United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

January 2003

TAX ADMINISTRATION

IRS Should Continue to Expand Reporting on Its Enforcement Efforts

Accountability * Integrity * Reliability

GAO-03-378

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GAO Accountability•Integrity•Reliability

Highlights

Highlights of GAO-03-378, a report to the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives

Why GAO Did This Study

Reported declines in the rate at which the Internal Revenue Service (IRS) audits (also referred to as "examines") individual income tax returns have raised concerns that taxpayers may have a false perception of the true level of IRS's tax enforcement efforts. In addition, many observers are concerned these reported declines may reduce taxpayers' motivation to voluntarily pay their taxes.

Because of these concerns, GAO was asked to review a number of issues surrounding IRS's enforcement efforts. GAO determined the trends in the percent of returns filed that are audited (contact rate) compared with similar data on taxpayer contacts through other enforcement programs for fiscal years 1993 through 2002. In addition, GAO reviewed whether IRS's reporting on its enforcement programs should be expanded.

What GAO Recommends

GAO recommends that IRS determine whether future reporting on its other enforcement programs can be more complete and comparable to reporting on audits. GAO also recommends that IRS correct underreporting of math error contacts.

In commenting on a draft of this report, IRS agreed with our recommendations. It has already begun to identify additional data to report on its enforcement programs.

www.gao.gov/cgi-bin/getrpt?GAO-03-378.

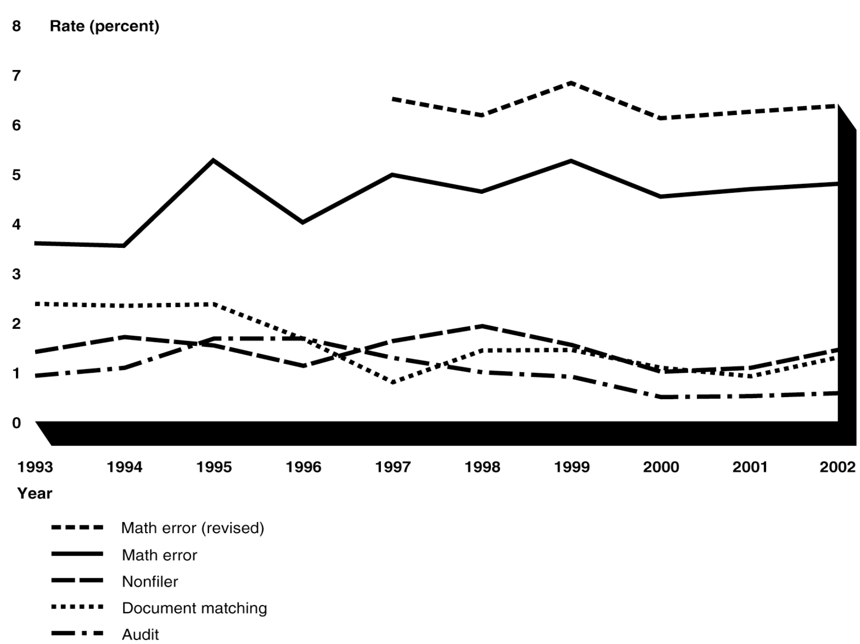
To view the full report, including the scope and methodology, click on the link above. For more information, contact Michael Brostek at (202) 512-9110 or BrostekM@gao.gov.

What GAO Found

IRS's often-cited audit rate has been declining for several years, as shown below. However, the audit rate portrays only a portion of IRS's efforts to enforce tax laws and not all of those efforts have been declining. For IRS's three nonaudit enforcement programs, the contact rates in 2002 compared to 1993, after year to year variations, declined for one, essentially remained the same for one, and significantly increased for one—math error. A complete math error contact trend is unavailable because IRS did not capture one type of data on a substantial number of contacts prior to 1997. For years where complete data are available, IRS has not included all math errors in external reports. IRS officials agreed that all types of errors are identified under the same math error authority and should be similarly counted and reported.

IRS annually reports extensive data on audits but only limited, or no, data on its other enforcement programs. This limited reporting does not provide policymakers or taxpayers information on the full extent of IRS's enforcement efforts. To the extent that taxpayers do, as is widely believed, take the level of enforcement into account when self-reporting their tax obligations, the audit rate alone may mislead them. IRS officials believe that more reporting is desirable and intend to report readily available, but incomplete, information on nonaudit programs in future reports.

IRS Enforcement Program Contact Rates, Fiscal Years 1993 through 2002.



Source: GAO analysis of IRS data.

Note: Data for revised math error contacts is not available for fiscal years 1993 to 1996. The revised math error line above includes all math error contacts by IRS for the relevant years.

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Abbreviations

EmTRAC	Employer-designed Tip Reporting Alternative Commitment
GAO	General Accounting Office
IRC	Internal Revenue Code
IRS	Internal Revenue Service
MSA	Medical Savings Accounts
NRP	National Research Program
RRA	IRS Restructuring and Reform Act of 1998
SSA	Social Security Administration
TIN	Tax Identification Numbers
TRAC	Tip Reporting Alternative Commitment
TRDA	Tip Rate Determination Agreement

United States General Accounting Office
Washington, DC 20548

January 31, 2003

The Honorable Amo Houghton
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

The United States tax system is based on self-reporting and voluntary compliance by taxpayers. The Internal Revenue Service (IRS) uses various enforcement programs to check the accuracy of tax returns and contacts taxpayers if problems are found. IRS makes the contacts through four major enforcement programs that have existed for many years.

- **Math Error Program**: While tax returns are being processed, this program uses IRS computers to identify and generate notices to contact taxpayers about obvious errors such as mathematical errors, omitted or inconsistent data, or other inconsistencies on the basis of other data reported on the return or to IRS. These errors must be corrected to process a tax return.

- **Document Matching Program**: This program matches information on selected tax issues (usually income) reported on tax returns by individual taxpayers and reported on information returns by employers, banks, and other payers of income. Document matching also matches information returns (schedule K-1) filed by pass-through entities—such as partnerships, trusts and S-corporations—to individual tax returns. IRS may contact taxpayers about any reporting discrepancies.

- **Nonfiler Program**: This program identifies and contacts potential nonfilers of tax returns by using data from information returns and previously filed income tax returns. The contacts can ask for the missing return or offer an IRS-generated return to substitute for the missing return.

- **Audit Program**: Also referred to as "examination," under this program, an IRS auditor checks compliance in reporting income, deductions, credits and other issues on tax returns, as well as in paying the correct tax liability. Audit contacts can be made through correspondence or in face-to-face meetings with taxpayers at an IRS office or a taxpayer location.

Widely reported substantial declines in the rate at which IRS audits income tax returns have triggered concern that the declines could reduce taxpayers' motivation to voluntarily pay their taxes. Many view IRS's enforcement programs as critical support to our voluntary system—they help provide taxpayers with confidence that their friends, neighbors, and business competitors are paying their share of taxes.

Because of your concerns that the declining audit rate may give taxpayers a misleading perception of the true level of IRS's tax enforcement efforts and encourage some taxpayers not to comply, you requested that we review a number of issues related to how IRS enforces tax laws and publicly reports on those efforts. This report

- compares IRS's enforcement programs in terms of their legal authority, and operational characteristics (including IRS staff time), and describes what is known about taxpayer perceptions of the enforcement programs.
- summarizes enforcement contact trends overall and by taxpayer income and their causes from 1993 to 2002.
- determines what IRS knows about the effect of its enforcement programs on individual taxpayer compliance and the burdens taxpayers experience when contacted under the programs.
- assesses whether and, if so, how IRS should expand reporting on its enforcement programs.

To address these objectives, our work included interviewing IRS officials and reviewing documents on the similarities and differences across IRS enforcement programs. To identify trends in IRS's enforcement programs including trends by taxpayer income levels, we analyzed IRS data from fiscal years 1993 through 2002.[1] To analyze impacts on taxpayers, and tradeoffs of reporting more data about the enforcement programs, we interviewed IRS officials and reviewed any available research on how the programs affect individual taxpayers' compliance and burden. (See our scope and methodology section for details on our approach.) In addition, you asked us to analyze trends in the number of contacts by the specific programs. Appendix III provides this information.

Results in Brief

Whether audits and other enforcement programs vary from each other depends on a number of factors. With regard to legal characteristics,

[1]The fiscal 2002 data on number of tax returns filed by individuals had not been finalized before we issued the report.

audits and other enforcement programs are all authorized to contact taxpayers about apparent noncompliance and to determine and adjust taxpayers' tax liability. However, audits have the broadest authority to detect possible noncompliance, significant powers to obtain information, and the most restrictions on how IRS is to interact with taxpayers. With regard to operational characteristics, the extent to which audits are operationally similar to or different from other enforcement programs varies depending on the type of audit. In general, audits done in taxpayer locations and IRS offices are not similar operationally to other enforcement programs. Audits done through correspondence with the taxpayer, while still different, are more operationally similar to the other programs. IRS officials were unaware of any research on whether taxpayers perceive differences among IRS's enforcement programs. However, looking at audits and other enforcement programs from the taxpayers' perspective, IRS officials and officials we interviewed who represent taxpayers believe that taxpayers may not perceive distinctions among many of the enforcement programs.

In fiscal years 1993 through 2002, the enforcement program contact rates often did not follow consistent patterns from one program to another or from year to year within programs.[2] Comparing just fiscal years 1993 to 2002, the contact rates for the audit and document matching programs dropped 38 percent and 45 percent, respectively, while the nonfiler program contact rates stayed about the same. Only the math error program had a contact rate significantly higher in 2002 than in 1993. However, this growth covers only a portion of math error contacts because data on one type of math error contact does not exist for years before 1997, and have not been reported by IRS as math errors. These unreported math error contacts total about 2 million annually. IRS officials agreed that these other contacts should be counted and reported as math errors. Excluding these contacts, the math error contact rate was 33 percent higher in 2002 than in 1993. For individuals, audit rates for taxpayers in higher and middle-income ranges were significantly lower in 2002 than in 1993, while the rate for the lowest income range was virtually the same in 2002 and 1993. Document matching program contact rates ended significantly lower in 2002 than 1993 for taxpayers in all three

[2]This report refers to the portion of tax returns audited by IRS as the audit contact rate. Similarly, the portion of tax returns for which IRS contacts taxpayers about possible noncompliance is the contact rate for the math error, document matching, and nonfiler programs.

income ranges. Income data for the contact rates in the math error and nonfiler programs were not available.

The divergent trends among the enforcement programs in their contacts with taxpayers are attributable to several factors, including statutory changes that expanded the types of issues IRS could address with nonaudit programs, declines in IRS enforcement staffing, and priorities in using staff. For example, the rise in math error contacts is at least partly attributable to a 1996 statutory change that enabled IRS to check hundreds of thousands of missing or invalid social security numbers through the math error program rather than audits. Declines in the audit program are generally attributable to statutory changes that reduced the availability of IRS staff to do audits and increased the time needed to do audits. In addition, declines in the number of staff assigned to work enforcement cases coupled with the priority IRS gives to staffing the math error program—because such errors must be resolved before tax returns can be processed—have contributed to declines in contacts with taxpayers in the audit, nonfiler, and document matching programs.

IRS has limited evidence on the effects of its enforcement programs on taxpayer compliance and no evidence on the burdens taxpayers experience when contacted under the programs. Although widespread agreement exists that enforcement programs are critical to ensuring voluntary compliance, IRS officials only identified one study that attempted to measure the effect of individual enforcement programs on compliance. This IRS study, using various data for 1982 through 1991, estimated that the audit and document matching programs had some positive effects on whether taxpayers filed returns and reported relevant information. No measures are available on the burdens placed on individual taxpayers due to IRS's enforcement contacts and IRS does not currently plan to start any studies to measure these burdens.

IRS's annual public reporting on its enforcement programs for individual taxpayers does not provide a complete perspective on its efforts to enforce the tax laws. IRS annually reports extensive data on audits but limited or no data on other enforcement programs. This limited reporting does not provide policymakers or taxpayers information on the full extent of IRS's enforcement efforts. To the extent policymakers and taxpayers focus on audits due to IRS's limited reporting, they may not understand that long-term declines in the audit rate are in part due to the movement of some tax issues from audits into other enforcement programs, and that these programs contact far more taxpayers about compliance issues than does the audit program. Of two options for expanding reporting that we identified, reporting more data on each enforcement program would avoid several disadvantages of combined reporting under an expanded definition of an audit. Expanding the definition of an audit would combine some enforcement activities that are so disparate—such as audits conducted at taxpayer locations of complex issues versus simple corrections of inadvertent math errors—that the consolidated reporting could be misleading. IRS officials plan to expand public reporting for fiscal year 2002 on IRS's major enforcement programs to the extent that data are available and cost effective to extract. They do not plan to determine whether IRS can cost effectively develop additional data to enable future reporting to more completely represent program results and to facilitate program comparisons.

We are recommending that IRS determine whether data can be cost effectively developed to make future reporting on its other enforcement programs more complete and comparable to reporting on audits. We also recommend that IRS correct underreporting of math error contacts. In commenting on a draft of our report, IRS agreed with our recommendations and has already begun to identify additional data to report on its enforcement programs.

Background

Each year, IRS screens all individual tax returns and selects a small percentage in which to contact taxpayers about potential noncompliance. Prior to doing automated checks of tax returns, IRS had relied on its audit program to contact taxpayers about apparent inaccuracies in reporting income, deductions, and other issues on their tax returns. For example, to verify interest income or dependent exemptions claimed by taxpayers, IRS auditors had to contact taxpayers, request and review documentation. Thus, if IRS audited the returns of 5 percent of all taxpayers, it could at most check on the accuracy of interest income for 5 percent of taxpayers.

Since the 1970s, IRS's ability to verify some items on individual returns expanded as IRS's capacity to use automated processes grew and as Congress enacted laws requiring third parties (like banks, mortgage finance firms, etc.) to provide information returns to taxpayers and IRS on income paid. These steps enabled IRS to more universally and efficiently check taxpayer compliance for those tax issues covered by information returns. For example, with the initiation of information returns for interest income and the development of IRS's automated capacity, IRS began to check whether every taxpayer for whom it had received an applicable information return had accurately reported that interest on their tax return.

As a result, for some wage earners who claim no deductions, IRS can review the accuracy of all, or nearly all, items reported on their tax return to the extent that third parties correctly filed all information returns. In these cases, IRS effectively receives information that should be in taxpayers "books and records" and no longer needs to use auditors to obtain such information from taxpayers' records for these selected issues.

Concurrent with these expansions in IRS's ability to check the accuracy of certain issues on taxpayers' returns, the number of taxpayer returns that IRS audited began to decline. For example, between fiscal years 1981 and 1992, the number of document matching contacts rose from 1.2 million to 3.8 million and the number of audits dropped from 2.5 million to 1.1 million.

Several GAO reports have discussed IRS audits, other enforcement contacts, and taxpayer burden as follows:

- In 1996, we reported that audit rates fell from 1988 to 1993 and then rose to a high of 1.67 percent in 1995.[3] In 2001, we reported that audit rates had steadily dropped from 1996 to 2000, declining to 0.49 percent.[4]
- During 2000, we reported that IRS made almost 10 million nonaudit contacts of taxpayers in 1998 through about 6 million math error notices, 2 million document matching notices, and 2 million soft notices. We recommended that IRS analyze the data collected for each of the three major nonaudit contact programs to improve taxpayer compliance and taxpayer service.[5]
- During 2000, we reported on IRS's efforts to estimate taxpayer compliance burden for prefiling, filing, and postfiling activities. We found that IRS was developing two models that, when combined, should provide more reliable estimates of compliance burden for wage earners.[6]

[3]U.S. General Accounting Office, *Tax Administration: Audit Trends and Results for Individual Taxpayers*, GAO/GGD-96-91 (Washington, D.C.: Apr. 26, 1996).

[4]U.S. General Accounting Office, *IRS Audit Rates: Rate for Individual Taxpayers Has Declined But Effect on Compliance Unknown*, GAO-01-484 (Washington, D.C.: Apr. 25, 2001).

[5]U.S. General Accounting Office, *Tax Administration: IRS' Use of Nonaudit Contacts*, GAO/GGD-00-7 (Washington, D.C.: Mar. 16, 2001).

[6]U.S. General Accounting Office, *Tax Administration: IRS Is Working to Improve Its Estimates of Compliance Burden*, GAO/GGD-00-11 (Washington, D.C.: May 22, 2000).

Scope and Methodology

To compare audit and other enforcement programs, we obtained information on their legal and operational characteristics. For legal authority, we reviewed the Internal Revenue Code (IRC) and IRS documents. For program operations, we reviewed IRS documents and interviewed responsible IRS officials to understand how each program works. For the average time spent on each type of contact, we analyzed available IRS data for fiscal years 1993 through 2002. For how taxpayers perceive IRS's enforcement programs, we interviewed IRS officials; reviewed tax research studies and press articles; and contacted four large national organizations representing attorneys, certified public accountants, enrolled agents, and tax preparers, as well as the largest tax return preparation firm, and IRS's national taxpayer advocate.

To summarize trends in the number and rate of individual taxpayer audits and other enforcement contacts in total and by taxpayer income, we analyzed available IRS data from fiscal year 1993 to fiscal year 2002 on each type of contact. To compute the audit contact rate, we used IRS's method, which equals the proportion of IRS audits closed in a fiscal year compared with returns filed in the previous calendar year. IRS has not stated a method for computing math error, document matching, and nonfiler rates. For the document matching and nonfiler programs, we compared the proportion of notices sent in a fiscal year to return filings in the previous year because these contacts generally occur in the year after a return is filed. For the math error program, we based the contact rate on the proportion of math error notices to the returns filed in that year because the notices are sent to taxpayers as IRS processes tax returns. For the math error, document matching, and nonfiler programs, we based the contact rate on the number of initial notices sent to taxpayers rather than closures because (1) it is the broadest measure of IRS's enforcement efforts with taxpayers and (2) the math error and document matching programs usually conclude the contact with the taxpayer within a few months after the initial notice is sent. Nonfiler contacts can take considerably longer to close, making it difficult to know which tax year to use in computing a contact rate. We used the number of initial notices so that the nonfiler program could be measured on a consistent basis with the document matching and math error programs. To understand the reasons for the trends, we analyzed our previously issued reports and IRS reports and interviewed IRS staff for each enforcement program.

To determine how audit and other enforcement programs affect individual taxpayer compliance and burden, we obtained and reviewed available data such as IRS studies and reports, our previous reports, and other research. We also interviewed responsible IRS officials.

To assess whether IRS should expand reporting on its enforcement efforts, we analyzed the types of enforcement data already publicly reported on an annual basis by IRS. We also analyzed the tradeoffs for two options we identified—expanding the definition of audit to include the other enforcement programs and reporting more data on each program. We used much of the information from the previous objectives and interviews with IRS officials.

For all objectives, our work focused on the four major enforcement programs identified by IRS—math error, document matching, nonfiler, and audit. We attempted to verify the completeness and accuracy of IRS's data but could not reconcile all differences given time constraints. As a result, we either did not report some data or disclosed limitations in the data being reported. Further, in analyzing audit and document matching rates by income level, we did not adjust the income levels for the effects of inflation over the 1993 to 2002 period because detailed data on taxpayer income was not available during the timeframes for the assignment. All data used in the report are final except for the number of tax returns filed in 2002. Because this number is preliminary, the final math error contact rate for fiscal year 2002 may differ somewhat from what we report. In addition, you asked us to analyze two newer IRS efforts—voluntary compliance agreements and soft notices. Appendix IV describes the two newer efforts.

We did our work at IRS's national office in Washington, D.C., and offices in New Carrolton, Maryland, and Atlanta, Georgia, between August 2002 and December 2002 in accordance with generally accepted government accounting standards. We requested comments on a draft of this report from IRS (see app. V).

Similarities and Differences among IRS Enforcement Programs Depend on the Type of Audit

Whether audits and other enforcement programs vary from each other depends on a number of factors. With regard to legal characteristics, audits and other enforcement programs are all authorized to contact taxpayers about apparent noncompliance and to determine and adjust taxpayers' tax liability. However, audits have the broadest authority to detect possible noncompliance, significant powers to obtain information, and the most restrictions on how IRS is to interact with taxpayers. With regard to operational characteristics, the extent to which audits are operationally similar to or different from other enforcement programs varies depending on the type of audit. Audits done in taxpayer locations and IRS offices are not similar operationally to other enforcement programs and audits done through correspondence with the taxpayer, while still different, are more operationally similar to some of the other programs. IRS officials were unaware of any research on whether taxpayers perceive differences among IRS's enforcement programs. However, looking at audits and other enforcement programs from the taxpayers' perspective, IRS officials and officials we interviewed who represent taxpayers believe that taxpayers may not perceive distinctions among many of the enforcement programs.

Legal Characteristics: Audits Have the Broadest Scope, Significant Powers to Obtain Information, and the Most Detailed Restrictions

In a general sense, the IRC provisions for enforcement are similar in that they authorize IRS to contact taxpayers about apparent noncompliance and to determine and adjust taxpayers' tax liability. However, the IRC provisions grant IRS the authority to review all matters that may affect a taxpayer's tax liabilities under audits but only certain specified tax issues under other enforcement programs. The IRC also establishes more rules—including significant powers to obtain information as well as restrictions on those powers—that govern the nature of audit contacts with taxpayers than for the other programs.

The IRC does not explicitly limit the tax issues to be covered by an audit, unlike for the other enforcement programs. Under the authority of section 7602, audits can cover any issue on a tax return, including those that the other programs cover.[7] In contrast, the IRC specifies the scope of legal authority for the three other enforcement programs. For example, after five statutory expansions since 1976, math error authority[8] now covers 11 tax issues (see app. I). Document matching—which grew primarily through the 1980s as Congress authorized more information reporting—now covers over 20 types of individual income as well as certain tax credits and deductions (see app. II).[9] The IRC also specifically authorizes

[7]For example, an audit might address unreported income, which is the focus of document matching, because document matching can only verify individual income reported on information returns. According to IRS, information returns only report 80 percent of all individual income reported on tax returns.

[8]IRC sec. 6213 grants math error authority for issues such as calculation errors, entries that are inconsistent with or exceed statutory limits, various omissions of information, or incorrect use of an IRS table.

[9]IRC sec. 6041, 6044, 6045, 6049, 6050, and 6051, among others, authorize information reporting to help identify a discrepancy on individual income such as wages, interest, dividends, pension distributions, and gross proceeds from stock sales.

the nonfiler program to pursue unfiled tax returns that should have been filed.[10]

The IRC also establishes more rules governing IRS's contacts with individual taxpayers under the audit program than it does for the math error, document matching, and nonfiler programs. These rules give IRS significant powers to obtain information needed to determine an individual's tax liabilities when doing an audit and, in turn, places restrictions on the use of those powers. If resolving issues raised under the other enforcement programs requires that IRS auditors become involved, the contacts with taxpayers become audits subject to these greater powers and restrictions. For example, if a taxpayer who receives a math error notice files a claim for IRS to abate the tax assessment, IRS could audit that claim. Similarly, if a taxpayer responds to a document matching notice with materials that cannot be readily and immediately used to settle the discrepancy, the case could be referred to audit staff.

The greater powers that IRS has under audit compared with the other programs include the authority to examine books and records and take testimony for purposes of determining the tax liability of a tax return. IRS also has the power to use a summons to compel taxpayers and third parties to provide books and records, and to enter premises to examine objects subject to taxation.[11]

Given these greater powers, the law also places more restrictions on audits to protect taxpayer rights.[12] For example, the law restricts IRS from doing unnecessary audits or generally doing more than one inspection of taxpayers' books for each tax year. The law also governs the time and place of an audit and burden of proof on IRS. In addition, the Internal Revenue Service Restructuring and Reform Act (RRA) of 1998 (P.L. 105-

[10]IRC sec. 6020 grants this authority to IRS and allows IRS to prepare a return for a taxpayer who did not file as required and process that return to assess taxes owed.

[11]IRC sections 7602 through 7606 and 7609 grant these powers.

[12]IRC sections 7602, 7605, 7609, and 7491 address these restrictions.

206) added several requirements, such as informing taxpayers of their rights during audits.[13]

On the other hand, RRA also added a provision that creates a legal similarity for all four enforcement programs because it affects any IRS employee, including those making audit or nonaudit contacts. Section 1203 of RRA lays out the conditions under which any IRS employee is to be fired for any of 10 specific acts or omissions. Many of these conditions involve contacts with taxpayers—such as harassing taxpayers or taxpayer representatives, violating their civil rights, or threatening to audit a taxpayer for personal gain. These restrictions were intended to protect taxpayers in their interactions with IRS.

Another legal provision creates a similarity between audits and two of the three other programs. Except for the math error program, when IRS proposes a change in taxpayers' liabilities, it is required to send a notice[14] informing taxpayers of their rights, such as the right to appeal additional taxes that IRS proposes. The IRC does not provide taxpayers a right to appeal assessments created under math error authority because that authority generally applies to obvious errors made by taxpayers on their returns. However, IRS informs taxpayers receiving a math error notice that they may file a claim to ask IRS to abate (reduce) the tax assessment if they believe IRS erred.

Operational Characteristics: Audits at IRS Offices or Taxpayer Locations Differ the Most from Other Enforcement Programs

The extent to which audits are operationally similar to or different from other enforcement programs varies depending on the type of audit. Compared with other enforcement programs, audits done in taxpayers' locations or IRS offices are more likely to deal with multiple and complex issues, require more skill and judgment by IRS employees, require a greater number of interactions with taxpayers, and take more IRS staff time. Correspondence audits also tend to differ from other enforcement programs in these operational characteristics but to a lesser degree, and in some cases correspondence audits and document matching contacts with

[13]The Restructuring Act also restricted the audit technique that can be used to identify unreported income; requires IRS to explain taxpayer rights including the right to be represented during audits; requires IRS to disclose the general criteria for why the return was selected for audit; and restricts the ability to summon a third party for an audit.

[14]Publication 1 (Your Rights as a Taxpayer) explains the rights that taxpayers have in contacts with IRS.

taxpayers can be very similar in these characteristics. Table 1 provides an overview of key operational dimensions across the enforcement programs.

Table 1: Operational Dimensions of IRS Enforcement Contacts

Contact	What triggers the contact?	How many contacts occur between IRS and the taxpayer?	How much skill and judgment is required by IRS staff?	When is the initial contact sent to the taxpayer?
Audits	• computer analysis of potentially noncompliant returns • referrals from inside or outside IRS • projects on specific areas of known noncompliance	likely requires multiple exchanges via notices/letters, telephone, and/or face-to-face meetings	skilled review of simpler issues and more sophisticated analysis of complex issues	usually within 1 year after the return is filed but may occur later as long as IRS finishes the audit within 3 years after the return is filed
Document Matching	computer identification of error based on information received from third parties on income paid	one notice from IRS and possible exchanges via letters or telephone	some skill/judgment	within 1 year after the return was filed
Non-filer	• computer identification of those who did not file or who stopped filing • referrals from inside or outside IRS	one notice from IRS and probable exchanges via letters, telephone, or meetings	some skill/judgment	usually within 1 year after the return was to be filed
Math Error	computer identification of error using taxpayer information on their tax returns or forms	one notice from IRS	little skill/judgment	as part of the initial processing for the tax return

Source: GAO analysis.

Note: Of the three types of audits, the simplest usually covers one to two tax issues handled by a lower-graded auditor and correspondence. More complex audits are done by meeting with taxpayers in IRS field offices. The most complex audits are done through field visits to taxpayer locations.

Reviewing these operational dimensions helps highlight similarities and differences across the four types of enforcement.

- *Contact triggers*: All enforcement contacts use computers to identify a potential compliance issue. However, audits are more likely to be triggered by other means such as a special compliance project or referrals from inside or outside of IRS.

- *Number of contacts*: Once any potential compliance issues are found, the fewest contacts with taxpayers to resolve the issues are likely under the math error and document matching programs because they have relatively simple issues. Correspondence audits might need more than one contact, depending on the complexity of the issue(s) being audited and taxpayers' responses. The number of contacts in the nonfiler program can vary depending on whether taxpayers respond to an IRS notice by filing a return, or explaining why a return was not required.[15] Some may not respond, possibly leading IRS to send a second notice or create a substitute return and send it to that taxpayer. Audits at IRS offices or taxpayer locations are likely to have the most contacts with taxpayers through meetings, notices, or the telephone because they tend to cover several, more complex issues.

- *IRS staff skill and judgment*: Audit contacts—especially those done in IRS offices or in taxpayer locations—require the most staff skill and judgment to analyze taxpayers' testimony and books and records. Being more automated and usually dealing with simpler issues, other enforcement programs rely on less staff skill and judgment. Document matching staff might have to analyze taxpayers' explanations for why they do not owe more tax but are to refer the case to the audit program if an explanation requires detailed analysis or includes books and records. The nonfiler program requires limited skill and judgment when automated processes send the notices or generate substitute returns. More skill and judgment is required when IRS staff manually create substitute returns or when taxpayers respond to a notice by saying that they do not have to file a return.

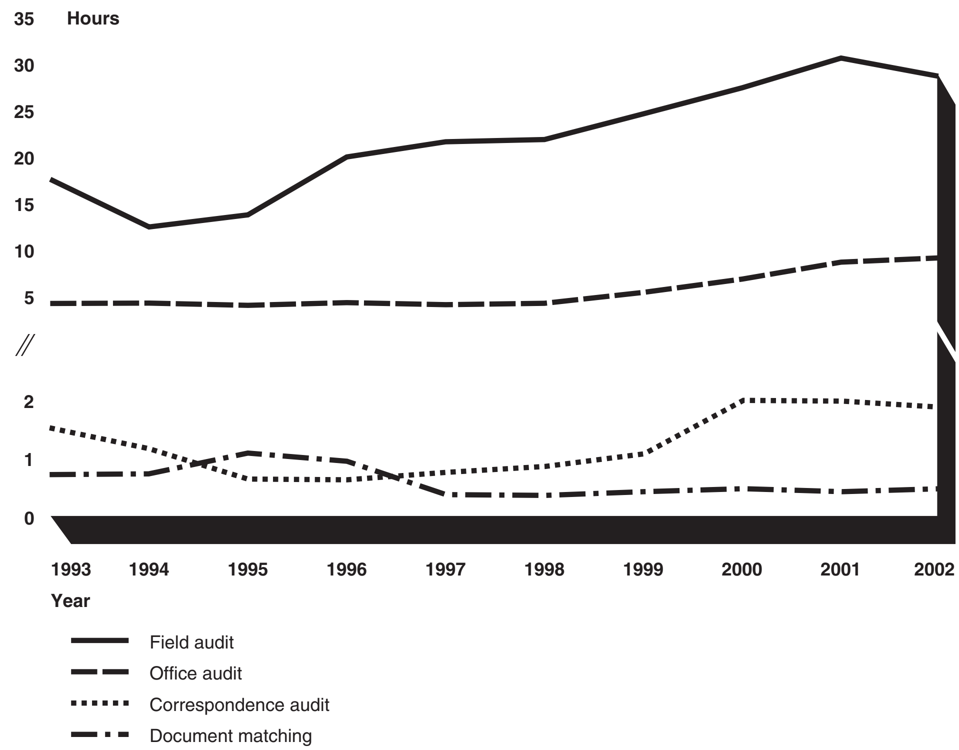
- *Timing of initial contact*: Math error contacts are made as the return is being processed and identify errors that must be corrected to finish processing the return. Document matching and nonfiler contacts usually occur within 1 year after the return is filed or is to be filed. Audits usually start within 1 year after a return is filed but can start later as long as IRS finishes the audit within 3 years after the return is filed.

Another operational characteristic is the average time spent by IRS staff. Figure 1 shows that audits use more staff time per case than document matching contacts.[16] For fiscal years 1993 through 2002, the staff time ranged from roughly an hour per document matching case to up to 30 hours per field audit. (see Table 9 in app. III for details.) IRS does not separately track the time spent on math errors from the rest of the returns filing process or on nonfilers from other work done by collection staff.

[15]Taxpayers are not always required to file a tax return such as when their income is too low.

[16]Document matching staff time includes the time to resolve discrepancies before and after contacting taxpayers.

Figure 1: Average Direct Staff Hours by Type of Audit and for Document Matching Cases, Fiscal Years 1993 through 2002



Source: GAO analysis of IRS data.

Note: Fiscal year 2002 data are estimated.

Looking across all of these operational dimensions in general, audits that take place in IRS offices or in taxpayer locations differ the most from other enforcement programs. They differ primarily because they are more likely to deal with multiple complex tax issues, require more skill and judgment by IRS employees, require a greater number of interactions with taxpayers, and take more IRS staff time. Although correspondence audits do differ from other enforcement programs on these characteristics, they do not differ as much from other enforcement programs as do the audits in IRS field offices or taxpayer locations. The closest similarity between correspondence audits and the other programs is with the document-matching program. In comparison to the document matching program, correspondence audits in some cases may deal with about the same number of issues, have the same number of interactions with taxpayers, and require similar skill, judgment, and time on the part of IRS staff. Correspondence audits are less similar to contacts under the math error and nonfiler programs than to document matching. Math error contacts deal with straightforward issues that must be corrected as a return is processed as opposed to contacting the taxpayer up to one year later about issues in the return. Nonfiler contacts deal with taxpayers who have not filed a return at all as opposed to seeking to correct issues related to a filed return.

In addition to the four major enforcement programs, starting in the mid-1990s, IRS created two new programs intended to help individual taxpayers file accurate tax returns. IRS sends so-called “soft notices” on duplicate claims for dependent exemptions and missing self-employment tax reporting. The soft notices do not require taxpayers to take action but are intended to educate them about the potential errors and encourage them to correct their returns, if necessary. The other new program is the voluntary compliance agreements program. These agreements are negotiated with certain employers with the goal of increasing their employees’ compliance in reporting tip income. As discussed in appendix IV, while these programs attempt to improve compliance, they have significant differences from the four major enforcement programs and IRS has little data on their use. However, IRS was able to provide us with data that it sent taxpayers 1.2 million soft notices on duplicate dependent claims in 2002.

No Research Identifies Whether Taxpayers Perceive Distinctions in Enforcement Programs but Officials Believe That Distinctions May Not Be Made

IRS officials were not aware of any research, and our search of the tax literature and press did not uncover research, on whether taxpayers perceive distinctions between audits and other enforcement programs. Of the four major enforcement program contacts, IRS officials said that they could see how some taxpayers might view two types of contacts—document matching and correspondence audits—as similar in that both tend to cover one or two tax issues that are fairly simple, contact taxpayers through the mail, and give taxpayers the same appeal rights. Otherwise, these officials did not see how taxpayers could view the enforcement contacts as similar, especially the math error contacts.

Although they had not surveyed taxpayers, officials we interviewed from six groups that represent taxpayers or help prepare their tax returns believed that many individuals perceive no distinction among the programs. For example, one representative attributed this to the conclusion that taxpayers view all IRS notices as stating the same thing—that the taxpayer owes more taxes.

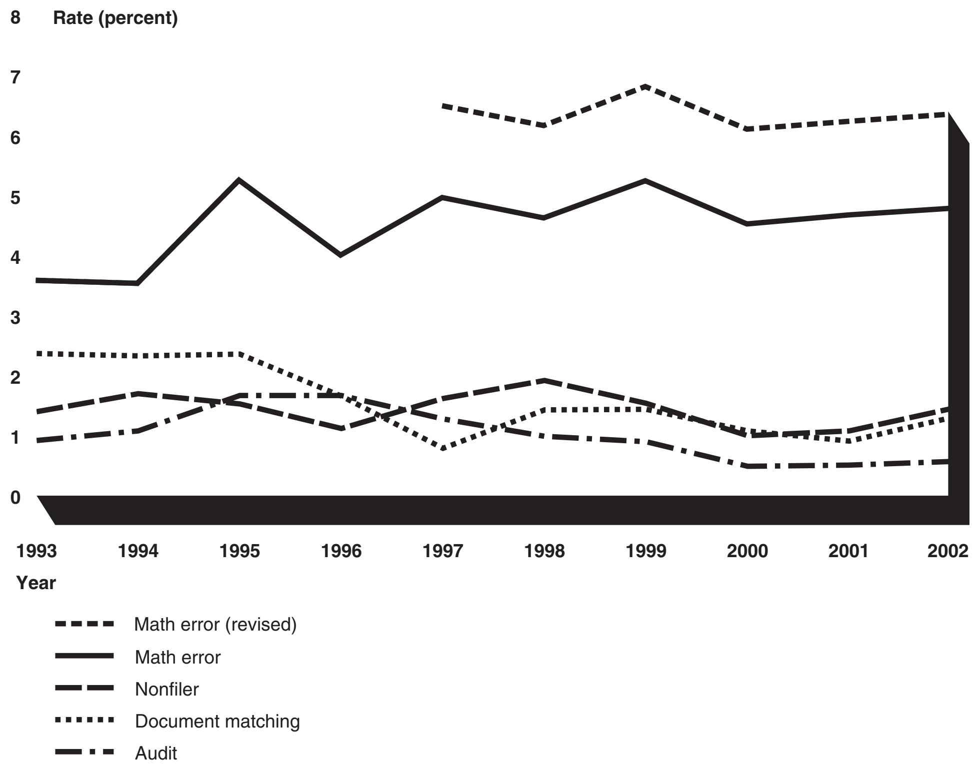
Enforcement Program Contact Rates Did Not Follow Consistent Patterns

From fiscal years 1993 through 2002, the rates for the four enforcement programs often did not follow consistent patterns from one program to another or from year to year within programs. Comparing just 1993 with 2002, the contact rates for two programs—audits and document matching—were significantly lower, the rate for math errors was significantly higher, and the rate for nonfilers was essentially the same. By taxpayer income level, the audit rate for higher and middle income taxpayers generally declined over the 10-year period—with the sharpest declines for higher income taxpayers. The rate for the lowest income taxpayers increased sharply between 1993 and 1995 and then generally fell, ending virtually the same as in 1993. The document matching contact rate by income class followed very similar patterns with the rates for all income levels dropping over the 10-year period. The enforcement contacts increased or decreased because of several reasons, including statutory changes, staffing declines, and priorities in the use of staff among the programs.

Enforcement Program Contact Rates Varied from Program to Program and Often from Year to Year within Programs

As figure 2 shows, the math error program contact rates rose or fell from year to year; however, it's the only enforcement program that had a significantly higher contact rate in fiscal year 2002 than in 1993. This is true even without counting certain math error contacts for which IRS lacks data over the 10-year period. Using only the math error count, which is consistent throughout the 10 years, the math error contact rate rose 33 percent (from 3.59 percent to 4.79 percent). Document matching contact rates went down and up at various times but ended 45 percent lower (from 2.37 percent to 1.30 percent) in 2002 compared to 1993. The nonfiler rates also went up and down but ended in 2002 about where they were in 1993. Comparing 1993 to 2002, the audit contact rate dropped 38 percent (from 0.92 percent to 0.57 percent), even though it rose significantly between 1993 and 1995. Over the 10 years, the math error rate exceeded the rate for each of the three other programs, and the audit rate was the lowest rate, except in fiscal years 1995, 1996, and 1997. The trends in the number of contacts in all four programs generally follow the trends in the rates. Appendix III provides details about the contact numbers and rates for all four programs.

Figure 2: IRS Enforcement Contact Rates, Fiscal Years 1993 through 2002



Source: GAO analysis of IRS data.

Notes: The math error (revised) line includes math error contacts from masterfile notices that IRS's reports had excluded. Data on such math errors were not available prior to fiscal year 1997. The figure does not include additional contacts for math errors related to the rate reduction credit during 2002.

Fiscal year 2002 data is estimated.

The trend line in Figure 2 shows a revised math error contact rate that includes masterfile[17] notices IRS had been sending throughout this period but had not been reporting as math errors. In data made publicly available on math error contacts,[18] IRS had excluded roughly 2 million masterfile

[17]The masterfile is IRS's historical record of transactions involving each taxpayer's account.

[18]IRS letter to respond to questions from the Senate Finance Committee, March 26, 2001.

math error contacts annually for fiscal years 1997 through 2002.[19] When included, the math error contact rate increases (e.g., from 4.97 percent to 6.5 percent in 1997). These math error contacts arise from IRS's match of filed tax returns to its masterfile accounts to identify tax returns that misreport taxes already paid such as in previous years or estimated tax payments. IRS officials said that the masterfile errors were not reported as math errors because they are identified through a different process at a later time compared to other math errors during the processing of tax returns. In our discussions, these officials agreed that both types of errors are identified under the same math error authority, are indistinguishable to taxpayers being contacted, and should be similarly counted and reported.

IRS also did not include in its published report about 8 million notices sent in fiscal year 2002 to correct errors in tax returns reporting the rate reduction credit.[20] If these notices had been included, the math error contact rate would have nearly doubled to 12.5 percent. The Economic Growth and Tax Relief Reconciliation Act of 2001 authorized tax rate reductions as well as an advance tax refund, called the rate reduction credit. Because the rate reduction credit applied for only 1 year, this error is unlikely to recur according to IRS officials. As a result, we did not include this information in figure 2.

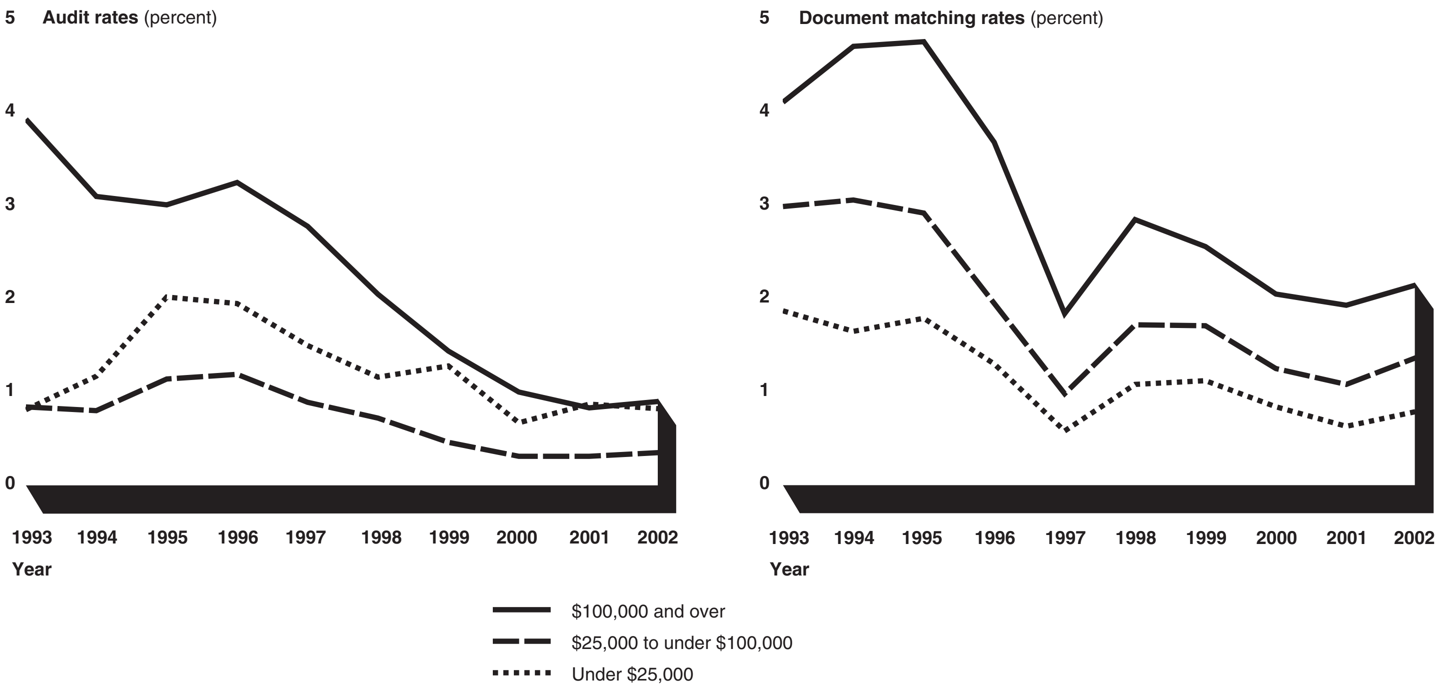
Audit and Document Matching Contact Rates Across Income Levels Have Generally Declined

Figure 3 shows that the contact rates generally declined in the audit and document matching programs for all taxpayer income levels between fiscal years 1993 and 2002. For the math error and nonfiler programs, data on contact rates by income level were not available, and IRS officials said that it would take some time and effort to develop math error and nonfiler contact rates by income levels. (See table 7 in app. III for details on contact rates by income levels.)

[19]IRS had not collected data on these masterfile math errors prior to fiscal year 1997.

[20]U.S. General Accounting Office, *Tax Administration: Advance Tax Refund Program was a Major Accomplishment, but Not Problem Free*, GAO-02-827 (Washington, D.C.: Aug. 2, 2002), U.S. General Accounting Office, *IRS's 2002 Tax Filing Season: Returns and Refunds Processed Smoothly; Quality of Assistance Improved* GAO-03-314 (Washington, D.C.: Dec. 20, 2002), and Internal Revenue Service, *Tax Compliance Activities Report*, June 24, 2002, prepared in response to a directive in the House Report accompanying the legislation (P.L. 107-67).

Figure 3: IRS Individual Audit and Document Matching Contact Rates by Income Level, Fiscal Years 1993 through 2002



Source: GAO analysis of IRS data.

Note: Data by income level for the math error and nonfiler programs are not available.

As figure 3 shows, because the audit contact rate declined (from 3.89 percent to 0.86 percent) for higher income (more than $100,000) individuals and remained virtually the same (from 0.77 percent to 0.78 percent) for the lowest income (less than $25,000) individuals between fiscal years 1993 and 2002, the rates for the highest and lowest income individuals essentially converged in 2001 and 2002. Over the same time, the document matching contact rate generally declined for all three income groups with fairly similar year-to-year patterns and with higher income individuals being contacted at the higher rate.

Statutory Changes, Fewer Staff, and Resource Priorities Explain Trends in Math Error, and Other Enforcement Contact rates

The divergent trends between the growing rate of math error contacts and the declining or relatively stable rates for the other enforcement programs can be attributed to how the programs have been affected by statutory changes, fewer enforcement staff, and priorities for using available staff. Math error contacts grew over the fiscal year 1993 through 2002 period in part because Congress expanded the types of tax issues covered by the math error authority. For example, in 1996, Congress gave IRS authority to shift a number of earned income tax credit issues from its audit program to its math error program in that year. As a result, in 1997, IRS shifted over 700,000 cases involving missing or invalid social security numbers (SSN) on tax returns from the audit program to the math error program. Under this and other statutory expansions, IRS was making hundreds of thousands of math error contacts with taxpayers by 2002 that were not made in 1993.

A second statutory change played a role in the diverging trends among the enforcement programs. In RRA, Congress took steps to better ensure that taxpayer rights were protected by revising certain audit processes, such as informing taxpayers about their rights and generally how they were selected for audit. According to IRS officials, the changes contributed to the decline in audits because IRS auditors had to spend more time to handle nonaudit duties, to be trained in new procedures and taxpayers' enhanced rights, and to do new tasks.[21] Those changes contributed to reductions in the number of audits that each auditor completed, meaning they were less productive in closing audit cases.

Finally, declines in enforcement staffing and priorities for using staff also contributed to trends in enforcement program contacts. IRS has reported that from 1993 to 2001, enforcement staffing levels declined about 24 percent. These staffing declines affected not only the audit program but also the document matching and nonfiler programs because those programs require that IRS staff screen most notices before they are sent and follow up when taxpayers respond to notices.[22] Given declining staff resources, IRS has restricted the number of notices sent when it finds probable noncompliance under the document matching and nonfiler programs. In contrast, IRS allocated enough resources over this period to the math error program to continue sending these notices. IRS officials said that IRS must resolve math errors to process tax returns and adjust the tax liability so that taxpayers are in compliance.[23]

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[21] Also see GAO-01-484.

[22] We did not analyze the portion of potentially noncompliant tax returns that IRS could not check due to resource limitations. In its September 2002 progress report to the IRS Oversight Board, IRS presented data showing that it is checking compliance on a decreasing portion of potentially noncompliant returns.

[23] To ensure efficient returns processing, returns with small dollar value discrepancies are accepted as filed and taxpayers are not sent math error notices.

Limited Evidence Suggests IRS Enforcement Programs Do Increase Compliance; No Measures Available on Enforcement Program Burden

Although widespread agreement exists that enforcement programs help ensure voluntary tax compliance, evidence is limited about the degree to which enforcement overall or by type of program affects taxpayer compliance. No studies are available that measure the burdens that taxpayers experience when contacted under IRS's enforcement programs.

Over the years, many tax practitioners and academics have suggested that enforcement programs are critical for ensuring voluntary compliance. However, measuring the effects of enforcement programs on compliance is a difficult task. IRS officials identified only one study that attempted to estimate the effects of its enforcement programs on compliance; no more recent work is underway or planned to measure these effects. Relying on an econometric analysis of taxpayer behavior—using various assumptions, IRS and non-IRS data for 1982 through 1991, and alternative measures of compliance—this IRS study estimated the effects of various IRS programs across the general taxpayer population. The study suggested that audits had a positive impact on compliance in reporting information on tax returns and that document matching had a positive effect on compliance in filing required returns. We did not have time to analyze the reasonableness of the study's approach, assumptions, and results.

To obtain current information on taxpayers' compliance in filing tax returns and reporting correctly on them, IRS developed its National Research Program (NRP).[24] This program is designed to yield reliable estimates of the compliance levels of individual taxpayers while addressing concerns about the burden such a measurement program can impose on taxpayers. NRP's design was completed in fiscal year 2002, and IRS will be auditing taxpayers' returns under the program during fiscal year 2003.[25] IRS plans to use the NRP results to update tools to select individual tax returns for audit, to allocate resources, to estimate the impacts of legislative and administrative changes on voluntary compliance and tax revenue, and to identify potential ways to improve voluntary compliance. Although NRP should yield useful data, it was not designed to

[24]IRS had measured the voluntary compliance of individual taxpayers periodically, last doing so for tax year 1988. IRS stopped because of various congressional and other concerns about the measurement program.

[25]See U.S. General Accounting Office, *Tax Administration: New Compliance Research Effort Is On Track, but Important Work Remains*, GAO-02-769 (Washington, D.C.: June 27, 2002).

measure the effect that each major enforcement program could have on voluntary compliance.

In addition, IRS has been working to produce more comprehensive estimates of burden that individual taxpayers face in meeting their tax obligations. IRS developed a system in 1984 for estimating the burdens taxpayers face in filing IRS forms, and began efforts during the 1990s to create a better model for estimating such compliance burdens. IRS recently announced that the new burden model is ready to be tested and likely will replace the old model during fiscal year 2003. Although the model should provide better estimates of individual taxpayer burdens in completing and filing tax returns, it is not designed to estimate the postfiling burdens related to IRS's enforcement efforts. IRS expects to model these postfiling burdens but does not yet know when that phase of its burden estimation project will begin.

IRS's Public Reporting on Its Enforcement Programs Is Incomplete

IRS's public reporting on its enforcement programs for individual taxpayers does not provide a complete perspective on its efforts to enforce tax laws because that reporting heavily focuses on audits. IRS's audit rate is often cited in the press and is often the focus of congressional and other debates concerning how well IRS is enforcing the tax laws. However, over time the audit rate has become increasingly less complete as a measure of IRS's efforts to enforce tax laws because IRS's other enforcement programs have expanded their coverage of issues once covered under audits.

At least two options exist for expanding reporting: changing the definition of audits to include other enforcement efforts and reporting more data on each enforcement program separately. The second option would achieve more complete and balanced reporting without incurring some of the disadvantages that could come from expanding the definition of audits. IRS officials plan to expand public reporting for fiscal year 2002 on IRS's major enforcement programs to the extent that data are available and cost effective to extract.

Limited Public Reporting on IRS's Enforcement Programs

IRS publishes extensive data on audits but only limited data on other enforcement programs in its Data Book.[26] Table 2 summarizes the data annually published on the enforcement programs involving individual taxpayers.

Table 2: Data Published on IRS Enforcement Programs for Individual Taxpayers, Fiscal Year 2001

Enforcement program	IRS published data
Audit	Number and/or rate of audits by • type of tax (e.g., individual income, gift) • type of return filed (e.g., Form 1040, Form 1040A) • taxpayer income class • type of audit (e.g., field, correspondence) • type of auditor (e.g., tax auditor, revenue agent) • whether the tax liability changed • total and average amount of recommended additional tax • whether taxapayers agreed with the recommended tax change Selected data on audits • resulting in tax refunds • preventing tax refunds on the basis of taxpayers' efforts to recoup taxes previously assessed or paid
Document Matching	• number of information returns received • number of taxpayer contacts • amount of additional tax assessed
Nonfiler	• number of taxpayer delinquency investigations completed • number of initial nonfiler notices sent • additional assessments for the substitute for returns program
Math error	No data are published

Source: IRS Data Book, fiscal year 2001.

As shown, IRS publishes no data on IRS's math error program—which affects millions of individual taxpayers annually. Compared with audits, public reporting on the document matching and nonfiler programs is much more limited. IRS officials said that IRS publicly reports more data on audits because IRS has had a separate audit case-tracking system for many years that produces such data. Also, they said that requests to publicly report more data on the other programs had not been made.

[26] IRS annually compiles data about its enforcement activities in its Data Book. IRS also publishes that data on its public Web site and may use some of that data in other publications such as budget documents.

IRS has not changed Data Book reporting on its enforcement programs to keep up with changes in its enforcement programs over the years. With its focus on audits, the reporting may lead others to focus on audits and thereby to have an incomplete understanding of IRS's enforcement efforts. For example, trends in the audit rate alone are difficult to use to assess IRS's enforcement presence because that rate does not measure the same phenomenon today as it did earlier. Even within the 10-year period we reviewed, some of the tax issues that formerly had been checked only under the audit program migrated into the other enforcement programs. This type of migration was more pronounced in the 1980s as the document matching program expanded substantially.

Although the scope of what IRS does under audits has changed considerably over the past few decades, and even within the past 10 years, the audit rate remains an often-cited statistic when Congress and others consider how well IRS is enforcing the tax laws. For instance, during annual oversight hearings on IRS's performance, members of Congress often raise questions about changes in the audit rate. Over the past several years, these hearings have included concerns about the declining audit rate and its possible affect on taxpayers' compliance. The IRS Commissioner also expressed concern about the decline in audits. However, the Commissioner said that he did not believe the audit rate needed to increase to the same level as a number of years ago because IRS has other programs to enforce the tax laws that were not available, or as broad in scope, in past years.

To the extent that IRS's audit rate is the major source of information available to taxpayers on IRS's enforcement efforts, the public cannot be fully aware of the extent to which IRS enforces tax laws and thus may misjudge the chances that noncompliance is likely to be detected. Taxpayers who are aware only of the audit rate would not be aware that IRS often contacts more taxpayers under each of its other enforcement programs—and IRS always contacts far more taxpayers in these other programs combined—than it does under the audit program. As discussed earlier, although the degree to which enforcement encourages voluntary compliance is difficult to measure, it is widely believed that public knowledge about enforcement efforts helps prompt higher levels of voluntary compliance. Although he did not specifically cite possible increases in voluntary compliance, in a letter issued in March 2001, the IRS

Commissioner said that only focusing on audits substantially understates IRS's capacity to find errors.[27]

While greater awareness of the scope of IRS's efforts to enforce the tax law may encourage compliance, it could also increase taxpayers' awareness of the trends in these efforts. It is not clear how taxpayers would interpret and react to the differing trends among IRS's enforcement programs. For the period from 1993 through 2002, trends in IRS's individual enforcement programs often varied from year to year as well as between the programs. Therefore, the compliance signals to taxpayers from publicizing data on the trends in these other programs probably would be different—and more mixed—than the signal they receive based exclusively on the audit rate.

In addition, awareness of the fuller range of IRS's enforcement efforts may not affect compliance of all groups of taxpayers equally. This could occur, for example, when the contact rates under the enforcement programs differ, as they do under the audit and document matching programs for different income groups. Further, to the extent that taxpayers know that IRS can only understand their tax situation through a traditional audit, their compliance might be less affected by fuller reporting on IRS's other enforcement efforts. The IRS Commissioner has said that the decline in the traditional audit rate is of concern in part because a growing portion of taxpayers and a growing amount of income is not well identified through such programs as document matching and nonfiler.

Expanding Public Reporting on Enforcement Programs Does Not Require Redefining Audits

Of two options we identified for expanding public reporting on IRS's enforcement efforts, providing data on each major program separately avoids certain disadvantages of aggregating data into one broad audit program. After we discussed the tradeoffs of these options with IRS officials, they said they plan to expand public reporting for each of the nonaudit enforcement programs.

One option for expanding reporting on IRS's enforcement programs would be to define all of IRS's enforcement programs to be audits for statistical reporting. If the programs were all defined to be audits, IRS might report a consolidated "audit rate" that would represent all of IRS's contacts with taxpayers. Consolidated reporting might also be done on such things as

[27]IRS's letter dated March 26, 2001.

the additional tax revenues identified through the contacts and the staff time invested by IRS.

This option could have several advantages. For instance, it would provide for more complete reporting on IRS's overall enforcement efforts in a single "rate." Another advantage to expanding the definition of an audit is that the major enforcement programs have an overall similarity in what they intend to achieve. Moreover, some document matching and math error checks now cover some tax issues that had been covered under audit authority. Thus, because audits do not measure the same thing over time, expanding the definition would create a more consistent measure of the extent to which IRS is enforcing tax laws.

However, combining all enforcement programs under one definition poses a number of potential disadvantages. For example, IRS's legal authority and operational rules, as well as taxpayers' rights, vary across enforcement programs. If all enforcement programs were called audits, IRS staff and taxpayers could become confused about the rights and restrictions that govern contacts with taxpayers. Labeling all enforcement programs as audits might confuse taxpayers about whether IRS could examine their books and records for a specific tax year (an action taken under IRS's current audit authority) if they had already been contacted under document matching and/or math error programs.

If all enforcement programs were called audits and aggregate reporting was done, IRS would face a challenge in ensuring that taxpayers and others are not misled. For example, a single audit rate would cover the range from intense audits covering multiple tax issues to the correction of simple math errors arising from inadvertent miscalculations by taxpayers. Given the higher number of math errors being detected by IRS over time, if taxpayers interpreted a revised audit rate as representing the former rather than the latter situation, they would be misled about IRS's true level of tax return scrutiny. Another challenge for IRS would be in reporting audit results like tax dollars assessed and time spent per audit. Considerable variability already exists in these results for audit—e.g., field audits take significantly more staff hours than correspondence audits. These differences would be more extreme under a consolidated audit reporting system that included document matching, nonfiler, and math error contacts. Finally, the IRS would need to account for potential double counting because taxpayers can be contacted through more than one enforcement program for the same return.[28]

In addition, labeling all IRS enforcement programs as audits might suggest that the programs are in some sense substitutable in detecting noncompliance and encouraging voluntary compliance. Although the document matching and nonfiler programs do replace part of what had previously been done by auditors, these programs do not completely substitute for audits. Math error program contacts are even less of a substitute for audit. Combining all of these efforts suggests an equivalence—one math error contact with a taxpayer is equivalent to a complex, intense audit of a taxpayer books and records—that is not correct. Therefore, if audits dropped even further than they have in recent years, but math error contacts rose even faster, some might assume that IRS is doing better at enforcing tax laws while others might disagree.

Because of such disadvantages, IRS officials said that they do not favor changing the audit definition to include the other enforcement programs at this time. Specifically, they said any changes would create confusion about IRS's enforcement activities and could distort any comparisons because the programs significantly differ.

Instead of expanding the audit definition, IRS has already expressed support for greater reporting on the full range of IRS's enforcement efforts. For example, in 2001, the IRS Commissioner stated that IRS's goal is to make public reporting on nonaudit enforcement efforts as informative and meaningful as possible.[29] This approach generally avoids the disadvantages associated with reporting IRS's enforcement efforts under one consolidated, redefined audit program. At the same time, it would provide more complete reporting to the public.

In December 2002, IRS officials told us that they plan to try to report more data on other enforcement programs to the extent that the data are available and cost-effective to extract. Officials expect that this expanded reporting will begin with the fiscal year 2003 Data Book if the necessary statistical tables cannot be produced in time for the 2002 edition that is to

[28]IRS does not track how many taxpayers are contacted by more than one program for a tax return.

[29]IRS's letter dated March 26, 2001.

be published in early calendar year 2003. The expanded information will also be available on the IRS Web site.

These officials said that they would attempt to report the number of cases closed, the staff time expended, and the tax amounts adjusted for document matching and for the automated substitute for return program (ASFR) component of the nonfiler program. For document matching, IRS plans to account for not only the cases in which taxpayers were contacted but also in which IRS staff resolved the apparent income discrepancy without contacting taxpayers. For ASFR, IRS is planning to adjust the data for cases in which IRS abated the additional tax amounts assessed after taxpayers later filed a tax return. For both programs, IRS officials said that reporting the data by the taxpayer's level of income is doubtful. For math errors, IRS officials said that they could report the number of notices, staff time, and tax amounts assessed but that reporting other data is questionable either because the data are not collected or are difficult or costly to extract. IRS has no plans to analyze whether changes could be made to cost-effectively extract or collect other data to facilitate understanding of and comparisons among these nonaudit enforcement programs.

Conclusions

Although research is not conclusive about the extent to which taxpayers comply with the law based on their perception of whether noncompliance will be caught, it is widely believed that those perceptions do contribute to the overall level of compliance by taxpayers. On the basis of this belief, observers in Congress and elsewhere have been concerned as IRS's oft-cited audit rate has declined in recent years.

To an unknown, but real extent, the long-term decline in the audit rate is attributable to the movement of some tax issues from IRS's audit program into its other enforcement programs. This movement has been facilitated by changes in technology, and has enabled IRS, for some tax issues, to more universally check whether taxpayers have accurately reported their tax liabilities. Although much of the movement of IRS's audits into other programs occurred during the 1970s and 1980s, this trend continued during the fiscal year 1993 through 2002 period.

Given these changes in IRS's enforcement operations, policymakers in Congress and elsewhere, as well as taxpayers, would be better informed about the scope of IRS's efforts to enforce tax laws if IRS were to expand its annual public reporting to include the full range of its enforcement programs. Toward this end, some interest has been expressed in having

IRS report a new audit rate that would aggregate IRS's various enforcement programs into a total, revised audit rate. Although such a measure would attempt to provide a more comprehensive picture of IRS's overall effort to detect compliance problems, the advantages of doing so do not clearly outweigh potential disadvantages. For instance, expanding the definition of an audit would package enforcement activities that are so disparate that the consolidated reporting could be misleading.

However, policymakers and taxpayers could be better informed about of the extent of IRS's efforts to enforce the tax laws without combining data on all of IRS's enforcement programs into one set of aggregate measures. IRS's commissioner set fuller reporting of IRS's enforcement efforts as an IRS goal, and IRS officials plan to move to fuller reporting of enforcement program results, perhaps as early as in the 2002 IRS Data Book, which will be published in early calendar year 2003. IRS officials expect that this expanded reporting will use only readily available data on the enforcement programs.

Because the document matching, math error, and nonfiler programs now cover many tax issues formerly covered by audits and they annually contact far more taxpayers than audits, expanded reporting on these programs, using readily available data, is an appropriate first step. However, the readily available data for the nonaudit programs is incomplete compared to data reported on audits. For example, the data do not cover all nonfiler contacts or the results of the programs by taxpayer income. IRS has no plans to determine whether it could cost-effectively extract or collect additional data in order to more completely present program results, and facilitate comparisons across the programs or with any new programs, as they evolve.

In the case of the math error program, total data that includes math errors identified during initial processing of tax returns as well as errors found in comparing tax return data to data in IRS's masterfiles should be reported. Excluding data on math errors found in comparing returns to IRS's masterfiles materially understates the volume of math error contacts with taxpayers.

Recommendations to the Acting Commissioner of Internal Revenue

The Acting Commissioner of Internal Revenue should

- determine whether additional data on each nonaudit program can be cost effectively extracted or collected to make future annual reporting on enforcement programs more complete and comparable.
- provide information on all types of math error contacts when publishing data on IRS's math error program.

Agency Comments

The Acting Commissioner of Internal Revenue provided written comments on a draft of this report in a January 27, 2003, letter, which is reprinted in appendix V. The Commissioner agreed with our recommendations. We are heartened that IRS has already begun to identify additional data to report on its enforcement programs. Given the differing nature of IRS's enforcement programs, we encourage IRS to provide information that is as comparable as possible among the programs.

As arranged with your office, we plan no further distribution of this report until 30 days from the date of its issue, unless you publicly announce its contents earlier. After that period we will send copies to the Chairman and Ranking Minority Member, House Committee on Ways and Means; and Chairman and Ranking Minority Member, Senate Committee on Finance. We will also send copies to the Acting Secretary of the Treasury; Acting Commissioner of Internal Revenue; the Director, Office of Management and Budget; and other interested parties. Copies of this report will be made available to others on request. In addition, the report will be made available at no charge on the GAO Web site at http://www.gao.gov.

If you have any questions, please contact me or Tom Short on (202) 512-9110. Key contributors to this report are acknowledged in appendix VI.

Sincerely yours,

Michael Brostek
Director, Tax Issues

Appendix I: Development of the Math Error Program

As early as the first codification of the Internal Revenue law in 1939, Congress granted IRS "math error" authority so that IRS does not have to provide the taxpayer with a statutory notice of deficiency[1] for math errors. In general, these are errors that must be corrected for IRS to process the tax return. A 1976 statutory revision defined the authority to include not only mathematical errors but other obvious errors such as omissions of data needed to substantiate an item on a return. In the 1990s, Congress extended the authority five times to help determine eligibility for certain tax exemptions and credits. Table 3 summarizes the legislative authority on math error provisions for individual tax returns.

Table 3: Legislative Authority on Math Error Provisions for Individual Tax Returns

Basis of Authority	Provision	Year
Internal Revenue Code	Provided a basic "math error" exception to the deficiency procedures whereby the Service could notify a taxpayer that on account of a mathematical error an amount of tax in excess of that shown on the return was due without first sending a notice of deficiency, which gives the taxpayer the right to judicial review.	As early as 1939
Tax Reform Act of 1976 (P.L. 94-455)	Expanded the definition of math errors to include 1. an error in addition, subtraction, multiplication, or division shown on the return; 2. incorrect use of an IRS table if the error is apparent from the existence of other information on the return; 3. inconsistent entries on the return; 4. an omission of information required to be supplied on the return in order to substantiate an item on that return; and 5. entry of a deduction or credit item in an amount which exceeds a statutory limit which is either (a) a specified monetary amount or (b) a percentage, ratio, or fraction if the items entering into the application of that limit appear on that return.	1976
Small Business Job Protection Act of 1996 (P.L. 104-188)	Extended math error authority to the omission of a correct Taxpayer Identification Number (TIN) required for the dependent care credit or the deduction for personal exemptions.	1996
Personal Responsibility and	Extended math error authority to the omission of a TIN for the earned income tax credit.	1996

[1]In general, IRS sends taxpayers a written notice, called a statutory notice of deficiency, which states that additional tax will be assessed and provides 90 days for them to respond. The proposed tax is automatically assessed if the taxpayer does not respond or does not file an appeal.

Basis of Authority	Provision	Year
Work Opportunity Reconciliation Act of 1996 (P.L. 104-193)		
Taxpayer Relief Act of 1997 (P.L. 105-34)	Extended math error authority to the omissions of correct TINs for the child tax credit and the higher education tuition tax credit, and to information required for the earned income tax credit for taxpayers who previously made improper claims.	1997
Tax and Trade Relief Extension Act (1999 Appropriations Act (P.L. 105-277))	Extended math error authority to the inclusion of a TIN on a return which allows IRS to determine ineligibility for the dependent care credit, child tax credit, or earned income tax credit on the basis of the statutory age restrictions of those credits	1999
Economic Growth and Tax Reconciliation Act of 2001 (P.L. 107-16)	Extended math error authority to include an entry on a return claiming the earned income tax credit when, according to the Federal Registry of Child Support Orders, the taxpayer is not the custodial parent of the child being claimed. This provision, effective January 1, 2004, includes a sunset provision of December 31, 2010.	2001

Source: GAO analysis of legislation.

According to IRS officials, math error authority applies to obvious errors where most taxpayers do not dispute IRS's decisions. However, if taxpayers do disagree with the changes in taxes assessed, they can request an abatement (reduction) of the additional taxes. The math error process also generates lower administrative and other costs because it is highly automated and requires little contact with taxpayers, according to IRS officials.

Appendix II: Use of Information Returns and Document Matching at IRS

IRS has endorsed the concept of matching information returns to income tax returns for the purpose of identifying unreported income since the 1960s. Prior to the 1960s, employers had reported on wages paid to employees by the name of the employee. To facilitate matching, Congress required a TIN—generally a social security number for individual taxpayers—that is unique to each taxpayer, unlike a name. IRS and those filing information returns (i.e., payers of income) need accurate TINs for the system to work well.[1] Filing of information returns on magnetic media or other electronic means combined with greater IRS computer capacity also has facilitated the matching process.

In 1962, Congress recognized that underreporting of nonwage income, such as interest and dividend income, was a serious problem. To correct it, Congress required information reporting on interest and dividend income. Congress substantially expanded information reporting requirements during the 1980s and added a few requirements during the 1990s. Table 4 lists each major statute expanding information returns authority.

[1]These payers file the information returns on income paid with IRS as well as the taxpayers receiving the income to induce their voluntary compliance in reporting the income on their tax returns.

Table 4: Major Legislation Affecting the Information Returns Program

Statute	Description
Public Law 87-397 (enacted 1961)	Required taxpayers to provide IRS and payers of income with a TIN and established penalties for failure to do so.
Revenue Act of 1962 (P.L. 87-834)	Required information returns reporting for interest and dividend income. Required payers to furnish copies of the information returns to those receiving interest and dividend income.
Combined Old-Age, Survivors, and Disability Insurance-Income Tax Reporting Amendments of 1975 (P.L. 94-202)	Directed IRS and Social Security Administration (SSA) to implement an annual wage reporting system, which enhanced IRS's machine processing efficiency because SSA had the equipment and capacity, which IRS did not, to process a large volume of Forms W-2.
The Economic Recovery Tax Act of 1981 (P.L. 97-34)	Expanded the requirement that payers furnish all types of information returns to the taxpayer receiving a payment. Increased the penalties for failure to provide copies of such returns to the taxpayer and to IRS.
The Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248)	Expanded information reporting to include state and local income tax refunds, and proceeds from brokers and barter exchanges. Mandated 10 percent withholding on interest, dividends, patronage dividends, and original issue discount. Expanded and increased penalties for failure to (1) file information returns, (2) provide copies to payees, and (3) provide a payer or payee TIN. Required backup withholding at a 15 percent rate in some instances where a payee failed to provide a correct TIN to a payer. Authorized the Secretary of the Treasury to prescribe regulations to define which returns are to be filed on magnetic media.
Interest and Dividend Tax Compliance Act of 1983 (P.L. 98-67)	Repealed the mandatory withholding requirements of the Tax Equity and Fiscal Responsibility Act of 1982. Expanded and revised backup withholding to include a 20 percent rate if (1) the payee does not furnish the payer with a TIN, (2) IRS notifies the payer that the TIN is incorrect, (3) the payee underreports interest or dividend income and IRS notifies the payer, or (4) the payee does not properly certify that he or she is not subject to backup withholding for interest and dividend income and that the TIN provided to the payer is correct. Strengthened TIN and failure to file penalties. Expanded the magnetic media filing requirements.
Tax Reform Act of 1984 (P.L. 98-369)	Required information reporting for foreclosures and abandonments of property which secure indebtedness and for mortgage interest. Provided penalties for failure to file and furnish such information returns.
Tax Reform Act of 1986 (P.L. 99-514)	Required real estate brokers to file an information return on any real estate transactions. Required federal executive agencies to file information returns on persons receiving contracts from them. Required persons making royalty payments aggregating $10 or more during any calendar year to file information returns on such payments and provide a copy of such return to the taxpayer who receives such royalties. Required TINs for dependents claimed on tax returns. Increased maximum penalties for failure to file information returns and to provide copies to taxpayers from $50,000 to $100,000. Added penalty for including incorrect information or for omitting required information on information returns.

Statute	Description
Technical Corrections to Tax Reform Act of 1986 (P.L. 100-647)	Required that information returns filed by partnerships having tax-exempt partners to include reporting of unrelated business taxable income.
Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239)	Imposed a uniform penalty of $50 per offense to a maximum of $250,000 per year on any person who fails to file timely and correct information returns, and to a maximum of $100,000 per year on any person who fails to (1) furnish correct payee statements or (2) meet other requirements.
Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66)	Required certain financial entities (such as Federal Deposit Insurance Corporation, Resolution Trust Corporation, and National Credit Union Administration) to file information returns on discharges of indebtedness of $600 or more.
Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191)	Established Medical Savings Accounts (MSAs). Required information returns for MSAs. Provided penalties for failure to file/furnish the returns.
Tax Relief Extension Act of 1999 (P.L. 106-170)	Required information reporting for indebtedness discharged by any organization for which a significant trade or business is the lending of money.

Source: GAO analysis.

IRS did not perform extensive document matching until 1974 when IRS established a program to match information returns against tax return data to identify potential income underreporting. Even so, IRS used labor-intensive, paper-driven methods. For example, clerks had to manually create case files for each potential underreporter, and IRS staff had to review the case files to determine if income was underreported. Clerks entered the results of these file reviews into systems, which generated notices to taxpayers. In 1987, IRS began to automate the document matching process. At that time IRS established the Automated Underreporter Program that allows access to computerized information, reducing the need for hard copy documents and clerks, and enabling a faster response to taxpayer inquiries.

By tax year 2000, almost 1.5 billion information returns were filed with IRS. Table 5 lists the major types of information returns filed for 1983 and 2000.[2]

[2]Among other reasons, we used 1983 because it was the first year after a major expansion of the information reporting requirements.

Table 5: Major Types of Information Returns Filed for Tax Years 1983 and 2000

			Information Returns Filed (millions)	
Form Number	**Title**	**Source**	**1983**	**2000**
1098	Mortgage Interest Statement	Banks and Mortgage Companies	[a]	80.2
1098-E	Student Loan Interest Statement	Educational Institutions and Financial Institutions	[a]	9.6
1098-T	Tuition Payments Statement	Educational Institutions	[a]	19.8
1099-A	Acquisition or Abandonment of Secured Property	Various Entities	[a]	0.4
1099-B	Proceeds from Broker and Barter Exchange Transactions	Brokers	10.0	329.4
1099-C	Cancellation of Debt	Various Entities	[a]	0.8
1099-G	Certain Government and Qualified State Tuition Program Payments	State Governments	36.0	63.7
1099-DIV	Dividends and Distribution	Brokers, Corporations	82.0	130.6
1099-INT	Interest Income	Banks	296.0	261.1
1099-MISC	Miscellaneous Income	Various Entities	39.0	77.7
1099-OID	Original Issue Discount	Banks, Corporations, and Other Financial Institutions	2.0	4.8
1099-PATR	Taxable Distributions Received from Cooperatives	Cooperatives	2.0	1.6
1099-R	Distributions from Pensions, Annuities, Retirement or Profit-sharing Plans, IRAs, Insurance Contracts, Etc.	Various Entities	6.0	65.8
1099-S	Proceeds from Real Estate Transactions	Various Entities	[a]	2.9
1099-SSA	Social Security Benefits	Social Security Administration	[a]	48.4
1099-RRB	Railroad Retirement Benefits	Railroad Retirement Board	[a]	0.6
5498	IRA Contribution Information	Banks, Brokers, and Insurance Companies	18.0	94.9
5498-MSA	Medical Savings Accounts or Medicare Plus Choice MSA Information	Trustees or custodians of MSAs or Medicare Plus Choice MSAs	[a]	0.1
CTR	Currency Transaction Report	Financial Institutions and Shareholders and Beneficiaries	[a]	14.4
K-1	Partner's Share of Income, Credits, Deductions, Etc.	Partnerships	15.0	19.1
W-2	Wage and Tax Statement	Employers	165.0	247.2
W-2G	Certain Gambling Winnings	Gaming Establishments	1.0	5.8
W-2P	Annuities, Pensions, Retired Pay, or IRA Payments	Various Entities	18.0	N/A
Other	Various	Various Entities	1.0	1.7
Total			**691.0**	**1,480.6**

Source: IRS and Statement of Johnny C. Finch, Senior Associate Director, General Government Division, GAO, Before the Subcommittee on Commerce, Consumer, and Monetary Affairs, Committee on Government Operations, House of Representatives, on IRS' Information Returns Matching Program, April 29, 1986.

[a]Information return not required for tax year 1983.

In 2002, IRS re-instituted matching[3] of income reported by flow-through entities such as trusts, partnerships, and S-corporations on Schedule K-1 to income reported on tax returns by the related partners and beneficiaries. Schedule K-1 shows the income distributed to partners and beneficiaries, who receive a copy as well as IRS. According to IRS, information provided on Schedule K-1 is important for determining whether recipients of flow-through income have properly reported that income on their tax returns. IRS expects the matching of Schedule K-1 data to increase accurate reporting of trust income on future tax returns by providing information that IRS can use to detect possible unreported income and to induce taxpayers to voluntarily comply. Under K-1 matching, IRS sent 69,097 notices to taxpayers in 2002 for tax year 2000. In most cases, the taxpayers did not owe additional tax for various reasons (e.g., taxpayers reported the income differently than expected). IRS does not yet have complete results from this new matching program. IRS officials told us that K-1 matching has been suspended for one year to analyze the matching criteria and results.

[3] IRS had done very limited K-1 matching, relying on electronically filed schedules K-1, but stopped this matching in the mid-1990s due to resource and other constraints.

Appendix III: Individual Audit and Other Enforcement Program Data

Table 6: Number and Rates of Individual Audit and Other Enforcement Contacts, Fiscal Years 1993 through 2002

	1993	1994	1995	1996
Audit contacts				
Field audits	250,712	364,016	338,605	252,430
Office audits	505,539	456,216	458,880	509,434
Correspondence audits	302,715	405,475	1,121,952	1,179,696
Revenue officer examiner audits	[a]	[a]	[a]	[a]
Total audits	1,058,966	1,225,707	1,919,437	1,941,560
Returns filed (previous calendar year)	114,718,900	113,754,400	114,683,400	116,059,700
Audit rate	**0.92**	**1.08**	**1.67**	**1.67**
Other enforcement contacts				
Math errors	4,088,000	4,059,000	6,102,000	4,750,771
Math errors (masterfile notices)	[b]	[b]	[b]	[b]
Math errors (revised)	[c]	[c]	[c]	[c]
Document matching	2,723,830	2,645,075	2,711,086	1,930,326
Nonfiler	1,603,969	1,931,781	1,756,325	1,302,432
Math error rate	**3.59**	**3.54**	**5.26**	**4.01**
Math error rate (revised)	[d]	[d]	[d]	[d]
Document matching rate	**2.37**	**2.33**	**2.36**	**1.66**
Nonfiler rate	**1.40**	**1.70**	**1.53**	**1.12**

1997	1998	1999	2000	2001	2002
209,781	168,054	124,518	91,586	77,950	88,896
505,834	383,366	235,625	145,975	115,971	111,695
803,628	625,021	715,789	366,657	529,241	538,779
[a]	16,339	24,341	13,547	8,594	4,543
1,519,243	1,192,780	1,100,273	617,765	731,756	743,913
118,362,600	120,342,400	122,546,900	124,887,100	127,097,400	129,948,400
1.28	**0.99**	**0.90**	**0.49**	**0.58**	**0.57**
5,983,944	5,668,906	6,552,290	5,751,462	6,082,967	6,265,455
1,834,232	1,894,170	1,965,405	2,010,514	2,026,802	2,061,830
7,818,176	7,563,076	8,517,695	7,761,976	8,109,769	8,327,285
931,354	1,726,098	1,770,695	1,353,545	1,161,901	1,687,800
1,917,212	2,313,633	1,890,794	1,251,375	1,371,401	1,882,475
4.97	**4.63**	**5.25**	**4.53**	**4.68**	**4.79**
6.50	**6.17**	**6.82**	**6.11**	**6.24**	**6.36**
0.79	**1.43**	**1.44**	**1.08**	**0.91**	**1.30**
1.62	**1.92**	**1.54**	**1.00**	**1.08**	**1.45**

Source: GAO analysis of IRS data.

Note: To compute individual audit and other enforcement rates, we used two methods. We used IRS's method for computing audit rates, which equals the proportion of IRS audits closed in a fiscal year as compared to returns filed in the previous calendar year. For example, as shown in the table above, the audit rate for 1993 is computed by dividing total audits (1,058,966) by the number of returns filed in the previous calendar year (114,718,900) to compute the audit rate (0.92).
IRS has not stated a method for computing math error, document matching, and nonfiler rates. For the document matching and nonfiler programs, we used the IRS audit rate method because document matching and nonfiler contacts generally occur in the year after a return is filed. For the math error program, we compared the math errors notices to the returns filed in that year because identifying math errors is part of IRS' returns processing system. For example, the math error rate for 1993 is computed by dividing the number of math errors (4,088,000) by the number of returns filed in 1993 (113,754,400) to compute the math error rate (3.59).
Note: IRS estimates that the number of returns filed in 2002 is about 130,905,000. Final data for fiscal year 2002 were not available at the time of publication of this report. We used the estimate of 130,905,000 returns filed to compute the math error rate and the math error rate (revised) for fiscal year 2002.

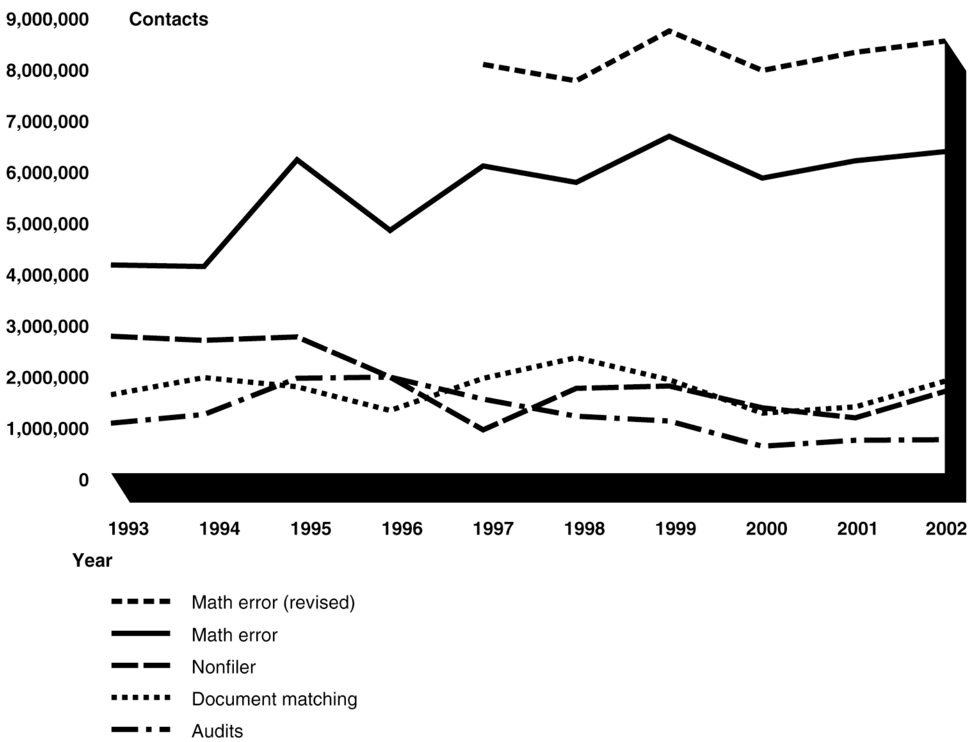
[a]IRS did not publish data on revenue officer examiner audits prior to 1998.

[b]Data for math error masterfile notices do not exist prior to fiscal year 1997.

[c]The number of math error (revised) contacts are the same as the number of math error contacts for fiscal years 1993 through 1996 because data for the number of masterfile notices does not exist for these years.

[d]The math error (revised) contact rate is the same as the math error contact rate for fiscal years 1993 through 1996 because data for the number of masterfile notices does not exist for these years.

Figure 4: Individual Audit and Other Enforcement Contacts, Fiscal Years 1993 through 2002



Source: GAO analysis of IRS data.

The absolute number of contacts with taxpayers under the four enforcement programs follows the same general year-to-year and overall pattern as for contact rates. Similarly, as with the contact rates, the number of audits and the number of document matching contacts were lower (30 and 38 percent, respectively) in fiscal year 2002 than in 1993. The number of nonfiler contacts also was somewhat higher (17 percent) in 2002 than in 1993 and the number of math error contacts—not counting math errors identified from masterfile comparisons—was significantly higher (53 percent) in 2002 than in 1993.

Table 7: Number and Rates of Individual Audit and Document Matching Contacts by Income Level, Fiscal Years 1993 through 2002

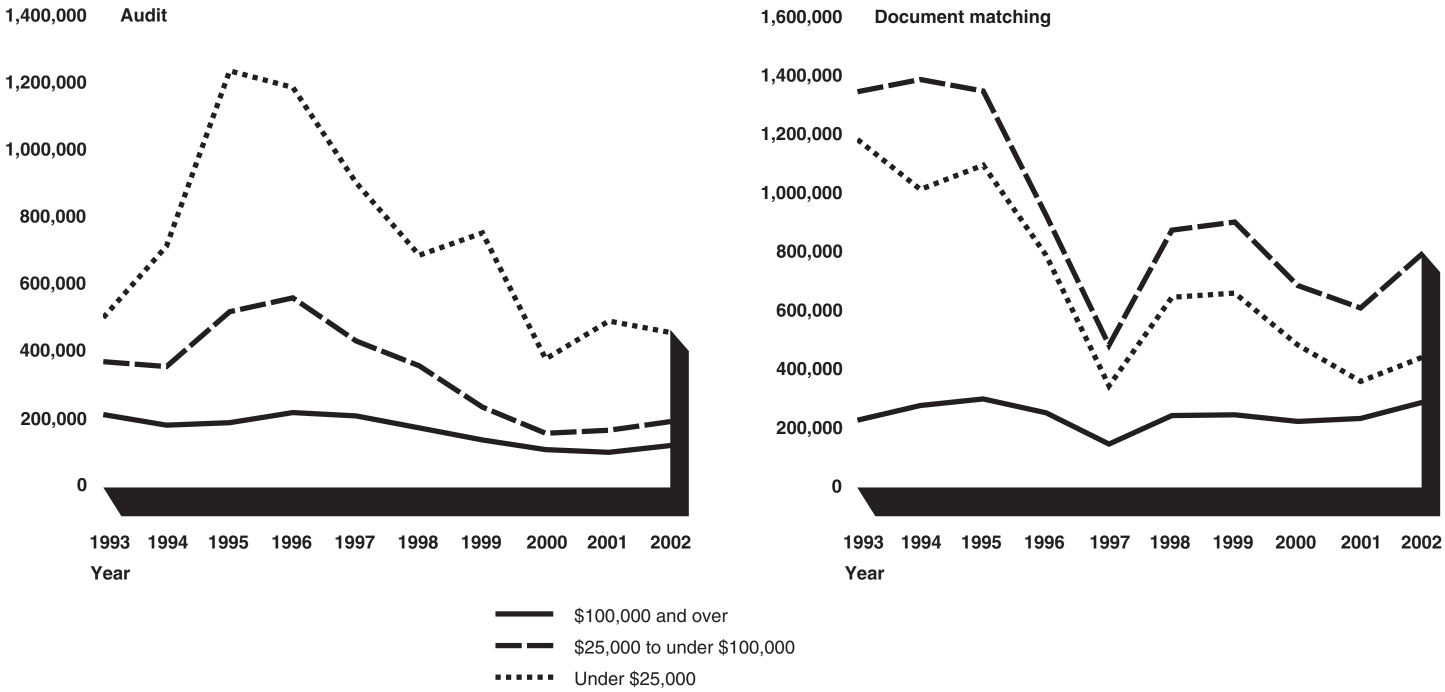
	1993	1994	1995	1996
Audit contacts				
$100,000 and over	204,079	172,483	179,871	210,032
$25,000 to under $100,000	361,787	347,200	510,764	552,011
Under $25,000	493,100	706,024	1,228,802	1,179,503
Document matching contacts				
$100,000 and over	213,070	263,287	285,767	238,330
$25,000 to under $100,000	1,337,067	1,378,983	1,339,480	914,540
Under $25,000	1,173,693	1,002,805	1,085,839	777,456
Returns filed				
$100,000 and over	5,240,200	5,635,300	6,058,100	6,546,700
$25,000 to under $100,000	45,333,900	45,640,000	46,506,400	47,865,000
Under $25,000	64,144,800	62,479,100	62,118,900	61,648,000
Audit rate				
$100,000 and over	3.89	3.06	2.97	3.21
$25,000 to under $100,000	0.80	0.76	1.10	1.15
Under $25,000	0.77	1.13	1.98	1.91
Document matching rate				
$100,000 and over	4.07	4.67	4.72	3.64
$25,000 to under $100,000	2.95	3.02	2.88	1.91
Under $25,000	1.83	1.61	1.75	1.26

1997	1998	1999	2000	2001	2002
200,070	164,314	128,398	99,547	91,550	112,266
423,548	349,378	226,261	148,306	157,296	183,847
895,625	679,088	745,614	369,912	482,910	447,800
131,348	228,934	231,482	208,839	218,981	275,088
469,761	863,408	891,237	674,154	597,034	786,172
330,449	633,756	647,976	470,552	345,886	429,879
7,301,900	8,156,600	9,178,000	10,368,600	11,610,500	13,020,183
49,805,300	51,389,100	53,389,200	55,729,700	57,268,000	59,216,431
61,255,400	60,796,700	59,979,700	58,788,800	58,218,900	57,208,333
2.74	2.01	1.40	0.96	0.79	0.86
0.85	0.68	0.42	0.27	0.27	0.31
1.46	1.12	1.24	0.63	0.83	0.78
1.80	2.81	2.52	2.01	1.89	2.11
0.94	1.68	1.67	1.21	1.04	1.33
0.54	1.04	1.08	0.80	0.59	0.75

Source: GAO analysis of IRS data.

Notes: Returns filed consists of previous calendar year data.
Number of returns filed in 2002 (calendar year 2001 data) is estimated.

Figure 5: Number of Individual Audit and Document Matching Contacts by Income Level, Fiscal Years 1993 through 2002



Source: GAO analysis of IRS data.

Note: Fiscal year 2002 data is estimated.

The absolute number of audits by income group generally follows the same year-to-year and overall pattern, as do the contact rates for the income groups. However, the change in the number of audits conducted in fiscal year 1993 compared to 2002 is not as dramatic for the upper and middle-income groups as was the change in their audit rates. The number of audits for the higher income group declined by 45 percent between 1993 and 2002 while the rate at which this group was audited declined 78 percent. The number of audits of the middle-income group declined 49 percent, while the rate at which this group was audited declined 61 percent. The rate at which these groups were audited fell more than did the absolute number of audits because the number of taxpayers in each group expanded over the 10-year period. Higher income taxpayers grew in numbers by 148 percent between 1993 and 2002 and middle-income taxpayers grew by 31 percent.

As with the absolute number of audits by income group, the number of document matching contacts by income group generally follows the same year-to-year and overall pattern as do the document matching contact rates. However, comparisons of the number of document matching contacts in fiscal year 1993 to those in 2002 differ substantially from comparisons of document matching contact rates for those years for one income group—the higher income taxpayers. The number of document matching contacts with the higher income taxpayers increased by 29 percent between 1993 and 2002, whereas the contact rate for this group fell by 48 percent. The percentage changes in numbers and rates of contacts for the other two groups were more similar. Middle-income document matching contacts fell 41 percent between fiscal year 1993 and 2001 while their document matching contact rate declined 55 percent. Lowest income taxpayer document matching contacts fell 63 percent, while their contact rate declined 59 percent.

Table 8: Number and Rates of Individual Audits by Type of Audit and Income Level, Fiscal Years 1993 through 2002

	1993	1994	1995	1996	1997
Field audits					
Under $25,000	80,881	189,748	161,800	85,153	49,053
$25,000 to under $100,000	82,731	98,393	100,501	80,509	66,558
$100,000 and over	87,100	75,875	76,304	86,768	94,170
Office audits					
Under $25,000	248,704	244,952	250,656	238,561	231,944
$25,000 to under $100,000	201,924	167,594	171,438	221,207	223,646
$100,000 and over	54,911	43,670	36,786	49,652	50,244
Correspondence audits					
Under $25,000	163,515	271,324	816,346	855,789	614,628
$25,000 to under $100,000	77,132	81,213	238,825	250,295	133,344
$100,000 and over	62,068	52,938	66,781	73,612	55,656
Returns filed					
Under $25,000	64,144,800	62,479,100	62,118,900	61,648,000	61,255,400
$25,000 to under $100,000	45,333,900	45,640,000	46,506,400	47,865,000	49,805,300
$100,000 and over	5,240,200	5,635,300	6,058,100	6,546,700	7,301,900
Field audit rate					
Under $25,000	0.13	0.30	0.26	0.14	0.08
$25,000 to < $100,000	0.18	0.22	0.22	0.17	0.13
$100,000 and over	1.66	1.35	1.26	1.33	1.29
Office audit rate					
Under $25,000	0.39	0.39	0.40	0.39	0.38
$25,000 to < $100,000	0.45	0.37	0.37	0.46	0.45
$100,000 and over	1.05	0.77	0.61	0.76	0.69
Correspondence audit rate					
Under $25,000	0.25	0.43	1.31	1.39	1.00
$25,000 to < $100,000	0.17	0.18	0.51	0.52	0.27
$100,000 and over	1.18	0.94	1.10	1.12	0.76

1998	1999	2000	2001	2002
35,891	26,228	21,433	16,784	15,480
49,891	35,540	28,666	26,159	33,093
82,272	62,750	41,487	35,007	40,323
171,918	95,308	57,017	42,016	31,192
170,341	109,696	68,740	54,526	56,509
41,107	30,621	20,218	19,429	23,994
460,795	608,154	284,981	420,346	399,175
124,451	73,996	45,346	73,189	92,293
39,775	33,639	36,330	35,706	47,311
60,796,700	59,979,700	58,788,800	58,218,900	57,208,333
51,389,100	53,389,200	55,729,700	57,268,000	59,216,431
8,156,600	9,178,000	10,368,600	11,610,500	13,020,183
0.06	0.04	0.04	0.03	0.03
0.10	0.07	0.05	0.05	0.06
1.01	0.68	0.40	0.30	0.31
0.28	0.16	0.10	0.07	0.05
0.33	0.21	0.12	0.10	0.10
0.50	0.33	0.19	0.17	0.18
0.76	1.01	0.48	0.72	0.70
0.24	0.14	0.08	0.13	0.16
0.49	0.37	0.35	0.31	0.36

Source: GAO analysis of IRS data.

Note: Revenue officer examiner audits are not included. See table 6.

Table 9: Average Direct Staff Hours by Type of Audit and For Document Matching Cases, Fiscal Years 1993 through 2002

Program	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Field audit	17.81	12.69	13.99	20.21	21.84	22.08	24.84	27.64	30.83	28.87
Office audit	4.47	4.51	4.27	4.56	4.34	4.49	5.66	7.09	8.91	9.37
Correspondence audit	1.43	1.15	0.74	0.73	0.83	0.91	1.08	1.80	1.79	1.71
Document matching	0.80	0.81	1.09	0.98	0.53	0.52	0.57	0.61	0.57	0.61

Source: GAO analysis of IRS data.

Note: Revenue officer examiner audits are not included. See table 6.

Appendix IV: Soft Notices and Voluntary Compliance Agreements

In addition to the four major enforcement programs, IRS started two programs in the mid-1990s to help ensure that taxpayers file timely and accurate returns, and to minimize the need for enforcement.

Through the soft notice program, IRS has been sending notices for apparent errors on two tax issues—duplicate claims for one allowable dependent exemption and unfiled self-employment tax returns. IRS uses soft notices when it has information to indicate that some taxpayer made an error but not enough information to know for sure, such as which taxpayer overclaimed a dependent. Soft notices are intended to stimulate taxpayers to correct the error without IRS having to invest audit time.

In addition, IRS uses the voluntary compliance agreements program to address known compliance problems in reporting tip income. To improve compliance of employees in industries where tip income is a part of wages, IRS had been auditing the tax returns of tipped employees, which burdened the employees and employers as well as IRS. To minimize these burdens while also addressing the compliance problems, IRS began to explore new methods to achieve voluntary compliance by tipped employees, such as voluntary compliance agreements. IRS has negotiated three types of agreements with certain employers (e.g., restaurants) to improve compliance by their individual employees in reporting tip income. These three types of agreements follow.

- The Tip Rate Determination Agreement (TRDA) requires that IRS and the business agree upon a tip rate for various occupations in the business and that at least 75 percent of employees in the business agree to report at that rate on their income tax return.
- The Tip Reporting Alternative Commitment (TRAC) does not require a tip rate to be determined, but does require that the business create written statements to record employee tips and send the statements to IRS. This agreement covers all employees and requires that the business educate employees about their obligation to report their tip income.
- The Employer-designed Tip Reporting Alternative Commitment Agreement (EmTRAC) requires that businesses establish tip reporting procedures and prepare a statement on a regular basis (no less than monthly) to reflect all tips for each employee. The business must establish an education program to train employees about their obligation to report tip income.

In general, these two programs are similar to the four major enforcement programs in that they attempt to correct noncompliance. They differ because, rather than enforcing the tax laws, both attempt to reduce the need for enforcement. In sum, their differences tend to outnumber their similarities, as discussed below.

Similar to the four enforcement programs, IRS sends soft notices to inform taxpayers of potential errors. However, the soft notice does not require taxpayers to take any action, and IRS takes no action to verify the error or assess tax. Instead, the notice asks taxpayers to examine the potential error and file an amended return if they confirm the error. Also, the notice informs taxpayers that IRS will monitor these types of errors and might contact them if they do not alter their reporting in the future.

The similarity between the voluntary compliance agreements and the other enforcement programs is that they attempt to correct noncompliance. Unlike the other programs, these agreements occur before a return is filed and do not involve sending any notices to taxpayers. IRS believes that these agreements enhance voluntary compliance so that IRS can avoid the need to take enforcement action and assess additional taxes after a return is filed. IRS assures the businesses that IRS will not audit their books and records as long as they abide by the agreement. However, IRS may still audit the books and records of a tipped employee and report any changes to the business. IRS officials said that current procedures require follow-up to check adherence to these agreements, but the officials were not sure about the extent to which this has been occurring.

IRS has limited data for the soft notice and voluntary compliance agreement programs, as follows.

- In 2002, IRS sent 1.2 million soft notices to taxpayers on duplicate dependent claims on 2001 tax returns; in 1998, IRS sent 1.6 million soft notices on these duplicate claims and on self-employment tax for 1996 and 1997 returns.[1] This involved 329,000 notices sent to taxpayers who reported self-employment income but had not filed a schedule SE or paid self-employment tax. IRS did not provide data on these notices for any later years.

[1]GAO/GGD-00-7.

- Through 2001, TRDAs and TRACs covered 48,348 establishments in the casino, beauty, and food and beverage industries. IRS did not have data on the number of individual taxpayers covered by these agreements because the agreements are made with employers rather than directly with the individual taxpayers.

Appendix V: Comments from the Commissioner of Internal Revenue

As part of its comments, IRS included an enclosure that provided additional data on nonaudit contacts. We did not include this enclosure as part of IRS's written comments because the data provided did not materially affect our conclusions and recommendations.

COMMISSIONER

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

January 27, 2003

Mr. Michael Brostek
Director, Tax Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Brostek:

Thank you for the opportunity to review and comment on your draft report entitled "Tax Administration: IRS Should Continue to Expand Reporting on Its Enforcement Efforts." I agree with both recommendations to the extent we can cost effectively provide informative and meaningful data. I believe that expanded reporting will clarify the nature of IRS enforcement efforts, which consist of a wide variety of actions, ranging from correction of simple errors on a tax return to extensive corporate examinations.

We will address your recommendations as follows:

- Determine whether additional data on each non-audit program can be cost effectively extracted and collected to make future annual reporting on enforcement program more complete and comparable.

  We will look for a cost effective manner to capture data for non-audit programs in the manner described in the report, which would be similar to that traditionally published as audit information.

- When publishing data on IRS' math error program, provide information on all types of math error contact.

  We will include all math error contacts when reporting math error program statistics and have adjusted our reporting criteria accordingly.

I plan to assign the responsibility for implementing the recommendations to the Small Business/Self-Employed Division, Wage and Investment Division, and the Office of Tax Administration Coordination.

We have already taken steps to expand reporting of non-audit program information that is currently available. Enclosed is additional data for 2002, which will be published on the IRS Website and in the 2002 IRS Data Book. Please note we have separated the Automated Underreporter Program into two categories. The first is when IRS personnel

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screen tax returns, cannot resolve discrepancies, and must contact the taxpayer. The second is when IRS personnel screen tax returns and resolve discrepancies. The screening process eliminated many taxpayer contacts and reduced burden on 1.1 million taxpayers in 2002.

If you have any questions, your staff may contact Gary Doniger, Acting Deputy Director, Office of Tax Administration Coordination at (202) 927-4800 or Joseph R. Brimacombe, Director, Compliance Policy, Small Business/Self-Employed Division at (202) 283-2200.

Sincerely,

Bob Wenzel

Bob Wenzel
Acting Commissioner

Enclosure

Appendix VI: GAO Contacts and Staff Acknowledgments

GAO Contacts

Michael Brostek, (202) 512-9110
Tom Short, (202) 512-9110

Staff Acknowledgments

In addition to those named above Susan Baker, Grace Coleman, Susan Conlon, Brendan Culley, Michele Fejfar, Leon Green, Marshall Hamlett, Shirley Jones, and Jay Pelkofer made key contributions to this product.

Related GAO Products

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