# *Reducing the Federal Tax Gap*

## A Report on Improving Voluntary Compliance

Internal Revenue Service

U.S. Department of the Treasury

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# EXECUTIVE SUMMARY

## INTRODUCTION

In Fiscal Year (FY) 2006, federal receipts totaled over $2.4 trillion. More than 95 percent of the net receipts were collected by the Internal Revenue Service (IRS) through its administration of the income, employment, transfer, and excise tax provisions of the Internal Revenue Code. Virtually all of these receipts were collected through a tax system under which taxpayers voluntarily report and pay their taxes with no direct enforcement and minimal interaction with the government.

The overall compliance rate achieved under the United States revenue system is quite high. For the 2001 tax year, the IRS estimates that, after factoring in late payments and recoveries from IRS enforcement activities, over 86 percent of tax liabilities were collected. Nevertheless, an unacceptably large amount of the tax that should be paid every year is not, such that compliant taxpayers bear a disproportionate share of the revenue burden, and giving rise to the "tax gap." The gross tax gap was estimated to be $345 billion in 2001. After enforcement efforts and late payments, this amount was reduced to a net tax gap of approximately $290 billion.

The Treasury Department and IRS are committed to improving current compliance levels and continuing to address all forms of noncompliance. The IRS Oversight Board has adopted an 86 percent voluntary compliance goal by 2009 and Senate Finance Committee Chairman Max Baucus has asked for a 90 percent voluntary compliance goal by 2017. This report sets forth steps that will be taken to improve compliance and enhance the IRS' ability to measure compliance. Once implemented, these steps will improve the IRS' ability to gauge progress in achieving specific long-term compliance objectives.

This report outline steps that the IRS will take to increase voluntary compliance and reduce the tax gap. It builds on the Comprehensive Strategy for Reducing the Tax Gap (the Treasury Strategy) that was released in September 2006 by the Treasury Department's Office of Tax Policy and provides more detail for that strategy.

The IRS regularly addresses compliance improvement measures in its planning and budgeting processes. The Administration's annual budget request identifies the resources the IRS will need to meet specific performance goals to achieve its strategic priorities. This document combines and addresses current tax gap efforts. In addition, the IRS has long been conducting research in compliance and the tax gap, and resulting data is incorporated throughout this document.

The steps outlined in this report are, in many respects, only initial steps toward improving compliance. As described below, one of the primary challenges that the IRS faces in improving compliance is to get a better understanding of the current sources of noncompliance by improving research in this area. Until that understanding is clarified, efforts to improve compliance may be misdirected and progress may not be measurable. The IRS has taken significant steps in this direction, most importantly through the National Research Program (NRP), which is the source of updated estimates of compliance among individual taxpayers for 2001. The IRS is committed to furthering its work in this area through updated individual taxpayer NRP examinations and a current study focusing on compliance among Subchapter S corporations (S corporations).

In implementing the steps set forth in this document, it is important to have realistic expectations and perspectives. Based on the limited information available, compliance rates appear to have remained relatively stable at around 85 percent for decades. To make a meaningful improvement in this number without a fundamental change in the relationship between taxpayers and the government will require a long-term, focused effort. Implementation of the steps outlined in this document and in the Administration's Fiscal Year (FY) 2008 Budget request for the IRS will be subject to the uncertainties associated with the annual budget process. Moreover, it must be recognized that the causes of noncompliance are numerous and that only a portion of the tax gap results from intentional avoidance or evasion of the law. An equally or perhaps more important part of the problem lies in the growing complexity of the tax laws, which will continue to frustrate efforts to improve compliance.

The Administration is committed to working with Congress and other stakeholders to reduce the tax gap. The Administration's FY 2008 Budget request includes $11.1 billion for the IRS, a 4.7 percent increase over the budget enacted for FY 2007. A total of $410 million is for new enforcement initiatives as part of a strategy to improve compliance by:

- Increasing front-line enforcement resources;
- Increasing voluntary compliance through improved taxpayer service options and enhanced research;
- Investing in technology to reverse infrastructure deterioration, accelerate modernization, and improve the productivity of existing resources; and
- Implementing legislative and regulatory changes.

Since 2001 (the tax year studied by the NRP), IRS tax collections have increased significantly, audit rates have improved across all taxpayer segments, and measurements of taxpayer service have risen to historic levels. While specific data is not available, there is every reason to believe that these improvements have contributed to a general shift away from aggressive tax planning and an improvement in compliance levels over the past six years. In calling for a significant increase in IRS funding, the Administration's budget recognizes, however, that much work remains to be done. Based on historic experience, the IRS estimates that the overall return on new investments in compliance averages 4:1, with an additional indirect impact resulting from the improved overall compliance that comes from more targeted and effective enforcement of the tax law. However, direct spending on compliance improvements does not lend itself to traditional revenue-estimating analysis, given the difficulty in quantifying the effect that such improvements have on taxpayer behavior.

This report provides detail on how the additional funds requested in the Administration's FY 2008 Budget will build on improvements the IRS has made in recent years to taxpayer service, modernization, and enforcement, all of which are critical elements in the long-term strategy to improve compliance. In particular, this report describes six separate initiatives in the FY 2008 Budget request that are aimed at improving enforcement. The report also details how additional funds requested will be targeted to improving taxpayer service, including implementation of the recommendations made in the recently released Taxpayer Assistance Blueprint (TAB). In addition, the report outlines how additional funds will accelerate implementation of IRS modernization programs, to permit better document matching, faster and more accurate processing of returns, and more timely access to taxpayer account information. A detailed timeline for implementing these various programs is included as an Appendix to this report.

The Treasury Department and IRS will continue to evaluate resource demands for improving taxpayer compliance. In addition, future budget requests will identify ways to utilize resources efficiently and effectively to target enforcement efforts to areas where they will have the greatest direct and indirect impact on compliance. The steps for improving compliance that are detailed in this report will continue to evolve over time as our understanding of the problem improves and as changes in the economy and changes in the tax law present new compliance challenges.

## The Treasury Department's Comprehensive Strategy for Reducing the Tax Gap

Four key principles guided the development of the Treasury Strategy and continue to guide IRS efforts to improve compliance:

- First, both unintentional taxpayer errors and intentional taxpayer evasion should be addressed.
- Second, sources of noncompliance should be targeted with specificity.
- Third, enforcement activities should be combined with a commitment to taxpayer service.
- Fourth, policy positions and compliance proposals should be sensitive to taxpayer rights and maintain an appropriate balance between enforcement activity and imposition of taxpayer burden.

These principles point to the need for a comprehensive, integrated, multi-year strategy to reduce the tax gap. Guided by these key principles, the Treasury Strategy outlines seven components which form the basis for the detailed compliance improvement efforts set forth in this document:

1. Reduce Opportunities for Evasion. The Administration's FY 2008 Budget request contains 16 legislative proposals to reduce evasion opportunities and improve the efficiency of the IRS. Three of these proposals were recently enacted in modified form. The 16 provisions would result in an estimated $29.5 billion of additional revenues over the next ten years. The Treasury Department and the IRS also continue to use the regulatory guidance process to address both procedural and substantive issues to improve compliance and reduce the tax gap.

2. Make a Multi-Year Commitment to Research. Research is essential to identify sources of noncompliance so that IRS resources can be targeted properly. Regularly updating compliance research ensures that the IRS is aware of vulnerabilities as they emerge. New research is needed on the relationship between taxpayer burden and compliance and on the impact of customer service on voluntary compliance. Research also is essential to establish accurate benchmarks and metrics to assess the effectiveness of IRS efforts, including the effectiveness of the Treasury Strategy.

3. Continue Improvements in Information Technology. Continued improvements to technology, including continued development of and additions to Modernized e-File, will provide the IRS with better tools to improve compliance through early detection, better case selection, and better case management.

**4. Improve Compliance Activities.** IRS actions have produced a steady climb in enforcement revenues since 2001, and an increase in both the number of examinations and the coverage rate in virtually every major category. By further improving examination, collection, and document matching activities, the IRS will be better able to prevent, detect, and remedy noncompliance. These activities will increase compliance – not only among those directly contacted by the IRS, but also among those who will be deterred from noncompliant behavior as a consequence of a more visible IRS enforcement presence. Aided by results from the recent NRP study of individual taxpayers, the IRS continues to reengineer examination and collection procedures and invest in technology, resulting in efficiency gains and better targeting of examination efforts. These efficiency gains translate into expanded examination coverage, higher audit yields, and reduced burden on compliant taxpayers.

**5. Enhance Taxpayer Service.** Service is especially important to help taxpayers avoid unintentional errors. Given the increasing complexity of the tax code, providing taxpayers with assistance and clear and accurate information before they file their tax returns reduces unnecessary post-filing contacts, allowing the IRS to focus enforcement resources on taxpayers who intentionally evade their tax obligations. The IRS also is working to provide service more efficiently and effectively through new and existing tools, such as the IRS website. The Taxpayer Assistance Blueprint (TAB), which was completed in April 2007, outlines a five-year strategic plan for taxpayer service. The TAB includes a process for assessing the needs and preferences of taxpayers and partners and a decision model for prioritizing service initiatives and funding.

**6. Reform and Simplify the Tax Law.** Simplifying the tax law would reduce unintentional errors caused by a lack of understanding. Simplification would also reduce the opportunities for intentional evasion and make it easier for the IRS to administer the tax laws. For example, the Administration's FY 2008 Budget request includes proposals to simplify tax credits for families and tax treatment of savings by consolidating existing programs and clarifying eligibility requirements. These initiatives will continue to be supplemented by IRS efforts to reduce taxpayer burden by simplifying forms and procedures.

**7. Coordinate with Partners and Stakeholders.** Enhanced coordination is needed between the IRS and state and foreign governments to share information and compliance strategies. Expanded coordination also is needed with practitioner organizations, including bar and accounting associations, to maintain and improve mechanisms to ensure that advisors provide appropriate tax advice. Through contacts with practitioner organizations, the Treasury Department and IRS learn about recent developments in tax practice and hear directly from practitioners about taxpayer concerns and potentially abusive practices. Similarly, contacts with taxpayers and their representatives, including small business representatives and low-income taxpayer advocates, provide the Treasury Department and the IRS with needed insight on ways to protect taxpayer rights and minimize the potential burdens associated with compliance strategies.

## The IRS Strategic Planning Process

The more detailed steps outlined for improving compliance are, in part, contingent upon the budget process for FY 2008 and beyond. Accordingly, adoption of the Administration's proposed FY 2008 Budget for the IRS along with the enactment of the legislative recommendations included as part of that budget are critical components of the strategy to reduce the tax gap.

The IRS has an extensive annual strategic planning process through which each of its operating divisions develop and estimate resource requirements needed to achieve functional priorities and performance targets based on budget allocations. Detailed action plans, which are part of the IRS' strategic planning process and are coordinated with this report, identify specific sub-goals and measures as well as accountable parties. Progress toward these plans is monitored internally and reported to the Treasury Department and the Office of Management and Budget (OMB) throughout the year.

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# UNDERSTANDING THE TAX GAP

The Internal Revenue Code places three primary obligations on taxpayers: (1) to file timely returns; (2) to make accurate reports on those returns; and (3) to pay the required tax voluntarily and timely. Taxpayers are compliant when they meet these obligations. Noncompliance – and the tax gap – results when taxpayers do not meet these obligations.

The tax gap is defined as the aggregate amount of **true tax liability** imposed by law for a given tax year that is **not paid voluntarily and timely**. **True tax liability** for any given taxpayer means the amount of tax that would be determined for the tax year in question if all relevant aspects of the tax law were correctly applied to all of the relevant facts of that taxpayer's situation. For a variety of reasons, this amount often differs from the amount of tax that a taxpayer reports on a return. The taxpayer might not understand the law, might make inadvertent mistakes, or might misreport intentionally.

To be **paid voluntarily**, a tax liability must be paid without direct IRS intervention. Taxpayers have the responsibility to determine and report their correct tax liability, and to make sure that amount is paid (whether through withholding, estimated tax payments, payments with a filed return, etc.). The IRS focuses its enforcement where it is needed most, but the overall rate of tax compliance in the United States is as high as it is because the vast majority of taxpayers meet their obligations with little or no involvement from the IRS. To be **paid timely**, a tax liability must be paid in full on or before the date on which all payments for the given tax year were legally due.

It is important to emphasize that IRS estimates of the tax gap are associated with the **legal sector** of the economy only. Although tax is due on income from whatever source derived, legal or illegal, the tax attributable to income earned from illegal activities is extremely difficult to estimate. Moreover, the government's interest in pursuing this type of noncompliance is, ultimately, to stop the illegal activity, not merely to tax it.

Although they are related, the tax gap is not synonymous with the **"underground economy."** Definitions of the "underground economy" vary widely. However, most people characterize it in terms of the value of goods and services that elude official measurement. Furthermore, there are some items in the "underground economy" that are not included in the tax gap (such as tax due on illegal-source income), and there are contributors to the tax gap that no one would include in the "underground economy" (such as the tax associated with overstated exemptions, adjustments, deductions, or credits, or with claiming the wrong filing status). The greatest area of overlap between these two concepts is sometimes called the "cash economy," in which income (usually of a business nature) is received in cash, which helps to hide it from taxation.

Equally important, the tax gap does not arise solely from tax evasion or cheating. It includes a significant amount of noncompliance due to tax law complexity that results in errors of ignorance, confusion, and carelessness. This distinction is important even though, at this point, the IRS does not have sufficient data to distinguish clearly the amount of noncompliance that arises from willful, as opposed to unintentional, mistakes. Moreover, the line between intentional and unintentional mistakes is often a grey one, particularly in areas such as basis reporting, where a taxpayer may know that his or her reporting is inaccurate but does not have ready access to accurate information. This is an area where additional research is needed to improve understanding.

## MEASURING THE TAX GAP

Historically, estimates of federal tax compliance were based on special studies, including the Taxpayer Compliance Measurement Program (TCMP), which covered income and self-employment taxes and groups of taxpayers, and consisted of line-by-line audits of random samples of returns. These studies provided the IRS with information on compliance trends and allowed the IRS to update audit selection formulas regularly. However, this method of data gathering was extremely burdensome on the taxpayers whose returns were selected. As a result of concerns raised by taxpayers, Congress, and other stakeholders, the last TCMP audits were done in 1988.

The IRS conducted several much narrower compliance studies between 1988 and 2001, but nothing that would provide a comprehensive perspective on the overall tax gap. Until recently, all of these subsequent estimates of the tax gap have been rough projections that basically assume no change in compliance rates among the major tax gap components even though the magnitude of these projections reflects growth in tax receipts in these major tax gap categories.

The NRP, which the IRS has used to estimate the most recent tax gap updates, arose out of a desire to find a less intrusive means of measuring tax compliance. The IRS used a focused statistical selection process that resulted in the selection of approximately 46,000 individual income tax returns for Tax Year (TY) 2001 – somewhat fewer than previous compliance studies, even though the population of individual tax returns had grown over time.

Like the compliance studies of the past, the NRP was designed to allow the IRS to meet certain objectives – to estimate the overall extent of reporting compliance among individual income tax filers and to update the audit-selection formulas. It also introduced several innovations designed to reduce the burden imposed on taxpayers whose returns were selected for the study.

The first NRP innovation was to compile a comprehensive set of data to supplement what was reported on the selected returns. The sources of the "case building" data included third-party information returns from payers of income (e.g., Form W-2 and Form 1099) and prior-year returns filed by taxpayers. Also, for the first time, the IRS added data on dependents obtained from various government sources, as well as data obtained from public records (e.g., current and prior addresses, real estate holdings, business registrations, and involvement with corporations). Together, these data reduced the amount of information requested from taxpayers, with some of the selected taxpayers not requiring any contact from the IRS. In effect, these data allowed the IRS to focus its efforts on return information that could not otherwise be verified. This pioneering approach was so successful it is being expanded in regular operational audit programs.

A second major NRP innovation was to introduce a "classification" process, whereby the randomly selected returns and associated case-building data were first reviewed by experienced auditors (referred to as classifiers) who identified not only which issues needed to be examined, but also the best way to handle each return in the sample. In this way, each return was either: (1) accepted as filed, without contacting the taxpayer at all (although, sometimes, minor adjustments were noted for research purposes); (2) selected for correspondence audit of up to three focused issues; or (3) selected for an in-person audit where there were numerous items that needed to be verified. In addition, the classifiers identified compliance issues that the auditor was required to evaluate, although the examiners had the ability to expand the audit to investigate other issues as warranted.

Other NRP innovations included streamlining the collection of data, providing auditors with new tools to detect noncompliance, and involving stakeholders (including representatives of tax professional associations) in the design and implementation of the study. Clearly, the NRP approach was much less burdensome on taxpayers than the old TCMP audits, which examined every line item on every return.

## TAX GAP ESTIMATES

As noted above, for the 2001 tax year, the overall gross tax gap was estimated to be approximately $345 billion, corresponding to a noncompliance rate of 16.3 percent. After accounting for enforcement efforts and late payments, the amount was reduced to $290 billion, corresponding to a net noncompliance rate of 13.7 percent.

Noncompliance takes three forms:

- not filing required returns on time (nonfiling);
- not reporting one's full tax liability on a timely filed return (underreporting); and
- not timely paying the full amount of tax reported on a timely return (underpayment).

The IRS has separate tax gap estimates for each of these three types of noncompliance. **Underreporting** (in the form of unreported receipts and overstated expenses) constitutes over 82 percent of the gross tax gap, up slightly from earlier estimates. **Underpayment** constitutes nearly 10 percent and **nonfiling** almost 8 percent of the gross tax gap.

### Nonfiling

The nonfiling gap is defined as the amount of true tax liability that is not paid on time by taxpayers who do not file a required return on time (or at all). It is reduced by amounts paid on time, such as through withholding, estimated payments, and other credits. The nonfiler population does not include *legitimate* nonfilers (i.e., those who have no obligation to file).

### Underreporting

The underreporting gap is defined as the amount of tax liability not voluntarily reported by taxpayers who file required returns on time. For income taxes, the underreporting gap arises from three errors: underreporting taxable income, overstating offsets to income or to tax, and net math errors. Taxable income includes such items as wages and salaries, rents and royalties, and net business income. Offsets to income include income exclusions, exemptions, statutory adjustments, and deductions. Offsets to tax are tax credits. Net math errors involve arithmetic mistakes or transcription errors made by taxpayers that are corrected at the time the return is processed. In addition to developing an estimate of the aggregate underreporting gap, it is possible to break aspects of this estimate down into measures of the underreporting gap attributable to specific line items on the tax return.

## Underpayment

The underpayment gap is the portion of the total tax liability that taxpayers report on their timely filed returns but do not pay on time. This arises primarily from insufficient remittances from taxpayers themselves. However, it also includes employer under-deposits of withheld income tax. In the case of withheld income tax, it is the responsibility of the employees to report the corresponding tax liability on timely filed returns, and it is the responsibility of their employers to deposit those withholdings with the government on time.

## THE TAX GAP MAP

Figure 1 summarizes the key components of the tax gap and how they relate to one another. It has come to be known as the "Tax Gap Map." As the Tax Gap Map indicates, the IRS estimates that, for 2001, approximately $55 billion of the gross tax gap will eventually be paid through enforcement or other late payments, leaving a net tax gap of about $290 billion. This projection of what will eventually be paid is based on fiscal year tabulations of past enforcement revenue and on prior studies of amounts that are paid late without enforcement efforts. Obviously, this projection depends directly on actions that both the IRS and taxpayers will take in the future, and the past is not likely to be a perfect predictor of that. Moreover, the IRS does not have good data on the amounts that are paid late without enforcement efforts. Consequently, this estimate of enforcement revenues and other late payments is necessarily subject to some uncertainty.

The Tax Gap Map distinguishes between "good" and "weak" estimates. For example, the corporation income tax estimates are acknowledged as weak because compliance behavior may have changed since the mid-1980s, which is the last time the IRS collected data on corporate compliance. Moreover, the underreporting tax gap is estimated as the difference between true tax liability and reported amounts. Determining true tax liability for large multi-national corporations can be difficult, given the complexity of the tax law, economic activities undertaken by these taxpayers, and the difficulty of making any kind of statistically valid assumptions based on a limited population of taxpayers. Weaknesses in general arise from two causes: using old data and using data and methods that do not adequately reflect the full extent of noncompliance.

Figure 2 organizes these estimates by type of tax and by type of noncompliance. As with tax gap estimates for prior tax years, the overall tax gap is dominated by the underreporting of individual income tax, which results in part from the dominant role that the individual income tax plays in overall federal tax receipts.

The individual income tax accounted for about half of all tax receipts in 2001. Individual income tax underreporting, however, was approximately $197 billion, or about 57 percent of the overall tax gap. While a comparison with 1988 data would suggest a slight decrease in individual income tax reporting compliance, it is important to remember that the data tell nothing about the years just before or just after TY 2001 and, as such, cannot show whether compliance trends today are improving or getting worse. Moreover, many aspects of the data and estimating methodologies used now are not comparable to earlier studies. In addition, broader changes in the economy over the past 20 years have made comparisons between the data difficult.

*Figure 1*

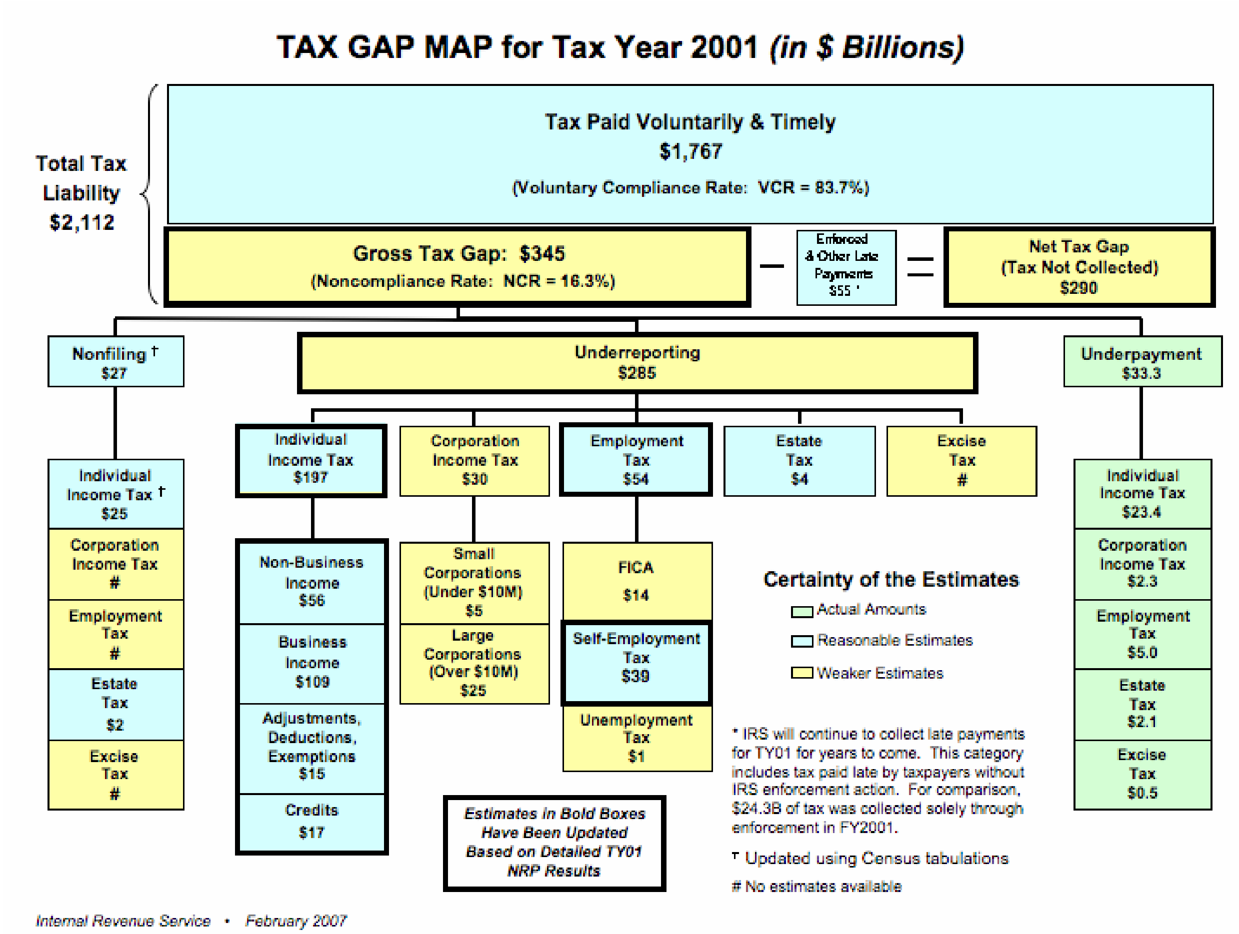



*Figure 2*

## Tax Year 2001 Gross Tax Gap by Type of Tax and Type of Noncompliance (in $ billions)

| *Type of Tax* | *Type of Noncompliance* | | | *TOTAL* | |
|---|---|---|---|---|---|
| | *Nonfiling Gap* | *Underreporting Gap* | *Underpayment Gap** | *Amount* | *Percent Distribution* |
| Individual Income Tax | 25 | 197 | 23.4 | 245 | 71.1% |
| Corporation Income Tax | # | 30 | 2.3 | 32 | 9.3% |
| Employment Tax | # | 54 | 5.0 | 59 | 17.0% |
| Estate & Gift Tax | 2 | 4 | 2.1 | 8 | 2.4% |
| Excise Tax | # | # | 0.5 | 1 | 0.1% |
| TOTAL<br>Percent Distribution | 27<br>7.8% | 285<br>82.5% | 33.3<br>9.7% | 345 | 100.0% |

* Since the underpayment gap figures are generally actual amounts rather than estimates, they are presented here to the closest $0.1 billion.

\# No estimates are available for these components.

Amounts may not add to totals due to rounding. See Figure 1 regarding the reliability of estimates.

The estimate of the self-employment tax underreporting gap is $39 billion, which accounts for about 11 percent of the overall tax gap. Self-employment tax is underreported primarily because self-employment income is underreported for income tax purposes. Taking individual income tax and self-employment tax together, then, it can be seen that individual underreporting contributes approximately 68 percent of the overall tax gap.

Figure 3 presents the same information, broken out by type of taxpayer (as defined by the IRS operating divisions that serve the taxpayer) rather than by type of noncompliance. This indicates that most of the underreporting of individual income tax is associated with individuals who have business income. The underreporting of self-employment tax is closely associated with the underreporting of business income by individuals; sole proprietors who understate their business income for income tax purposes are not likely to report the unreported income for employment tax purposes either.

*Figure 3*

**Tax Year 2001 Gross Tax Gap by Type of Tax and IRS Operating Division (in $ billions)**

| Type of Tax | IRS Operating Division | | | | | | TOTAL | |
|---|---|---|---|---|---|---|---|---|
| | Wage & Invest-ment | Small Business / Self-Employed | | | Large & Mid-Size Business | Tax-Exempt & Gov't Entities | Tax Gap | Non-Compliance Rate |
| | | Indi-viduals | Corpor-ations | Total | | | | |
| Individual Income Tax | 50 | 195 | N/A | 195 | N/A | N/A | **245** | 20.9% |
| Corporation Income Tax * | N/A | N/A | 6 | 6 | 25 | 1 | **32** | 18.5% |
| Employment Tax | 0 | 40 | 7 | 47 | 8 | 4 | **59** | 8.1% |
| Self-Employment | N/A | 39 | N/A | 39 | N/A | N/A | **39** | 51.9% |
| FICA and FUTA | 0 | 1 | 7 | 8 | 8 | 4 | **20** | 3.0% |
| Estate & Gift Tax | # | 8 | N/A | 8 | N/A | N/A | **8** | 22.9% |
| Excise Tax † | 0 | 0 | 0 | 0 | 0 | 0 | **1** | |
| **TOTAL Gap**<br>Percent of Total | **50**<br>14.5% | **243**<br>70.5% | **14**<br>4.0% | **257**<br>74.5% | **34**<br>9.8% | **4**<br>1.2% | **345**<br>100.0% | |
| Noncompliance Rate | 12.1% | 27.1% | 5.3% | 22.3% | 8.0% | 3.4% | | 16.3% |

* Unrelated Business Income Tax is shown as corporation income tax.

† Includes underpayment gap only.

# No estimate is available for this component.

Amounts may not add to totals due to rounding. Zeros indicate amounts less than $0.5 billion. See Figure 1 regarding reliability of estimates.

Individual income tax accounts for over 71 percent of the overall tax gap estimate of $345 billion. This is due, in part, to the fact that individual income tax is the largest single source of federal receipts.

The individual income tax underreporting gap can be broken out by the various line items on a typical return – income sources, offsets to income (i.e., exemptions, adjustments, and deductions), and offsets to tax (i.e., credits). Figure 4 provides updated estimates of both the tax gap arising from misreporting on each line item and the corresponding Net Misreporting Percentage (NMP).[1] These estimates are based on thorough audits of a representative sample of returns, but they also account for underreporting that is not detected in those audits.

As in previous compliance studies, the NRP data suggest that well over half ($109 billion) of the individual underreporting gap came from understated net business income (e.g., unreported receipts and overstated expenses). Approximately 28 percent ($56 billion) came from underreported non-business income, such as wages, tips, interest, dividends, and capital gains. The remaining $32 billion came from overstated subtractions from income (i.e., statutory adjustments, deductions, and exemptions) and from overstated tax credits.

An obvious conclusion from Figure 4 is that the accuracy of reporting the various line items on the average income tax return varies widely, depending on the type of income or offset being reported. Figure 5 presents the same line items grouped by the degree to which the items are "visible" to the IRS – that is, the extent to which they are subject to information reporting and withholding. The conclusion is striking: reporting compliance is strongest in the presence of substantial information reporting and withholding. This is illustrated graphically in Figure 6. Although the contribution to the underreporting gap depends on the dollars of income or offset at stake, the NMP is clearly inversely related to the degree of visibility.

It appears that compliance rates for sections of the Form 1040 where the most noncompliance occurs have not changed dramatically since the last compliance study for TY 1988. The amounts least likely to be misreported on tax returns are subject to both third-party information reporting and withholding and are, therefore, the most visible (e.g., wages and salaries). The net misreporting percentage for wages and salaries is only 1.2 percent.

Amounts subject to third-party information reporting, but not to withholding (e.g., interest and dividend income), exhibit a somewhat higher misreporting percentage. For example, there is about a 4.5 net misreporting percentage rate for items subject to substantial information reporting, such as interest, dividends, pensions, and social security benefits.

Amounts subject to partial reporting by third parties (e.g., capital gains) have a still higher net misreporting percentage rate of 8.6 percent. As expected, amounts not subject to withholding or third-party information reporting (e.g., sole proprietor income and the "other income" line on Form 1040) are the least visible and, therefore, are most likely to be misreported. The net misreporting percentage for this group of line items is 53.9 percent.

[1] The net amount of income misreported divided by the sum of the absolute values of the amounts that should have been reported. The NMP measures provide insight into the extent of noncompliance for any given provision. However, caution should be applied when comparing NMPs across tax provisions. First, a provision may have a large NMP but contribute only slightly to the tax gap (e.g., the total true tax liability for a particular item is relatively small). Second, the NMP contains an adjustment for income amounts that were underreported but does not have a corresponding adjustment for offset amounts that were not claimed.

*Figure 4*

**Tax Year 2001 Individual Income Tax Underreporting Gap and Net Misreporting Percentage (NMP) Associated with Income and Offset Line Items**

| Type of Income or Offset | Underreporting Gap ($B) | Net Misreporting Percentage † |
|---|---|---|
| **Total Underreporting Gap** | **197** | **18%** |
| **Underreported Income** | **166** | **11%** |
| ***Non-Business Income*** | **56** | **4%** |
| Wages, salaries, tips | 10 | 1% |
| Interest income | 2 | 4% |
| Dividend income | 1 | 4% |
| State income tax refunds | 1 | 12% |
| Alimony income | * | 7% |
| Pensions & annuities | 4 | 4% |
| Unemployment compensation | * | 11% |
| Social Security benefits | 1 | 6% |
| Capital gains | 11 | 12% |
| Form 4797 income | 3 | 64% |
| Other income | 23 | 64% |
| ***Business Income*** | **109** | **43%** |
| Non-farm proprietor income | 68 | 57% |
| Farm income | 6 | 72% |
| Rents & royalties | 13 | 51% |
| Partnership, S-Corp, Estate & Trust, etc. | 22 | 18% |
| **Overreported Offsets to Income** | **15** | **4%** |
| Adjustments | -3 | -21% |
| SE Tax deduction§ | -4 | -51% |
| All other adjustments | 1 | 6% |
| Deductions | 14 | 5% |
| Exemptions | 4 | 5% |
| **Credits** | **17** | **26%** |
| **Net Math Errors (non-EITC)** | ***** | |

† The amount of income or offset misreported divided by the amount that should have been reported. The NRP contains an adjustment for income amounts that were underreported, but does not have a corresponding adjustment for offset amounts that were not claimed.

* Less than $0.5 billion.

§ Taxpayers *understate* this adjustment because they understate their self-employment income and, thereby, their self-employment tax. Therefore, the gap associated with this item is negative.

*Figure 5*

**Tax Year 2001 Individual Income Tax Underreporting Gap and Net Misreporting Percentage (NMP) Associated with Income and Offset Line Items, By Visibility Groups**

| Visibility Group<br>Type of Income or Offset | Underreporting Gap ($B) | Net Misreporting Percentage † |
|---|---|---|
| **Total Underreporting Gap** | **197** | **18%** |
| **Items Subject to Substantial Information Reporting and Withholding** | **10** | **1%** |
| Wages, salaries, tips | 10 | 1% |
| **Items Subject to Substantial Information Reporting** | **9** | **5%** |
| Interest income | 2 | 4% |
| Dividend income | 1 | 4% |
| State income tax refunds | 1 | 12% |
| Pensions & annuities | 4 | 4% |
| Unemployment compensation | * | 11% |
| Social Security benefits | 1 | 6% |
| **Items Subject to Some Information Reporting** | **51** | **9%** |
| Partnership, S-Corp, Estate & Trust, etc. | 22 | 18% |
| Alimony income | * | 7% |
| Capital gains | 11 | 12% |
| Deductions | 14 | 5% |
| Exemptions | 4 | 5% |
| **Items Subject to Little or No Information Reporting** | **110** | **54%** |
| Non-farm proprietor income | 68 | 57% |
| Farm income | 6 | 72% |
| Rents & royalties | 13 | 51% |
| Form 4797 income | 3 | 64% |
| Other income | 23 | 64% |
| Total statutory adjustments | -3 | -21% |
| **Not Shown on Figure 6§** | **17** | **26%** |
| Credits | 17 | 26% |

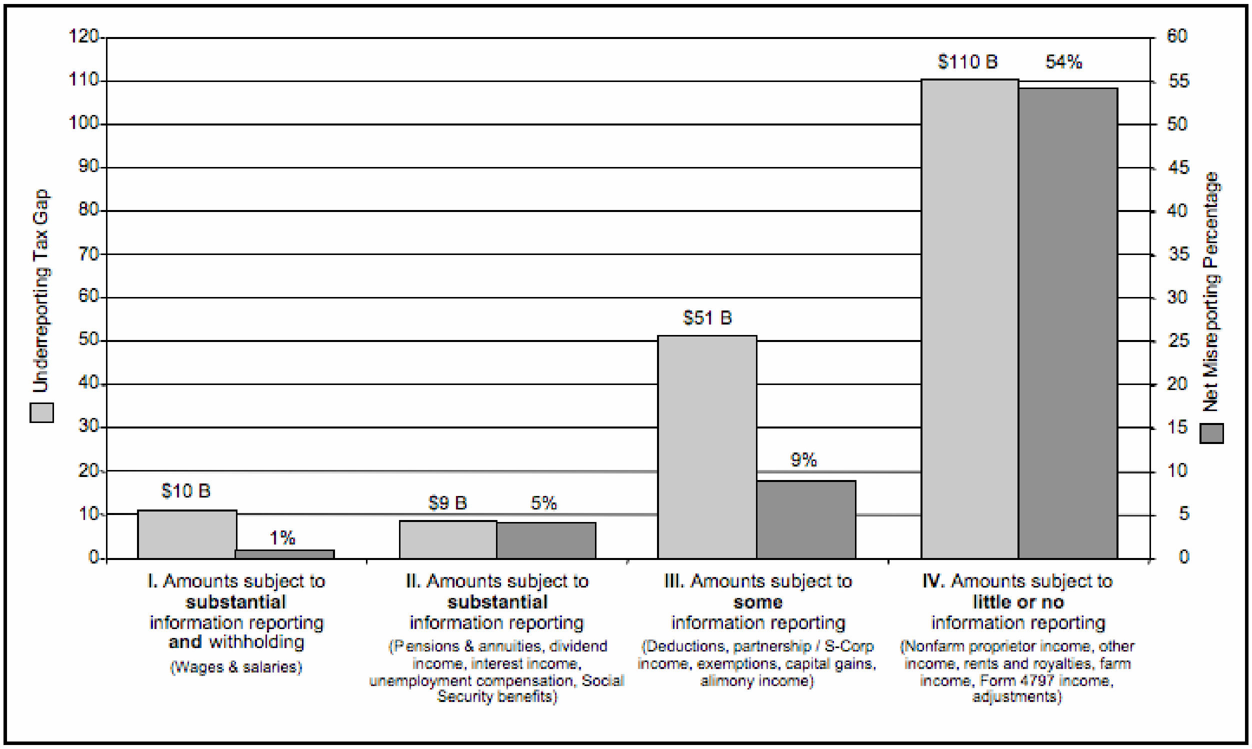
† The aggregate amount of income or offset misreported divided by the sum of the absolute values of the amount that should have been reported. The estimates of the amounts that should have been reported account for underreported income that was not detected by the audits, but do not have a corresponding adjustment for unclaimed offsets (e.g., deductions, exemptions, statutory adjustments, and credits) that were not detected.

* Less than $0.5 billion.

§ Since credits are offsets to tax, it is difficult to combine them with income and income offset items when calculating a combined NMP.

*Figure 6*

**Tax Year 2001 Individual Income Tax Underreporting Gap**
Misreporting of Income and Offsets by "Visibility" Categories




Based on updated estimates derived from the TY01 National Research Program study of individual income tax reporting compliance.

With transactions that are less visible to the IRS, and with very low audit rates by historical standards, some sole proprietors may have become emboldened to cut corners on their taxes. Other small business owners may fail to comply fully because they are overwhelmed by the cost and complexity of meeting their tax obligations and their business requirements. Whatever the reasons, there is a serious problem with underreporting for those items not subject to information reporting.

The underpayment gap is the simplest component of the tax gap to measure since, for the most part, it is observed in full. The underpayment gap is the difference between the tax that taxpayers report on their timely filed returns and the amount that is actually paid by the payment due date. The first amount is tabulated from the Individual Master File. With the exception of employer under-deposit of withheld income tax, the amount paid is also tabulated from the Individual Master File.

Figure 7 summarizes the underpayment gap and rates for TY 2001 arrayed by taxpayer type (rather than tax type as in Figure 1). Almost all of what is voluntarily reported is also paid on time, and more than two-thirds of the balance is paid within two years. Individual income tax contributes almost two-thirds of the total underpayment gap, and over three-quarters of the individual income tax underpayment gap is associated with taxpayers who have business income.

Since sole proprietors report their self-employment tax on their individual income tax returns (Form 1040), the TY 2001 NRP study provided new compliance data with which to estimate this component of the tax gap. Self-employment tax is sometimes not reported correctly (or at all) in connection with reported self-employment income that is reported. However, most of this component of the tax gap is associated with unreported self-employment income. The NRP auditors detected some of this unreported income, but not all of it. The IRS estimate of the self-employment tax underreporting gap accounts for this undetected income. Estimates also account for the fact that some of this unreported income would not be subject to full self-employment tax, given the annual cap on Social Security taxes. Accounting for all of these factors, the updated estimate of the self-employment tax gap for TY 2001 is $39 billion.

The remaining tax gap estimates shown on the Tax Gap Map (Figure 1) are based on data older than TY 2001. In order to develop estimates based on the latest data, but for a common tax year, the IRS projected the most recent previous estimates to TY 2001 using a simple approach. Lacking information to the contrary, the IRS assumed that the compliance rate for each major component remained constant. The tax gap in a given component was projected to grow at the same rate as tax receipts in that component. The IRS plans to update these estimates as newer compliance data become available.

The main lesson from the Tax Gap Map is that noncompliance is worst where the barriers to voluntary compliance or the opportunities for noncompliance are greatest. This is seen even more vividly in Figure 6, which shows the importance of third-party information reporting.

*Figure 7*

### Tax Year 2001 Underpayment Gap By Type of Taxpayer

| Type of Taxpayer | Gross Underpayment Gap ($ Billions) | Voluntary Payment Compliance Rate† | Net Underpayment Gap ($ Billions) | | Cumulative Payment Compliance Rate† | |
|---|---|---|---|---|---|---|
| | | | After 1 Year | After 2 Years | After 1 Year | After 2 Years |
| **All Taxes** * | **31.7** | **98.6%** | | | | |
| Wage & Investment | 4.3 | 98.9% | 2.1 | 1.8 | 99.4% | 99.6% |
| Small Business / Self-Employed | 23.7 | 97.6% | 7.3 | 6.5 | 99.2% | 99.3% |
| Large & Mid-Size Business | 3.3 | 99.6% | 2.0 | 2.0 | 99.7% | 99.7% |
| Tax Exempt / Government Entities | 0.4 | 99.87% | 0.2 | 0.1 | 99.95% | 99.97% |

† The Voluntary Payment Compliance Rate is the portion of tax reported on timely filed returns that is paid on time. The Cumulative Payment Compliance Rate is the portion of tax reported on timely filed returns that is paid as of a certain date.

* The $31.7 billion total for all taxes excludes $1.6 billion of individual income taxes withheld by employers but neither reported on timely filed employment tax returns nor paid by employers.

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# VOLUNTARY COMPLIANCE

A wide range of factors influence voluntary compliance, although there is little empirical confirmation as to the most important of these factors or their magnitudes. However, it is generally agreed that IRS actions are not the sole – or perhaps even the primary – determinants of voluntary compliance. In addition to whether information reporting and withholding requirements exist as mentioned previously, other important factors include the following:

- Tax law changes, including:
    - opening or closing opportunities for noncompliance
    - tax law complexity may confuse taxpayers or make noncompliance more difficult to observe
    - tax rates may affect incentives to report income

- The economy, including:
    - income and unemployment levels
    - the mix of industries

- Demographics, including:
    - the aging of the population
    - changing household arrangements
    - growth in the number of non-English-speaking taxpayers

- Socio-political factors, including:
    - swings in patriotic sentiments
    - taxpayer perceptions of whether they are getting their money's worth from their taxes

Additionally, there are both direct and indirect effects of enforcement activities. Direct effects refer to the collection of additional revenue from taxpayers who are subject to enforcement actions. Indirect effects refer to "spillover" effects when enforcement activity on one set of taxpayers has positive effects on the compliance behavior of the rest of the taxpayer population in response to heightened enforcement activity.

## MEASURING VOLUNTARY COMPLIANCE

It is very difficult to determine the impact that any IRS activity has on voluntary compliance. While the direct effect of IRS enforcement activities is identifiable through the impact on collections, the IRS cannot easily estimate the indirect effects. That is partly because the IRS cannot observe taxpayers' true tax liabilities (they must be estimated), and partly because so many factors may influence the extent to which they pay their tax voluntarily and timely – including many factors outside of IRS control. The challenge is to estimate the impact of each IRS activity on observable behaviors – returns filed, tax reported, and tax paid – controlling for other influences as much as possible. Only then will the IRS know the best mix of activities that will foster the greatest degree of voluntary compliance.

## Long-Term Goal for Voluntary Compliance

The Voluntary Compliance Rate (VCR) is the amount of tax for a given tax year that is paid voluntarily and timely, expressed as a percentage of the corresponding amount of tax that the IRS estimates should have been paid. It reflects taxpayers' compliance with their filing, reporting, and payment obligations. The latest estimate of VCR is 83.7 percent for all taxes and all taxpayers for TY 2001.

In the Administration's budget request for FY 2007, the IRS established a long-term goal of an 85 percent voluntary compliance by TY 2009. In February of 2007, the IRS Oversight Board, as part of establishing a strategic direction for the IRS, established a long-term goal of an 86 percent voluntary compliance rate by TY 2009. Senator Baucus, Chairman of the Senate Finance Committee, has asked for a 90 percent voluntary compliance goal by TY 2017.

An increase in the VCR to 86 percent by TY 2009 may not seem large, but the available evidence suggests that the VCR has not changed dramatically over the last 20 to 30 years. For example, based on TCMP data from the 1960s through the 1980s, the IRS estimates that the VCR has moved within a range of two percentage points and was virtually the same in TY 2001 as it had been in TY 1985.

Much of the estimated fluctuation during this time likely was due to the inherently imprecise nature of these estimates, the impact of the Tax Reform Act of 1986, and the changing relative sizes of revenues from different taxes. Since the IRS has estimated the overall VCR for just a few selected years in that period, it is possible that compliance may have fluctuated in the intervening years. However, the evidence from individual income tax underreporting – by far the largest portion of the tax gap, and the component most frequently measured – indicates that there was no consistent trend over this time period.

The IRS and the public must have realistic expectations about the magnitude and timing of the impact of any reasonable actions to reduce the tax gap, particularly if it is not accompanied by broader simplification and reform of the tax code, or significant advances in compliance technology. Implementing efforts to reduce the tax gap will take time; changing taxpayer behavior significantly will also take time. Accordingly, results from these efforts will be realized incrementally over a number of years. As part of the actions outlined in this report, the IRS will, for example, acquire and analyze new data, improve document-matching programs, refine examination selection criteria, purchase and test new technology, and train employees to handle new enforcement and customer service responsibilities.

Moreover, while it may be possible to take action to *reduce* the tax gap, it is not possible to implement a policy that *eliminates* the tax gap without an unacceptable change in the fundamental nature of the current tax compliance system. The IRS is, however, committed to addressing all levels of noncompliance. Therefore, the efforts to reduce the tax gap will continue to be developed and refined to achieve the highest level of compliance possible.

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# COMPONENTS

With an estimated net tax gap of $290 billion for TY 2001, no single approach will be successful at substantially reducing noncompliance. Accordingly, the Treasury Strategy set out a comprehensive, integrated, multi-year strategy that must be implemented within the context of the annual budget process. This report builds on the work of the Treasury Strategy to provide a comprehensive framework that will be institutionalized by the IRS as part of sound tax administration.

This report includes seven components, detailed below:

1. **Reduce Opportunities for Evasion** (pages 20-25)
2. **Make a Multi-Year Commitment to Research** (pages 26-27)
3. **Continue Improvements in Information Technology** (pages 28-32)
4. **Improve Compliance Activities** (pages 33-41)
5. **Enhance Taxpayer Service** (pages 42-49)
6. **Reform and Simplify the Tax Law** (page 50-52)
7. **Coordinate with Partners and Stakeholders** (page 53-56)

Component 1

## Reduce Opportunities for Evasion

**Legislative changes and published guidance will reduce opportunities for evasion.**

### Legislative Proposals

The Administration's FY 2007 Budget contained five legislative proposals that would reduce evasion opportunities by focusing on employment taxes, information reporting, streamlining collection procedures, and problem return preparers. The Administration's FY 2008 Budget expands on those five and contains several additional proposals that would further reduce opportunities for evasion without unduly burdening honest taxpayers. Collectively, the Department of Treasury estimates that these16 legislative proposals would generate $29.5 billion over the next 10 years. The IRS is encouraged to see that three of the proposals have already become law (in modified form) and that Congress is taking action on a number of the remaining proposals.

Public Law 110-28, Title VIII, the Small Business and Work Opportunity Tax Act of 2007, enacted proposals on amending the collection due process procedures for employment tax liabilities, expanding preparer penalties, and creating an erroneous refund claim penalty. These proposals, along with others contained in the FY 2008 Budget, are described below in more detail:

*Expanding Information Reporting:* Third-party reporting is critical for ensuring voluntary compliance. Without reliable third-party data, the IRS cannot easily detect errors in the absence of expensive and intrusive audits. The IRS receives over 1.5 billion information returns a year, reporting income from employers, financial institutions, third-party payers, and state and federal governments. However, the IRS still lacks reliable information on certain types of income, most notably income earned by small businesses and the self-employed. Information reporting proposals in the Administration's FY 2008 Budget would:

- *Require information reporting on payments to corporations*. This proposal would require a business to file an information return for payments aggregating to $600 or more in a calendar year to a corporation (except a tax-exempt corporation). This proposal is estimated to generate $7.7 billion over the next ten years.

- *Require basis reporting on security sales*. This proposal would require certain brokers to report information regarding adjusted basis in connection with the sale of certain publicly traded securities. Brokers would also be required to report acquisition or disposition dates to help determine gain or loss for taxpayers. This proposal is estimated to generate $6.7 billion over the next ten years.

- *Expand broker information reporting*. This proposal would require a broker who is an auctioneer or operates a consignment business (electronic or other) to file an information return showing customer information and gross proceeds from the sale of tangible personal property. The requirement would apply only for customers with 100 or more separate transactions generating at least $5,000 in gross proceeds in a year. This proposal is estimated to generate $2.0 billion over the next ten years.

- *Require information reporting on merchant payment card reimbursements*. This proposal would provide the IRS with authority to put into effect regulations requiring merchant acquiring banks (organizations that process card payments for merchants) to report to the IRS annually the gross reimbursement payments made to merchants in a calendar year. This proposal is estimated to generate $10.7 billion over the next ten years.

- *Require a certified Taxpayer Identification Number from contractors*. This proposal requires a contractor receiving payments of $600 or more in a calendar year from a particular business to furnish to the business its certified Taxpayer Identification Number (TIN). This proposal would require a business to verify the TIN with the IRS, which would be authorized to disclose whether the TIN-name combination matches IRS records. If a contractor fails to furnish an accurate certified TIN, the business would then be required to withhold a flat rate. This proposal is estimated to raise $749 million over the next ten years.

- *Require increased information reporting for certain government payments for property and services*. This proposal would authorize the IRS and Treasury Department to issue regulations requiring information reporting on all non-wage payments by federal, state and local governments to procure property and services. This proposal is estimated to generate $390 million over the next ten years.

- *Increase information return penalties*. This proposal would increase the $50 and $100 penalty amounts to $100 and $250, respectively, and would increase the $250,000 and $100,000 penalty caps to $1,500,000 and $500,000, respectively. This proposal is estimated to generate $546 million over the next ten years.

*Improving Compliance by Businesses:* More efficient filing mechanisms, clearer rules on who is liable for employment taxes, and streamlined collection due process will contribute to improved business tax compliance.

- *Require e-filing by certain large organizations*. This proposal would require all corporations and partnerships required to file Schedule M-3 to file their income tax returns electronically. In the case of large taxpayers not required to file Schedule M-3, such as exempt organizations, the regulatory authority to require electronic filing would be expanded beyond the current 250-return minimum.

- *Implement standards clarifying when employee leasing companies can be held liable for their clients' federal employment taxes*. This proposal would set standards for holding employee leasing companies jointly and severally liable with their clients for federal employment taxes. This proposal would provide standards for holding employee leasing companies solely liable if they meet specified requirements. This proposal is estimated to generate $57 million over the next ten years.

- *Amend collection due process procedures for employment tax liabilities*. Legislation was signed May 25, 2007, implementing a modified version of this proposal. It expands the exception to the requirement for pre-levy Collection Due Process proceedings to include certain levies issued to collect federal employment taxes. The change will generate an estimated $364 million over the next ten years.

*Strengthening Tax Administration:* Tax administration will be strengthened through disclosure revisions and stronger penalties for nonfiling.

- *Expand IRS access to information in the National Directory of New Hires (NDNH) for tax administration purposes*. This proposal would amend the Social Security Act to expand IRS access to NDNH data for general tax administration purposes, including data matching, verification of taxpayer claims during return processing, preparation of substitute returns for noncompliant taxpayers, and identification of levy sources.

- *Permit disclosure of prison tax scams*. This proposal would authorize the IRS to disclose certain limited return information about tax violations by inmates so prison officials could punish and deter such conduct through administrative sanctions. This is expected to generate $5 million over the next ten years.

- *Make repeated willful failure to file a tax return a felony*. This proposal would subject any person who willfully fails to file tax returns in any three years within any five year period, if the aggregated tax liability for such period is at least $50,000, to a new aggravated failure to file criminal penalty. This proposal is estimated to generate $12 million over the next ten years.

*Strengthening Penalties:* Enhanced penalties will help to deter noncompliance.

- *Expand preparer penalties*. Legislation was signed May 25, 2007, implementing a modified version of this proposal. It expands the scope of the existing preparer penalties to include non-income tax returns and related documents. The proposal also increases related penalty amounts. The change will generate an estimated $80 million over the next ten years.

- *Impose penalty on failure to comply with electronic filing requirement*. This proposal would establish a penalty for failure to comply with e-file requirements. The amount of the penalty would be $25,000 for a corporation or $5,000 for a tax-exempt organization.

- *Create an erroneous refund claim penalty*. Legislation was signed May 25, 2007, implementing a version of this proposal. It imposes a penalty of up to 20 percent of a disallowed portion of a claim for refund or credit for which there is no reasonable basis for the claimed tax treatment, or for which the taxpayer did not have reasonable cause. The change will generate an estimated $98 million over the next ten years.

The Treasury Department and the IRS will continue to explore additional possibilities for legislative proposals, as well as improved methods for using external data and data from information reports.

## Published Guidance

Published guidance in the form of regulations, revenue rulings, revenue procedures, notices, and announcements is a critical element in the IRS' efforts to reduce tax avoidance, improve taxpayer compliance, and close the tax gap.

Published guidance:

- Enhances compliance by providing detailed substantive and procedural rules;
- Helps compliant taxpayers better understand how to determine and pay their tax liability;
- Reduces disputes between the IRS and taxpayers regarding the proper interpretation of the tax law and the procedures necessary to comply with it; and
- Makes it more difficult for noncompliant taxpayers to avoid detection or incorrectly claim that their behavior is permitted under the tax law.

Some tax statutes specifically direct the Treasury Department and the IRS to issue regulations or other guidance. Certain statutory provisions have little or no effect until implemented by regulations or other administrative guidance, and some provide only general direction and broadly delegate authority to publish regulations. Published guidance interprets the tax law and articulates how it applies in different circumstances, thus helping taxpayers determine how to comply with their tax obligations.

The Treasury Department and the IRS continue to resolve many difficult issues and remove impediments to voluntary compliance through published guidance. The ever-increasing complexity of, continuing changes in, and temporary nature of the tax law also present significant challenges to addressing long-standing compliance problems through guidance. The published guidance program also aids in identification of issues that guidance cannot address and serves a significant role in developing suggestions for legislative solutions.

Each year, the Treasury Department and the IRS issue a Priority Guidance Plan (PGP) that sets forth the guidance projects targeted for completion over the course of the following 12 months. The PGP typically includes more than 250 separate guidance projects.

Examples of published guidance designed to improve compliance recently issued by the Treasury Department and the IRS include:

- Regulations clarifying the tax rules and information reporting requirements for widely held fixed investment trusts;
- Regulations implementing and explaining new tax shelter disclosure rules and penalties;
- Regulations and other guidance on reporting and inclusion in income of deferred compensation from nonqualified deferred compensation plans;
- Regulations and other guidance clarifying and explaining the new deduction for domestic production activities;
- Guidance explaining the rules governing charitable contributions of vehicles;

- Guidance on transfer pricing issues related to cross-border services and cost-sharing agreements;
- Proposed regulations addressing the tax treatment of private annuities;
- Guidance designating a loss importation strategy as a listed transaction;
- Guidance implementing a new excise tax on tax-exempt entities and their managers in connection with participation in certain potentially abusive transactions;
- Guidance improving information reporting for certain wagering activities;
- Proposed regulations addressing when expenditures for tangible property may be deducted or must be capitalized; and
- Rulings addressing the consequences, including potential penalties, of filing returns (or failing to file returns) based on frivolous tax positions.

Issuing published guidance is an important tool for the IRS in closing the tax gap. Notwithstanding the inherent challenges, the Treasury Department and the IRS will continue to provide published guidance to improve compliance by addressing abusive tax avoidance transactions, providing clarifications and explanations of the tax laws, ensuring consistency of treatment of similarly situated taxpayers, and where possible, reducing burden on compliant taxpayers.

Some projects currently underway include development of guidance in these areas:

- Transfer pricing (Internal Revenue Code (IRC) section 482)
- Foreign tax credits (IRC section 901)
- Patent cross licensing
- International restructurings (IRC section 367)

## Initiatives

- Work with Congress to enact remaining legislative proposals included in Administration's FY 2008 Budget:
    - Require information reporting on payments to corporations;
    - Require basis reporting on security sales;
    - Expand broker information reporting;

- Require information reporting on merchant payment card reimbursements;
    - Require a certified Taxpayer Identification Number from contractors;
    - Require increased information reporting for certain government payments for property and services;
    - Increase information return penalties;
    - Require e-filing by certain large organizations;
    - Implement standards clarifying when employee leasing companies can be held liable for their clients' federal employment taxes;
    - Expand IRS access to information in the NDNH for tax administration purposes;
    - Permit disclosure of prison tax scams;
    - Make repeated willful failure to file a tax return a felony; and
    - Impose penalty on failure to comply with electronic filing requirement.

- Develop new legislative proposals for consideration in the Administration's FY 2009 Budget. Approaches under consideration include:
    - Improvements in coordination with State governments, including coordination concerning licensing activities; and
    - Further expansions of information reporting requirements, including reporting of financial activity that currently may not be subject to information reporting.

- Develop regulations and other published guidance clarifying ambiguous areas of the law, targeting specific areas of noncompliance, and preventing abusive behavior.

Component 2

## Make a Multi-Year Commitment to Research

**Research is critical in helping the IRS understand behavior, develop strategies, and measure progress.**

Research enables the IRS to develop strategies to combat specific areas of noncompliance, improve voluntary compliance, allocate resources more effectively, and reduce the tax gap. Compliant taxpayers benefit when the IRS uses the most up-to-date research to improve workload selection formulas, because this reduces the burden of unnecessary taxpayer contacts and because it enables the IRS to collect more with a given level of resources. Research is also critical in helping the IRS establish benchmarks against which to measure progress in improving compliance.

The NRP demonstrates the importance of comprehensive compliance data. In addition, accurate NRP data provides a critical benchmark for determining the sources of noncompliance and for measuring changes in compliance over time. Data from the NRP reporting compliance study have allowed the IRS to:

- Target examinations and other compliance activities better, thus increasing the dollar-per-case yield and reducing "no change" audits of compliant taxpayers; and

- Improve operational audits by using innovations pioneered during the 2001 NRP to reduce taxpayer burden.

Continued compliance research is a vital component of a sound tax gap strategy. An NRP reporting compliance study of 5,000 S corporation tax returns filed in 2003 and 2004 is currently in process. Since 1985, S corporation return filings have increased dramatically. In that year, there were 722,444 Forms 1120S filed. In 2004, that number had grown by nearly five times to over 3.6 million, while other corporate returns declined by approximately 500,000 for the same period.

By 1997, S corporations had become the most common corporate entity. In 2004, tax returns filed by S corporations accounted for over 63 percent of all corporate returns filed. The last time the IRS conducted an S corporation study was 1984. As a result, the IRS does not have reliable reporting compliance data for these entities. The current S corporation study represents the first time that the IRS has conducted a reporting compliance study across tax years, and it will require that the data be knitted together to provide a comprehensive picture. The study will continue through 2007.

Without new reporting compliance studies, the IRS must rely on studies conducted over 20 years ago to estimate compliance for areas other than individual income tax or S corporations. Moreover, with each passing year, the data from the 2001 study on individual income tax compliance becomes more outdated. Without up-to-date studies in all areas, the IRS is hampered in its ability to respond rapidly to trends and emerging vulnerabilities in the tax system. A multi-year commitment to research ensures that the IRS can efficiently target resources and effectively respond to new sources of noncompliance as they emerge.

The Administration's FY 2008 Budget request for the IRS funds for three significant research initiatives. These include:

- *Increasing compliance studies*. The IRS will conduct reporting compliance studies for additional segments of taxpayers for which the IRS now relies on very old data (e.g., corporation income tax, employment tax, and partnerships), or for which the IRS has never conducted any compliance studies at all (e.g., excise tax).

- *Updating existing data from the 2001 NRP study*. The IRS will conduct an annual study of compliance among Form 1040 filers based on a smaller sample size than the 2001 NRP study. This will provide fresh compliance data each year and, by combining samples over several years, will provide a regular update to the larger sample size needed to keep the IRS' targeting systems and compliance estimates up to date.

- *Researching the effect of service on taxpayer compliance*. This project will undertake new research on the needs, preferences, and behaviors of taxpayers. The research will focus on four areas:

    1. Meeting taxpayer needs by providing the right channel of communication;
    2. Better understanding taxpayer burden;
    3. Understanding taxpayer needs through the errors they make; and
    4. Researching the impact of service on overall levels of voluntary compliance.

### Initiatives

- Undertake additional compliance studies, including S corporations and individuals.
- Update tax gap estimates using new and existing data.
- Research the effect of service on taxpayer compliance.
- Research the relationship between complexity, burden, and compliance.

Component 3

## Continue Improvements in Information Technology

**A combination of new systems and enhancements to existing systems is critical to a productive use of resources.**

Information technology (IT) modernization is critical to ensuring the most productive use of both taxpayer service and compliance resources. It provides the necessary infrastructure that allows the most efficient utilization of resources, which in turn allows the IRS to target key components of the tax gap better. Because IT modernization is a cornerstone to efficient and effective tax administration, the IRS is committed to strong oversight and accountability of IT projects.

The IRS information technology vision includes systems that:

- Allow for better identification of the cases to be worked;
- Route those cases to the most appropriate workstream; and
- Employ cost effective technology analytics to best manage cases once they reach the correct workstream.

The IRS' current investment in technology infrastructure includes a combination of new systems and enhancements to existing systems, with emphasis on improving both effectiveness and efficiency. Included in this infrastructure are tools to increase taxpayer compliance through early detection, improved case selection, more efficient case delivery, and better case management:

- Case Selection. The NRP provides significant data for improving case selection criteria. NRP data facilitates selection of the most productive returns to examine. This not only reduces the tax gap, but also allows the IRS to update tax gap estimates. The case selection process is further enhanced through automated classification processes. The IRS also uses current audit information from "issue management" systems to provide for immediate identification of emerging issues. For Collection programs, the IRS will use improved decision analytics to select cases and route them to the most appropriate workstream.
- Case Delivery. Delivery systems also are being modified to move audit work into the system more effectively and efficiently. Both return classification and delivery will move toward digital rather than paper-based returns, eliminating the time consuming and expensive process of ordering returns and sending examiners out to IRS campus locations for classification details. Additionally, the IRS will replace manual processes with electronic case building and instant access to multi-year tax return information.
- Case Management. Automated systems are being deployed to allow more batched processing of high volume types of examinations. Technology enhancements will allow

employees to work cases in an online environment, where returns and case-related data can be downloaded, and actions can be tracked electronically. The IRS will continue to link multiple internal and external databases to enhance overall effectiveness, allowing better identification, management, and performance monitoring for compliance workload. The IRS also has several projects that will enhance criminal enforcement, with spillover effects to civil cases.

The Administration's FY 2008 Budget request includes an additional $81 million in funding to improve the IRS' information technology infrastructure, which is vital to improving IRS' enforcement and services capabilities. The investments proposed in the Budget will allow the IRS to:

- *Upgrade critical IT infrastructure.* This will provide funding to upgrade the backlog of IRS equipment that has exceeded its life cycle. Failure to replace the IT infrastructure will lead to increased maintenance costs and will increase the risk of disrupting business operations. Planned expenditures in FY 2008 include procuring and replacing desktop computers, automated call distributor hardware, and Wide Area Network/Local Area Network routers and switches.

- *Enhance the Computer Security Incident Response Center (CSIRC) and the network infrastructure security*. This will allow the CSIRC to keep pace with the ever-changing security threat environment through enhanced detection and analysis capability, improved forensics, and the capacity to identify and respond to potential intrusions before they occur.

- *Enhance the IRS' network infrastructure security*. This will provide the capability to perform continuous monitoring of the security of operational systems using security tools, tactics, techniques, and procedures to perform network security compliance monitoring of all IT assets on the network.

The FY 2008 Budget request also includes a total of $282 million to continue the development and deployment of the IRS' Business Systems Modernization (BSM) program in line with the recommendations identified in the IRS' Modernization, Vision, and Strategy. This funding will allow the IRS to continue progress on modernization projects, such as the Customer Account Data Engine (CADE), Account Management Services (AMS), Modernized e-File (MeF), and Common Services Projects (CSP).

- *Continue development of CADE and AMS*. The development of CADE and AMS systems is the heart of IRS' IT modernization. These two systems, working together, will enable the IRS to process tax returns and deal with taxpayer issues in a near real-time manner. The objective is for the IRS to operate similarly to a bank, where account transactions occurring during the business day are posted and available by the next business day. In addition, AMS will enable the IRS representatives who work with taxpayers to have access to all current information regarding that taxpayer, including electronic access to tax return data and electronic copies of correspondence. Armed with such comprehensive and up-to-date information, IRS representatives will be in a much better position to help taxpayers resolve their issues, which benefits both the IRS and taxpayers while promoting voluntary compliance.

The development of CADE and AMS also includes a comprehensive re-working of the notice system to streamline the process and enhance its efficiency. In July 2008, CADE is scheduled to post and settle tax returns with a balance due condition and amended tax returns, Form 1040X. The daily settlement of these accounts through CADE and the linkage with AMS will enable the balance due notices to be sent on a daily basis and delivered to the taxpayer as much as eight days faster than current time lines.

- *Continue development of MeF*. MeF is the future of electronic filing. It provides a standard data format for all electronically filed tax returns, which will reduce the cost and time to add and maintain additional tax form types. MeF is a flexible real-time system that streamlines the processing of e-filed tax returns, resulting in a quicker filing acknowledgement to the taxpayer or their representative. In FY 2007, the IRS is beginning the development and implementation of the Form 1040 on the MeF platform. The MeF system will enable the IRS to better analyze tax compliance issues and address noncompliance among taxpayers by removing the impediments caused by lack of data availability and completeness, access, and data accuracy. MeF will allow the re-engineering of much of the current manual and time consuming compliance processes including the following:

    - Completeness of Data. The MeF system provides 100 percent of the data contained within the returns, their schedules and attachments, third-party documents, and amended returns in an electronic form. All documentation will be available completely and electronically, which is equivalent to a paper copy of the entire return file, but in a more usable and transportable form. The current e-filing system only provides returns and does not have the ability to provide supplemental documentation, including attachments, electronically. Paper submissions provide only limited transcriptions of return data or an image of the return. All other documentation is recalled and analyzed using time consuming manual processes.

    - Data Availability and Access. Currently, IRS electronic systems capture an average of 20 percent of the data contained within tax and information returns. To gather additional information for compliance needs, the IRS must conduct manual transcriptions, which are costly and time consuming. For each form, the amount of information retained or transcribed varies by form type, complexity, and size. For those returns submitted through MeF, 100 percent of the data will be available to the IRS in electronic format, including associated schedules and attachments, regardless of the form type and without additional expense.

    - Data Accuracy. The IRS currently expends time and resources ensuring the data received from tax and information filers and transcriptions are accurate and reliable. The MeF system and its processes increase data accuracy by reducing the incidence of errors and by minimizing the need for manual transcriptions. This is made possible by validating the information prior to submission. The use of business rules also ensures that the returns are free of computation errors.

- Cost Effective Data Capture & Storage. The manual processing of return data, attachments, and schedules is time consuming and costly. E-filing is the most effective means of capturing, storing, and recalling data. Savings include a reduction in submission processing and storage costs. Additional savings will be achieved from reduced cost for retrieving and re-filing returns for examinations and transcription for identification of compliance trends or research.

- *Fed/State Electronic Federal Tax Payment System.* The IRS and the Treasury Department's Financial Management Service are developing a pilot in conjunction with South Carolina and Illinois. The pilot will enable Illinois taxpayers (South Carolina will participate in a later phase) to pay all their federal and certain state taxes online via the Treasury's Electronic Federal Tax Payment System (EFTPS). This initiative will provide one stop for taxpayers to make their federal and state tax payments.

- *Compliance Monitoring Process*. Compliance monitoring is premised on the notion that the IRS should make use of every available tool and public data source in trying to bring corporations into compliance. The Large and Mid-Size Business (LMSB) division has designed a Compliance Monitoring Process (CMP). LMSB developed and will be implementing an enhanced compliance initiative dependent on information technology that leverages the increases in transparency mandated by Sarbanes-Oxley and other laws. This program also leverages the increased transparency of public companies' financial statements that will result from implementation of Financial Accounting Standards Board Interpretation No. 48 (FIN 48).

The benefits accruing from the delivery and implementation of BSM projects not only provide value to taxpayers, and the business community, but also contribute to operational improvements and efficiencies within the IRS.

## Initiatives

- Improve high income and non-EITC exam workload selection and method of delivery and assess the effectiveness of the exam treatment stream on selected nonfiler cases. (Also supports Component 4)
- Expand Automated Underreporter (AUR) Auto Notice Generation to include additional income types and all Form 1040 family returns. (Also supports Component 4)
- Develop system requirements for expanding the AUR Soft Notice Test, which involves asking taxpayers to voluntarily self-correct for future years. (Also supports Component 4)
- Evaluate the AUR matching process, and implement an improved case scoring and selection concept to select the most productive cases. (Also supports Component 4)
- Develop enhancements to the Compliance Data Warehouse to improve workload identification and prioritization algorithms, allowing better evaluation of alternative treatment streams and ensuring Collection cases receive the most efficient and effective treatments. (Also supports Component 4)

- Update the Collection inventory management system to improve functionality navigation, performance, and efficiency. (Also supports Component 4)
- Automate lien delivery, recording, and release processes with state and local jurisdictions to improve the timeliness of lien filings and the payment of fees. (Also supports Component 4)
- Test the use of statistical modeling techniques within the Tax Exempt and Government Entities Division (TEGE) to detect high-risk compliance patterns in order to use data to expand and improve examination case selection. (Also supports Component 4)
- Develop and implement a set of compliance decision analytical tools that will support analysis of TEGE returns and other data to detect compliance trends and improve case and issue selection. (Also supports Component 4)
- Implement a new TEGE electronic examination system (TREES) that will consolidate agent tools to increase the accuracy and efficiency of the examination process.
- Build and implement MeF receipt of electronic transmissions for additional tax forms.

Component 4

## Improve Compliance Activities

**Obtaining maximum coverage and yield from available resources is necessary for the greatest impact on compliance.**

The IRS has made significant progress in reducing the tax gap through improvements in enforcement efforts. The following examples demonstrate this progress:

- Enforcement revenues have grown by nearly $15 billion since FY 2001, totaling $48.7 billion in FY 2006.
- Examinations of individual taxpayer returns increased by 77 percent between FY 2001 and FY 2006, when the IRS conducted nearly 1.3 million examinations. Similarly, the coverage rate rose from 0.58 percent to 0.98 percent during that period.
- The IRS has focused more resources on examinations of individuals with income over $1 million. The number of examinations in this category rose by almost 80,000 in FY 2006 as compared to FY 2004, the first year the IRS began tracking them separately. The coverage rate has similarly risen from 5.03 percent to 6.30 percent in that period.
- Audits of business returns increased by 29 percent between FY 2001 and FY 2006. The coverage rate over the same period rose from 0.55 percent to 0.60 percent.
- Audits of corporations with assets over $10 million grew from 8,718 in FY 2001 to 10,578 in FY 2006, and the coverage rate increased from 15.1 percent to 18.6 percent.
- Examinations of the very largest corporations, those with assets over $250 million, increased by nearly 30 percent growing from 3,305 in FY 2001 to 4,276 in FY 2006.
- For audits of taxpayers with assets greater than $10 million, the cycle time per audit has been reduced by 22.6 percent from 23 months in FY 2001 to 17.8 months in FY 2006. This allows IRS to use its resources more efficiently and increase the number of corporate audits conducted.
- The IRS has placed more emphasis on tax-exempt organizations by increasing the number of examinations by nearly 33 percent from 5,342 in FY 2001 to 7,079 in FY 2006.
- The IRS achieved a 91.4 percent conviction rate on criminal investigation cases from FY 2001 through December 31, 2006.
- The IRS established the position of Deputy Commissioner, International to improve oversight of and focus on global taxation issues.

These results reflect the direct impact of IRS enforcement initiatives. Though difficult to quantify, there is also a significant indirect effect of IRS enforcement, which some research suggests could be at least three times the direct effect of enforcement efforts. This indirect effect is seen when an individual thinks twice about failing to report income or overstate a deduction if he or she knows a neighbor or friend has been audited. Similarly, if taxpayers are aware that the IRS is more active, voluntary compliance increases.

The IRS' compliance strategy attacks the tax gap by balancing three critical enforcement principles.

- Coverage. Balanced audit coverage is important from an IRS presence and noncompliance deterrence perspective.

- Yield. It is important that IRS resources address those noncompliant returns that will yield the greatest revenue impact for the Treasury Department.

- Intentional Noncompliant Behavior. The larger components of the tax gap involve more complex issues and/or unreported income that usually require more in-depth audits or in flagrant cases of tax evasion, criminal investigation.

Where possible, the IRS will use low-cost, highly automated systems and resources to maintain or increase compliance coverage levels. Many of these systems will not involve face-to-face interactions with taxpayers. This includes programs such as Automated Underreporter, Automated Collection System, Automated Substitute for Return, correspondence exam, and "soft notices."

The IRS will use a combination of low-cost, highly automated systems and face-to-face interactions with taxpayers to address high yield and complex compliance issues. These include field audits, field collection contacts, and large corporate audits. Resources will be devoted to addressing major and persistent areas of noncompliance through face-to-face interactions with taxpayers.

To ensure coordination of IRS efforts to address all aspects of the tax gap, the Deputy Commissioner for Services and Enforcement has formed an executive level tax gap committee. This committee analyzes compliance data and makes recommendations on the proper allocation of compliance resources so that the IRS can maximize its ability to address the tax gap components. This group is currently quantifying:

- Coverage rates;
- Resource utilization;
- Return on investment (ROI); and
- Effectiveness of compliance programs.

Though it is not feasible to eliminate the tax gap completely, it is possible to maximize the use of existing resources to address coverage, yield, and noncompliant behavior better. As resources are made available due to shifts in return filing patterns, or from efficiencies achieved from systemic changes (both technology and process), resources will be redirected to address significant components of the tax gap, keeping the factors mentioned above in the proper balance. For example, the IRS cannot simply allocate resources to the highest yielding activities and thereby sacrifice balanced coverage across all elements of noncompliance. Audit coverage rates and return on investment information is provided in Figures 8 and 9.

*Figure 8*

**FY 2006 Coverage Rates for Key Taxpayer Categories**

| Enforcement Area | | Coverage Rate |
|---|---|---|
| Corporations | Corporations with Assets > $250M | 35.3% |
| | Corporations with Assets $10M - $50M | 14.2% |
| | 1120S Corporations | 0.38% |
| Individual Income Tax | Individuals > $1M | 5.23% |
| | Individuals > $100,000 | 1.67% |
| | Individuals < $100,000 | 0.89% |
| | All Individuals | 0.98% |
| Employment Tax | Employment Tax Returns | 0.11% |
| Estate Tax | Estate Tax with Gross Estate > $5M | 28.12% |

*Figure 9*

**Estimated Program Marginal Direct Return on Investment (ROI) for FY 2008 Hiring Initiatives***

| IRS Program | ROI |
|---|---|
| Large Corporate Exam Program | 3:1 |
| Small Business Exam and Collection Program | 3:1 |
| Individual Document Matching | 9:1 |
| Automated NonFiling Program | 14:1 |

* *Marginal ROIs are computed by applying an assumed "marginality" factor to the observed average return on investment.*

Some specific examples of IRS efforts to allocate resources to target specific noncompliance attributed to the tax gap include addressing:

- *Promoters of abusive tax avoidance transactions*. While these cases are time consuming to investigate, civil injunction actions often lead to the identification of scheme participants, including many small corporate and individual taxpayers. The IRS then allocates resources to examine and correct the abusive transactions. The IRS also assesses civil penalties as appropriate against abusive promoters and preparers.

- *High income nonfilers*. The IRS has campus Taxpayer Delinquency Investigation (TDI) and Automated Substitute for Return (ASFR) programs that address nonfilers. Some high-income cases are not typical and require complex skills to examine. The IRS allocates field resources to investigate and resolve these cases.

- *Offshore activity*. Taxpayers who engage in offshore activity for the purposes of underreporting income or participating in a tax haven taxation regime must be addressed. The IRS is improving its ability to identify these cases and the specialized skills of the examiners who handle them.

- *Unscrupulous return preparers*. Most return preparers are professional, provide valuable service to their clients, and are effective advocates for good tax administration. Unfortunately, a few unscrupulous preparers can have a significant negative effect on compliance. The IRS allocates resources to conduct visits to Electronic Return Originators (EROs), pursue preparer examinations with the goal of penalizing improper behavior, and seek civil injunctions and/or criminal indictments against the most egregious behavior.

- *Small businesses*. Because research indicates there is a greater likelihood of misreporting and underreporting by small businesses, the IRS plans to increase the level of Form 1040, Schedule C examinations.

Improving audit currency and identifying issues for examination are key elements of the IRS' effort to target noncompliance. These efforts often involve finding ways to streamline examinations of compliant taxpayers, so that examination resources can be focused on more problematic areas. Efforts to improve currency and transparency include:

- *Schedule M-3*. To improve transparency of corporate taxpayers, the IRS mandated a new Schedule M-3 for large business taxpayers. The Schedule M-3 provides more detail on book-tax differences, enabling the IRS to identify and focus more quickly and precisely on those tax returns and issues that present the highest potential compliance risk.

- *Compliance Assurance Program*. The IRS is also expanding the Compliance Assurance Program (CAP), to improve both currency and transparency. The CAP program is a real-time approach to compliance review that allows the IRS, working in conjunction with the taxpayer, to determine tax return accuracy prior to filing. CAP is more efficient than a post-filing examination – as it provides corporations certainty about their tax liability for a given year within months, rather than years, of filing a tax return. This provides compliant taxpayers with greater certainty as to their tax and financial reporting positions, and allows the IRS to focus its examination resources on more problematic areas.

- *Pre-Filing Agreement*. The Pre-Filing Agreement (PFA) program provides taxpayers an opportunity to request that revenue agents examine and resolve potential issues before tax returns are filed. The IRS continues to explore other ways to work with LMSB taxpayers on a pre-filing basis to address their federal tax liability compliance.

- *Leverage Corporate E-file*. The IRS is improving issue identification and the selection for examination of high-risk returns through new mandatory e-filing. Many corporations are now required to file their tax returns electronically and this mandate will expand in future tax years. E-filing will provide more consistent treatment and data analysis for efficient, near real time identification of high-risk issues and taxpayers. E-filing and Schedule M-3 together also allow the IRS to identify and exclude more efficiently lower-risk taxpayers from full examinations.

Additional compliance initiatives in process on IRS campuses include:

- *International support*. The IRS is expanding investigations of individuals who report income to Puerto Rico but fail to file a Form 1040PR to report social security, begin or end bona fide residence in a U.S. possession, and request to limit partnership withholding from foreign sources.

- *Form 941 nonfilers*. The IRS is expanding employment tax compliance efforts through matching information returns filed with the Social Security Administration to the filing of related employment tax returns.

- *Form 1120-S compliance*. The IRS is increasing reviews of invalid S corporation returns and their shareholders. Entities that do not have valid elections, and their shareholders' returns, will be adjusted to reflect the proper tax effect.

- *Fed/State referrals*. The IRS actively pursues leads obtained through information sharing with the states, as well as initiates examinations based on outcomes of state audits.

IRS employees play a critical role in the effort to improve compliance in terms of both taxpayer service and enforcement. In addition to implementing elements of any strategy to improve compliance, IRS employees also serve as a source for developing these elements in the first place. In order to ensure that the IRS' workforce is responsive to the need to improve compliance, the IRS recently published regulations that remove limitations on the use of quantity measures in evaluating the performance of, or imposing or suggesting goals for, IRS organizational units. These regulations will improve accountability while not changing current provisions that bar the use of performance measures based on quantity measures when evaluating employees' performance.

There are six specific initiatives in the FY 2008 Budget request that are aimed at significantly improving compliance activities. Collectively these initiatives should generate an additional $699 million in revenue when all of the new hires reach full potential in FY 2010. These initiatives will:

- *Improve compliance among small business and self-employed taxpayers in the elements of reporting, filing, and payment compliance*. This funding will be allocated for increasing audits of high-risk tax returns, collecting unpaid taxes, and investigating for possible criminal referral persons who have evaded taxes.

- *Increase examination coverage for large, complex business returns, foreign residents, and smaller corporations with significant international activity.* Using information from Form 1120, Schedule M-3 and enhanced data resulting from mandatory e-filing, this initiative will address risks arising from the rapid increase in globalization, and the related increase in foreign business activity and multinational transactions where the potential for noncompliance is significant. Improved business processes along with this funding will allow IRS to maintain its attention to the very largest businesses while expanding the overall coverage rate for large corporate and flow-through returns from 7.9 percent to 8.2 percent in FY 2008.

- *Expand document matching in existing sites and the inclusion of document matching at a new site*. This enforcement initiative will increase coverage within the Automated Underreporter (AUR) document matching program, resulting in an increase in AUR closures from 2.05 million in FY 2007 to 2.64 million in FY 2010. In addition, a new document matching program will be established at the IRS' Kansas City campus. The establishment of this new AUR site is estimated to result in over $183 million in additional enforcement revenue per year beginning in FY 2010.

- *Increase individual filing compliance through the Automated Substitute for Return Refund Hold Program*. This will minimize revenue loss by holding the current-year refunds of taxpayers who are delinquent in filing individual income tax returns and are expected to owe additional taxes. It is estimated that this initiative will result in securing more than 90,000 delinquent returns in FY 2008.

- *Improve tax-exempt entity compliance by preventing the misuse of such entities by third parties for tax avoidance or other unintended purposes*. This funding will aid in increasing the number of TEGE compliance contacts by 1,700 (6 percent) and employee plan/exempt organization determinations closures by over 9,000 (8 percent) annually by FY 2010.

- *Increase criminal tax investigations, which will aggressively attack abusive tax schemes, corporate fraud, nonfilers, and employment tax fraud*. These investigations will also address other tax and financial crimes identified through Bank Secrecy Act related examinations and case development efforts, which include an emphasis on the fraud referral program.

In addition to these initiatives, the IRS is beginning to realize benefits from the Private Debt Collection program. Pursuant to Congressional authorization, taxpayers receive the same treatment from private collection agencies (PCAs) that they would from the IRS, including access to the Taxpayer Advocate Service. The PCAs only work cases where the taxpayer does not dispute the liability and collect money the IRS could not collect otherwise. Ninety-seven percent of the taxpayers who responded to the IRS customer satisfaction survey regarding contact by a PCA were satisfied with the service received.

Improving compliance in the cash economy is also a focus. A joint IRS/Taxpayer Advocate team is exploring alternatives for improving compliance in this portion of the tax gap. The team has reviewed data from multiple existing studies and is surveying both internal and external sources for potential recommendations.

Another focus is to ensure that attorneys, accountants, and other tax practitioners adhere to high professional standards. The Office of Professional Responsibility (OPR) recently obtained a wholesale review of practitioner tax filing patterns. In addition to providing a statistical analysis of practitioner tax noncompliance, this review identified practitioners whose personal filing patterns were problematic. Circular 230 enforcement action in this area has had the collateral effect of prompting well over 75 percent of the delinquent practitioner returns to be filed after contact by OPR. This enforcement effort reinforces the message that OPR considers tax compliance to be an important matter and expects tax professionals to remain compliant.

OPR is also a participant and lead facilitator of a new return preparer strategy designed to maximize resources and coverage in the noncompliant tax preparer arena. The Servicewide Enforcement Preparer Strategy is comprised of a team representing all functions involved with the return preparer/parallel investigation workload. In addition to an annual planning meeting that has taken place, monthly conference calls are conducted among all members to coordinate between functions to ensure issues and enforcement actions such as injunctions and penalties are consistent, timely, and effective.

Criminal Investigation (CI) supports compliance initiatives and sends a strong public message by investigating egregious tax evaders, chronic noncompliance, promoters and participants in abusive schemes, employment tax evasion, high-income nonfilers, and unscrupulous return preparers. IRS CI has one of the highest conviction rates in federal law enforcement. Over 79 percent of convicted offenders are sentenced to prison terms averaging 22 months.

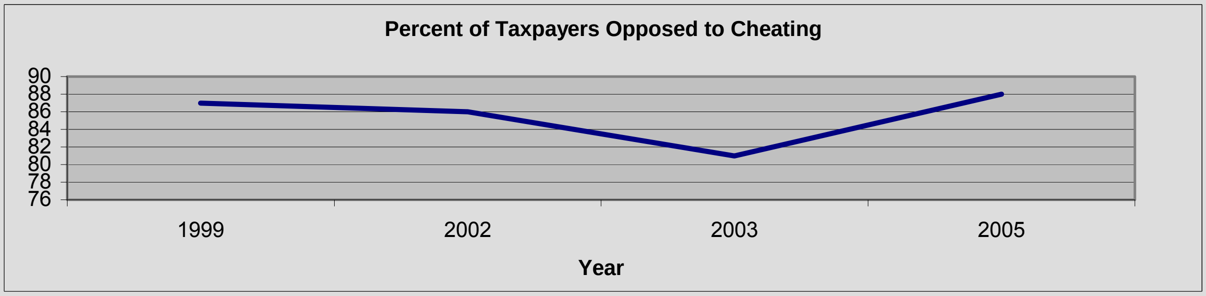
To address offshore and cross-border compliance risks (through enforcement and by issuing guidance), the IRS has formed Issue Management Teams in the following areas:

- Cost sharing;
- Abusive foreign tax credit generators;
- Section 936 exit strategies;
- Foreign earnings repatriation;
- Hybrid instruments; and
- Transfer pricing.

Tax Treaties and Tax Information Exchange Agreements (TIEAs) are two additional important tools in addressing and enhancing international compliance through the exchange of information with other national tax authorities. Through TIEAs and the Exchange of Information Article of Tax Treaties, the IRS is able to develop cross-border information to identify and address abusive transactions for civil and criminal purposes.

Americans seem less tolerant of tax cheating than they did only a few years ago and are generally supportive of IRS compliance activities against tax scofflaws. According to a 2003 Roper poll conducted for the IRS Oversight Board, 81 percent of Americans said it is unacceptable to cheat on income taxes. A 2005 survey for the IRS Oversight Board shows that the number is now 88 percent, as demonstrated in Figure 10.

*Figure 10*




Source: IRS Oversight Board Taxpayer Attitude Surveys

In addition, attitudinal support for compliance remains high as illustrated by the following statistics:

- Nearly three out of four taxpayers agree that it is everyone's civic duty to pay their fair share of taxes.

- Nearly one in every three Americans (30 percent) agree that it is everyone's personal responsibility to report anyone who cheats on their taxes, a six point increase from 2004 and 11 point increase from 2003.

- Although the public continues to feel strongly that the IRS should target large corporations and those at high-income levels who do not comply, increasing numbers feel that it is important to ensure compliance from small businesses (73 percent) and lower-income taxpayers (66 percent), as well.

- An increasing number of taxpayers cite third-party reporting as a deterrent to noncompliance (41 percent).

- Over 82 percent of Americans say that their own personal integrity has the greatest influence on whether they report and pay their taxes honestly. This is double the number citing any other factor.

According to the Pew Research Center study "A Barometer of Modern Morals," 79 percent of Americans consider not reporting all income on one's tax return to be morally wrong, while just 5 percent consider it morally acceptable and 14 percent say it is not a moral issue. Of those who said this behavior is morally wrong, cheating on one's taxes ranked second only to cheating on one's spouse.

## Initiatives

- Increase audit coverage and better target returns for examination.
- Enhance the ability to identify and address tax schemes of business and individuals involving offshore activity, address illegitimate use of tax havens to shelter income, and increase information matching and examination activity for individuals living abroad.
- Enhance collection programs and increase the Federal Payment Levy Program using third-party data.
- Work with other federal agencies regarding the Federal Payment Levy Program. (Also supports Component 7)
- Improve compliance by tax preparers through implementation of the Service Wide Enforcement Preparers Strategy. (Also supports Components 3 and 7)
- Improve collection selection criteria and filters for balance due and nonfiler cases, including identifying and addressing potential high-income nonfilers. (Also supports Component 3)
- Litigate cases, work settlements, and design large scale resolution initiatives for tax shelter transactions to deter noncompliance. (Also supports Component 1)
- Initiate a project using Combined Annual Wage Reporting (CAWR) data to identify tax-exempt organizations that may not be properly reporting and paying employment taxes. (Also supports Component 3)
- Increase criminal enforcement on abusive schemes, corporate fraud, employment tax, egregious nonfilers, and on Bank Secrecy Act violations.
- Improve the alignment and allocation of service-wide resources to identify, develop, and resolve challenges better in the global taxation arena.
- Improve tax administration to deal more effectively with increased emphasis on globalization by all corporate and individual taxpayers.
- Increase industry and global issue focus by aligning resources to cases and issues with the highest compliance risk.
- Leverage the efforts of examiners as well as external partnerships with foreign tax administrators to identify and address emerging issues of significant compliance risk. (Also supports Component 7)
- Address offshore and cross-border compliance risks through enforcement and by issuing guidance in the following areas:
    - Cost sharing;
    - Abusive foreign tax credit generators;
    - Section 936 exit strategies;
    - Foreign earnings repatriation;
    - Hybrid instruments; and
    - Transfer pricing.

Component 5

## Enhance Taxpayer Service

**Effective taxpayer service has a significant effect on voluntary compliance.**

Taxpayer service is especially important for helping taxpayers avoid making unintentional errors. The IRS provides year-round assistance to millions of taxpayers through many sources, including outreach and education programs, tax forms and publications, regulations and other published guidance, toll-free call centers, the Internet, and Taxpayer Assistance Centers (TACs). In addition, during the filing season, IRS-supported Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites provide free return preparation services for low-income, elderly, and limited-English-proficiency taxpayers.

Assisting taxpayers with their tax questions before they file their returns reduces burdensome post-filing notices and other correspondence from the IRS and reduces overall inadvertent noncompliance and the need for downstream enforcement.

According to a survey commissioned by the IRS Oversight Board in 2006, taxpayers increasingly recognize that the IRS provides good quality service through a variety of channels, such as its website, toll-free telephone lines, and TACs. This is supported by the metrics used to measure the effectiveness of the IRS' taxpayer service efforts. In category after category, there is improvement in the levels of telephone services, electronic filing, and access to IRS.gov. This is demonstrated by the following statistics:

- E-filing by individuals has continued to increase, up three percentage points in TY 2005, from 51 percent to 54 percent of all individual returns.

- The level of service for toll-free assistance was 82 percent, about the same level as in 2005 and up substantially from 2001. (Level of service is a measure that reflects the percentage of calls answered through the IRS' toll-free taxpayer assistance program compared to total call attempts, including calls answered, busy, disconnected, and abandoned.)

- The level of customer satisfaction with the toll-free line remains 94 percent, the same as in 2005.

- The tax law accuracy of toll-free response edged up to 91 percent from 89 percent in 2005.

- Taxpayers continued to find IRS.gov a useful source of information for complying with their tax obligations. Visits to the IRS website jumped nearly 10 percent in 2006 to more than 197 million visits.

- More taxpayers used the online refund status tool "Where's My Refund." In 2006, there were 24.7 million status checks, up nearly 12 percent from 2005.

Expanded outreach activities to individuals currently underway include:

- *Military Initiative.* During FY 2008 the IRS will analyze and determine the results of prior year targeted outreach to retired and soon-to-be retired military on the taxability of military pensions.

Using a control group approach, the comparison of post-outreach delinquency rates with pre-outreach rates will assist the IRS in determining the effectiveness and impact of its efforts. Once results are analyzed, strategic direction will be determined for future years for the entire federal employee and retiree population.

- *Disability Initiative.* The IRS is partnering with national and local organizations that serve taxpayers with disabilities in an effort to provide education on available tax credits and tax preparation assistance. Initially 30 cities participated and in 2007 it has been expanded to 54 cities.
- *Limited English Proficiency Hispanic Initiative.* The IRS is supporting an aggressive multimedia and grassroots outreach campaign targeting communities with a significant number of Hispanic individuals to disseminate tax information and distribute Spanish products.
- *Native American Initiative.* Partnering with national and local volunteer organizations to reach hard-to serve areas, such as Indian Reservations, the focus of this initiative is to develop new and enhance existing relationships to increase distribution of educational products and information, expand tax preparation assistance and provide access to a broader array of resources for implementing strategies that include the Earned Income Tax Credit (EITC).
- *Rural Initiative.* Building alliances with groups that have extensive pre-existing rural infrastructures and knowledge to reach rural populations, the IRS will partner with the W.K. Kellogg Foundation to bring the Rural Strategy to a national scale. In FY 2007, the Kellogg Foundation agreed to fund rural initiatives in seven states. The IRS will also partner with the U.S. Department of Health and Human Services Welfare Peer Technical Assistance to develop state-wide rural strategies in two states.

## The Taxpayer Assistance Blueprint

In July 2005, the Senate Committee on Appropriations issued report language requesting that the IRS conduct a comprehensive review of its current portfolio of services and develop a five-year plan for taxpayer services. This review, conducted jointly with the National Taxpayer Advocate and the IRS Oversight Board, was designed to achieve the following objectives:

- Establish a credible taxpayer/partner baseline of needs, preferences, and behaviors;
- Implement a transparent process for making service-related resource and operational decisions;
- Develop a framework for institutionalizing key research, operational, and assessment activities to plan and manage improved service delivery; and
- Utilize both short-term performance and long-term business outcome goals and metrics to assess service value.

In April 2006, the Taxpayer Assistance Blueprint (TAB) Phase 1 report was completed and the results presented to Congress. Phase 1 identified and reported five strategic service improvement themes for enhancing taxpayer and practitioner service needs and preferences:

- Improve and expand education and awareness activities.  This theme addresses the critical need for making taxpayers and practitioners aware of the most effective and efficient IRS service options and delivery channels for meeting their tax obligations and receiving benefits they are due.

- Optimize the use of partner services.  This theme emphasizes the critical role of third parties in the delivery of taxpayer services, and calls for improving the level of support and direction provided to partners to ensure consistent and accurate administration of the tax law.

- Elevate self-service options to meet the expectations of taxpayers.  This theme focuses on providing clear, standard, and easily customized automated content to deliver accurate, consistent, and understandable self-assistance service options.

- Improve and expand training and support tools to enhance assisted services.  This theme highlights the need for ensuring accurate information across all channels by improving and expanding training, technology infrastructure, and support for employees, partners, and taxpayers.

- Develop short-term performance and long-term outcome goals and metrics.  This theme provides for the development of a comprehensive set of performance goals and metrics to evaluate how effectively the IRS is meeting taxpayer expectations, and how efficiently it is delivering services.

TAB Phase 2 focused on developing refined data around taxpayer and partner needs, preferences, and behaviors.  Phase 2 also identified current planning documents, decision processes, and existing commitments affecting IRS service strategy.  The TAB Phase 2 Report, delivered to Congress in April 2007, includes analysis of research results as well as details of a five-year strategic plan for taxpayer service.  The TAB Strategic Plan outlines a multi-year commitment to research, including conducting research on the impact of taxpayer service on compliance.  This will help the IRS better target taxpayer services and develop programs that can improve voluntary compliance and contribute to reducing the tax gap.  The TAB Strategic Plan includes performance measures, service improvement initiatives, and a decision-making and governance process to prioritize service and research initiatives and funding proposals.  Continued stakeholder, partner, and employee engagement is incorporated into all aspects of the TAB Strategic Plan.

The IRS does not know what percent of the tax gap is due to inadvertent, unintentional non-compliance that arises from the complexity and confusion surrounding our tax laws, having very little research currently available that addresses this issue.  Several research studies are currently underway as part of the TAB Phase 2 to measure the impact of service on reducing inadvertent errors.  Additional studies will be included in the proposed five-year research plan.  Current research includes:

*Benchmark Survey of Taxpayers*.  This survey will ask 40,000 taxpayers if they have used IRS taxpayer services to help prepare and file their tax returns – and which services and channels (e.g., phone, walk-in, Internet, publications) they used to get this help.  The IRS will test to see if there are differences in average values for measures of filing, reporting, and payment compliance for respondents who did or did not use various IRS taxpayer services.

- *NRP Study*. The IRS is working to add survey questions to the next set of NRP audits to (1) find out whether taxpayers who used customer service programs had fewer reporting errors on their returns and (2) try to collect useful data on the root causes of inadvertent errors and possible treatments. The IRS is exploring the possibility of incorporating these types of questions into field examination audits on a pilot basis.

- *The Compliance Impact of Preparer, IRS and Self-Prepared Returns.* This analysis will divide all returns processed into groups based on who prepared the return: self-prepared, practitioner prepared, IRS prepared, software prepared and other options. The IRS will test to see if measures of filing, reporting, and payment compliance among these groups are significantly different.

- *The Impact of Taxpayer Advocate Service (TAS) Programs on Compliance.* This analysis will use Master File transaction codes to determine which taxpayers used TAS services in a particular fiscal year. This group will serve as a test group, and their subsequent filing, payment, and reporting compliance will be tracked. A control group comprised of a random sample of taxpayers who did not use TAS services or IRS services during the same fiscal year will be tracked to determine whether there are significant differences in compliance rates between the two groups.

- *Behavior Testing Lab*. This initiative will measure the accuracy of sample tax returns prepared by several focus groups of taxpayers, with and without access to IRS taxpayer services. This is another methodology for measuring the impact of service on compliance.

Analysis of the wealth of taxpayer data compiled as part of TAB Phase 2 revealed certain recurring findings about taxpayer needs, preferences, and behavior. The findings, combined with ongoing policy considerations and priorities, led to the development of TAB Guiding Principles that provide the groundwork for the development of the TAB Strategic Plan for taxpayer service. The TAB Guiding Principles are:

1. The primary goal of service for individual taxpayers is to facilitate compliance with federal tax obligations.

2. A portion of the tax gap is attributable to errors by individual taxpayers. IRS service programs should be designed to prevent, minimize, and correct such errors with due consideration of taxpayer burden.

3. IRS service investments will focus on preventing, minimizing, and correcting taxpayer noncompliance.

4. Enhance the IRS website so that it becomes the first choice of more taxpayers for obtaining the information and services needed to comply with tax obligations.

5. The IRS recognizes the significant role that partners play in tax administration. As such, the IRS will look for opportunities to assist these third parties in helping taxpayers understand and meet their tax obligations.

Based on these principles and extensive research analysis, the TAB Strategic Plan was designed to outline the vision for taxpayer service delivery over the next five years. Key components of the TAB Strategic Plan include the Performance Measures Portfolio, the Service Improvement Portfolio, and the Implementation Strategy. The IRS' ability to conduct research and to improve the delivery of services, and consequently improve compliance, is dependent on a number of variables that contribute to the constant evolution of the TAB Strategic Plan, including tax legislation, the IRS budget, technology, and the public marketplace. Therefore, the implementation strategy must be institutionalized before specific elements of the plan can be realized.

Based on recommendations in the TAB Strategic Plan, consideration is being given to the funding necessary to enhance IRS.gov so that becomes the first choice of individual taxpayers and their preparers when they need to contact the IRS for help. Consideration is also being given to other program initiatives that will address inadvertent, unintentional errors caused by:

- Language barriers. Pursuing strategies that focus on providing tax information in languages other than English.

- Educational barriers. Pursuing strategies that focus on expanding and improving the quality of voluntary assistance though VITA/TCE and similar partnership efforts.

- Misunderstanding of tax law. Pursuing strategies that focus on clarifying and improving forms, instructions and publications to reduce the burden that taxpayers experience in attempting to comply.

- Communication barriers. Pursuing strategies that focus on improving the quality, ease of use, and access to printed, electronic, and telephonic assistance channels; as well as placement of face-to-face assistance resources to effectively serve taxpayers unlikely to use other service channels.

- Practitioners' lack of knowledge/understanding of tax law. Pursuing strategies designed to enhance the quality and accessibility of practitioner assistance through education, tailored assistance channels, and effective monitoring of practitioner behavior and return preparation quality.

The Administration's FY 2008 Budget request includes the funding necessary to implement many of the telephone service and website enhancements recommended by the TAB Strategic Plan, as well as funding for research to understand better individual taxpayer noncompliance and the effect of service on compliance. Specific taxpayer service initiatives in the request include:

- *Expand Volunteer Income Tax Assistance (VITA) programs*. This will help expand IRS volunteer return preparation, outreach and education, and asset-building services to low income, elderly, Limited English Proficiency (LEP), and disabled taxpayers. It will increase the ability to recruit, train, and support partners for outreach and tax assistance, and to identify those partners best suited to reach special populations.

- *Begin initial implementation of TAB Strategic Plan recommendations*. Based on the findings of the TAB, the funding for this initiative will implement telephone service and website electronic interaction enhancements, including the following:

  - Contact Analytics. This will provide tools for evaluating contact center experiences by recording, storing, and analyzing every element of a taxpayer's service call. It will provide the capability to drill down to individual recordings, improving the ability to measure call accuracy, timeliness, and professionalism – leading to process improvements and cost savings. It also will improve the ability to identify and respond to problems – leading to more accurate, clearer responses to taxpayers. Employee satisfaction will increase through improved work processes that allow assistors to handle more complex calls with fewer transfers.

  - Estimated Wait Time. This will provide a real-time message on the telephone service channel that informs taxpayers about their expected wait time in queue, allowing them to make more informed decisions based on the status of their call. This will reduce taxpayer burden and increase customer satisfaction.

  - Expanded Portfolio of Tax Law Decision Support Tools. This enhancement to IRS.gov will provide a common set of support tools to maximize use by taxpayers, partners, and IRS employees. It will enable users to conduct key word and natural language queries on a Frequently Asked Questions (FAQs) database and to receive answers to tax-law questions on an interactive basis. By monitoring taxpayer use, the IRS can continuously improve the information provided to taxpayers, thereby increasing customer satisfaction and operational savings.

  - Spanish "Where's My Refund?" This adds the refund status feature to the Spanish webpage on IRS.gov to provide the Spanish-speaking community with the same level of customer service available on the English webpage.

- *Conduct research on the effect of service on taxpayer compliance.* This will provide additional resources for a long-term, concerted research effort to identify ways to close the tax gap and to base the allocation of resources to both service and enforcement activities on a clearer understanding of how these activities affect voluntary compliance. This will require compiling more comprehensive data over a number of years, culminating in yearly analyses designed to quantify the effect of most IRS activities on the voluntary compliance of specific taxpayer populations. The research will focus on four areas:

  - Meeting taxpayer needs through the most effective and efficient service channels;

  - Developing a better understanding of taxpayer burden;

  - Understanding taxpayer needs through the errors they make; and

  - Examining the effect of service on overall levels of voluntary compliance.

## Electronic Tax Administration

There is perhaps no area with greater potential for reducing burden for both taxpayers and the IRS than Electronic Tax Administration (ETA). The benefits of electronic interaction with taxpayers are clear and compelling. Many taxpayers find it more convenient and beneficial to do business electronically than to send paper through the mail. In addition, taxpayers can get their questions answered and can download the form they need at their convenience, at any time of the day or night. For the IRS, handling taxpayer contacts electronically means that employees can be refocused to other high-benefit purposes.

Significant challenges remain in transitioning from a paper-based environment to an electronic-based environment. The IRS has developed an E-Strategy for Growth, which outlines the IRS' plans to reduce taxpayer burden. To achieve the strategic goals, the IRS will develop and implement e-file marketing strategies, continue to expand the use of electronic signatures, and enhance IRS website services for both practitioners and taxpayers. Ultimately, the goal of the IRS is to offer all taxpayers and their representatives the ability to conduct nearly all of their interactions with the IRS electronically.

A key component of ETA for the IRS is e-filing. This system has demonstrated measurable success with regard to individual taxpayer satisfaction. From its modest beginning as a pilot program in 1986 – when 25,000 returns were filed electronically – the number of e-filed returns has dramatically increased, with more than 71 million returns filed electronically in the last filing season. The benefits to these taxpayers include:

- Faster refunds;
- More accurate returns;
- Quick electronic confirmation;
- Free Internet filing;
- Easy payment options; and
- Federal/State e-filing.

An additional service that allows tax professionals and payers to do business with the IRS electronically is e-Services, a suite of Internet based products. These services include Preparer Taxpayer Identification Number (PTIN) applications with instant delivery, Taxpayer Identification Number (TIN) matching for third-party payers, on-line registration for electronic e-Services, and on-line initiation of the electronic return originator application. The e-Services' Incentives Products offered to increase e-filing are on-line Disclosure Authorization, Electronic Account Resolution, and Transcript Delivery System. Due to industry demand, the availability of incentives to those tax professionals and payers that e-file has been lowered from 100 to 5 individual returns filed.

Another electronic service success launched recently is the new Online Payment Agreement available on IRS.gov. Over 90 percent of taxpayers entering into payment agreements with the IRS can now request an agreement and receive confirmation of its approval through this application.

### Initiatives

- Enable taxpayers with disabilities to understand available tax credits and receive tax preparation assistance through partnerships with national and local organizations that serve this unique group of taxpayers. (Also supports Component 7)
- Increase accuracy on toll-free telephone customer inquiries, processing functions, and paper adjustments.
- Improve the quality of volunteer-prepared returns through enhancements to the VITA program, including quality training and sample processing reviews.
- Enhance services to persons with limited English proficiency through: the Taxpayer Assistance Blueprint; development of a Multi-Lingual Strategic Plan; development of a Virtual Translation Office; and launch of a revised version of the Spanish IRS.gov webpage.
- Improve quality and timeliness of taxpayer contacts by maintaining an enhanced integrated quality assurance process with internal and external partners. (Also supports Component 4)
- Enhance IRS.gov.
- Improve services through programs at both the national and local level by expanding collaborations with organizations serving the disabled, Native American communities, and pre-existing rural infrastructures.
- Expand and enhance the Spanish website to increase electronic options, including options for Spanish language delivery of applications currently only available in English. (Also supports Component 3)
- Provide Reporting Agents with access to e-Services. (Also supports Component 3)
- Implement Taxpayer Assistance Blueprint Phase 2, which includes a five-year strategic plan for taxpayer service based on extensive research to understand taxpayer and stakeholder needs.
- Implement Internet-Customer Account Services (I-CAS) Release 1, which will enable taxpayers to view account information. (Also supports Component 3)
- Implement I-CAS Release 2, which will enable taxpayers to change their address, file an extension, submit a Power of Attorney, and calculate a payoff amount on balances due via a secure Internet link. (Also supports Component 3)
- Continue publicity efforts encouraging use of Online Payment Agreement.

Component 6

## Reform and Simplify the Tax Law

**Current tax law complexity is a substantial barrier to compliance.**

The complexity of the tax code makes it difficult for taxpayers to understand their tax obligations and for the IRS to administer the tax law. Special rules, subtle distinctions in the tax law and complicated computations add to this complexity and foster a sense of unfairness in our tax system, which ultimately discourages compliance. Notwithstanding an increasing awareness of the discrepancy in taxes due and taxes paid, the tax law continues to move in a direction of increasing complexity, which frustrates efforts to reduce the tax gap. In 2006 alone, Congress passed six items of legislation that affected the tax law. Within these bills, 223 provisions required over 1,200 actions by the IRS to implement the new requirements. These changes to the tax law further increased complexity and, therefore, lessened the IRS' ability to increase voluntary compliance. Simplification may require a paradigm shift.

Taxpayers who want to comply with the tax law often make unintentional errors on their returns as they struggle to understand complicated rules and forms. Complexity also provides opportunities for those who are willing to exploit the system. Furthermore, complexity makes it difficult for the IRS to detect noncompliance. Simplifying the tax code will reduce unintentional errors by well-meaning taxpayers and reduce opportunities for evasion. A simpler tax code will also be easier for the IRS to administer.

The Administration's FY 2008 Budget provides several proposals that would assist with simplification, reduce errors, and improve taxpayers' understanding of available tax benefits. These proposals would:

- Clarify the uniform definition of a child;
- Simplify Earned Income Tax Credit (EITC) eligibility requirements regarding filing status, presence of children, and work and immigrant status; and
- Reduce computational complexity of the refundable child tax credit.

The complexity of the tax law necessitates that limited IRS resources are increasingly committed to administering a wide array of targeted tax provisions created to meet social policy goals. These targeted provisions divert IRS resources from basic compliance efforts. The IRS has taken a number of steps to reduce taxpayer burden, including the establishment of the Office of Taxpayer Burden Reduction (TBR). Recent improvements in IRS forms, processes, and procedures include:

- Simplifying the filing requirements for Form 944 (Employer's Annual Federal Tax Return);
- Eliminating the need for filing Form 2688 (Application for Additional Extension of Time to File U.S. Individual Income Tax Return) by allowing taxpayers to get an automatic six month extension to file; and

- Creating the EITC Assistant, an on-line tool that helps taxpayers determine their eligibility for the earned income tax credit (EITC) and their estimated EITC amount.

Additional projects to simplify tax forms and processes are currently under review by TBR.

Another IRS resource commitment aimed at addressing the issue of helping taxpayers understand complex tax rules involves form and publication improvement efforts. The IRS originates and improves tax forms, instructions and publications to ensure they are technically accurate, timely, understandable, and as easy to use as possible in order for taxpayers to fulfill their tax filing and payment obligations. There are currently over 1,000 tax products, including forms, instructions, publications, and Spanish tax products. Each year the IRS reviews its products with the goal of simplifying, reducing burden, increasing understanding, eliminating redundancy, and fostering compliance. Based on taxpayer feedback, research, and tax law changes, existing products are revised and new products developed regularly. Recent examples include the Schedule M-3, Form 944, Employer's Annual Federal Tax Return, and the new draft Form 990, Return for Organization Exempt from Income Tax, which is now available for public comment. There are also compliance proposals under review for Forms 1120, U.S. Corporation Income Tax Return, and Form 1065, U.S. Return of Partnership Income. To address potential compliance issues for small businesses and individuals with limited English proficiency, chapters in Publication 17, Your Federal Income Tax, and Publication 334, Tax Guide for Businesses, are being translated into Spanish.

IRS.gov is used to disseminate tax product information and changes. It contains draft forms, final forms, and a What's Hot in Tax Forms, Publications, and Other Tax Products, which includes articles on tax product changes. In addition, there is an email address – taxforms@irs.gov – for submitting comments on IRS tax products.

Focus groups are conducted regularly to obtain taxpayer information relative to product changes. Public interaction is also a focal point of the IRS Nationwide Tax Forums, an annual venue that provides another opportunity for feedback regarding tax forms and publications, and other interactions with stakeholder groups.

## Initiatives

- Work with Congress to enact simplification legislative proposals in Administration's FY 2008 Budget to:
    - Clarify the uniform definition of a child;
    - Simplify EITC eligibility requirements regarding filing status, presence of children, and work and immigrant status; and
    - Reduce computational complexity of the refundable child tax credit.

- Continue Taxpayer Burden Reduction projects involving:
    - Simplifying the S-corporation election process;
    - Simplifying employment tax return amendments (Forms 941, 943, 944, and 945); and
    - Redesigning Form 8857, Request for Innocent Spouse Relief.
- Continue Tax Form and Publication improvements.

Component 7

## Coordinate with Partners and Stakeholders

**Conducting outreach and leveraging external partnerships is a key component.**

The IRS is partnering and leveraging resources with local, state, and federal agencies across the country. Examples of accomplishments resulting from these relationships include the following:

- Centralizing the process for IRS assessments based on state audit reports;
- Implementing a Questionable Employment Tax Practices (QETP) Initiative to develop a federal and state interagency approach to combat employment tax schemes and increase voluntary compliance. To date, 16 states have agreed to partner with the IRS on this initiative;
- Obtaining 88 agreements in 27 states with stakeholders such as state professional licensing agencies and local business licensing agencies to distribute educational information to small business applicants;
- Establishing the Leeds Castle Group with the tax administration agencies of China, India, South Korea, the United Kingdom, Japan, Australia, Canada, France, and Germany to meet regularly to consider and discuss issues related to global and national tax administration;
- Developing a Joint Operations Center (JOC) for National Fuel Tax Compliance in partnership with the Federal Highway Administration (FHWA) and participating states to act as one seamless organization leveraging resources at the state and federal level to develop fuel tax compliance strategies, including joint examinations and investigations based on JOC data analysis;
- Utilizing state/federal data for Combined Annual Wage Reporting (CAWR)/Federal Unemployment Tax (FUTA) matches; and
- Partnering with foreign tax agencies as part of the Organization for Economic Cooperation and Development's (OECD) Forum on Tax Administration.

The IRS, in connection with the OECD Working Party on Aggressive Tax Planning, is currently designing a database of various cross-border tax avoidance schemes in order to share knowledge and information among the OECD members. In addition, several Tax Information Exchange Agreements (TIEAs) recently became effective that will be useful in gathering valuable information (i.e., financial institution information) in the effort to reduce the tax gap.

The United States, Canada, Australia, and the United Kingdom continue their collaboration at the Joint International Tax Shelter Information Center (JITSIC) to supplement the ongoing work of each of the tax administrations in identifying and curbing abusive tax avoidance transactions, arrangements, and schemes. The objectives of JITSIC are to deter promotion and investment in abusive tax schemes, primarily through exchange of information. Exchange of information in JITSIC is done in accordance with the provisions of the bilateral treaties between each of the four countries involved.

Initiatives under development include the following:

- Data Warehouse/Mining: Conducting a test to evaluate the tax administration benefits of utilizing the state data warehouse concept.

- State Reverse File Match Initiative (SRFMI): Developing a system where states match IRS master file extracts against state master files to identify those who filed state but not federal returns, and those who reported different amounts on their state and federal returns.

- Tax Education: Entering into agreements with state education departments and federal immigration agencies to promote "Understanding Taxes" materials to educate younger citizens and foreign taxpayers going through naturalization about U.S. tax responsibilities.

- Small Business Assistance: Expansion of partnerships with the Small Business Administration (SBA) and its Service Corps of Retired Executives (SCORE) program and Small Business Development Centers (SBDCs), as well as other partners to deliver expanded educational messages directly to business owners.

The IRS also has a robust outreach and education program accomplished through relationships with national and local payroll, practitioner, small business, and industry stakeholder organizations. Examples of accomplishments include:

- Development of relationships with over 1,500 small business industry and tax professional organizations to deliver expeditiously key tax-related messages to small business audiences.

- Delivering information through Phone Forums to practitioners, industry representatives, and small business owners.

- Implementing Small Business Forums with industry representatives and small business owners.

- Offering multiple educational products, such as:

  - Electronic newsletters including "e-news for Tax Professionals" and "e-news for Small Businesses";

  - The Virtual Small Business Tax Workshop DVD, a 10-lesson interactive video;

  - The Small Business Resource Guide CD-Rom;

  - The Tax Calendar for Small Businesses and Self-Employed; and

  - "Tax Talk Today," a monthly web cast for tax professionals featuring IRS representatives discussing significant tax issues.

- Developing and widely distributing educational information on areas of high noncompliance, such as computation of business income, cost of goods sold, and various business expenses.

- Establishing a system to track resolution of problem issues identified by stakeholders (Issue Management Resolution System);

- Delivering an outreach campaign to industries that includes Audit Technique Guides and Tax Tips, which provide specific information for small businesses; and

- Providing Ethics Seminars for Practitioners addressing requirements from the Circular 230.

Initiatives include development of strategies to:

- Provide outreach and education to unaffiliated tax professionals – those who provide tax preparation services but do not align themselves with a professional organization; and

- Increase outreach and education regarding e-Commerce issues, including taxability of sales transactions on auction sites.

In addition, the IRS works with partners to disseminate tax information on subjects such as the EITC, child tax credit, e-file, life-cycle events, and compliance issues and to provide free income tax preparation to specific taxpayer populations (i.e., low income, elderly, limited English proficiency, disabled). Relationships exist with 60 national partners such as AARP, Armed Forces Tax Council, United Way, Health & Human Services, Annie E. Casey, and the Kellogg Foundation. In addition, the IRS supports more than 300 coalitions nationwide, comprised of thousands of community partners who educate or serve millions of taxpayers. This effort facilitated the opening of over 12,000 VITA and Tax Counseling for the Elderly sites with more than 68,000 volunteers during the 2006 filing season.

### Initiatives

- Further enhance the centralized process to maximize the utilization of State Audit Reports (SARs) by IRS for federal assessments. (Also supports Component 4)
- Implement a Questionable Employment Tax Practices (QETP) initiative in partnership with the Department of Labor, the National Association of State Workforce Agencies, the Federation of Tax Administrators, and state workforce agencies, to provide a collaborative national approach to combat employment tax schemes. (Also supports Component 4)
- Further enhance the Fed/Fed program by facilitating and expanding partnerships with other federal agencies to improve tax administration. (Also supports Component 4)
- Engage all 50 states through the State Reverse File Match Initiative (SRFMI) - a process that matches IRS extracts received through the Governmental Liaison Data Exchange Program against state master files to identify individuals and businesses who filed a state return but not a federal return and to identify differences in federal and state income reporting. (Also supports Component 4)
- Determine tax administration benefits of utilizing state date warehouse concept. (Also supports Components 3 and 4)

- Develop an educational targeted outreach DVD for military personnel preparing for retirement. (Also supports Component 5)
- Enhance outreach efforts to industry audiences about available Audit Technique Guides and Tax Tips.
- Establish links to IRS.gov on industry, practitioner, educational, and governmental stakeholders' websites.
- Develop and widely distribute educational fact sheets on areas of high noncompliance.
- Develop a strategy to reach practitioners without affiliation to a professional organization.
- Leverage key partners such as the SBA and its SCORE program and SBDCs to deliver small business workshops to the new business community.
- Deliver educational messages through existing relationships with universities and colleges.
- Develop audio educational messages for toll-free wait times.
- Customize outreach to specific industries to encourage voluntary compliance.
- Request feedback from internal and external stakeholders on existing outreach and educational programs to identify best practices and enhancements.
- Develop strategies to educate first-time business filers.
- Expand relationships and collaboration with foreign tax administrations to increase the informal and formal communications on international tax administration matters.

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# SUMMARY

To implement the steps outlined in this report successfully, it is imperative for the IRS to have a highly trained and engaged workforce. While not addressed in detail in this report, the IRS is committed to employee engagement, ongoing training assessments and delivery, ongoing agency-wide communications, employee and managerial burden reduction, leadership empowerment, and succession planning. The IRS has extensive action plans and strategies in each of these areas. For example, in the area of succession planning, the IRS has established a Leadership Succession Planning office and is implementing a Leadership Succession Review (LSR) process in FY 2007. The LSR process involves leadership assessments of all senior managers, executive review of the assessments, and one-on-one feedback and discussion of executive potential.

The actions outlined in this report address improving compliance through a balanced approach. This report describes steps currently being taken, and those under development, by the IRS to reduce opportunities for tax evasion, details how the IRS will leverage technology, recognizes the critical need for a strong taxpayer service program, discusses development of taxpayer service initiatives, and describes legislative proposals that, when implemented, will improve compliance. At the same time, the initiatives maintain respect for taxpayer rights, limit burden on compliant taxpayers, and present an outreach approach to ensure all taxpayers understand their tax obligations. This report also details the importance of having a multi-year research program that will assist both in understanding the scope and reasons for noncompliance.

It is important to take all reasonable steps to improve voluntary compliance. As more is learned about the causes of noncompliance and ways to improve voluntary compliance, strategies will be modified to reflect the latest information.

It is clear that consistent efforts to keep the complexity and unnecessary burden of the tax system to a minimum, to provide the level of service that the taxpaying public deserves, and to maintain a strong and well-targeted enforcement presence are necessary to improve compliance rates. The IRS is committed to applying its resources where they are of most value in reducing noncompliance while ensuring fairness, observing taxpayer rights, and reducing the burden on taxpayers who comply.

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# APPENDIX

## Timeframes for Initiative Implementation

| Initiatives | Related Treasury Strategy Component(s)[†] (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009[‡] |
|---|---|---|---|---|
| Work with Congress to enact remaining legislative proposals included in the Administration's FY 2008 Budget. | **1,** 6 | Ongoing<br>IRS will continue to identify legislative proposals in partnership with Treasury | 2/09<br>IRS will continue to identify legislative proposals in partnership with Treasury | √ |

[†] 1. Reduce Opportunities for Evasion; 2. Make a Multi-Year Commitment to Research; 3. Continue Improvements in Information Technology; 4. Improve Compliance Activities; 5. Enhance Taxpayer Service; 6. Reform and Simplify the Tax Law; and 7. Coordinate with Partners and Stakeholders.

[‡] Check indicates initiative will continue beyond FY09 depending on budget availability.

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Develop regulations and other published guidance clarifying ambiguous areas of the law, targeting specific areas of noncompliance and preventing abusive behavior. | **1** | 6/30/08<br>Request recommendations from stakeholders for topics on which guidance should be a priority<br><br>7/30/08<br>Identify approximately 250 items for which guidance is a priority<br><br>8/30/08<br>Release the 2008-2009 Priority Guidance Plan (PGP)<br><br>9/30/08<br>Release at least 80% of the items appearing on the 2007-2008 PGP | 6/30/09<br>Request recommendations from stakeholders for topics on which guidance should be a priority<br><br>7/30/09<br>Identify approximately 250 items for which guidance is a priority<br><br>8/30/09<br>Release the 2009-2010 PGP<br><br>9/30/09<br>Release at least 85% of the items appearing on the 2008-2009 PGP | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Undertake additional compliance studies, including S corporations and individuals. | **2** | 10/1/07<br>Begin reporting compliance study for TY 2006 individual income tax returns<br><br>6/30/08<br>Complete S corporation compliance study | 10/1/08<br>Begin reporting compliance study for TY 2007 individual income tax returns | √ |
| Update tax gap estimates using new and existing data. | **2** | 6/30/08<br>Release S corporation reporting compliance study tabulations<br><br>6/30/08<br>Update payment compliance estimates | 6/30/09<br>Update payment and filing compliance estimates | √ |
| Research the effect of service on taxpayer compliance. | **2** | 9/30/08<br>Undertake at least three significant research projects linking service to compliance (e.g., study relationship between taxpayer attitudes and compliance) | 9/30/09<br>Undertake at least three significant research projects linking service to compliance (e.g., study how particular types of service delivery affect individual compliance) | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Research the relationship between complexity, burden, and compliance. | **2** | | 9/30/09<br>Undertake survey of individual taxpayers to improve burden estimates (e.g., conduct a new survey of individual taxpayer burden)<br><br>9/30/09<br>Begin at least three research projects focusing on the relationships between complexity, burden, and compliance | √ |
| Improve high income and non-EITC exam workload selection and method of delivery and assess the effectiveness of the exam treatment stream on selected nonfiler cases. | **3**, 4 | 10/1/07<br>Begin selecting, classifying, and auditing individual returns based on updated selection scores derived from NRP TY 2001 results<br><br>1/30/08<br>Implement initial phase of an automated case screening and selection process | 10/1/08<br>Begin evaluating the productivity of high-income taxpayer cases identified using the revised scores and activity codes<br><br>9/30/09<br>Complete implementation of the automated case screening and selection process | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Expand AUR Auto Notice Generation to include additional income types and all Form 1040 family returns. | **3**, 4 | 9/30/08<br>Expand the volume of auto notices bypassing the screening phase on 1040 series returns | 9/30/09<br>Expand the volume of auto notices bypassing the screening phase by including the entire ELF Form 1040 series and add cases from SB/SE inventories<br><br>Add withholding to the auto notice income issues in an effort to work the most productive cases | √ |
| Evaluate the AUR matching process, and implement an improved case scoring and selection concept to select the most productive cases. | **3,** 4 | 12/31/07<br>Reengineer the AUR matching process to improve coverage and maximize resource utilization resulting in increased AUR closures<br><br>9/30/08<br>Streamline overhead costs by reducing manual screening<br><br>9/30/08<br>Complete studies and implement an enhanced workload selection system | 9/30/09<br>Implement additional improvements to workload selection tools (e.g., incorporating results as feedback to validate rules/score, and adding the capability to select cases for different treatments) | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Develop system requirements for expanding the AUR Soft Notice Test, which involves asking taxpayers to voluntarily self-correct for future years. | **3**, 4 | 9/30/08<br>Develop and complete programming requirements | 9/30/09<br>Implement initiative for approximately 250,000 taxpayers | √ |
| Develop enhancements to the Compliance Data Warehouse to improve workload identification and prioritization algorithms, allowing better evaluation of alternative treatment streams and ensuring Collection cases receive the most efficient and effective treatments. | **3**, 4 | 1/1/08<br>Release Phase 1 | 1/1/09<br>Release Phase 2 | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Update the Collection inventory management system to improve functionality and navigation and provide capability to interface with other modernized systems. | **3**, 4 | <u>9/30/08</u><br>Completion of coding and integration testing | <u>11/1/08</u><br>Begin piloting of the updated system<br><br><u>1/1/09</u><br>Begin nationwide deployment of updated system<br><br><u>6/30/09</u><br>Nationwide deployment completed | |
| Automate lien delivery, recording, and release processes with state and local jurisdictions to improve the timeliness of lien filings, lien releases, and the payment of fees. | **3**, 4 | <u>9/30/08</u><br>Complete cost analysis, design specifications, and establish enterprise standards | <u>8/31/09</u><br>Establish and fully test prototype<br><br><u>9/30/09</u><br>Full deployment | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Test the use of statistical modeling techniques within TEGE to detect high-risk compliance patterns in order to use data to expand and improve examination case selection. | **3**, 4 | 1/31/08<br>All test examinations completed<br><br>4/30/08<br>Final report completed | | |
| Develop and implement a set of compliance decision analytic tools that will support analysis of TEGE returns and other data to detect compliance trends and improve case and issue selection. | **3**, 4 | 1/15/08<br>Complete logical and physical design phase<br><br>5/31/08<br>Complete system development<br><br>7/31/08<br>Deploy system to all users | | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Implement a new TEGE electronic examination system (TREES) that will consolidate agent tools to increase the accuracy and efficiency of the examination process. | **3** | Deployment began in May 2007<br><br><u>11/30/07</u><br>Complete roll-out of TREES to all TEGE examination revenue agents | | |
| Build and implement MeF receipt of electronic transmissions for additional tax forms. | **3** | <u>1/08</u><br>Deploy Form 1120F on the MeF platform<br><br><u>1/08</u><br>Deploy Form 990N (ePostcard) on the MeF platform | <u>9/09</u><br>Deploy first phase of Form 1040 on the MeF platform | |
| Increase audit coverage and better target returns for examination. | **4** | <u>10/1/07</u><br>Begin selecting, classifying, and auditing individual returns based on updated selection scores (DIF) derived from NRP TY 2001 results<br><br>(cont'd) | <u>10/1/08</u><br>Begin evaluating the effectiveness of the updated DIF scores<br><br><u>9/30/09</u><br>Increase number of Schedule C audits by an additional 5% to<br>(cont'd) | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| (cont'd) | | 9/30/08<br>Increase number of Schedule C audits by 7% to address the individual business income tax underreporting gap<br><br>9/30/08<br>Migrate correspondence exam telephone customers to the enterprise call routing platform, which will expedite case closures | address the individual business income tax underreporting gap<br><br>9/30/09<br>Utilize information obtained from the Subchapter S Corporation National Research Project to enhance return selection and examinations<br><br>9/30/09<br>Begin screening amended returns through the Dependent Database<br><br>9/30/09<br>Improve the number of correspondence audits that are closed by enhancing the case selection methodology with real-time information<br><br>1/31/09<br>Improve correspondence case selection methodologies based on real-time information | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Enhance the ability to identify and address tax schemes of business and individuals involving offshore activity, address illegitimate use of tax havens to shelter income, and increase information matching and examination activity for individuals living abroad. | **4** | 9/30/08<br>Complete the examination of cases in the pilot phase of the Broker Compliance Initiative Project. Make IRC section 6700 promoter investigation referrals for those individuals and large businesses identified as facilitating abusive offshore transactions as a result of this project<br><br>9/30/08<br>Develop compliance initiative projects in the areas of private banking and offshore merchant accounts to address offshore noncompliance | 9/30/09<br>Analyze results of cases in the Broker Compliance Initiative Pilot phase and update selection criteria for future cases. Make IRC section 6700 promoter investigation referrals for those individuals and large businesses identified as facilitating abusive offshore transactions<br><br>9/30/09<br>Implement pilot phase for any approved compliance initiative projects | √ |
| Enhance collection programs and increase the Federal Payment Levy Program using third-party data. | **4** | 8/31/08<br>Work with Centers for Medical Services (CMS) to modify levy processing and improve offsets of Medicare reimbursements for tax debts | 3/31/09<br>Work with Financial Management Service (FMS) to determine feasibility of including CMS Medicare payments in the Treasury Offset Program/FPLP | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Work with other federal agencies regarding the Federal Payment Levy Program (FPLP). | **4**, 7 | 6/30/08<br>Increase dollars collected by expanding FPLP to:<br>• Defense Finance and Accounting Service salary payment files<br>• Department of Defense Civilian Employees<br>• Department of Health and Human Services<br>• Environmental Protection Agency<br>• Department of Energy | 3/31/09<br>Increase dollars collected by pursuing agreements with the Department of Defense to add additional Federal wage and other payments | |
| Improve compliance by tax preparers through implementation of the Servicewide Enforcement Preparers Strategy. | 3, **4**, 7 | 10/1/07<br>Convene servicewide preparer strategy summit<br><br>3/30/08<br>Finalize and begin implementation of service-wide preparer strategy<br><br>1/1/08<br>Initiate research study of preparer compliance | 10/1/08<br>Update, as necessary, service-wide preparer strategy based on research study findings | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Improve collection selection criteria and filters for balance due and nonfiler cases, including identifying and addressing potential high income nonfilers. | 3, **4** | 12/31/07<br>Expand use of third-party information and research to enhance case selection<br><br>12/31/07<br>Finalize Servicewide Nonfiler Strategy | 12/31/08<br>Refine Decision Analytics rules to improve inventory delivery<br><br>12/31/08<br>Develop a new model to enhance collection case selection criteria | |
| Litigate cases, work settlements, and design large scale resolution initiatives for tax shelter transactions to deter noncompliance. | 1, **4** | 3/31/08<br>Complete examination of Global Settlement Initiative (GSI) participants<br><br>9/30/08<br>Litigate unresolved Son of Boss cases, cases of GSI non-participants, and promoter penalty cases that opted not to take the resolution initiative | 9/30/09<br>Complete audits of GSI non-participants<br><br>9/30/09<br>Continue to litigate unresolved Son of Boss cases, cases of GSI non-participants, and promoter penalty cases that opted not to take the resolution initiative | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Initiate a project using Combined Annual Wage Reporting (CAWR) data to identify tax-exempt organizations that may not be properly reporting and paying employment taxes. | 3, **4** | 11/30/07<br>Identify opportunities for other employment tax related projects<br><br>2/28/08<br>Analyze results of FY 2007 CAWR examinations and document lessons learned for future CAWR projects | | |
| Increase criminal enforcement on abusive schemes, corporate fraud, employment tax, egregious nonfilers, and on Bank Secrecy Act violations. | **4** | 9/30/08<br>Achieve an average conviction rate of 92% for the combined component programs<br><br>9/30/08<br>Achieve an average publicity rate of 80% for the combined component programs | 9/30/09<br>Achieve an average conviction rate of 92% for the combined component programs<br><br>9/30/09<br>Achieve an average publicity rate of 80% for the combined component programs | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Improve the alignment and allocation of service-wide resources to identify, develop, and resolve challenges better in the global taxation arena. | **4** | 12/31/07<br>Realign LMSB International Resources to Improve Integration/Leverage Expertise<br><br>12/31/07<br>Utilize International Planning and Operations Council to identify opportunities to conduct cross-divisional examinations | 3/31/09<br>Increase International Examiner hiring with emphasis upon high-risk geographic areas<br><br>12/31/08<br>Enhance cross-divisional coordination to ensure coverage and development of significant issues while reducing burden<br><br>6/30/09<br>Promote identification and assessment of emerging international/U.S. Possessions compliance issues through development of a process for referrals and a system for timely evaluation of those referrals | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
| --- | --- | --- | --- | --- |
| Improve tax administration to deal more effectively with increased emphasis on globalization by all corporate and individual taxpayers. | **4** | 3/31/08<br>Expand information-sharing through increased membership in the Joint International Tax Shelter Information Centre (JITSIC), by adding Japan and expanding JITSIC offices to London<br><br>3/31/08<br>Introduce new M-3 for Form 1120F to gather information on foreign controlled corporations<br><br>Ongoing<br>Increase education and guidance to U.S. taxpayers of their withholding responsibilities on Fixed Determinable Annual Periodic (FDAP) payments to non-U.S. persons and expand similar activities with qualified intermediaries | 9/30/09<br>Introduce revised Form 5471 for international transactions that have potential U.S. tax issues<br><br>9/30/09<br>Pilot issue identification and workload selection using filings of the revised form 1120F with Schedule M-3 | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Increase industry and global issue focus by aligning resources to cases and issues with the highest compliance risk. | **4** | 9/30/08<br>Pilot the Shelter Data Management system and the automated international issue selection process<br><br>9/30/08<br>Use Transactions of Interest under proposed regulation 6011 (when finalized) to identify emerging issues | 6/30/09<br>Fully implement the Shelter Data Management System (SDM) and pilot the larger Selection and Workload Classification system, of which SDM is a part<br><br>9/30/09<br>Integrate international issue identification into overall workload selection process<br><br>9/30/09<br>Expand use of Transactions of Interest approach | |
| Leverage the efforts of examiners as well as external partnerships with foreign tax administrators to identify and address emerging issues of significant compliance risk. | **4**, 7 | 12/31/07<br>Expand the use of the Organization for Economic Co-operation and Development (OECD) Abusive Transaction Database to identify emerging abusive transactions/ issues<br><br>9/30/08<br>Hire additional International Examiners in areas with high risk international issues | 9/30/09<br>Complete Basic level International Training of LMSB Front-line and Senior Managers to improve Issue Identification and Familiarity | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Address offshore and cross-border compliance risks through enforcement and by issuing published guidance. | **4** | 12/31/07<br>Initiate Project on Foreign Athletes & Entertainers (FAE) to ensure appropriate reporting and sourcing of income<br><br>12/31/07<br>Complete Voluntary Settlement Initiative for embassy/consular employees and begin enforcement activities on non-electors<br><br>9/30/08<br>Issue regulations on transfer pricing, foreign tax credit, and foreign trusts | 9/30/09<br>Issue additional regulations on transfer pricing guidance, foreign tax credit, and foreign trusts, and new regulations on cross border restructuring | √ |

| Initiatives | Related Treasury Strategy Component(s)[†] (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009[‡] |
|---|---|---|---|---|
| Enable taxpayers with disabilities to understand available tax credits and receive tax preparation assistance through partnerships with national and local organizations that serve this unique group of taxpayers. | **5**, 7 | <u>12/30/08</u><br>Partner at the local and national levels to expand efforts with organizations that serve people with disabilities, to increase return preparation assistance space<br><br><u>3/31/09</u><br>Work with select government entities to increase the availability of free tax assistance programs | <u>12/31/09</u><br>Partner at the local and national levels to expand efforts with organizations that serve people with disabilities and to increase return preparation | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Increase accuracy on toll-free telephone customer inquiries, processing functions, and paper adjustments. | **5** | 1/31/08<br>Implement an Interactive Tax Law Assistant (ITLA) tool to assist employees in providing accurate, efficient, and complete responses to basic tax law telephone inquiries<br><br>1/31/08<br>Continue to develop Accessory Manager Tools that provide standard research paths, consolidate account data, and automatically populate input fields<br><br>9/30/08<br>Implement recommendations from the Correspondence Accuracy Improvement Study | 1/31/09<br>Continue to develop and enhance the Interactive Tax Law Assistant (ITLA) tool to assist employees in providing accurate, efficient, and complete responses to a wider variety of more complex tax law telephone inquiries<br><br>1/31/09<br>Review nationwide error trends to determine the areas where implementation of an Accessory Manager Tool would have the most significant impact, and develop tools based on this analysis<br><br>1/31/09<br>Continue to utilize program review teams to conduct annual quality reviews to seek improvement opportunities and identify best practices | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Improve the quality of volunteer-prepared returns through enhancements to the Volunteer Income Tax Assistance (VITA) Program, including quality training and sample processing reviews. | **5** | <u>3/31/08</u><br>Conduct on-site workshops to address quality concerns identified while making visits during filing season | <u>12/31/09</u><br>Replace current knowledge-based tax law preparation training with a process-based training approach | √ |
| Enhance services to persons with limited English proficiency (LEP) through: the Taxpayer Assistance Blueprint (TAB); development of a Multi-Lingual Strategic Plan; development of a Virtual Translation Office; and launch of a revised version of the Spanish irs.gov webpage. | **5** | <u>1/31/08</u><br>The Internet application "Where's My Refund" allows taxpayers to access their refund information. This application will be offered on the Spanish IRS.gov<br><br><u>9/30/08</u><br>The Multi-Lingual Project Office will work with Research to pinpoint isolated community locations and identify actions to customize assistance<br><br>(cont'd) | <u>Ongoing</u><br>Maintain the application and upgrade annually as needed<br><br><u>Ongoing</u><br>Continue expansion efforts | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| (cont'd) | | 9/30/08<br>Launch targeted outreach messages for LEP taxpayers in isolated communities<br><br>9/30/08<br>Expand the Virtual Translation Office (VTO) to increase and enhance VTO translations. The VTO will:<br>• translate glossaries of tax terms into multiple languages<br>• produce the tax forms and publications currently published in Spanish<br>• create additional forms and educational materials in Spanish<br>• produce new educational materials in other languages<br>• lay the foundation for translating products into other IRS-priority languages | | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Improve quality and timeliness of taxpayer contacts by maintaining an enhanced integrated quality assurance process with internal and external partners. | 4, **5** | 12/31/08<br>Develop and deliver Site Coordinator's Training<br><br>12/31/08<br>Define volunteer training levels and focus on consistent use of intake and interview sheets and volunteers performing quality reviews<br><br>6/30/08<br>Engage partners and employees in feedback solicitation through roundtable discussions and partner satisfaction surveys | 6/30/09<br>Engage partners and employees in feedback solicitation through roundtable discussions and via partner satisfaction surveys | |
| Enhance IRS.gov. | **5** | 9/30/08<br>Deploy an interactive tax law decision support tool as recommended in the Taxpayer Assistance Blueprint report and deliver improved Frequently Asked Questions (FAQs) support | 9/30/09<br>Deploy enhancements to the interactive tax law decision support tool to deliver Probe and Response Capability | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Improve services through programs at both the national and local level by expanding collaborations with organizations serving the disabled, Native American communities, and pre-existing rural infrastructures. | **5** | 9/30/08<br>Increase availability of EITC education and financial education in hard to serve Native American communities through network of partnerships involving Native community financial institutions, community development corporations, financial education providers, and Native American advocates | 3/31/09<br>Work with U.S. Department of Agriculture to increase the availability of free tax assistance programs<br><br>12/31/09<br>Collaborate with Rural Funding Foundations to expand tax related services in rural areas | |
| Expand and enhance the Spanish Website to increase electronic options, including options for Spanish language delivery of applications currently only available in English. | 3, **5** | 1/31/08<br>Launch Spanish version of the internet application "Where's My Refund," which allows taxpayers to access their refund information<br><br>9/30/08<br>Expand and enhance the Spanish website to educate Spanish speaking taxpayers about tax responsibilities for determining various tax eligibility | Ongoing<br>Maintain the application and upgrade annually as needed | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Provide Reporting Agents with access to e-Services. | 3, **5** | Deployed access to Electronic Account Resolution (EAR) and Transcript Delivery System (TDS) for Reporting Agents in June 2007<br><br><u>10/1/07</u><br>Market availability of new services to all Reporting Agents<br><br><u>6/30/08</u><br>Monitor access and modify as necessary<br><br><u>9/30/08</u><br>Work with Reporting Agents to explore opportunities for electronic delivery of bulk notices | <u>Ongoing</u><br>Maintain the application and upgrade annually as needed | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Implement Taxpayer Assistance Blueprint Phase 2, which includes a five-year Strategic Plan for taxpayer service, based on extensive research to understand taxpayer and stakeholder needs. | **5** | 9/30/08<br>Identify attributes of intentional versus unintentional taxpayer noncompliance | 9/30/09<br>Pending success of model development, determine causes for taxpayer errors and begin to develop appropriate treatments | √ |
| Implement Internet-Customer Account Services (I-CAS) Release 1, which will enable taxpayers to view account information. | 3, **5** | 9/30/08<br>Implement I-CAS Release 1 to enable taxpayers filing Form 1040 to view account information via a secure Internet link. I-CAS will offer online tax account services that will emulate an online banking experience | | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Implement I-CAS Release 2, which will enable taxpayers to change their address, file an extension, submit a Power of Attorney, and calculate a payoff amount on balances due via a secure Internet link. | 3, **5** | | 9/30/09<br>Implement I-CAS Release 2 to enable taxpayers to change their address, file an extension, submit a Power of Attorney, and calculate a payoff amount on balances due via a secure Internet Link | |
| Continue publicity efforts encouraging use of Online Payment Agreement. | **5** | Ongoing During Filing Season<br>Issue News Releases and other communications encouraging use of on-line application for tax year 2007 balance due returns<br><br>Ongoing<br>Promote ease of using Online Payment Agreement via multifaceted stakeholder distribution networks | Ongoing During Filing Season<br>Issue News Releases and other communications encouraging use of on-line application for tax year 2008 balance due returns<br><br>Ongoing<br>Promote ease of using Online Payment Agreement via multifaceted stakeholder distribution networks | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Work with Congress to enact simplification legislative provisions in Administration's FY 2008 Budget. | **1, 6** | Ongoing<br>Treasury and IRS and will work with Congress to enact legislative proposals. | 2/09<br>Treasury and IRS and will recommend additional legislative initiatives to Congress | |
| Continue Taxpayer Burden Reduction projects. | **6** | 1/31/08<br>Release new Forms 1120S and 2553<br><br>2/29/08<br>Complete regulations for new amended Forms 94X, (new forms under development to reduce employment tax reporting errors)<br><br>3/31/08<br>Verify customer acceptance of new Form 8857, Innocent Spouse Relief | 1/31/09<br>Release new amended Forms 94X | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Continue Tax Form and Publication improvements. | **6** | 9/30/08<br>Develop a multi-year prioritized plan of burden reduction activities to include forms redesign and simplification<br><br>9/30/08<br>Define the Modernized e-file (MeF) platform for the XML enabled PDF Form 1040, U.S. Individual Income Tax Return, for Tax Year 2009<br><br>9/30/08<br>Launch a hyperlinked Publication 17, Your Federal Income Tax, on the irs.gov website. Hyperlinks will be incorporated, enabling taxpayers to link to relevant sections within Publication 17 to assist in tax preparation research | | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Further enhance the centralized process to maximize utilization of State Audit Reports (SARs) by IRS for federal assessments. | 4, **7** | 5/31/08<br>Establish a system to baseline usability and productivity of incoming SARs | 6/30/09<br>Partner with states to implement enhancements to improve the usability of SARs | Partner with states to automate receipt of SARs |
| Implement a Questionable Employment Tax Practices (QETP) Initiative in partnership with the U.S. Department of Labor, the National Association of State Workforce Agencies, the Federation of Tax Administrators, and state workforce agencies to provide a collaborative national approach to combat employment tax schemes. | 4, **7** | 12/31/07<br>Launch QETP initiative by securing a minimum of 20 state participants<br><br>6/30/08<br>Fully implement process to deliver data provided by the states for incorporation into employment tax audit work streams<br><br>9/30/08<br>Increase number of states participating by 25% | 9/30/09<br>Continue to increase state participation by an additional 25% | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Further enhance the Fed/Fed program by facilitating and expanding partnerships with other federal agencies to improve tax administration. | 4, **7** | 6/30/08<br>Develop and launch a minimum of two new federal agency partnerships (e.g., SSA and SBA) | | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Engage all 50 states through the State Reverse File Match Initiative (SFRMI) – a process that matches IRS extracts received through the Governmental Liaison Data Exchange Program against state master files to identify individuals and businesses who filed a state return but not a federal return and to identify differences in federal and state income reporting. | 4, **7** | <u>7/31/08</u><br>Pilot use of systemic SRFMI data received from 14 states to identify nonfilers and underreporters | <u>6/30/09</u><br>Launch Phase 2 of pilot by increasing state agency participation by 50% to 21 taxing agencies | Continue expansion of SFRMI participation to all appropriate state tax agencies |
| Determine tax administration benefits of utilizing state data warehouse concept. | 3, 4, **7** | <u>7/31/08</u><br>Complete project analysis test and issue report of findings | <u>9/30/09</u><br>Based on test outcomes, take steps to expand as appropriate | √ |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Develop an educational targeted outreach DVD for military personnel preparing for retirement. | 5, **7** | 12/31/08<br>Distribute and integrate DVD into all military pre-retirement seminars to reduce the percentage of military retirees entering the Federal Employee/Retiree Delinquency Initiative (FERDI) population | 3/31/09<br>Obtain FY 2008 FERDI data for comparison to baseline data to measure DVD's effectiveness<br><br>9/30/09<br>Conduct research to determine the need for military disability tax-related services<br><br>12/31/09<br>Continue distributing DVD in all military pre-retirement seminars to reduce the percentage of military retirees entering the FERDI population | |
| Enhance outreach efforts to industry audiences about available Audit Technique Guides and Tax Tips. | **7** | 6/30/08<br>Work with industry partners to determine enhancements needed to existing guides as well as input on development of new guides<br><br>Ongoing<br>Publicize Audit Technique Guide availability to industries through national/local liaison activities | | |

| Initiatives | Related Treasury Strategy Component(s)[†] (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009[‡] |
|---|---|---|---|---|
| Establish links to IRS.gov on industry, practitioner, educational, and governmental stakeholders websites. | **7** | 5/31/08<br>Promote Tax Centers (dedicated web space) and links to state and national organizations | | |
| Develop and widely distribute educational fact sheets on areas of high noncompliance. | **7** | 9/30/08<br>Complete monthly distribution of 12 additional fact sheets | 9/30/09<br>Complete monthly distribution of 12 additional fact sheets | |
| Develop a strategy to reach practitioners without affiliation to a professional organization. | **7** | 3/30/08<br>Develop grass-roots delivery channel with national retail tax preparation firms<br><br>9/30/08<br>Expand outreach to colleges and universities to include graduates entering tax preparation careers | | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Leverage key partners such as the SBA and its SCORE program and SBDCs to deliver small business workshops to the new business community. | **7** | <u>Ongoing</u><br>Continue contacts with traditional partners to maximize leveraged opportunities that provide education and outreach directly to business owners<br><br><u>10/01/07</u><br>Establish a baseline of current leveraged small business tax workshops<br><br><u>12/31/07</u><br>Partner with SCORE and SBDCs to enhance quality and consistency of leveraged Small Business Tax Workshops<br><br><u>3/31/08</u><br>Partner with SBA to increase outreach through the National Women's Business Council<br><br><u>3/31/08</u><br>Partner with SBA to promote voluntary compliance and share information customized information for new business owners<br><br>(cont'd) | <u>12/31/08</u><br>Incorporate information regarding common filing errors into current tax workshop curriculum | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| (cont'd) | | 9/30/08<br>Increase the number of Small Business Tax Workshops | | |
| Deliver educational messages through existing relationships with universities and colleges. | **7** | 9/30/08<br>Incorporate key messages into professional curriculum taught via Tax Practitioner Institutes across the country | 9/30/09<br>Determine a baseline and expand the participation of current Historically Black Colleges and Universities (HBCUs) in the VITA program<br><br>12/31/09<br>Increase the participation of Beta Alpha Psi, a national scholastic and professional fraternity, in the VITA program by 10%<br><br>12/31/09<br>Determine baseline and expand the Cooperative Extension Services Network tax prep and education programs in each of the four regions, HBCUs, tribal colleges and universities | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Develop audio educational messages for toll-free wait times. | **7** | 1/31/08<br>Develop text and appropriate placement of specific educational messages. Submit Systems Change Request | 1/31/09<br>Implement approved educational messages<br><br>9/30/09<br>Work collaboratively with appropriate functions to create educational messages | |
| Customize outreach to specific industries to encourage voluntary compliance. | **7** | 3/31/08<br>Begin launch of industry specific communication/outreach to small business/industry stakeholders and state licensing agencies based on data driven analysis of key issues<br><br>9/30/08<br>Provide educational materials to new and existing business owners through partnerships with small business/industry stakeholders and state licensing agencies in all 50 states | 9/30/09<br>Conduct outreach in all states to promote the use of the IRS' web-based Tax Centers designed to provide education and web resources for specific industries and professions | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Request feedback from internal and external stakeholders on existing outreach and educational programs to identify best practices and enhancements. | **7** | 10/1/07<br>Convene Service-wide task force to collect and review stakeholder feedback<br><br>10/31/07<br>Share recommendations with external stakeholders and obtain additional feedback<br><br>12/31/07<br>Provide recommendations based on feedback<br><br>Ongoing<br>Implement appropriate recommendations | Ongoing<br>Implement recommendations | |

| Initiatives | Related Treasury Strategy Component(s)† (Bold = Primary) | FY 2008 Milestones | FY 2009 Milestones | Beyond FY 2009‡ |
|---|---|---|---|---|
| Develop strategies to educate first-time business filers. | **7** | 3/31/08<br>Collaborate with small business/industry partners to develop an outreach campaign to educate first time Schedule C filers, including common errors to avoid<br><br>12/31/08<br>Implement outreach strategy to first-time business filers | | |
| Expand relationships and collaboration with foreign tax administrations to increase informal and formal communications on international tax administration matters. | **7** | 9/30/08<br>Complete OECD project dealing with international guidelines on attribution of profits to permanent establishments<br><br>9/30/08<br>Participate in OECD monitoring of Transfer Pricing Guidelines including international business restructurings project | 9/30/09<br>Participate in OECD work on monitoring Transfer Pricing Guidelines | √ |

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# GLOSSARY

AARP - American Association of Retired Persons

AMS - Account Management Services

ASFR - Automated Substitute for Return

AUR - Automated Underreporter

BSA - Bank Secrecy Act

BSM - Business Systems Modernization

CADE - Customer Account Data Engine

CAP - Compliance Assistance Program

CAWR - Combined Annual Wage Reporting

CI - Criminal Investigation

CMP - Compliance Monitoring Process

CSIRC - Computer Security Incident Response Center

CSP - Common Services Projects

CTC - Child Tax Credit

EFTPS - Electronic Federal Tax Payment System

EITC - Earned Income Tax Credit

ERO - Electronic Return Originator

ETA - Electronic Tax Administration

FAQ - Frequently Asked Question

FHWA - Federal Highway Administration

FIN 48 - Financial Accounting Standards Board Interpretation No. 48

FUTA - Federal Unemployment Tax

FY - Fiscal Year

IRC - Internal Revenue Code

IRS - Internal Revenue Service

I-CAS - Internet Customer Account Services

IT - Information Technology

JITSIC - Joint International Tax Shelter Information Center

JOC - Joint Operations Center

LEP - Limited English Proficiency

LMSB - Large & Mid-Size Business Operating Division

LSR - Leadership Succession Review

MeF - Modernized e-File

NDNH - National Directory of New Hires

NMT - Net Misreporting Percentage

NRP - National Research Program

NTA - National Taxpayer Advocate

OECD - Organization for Economic Cooperation and Development

OPR - Office of Professional Responsibility

PCA - Private Collection Agency

PFA- Pre-Filing Agreement

PDC - Private Debt Collection

PGP - Priority Guidance Plan

PTIN - Practitioner Taxpayer Identification Number

QETP - Questionable Employment Tax Practices

ROI - Return on Investment

SAR - State Audit Reports

SBA - Small Business Administration

SB/SE - Small Business/Self-Employed Operating Division

SBDC - Small Business Development Center

SCORE - Service Corps of Retired Executives

SRFMI - State Reverse File Match Initiative

TAB - Taxpayer Assistance Blueprint

TAC - Taxpayer Assistance Center

TAS - Taxpayer Advocate Service

TBR - Taxpayer Burden Reduction

TCE - Tax Counseling for the Elderly

TCMP - Taxpayer Compliance Measurement Program

TDI - Taxpayer Delinquency Investigation

TEGE - Tax Exempt & Government Entities Operating Division

TIEA - Tax Information Exchange Agreements

TIN - Taxpayer Identification Number

TREES - TEGE Electronic Examination System

TY - Tax Year

VCR - Voluntary Compliance Rate

VITA - Volunteer Income Tax Assistance

W&I - Wage & Investment Operating Division Return to Table of Contents