

Enclosure 1: RETURN VERIFICATION TECHNIQUES

TECHNIQUE	TYPE OF RETURN/ISSUE		
Math Error	<ul style="list-style-type: none"> ▪ 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	<ul style="list-style-type: none"> ▪ 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). 		
Matching	<table border="0" style="width: 100%;"> <tr> <td style="vertical-align: top; width: 50%;"> <ul style="list-style-type: none"> - Wages - Interest - Dividends - State and Local Income Tax Refunds - Rents and Royalties - Patronage Dividends - Crop Insurance Proceeds - Unemployment Compensation - 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 </td><td style="vertical-align: top; width: 50%;"> <ul style="list-style-type: none"> - Taxable Grants - Proceeds from Securities Sales - Bartering - Refund of Overpaid Mortgage Interest - Social Security/Railroad Retirement Benefits - Gambling Income - Cancellation of Debt - Proceeds from the Sale or Exchange of Real Estate </td></tr> </table>	<ul style="list-style-type: none"> - Wages - Interest - Dividends - State and Local Income Tax Refunds - Rents and Royalties - Patronage Dividends - Crop Insurance Proceeds - Unemployment Compensation - 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 	<ul style="list-style-type: none"> - Taxable Grants - Proceeds from Securities Sales - Bartering - Refund of Overpaid Mortgage Interest - Social Security/Railroad Retirement Benefits - Gambling Income - Cancellation of Debt - Proceeds from the Sale or Exchange of Real Estate
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Enclosure 1: RETURN VERIFICATION TECHNIQUES, CONTINUED

TECHNIQUE	TYPE OF RETURN/ISSUE
Matching, cont.	<ul style="list-style-type: none"> ▪ 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	<ul style="list-style-type: none"> ▪ 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

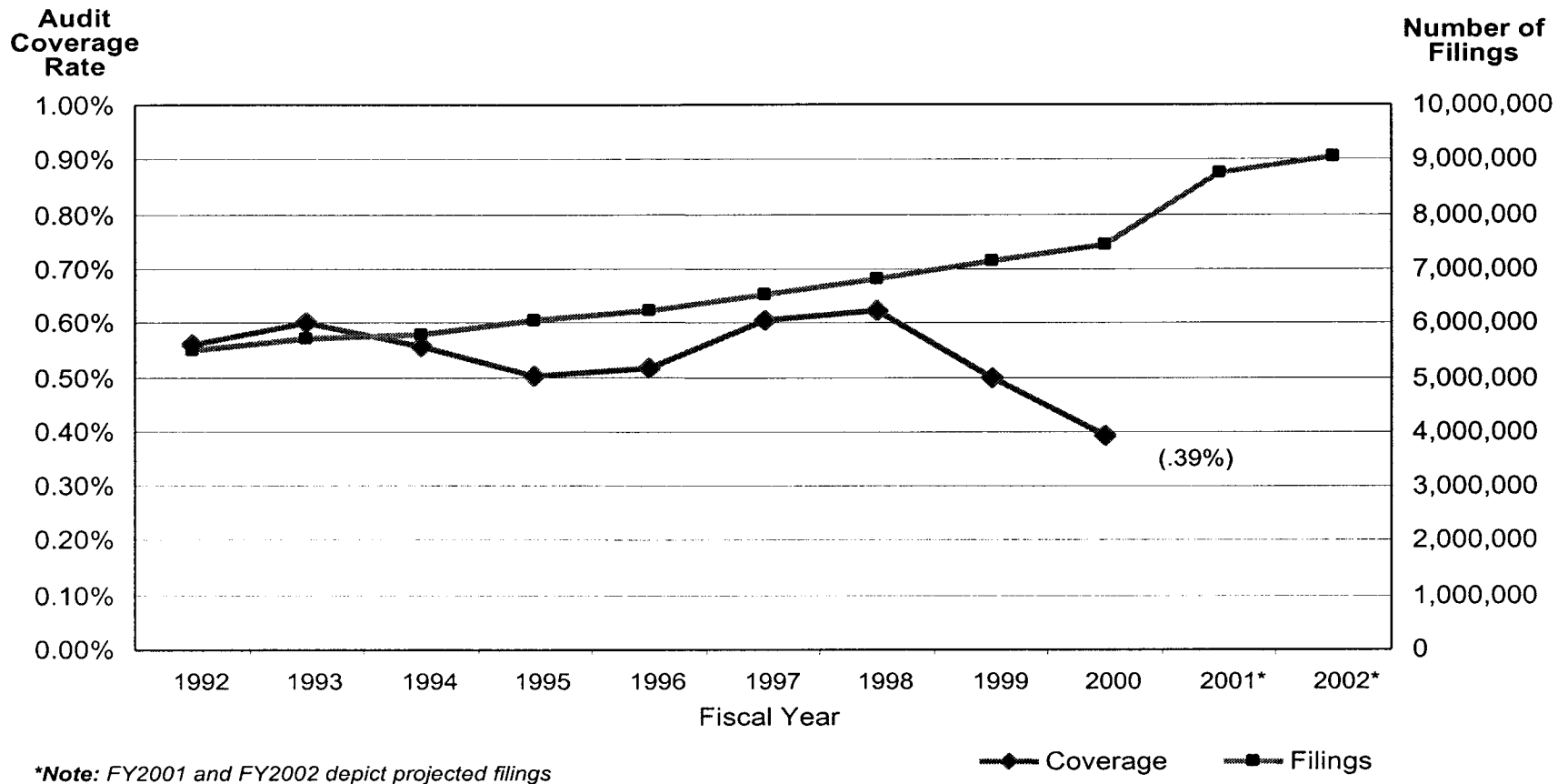
SOURCE	NUMBER OF RETURNS	GROSS RECEIPTS	TOTAL INCOME
	<i>Total number of returns filed, includes returns reporting positive, negative or zero quantities</i>	<i>As reported on of Form 1065-line 1c, Form 1120S-line 1c, Form 1041-line 9</i>	<i>Income distributed to partners, shareholders and beneficiaries</i>
Partnerships¹	2,045,000	\$1.57 trillion	\$408 billion
Subchapter-S Corporations	2,928,000	\$3.32 trillion	\$234 billion
Trusts²	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	\$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	\$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
<i>Net Revenue Protected</i>						\$930,244	\$548,072	\$382,963	\$291,538
<i>Net Protected per Notice</i>						\$1,029	\$880	\$807	\$730
Math Errors in Dependent/ Primary/ Secondary TIN						1,300	1,095	958	1,270
<i>Net Revenue Protected</i>						\$468,000	\$245,435	\$244,796	\$301,710
<i>Net Protected per Notice</i>						\$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