

FY2008

FEDERAL, STATE AND LOCAL
GOVERNMENTS

WORK PLAN



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**FY2008
FSLG Work Plan**

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Executive Summary

The Office of Federal, State and Local Governments (FSLG) supports the Internal Revenue Service (IRS) and the Tax Exempt and Government Entities (TEGE) Division strategic goals of:

- 1) Enhancing Enforcement of the Tax Law;
- 2) Taxpayer Education and Outreach; and
- 3) Modernizing the IRS through its People, Processes and Technology.

In support of these goals, FSLG has committed to the following work plan areas:

- Expand FSLG compliance activities,
- Continue the Federal Agency compliance initiative,
- Continue the Large Entity compliance initiative,
- Continue a multi-year compliance project to address various compliance issues of specific market segments within state and local entities,
- Continue to address Abusive Tax Avoidance Transactions (ATATs),
- Build a highly qualified and satisfied work force,
- Meet customer needs by providing educational activities,
- Encourage voluntary compliance by government entities,
- Improve organizational performance, and
- Improve knowledge and information management

A central theme in the FY2008 Work Plan is FSLG's focus on continuing to improve its enforcement activity. Specifically, FSLG is committed to continuing its Federal Agency and Large Entity compliance initiatives that began in FY2005. FSLG will continue to conduct compliance projects designed around specific market segments or issues to improve compliance among state and local entities. FSLG will complete a project to analyze its classification program to improve the case selection process. It will hire and train additional Specialists, which will allow FSLG to increase compliance enforcement activities in FY2009.

Strategic Initiatives

In FY2005, FSLG committed to addressing compliance by Federal agencies with Federal tax laws. The compliance plan included the formation of a dedicated Federal Agency compliance group in September, 2005. In FY2007, the Federal Agency compliance group opened 20 examinations and completed examinations of 17 Federal agencies. In FY2008, FSLG anticipates opening 20 and closing 20 examinations of Federal agencies or sub-agencies. FSLG will also continue to work with Collection and the CFO's office to coordinate resolution of employment tax delinquencies by Federal agencies.

In FY2005, FSLG also committed to implementing a compliance program that addresses large non-Federal government taxpayers. These taxpayers, with

annual payrolls in excess of \$40 million, have generally never been examined and are large enough to have significant impacts on the Social Security and Medicare trust funds. These taxpayers employ over 80% of all non-Federal government employees. In FY2007, FSLG opened examinations of 29 large non-Federal entities and closed 30, and in FY2008, FSLG anticipates opening 29 and closing 30 examinations of large entities.

FSLG will work on an National Research Program (NRP) project to develop data to help identify sources of the tax gap in its market segments (Federal, State, and Local Governments). The tax-gap research program project on employment taxes will be developed during FY2008, as part of an IRS-wide effort. Although exempt from income tax, Federal, state and local governments are subject to employment taxes. These sectors have unique compliance issues and are not included in any previous NRP plans. A comprehensive study will not only identify the extent of problems but also where they are likely to occur so that FSLG can efficiently apply its resources to address non-compliance issues.

Abusive Tax Avoidance Transactions

In FY2007, FSLG completed 17 examinations of Health Reimbursement Arrangements (HRAs) that did not meet the requirements of the Code. All 17 examinations involved the same provider. FSLG entered into a closing agreement with the provider in lieu of employment and income tax to resolve similar HRAs provided to more than 500 government entities. Based on the facts it was determined that a section 6700 examination of the provider was not necessary. FSLG has identified several additional providers of other HRAs that do not appear to meet the requirements of the Code. FSLG will conduct additional examinations to investigate these programs. Upon completion of these examinations, FSLG will also consult with Counsel to determine whether a section 6700 examination should be conducted with regard to the promoters of the HRAs.

FSLG supports the IRS wide effort to identify and eliminate ATATs. It will continue with its efforts to identify customer participation in abusive schemes. The FSLG customer base is primarily tax-neutral enablers of some schemes. Its efforts will include developing information for use in educational programs as well as providing guidance to its compliance personnel.

Special Projects

FSLG began its first market segment project in FY2007 by adopting a market-segment approach for identifying and selecting returns for examination. FSLG will complete this project, Community Colleges, in FY2008 and, based on issues surfaced by the Specialists, will plan outreach activities to improve compliance. In FY 2008, FSLG will begin a market segment examination project on housing authorities. These projects will allow FSLG to determine trends and issues in

various market segments. FSLG will use the results to plan outreach activities to improve compliance.

In FY2007, FSLG completed focused outreach for fire districts to deliver educational materials and to conduct outreach events tailored to provide guidance on a variety of fire district compliance issues. FSLG completed 35 events and reached 2265 participants. In addition, a newsletter article reached approximately 44,000 readers, including fire chiefs, administrators of fire and rescue organizations, and other fire and rescue personnel. Specialists provided a copy of the article to local associations that support fire districts. In FY2008, it will conduct compliance checks on fire districts.

FSLG will continue to address key areas of noncompliance through a combination of targeted outreach, development of new educational products, and various field compliance activities. While focus will be placed on the national and regional issues identified through research, environmental scanning, and other means, activities to address significant local issues will also be supported.

FSLG will use the employee survey to identify opportunities for improvements in employee satisfaction. It will continue to involve managers and employees in improvement processes for FSLG and train its workforce to ensure that employees have the skills necessary to meet customer needs.

Planning Process

OVERVIEW OF FSLG

The office of Federal, State and Local Governments is responsible for Federal tax administration issues relating to 87,000-plus governmental units and their subordinate agencies in the United States. Issues addressed primarily involve employment taxes and information reporting. FSLG is also responsible for ensuring compliance with, and assisting in, the administration of FICA coverage agreements under the provisions of Section 218 of the Social Security Act.

FSLG's primary goals for FY2008 include continued expansion of its compliance efforts and maximizing its educational efforts. In FY2008, FSLG will continue to maintain an effective balance between traditional compliance work and educational activities. Compliance activities will again be a major focus for all field groups.

FSLG continues to develop an annual comprehensive compliance plan involving managers, field Specialists and CPM staff. This compliance plan is incorporated into the FSLG Annual Work Plan. Responsibility for the development of the Annual Work Plan is vested with the Manager, Compliance and Program Management.

FSLG's interaction with its customer base affects compliance levels of the governmental employers and their 23 million employees. These entities employ approximately 20% of the American workforce, pay wages in excess of \$775 billion annually and pay employment taxes in excess of \$200 billion. Governments also purchase goods and services of more than \$2.9 trillion, which represents 19% of the United States gross domestic product, and have assets in excess of \$16 trillion.

At the start of FY2008, FSLG will have 74 FSLG Specialists, including 10 FSLG Specialists assigned to the Federal Agency Group. Five Specialists hired during FY2006 and 2007 have not received FSLG phase training. In FY2008, FSLG will hire nine Specialists under the "Tax Gap Initiative" and two through attrition hiring. Approximately 13 percent of FSLG Specialists are eligible to retire in FY2008. Due to the loss of senior Specialists and resources being diverted to training new Specialists, during FY2008, FSLG will continue to maintain the same level of compliance enforcement activities as outlined in the FY2007 workplan. FSLG expects that new employees will not have an impact on compliance enforcement levels until FY2009.

METHODOLOGY

Trends, Issues, and Problems (TIPs) were identified in the Strategic Business Plan for FY2008 at the time of its formulation. The FSLG office involved the field Specialists, managers, and CPM staff in the development of the work plan.

The foundation for the formulation of the FY2008 FSLG Work Plan is based on the TIP areas, but refined to specific issues through the analysis of IRS data, stakeholder input, and employee input. These issues form the basis for the compliance activities to be undertaken in FY2008. The major areas of emphasis are: examinations, compliance checks, and information reporting compliance.

The employment tax field in general and the governmental sector in particular, have not been the subject of significant research activity or information gathering at the Service level. Governments generally file only employment tax and information returns. There are no additional returns to provide compliance indicators, thus classification avenues are limited. An additional complicating factor is the ability of governments to file “consolidated” employment tax returns, a process unavailable to any other group of employers in the country.

This lack of basic information has been considered in developing the FSLG compliance workload selection process. FSLG has considered anecdotal evidence, customer contact data, results from past compliance contacts, and employee input in developing its examination plans for FY2007-2008. It is continually improving the process. To accomplish this, FSLG:

- developed a formal workload selection plan to ensure consistency and impartiality in its examination process;
- established state folders that include state specific information (section 218 agreement, qualified retirement plan, section 403(b) plan, etc.) which are a useful tool in workload selection;
- included workload selection and risk analysis in its FY2007-2008 Research Plan;
- will conduct a portion of its examinations based on market segments to determine compliance levels and identify significant issues in those segments; and
- will continue to analyze the data collected from closed compliance checks and examinations and utilize the data in workload selection and in conducting future outreach activities.

WORK PLAN AREAS

FSLG will support the TEGE Division major strategies and operating priorities for FY2008. These strategies address key challenges FSLG faces in delivering top quality service to customers, and productivity through a quality work environment. These include actions to:

- Improve Compliance FSLG will continue to utilize employee input, customer feedback, data analysis, and environmental scanning, to secure a comprehensive knowledge of key compliance issues and causes of noncompliance. The information obtained from these and other sources will be used to improve compliance within its customer base.
- Meet Customer Needs FSLG will work closely with stakeholders, partners, and the Advisory Committee on Tax-exempt and Government Entities (ACT) to ascertain FSLG customer's needs, as well as to design and deliver mutually agreeable remedies to identified compliance concerns and problems whenever possible. In addition, the FSLG Newsletter and educational products will be used to address compliance questions and issues.
- Improve Organizational Performance FSLG will utilize balanced measures and analyze the results to effect operational enhancements to improve performance.
- Improve Knowledge and Information Management FSLG will expand its gathering and use of data, and fully develop database tools to improve its abilities to identify, track, and measure the impact of all field activities. FSLG knowledge sharing groups will be used to pass technical knowledge and experience from senior Specialists to new Specialists, educate stakeholders and to assist in compliance activities in specific areas. It will continue to support the development and implementation of TREES as the TE/GE work-center.
- Continue to address Federal Agency Compliance FSLG will continue examinations of Federal agencies during FY2008.
- Continue the Large Entity Compliance FSLG will continue examinations of larger entities during FY2008.
- Address Abusive Tax Avoidance Transactions FSLG will continue to work on cases involving abusive health reimbursement arrangements and coordinate with Chief Counsel and area counsel. In addition, FSLG will incorporate steps to identify customer participation in abusive schemes. Its efforts will include developing information for use in educational programs as well as providing guidance to its compliance personnel.
- Build a Highly Qualified and Satisfied Work Force FSLG will continue to train its workforce to ensure that employees have the skills necessary to meet customer needs. It will continue its use of the employee survey to identify opportunities for improvements in employee satisfaction. It will continue to involve managers and employees in improvement processes for FSLG.

BUDGET ACTIVITY CODE 52, PAC TT

These codes correspond to the resources devoted to Pre-filing Education and Assistance, which includes customer education and outreach, direct and indirect assistance, and coordination of assistance actions between FSLG and other functions.

Customer Education and Outreach

FSLG will address key areas of noncompliance through a combination of targeted outreach, development of new educational products, and various field compliance activities.

In FY2007, FSLG conducted two phone forums with the National Conference on State Social Security Administrators (NCSSSA) and one with National Association of State Auditors, Comptrollers and Treasurers (NASACT). In FY2008, it is planning to conduct additional phone forums with NCSSSA and potentially expand these to other stakeholders.

FSLG will continue to publish its semiannual newsletter. The FSLG Newsletter serves as a useful means for providing information on current issues, such as tax law changes, ATATs, and new published guidance.

FSLG will also continue to upgrade the Public Employer Toolkit developed in FY2006 and its portion of the www.irs.gov web site.

Partnering with Social Security Administration

FSLG will continue to partner with the Social Security Administration (SSA) as a major external stakeholder while maintaining and increasing partnership activities with other stakeholders. In FY2007, FSLG worked with SSA to develop procedures for its employees to contact designated officials at SSA with regard to the interpretation of Section 218 Agreements during an examination. This partnership with SSA will enhance its relationship with an important partner in addition to improving cycle time on examinations.

Other Actions

Balanced Measures - FSLG will continue to utilize balanced measures to determine employee satisfaction, customer satisfaction, and business results. Results of these measures will assist FSLG in ensuring that actions undertaken do not adversely impact any of the three areas, and will assist FSLG in identifying areas in need of operational improvements in subsequent years.

The FSLG measures being utilized for employee satisfaction and business results are generally consistent with measures used by other functions. FSLG

will continue use of the employee survey to identify opportunities for improvements in employee satisfaction. It will continue to involve managers and employees in improvement processes for FSLG. As described below, FSLG will continue to provide training to its workforce to ensure that employees have the skills necessary to meet the visions and goals of FSLG.

The FSLG Customer Satisfaction Survey conducted at outreach events has shown a high degree of customer satisfaction with the content and delivery of its educational programs. FSLG will work to keep the customer satisfaction at current levels during FY2008.

Performance Measures

The following performance indicators will be used in FY2008 for assessing Budget Activity Code 52, PAC TT activities:

Federal State & Local Governments	FY2007 Projected	FY2008 Plan
Number of Outreach Events	136	142
Number of Customers Reached	14,200	14,200

BUDGET ACTIVITY CODE 64, PAC EF

This area represents the resources devoted to Field Compliance Services, including compliance checks, return examinations, research projects, and related support work.

Workload Selection

FSLG will continue to refine the workload selection criteria utilized in prior years. In addition, FSLG will partner with Exempt Organizations (EO) in situations where the government entity is also an exempt organization (e.g., community colleges, charter schools, hospitals) and Employee Plans (EP) where the government entity is participating in a retirement plan or similar arrangement.

Workload selection will be monitored to ensure that key areas identified through environmental scanning, research, and other means are addressed, and that the actions being assigned represent the optimal approach to the identified issue. FSLG will continue to undertake compliance checks as a mechanism to provide broad-based compliance coverage, to identify customer needs, and to foster self-correction. In appropriate situations, compliance checks may be converted to examinations with the approval of the group managers.

Training

FSLG provides basic and advance training to its newly hired Specialists and Continued Professional Education to all Specialists. FSLG Specialists have consistently commented favorably on the training provided. In FY2007, a task force was created to rewrite the new hire training. The task force will complete its work by the end of the 2nd quarter of FY2008. For the Training Plan, see Appendix A.

Compliance Plan

FSLG examinations of books and records relating to the determination of a tax liability will generally address employment tax issues, Social Security Act Section 218 compliance issues, information return issues, FICA replacement plan issues, Abusive Tax Avoidance Transactions and other priority work. Examinations are generally limited to the most current year. Expansion to other years occurs in appropriate situations with written managerial approval.

Claim examinations will continue to constitute a significant portion of FSLG's examination workload for FY2008. Field groups will prioritize claim work while maintaining an active non-claim examination program.

FSLG generally conducts compliance checks on smaller entities (annual payroll less than \$10 million) to determine compliance with their employment tax and information return reporting obligations. Compliance checks do not include review of the books and records of the taxpayer and are designed to foster self compliance. If the Specialist determines that the government entity is not in compliance, an advisory letter is issued to the government entity.

FSLG will continue the two strategic initiatives started in 2005: the Federal Agency Initiative and the Large Entity Initiative. In addition, FSLG will complete the Community College Project begun in FY2007 and begin a Housing Authority Project. For the Compliance Plan see Appendix B.

FSLG will work on a National Research Program (NRP) project to develop data to help identify sources of the tax gap in its market segments (Federal, State, and Local Governments). The tax-gap research program project on employment taxes will be developed during FY2008, as part of an IRS-wide effort. Although exempt from income tax, Federal, state and local governments are subject to employment taxes. These sectors have unique compliance issues and are not included in any previous NRP plans. A comprehensive study will not only identify the extent of problems, but also where they are likely to occur so that FSLG can efficiently apply its resources to address non-compliance issues.

Research

FSLG will continue to work on perfecting the customer database. During FY2006, FSLG worked with the Census Bureau database of government entities to identify its customers and substantially increase the number of government entities listed on the IRS Business Master File. As discussed in Appendix C, there are certain systemic coding errors which need to be corrected in order for certain FSLG customers to remain coded properly. FSLG has submitted Requests for Information Services (RIS) to the appropriate system owners to make the corrections. In FY2007, FSLG worked with the system owners to correct the systemic errors and also to update the IRM procedures that must be changed as a result of the RISs. These changes will be implemented in FY2008. For the Research Plan see Appendix C.

Performance Measures

The following performance indicators will be used in FY2008 for assessing Budget Activity Code 64, PAC EF:

Federal State & Local Governments	FY2007 Projected	FY2008 Plan
Examinations Closed	1730	1730
Compliance Checks Closed	830	833
Examination Timeliness	298	298
Examination Quality	76%	82%

Appendix A

TRAINING

The following items are descriptions of FSLG training courses:

Course 10055: Continuing Professional Education – FSLG

This course covers continuing education to maintain and enhance employee professional skills. The class will be provided to all field Specialists and selected OPR staff.

Course 4237: RICS – Phase I

This training covers RICS functionality for basic RICS users. The purpose of the training is to support the classification of FSLG compliance workload and development of the FSLG workplan and compliance projects. Two (2) CPM staff will attend this class.

Course: TREES

This training will provide Work Center training for all FSLG employees. New FSLG Specialists, managers and selected CPM staff will attend this training.

Course 4307: Medical Resident FICA Claims Training

This training will provide guidance to selected FSLG examination personnel in handling FICA refund claims and related issues with respect to medical residents.

Course 4321: Federal, State and Local Government Specialist- Ph I

This training will focus on providing initial FSLG tax law training for newly selected FSLG employees, including basic employment tax training for FSLG Specialists. Training will be provided to new FSLG field Specialists, managers, and CPM staff.

Course 4323: Federal, State and Local Government Specialist- Ph II

This training will focus on providing additional FSLG tax law training for FSLG employees, including more complex employment tax training for FSLG Specialists. Training will be provided to new FSLG field Specialists, managers, and CPM staff.

Course 4323: Federal, State and Local Government Specialist- Ph III

This is advanced phase training for FSLG field employees. Training will be provided to new FSLG field Specialists, managers, and CPM staff.

Course 3142: Basic Employment Tax Training

New FSLG Specialists attend the basic employment tax training offered by SB/SE when FSLG Phase training is not available.

Course: On-the-Job Instruction Phase I

This course provides workshops and on-the-job experiences to new FSLG Specialists following FSLG Phase I to prepare them to do FSLG compliance checks.

Course: On-the-Job Instruction Phase II

This course provides workshops and on-the-job experiences to new FSLG Specialists following FSLG Phase II to prepare new FSLG Specialists to do FSLG examinations.

Course: Functional Leadership

This course provides training to frontline managers.

Course: Mandatory Topics

This training includes various annual mandatory briefings such as UNAX, Ethics, POSH, etc.

Course: Frontline Leadership Readiness Program

This course provides training to frontline managers.

Course: International Tax Seminar

This training provides information about international tax law.

Course: SPSS / SASS

This course teaches uses of SAS Enterprise Guide, which is used for analyzing surveys, such as employee environmental scan and customer surveys. This training will be provided to one or more members of CPM staff.

Advanced SASS

This is an advanced course teaches students how to access, manage, summarize, and present data using SAS Enterprise Guide. This training will be provided to one member of CPM staff.

Appendix B

COMPLIANCE PLAN

I. INTRODUCTION

The FY2008 compliance plan continues to focus on areas where FSLG can most effectively apply its compliance resources to meet organizational goals.

Compliance activities include general examinations, examinations of refund claims, and compliance checks of entities for reporting compliance, non-filing conditions, and balance due accounts. In response to numerous Government Accountability Office (GAO), Treasury Inspector General for Tax Administration (TIGTA) and Office of Management and Budget (OMB) reports indicating widespread and longstanding Federal agency non-compliance, during FY2005 FSLG established a group dedicated exclusively to working Federal agencies.

II. CHALLENGES AND CONSIDERATIONS IN DEVELOPING THE COMPLIANCE PLAN

Determining the best use of compliance activities is a daunting challenge, made more so because of the lack of FSLG examination benchmarks and baselines.

In its first years of existence, FSLG was primarily involved in working claim cases. In FY2006, FSLG began collecting examination results with the use of Case Selection Survey sheets that are required to be completed by the Specialists for all closed examinations and compliance checks. While FSLG began collecting data since January 1, 2005, the data was not collected in a manner conducive to analysis. Since January 2006, the Case Selection Survey sheets have been completed electronically and thus the information on the sheets can be researched and analyzed. During FY2007, FSLG completed modifications to the information database and has begun analyzing the data collected. Although in-depth analysis of the data is not yet available for extensive use in creating the FY2008 Compliance Plan, such analysis should be available at the beginning of FY2008 to help identify the most productive classification criteria to use in the return classification process. The data may also provide compliance information that can be used in outreach activities.

The Compliance Plan is developed through a cooperative process involving input from field group managers, Specialists and the CPM staff. Field groups contribute to the plan by continuing to refer issues and information for consideration in the planning process. CPM utilizes the approved Compliance Plan and the supporting information to develop workload classification criteria for FSLG.

Because FSLG baseline data is currently insufficient to provide statistically valid data, FSLG must rely on currently available data in developing issues for audit consideration. These sources include:

- Anecdotal comments based on employee experience;
- State folders developed by Specialists;
- Outreach results;
- Filters developed by CPM;
- cursory review of compliance issues reported on closed compliance check and examination cases;
- Referrals;
- GAO Reports, and
- Top Payers with TIN mismatch reports.

Coordinated/Support Examinations with Other IRS Functions

FSLG continues to work with EP when issues arise with respect to retirement plans and also when EP discovers employment tax issues during its examinations. In addition, FSLG works with EO where the government entity is also an exempt organization. In addition, in FY2007, FSLG and LMSB (International) began coordination of common issues, such as appropriate classification and tax treatment of workers in Federal agency offices overseas where the workers are United States citizens or residents. This coordination will continue in FY2008.

FSLG receives referrals from, and provides referrals to, EP and EO via the Specialist Referral System program.

III. EXAMINATION PLAN

All compliance work will originate in or be approved by CPM prior to initiation of the cases. Compliance selections will include large, medium and small entities.

(a) STRATEGIC INITIATIVES

FSLG Large Entity Program

During FY2008, FSLG will address a number of entities with annual payrolls in excess of \$40 million. This is a nationwide strategy - each group across the country will be responsible for working a number of large entity examinations. These are time intensive cases and will often require the assignment of a team of Specialists. Most of these examinations will be conducted as focused audits. The cases will be identified by CPM using RICS. FSLG will commence 29 examinations of large government entities in FY2008.

Based upon the results of the large entity examinations conducted in FY2006 and 2007, FSLG will continue to:

- refine large case selection criteria,
- commence 29 examinations of large government entities and complete at least 30,
- conduct focused examinations of large entities (the issues on which the Specialist will focus will be determined with the assistance of the group manager and will be based on the Case Selection Survey sheet provided by CPM),
- increase use of teams (two or more Specialists and CAS, if needed) to conduct audits on larger governments, and,
- plan outreach activities based on results.

Uncertainty continues to surround resolution of medical resident claims. This uncertainty precludes specific planning objectives for these claims. Most of the medical resident claims are filed by large entities.

Federal Agencies Program

During FY2008, examinations of Federal agencies and sub-agencies will remain a strategic initiative of FSLG. These present the largest and most complex cases. Examinations in this sector will be based initially on specific non-compliance issues identified from sources such as GAO reports, SS-8 determinations, outreach/assistance efforts, and other sources. As noted in GAO Report 04-74, Federal agencies continue to exhibit significant non-compliance with information returns and backup withholding requirements. FY2006 was the first full year for FSLG to conduct examinations of Federal agencies. The issues most prevalent in such examinations were: worker classification, relocation and settlement payments, foreign residents; information reporting, and fringe benefits. In other words, issues similar to those raised in state and local governments. In FY2008, FSLG will increase the examination of large Federal agencies and conduct such examinations using a team audit method. The Director, FSLG will continue to approve all proposed Federal examinations prior to initiation. FSLG will commence examinations of 20 Federal agencies in FY2008.

Based upon the results of the Federal agency examinations conducted in FY2006 and 2007, FSLG will continue to:

- refine case selection criteria,
- evaluate the need for resources,
- commence 20 examinations of Federal agencies/sub agencies and complete at least 20,
- continue to refine processes for Federal agency examinations,

- conduct focused examinations (the issues on which the Specialist will focus will be determined with the assistance of the group manager and will be based on the Case Selection Survey sheet provided by CPM),
- increase use of teams to conduct audits on larger Federal agencies, and
- plan outreach activities.

For several years, FSLG, the CFO's office, and Collection have been discussing the issue of Federal agency delinquencies. In FY2007, FSLG, the CFO's office and SB/SE Collection began monthly status calls/meetings to discuss the roles and responsibilities of the three functions and the IRS policy for enforcing Federal Agency filing and paying compliance issues. This will continue in FY2008.

National Research Program (NRP) Project

FSLG will work, in conjunction with a GE Research Specialist, on an NRP project to develop data to help identify sources of the tax gap in its market segments (Federal, State, and Local Governments). The tax-gap research program project on employment taxes will be developed during FY2008, as part of an IRS-wide effort. Although exempt from income tax, Federal, state and local governments are subject to employment taxes. These sectors have unique compliance issues and are not included in any previous NRP plans. A comprehensive study will not only identify the extent of problems but also where they are likely to occur so that FSLG can efficiently apply its resources to address non-compliance issues.

(b) GENERAL CASE WORK

States and State Agencies

These cases are potentially very large and complex, on a par with Federal entities. The challenge in this sector is to determine the number of filing entities in each state. State agencies and entities have been identified by the field and furnished to CPM. CPM will cross-reference this data with the BMF to determine the number of state entity filers. State level entities will then be identified for examination through the field referral process, third-party information, compliance issues developed in outreach/assistance efforts, and regular CPM examination selection criteria.

Local Governments

These include all other entities. The complexity and size of these entities varies significantly. The local government sector includes the following major segments: counties, cities/municipalities (further stratified by population, wages or other criteria), school districts, local hospitals/medical facilities, library boards, and special purpose districts.

Information Reporting

Payments by FSLG customers represent a significant part of the national economy. When information returns are not issued, or incorrect TINS are used, significant income amounts are not reported on tax returns. A GAO review of Federal agencies found significant compliance issues involving information reporting and back-up withholding. No similar study was done on non-Federal entities. FSLG requires that each examination and compliance check contain an information reporting compliance determination. FSLG will work with governments to improve information reporting at all levels of government. Reporting compliance in the proper filing of Forms 1099, 1042, 1042-S, and W-2G will be addressed through field compliance actions, including compliance checks and examinations. A determination whether the government entity meets with its information reporting requirement is mandated in every examination and compliance check.

(c) SPECIFIC PROJECTS

Community Colleges

FSLG began its first structured market segment examination project on the community college market segment. CPM developed a list of community colleges using a listing of U.S. community colleges secured from the American Association of Community Colleges and the University of Texas. A statistically valid random sample was completed with the assistance of TEGE Research. Of the 983 community colleges identified, 88 were selected for examination to establish a 95% confidence level in the results with a margin of error +/- 10.5%. The project was designed to more clearly define areas of significant non-compliance. All exams are expected to be completed by December 31, 2007. FSLG will work with the GE research analyst and TEGE research to analyze the data gathered during compliance activities and to provide a basis for potential indicators of common areas of non-compliance. Common areas of non-compliance may be used to enhance outreach activities and to improve future case selection in this market segment based on specific areas of non-compliance.

Housing Authorities

FSLG will begin a nationwide project to examine a sample of housing authorities. Based upon limited compliance activities conducted in the Housing Authority Project, there appears to be a number of non-compliance areas that warrant additional compliance work, including unreported taxable fringe benefits, failure to file Forms 1099, and poor internal controls, which can lead to additional compliance problems such as fraud and accuracy related problems. Ninety six housing authorities will be selected across the country using a variety of selection

methods, including standard FSLG classification queries, random selections, and internet research. Although this selection mythology will not result in a statistically valid sample, which would allow FSLG to measure the level of compliance across the entire universe, FSLG will be able to identify trends and compliance issues that are common to this universe without adversely impacting other resources, such as the Large Case Initiative or other projects. FSLG will work with the GE research analyst and TEGE research to develop a plan to conduct the project and to analyze the data gathered during FY2006 compliance activities to provide a basis for potential indicators of common areas of non-compliance which will be used to potentially limit the scope of these examinations. Some housing authorities have received a determination from EO that they are organizations described under section 501(c) of the Code. As a result, FSLG will work with EO in determining the universe of housing authorities and coordinating examinations as necessary. The project will be designed to more clearly define areas of significant non-compliance and to provide data to enhance FSLG's educational outreach efforts to this market segment.

Fire Districts

In FY2007, FSLG conducted outreach events for fire districts to deliver educational materials tailored to provide guidance on a variety of compliance issues. During FY2008, FSLG will conduct compliance checks on a sample of fire districts. The project initiative will be designed to more clearly define areas of significant non-compliance and to provide data to enhance its educational outreach efforts to this market segment. FSLG will analyze the results of the compliance checks to determine if additional compliance enforcement activities are necessary.

Abusive Tax Avoidance Transactions (ATATs)

FSLG customers that participate in ATATs may derive current revenue, not tax benefits from the transactions. As tax neutral third parties ('accommodation parties'), they are not normally concerned with the income tax effects of the transactions. In addition, there is a potential issue when FSLG's customers purchase retirement or health plans that are misrepresented as complying with the Internal Revenue Code when they do not, resulting in additional taxable wages for the participants. In FY2007, FSLG completed 17 examinations of Health Reimbursement Arrangements (HRAs) promoted and sold by one provider, which do not meet the requirements of the Code. FSLG entered into a closing agreement with the provider which made a settlement payment in lieu of employment and income tax that resolved issues with regard to more than 500 government entities that had participated in similar HRAs. Based on the facts of the cases under exam, it was determined that a section 6700 examination was not necessary. FSLG has identified several additional providers of other HRAs that do not appear to meet the requirements of the Code. FSLG will conduct additional examinations to investigate these programs. Upon completion of

these examinations, FSLG will also consult with Counsel to determine whether a section 6700 examination should be conducted with regard to the promoters of the HRAs. Additionally, FSLG Specialists will include an assessment and/or referral of potential ATAT issues in all examinations.

Section 403(b) Examinations

An FSLG Specialist identified a compliance issue related to elections on 403(b) plans of some government entities in the Northeast, which resulted in under-reporting FICA taxes. Eight examinations will be conducted to gather additional information about this potential compliance issue. Research was conducted to identify entities with plan language that indicates a high potential for the compliance issue. Based upon findings of these examinations, FSLG may expand this into a project for FY2009 or 2010. FSLG will coordinate these examinations with EP as necessary.

(d) COMPLIANCE CHECKS

Fire districts will constitute approximately 28% of compliance check activities. Other compliance checks planned for FY2008 will primarily address nonfiler entities and Form 1099 filing compliance issues and will generally encompass the entities with an annual payroll of less than \$10 Million. These types of compliance check cases may not directly translate into examination issues/adjustments; however, field groups will be encouraged to recognize situations where a significant examination issue arises from a compliance check and to re-establish the case appropriately. Data regarding issues found is being gathered for use in future compliance efforts. FSLG is currently planning on completing 833 compliance checks in FY2008, covering all of its market segments. Compliance checks will be the primary source of training cases for new hires in FY2008.

(e) NONFILERS

In addition to addressing nonfilers through compliance checks, FSLG Specialists are encouraged to be mindful of nonfilers. In FY 2007, as a result of one Specialist learning that a number of similar entities in a state were nonfilers, FSLG was able to bring more than 300 such entities into compliance through correspondence and phone calls. In FY 2008, Specialists will be encouraged to follow up on filing noncompliance discovered during their compliance work. In addition, CPM will continue to conduct research to identify government entities that are nonfilers for potential workload selection.

Appendix C

FY2008 FSLG RESEARCH PLAN

I. OVERVIEW OF RESEARCH PLAN

Purpose

The purpose of the FSLG Research Plan is to coordinate existing and future research efforts that FSLG is conducting to address identification of customers, customer characteristics, assessment of risk, allocation of resources, trends, issues and problem identification. The research plan is necessary to meet the goals and objectives of the TE/GE Strategic and Program Plan as well as the FSLG Work Plan. The research plan will also provide a basis for predicting taxpayer needs and compliance levels.

Information developed through research will allow FSLG to identify and analyze risk, educational gaps, and to develop trends and measurements. An ongoing research process is an essential component of FSLG's efforts to ensure compliance. In order to meet its obligations to its customers, FSLG will use techniques including focused taxpayer education, improved reporting, and early intervention through notices and phone calls, to address voluntary compliance.

The primary objectives of the research plan are to identify, quantify and monitor FSLG customers and their unique compliance issues. The major goals of the plan are as follows:

- ◆ To identify all government entity customers
- ◆ To identify trends, issues and problems of customers
- ◆ To determine compliance risk levels
- ◆ To identify workload for various compliance treatments

Scope

The scope of the research plan is being set at a level that can be achieved using existing resources without adversely impacting FSLG's major educational and compliance goals.

Background

The FSLG customer base comprises 85,382 government entities. This figure does not include potentially thousands of sub-units that provide employment tax and information return reporting information for consolidation to a particular entity. Of those, 73,069 customers filed at least one Form 941 in the tax year 2005. There were 69,010 FSLG customers who filed Form 941, and 3734 who filed an annual Form 944 for the tax year 2006. Government entities employ approximately 20% of the workers in the US, approximately 23 million government employees. They pay over \$775 billion annually in wages and employment taxes in excess of \$200 billion. The majority of these organizations are local government entities such as cities, counties, towns, school districts, etc. The governments also purchase goods and services of more than \$2.9 trillion and have an economic impact of representing 19% of the United States gross domestic product.

II. IDENTIFICATION OF CUSTOMERS

Objective

To identify the universe of FSLG customers

Background

FSLG has identified 85,382 government entities through the IRS Business Master File (BMF). However, this figure does not include all of the sub-units that report employment tax and information return reporting information to the entity that files a consolidated Form 941 or has one Employer Identification Number. There are many larger government entities that contain multiple operating units that are counted as a single entity while filing multiple returns or, conversely, entities filing a single return for multiple entities. These units report millions of dollars of wages and vendor/contractor payments through the “filing” entity. For example, the U.S. Department of Agriculture National Finance Center processes payroll for a significant number of Federal agencies and files one return. This significantly understates the number of government entities in the FSLG customer base.

FSLG identified its initial customer base using the Government Integrated Directory (GID) based on the Census of Governments conducted by the U.S. Bureau of the Census every five years. FSLG uses IRS BMF records with employment codes F (Federal agencies), G (state and local governments) and T (state or local governments with Section 218 Agreements with the Social Security Administration) to identify return filings of its identified customer base.

However, these data sets contain some significant flaws. These include:

- The Census database contains duplicate, disestablished and incomplete data. The Census data is from 2002. Census data excluding duplicate identification numbers is now computed at 77,053.
- The Public Employer FICA Compliance Initiative (218 Initiative) data is not provided in electronic format and does not provide an EIN (Employer Identification Number). This data needs to be compiled, scanned and researched for an EIN before an employment code T can be added to the BMF to identify FSLG with a Section 218 Agreement.
- The employment code F, G, and T listings need to be updated. FSLG customers are not given an employment code of F or G if they do not have employees. FLSG customers are generally not assigned an employment code of T unless the taxpayer correctly indicates on the Form SS-4 that they have a 218 agreement.
- Significant sub-units of governments are not identified as part of a larger organization.

Available Data Sources

- Business Masterfile Entity records
- Bureau of Census database for 2002 Census of Governments
- Public Employer FICA Compliance Initiative (218 Initiative) data
- Information Returns data (RICS)
- TEGE Entity information from RICS
- Various internet sites listing governmental organization data

Resource Requirements

- Assistance of LMSB Computer Audit Specialist
- Assistance from the EOCA at Ogden Campus with staff time (FTE) to update BMF and contact taxpayers
- Assistance of TE/GE research office and GE research analyst in developing criteria and ensuring statistical accuracy of the program.
- Appropriate computer systems support, including software, training and equipment.
- Adequate staff time (FTE) to develop this aspect of the program.
- Assistance from MITS in updating the FSLG customers with the proper employment codes.
- Assistance from MITS in correcting the master file software to accept entities that do not file tax returns but are government entities
- Assistance from MITS in searching payer master file data to identify non-filers

Milestones

The principal task is to compare and reconcile various sources to identify all government entities or significant sub-units for inclusion in FSLG's customer base. Many major milestones have been completed. However, the identification of FSLG customers will be an ongoing process due to new entities, mergers, and dissolutions. The major milestones completed and to be completed are as follows:

- Match data from the census of government's data to BMF data to develop unmatched entity database and identify needed BMF corrections - Completed 09/30/06.
- Send survey letters/request for entity information to taxpayers on the unmatched database (25,167 entities) - Completed 01/29/07.
- Reconcile unmatched entities to determine proper classification and contact those taxpayers where additional information is necessary to determine whether entity should have an employment code of G, T or F. This includes reviewing survey letters responses (11,636). This is being worked by EOCA at the Ogden Campus, which has reviewed and researched over 1524 letters and updated over 290 entities to reflect a proper FSLG employment code. Completion estimated FY2010.
- Work with BMF analysts and programmers to correct systemic problems in entering FSLG employment codes. Completed a work request to allow BMF to accept an employment code with no filing requirements. Completed 09/30/06 for change to be implemented July, 2007.
- Request that all relevant IRM procedures be revised to ensure FSLG employment codes are assigned even if there are no filing requirements – Completed 07/27/06 and 08/07/06, effective July, 2007.
- Identify potential non-filers – work request completed to request a list of taxpayers that exist in the Payer Master File but not in the Business Master File. Information received June, 2007.
- Identify and correct errors in employment codes – Submitted work request that will keep FSLG employment codes in master file indefinitely. This work request will allow unique filing requirement codes, such as Puerto Rico, Virgin Islands, Guam and American Samoa filers to be coded as FSLG customers. Effective January, 2008.
- Identify significant sub-units through on-line research and other appropriate means – Initiated with the survey letter project at the Ogden Campus and with the review and research of Section 218 entities and the RICS database, Ongoing.
- Identify and implement procedures to keep the database of customer's current- Work request submitted to update entities that have been identified as FSLG customers. Effective January, 2008.

III. IDENTIFICATION OF TRENDS, ISSUES AND PROBLEMS (TIP)

Objective

Identify customer trends, issues and problems to support TE/GE Strategic Program and Plan and the FSLG Workplan.

Background

There is an ongoing need to develop TIPs for planning purposes. FSLG has been gathering information from various sources for this purpose. Some examples are customer outreach data, issues identified during compliance checks and examinations, internal/external information items, etc. Including these sources in the research plan will allow FSLG to formalize the process of securing the information, analyzing the data, and taking actions to address the TIPs as part of the planning process.

Available Data Sources

- FSLG outreach database
- Examination/Compliance Check issue tracking data
- Internal/external information reports
- Internet/media reports
- Payer Master File Data
- La Hacienda, Puerto Rico
- Other Divisions: EO, SBSE

Milestones

- Centralization of data
- Analysis of current data
- Identification of TIPs
- Identification of compliance issues suitable for targeted treatments

IV. ASSESSMENT OF RISK OF NON COMPLIANCE

Objective

To determine the risk of non-compliance with employment tax and information return reporting statutes. This also involves identifying major compliance risks.

Background

The risk of non-compliance is primarily based on limited compliance activities, anecdotal information and various external reports/data. FSLG believes that

government entities want to comply. There is also an assumption that the smaller local governments are at greater risk due to lack of understanding of the Federal tax law as well as high rates of employee turnover. The larger entities, including Federal and state agencies, are at risk due to their larger numbers of employees, potential for error and impact on the trust funds due to their size.

Available Data Sources

- Bureau of Census database for 2002 Census of Governments
- Historical Forms 941 data from master file
- Forms 941 data for CY2001 forward on RICS
- Public Employer FICA Compliance Initiative (Section 218)
- Information returns data (RICS)
- Balance due data based on employment codes
- FSLG customer contact data
- Additional data sources to be made accessible to RICS
- Potential development of a service wide employment tax classification database currently under development in SB/SE

Resource Requirements

- Assistance of TE/GE research office in developing criteria and ensuring statistical accuracy of the program
- Appropriate computer systems support, including software, training and equipment
- Adequate staff time (FTE) to develop this aspect of the program
- Formal training on use of software

Milestones

- Develop an FSLG risk analysis methodology in conjunction with TE/GE research
- Refine definitions of non-compliance for FSLG entities in cooperation with TE/GE research office
- Identify and obtain additional data sources
- Maintain the developed risk analysis system to insure continued viability