.15	50.74	-35.89%
$10 million to under $50 million	482	516	7.05%	114.35	79.60	-30.39%
$50 million to under $100 million	479	581	21.29%	138.20	103.85	-24.86%
$100 million to under $250 million	544	554	1.84%	150.41	84.65	-43.72%
$250 million and over	735	625	-14.97%	304.24	149.88	-50.74%
Unknown	2,521	1,585	-37.13%	36.26	31.51	-13.10%
Totals	590	478	-18.98%	73.87	48.89	-33.82%

Source: TIGTA analysis of the AIMS for partnership and S corporation return examinations completed in FYs 2004 and 2005.

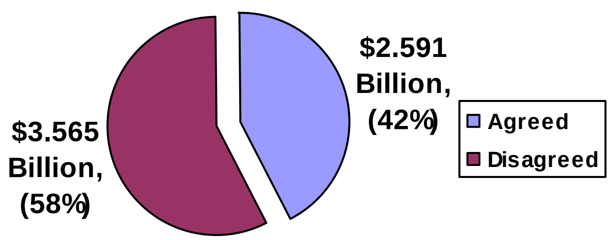
While the time and length of partnership and S corporation examinations are trending downward, the amount of examination adjustments made to items reported on the tax returns increased 81 percent between FYs 2004 and 2005.[18] When analyzing the examination adjustments, it is important to recognize what they do and do not represent. The examination adjustments, in general, measure only the items or portion of items the examiner believes were not properly reported on the tax return when it was filed. Examination adjustments do not measure the amount of taxes that ultimately will be assessed. Generally, the taxes assessed are significantly lower than the adjustments recommended by examiners to the items on the tax returns.

At the close of an examination, the partners or shareholders may either agree or disagree with the examiner's determination. If the partners or shareholders agree, the examination adjustments are passed through to their individual tax returns where the taxes are computed based on their income tax brackets and percentage ownership in the entity. For example, if adjustments of $4,000 were made to the deductions on a tax return of an S corporation that had 2 equal shareholders who were in the maximum 35 percent tax bracket, each shareholder would be

[16] See Appendix IV, Figures 25 and 27.
[17] See Appendix IV, Figures 26 and 28.
[18] See Appendix IV, Figures 21 and 22.

assessed $700 (50 percent of $4,000 multiplied by the 35 percent tax rate). If the partners or shareholders disagree with the examiner's determination, the dispute is generally settled through the IRS appeals process or the court system, both of which can significantly reduce or even eliminate the adjustments.

Figure 6: Partnership and S Corporation Adjustments FY 2005 (in billions)



Source: TIGTA analysis of the FY 2005 AIMS.

Due to limitations with the IRS databases, we were unable to determine the tax assessments from partnership and S corporation examinations. However, the databases do track the amount of recommended adjustments and show that these entities are agreeing to more recommended adjustments. Nonetheless, the entities agreed with only 42 percent of the adjustments recommended in FY 2005 (see Figure 6). They continued to disagree with most adjustments. In FY 2005, partnerships and S corporations disagreed with 58 percent of the $6.2 billion in recommended adjustments.[19]

The numbers of partnership and S corporation examinations that result in no adjustments remains a concern

Despite the positive trends in examination results, the large numbers of partnership and S corporation examinations closed with no adjustments will likely continue without NRP data to assist in the identification, selection, and examination processes. As the IRS reported to Congress in 2003, this no-change rate means a significant amount of resources are being devoted to unproductive examinations, and compliant partnerships and S corporations are being unnecessarily burdened.

In FY 2005, 44 percent of partnership and 43 percent of S corporation examinations resulted in no adjustments. From FY 2004, this was a 16 percent increase for partnerships and a 48 percent increase for S corporations (see Figure 7). The no-change rates in FYs 2001, 2002, and 2003 for partnerships were in the upper 40 percent range, while for S corporations they were in the upper 30 percent range.[20]

[19] See Appendix IV, Figures 23 and 24.
[20] See Appendix IV, Figures 19 and 20.

Figure 7: FYs 2004 and 2005 Partnership and S Corporation No-Change Examination Results, by Total Assets

	Percentage of Partnership Return Examinations With No Changes			Percentage of S Corporation Return Examinations With No Changes		
Total Assets	**FY 2004**	**FY 2005**	**Percentage Change**	**FY 2004**	**FY 2005**	**Percentage Change**
Under $250,000	33.93%	41.86%	23.40%	29.62%	40.55%	36.92%
$250,000 to under $1 million	33.93%	55.40%	63.30%	21.92%	40.69%	85.67%
$1 million to under $5 million	38.68%	52.79%	36.48%	21.79%	52.48%	140.84%
$5 million to under $10 million	47.99%	42.17%	-12.13%	24.11%	55.71%	131.04%
$10 million to under $50 million	48.83%	38.66%	-20.83%	41.27%	45.52%	10.32%
$50 million to under $100 million	49.54%	37.60%	-24.10%	38.64%	31.29%	-19.01%
$100 million to under $250 million	31.11%	38.03%	22.25%	34.44%	36.79%	6.82%
$250 million and over	27.44%	28.72%	4.66%	20.00%	35.90%	79.49%
Unknown	29.61%	28.33%	-4.32%	23.33%	29.35%	25.80%
Totals	37.94%	44.13%	16.32%	29.16%	43.05%	47.62%

Source: TIGTA analysis of the AIMS for partnership and S corporation return examinations completed in FYs 2004 and 2005.

IRS officials told us they are concerned with the trend in the number of no-change examinations and are evaluating closed examination case files to determine if factors other than the absence of current compliance data may be contributing to the no-change rates. Additionally, officials noted that the productivity from partnership and S corporation examinations may be higher than reflected by the no-change rate because the IRS reports the results as a no-change when the adjustments do not change the partnership or S corporation tax return, but do change a partner or shareholder tax return.

Besides providing updated data for deciding which tax returns should be examined, the NRP study data are expected to be used for such other important tax administration activities as identifying areas in which instructions and prefiling taxpayer services could be improved, suggesting legislative changes, and refining estimates of the tax gap (i.e., the amount of taxes owed but not voluntarily paid). Because of its benefits, numerous stakeholders support the NRP. In addition to the TIGTA, the Government Accountability Office has discussed and reiterated the need for such compliance data in several reports and Congressional testimony.[21] The IRS Commissioner has indicated the NRP is critical for measuring the level and sources of

[21] *Testimony on Making Significant Progress in Improving Tax Compliance Rests on Enhancing Current IRS Techniques and Adopting New Legislative Actions* (Washington DC: GAO-06-453T, February 15, 2006), 11 and *Report on Better Compliance Data and Long-Term Goals Would Support a More Strategic IRS Approach to Reducing the Tax Gap* (Washington DC: GAO-05-753, July 2005) 7-19.

noncompliance. In its FY 2001 annual report, the IRS Oversight Board[22] supported the effort and solicited Congressional support for the Program.

[22] The IRS Oversight Board is a nine-member independent body created by the IRS Restructuring and Reform Act of 1998 (P.L. 105-206) to improve the IRS so it may better serve the public and meet the needs of taxpayers. It is charged to oversee the IRS in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws and to provide experience, independence, and stability to the IRS so it may move forward in a cogent, focused direction.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of the review was to analyze the filing characteristics and examination trends of flowthrough entities.[1] We used computer programs to obtain data from the IRS BRTF[2] and AIMS.[3] We did not audit to determine the accuracy and reliability of the information in any of the databases. However, we assessed the reasonableness and completeness of the data analyzed as outlined in Steps III. and IV. To accomplish our objective, we:

I. Analyzed extracts from the IRS BRTF to assess the filing characteristics and trends of partnership and S corporation returns processed in PYs 2000 through 2004.

II. Analyzed extracts from the IRS AIMS to assess the characteristics and trends of partnership and S corporation examinations closed in FYs 2001 through 2005.

III. Compared extracts from the IRS BRTF to the IRS Data Books[4] to provide assurances the data analyzed were reasonable and complete.

IV. Compared extracts from the IRS AIMS to the IRS Table 37, Examination Program Monitoring, to provide assurances the data analyzed were reasonable and complete.

[1] Flowthrough entities describe certain entities, such as partnerships and S corporations, because their income, losses, credits, and other tax items generally are distributed untaxed to their owners.
[2] The BRTF is a computer file of the transcribed line items on all business returns and their accompanying schedules or forms.
[3] The AIMS is a computer system used during examination and appeals activities to control returns, input assessments/adjustments to the Master File, and provide management reports. The Master File is an IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
[4] IRS Data Books contain tax administration statistics on topics such as examination activities, collections, penalties, and refunds.

Appendix II

Major Contributors to This Report

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Appendix III

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Appendix IV

Detailed Figures of Statistical Information

Figure 1: Income Tax Advantages of Flowthrough Entities. One benefit of operating as a partnership or S corporation is that business profits are taxed only once, rather than twice like a conventional corporation. This can be illustrated with the following example assuming the maximum corporate and individual tax rates are applicable for the entities involved and all profits are remitted to the owners. In a conventional corporation, $1,000 of business profits is first taxed at the corporate level, resulting in $350 in corporate income tax ($1,000 multiplied by the 35 percent maximum corporate tax rate), with the remaining $650 being paid to the shareholder as a dividend. The $650 dividend is subject to a special 15 percent tax rate for dividends at the individual level for a personal income tax of $97.50 ($650 multiplied by the 15 percent). As a result, the total tax on $1,000 of corporate earnings is $447.50. In contrast, $1,000 of business profits in a flowthrough entity (partnership or S corporation) is taxed only once at the individual level, resulting in a tax of $350 ($1,000 multiplied by the 35 percent individual tax rate).

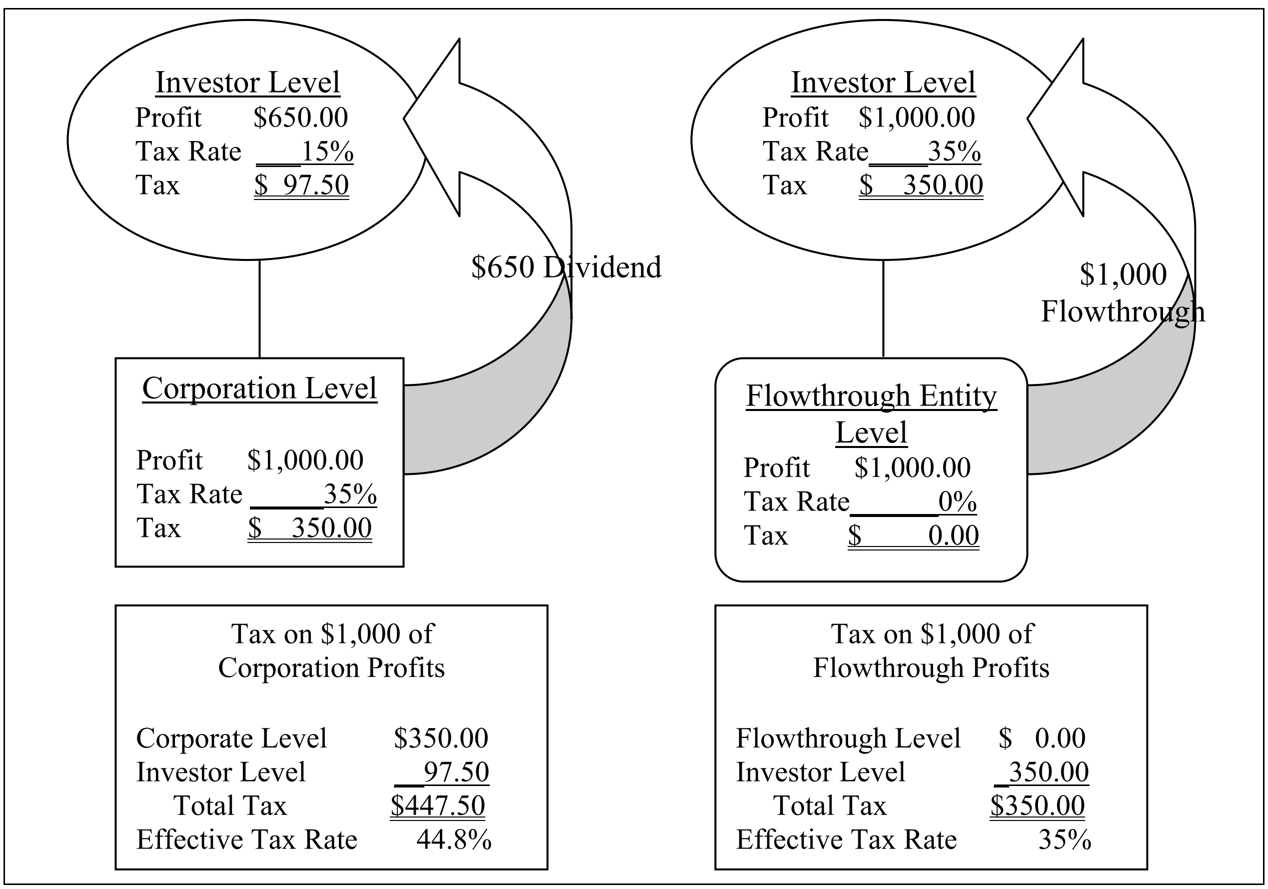


Figure 2: Partnership Filings by Asset Class. Partnership filings grew 22.21 percent in PYs 2000 - 2004. Partnerships reporting assets of over $10 million grew 36.71 percent, while those reporting assets of $10 million and under grew 21.81 percent.

	Processing Years					Percentage Change
Asset Class	**2000**	**2001**	**2002**	**2003**	**2004**	**PYs 2000 - 2004**
Under $250,000	1,319,655	1,351,902	1,389,769	1,482,285	1,554,061	17.76%
$250,000 to under $1 million	374,111	400,938	427,266	439,215	466,473	24.69%
$1 million to under $5 million	266,406	293,183	317,943	334,975	359,028	34.77%
$5 million to under $10 million	48,798	54,725	60,240	64,144	67,555	38.44%
$10 million to under $50 million	42,451	47,885	53,292	55,173	58,562	37.95%
$50 million to under $100 million	6,223	6,912	7,878	7,737	8,130	30.64%
$100 million to under $250 million	4,355	4,830	5,496	5,497	5,705	31.00%
$250 million and over	3,129	3,460	4,050	4,061	4,375	39.82%
Totals	2,065,128	2,163,835	2,265,934	2,393,087	2,523,889	22.21%

Source: TIGTA analysis of the partnership BRTF[1] for PYs 2000 - 2004.

Figure 3: S Corporation Filings by Asset Class. S corporation filings grew 20.69 percent in PYs 2000 - 2004. S corporations reporting assets of over $10 million grew 27.14 percent, while those reporting assets of $10 million or under grew 20.64 percent.

	Processing Years					Percentage Change
Asset Class	**2000**	**2001**	**2002**	**2003**	**2004**	**PYs 2000 - 2004**
Under $250,000	2,262,371	2,359,609	2,477,088	2,628,151	2,746,315	21.39%
$250,000 to under $1 million	404,521	425,186	446,401	463,983	478,266	18.23%
$1 million to under $5 million	173,570	182,275	191,358	197,359	202,867	16.88%
$5 million to under $10 million	27,180	29,076	29,898	31,073	31,952	17.56%
$10 million to under $50 million	19,469	21,336	22,124	23,025	24,347	25.06%
$50 million to under $100 million	1,846	2,053	2,297	2,418	2,524	36.73%
$100 million to under $250 million	1,016	1,126	1,374	1,383	1,449	42.62%
$250 million and over	462	602	952	668	660	42.86%
Totals	2,890,435	3,021,263	3,171,492	3,348,060	3,488,380	20.69%

Source: TIGTA analysis of the S corporation BRTF for PYs 2000 - 2004.

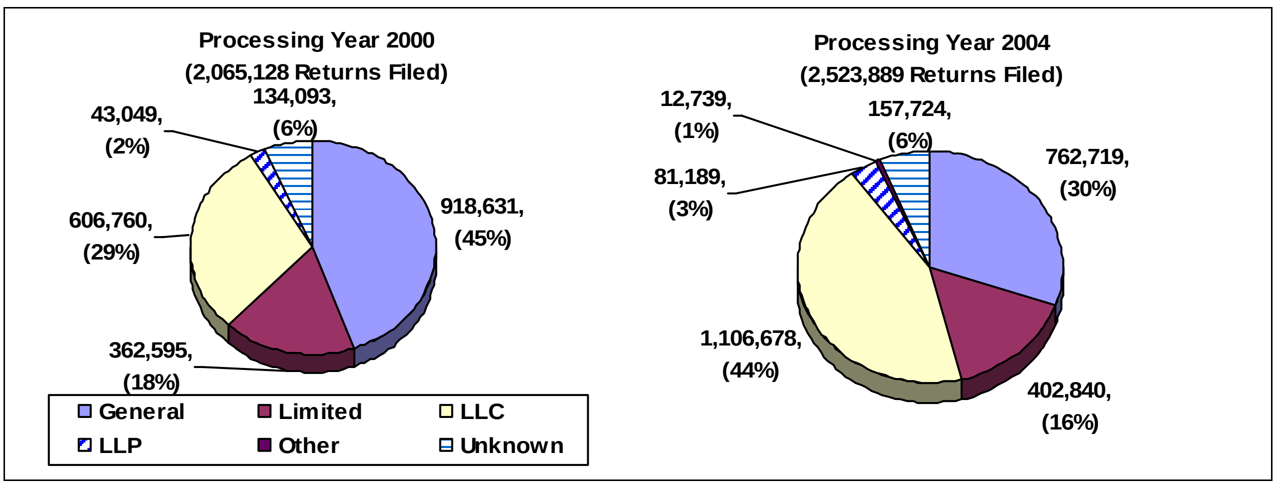
[1] The BRTF is a computer file of the transcribed line items on all business returns and their accompanying schedules or forms.

Figure 4: Partnership Filings by Type of Entity Classification. Overall partnership filings grew 22.21 percent. In PYs 2000 - 2004, components grew as follows: LLCs 82.39 percent, LLPs 88.60 percent, and Limited Partnerships 11.10 percent. General partnerships declined nearly 17 percent over the same period. Foreign partnerships grew 79.48 percent, and other partnerships grew 32.78 percent.

	Processing Years					Percentage Change
Partnership Classification	**2000**	**2001**	**2002**	**2003**	**2004**	**PYs 2000 - 2004**
General Partnership	918,631	876,586	832,843	796,323	762,719	-16.97%
Limited Partnership	362,595	370,533	384,120	394,287	402,840	11.10%
LLC	606,760	714,048	832,268	962,894	1,106,678	82.39%
LLP	43,049	59,006	65,646	73,927	81,189	88.60%
Foreign Partnership[2]		2,178	3,033	3,530	3,909	79.48%
Other[3]		6,650	7,737	8,393	8,830	32.78%
Unknown	134,093	134,834	140,287	153,733	157,724	17.62%
Totals	2,065,128	2,163,835	2,265,934	2,393,087	2,523,889	22.21%

Source: TIGTA analysis of the partnership BRTF for PYs 2000 - 2004.

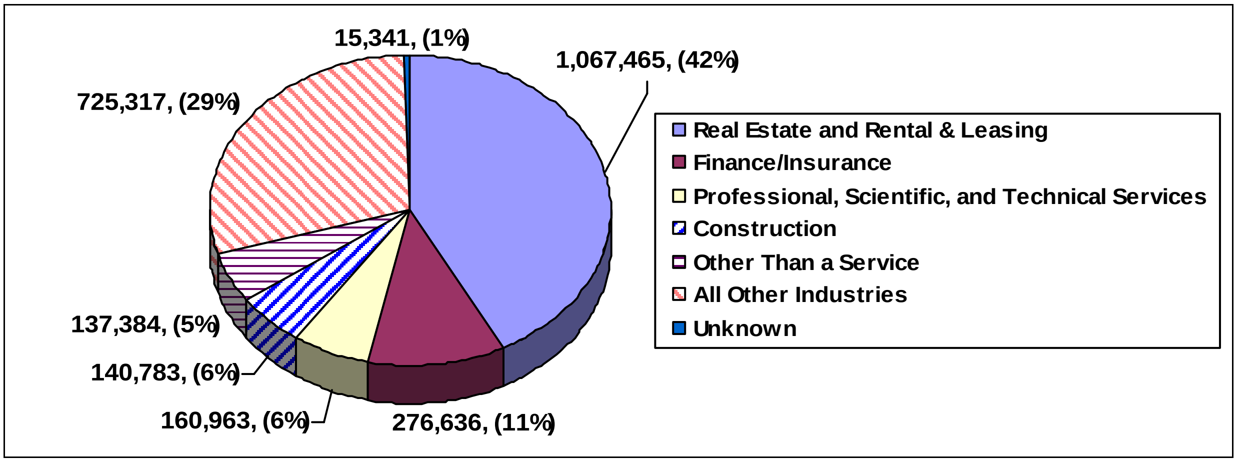
Figure 5: Composition of Partnership Entity Filings (PYs 2000 and 2004). LLCs increased from 29 percent to 44 percent of partnerships, while General Partnerships decreased from 45 percent to 30 percent and Limited Partnerships decreased from 18 percent to 16 percent.



Source: TIGTA analysis of the partnership BRTF for PYs 2000 and 2004.

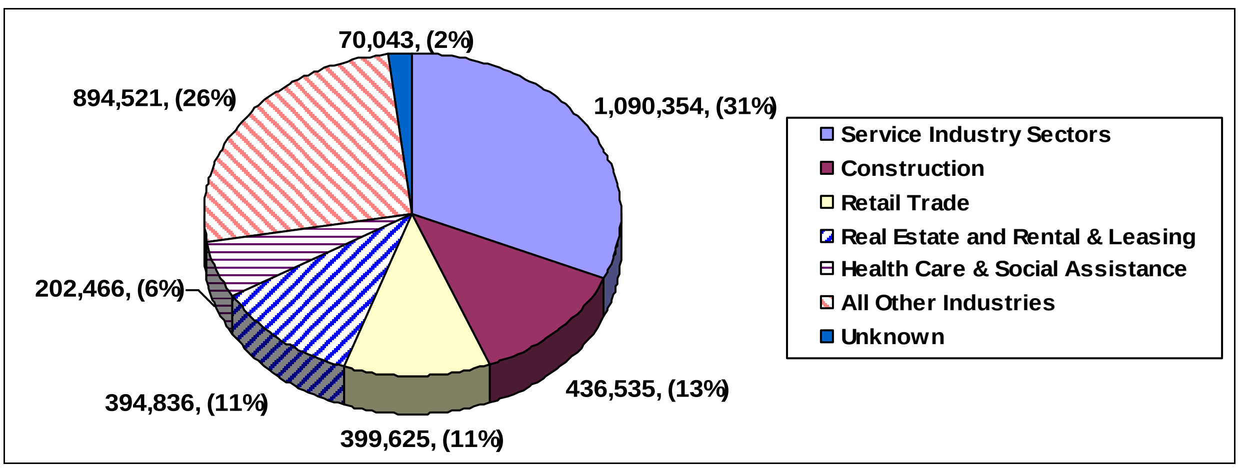
[2] The IRS began collecting information on foreign partnership returns with the TY 2000 partnership returns processed in PY 2001.
[3] The IRS began collecting information on other partnership returns with the TY 2000 partnership returns processed in PY 2001.

Figure 6: Industry Composition of Partnership Filings (PY 2004). The top 5 industry classifications accounted for 71 percent of all partnership filings in PY 2004. "Real Estate and Rental & Leasing" and "Finance/Insurance" made up 53 percent of these partnership filings in PY 2004.



Source: TIGTA analysis of the partnership BRTF for PY 2004.

Figure 7: Industry Composition of S Corporation Filings (PY 2004). The top 5 industry classifications accounted for 72 percent of the S corporation filings in PY 2004. Service sector industries made up 31 percent of these S corporation filings in PY 2004.



Source: TIGTA analysis of the S corporation BRTF for PY 2004.

Figure 8: Partnership Filings by Industry Classification. Partnership returns processed in PYs 2000 - 2004 were concentrated in the real estate and finance/insurance industry sectors. The top 5 industry categories of partnerships grew 28 percent.

	Processing Years					Percentage Change
Industry Classification	**2000**	**2001**	**2002**	**2003**	**2004**	**PYs 2000 - 2004**
1. Real Estate and Rental & Leasing	832,348	878,128	925,188	1,001,047	1,067,465	28.25%
2. Finance/Insurance	210,971	240,095	259,380	271,205	276,636	31.13%
3. Professional, Scientific, and Technical Services	127,744	135,935	144,795	154,326	160,963	26.00%
4. Construction	113,797	120,903	128,200	133,918	140,783	23.71%
5. Other Than a Type of Service	103,056	107,456	109,211	124,814	137,384	33.31%
Totals for Top 5 Industries	1,387,916	1,482,517	1,566,774	1,685,310	1,783,231	28.48%
Retail Trade	107,712	109,850	113,064	121,539	128,355	19.16%
Agriculture, Forestry, Fishing, and Hunting	116,885	119,331	121,205	125,534	127,475	9.06%
Other Services	60,656	63,183	66,773	72,772	77,503	27.77%
Accommodation and Food Services	58,861	62,565	66,356	72,157	76,546	30.05%
Health Care and Social Assistance	37,254	39,626	42,615	46,153	49,087	31.76%
Manufacturing	33,250	35,293	36,736	39,915	41,833	25.81%
Wholesale Trade	28,503	31,134	33,266	35,519	38,173	33.93%
Arts, Entertainment, and Recreation	26,965	28,703	30,773	33,430	35,436	31.41%
Administration and Support, Waste Management, and Remediation Services	23,391	26,104	28,653	32,328	34,611	47.97%
Transportation and Warehousing	21,099	23,184	24,902	27,388	28,791	36.46%
Information	21,105	22,812	23,663	26,366	27,969	32.52%
Mining	23,876	24,269	25,032	26,222	26,875	12.56%
Management of Companies and Enterprises	11,684	13,148	14,644	17,399	18,520	58.51%
Education Services	4,029	4,341	4,797	5,361	5,857	45.37%
Service Type of Business	7,372	8,274	7,823	7,296	5,582	-24.28%
Utilities	2,107	2,315	2,448	2,579	2,704	28.33%
Unknown	92,463	67,186	56,410	15,819	15,341	-83.41%
Totals	2,065,128	2,163,835	2,265,934	2,393,087	2,523,889	22.21%

Source: TIGTA analysis of the partnership BRTF for PYs 2000 - 2004.

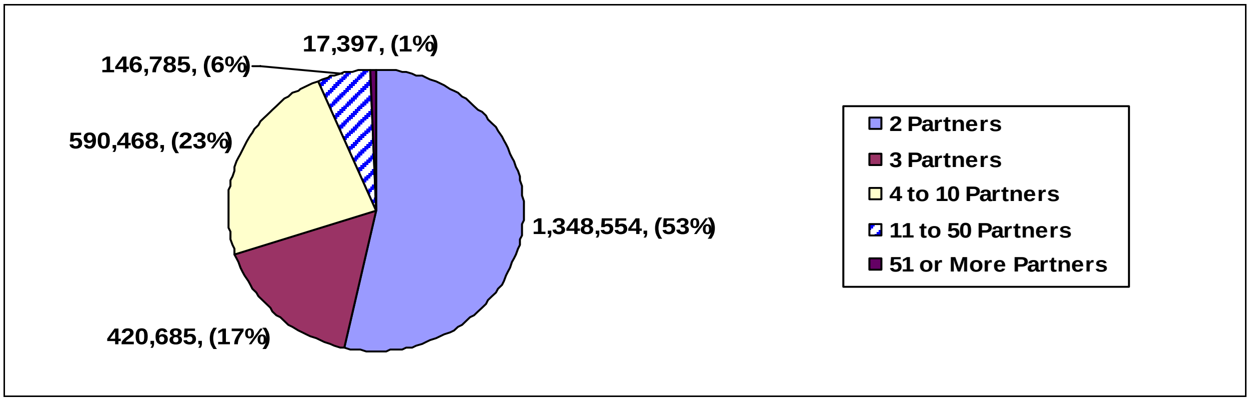
Figure 9: S Corporation Filings by Industry Classification. The top 5 industry categories of S corporations grew 30 percent in PYs 2000 - 2004. Industry classifications in the service sector grew 30 percent.

	Processing Years					Percentage Change
Industry Classification	**2000**	**2001**	**2002**	**2003**	**2004**	**PYs 2000 - 2004**
1. Service Industry Sectors[4]	840,089	913,632	971,034	1,045,206	1,090,354	29.79%
2. Construction	322,702	355,350	385,328	411,324	436,535	35.27%
3. Retail Trade	325,090	342,665	362,761	384,347	399,625	22.93%
4. Real Estate and Rental & Leasing	319,048	334,426	352,210	374,264	394,836	23.75%
5. Health Care and Social Assistance	133,873	148,351	165,227	184,414	202,466	51.24%
Totals for Top 5 Industries	1,940,802	2,094,424	2,236,560	2,399,555	2,523,816	30.04%
Wholesale Trade	152,130	158,089	164,267	166,274	167,710	10.24%
Manufacturing	140,785	145,664	149,181	153,892	154,837	9.98%
Finance/Insurance	108,189	116,960	125,390	133,569	140,615	29.97%
Transportation and Warehousing	88,383	95,625	100,858	107,522	111,646	26.32%
Agriculture, Forestry, Fishing, and Hunting	66,441	69,967	72,683	75,916	77,639	16.85%
Arts, Entertainment, and Recreation	57,301	60,923	65,403	69,740	72,998	27.39%
Other Than a Type of Service	72,927	63,471	63,461	64,742	72,523	-0.55%
Information	49,908	52,848	55,021	56,974	59,251	18.72%
Mining	18,033	18,294	18,655	19,302	19,483	8.04%
Management of Companies and Enterprises	12,007	12,234	13,041	13,655	14,185	18.14%
Utilities	3,325	3,265	3,362	3,594	3,634	9.29%
Unknown	180,204	129,499	103,610	83,325	70,043	-61.13%
Totals	2,890,435	3,021,263	3,171,492	3,348,060	3,488,380	20.69%

Source: TIGTA analysis of the S corporation BRTF for PYs 2000 - 2004.

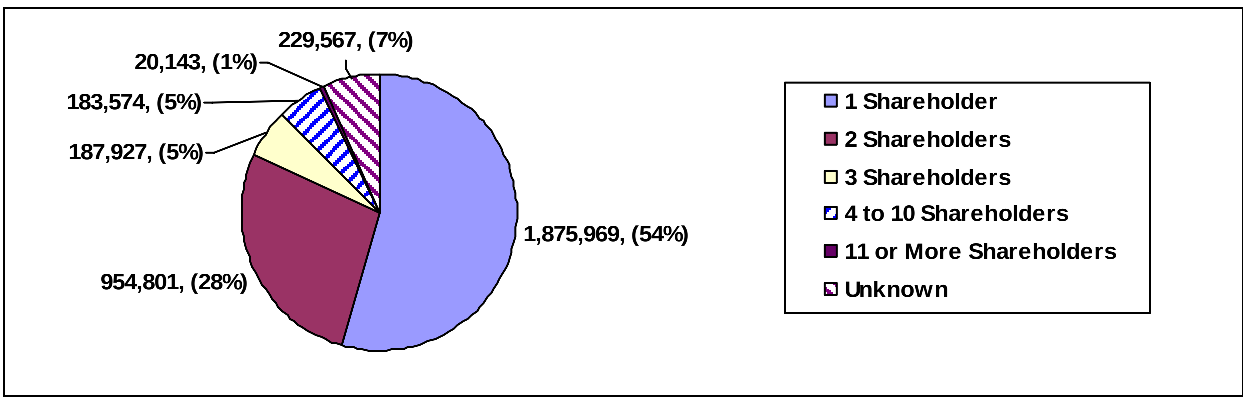
[4] For presentation purposes, we combined several service industry sectors. The specific sectors combined included Professional, Scientific and Technical Services, Other Services, Accommodation and Food Services, Administration and Support, Waste Management and Remediation Services, Education Services, and Service.

Figure 10: Ownership of Partnerships (PY 2004). Ninety-three percent of all partnerships have 10 or fewer partners. Fifty-three percent of partnerships have 2 partners, 17 percent have 3 partners, 23 percent have 4 to 10 partners, and 6 percent have 11 to 50 partners. Partnerships with 51 or more partners represent only 1 percent of all partnerships.



Source: TIGTA analysis of the partnership BRTF for PY 2004.

Figure 11: Ownership of S Corporations (PY 2004). Eighty-seven percent of S corporations have three or fewer shareholders. Fifty-four percent of S corporations have 1 shareholder, 28 percent have 2 shareholders, and 5 percent have 3 shareholders.



Source: TIGTA analysis of the S corporation BRTF for PY 2004.

Figure 12: Tiered Partnership[5] Filings by Asset Class. Tiered partnerships grew 31 percent in PYs 2000 – 2004, while tiered partnerships with $10 million or more in assets grew 45 percent.

	Processing Years					Percentage Change
Asset Class	**2000**	**2001**	**2002**	**2003**	**2004**	**PYs 2000 - 2004**
Under $250,000	136,478	126,237	135,585	164,426	177,573	30.11%
$250,000 to under $1 million	71,268	70,165	75,158	82,085	86,002	20.67%
$1 million to under $5 million	88,039	90,729	98,916	108,813	115,369	31.04%
$5 million to under $10 million	24,576	26,044	29,434	32,732	34,595	40.77%
$10 million to under $50 million	26,256	28,257	32,810	35,350	37,922	44.43%
$50 million to under $100 million	4,355	4,621	5,641	5,683	6,138	40.94%
$100 million to under $250 million	3,012	3,252	3,935	4,046	4,360	44.75%
$250 million and over	2,031	2,087	2,737	2,782	3,183	56.72%
Totals	356,015	351,392	384,216	435,917	465,142	30.65%

Source: TIGTA analysis of the partnership BRTF for PYs 2000 - 2004.

Figure 13: Top 5 Industry Classifications of Tiered Partnership Filings With Assets of $10 Million or More. Tiered partnerships with assets over $10 million grew 45 percent in PYs 2000 - 2004. Partnerships in the "Finance/Insurance" category grew 63 percent, while partnerships in the "Real Estate and Rental & Leasing" category grew 43 percent.

	Processing Years					Percentage Change
Industry Classification	**2000**	**2001**	**2002**	**2003**	**2004**	**PYs 2000 - 2004**
1. Real Estate and Rental & Leasing	16,488	17,764	20,703	22,278	23,658	43.49%
2. Finance/Insurance	11,144	12,303	15,253	16,142	18,149	62.86%
3. Accommodation and Food Services	975	977	1,089	1,108	1,136	16.51%
4. Management of Companies and Enterprises	818	809	938	1,053	1,095	33.86%
5. Manufacturing	673	761	853	910	946	40.56%
Totals for Top 5 Industries	30,098	32,614	38,836	41,491	44,984	49.46%
All Other Industries	3,804	4,017	4,433	4,710	4,912	29.13%
Unknown	1,752	1,586	1,854	1,660	1,707	-2.57%
Totals	35,654	38,217	45,123	47,861	51,603	44.73%

Source: TIGTA analysis of the partnership BRTF for PYs 2000 to 2004.

[5] A tiered partnership generally involves one that owns or is owned by one or more other partnerships.

Figure 14: Partnership Return Examinations by Asset Class. Partnership return examinations increased 37 percent between FYs 2004 and 2005 with the largest increase, 66 percent, taking place in partnership returns with assets of $250,000 to under $1 million.

	Fiscal Years					Percentage Change	
Asset Class	**2001**	**2002**	**2003**	**2004**	**2005**	**FYs 2001 - 2005**	**FYs 2004 - 2005**
Under $250,000	1,217	1,536	2,490	2,199	3,544	191.21%	61%
$250,000 to under $1 million	592	734	938	622	1,035	74.83%	66%
$1 million to under $5 million	749	939	1,249	838	1,243	65.95%	48%
$5 million to under $10 million	248	370	626	356	469	89.11%	32%
$10 million to under $50 million	405	597	1,027	982	935	130.86%	-5%
$50 million to under $100 million	171	172	272	272	286	67.25%	5%
$100 million to under $250 million	127	160	243	290	307	141.73%	6%
$250 million and over	154	240	283	348	409	165.58%	18%
Unknown	1,392	779	712	254	187	-86.54%	-26%
Totals	5,055	5,527	7,840	6,161	8,415	66.47%	37%

Source: TIGTA analysis of the AIMS for partnership return examinations completed in FYs 2001 - 2005.

Figure 15: S Corporation Return Examinations by Asset Class. S corporation return examinations increased 63 percent between FYs 2004 and 2005 with the largest increase, 119 percent, taking place in returns with assets of $1 million to under $5 million.

	Fiscal Years					Percentage Change	
Asset Class	**2001**	**2002**	**2003**	**2004**	**2005**	**FYs 2001 - 2005**	**FYs 2004 - 2005**
Under $250,000	4,631	4,807	4,367	3,473	5,737	23.88%	65%
$250,000 to under $1 million	1,567	1,697	1,359	616	1,189	-24.12%	93%
$1 million to under $5 million	2,242	2,351	1,751	617	1,353	-39.65%	119%
$5 million to under $10 million	802	885	654	282	569	-29.05%	102%
$10 million to under $50 million	1,122	942	963	795	1,063	-5.26%	34%
$50 million to under $100 million	143	135	132	132	150	4.90%	14%
$100 million to under $250 million	97	97	97	91	106	9.28%	16%
$250 million and over	30	34	39	58	42	40.00%	-28%
Unknown	1,818	695	333	336	201	-88.94%	-40%
Totals	12,452	11,643	9,695	6,400	10,410	-16.40%	63%

Source: TIGTA analysis of the AIMS for S corporation return examinations completed in FYs 2001 - 2005.

Figure 16: Top 5 Industry Classifications of Partnership Return Examinations. Examination of partnership returns in the "Finance/Insurance" and the "Real Estate and Rental & Leasing" industry classifications increased 228 percent and 97 percent, respectively, in FYs 2001 - 2005.

	Fiscal Years					Percentage Change	
Industry Classification	**2001**	**2002**	**2003**	**2004**	**2005**	**FYs 2001 - 2005**	**FYs 2004 - 2005**
1. Finance/Insurance	566	756	1,111	1,084	1,856	227.92%	71.22%
2. Real Estate and Rental & Leasing	813	1,020	1,470	1,245	1,601	96.92%	28.59%
3. Agriculture, Forestry, Fishing, and Hunting	261	378	499	241	578	121.46%	139.83%
4. Professional, Scientific, and Technical Services	213	229	392	414	505	137.09%	21.98%
5. Retail Trade	158	259	420	351	493	212.03%	40.46%
Totals Top 5 Industries	2,011	2,642	3,892	3,335	5,033	150.27%	50.91%
All Other Industries	1,453	1,906	3,028	2,479	3,104	113.63%	25.21%
Unknown	1,591	979	920	347	278	-82.53%	-19.88%
Totals	5,055	5,527	7,840	6,161	8,415	66.47%	36.58%

Source: TIGTA analysis of the AIMS for partnership return examinations completed in FYs 2001 - 2005.

Figure 17: Top 5 Industry Classifications of S Corporation Return Examinations. Examinations of S corporation returns in the "Retail Trade" industry increased 26 percent, while those in the "Construction" industry declined 25 percent between FYs 2004 and 2005.

	Fiscal Years					Percentage Change	
Industry Classification	**2001**	**2002**	**2003**	**2004**	**2005**	**FYs 2001 - 2005**	**FYs 2004 - 2005**
1. Retail Trade	1,057	1,153	1,027	751	1,332	26.02%	77.36%
2. Construction	1,554	1,572	1,333	600	1,160	-25.35%	93.33%
3. Finance/Insurance	423	528	377	376	960	126.95%	155.32%
4. Manufacturing	1,335	1,297	1,006	547	906	-32.13%	65.63%
5. Professional, Scientific, and Technical Services	829	908	832	713	895	7.96%	25.53%
Totals Top 5 Industries	5,198	5,458	4,575	2,987	5,253	1.06%	75.86%
All Other Industries	4,782	4,924	4,383	2,881	4,716	-1.38%	63.69%
Unknown	2,472	1,261	737	532	441	-82.16%	-17.11%
Totals	12,452	11,643	9,695	6,400	10,410	-16.40%	62.66%

Source: TIGTA analysis of the AIMS for S corporation return examinations completed in FYs 2001 - 2005.

Figure 18: Partnership Return Examinations by Type of Entity Classification. Partnership return examinations increased 37 percent between FYs 2004 and 2005. LLC examinations increased 51 percent, Limited Partnership examinations increased 43 percent, LLP examinations increased 10 percent, and General Partnership examinations increased 30 percent during the period.

	Fiscal Years					Percentage Change	
Partnership Classification	**2001**	**2002**	**2003**	**2004**	**2005**	**FYs 2001 - 2005**	**FYs 2004 - 2005**
General Partnership	1,261	1,372	2,060	1,463	1,903	50.91%	30.08%
Limited Partnership	1,135	1,481	2,003	1,631	2,332	105.46%	42.98%
LLC	1,038	1,550	2,568	2,264	3,414	228.90%	50.80%
LLC	76	93	119	123	135	77.63%	9.76%
Foreign Partnership[6]		21	19	20	40	90.48%	100.00%
Other[7]		16	28	34	27	68.75%	-20.59%
Unknown	1,545	994	1,043	626	564	-63.50%	-9.90%
Totals	5,055	5,527	7,840	6,161	8,415	66.47%	36.58%

Source: TIGTA analysis of the AIMS for partnership return examinations completed in FYs 2001 - 2005.

Figure 19: Partnership Return Examination No-Change Rates by Asset Class. The partnership no-change rate increased by 16 percent to a 44 percent no-change rate between FYs 2004 and 2005. The largest increase was in returns with assets of $250,000 to under $1 million, which increased 63 percent to a 55 percent no-change rate.

	Fiscal Years					Percentage Change	
Asset Class	**2001**	**2002**	**2003**	**2004**	**2005**	**FYs 2001 - 2005**	**FYs 2004 - 2005**
Under $250,000	42.70%	39.11%	41.47%	33.93%	41.86%	-1.96%	23.40%
$250,000 to under $1 million	45.30%	43.70%	51.87%	33.93%	55.40%	22.31%	63.30%
$1 million to under $5 million	48.28%	49.89%	53.74%	38.68%	52.79%	9.34%	36.48%
$5 million to under $10 million	44.55%	46.44%	53.96%	47.99%	42.17%	-5.32%	-12.12%
$10 million to under $50 million	47.38%	58.52%	58.70%	48.83%	38.66%	-18.40%	-20.83%
$50 million to under $100 million	24.79%	48.70%	58.15%	49.54%	37.60%	51.67%	-24.10%
$100 million to under $250 million	46.75%	45.24%	54.12%	31.11%	38.03%	-18.65%	22.25%
$250 million and over	48.57%	48.00%	39.55%	27.44%	28.72%	-40.87%	4.66%
Unknown	43.71%	37.43%	31.41%	29.61%	28.33%	-35.18%	-4.32%
Totals	44.32%	44.46%	48.01%	37.94%	44.13%	-0.44%	16.31%

Source: TIGTA analysis of the AIMS for partnership return examinations completed in FYs 2001 - 2005.

[6] The IRS began collecting information on foreign partnership returns with the TY 2000 partnership returns processed in PY 2001.
[7] The IRS began collecting information on other partnership returns with the TY 2000 partnership returns processed in PY 2001.

Figure 20: S Corporation Return Examination No-Change Rates by Asset Class. The partnership no-change rate increased 48 percent to 43 percent between FYs 2004 and 2005. The largest increase was in returns with assets of $1 million to under $5 million, which increased 141 percent to a 52 percent no-change rate between FYs 2004 and 2005.

	Fiscal Years					Percentage Change	
Asset Class	**2001**	**2002**	**2003**	**2004**	**2005**	**FYs 2001 - 2005**	**FYs 2004 - 2005**
Under $250,000	40.83%	39.75%	39.92%	29.62%	40.55%	-0.68%	36.92%
$250,000 to under $1 million	41.80%	35.00%	36.55%	21.92%	40.69%	-2.65%	85.67%
$1 million to under $5 million	40.20%	42.02%	38.89%	21.79%	52.48%	30.55%	140.84%
$5 million to under $10 million	37.33%	37.44%	36.36%	24.11%	55.71%	49.25%	131.04%
$10 million to under $50 million	34.53%	36.98%	32.98%	41.27%	45.52%	31.84%	10.32%
$50 million to under $100 million	35.56%	31.58%	33.33%	38.64%	31.29%	-11.99%	-19.01%
$100 million to under $250 million	28.57%	30.43%	41.94%	34.44%	36.79%	28.77%	6.82%
$250 million and over	28.57%	40.63%	27.78%	20.00%	35.90%	25.64%	79.49%
Unknown	34.36%	25.00%	26.81%	23.33%	29.35%	-14.58%	25.80%
Totals	38.93%	38.08%	37.78%	29.16%	43.05%	10.59%	47.62%

Source: TIGTA analysis of the AIMS for S corporation return examinations completed in FYs 2001 - 2005.

Figure 21: Partnership Adjustments. Partnership examination adjustments increased 82 percent between FYs 2004 and 2005, from $2.3 billion to $4.3 billion.

	Fiscal Years					Percentage Change
Asset Class	**2001**	**2002**	**2003**	**2004**	**2005**	**FYs 2004 - 2005**
Under $250,000	$134,732	$198,312	$223,627	$384,169	$1,612,941	319.85%
$250,000 to under $1 million	79,725	1,414,057	316,387	248,521	49,629	-80.03%
$1 million to under $5 million	104,377	49,325	924,701	228,726	248,712	8.74%
$5 million to under $10 million	30,965	27,343	154,092	127,044	153,126	20.53%
$10 million to under $50 million	77,358	123,873	243,002	868,574	676,177	-22.15%
$50 million to under $100 million	30,132	213,179	63,952	141,028	315,760	123.90%
$100 million to under $250 million	42,364	174,919	356,084	231,962	268,638	15.81%
$250 million and over	238,807	41,056	169,080	90,385	826,324	814.23%
Unknown	363,487	307,372	362,471	23,014	102,694	346.22%
Totals	$1,101,948	$2,549,436	$2,813,395	$2,343,423	$4,254,001	81.53%

Source: TIGTA analysis of the AIMS for partnership return examinations completed in FYs 2001 - 2005.

Figure 22: S Corporation Adjustments. S corporation examination adjustments increased 81 percent between FYs 2004 and 2005, from $1.05 billion to $1.90 billion.

	Fiscal Years					Percentage Change
Asset Class	**2001**	**2002**	**2003**	**2004**	**2005**	**FYs 2004 - 2005**
Under $250,000	$188,328	$212,102	$686,429	$300,115	$488,000	62.60%
$250,000 to under $1 million	69,891	95,758	101,681	55,866	152,439	172.86%
$1 million to under $5 million	181,041	147,002	129,929	95,014	194,157	104.35%
$5 million to under $10 million	68,362	84,887	79,487	75,198	96,318	28.09%
$10 million to under $50 million	222,357	418,899	377,428	185,734	472,187	154.23%
$50 million to under $100 million	57,584	22,752	74,342	43,441	66,327	52.68%
$100 million to under $250 million	66,979	64,194	134,967	179,283	313,533	74.88%
$250 million and over	8,451	14,129	58,928	68,505	84,779	23.76%
Unknown	471,812	98,798	361,222	46,593	35,027	-24.82%
Totals	$1,334,805	$1,158,521	$2,004,413	$1,049,748	$1,902,767	81.26%

Source: TIGTA analysis of the AIMS for S corporation return examinations completed in FYs 2001 - 2005.

Figure 23: Partnership Unagreed and Agreed Examination Results by Asset Class (FYs 2004 - 2005). Unagreed examination adjustments increased 78 percent, while agreed examination adjustments increased 87 percent between FYs 2004 and 2005.

(In Thousands)						
	Unagreed Examination Adjustments			**Agreed Examination Adjustments**		
Total Assets	**FY 2004**	**FY 2005**	**Percentage Change**	**FY 2004**	**FY 2005**	**Percentage Change**
Under $250,000	$241,082	$1,389,298	476.28%	$143,086	$223,642	56.30%
$250,000 to under $1 million	164,687	39,399	-76.08%	83,834	10,073	-87.98%
$1 million to under $5 million	126,449	63,502	-49.78%	102,277	185,210	81.09%
$5 million to under $10 million	26,933	112,987	319.51%	100,112	40,139	-59.91%
$10 million to under $50 million	715,272	454,910	-36.40%	153,301	221,268	44.34%
$50 million to under $100 million	101,913	229,802	125.49%	39,115	85,957	119.75%
$100 million to under $250 million	40,983	151,811	270.42%	190,979	116,826	-38.83%
$250 million and over	44,098	141,958	221.91%	46,287	684,366	1,378.54%
Unknown	6,792	36,070	431.05%	16,222	66,624	310.71%
Totals	$1,468,210	$2,619,739	78.43%	$875,213	$1,634,105	86.71%

Source: TIGTA analysis of the AIMS for partnership and S corporation return examinations completed in FYs 2004 and 2005.

Figure 24: S Corporation Unagreed and Agreed Examination Results by Asset Class (FYs 2004 - 2005). Unagreed examination adjustments increased 72 percent, while agreed examination adjustments increased 91 percent between FYs 2004 and 2005.

(In Thousands)						
	Unagreed Examination Adjustments			**Agreed Examination Adjustments**		
Total Assets	**FY 2004**	**FY 2005**	**Percentage Change**	**FY 2004**	**FY 2005**	**Percentage Change**
Under $250,000	$170,551	$228,642	34.06%	$129,424	$259,298	100.35%
$250,000 to under $1 million	33,281	121,021	263.63%	22,585	31,418	39.11%
$1 million to under $5 million	38,515	133,797	247.39%	56,499	60,360	6.83%
$5 million to under $10 million	34,760	56,887	63.66%	40,438	39,431	-2.49%
$10 million to under $50 million	93,744	202,153	115.64%	91,989	270,034	193.55%
$50 million to under $100 million	26,481	24,781	-6.42%	16,960	41,546	144.97%
$100 million to under $250 million	99,949	133,432	33.50%	79,335	180,100	127.01%
$250 million and over	31,861	35,307	10.81%	36,644	49,472	35.01%
Unknown	19,879	9,274	-53.35%	26,714	25,724	-3.70%
Totals	$549,022	$945,294	72.18%	$500,587	$957,385	91.25%

Source: TIGTA analysis of the AIMS for partnership and S corporation return examinations completed in FYs 2004 and 2005.

Figure 25: Partnership Examination Hours per Return by Asset Class. Hours per return fell 34 percent, from 74 hours to 49 hours, on partnership examinations between FYs 2004 and 2005. The greatest decline came on returns with assets of $250 million and over, with a decline of 51 percent from 304 hours to 150 hours.

	Fiscal Years				**Percentage Change**	
Asset Class	**2002**	**2003**	**2004**	**2005**	**FYs 2002 - 2005**	**FYs 2004 - 2005**
Under $250,000	36	38	44	39	7.30%	-11.00%
$250,000 to under $1 million	45	53	49	36	-19.97%	-25.80%
$1 million to under $5 million	51	60	56	34	-32.52%	-38.35%
$5 million to under $10 million	65	78	79	51	-21.73%	-35.90%
$10 million to under $50 million	56	98	114	80	43.38%	-30.39%
$50 million to under $100 million	149	91	138	104	-30.26%	-24.85%
$100 million to under $250 million	163	128	150	85	-48.02%	-43.72%
$250 million and over	138	192	304	150	8.48%	-50.74%
Unknown	56	35	36	32	-43.39%	-13.09%
Totals	54	61	74	49	-8.83%	-33.82%

Source: TIGTA analysis of the AIMS for partnership return examinations completed in FYs 2002 - 2005.

Figure 26: S Corporation Examination Hours per Return by Asset Class. Hours per return fell 23 percent, from 66 hours to 50 hours, on S corporation examinations between FYs 2004 and 2005. The largest decline came on returns with assets of $1 million to under $5 million, with a decline of 34 percent from 64 hours to 42 hours.

	Fiscal Years				Percentage Change	
Asset Class	**2002**	**2003**	**2004**	**2005**	**FYs 2002 - 2005**	**FYs 2004 - 2005**
Under $250,000	50	53	47	36	-26.66%	-22.87%
$250,000 to under $1 million	51	56	54	38	-25.18%	-29.41%
$1 million to under $5 million	61	70	64	42	-31.37%	-33.63%
$5 million to under $10 million	77	84	84	58	-25.08%	-31.24%
$10 million to under $50 million	120	133	120	113	-5.53%	-5.67%
$50 million to under $100 million	155	161	129	160	3.20%	23.87%
$100 million to under $250 million	250	245	198	142	-43.30%	-28.19%
$250 million and over	285	225	231	201	-29.64%	-13.18%
Unknown	83	94	50	66	-20.64%	30.54%
Totals	65	72	66	50	-23.09%	-23.41%

Source: TIGTA analysis of the AIMS for S corporation return examinations completed in FYs 2002 - 2005.

Figure 27: Partnership Examination Cycle Time[8] per Return by Asset Class. The length of an examination as measured by average cycle time declined 19 percent, from 590 calendar days to 478 calendar days between FYs 2004 and 2005.

	Fiscal Years					Percentage Change	
Asset Class	**2001**	**2002**	**2003**	**2004**	**2005**	**FYs 2001 - 2005**	**FYs 2004 - 2005**
Under $250,000	551	458	393	495	456	-17.29%	-7.95%
$250,000 to under $1 million	407	376	393	530	350	-13.99%	-33.96%
$1 million to under $5 million	448	435	433	551	386	-13.90%	-29.96%
$5 million to under $10 million	510	526	497	511	521	2.21%	1.87%
$10 million to under $50 million	547	489	444	482	516	-5.59%	7.22%
$50 million to under $100 million	595	510	477	479	581	-2.39%	21.33%
$100 million to under $250 million	626	758	743	544	554	-11.56%	1.82%
$250 million and over	661	720	587	735	625	-5.51%	-15.00%
Unknown	1,188	1,665	3,075	2,521	1,585	33.48%	-37.11%
Totals	686	626	661	590	478	-30.29%	-18.91%

Source: TIGTA analysis of the AIMS for partnership return examinations completed in FYs 2001 - 2005.

[8] Cycle time is the number of calendar days it takes to complete the examination of a tax return.

Figure 28: S Corporation Examination Cycle Time per Return by Asset Class. The length of an examination as measured by average cycle time declined 21 percent, from 421 calendar days to 334 calendar days between FYs 2004 and 2005.

	Fiscal Years					Percentage Change	
Asset Class	**2001**	**2002**	**2003**	**2004**	**2005**	**FYs 2001 - 2005**	**FYs 2004 - 2005**
Under $250,000	322	328	356	380	314	-2.33%	-17.21%
$250,000 to under $1 million	324	334	352	473	333	2.92%	-29.57%
$1 million to under $5 million	307	302	361	510	316	3.04%	-38.02%
$5 million to under $10 million	297	328	362	480	314	5.95%	-34.51%
$10 million to under $50 million	354	396	383	385	315	-10.92%	-18.15%
$50 million to under $100 million	459	451	415	370	438	-4.55%	18.17%
$100 million to under $250 million	513	461	486	458	413	-19.59%	-9.86%
$250 million and over	539	608	463	422	486	-9.71%	15.31%
Unknown	596	786	1,301	648	1,010	69.44%	55.84%
Totals	364	360	394	421	334	-8.35%	-20.86%

Source: TIGTA analysis of the AIMS for S corporation return examinations completed in FYs 2001 - 2005.