U.S. SENATE COMMITTEE ON
Finance
SENATOR CHUCK GRASSLEY, OF IOWA - CHAIRMAN

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For Immediate Release
Wednesday, March 28, 2001

IRS Says Grassley is Right About Taxpayer Review, Audit Rates

WASHINGTON – Sen. Chuck Grassley, chairman of the Committee on Finance, has received an acknowledgment from the Internal Revenue Service that the agency does indeed subject millions more taxpayers to review than it has maintained. The text of the letter from IRS Commissioner Charles Rossotti, Grassley's response and the enclosures to the Rossotti letter follow.

March 26, 2001

The Honorable Charles E. Grassley
Chairman, Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter concerning how the IRS reports on audits and other forms of verification of tax returns. I believe this is an important question and I will do my best to clarify the issues you raise as well as provide the specific data you request.

While the audit rate alone is not an adequate indicator of IRS's compliance activities, audits remain extremely important for ensuring the fairness of the tax system to the average taxpayer. Our budget proposal was carefully designed to meet this minimum goal.

I understand that the basic thrust of your letter is to question whether the "audit rate" as publicly reported by the IRS understates the ability of the IRS to verify the accuracy of individual tax returns. My view is that your question is well founded. Simply focusing on the audit rate does substantially understate the IRS's capacity to find errors in returns, especially in certain kinds of returns. In my many press interviews in the past few years in which this topic has come up, I have consistently made this point, often citing our computer matching program as an example of a technique that the IRS uses in addition to traditional audits. Recently I gave an interview to the *New York Times* on this subject, which resulted in a "quote of the day" *(Friday, February 16, 2001)* as follows:

With the use of document matching as well as other return verification techniques that will eventually be enabled by new technology, it is my view that there is no need to return to the levels of individual audit coverage that existed even five years ago, which was three times the FY 2000 level. The IRS strategic plan and budget proposals as presented to the IRS Oversight Board do not call for this approach. However, our strategic plan sets forth an approach in the short run to stabilize our level of traditional compliance activities, such as individual audits, at or slightly above current levels and to focus them on the areas where they are most required. In the long run, we will rely on our business systems modernization program to increase the effectiveness and efficiency of these activities.

As noted in your letter, the IRS has for many years relied on a range of techniques to verify certain items on tax returns. Each of these techniques is appropriate for particular returns or types of potential errors. Enclosure 1 provides a list of techniques used by the IRS for verifying tax returns and the type of return/issue for which they are most useful. As you requested, we have also shown historical data on the use of each such technique (Enclosure 2).

With respect to Information Returns Processing, or document matching as it has often been called, this technique is very effective for verifying certain income items reported on individual returns against that reported by third parties, including wages, interest, dividends and miscellaneous payments. It can also be used to verify gross sales of assets, such as securities, but cannot be used to verify the gain or loss on such sales since we have no third-party reporting on the cost basis of assets. It is also of limited value in verifying some deductions, such as mortgage interest.

Document matching is not useful for verifying business income, gain or loss on asset sales, or most itemized deductions. We estimate that the total personal income that cannot be verified by document matching represented about $1.2 trillion in FY 1998, or 19.7% of total reported personal income. An important role of audits is to verify these major categories of income and deductions.

The significance of verifying income and deduction items through audits is illustrated by the fact that the average in-person audit of an individual return results in an assessment of approximately $9,540, while the average assessment from a document matching case is $1,506. In FY 2000, the IRS closed 247,212 in-person audits of individual returns and assessed $2.4 billion from this program; in the document matching program in FY 2000, the IRS closed 1,353,545 cases and assessed $2.1 billion.

One of my real concerns about the decline in audits is fairness to the majority of taxpayers whose income is reported and can be readily verified. It is relatively easy for the IRS to verify the returns and reported income of taxpayers whose income results from wages, interest and dividends and who take the standard deduction, who comprise the majority of taxpayers. It is harder, and often requires audits, to verify the income of taxpayers with other forms of income and deductions or more complex returns, who are often higher income taxpayers. The proportion of income that cannot be verified through document matching is 10% for taxpayers with income under $100,000, as compared with 35% for taxpayers over $100,000. Also, 91% of returns reporting income over $100,000 itemize deductions, compared to 26% of those below $100,000, and most itemized deductions cannot be verified through document matching. To the extent that the IRS uses more and more document matching and less and less auditing, the effect may be perceived as, and will in fact be unfair because higher income taxpayers will not have their returns verified to the same degree as middle income taxpayers.

Another concern with respect to both tax revenues and fairness is the income reported by corporations and partnerships. While the IRS continues to audit the 1,100 largest corporations every year, the audit rate for all other corporations has declined from 3.0% in 1992 to 1.1% today. A particular source of concern is the growing number of entities, such as partnerships, trusts and S-corporations, which pay no income tax at the business level but pass their net income on to their shareholders or partners. As shown in Enclosure 3, in 2000, these "passthrough" entities filed 7.4 million returns, reported $5.0 trillion of gross revenues and $680 billion of income. However, the IRS audited only 29,057 of these entities, or only 1 of every 256 returns - .39% (Enclosure 4). We do plan to begin a program to match income reported on K-1 forms from these entities to individual tax returns. However, this technique will not provide any verification of the income reported by the business entity itself, which requires an audit.

Our strategic plan attempts to reconcile all these factors with the objective of increasing the IRS' s ability to achieve our second strategic goal, which is service to all taxpayers through fair and uniform application of the tax law. If our modernization program is successful, we believe we can do this while continuing to shrink the size of the IRS in relation to the economy.

With respect to the question of why document matching cases are not considered audits, the technical reason is that Section 7605(b) of the tax code generally limits the ability of the IRS to require a taxpayer to submit books and records for inspection by the IRS more than once per return. Since document matching cases do not require the taxpayer to submit books and records to the IRS, a document matching case does not preclude a subsequent audit. Revenue Procedure 94-68 specifically defines IRS taxpayer contacts, including document matching, which are not considered audits for the purpose of Section 7605(c). More generally, it is my understanding that some years ago the IRS proposed to change the definition of an audit to permit inclusion of the document matching cases in the overall reported number of audits, and this proposal was criticized in some parts of Congress as an attempt to inflate IRS's statistics.

Notwithstanding these previous issues, all of these IRS statistics, including the number of document matching cases, are publicly reported and it is our goal to make these reports as informative and meaningful as possible. I would be pleased to discuss with you how we could improve this reporting.

Enclosure 5 provides data in answer to your specific questions.

Sincerely,

Charles O. Rossotti

Enclosures

March 28, 2001

Mr. Charles Rossotti
Commissioner
Internal Revenue Service
Washington, D.C. 20224

Dear Mr. Commissioner:

I am writing in response to your letter of March 26, 2001, regarding audit rates and overall enforcement efforts at the Internal Revenue Service (IRS). I believe our exchange of letters has been extremely useful in highlighting for the Committee, and more importantly, the American taxpayer, that the IRS is quite effective at reviewing and verifying most information on the vast majority of tax returns.

The General Accounting Office (GAO) confirmed for the Committee today that almost all individual tax returns are subject to IRS computer review for third party information under the information reporting program (IRP) as well as checked for math errors. The size and scope of this computer review are reflected in your Enclosure 5, which shows that over 14 million tax returns in 1998 (the most recent data available) were flagged for potential discrepant income or deductions. There were approximately 120 million returns filed in the previous year, thus well over 10% of taxpayer returns were identified by IRS computers for possible further review.

As we approach the end of filing season, it is critical that the American taxpayer hears from the IRS that both they and their neighbors' tax returns will be subject to these vigorous reviews.

Thus, I appreciate your statement in your March 26th letter that focusing solely on the face-to-face audit rate "does substantially understate the IRS's capacity to find errors in returns, especially in certain kinds of returns" and encourage your office to widely publicize the effectiveness of the computer matching program.

That the IRS is on the job is an important message the public must hear, particularly given the explosive growth we have recently seen in Internet tax schemes, scams and cons – the main topic of the April 5th Finance Committee hearing at which you will be testifying. Many web sites promoting these tax scams cite the low audit rate as an inducement to buy their schemes.

Your letter is also extremely useful in beginning the discussion of where we need to be in terms of compliance efforts. I appreciate your recognition that:

> With the use of document matching as well as other return verification techniques that will eventually be enabled by new technology, it is my view that there is no need to return to the levels of individual audit coverage that existed even five years ago, which was three times the FY 2000 level.

This statement is very useful and begins to bring the discussion of audit coverage into better focus and, as important, dismisses histrionic claims that we must return to earlier high levels of face-to-face audit levels. Further, this will allow a more objective and rational review of the IRS' budget proposal.

The focus of my letter was on individual tax returns not pass-through entities. However, I welcome your discussing this important aspect of enforcement. I wish to work with you to ensure that, at a minimum, greater resources within the IRS are made available to address these enforcement issues. I would encourage you to make a priority of having a computer program in place to match income reported on K-1 forms. It is my understanding that the State of California already has a computer program in place that provides this very useful function. Would it be possible for the IRS to gain from California's experience in this area? We are seeing an extensive use of partnerships and other pass-through entities in the area of tax schemes that will be discussed at the April hearing and it is important that would technology be brought to bear on this matter.

In addition, it is important that the IRS have updated data on taxpayer compliance so that it can better target the audits it does perform. More effective and targeted auditing can go far in limiting the number of audits that need to be performed. I believe it is possible to obtain such taxpayer compliance information without subjecting individual taxpayers to an accountant's version of root canal. The IRS has stated for years that it is developing an alternative program to measure taxpayer compliance. I would ask that in your testimony on April 5th, you state when we can anticipate seeing results in this area.

I particularly urge you to proceed in obtaining taxpayer compliance data in the areas of trusts and partnerships. The data in the field of trusts and partnerships, I understand, is very old and given tax schemes like "pure trusts," it is particularly imperative that obtaining new taxpayer compliance data in these fields be a priority.

As the Committee prepares for the April 5th hearing, I will have additional comments about your March 26th letter. For now I want to thank you for your candor in responding to my letter and again encourage the IRS to widely broadcast the news that tax cheats should not rest easy – the IRS is on the job.

Cordially yours,

Charles E. Grassley
Chairman

Enclosures to Commissioner Rossotti Letter

Enclosure 1: RETURN VERIFICATION TECHNIQUES

TECHNIQUE	TYPE OF RETURN/ISSUE	
Math Error	▪ An addition, subtraction, multiplication or division error on any return. ▪ Incorrect use or selection from tax tables, schedules, etc. provided by the IRS. ▪ Entry on a return inconsistent with an entry on a schedule, form, statement, or list filed with the return. ▪ An omission of information required on the return to substantiate an entry on the return. ▪ An entry on a return of a deduction or credit in an amount which exceeds a statutory monetary limit, a percentage, a ratio, or a fraction. The items that are considered in applying the limitation have to appear on the return. ▪ Missing or incorrect taxpayer identification numbers (TINs) for personal exemptions for the primary and secondary taxpayers, dependents, Child and Dependent Care Credit, EITC, Child Tax Credit, Lifetime Learning Credit, or Hope Scholarship Credit. ▪ EITC is claimed based on self-employment income but self-employment tax has not been paid. ▪ Primary and secondary taxpayers do not meet the age requirements for claiming EITC when there is no qualifying child. ▪ EITC is claimed based on a qualifying child but the child's date of birth is missing or incorrect. ▪ EITC is claimed and EITC claimed in a previous year was disallowed through an examination and Form 8862 (Earned Income Credit Eligibility) is not filed with the return. ▪ Child Tax Credit or Child and Dependent Care Credit is claimed but the dependent does not meet the age criteria.	
Information Returns/ Document Matching	Income items reported by a third-party payer are matched to the income items reported on the individual's income tax return. The types of income reported by payers are listed below. Contact is made when there is a discrepancy (income reported on the tax return is less (underreported) than the income reported by the payer).	
	▪ Wages	▪ Taxable Grants
	▪ Interest	▪ Proceeds from Securities Sales
	▪ Dividends	▪ Bartering
	▪ State and Local Income Tax Refunds	▪ Refund of Overpaid Mortgage Interest
	▪ Rents and Royalties	▪ Social Security/Railroad Retirement Benefits
	▪ Patronage Dividends	▪ Gambling Income
	▪ Crop Insurance Proceeds	▪ Cancellation of Debt
	▪ Unemployment Compensation	▪ Proceeds from the Sale or Exchange of Real Estate
	▪ Nonemployee Compensation (Fees, commissions, or any other compensation paid by a business to an individual who is not an employee.) ▪ Retirement Plans (Pensions, annuities, IRA distributions, lump-sum distributions, employee savings plans, stock bonus plans, profit-sharing plans, etc.) ▪ Substitute Payments in Lieu of Dividends or Interest ▪ Medical Payments (Compensation paid to doctors, dentists and others in the medical profession.) ▪ Fishing Income (Payments to fishing boat crew members.) ▪ Distributive Shares of Income from a partnership, Subchapter S corporation or estates or trusts. ▪ Agricultural Subsidies/Commodity Credit Corporation Loans Forfeited	

Enclosure 1: RETURN VERIFICATION TECHNIQUES, CONTINUED

TECHNIQUE	TYPE OF RETURN/ISSUE
Matching, cont.	▪ Only one deduction (mortgage interest and points) is subject to reporting by third-party payers. Mortgage interest reported as paid by lenders is matched to the mortgage interest deducted on the individual's income tax return. Contact is made when there is a discrepancy. ▪ If a taxpayer has not filed a tax return after repeated letters requesting a return and information documents indicate income amounts would require a return, the income amounts reported by third-party payers will be used to compute a tax liability for the taxpayer. This is in accordance with the authority granted the IRS under IRC 6020(b).
Examination of Books/Records	▪ Income, deductions, credits, or other issues on partnership, corporation, Subchapter S corporation, and trust returns. ▪ Itemized deductions reported by an individual. These include medical and dental expenses, taxes, interest other than home mortgage interest and points, gifts to charity, casualty and theft losses, unreimbursed employee expenses, business use of home or car, educational expenses, etc. ▪ Income and expenses from a sole proprietorship (Schedule C) business. ▪ Basis and acquisition and sold dates for long-term or short-term capital assets. ▪ Rental and royalty expenses. ▪ Income and expenses from farming (Schedule F). ▪ Credits (EITC, Child Tax Credit, Child and Dependent Care Credit, Adoption Credit, Education Credits, etc.) and Dependency Exemptions. Any requirements other than TINs and date of birth that are required to claim the credit or the dependent as an exemption. Criteria such as, child/dependent meets certain criteria, such as relationship, residency and citizenship. ▪ Foreign tax credit ▪ Foreign earned income exclusion ▪ Deductions such as IRA, student loan interest, moving expenses, self-employed health insurance, alimony paid, etc. to arrive at adjusted gross income. ▪ Household employment taxes

Enclosure 2: TOTAL NUMBER OF RETURNS CLOSED IN FISCAL YEAR

FISCAL YEAR	MATH ERRORS	UNDERREPORTER (Document Matching)	CORRESPONDENCE AUDIT	IN-PERSON AUDIT
1971	N/A	N/A	N/A	1,346,000
1972	N/A	N/A	N/A	1,343,000
1973	N/A	N/A	482,432	1,409,000
1974	N/A	N/A	714,000	1,686,686
1975	N/A	N/A	1,329,305	1,838,558
1976	N/A	N/A	1,882,178	2,043,595
1977	N/A	N/A	913,460	1,742,056
1978	N/A	N/A	663,173	1,675,852
1979	N/A	N/A	696,341	1,645,079
1980	N/A	N/A	728,119	1,638,785
1981	N/A	1,200,000	975,541	1,482,586
1982	N/A	2,900,000	819,366	1,352,083
1983	N/A	2,900,000	1,078,065	1,279,810
1984	N/A	3,900,000	761,126	1,135,533
1985	N/A	3,600,000	680,951	1,143,517
1986	N/A	3,200,000	643,578	1,031,422
1987	N/A	2,242,000	684,560	927,964
1988	N/A	3,800,000	735,534(2)	885,134
1989	N/A	3,650,000	599,348	785,647
1990	N/A	2,950,000	425,641	719,319
1991	N/A	4,840,000	612,547	700,621
1992	4,985,000	3,771,509	458,727	661,714
1993	4,088,000	2,723,830	301,160	727,223
1994	4,059,000	2,645,075	358,829	775,142
1995	6,102,000	2,711,086	1,147,296	687,496
1996	4,751,000	1,930,326	1,154,562	648,703
1997	5,984,000(1)	931,354	769,181	686,167
1998	5,669,000	1,726,098	628,484	560,728
1999	6,552,000	1,770,695	708,886	384,178
2000	5,751,000	1,353,545	362,830	247,212

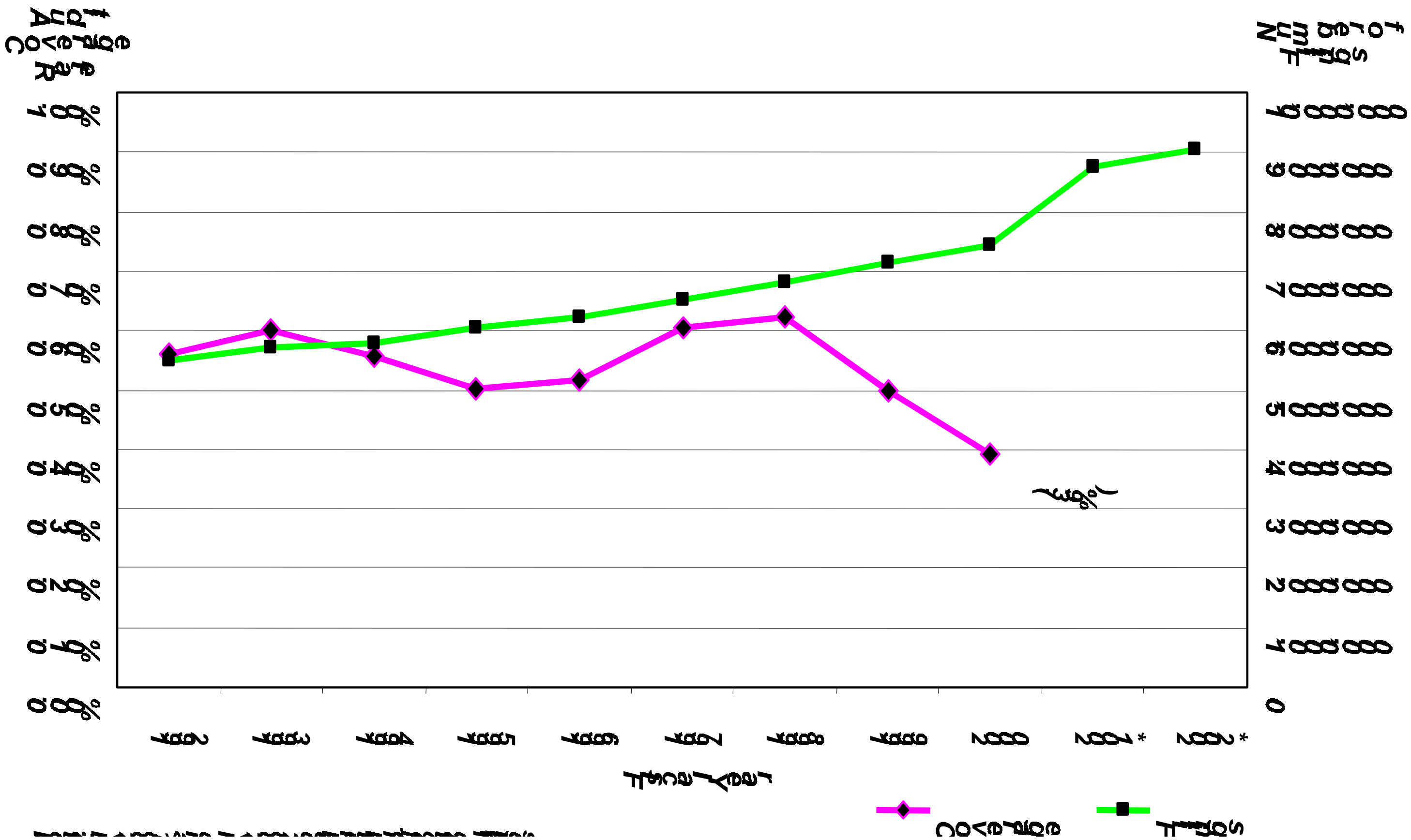
***Sources*:**
Math Error: Individual Master File Control Reports, Math Error Master File extract, Workload Inventory Tracking System Report
Under-reporter: Management Information System for Top Level Executives; Work Plan and Control Reports
Correspondence and in-person audits: FY1992-FY2000 is ERIS database; FY1988-FY1991 is Commissioner's Databook; FY1971-1987 is the Commissioner's Annual Report
***Notes*:**
(1) Expanded Math Error authority was implemented in CY1997 for TY1996, data prior to FY1998 does not include EITC or TIN math errors.
(2) Prior to FY 1988, service center data from the Commissioner's Annual Report included all types of returns corrected. However, the majority of the work performed in the service center program dealt with individual returns.

Enclosure 3: PASSTHROUGH ENTITIES REPORTING

SOURCE	NUMBER OF RETURNS	GROSS RECEIPTS	TOTAL INCOME
	Total number of returns filed, includes returns reporting positive, negative or zero quantities	*As reported on of Form 1065-line 1c, Form 1120S-line 1c, Form 1041-line 9*	*Income distributed to partners, shareholders and beneficiaries*
Partnerships[1]	2,045,000	$1.57 trillion	$408 billion
Subchapter-S Corporations	2,928,000	$3.32 trillion	$234 billion
Trusts[2]	2,470,500	$.12 trillion	$38 billion
Total	7,443,500	$5.01 trillion	$680 billion

Source: *Preliminary analysis of TY1999 data, Processing Year 2000 Business Return Transaction file*
Notes: *(1) Of the 2 million partnership forms filed, 1.3 million claimed zero or negative receipts.*
(2) Does not include approximately 1 million grantor trusts, which have no passthrough income.

Enclosure 4: TOTAL PASSTHROUGH FILINGS & COVERAGE



Enclosure 5: RESPONSE TO DATA REQUESTS

NOTE ON DATA AVAILABILITY: The IRS does not have accurate data on enforcement revenue collections prior to FY1992. At that time, the Enforcement Revenue Information System (ERIS) became fully operational - for the first time linking the Service's various enforcement databases (primarily the masterfiles and the Audit Information Management System - AIMS). The service does have some data available prior to that time, however that data is not comparable in format and substance to the data we have submitted in this document. For example: some of the functions' revenue totals were estimated prior to FY1992 often resulting in double counting between functional areas (e.g. revenue resulting from an Examination assessment that was actually collected in the Collection function was counted by both functions). We believe the data provided in this enclosure provides accurate, timely information and provides the best insight into enforcement actions at the IRS today.

Request 1. *The number of IRP contacts for 2000 as well as for the last twenty years the number of returns subject to computer-based review that did not result in the sending of a letter to the taxpayer.*

AUR DEFINITIONS

TERM	DEFINITION
Total AUR Inventory	Total number of tax returns identified by the computer-matching criteria for potential discrepant income/deduction(s)
Screened	Number of tax returns that are physically reviewed for potential discrepant income/deduction(s)
Screened Out	Number of tax returns where the income was identified as reported somewhere else on the return, an explanation included on the return explained the discrepancy, etc.
Taxpayers Contacted	Number of taxpayers who received a notice/letter requesting an explanation for the discrepancy
Change Cases	Number of taxpayer's returns that were changed due to the identified discrepancy

AUR HISTORY BY TAX YEAR

INVENTORY	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total AUR Inventory	11,328,231	9,111,462	11,086,181	11,549,341	12,237,481	11,562,667	11,873,979	13,350,638	14,121,015
Screened	4,175,651	4,168,986	3,744,373	2,283,197	1,625,714	3,219,329	3,112,509	2,992,551	2,448,389
Screened Out	1,548,308	1,480,455	1,152,865	927,071	713,095	956,074	918,670	1,193,047	1,019,477
Taxpayers Contacted	2,627,343	2,688,531	2,591,508	1,356,126	912,619	2,263,255	2,193,839	1,799,504	1,428,912
Change Cases	2,001,096	2,020,041	2,010,606	988,987	659,153	1,718,345	1,760,017	1,309,327	1,096,788

Sources: *Management Information System for Top Level Executives; Work Plan and Control Reports*

Request 2. The *number of dollars assessed and collected through the IRP program for the last twenty years.*

TOTAL ENFORCEMENT DOLLARS ASSESSED TO DATE

	FY 1992	FY 1993	FY 1994	FY 1995	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	Total
District Audits *(In person)*	$4,267,628,325	$4,265,055,282	$5,357,315,037	$5,782,643,649	$5,260,263,537	$5,462,733,565	$4,665,971,725	$3,276,169,647	$2,358,427,054	$40,696,207,821
Service Center Audits (*Correspondence)*	$2,107,600,679	$1,613,464,390	$1,252,687,782	$2,358,658,954	$2,784,065,045	$3,561,231,369	$2,787,166,772	$1,969,693,717	$1,362,326,701	$19,796,895,409
Underreporter (*Document Matching*)	Data not available		$1,006,629,694	$1,624,331,331	$1,449,165,285	$1,478,888,181	$1,698,438,255	$2,062,718,637	$2,037,937,452	$11,358,108,835

Source: ERIS data
Notes: Results above are related to cases closed in Exam or IRP Underreporter in that fiscal year
Assessed dollars include tax, penalty, and interest. Some of the cases closed in these fiscal years are in the Appeals process and therefore have no assessments.

TOTAL ENFORCEMENT REVENUE ASSESSED DOLLARS COLLECTED TO DATE

	FY 1992	FY 1993	FY 1994	FY 1995	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	Total
District Audits *(In person)*	$1,726,691,290	$1,780,689,403	$1,828,776,163	$1,726,477,044	$1,813,788,376	$2,017,646,371	$1,774,277,141	$1,165,385,199	$671,430,303	$14,505,161,290
Service Center Audits (*Correspondence)*	$1,016,491,617	$687,557,704	$526,609,451	$666,618,496	$777,337,295	$815,523,030	$658,498,312	$483,559,878	$344,592,608	$5,976,788,391
Underreporter (*Document Matching*)	Data not available		$869,075,960	$1,238,308,612	$1,025,978,898	$1,062,864,926	$1,171,395,284	$1,307,984,870	$984,887,701	$7,660,496,250

Source: ERIS data
Notes: Results above are related to cases closed in Exam or IRP Underreporter in that fiscal year
Collected dollars include tax, penalty, and interest

Request 3. ***The cost per IRP review and contact as well as the cost per service center audit and face-to-face audit for the past twenty years.***

Cost per contact/audit calculations are estimated using closed case data for the year in which the case is closed.. Due to the long case processing time for in-person audits and some service center audits –cases may take a year or longer – case closures and new cases initiated can vary substantially each year with little change in actual costs. For example, a high number of closures toward the end of a year would appear to have low costs per case while the following year would show more cases initiated but not closed appearing to have high costs per case.

The following table provides estimated costs per contact/case for fiscal years 1992 through 2000 for the Automated Underreporter Program (AUR) – formerly known as IRP – and for both service center and face-to-face audits for individual income tax returns. These estimates were derived for AUR and service center exams using the total labor costs (direct salary and benefit costs) and the number of contacts completed/cases closed for each program for each year. Historical staff year rates were applied to create estimates of the costs associated with individual exams only. Financial data were available only for all cases combined, including corporate audits. Cost estimates for face-to-face audits may be slightly overstated because calculations were made using an average labor cost. Revenue Agents working corporate cases are higher graded, resulting in a slightly higher average labor cost. All costs are expressed in actual dollars. More detail is available but will require additional analysis.

ESTIMATED COSTS FOR CONTACT/CASE

FY	TYPE OF CONTACT/AUDIT – INDIVIDUAL RETURNS		
	AUR*	**Service Center Audits**	**Face-to-Face Audits**
1992	$ 26.68	$ 210	$ 667
1993	$ 36.25	$ 332	$ 730
1994	$ 31.60	$ 268	$ 697
1995	$ 32.53	$ 116	$ 692
1996	$ 36.16	$ 104	$ 704
1997	$ 24.33	$ 174	$ 728
1998	$ 25.89	$ 193	$ 904
1999	$ 29.04	$ 171	$1,054
2000	$ 28.13	$ 336	$1,535

Source: *IRS Analysis*
Note: ***** *AUR data consists of cost estimates per Tax Year*

Request 4. ***The IRS has significant correspondence with taxpayers regarding math error, which realizes millions in additional revenue. Please explain if these dollars are included in enforcement revenue and also how many math error contacts are done each year for the past twenty years and how much revenue has resulted from this effort for the past twenty years.***

Enforcement revenue can result from a taxpayer failing to file a return, a taxpayer filing a return with a balance due that is not paid until enforcement action is begun (a collection notice is issued) or IRS collects additional taxes assessed from an examination or document matching contact. Not all revenue resulting from math error notices is considered enforcement revenue by the Service. Math error adjustments are made during the processing of a tax return. A math error adjustment will result in either the taxpayer receiving less of a refund than shown on the return or the taxpayer will have a balance owing. A taxpayer is sent a notice of the math error adjustment, including the amount of the "reduced refund" or the balance that is now owed.

If the taxpayer, having a balance due as a result of a math error adjustment, pays before a collection notice is issued, the revenue is not enforcement revenue. This is the same as if the taxpayer had filed the return with a balance due and paid the balance due before a collection notice was issued. Revenue collected before or after the collection notice is issued is additional dollars in the Treasury and included in IRS total receipts. Much of the benefit of math error notices is in the area of revenue protected rather than enforcement revenue. Revenue protected is a situation where monies are prevented from leaving the Treasury, while enforcement revenue is usually new dollars coming into the Treasury. Data on revenue protected by EITC and Dependent Taxpayer Identification Number math error notices is tracked by the Service, but revenue protected for all other math error notices is not tracked.

MATH ERROR ANALYSIS FY1992 – 2000 ($ in 000s)

	1992	1993	1994	1995	1996	1997	1998	1999	2000
Math Errors in Earned Income Tax Credit (EITC)	Data not available[2]					**903**	**623**	**475**	**400**
Net Revenue Protected						*$930,244*	*$548,072*	*$382,963*	*$291,538*
Net Protected per Notice						*$1,029*	*$880*	*$807*	*$730*
Math Errors in Dependent/ Primary/ Secondary TIN						**1,300**	**1,095**	**958**	**1,270**
Net Revenue Protected						*$468,000*	*$245,435*	*$244,796*	*$301,710*
Net Protected per Notice						*$360*	*$224*	*$256*	*$237*
EITC/TIN Math Error (#)						**2,203**	**1,718**	**1,433**	**1,670**
Revenue Protected by EITC/TIN Math Error ($000s)						*$1,398,244*	*$793,507*	*$627,760*	*$593,248*
Average revenue protected per EITC/TIN Notice						*$635*	*$462*	*$438*	*$355*
All Other Math Error[1]	**4,985**	**4,088**	**4,059**	**6,102**	**4,751**	**3,781**	**3,951**	**5,119**	**4,081**
Total Math Error (#)	**4,985**	**4,088**	**4,059**	**6,102**	**4,751**	**5,984**	**5,669**	**6,552**	**5,751**

Source: *Individual Master File Control Reports, Math Error Master File extract, Workload Inventory Tracking System Report*

Notes: *(All) Counts (shown in bold) are number of returns with errors, not number of errors. One taxpayer return could have multiple math errors but would receive one notice informing the taxpayer of all errors in the return.*

(1) Revenue protected for all other math errors is not tracked.

(2) The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 expanded Math Error Authority for EITC and Dependent TINs. This expanded authority was implemented in Calendar Year (CY) 1997 for Tax Year (TY) 1996. The only data available prior to TY 1997 is aggregate data on all other math errors.

Request 5. ***Please explain why the 715,000 Service Center audits, which are essentially correspondence to the taxpayer, are considered an audit for IRS statistical purposes, yet the 3.6 million IRP notices from the service centers are not*****.**

Internal Revenue Code (IRC) section 7605(b) restricts the IRS to only one examination of a taxpayer's books and records for each taxable year. The definition of an examination/audit, in IRS' MasterFile and other records, is a contact that required the taxpayer to submit books and records for IRS review. IRS uses this same definition of an audit for statistical purposes. The 715,000 Service Center audits required taxpayers to submit books and records to substantiate a deduction, credit, etc. The 3.6 million IRP notices result from 2 different types of contact neither of which meet the criteria of an audit. These are:

- **Underreported Income** – There is a discrepancy between the income reported on the individual income tax return and the income reported by a third-party payer. The taxpayer is asked to explain the discrepancy but does not provide books and records for IRS review.

- **Nonfiling** – The taxpayer has not filed a tax return after repeated letters requesting a return and income reported on information documents indicate a return is required to be filed. Under the authority in IRC 6020(b), IRS computes a tax liability based on the information documents and the taxpayer is sent a notice of the proposed tax due. The taxpayer does not provide any books and records for IRS