

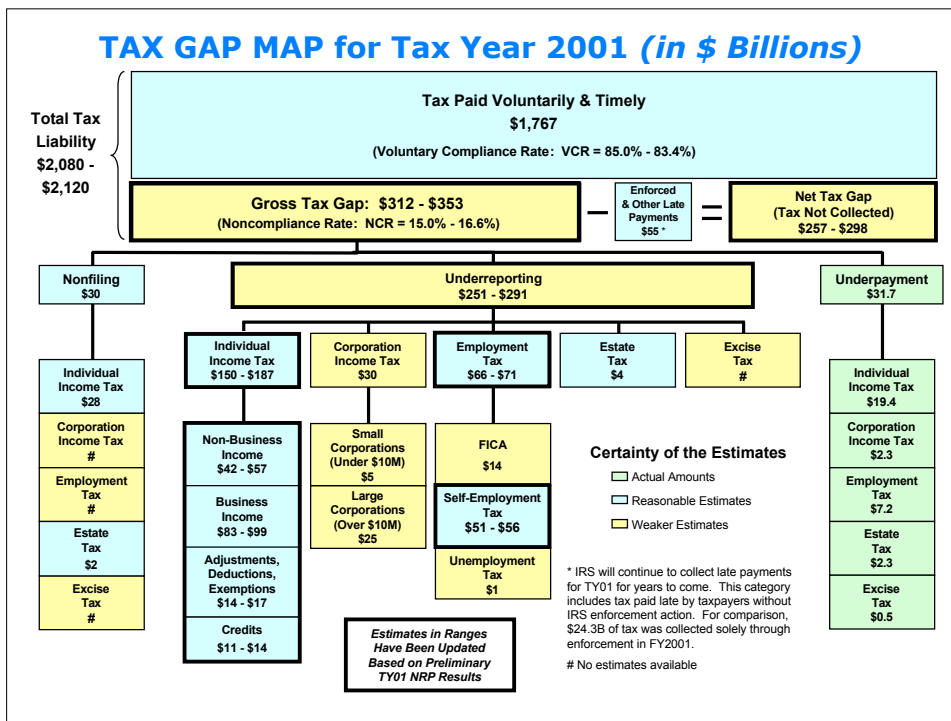
National Research Program: Early Results & Future Efforts

**Internal Revenue Service
Office of Research, Analysis, and Statistics
June 15, 2005**

NRP- A Comprehensive Effort

- NRP provides three compliance measures for different types of taxes and different groups of taxpayers
 - Filing Compliance: Percent of Returns Timely Filed
 - Payment Compliance: Percent of Reported Tax Liability Timely Paid
 - Reporting Compliance: Accuracy of Tax Timely Reported

TAX GAP MAP for Tax Year 2001 (in \$ Billions)



Reporting Compliance

- NRP reporting compliance studies replace the Taxpayer Compliance Measurement Program (TCMP).
- NRP reporting compliance studies rely on direct examinations of randomly selected returns.
- Greater reliance on internal and external information sources make NRP examinations less burdensome than TCMP.
 - IRS was able to accept as filed approximately 3,000 NRP returns.
 - IRS gathered reporting compliance data from another 2,000 returns via correspondence exam.
- The first NRP reporting compliance study focused on individual income taxpayers.

Individual Reporting Compliance Study

- Processing of approximately 46,000 tax year 2001 NRP cases is complete (41,000 face-to-face, 2,000 correspondence, and 3,000 accepted as filed).
- 4,500 employees received NRP training.
- Examinations began in October 2002 and continued through September 2004.
- NRP provided data from the study on December 30, 2004; use of the data started in January 2005.
- NRP will update the database in June 2005.
- New audit selection formulas expected to be implemented in early 2006.

What Were the Classification Results?

Distribution of Sample Returns by Data Collection Method

Classification Result	Number	%
Accepted as Accurate	2,535	5.5
Accepted with Adjustment	402	0.9
Previously Audited	186	0.4
Selected for Correspondence Audit	1,817	3.9
Selected for Face-to-Face Audit	41,067	89.3
Total	46,007	100.0

Were the Classification Results Expected?

Initial estimates of the numbers of accepted returns and returns selected for correspondence audit were larger than those produced by the study. Possible reasons for this outcome include:

- the final sample design required the selection of more complex, higher-income returns;
- classification procedures had not been fully developed when the initial estimates were released; and/or
- early expectations were overly optimistic concerning the types and numbers of compliance issues that could be handled by correspondence audit.

How Accurate Is Reported Total Tax?

Change to Total Tax (\$ Billions)

Tax Year	Underreported	Overreported
1988 (TCMP)	32.3	2.1
2001 (NRP)	80.3	4.9

Voluntary Reporting Rate (VRR*) Trend

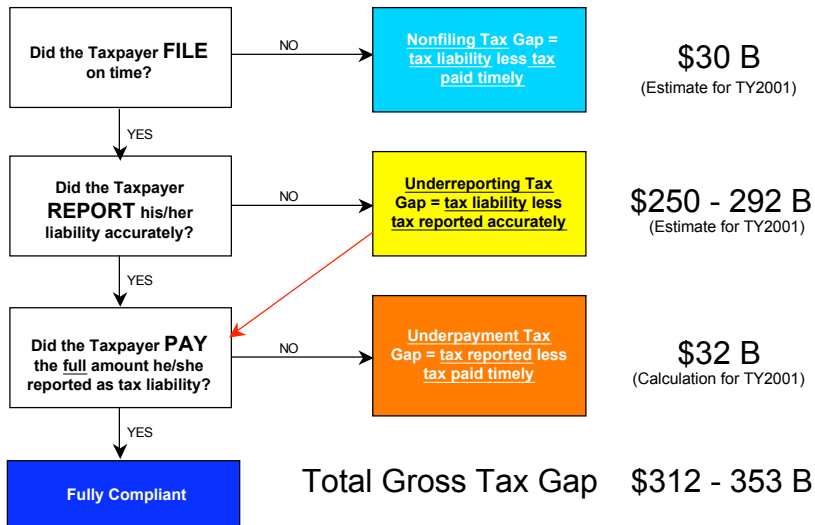
Tax Year	VRR
1979	91.6%
1982	92.7%
1985	92.0%
1988	93.2%
2001 (NRP)	92.4%

* **VRR** is the percentage of the total tax required to be reported that taxpayers voluntarily reported on their timely-filed returns. $VRR = \text{reported total tax} \div \text{sum of reported total tax and net change to total tax}$.

Distribution of Total Tax Liability Change (\$ Billions) and VRR by IRS Operating Division

Category	Small Business / Self Employed	Wage & Investment
Underreported	58.9	21.5
Overreported	3.0	1.8
VRR	90.4%	95.2%

The IRS Has Developed a Set of Measures to Estimate Noncompliance and the Tax Gap.



2001 Individual Income Tax Gap Major Contributors Ranked by Dollars

Form 1040 Line	Preliminary Estimate* (\$ Billions)
Total	150 - 187
Non-Business Income	42 - 57
Other income (gambling winnings, awards, etc.)	14 - 18
Wages, salaries, tips, etc.	13 - 15
Net capital gains, distributions, other gains	6 - 9
Taxable pension, annuities, IRA distributions	4 - 8
Taxable interest and dividend income	3 - 5
Miscellaneous	< 3
Business Income	83 - 99
Non-farm proprietor net income	59 - 65
Partnership, S-Corp, estate and trust net income	16 - 24
Rent, royalty net income	7 - 8
Farm net income	2 - 3
Offsets to Income or to Tax	25 - 30
Deductions	15 - 18
Credits	11 - 14
Exemptions	5
Adjustments: All Other	≤ 1
Adjustments: 1/2 of Self-Employment Tax	-6 to -7

* Line item estimates subject to significant changes; detailed analyses to be completed by the end of 2005.

2001 Individual Income Tax Gap Major Contributors Ranked by Misreporting Percentage

Form 1040 Line	Tax Gap (\$ Billions)	Preliminary Misreporting %*
Non-Business Income		
Alimony income	< 1	21.0 – 23.8
Unemployment compensation	≤ 1	8.3 – 15.3
State income tax refunds	< 1	5.9 – 6.5
Taxable pension, annuities, IRA distributions	4 – 8	4.1 – 7.4
Taxable interest and dividend income	3 – 5	3.9 – 5.7
Taxable Social Security benefits	1	3.9 – 4.0
Wages, salaries, tips, etc	13 – 15	1.2 – 1.4
Net capital gains, distributions, other gains	6 – 9	n/a
Other income (gambling winnings, awards, etc.)	14 – 18	n/a
Business Income		
Non-farm proprietor net income	59 – 65	n/a
Partnership, S-Corp, estate and trust net income	16 – 24	n/a
Rent, royalty net income	7 – 8	n/a
Farm net income	2 – 3	n/a
Offsets to Income or to Tax		
Credits	11 – 14	17.1 – 22.5
Deductions	15 – 18	5.2 – 6.0
Exemptions	5	4.8 – 5.0
Adjustments: All Other	< 1	n/a
Adjustments: 1/2 of Self-Employment Tax	-6 to -7	n/a

* Line item estimates subject to significant changes; detailed analyses to be completed by the end of 2005.

Has the IRS Used the Results of the Individual Filer Study?

- While we've only just begun to mine the data, some initial work has been done in the following areas:
 - Analyses of market segments, e.g. high-income individuals, EITC claimants, and others
 - Updated DIF formulas to be implemented in 2006
 - Preliminary estimates of tax gap

NRP Taxpayer Satisfaction Survey

- The IRS contacted approximately 8,000 NRP taxpayers using contractor administered customer satisfaction surveys.
 - Surveying approximately 6,000 taxpayers from face-to-face examinations and 2,000 correspondence examination taxpayers.
 - Contractor began mailing surveys in September 2003 and continued monthly mail outs through September 2004 .
 - NRP surveys match regular IRS field and correspondence exam questionnaires, allowing for comparison with operational exams.
 - NRP surveys include two additional questions related to burden (i.e., amount of time and dollar costs associated with the exam).
 - NRP taxpayer satisfaction rates for face to face and correspondence examinations are statistically significantly higher than those from operational examinations.

Next NRP Reporting Compliance Study on Business Returns

- The IRS approved a pilot reporting compliance study of flow-through entities, specifically subchapter S corporations (Forms 1120-S) and partnerships (Form 1065), in November, 2003.
- The pilot started in October, 2004 and will provide experiential data on methodology and logistics, as well as a provide a foundation for a future full study.
 - The pilot includes approximately 130 returns, divided evenly between the two form types.
 - Pilot returns will test our data capture systems and assess examination skill base and training needs.
- The pilot is now well underway.
 - Feedback from practitioners and taxpayers is positive.

NRP Now Preparing for a Full 1120S Study

- IRS will conduct a full study of Form 1120S returns.
 - Small Business/Self-Employed will examine 4,700 returns.
 - Large & Mid-Size Business will examine 300 returns.
 - The sample will include two tax years.
- NRP has finalized sample design for the study and is close to selecting TY03 return portion.
- Training process will start in July.
 - IRS will deliver most training via Centra computer-based application.
- Classification will start in August
- The proposed start date for study examinations is October, 2005.
- The entire examination process will likely take three years.
 - Each tax year would have an examination cycle of approximately 24 months.

Any Questions?

- For a copy of this presentation:
 - Give me a business card or a piece of paper with your email address; or
 - Send a request to Robert.E.Brown2@irs.gov.