Challenges Associated with Collecting Compliance Data

IRS Research Conference, 2002
Session 6: Data Availability, Access and Security Issues

Table of Contents

Background…… 1
- The Need for Strategic Compliance Measures at the IRS…… 1
- The Strategic Planning Process at the IRS…… 2
- Data Availability and its Impact on IRS Programs…… 4
- Challenges Associated with Collecting Strategic Compliance Data…… 5

Data Issues by Compliance Measure…… 6
- Filing Compliance…… 6
  - Limitations and Challenges…… 7
- Payment Compliance…… 7
  - Limitations and Challenges…… 9
- Reporting Compliance…… 10
  - Historical Perspective—What did TCMP Do?…… 10
  - The NRP Reporting Compliance Measures…… 11
  - Limitations and Challenges…… 13
  - Issues Unique to NRP…… 14
    - Privacy and Access Issues…… 14
    - Research vs. Reality…… 14
    - Internal Communication…… 16
    - External Communication…… 17

Use of Data Once It Is Collected…… 20

Appendix: Data Sources of NRP Measures…… 25
- Filing Compliance…… 25
- Payment Compliance…… 26
- Reporting Compliance…… 27

Challenges Associated with Collecting Compliance Data

BACKGROUND

The National Research Program (NRP) is a comprehensive effort by the IRS to measure voluntary compliance. Types of voluntary compliance include reporting compliance, filing compliance and payment compliance. The measure of filing compliance is the percent of required returns that are timely filed. The measure of payment compliance is the percent of reported tax that is timely paid. The measure of reporting compliance is the percent of true tax liability that is correctly reported. One of the most important objectives of the NRP is to ensure that our tax system is fair, to the taxpayer population as a whole as well as to each individual taxpayer. One of the ways NRP will meet this objective is by being less intrusive and burdensome on taxpayers when collecting the compliance data relative to previous efforts to measure compliance.

By learning from attempts to measure compliance in the past, the IRS has framed this new approach using the following set of guiding principles:

- minimize taxpayer burden as data is collected;
- involve the Business Operating Divisions as partners in the design and implementation of the program, as well as customers of the results; and
- solicit external stakeholder ideas and support in the design of the program.

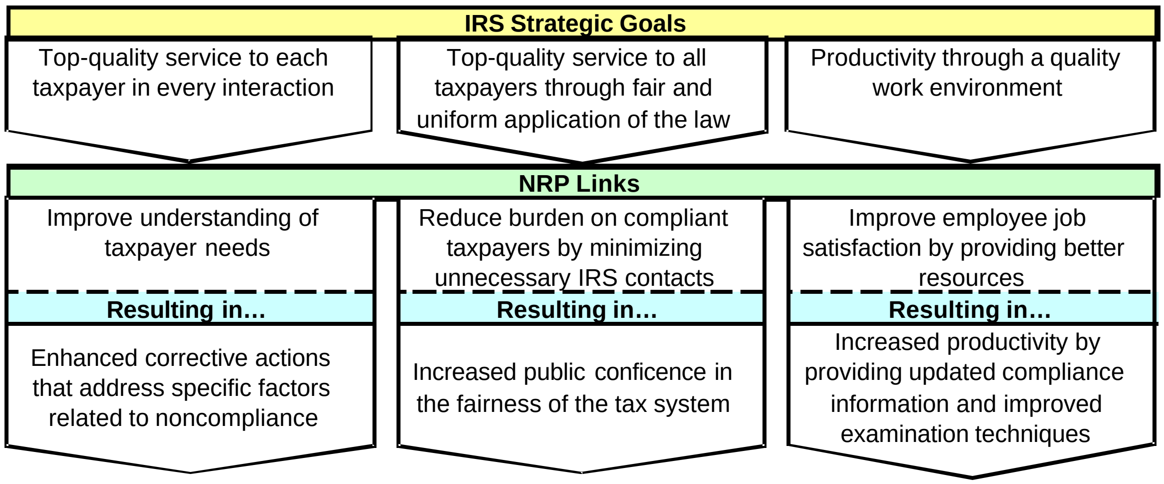
The need for strategic compliance measures at the IRS

Under the Reform and Restructuring Act of 1998 (RRA '98), Congress mandated that the IRS deliver service to taxpayers at a new and much higher level of performance. As a result, the Service redefined its mission, restructured its organizations around its customer segments, and identified "top-quality service to each taxpayer in every interaction[1]" as its first strategic goal. With the establishment of the new organizational structure and close oversight of IRS' modernization progress, the IRS needs reliable, regular, and up-to-date approaches to measure overall compliance. The Service will use NRP to measure Servicewide strategic compliance measures and has integrated its newly defined strategic goals and balanced measures into the NRP design and output. Figure 1 depicts how NRP links to the Service's balanced measures.

[1] IRS Strategic Plan (Fiscal Years 2000-2005) p. 4

Figure 1: NRP Links to IRS Strategic Goals

NRP will increase public confidence in the fairness of our tax system by helping us identify where compliance problems occur and focus our resources accordingly.



To demonstrate to Congress and America's taxpayers that it is capable of maintaining the integrity of the federal tax system, the IRS must realize its organizational goals and strategic objectives. The IRS strategic planning and budgeting process provides a formal, structured environment for establishing strategic direction, determining resource levels to support the priorities and projects stemming from that direction, and evaluating performance results. It is both cyclical and iterative, and is dependent upon rigorous research and analysis.[2]

The IRS requires regular estimates of taxpayer compliance with federal income tax laws, along with contributing factors, since we expect patterns of noncompliance in the population to change over time. Only then can the IRS rely on the compliance measures as strategic performance indicators.

The strategic planning process at the IRS

Strategic planning begins with the IRS Operating Divisions and headquarters accessing available information that includes the annual NRP compliance measures. With the organization aligned into four Business Operating Divisions, each division will continue to reengineer or design new processes to meet the demands of each specific customer base. For strategic planning and budgeting purposes, each Operating Division will require annual measurements of compliance for its customer segments.

To support this need, NRP has already generated estimates of voluntary filing and payment compliance and will update these compliance data on an annual basis. NRP

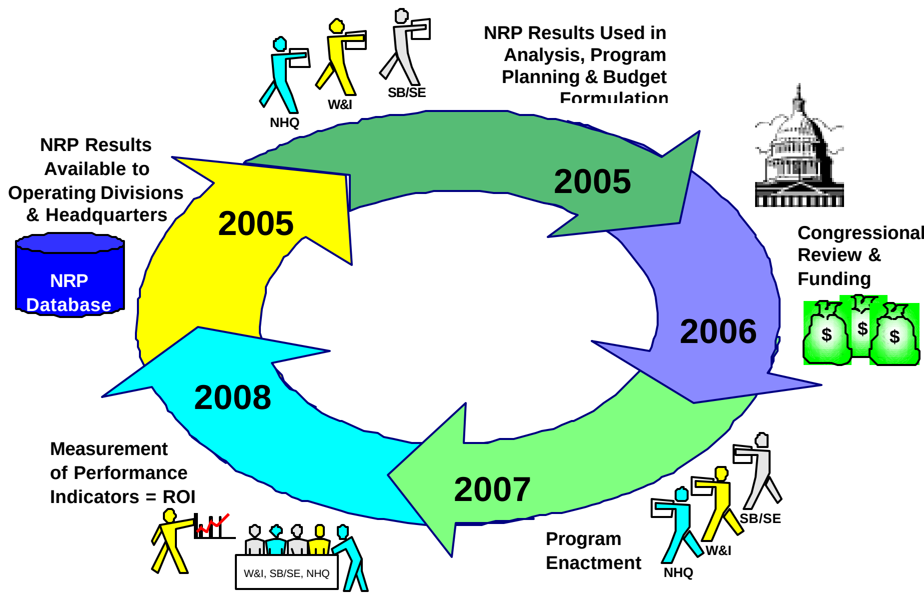
[2] IRS Strategic Plan (Fiscal Years 2000-2005) p. 87

expects to conduct reporting compliance surveys every three years. For tax years between the NRP survey years, we plan to use operational audit results (from the Examination Operational Automation Database—EOAD—if possible) to make interim estimates of the Voluntary Reporting Rate (VRR). NRP is currently evaluating alternative techniques to link operational audit results to the random samples of the NRP studies. The IRS will begin to measure reporting compliance for individual taxpayers in the fall of 2002 and is currently making plans for future reporting compliance surveys of small corporations, partnerships and trusts.

The Operating Divisions will be able to analyze and use NRP data as needed in relation to their environment, customers and resources to make decisions about necessary shifts in resources and program initiatives through program planning and budget formulation. Eventually, the IRS consolidates the plans of all Operating Divisions for preparing its Annual Performance Plan and budget submission to Treasury, the Office of Management and Budget (OMB) and the Congress.

Figure 2 below depicts how annual measures resulting from NRP will feed directly into the IRS strategic planning and budgeting process, helping senior management make informed strategic planning and budgeting decisions.

Figure 2: NRP and the IRS Strategic Planning & Budgeting Cycle



Data availability and its impact on IRS programs

Administering a tax system that promotes fairness is dependent on the Service's ability to distinguish between the many factors that impact compliance with the tax laws. Without reliable compliance measures, the Service will have limited capability to determine what key areas of noncompliance to address and what treatments to apply to maximize the use of its limited resources.

The National Commission on Restructuring the IRS pointed out that "…one of the most significant criticisms of the IRS compliance research approach is the lack of current reliable data on noncompliance."[3] The IRS last measured voluntary filing compliance in 1988, and its last study of voluntary payment compliance occurred in 1984. As Table 1 shows, our existing measure of reporting compliance is based on very old Taxpayer Compliance Measurement Program (TCMP) data.

Table 1: Most Recent Reporting Compliance Surveys

Type of Return	Last Tax Year Studied (TCMP)	Notes
Form 1040 (Individual)	1988	All Schedule Types, includes returns that are now designated Wage and Investment
Form 1120 (Corporate)	1987	Study included only returns with Assets < $10 M
Form 1120S (Corporate)	1984	TCMP data was corrupted and not included in the CRIS Business Filer Model (BFM). If the TCMP data had been available it would have been too old to be of value in the CRIS BFM.
Form 1065 (Partnership)	1981	TCMP data was corrupted and not included in the CRIS BFM. If the TCMP data had been available it would have been too old to be of value in the CRIS BFM.
Fiduciary (Trusts)	1975	TCMP data was too old to be of value in the CRIS BFM.
Estate Tax	1971	TCMP data was too old to be of value in the CRIS BFM.
Form 940 (Employment Tax)	None	There have been no TCMP studies of Employment Tax returns. Estimated employment tax gap based on related return information from other TCMP studies

The NRP will help the Service meet its need for current compliance information by providing a statistically valid representation of the compliance characteristics of taxpayers. NRP results will improve the IRS' ability to detect noncompliance, reduce the burden of unnecessary IRS contacts on compliant taxpayers and support strategic

[3] National Commission on Restructuring the IRS, final report, Paragraph 83.

decision-making, program development and resource allocation of the IRS Operating Divisions.

Challenges associated with collecting strategic compliance data

However, as this paper documents, collecting the data for these compliance measures is no mean feat. In addition to the logistical considerations of normal data collection exercises, NRP must deal with such challenges as data availability, political considerations and pressures, and taxpayer privacy and burden issues. In addition, this data collection effort is not the sole province of the NRP Office. The efforts of various research and examination offices throughout the IRS will be involved in collecting and generating the strategic compliance measures, requiring extensive communication, coordination and participation throughout the IRS.

The purpose of this paper is to introduce NRP's voluntary compliance measures, as well as the major challenges associated with collecting the data to report those measures. We will also discuss some of the efforts to overcome those challenges, as well as some of the potential uses of the measures and associated data. In the appendix to this paper we present the sources of the data that go into the compliance measures and how these strategic measures relate to the operational measures that currently exist within the IRS.

DATA ISSUES BY COMPLIANCE MEASURE

Filing compliance

The NRP has developed two strategic filing compliance measures: the Filing Rate and the Nonfiling Tax Gap. The IRS has defined the Filing Rate as the percentage of the taxpayer population with a filing requirement that filed timely. The equation for the Filing Rate is:

$$\text{Filing Rate} = \frac{\text{Number of required returns filed timely}}{\text{Total number of returns required to be filed}} \times 100$$

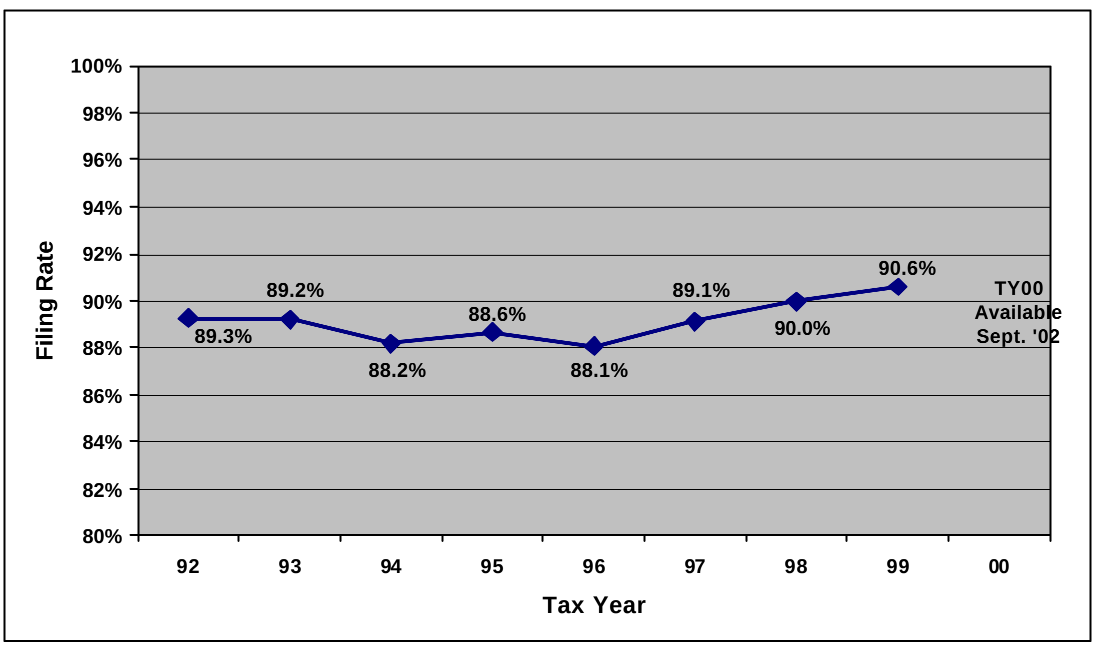
The Nonfiling Tax Gap is the dollar amount of unpaid taxes due from delinquent and non-filed returns. The equation for the Nonfiling Tax Gap is:

$$\text{Nonfiling Tax Gap} = \text{Total tax liability of late filers and nonfilers} - \text{Tax paid timely by late filers and nonfilers}$$

The two measures are somewhat complementary to one another in that the Filing Rate captures the frequency of voluntary filing compliance while the Nonfiling Tax Gap captures the dollar amount of filing noncompliance.

The issue of filing compliance is not a small one. As Figure 3 shows, the IRS estimates that the Filing Rate for individual taxpayers in tax year 1999 was 90.6%. And while the Filing Rate has climbed in the three most recent consecutive years, we estimate that more than 11 million taxpayers are either filing their returns late or not at all.

Figure 3: Individual Income Tax Filing Rates



Limitations and Challenges

The primary limitation of the data is the scope of coverage. Unlike the strategic payment and reporting compliance measures, which can report at the Operating Division level, the Filing Rate and Nonfiling Tax Gap are available for individual taxpayers only, and it is unlikely that we could provide a breakdown of individual filers into SB/SE and W&I groupings.

One problem is the availability of data sources for tax entities other than individuals. Problems identifying and classifying business income exists even among individuals. For example, proprietors who fail to report any business income appear in IRS data to belong to the Wage & Investment division, but those who report some business income to the Census Bureau will appear to belong to the Small Business/Self-Employed division in the Census records. Moreover, the only way the IRS knows that a tax entity (whether an individual acting as a small business or a corporation) might have an employment tax filing requirement is when that entity requests an Employer Identification Number (EIN). Without that request, the IRS has no idea whether a tax entity should be filing employment tax forms. To complicate matters, not all entities with EINs have employment tax filing requirements. Likewise, the IRS has yet to identify a suitable data source for estimating the population of corporations.

A second limitation to the Filing Rate data is the time required to develop them. The IRS will publish the Filing Rate on an annual basis (by tax year), but each release will occur about 18 months after the end of each tax year. For example, the IRS announced the Filing Rate for tax year 1999 in October 2001.

The Nonfiling Tax Gap has an additional, even more compelling limitation. There exists a high level of sensitivity to the notion that the IRS would have access to Census information. One of the foundations of the Census is the anonymity each respondent has when answering the questions. The IRS fully agrees with the Census position, and would never consider using Census data for enforcement purposes. Still, both agencies must take care to avoid even the perception of data sharing for enforcement. In order to preserve the anonymity of the study participants, the IRS will have access only to publicly available tabulations—any taxpayer identity associated with those tabulations will be completely unknown to the IRS. The Census Bureau already receives specified data from the IRS annually, pursuant to legislation.

Payment Compliance

The NRP has developed two strategic payment compliance measures: the Voluntary Payment Compliance Rate (VPCR) and the Cumulative Payment Compliance Rate (CPCR). The IRS has defined the VPCR as the percentage of the total tax paid timely on timely filed returns relative to the total tax reported on timely filed returns. The equation for the VPCR is:

$$\text{VPCR} = \frac{\text{Tax paid timely on timely filed returns}}{\text{Tax reported on timely filed returns}} \times 100$$

The CPCR is the percentage of tax paid on timely filed returns to date relative to the total tax reported on timely filed returns. The IRS designed the CPCR to measure the revenue flow associated with timely filed returns over time. A key difference between the CPCR and operational payment compliance measures is that the CPCR focuses only on the tax due and ignores interest and penalties. The equation for the CPCR is:

$$\text{CPCR} = \frac{\text{Tax paid to date on timely filed returns}}{\text{Tax reported on timely filed returns}} \quad \text{X } 100$$

The two measures complement one another in that the VPCR captures the initial payment compliance of timely filers while the CPCR captures subsequent payments associated with those timely filed returns.

As the Table 2 shows, the IRS estimates that the VPCR for individual taxpayers in tax year 1999 was 98.8%. While that percentage is reasonably high, it represents a total of nearly $11 billion that taxpayers did not forward to the IRS in a timely manner. Note also that the table includes data from the CRIS database rather than master file. It is highly likely that master file data will yield slightly lower payment compliance rates and thus a larger amount of unpaid taxes on timely-filed returns[4].

Table 2: Estimates of Individual Voluntary Payment Compliance

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Year	Total Tax Per Taxpayer	Earned Income Tax Credit (EITC) Per Taxpayer	Total Tax Per Taxpayer After EITC	Total Payments	Total Tax After EIC Minus Total Payments	**VPCR**
1997	$760,942,024,872	$29,731,692,006	$755,157,433,420	$744,774,204,033	$10,383,229,387	**98.63%**
1998	$804,378,243,939	$30,134,237,758	$799,990,431,348	$791,304,980,309	$8,685,451,039	**98.91%**
1999	$879,056,709,508	$30,776,256,253	$874,896,934,375	$864,001,772,217	$10,895,162,158	**98.75%**

Notes: Only returns that were filed timely were considered in determining payment compliance

Only timely payments were considered in determining payment compliance

Total Tax per Taxpayer after EITC (col 4) was determined by subtracting EITC per Taxpayer (col 3) from Total Tax per Taxpayer (col 2) (but not below zero).

Total Payments (col 5) was limited to Total Tax per Taxpayer after EITC (col 4) if in excess of that amount.

VPCR (col 7) = Total Payments (col 5) / Total Tax per Taxpayer after EITC (col 4)

Source: CRIS 2001 Individual Filer Model

[4] There are two reasons for the potential difference. The first is that the CRIS database contains only a sample of the taxpayer population while the master file data represents all taxpayers. This, however, would only explain a difference, not the direction of that difference. A more likely reason is how the two databases treat amended returns. Consider the following scenario: a taxpayer files a timely return and is expecting a refund. Prior to the original due date, the taxpayer discovers an error resulting in additional tax. The taxpayer files an amended return prior to the original due date but makes no payment, expecting the IRS to either reduce the refund or pay the additional tax with the refund. In this example, the master file measure would account for the additional tax liability (in the denominator), but the CRIS measure would not. Neither measure considers the payment because it was not made timely. Consequently, the master file measure would be lower than the CRIS measure.

Limitations and Challenges

As mentioned in the Data Sources section above, the IRS has complete payment compliance data for each taxpayer, so the only limits on the data analysis would be those associated with the statistical reliability of the data and the data-extract programs themselves. NRP is creating tables that report the VPCR and CPCR by IRS Operating Division, by tax year, and by type of tax. It is conceivable, however, that the Operating Divisions may want to examine payment compliance at greater degrees of detail, such as by exam class, industry or geographic region. The current programs do not support such cuts of the data. Additionally, there may not be enough data points to yield statistically reliable results at such a micro level.

The challenge in developing these measures is not in the availability of data, but in the definitions of what is (or is not) a payment and what is (or is not) a late payment. There are a myriad of payments, credits, adjustments and other items that can affect reported income and reported tax on a return, and NRP took great pains in determining whether and how a master file transaction impacted the VPCR and CPCR.

For example, the IRS master file database treats the Earned Income Tax Credit (EITC) as a payment that reduces the tax that a taxpayer owes. By that definition, the EITC would appear in both the numerator and the denominator of the VPCR and the CPCR. The EITC, however, is not truly a payment, and NRP and the NHQ Office of Research decided that the best way to treat it was as a direct reduction to the total tax reported. In the payment compliance calculations, we subtract any EITC from the total tax reported on the return and then take the ratio of timely payments to the adjusted total tax reported.

Another major definitional issue arose when we considered required periodic payments made throughout the year, such as estimated tax payments and federal tax deposits. These payments all have their own due dates, and if a taxpayer misses a deadline the IRS is likely to levy a penalty against that taxpayer. At the same time, if the taxpayer pays all of the tax due by the return due date, the IRS considers that taxpayer timely paid even though it may assess a delinquent payment penalty. Additionally, the master file data do not distinguish between insufficient payments made timely versus sufficient payments that came in late.

NRP decided that rather than trying to track the dollars associated with these delinquent payment flags we would look at them as counts of delinquency. Specifically, NRP will include all periodic payments made prior to the final payment due date (i.e., associated with the return due date) in the VPCR (treating them as timely). NRP will also include a line on the report that tracks how many cases have delinquency flags associated with those payments. Separate counts will be made for those whose reported tax liability is fully paid by the final payment due date (i.e., associated with the return due date), and those whose reported tax liability is not fully paid by that date.

Reporting Compliance

The most widely known program under NRP is reporting compliance measurement. NRP has designed a study that will provide the same level of reporting compliance data as earlier Taxpayer Compliance Measurement Programs (TCMP) and will also significantly reduce burden levels of participating taxpayers.

Historical Perspective—What did TCMP do?

Historically, the IRS measured taxpayer reporting compliance through a series of studies called the Taxpayer Compliance Measurement Program (TCMP). TCMP studies of individual income tax return filers typically included a sample of approximately 50,000 returns, which examiners reviewed line by line. The resulting data allowed the IRS to develop discriminant function (DIF) models to forecast taxpayer compliance behavior.

While the TCMP studies yielded reliable estimates of reporting compliance, the burden imposed on both the taxpayer and the IRS to complete the studies was quite high. Taxpayers needed to provide documentation for every item they entered on their returns. IRS tax examiners had to work through each line item on these returns and sort through all the supporting documentation to identify levels of compliance. These interactions between the IRS and taxpayers could take several days each. Additionally, while tax examiners were working on TCMP cases, they had to defer work on operational audits.

These high burden levels compelled both the IRS and Congress to rethink continuing with the studies in the 1990s. In the 1990s, the Service designed and then cancelled three Taxpayer Compliance Measurement Program (TCMP) surveys due to taxpayer perceptions that line-by-line audits are intrusive and burdensome, the cost to the Service, inadequate partnership development, and the political climate. The last successful TCMP occurred using tax year 1988 returns, which means that the IRS is now relying on 13-year old data for estimating taxpayer behavior.

It is clear that the IRS must obtain reporting compliance measurement data differently than it did in the past. The IRS has gone to great lengths to apply its experience with previous efforts to develop an improved and more pragmatic approach. As currently designed, NRP will minimize taxpayer burden and will be far less intrusive and burdensome on taxpayers than previous efforts to measure compliance. The availability of significantly different and better technology and resources have allowed the IRS to build improved quality and less error into the NRP approach. This is especially true in the case of measuring reporting compliance.

The NRP process for determining return accuracy will minimize taxpayer burden through reliance on data available to the IRS (some of which was not previously available) instead of line-by-line audits. Additionally, an experienced examiner cadre, including managers, will be conducting NRP audits. These individuals will receive specialized training to work the audits, as well as the data associated with each return in the program. The IRS will use these data sources to identify compliance issues and validate taxpayer information on the return without contacting the taxpayer.

Data gathering and reporting processes for all compliance measures will be streamlined and automated using technology already familiar to examiners. Quality review processes will also be embedded throughout NRP systems and processes. The results will be available electronically to the Operating Divisions that are involved as partners in the design and implementation of NRP and as customers of the results. These improvements to past compliance studies are summarized in Figure 4.

Figure 4: NRP Improvements to Compliance Measurement

TCM	NRP
Line by line audits of every return in the survey -- extraordinarily intrusive to the taxpayer	No audits comparable to TCMP. Instead, reliance on data available to the IRS and face-to-face audits when necessary.
Purpose: Compliance	Purpose: Compliance and customer-focused programs
Some untrained examiners participated in TCMP	Experienced examiner cadre with specialized training
Required use of paper checksheets	Streamlined electronic data collection methods
Little emphasis on understanding reasons for noncompliance	Significant emphasis on understanding specific factors associated with noncompliance
Results were not consistently integrated into strategic planning process	Results will be integrated into strategic planning
Samples considered too large and impacted too many taxpayers	Sample size minimized – fewer taxpayers impacted
Measures were not available for three or more years	Measures will be available annually
Stand-alone research study without buy-in or ownership of Exam or other IRS functions.	The Business Operating Divisions and their embedded examination functions are partners in the research

The NRP Reporting Compliance Measures

NRP has developed several strategic reporting compliance measures: the Voluntary Reporting Rate (VRR), the Underreporting Gap, and the Net Misreporting Percentage.

The IRS has defined the Voluntary Reporting Rate as the percentage of the tax that taxpayers accurately reported on timely filed returns. The equation for the VRR is:

$$\text{VRR} = \frac{\text{Total tax reported on timely filed returns}}{\text{Total tax reported + Estimate of tax misreported}} \times 100$$

Past national compliance studies (the last of which was conducted for tax year 1988) yielded VRR estimates in the 91%-to-92% range. Notice that the denominator includes an estimate of the amount of tax misreported—not just the amount underreported, as was the case with the Voluntary Compliance Level (VCL) calculated for previous compliance studies.[5]

The IRS defines the Underreporting Gap as the amount of tax that is not voluntarily reported on timely filed returns for a given tax year. It is the extent to which timely filers understate their true tax liability[6] on their returns, and is net of their overstatements. The starting point for this estimate is the estimated amount of misreporting derived for the denominator of the VRR, which takes into account what is detectable by a "calibration sample[7]," but not by the NRP audits themselves. However, estimates of the underreporting gap also take into account misreporting that cannot be detected even by comprehensive line-by-line audits. Additional adjustments are made for most kinds of income to compensate for the fact that all the examiners cannot detect misreporting with equal ability. For other types of income, where noncompliance is particularly difficult to detect,[8] separate estimates will be developed from targeted, non-NRP studies.

Estimating the extent to which line-by-line audits do not detect all unreported income is the most challenging of these adjustments. In the past, our method for making the non-detection adjustments was based on an analysis of a special study of the 1976 TCMP data. Since the circumstances that justified this analysis no longer exist,[9] it cannot be repeated for more recent studies—including the NRP survey. In its place, we plan to use the "detection controlled estimation" method developed by Professor Jonathan Feinstein for income tax audits, Nuclear Regulatory Commission inspections, and Occupational Health and Safety Administration inspections.[10] This sophisticated statistical methodology provides a way to estimate the undetected tax liability based on the observed variation in skill levels among the examiners. The key requirement is that

---

5 The amount misreported is the net of the amounts underreported and the amounts overreported.

6 Actually, the underreporting gap also reflects the extent to which taxpayers misreport refundable credits, such as the Earned Income Tax Credit.

7 Because the NRP reporting compliance study's case building/classification approach is both new and different from previous reporting compliance studies, NRP will subject a small number of taxpayers to a more comprehensive audit in an attempt to calibrate the NRP results to those we might have achieved with more intrusive examinations. The calibration sample will provide the IRS with some insights as to the accuracy of the case building/classification methodology, the bias (if any) introduced by the reduced burden on taxpayers in the NRP approach, a basis for correcting any bias in the aggregate NRP measures, and indications of where future NRP studies might be improved.

8 The primary examples are informal supplier income and tip income. Informal suppliers are sole proprietors who provide goods or services in an informal business style, typically on a cash basis, with few, if any, paper records. Examples include full-time street vendors and part-time moonlighters. Since it is very difficult to detect the magnitude of these earnings by auditing the proprietors themselves, we have commissioned separate studies focused on the consumers of these goods and services.

9 The 1976 TCMP survey was the last one in which the examiners did not have at their disposal the information returns provided by payers of income, etc., on behalf of the taxpayers. The special study measured the extent to which the examiners were able to detect unreported income without those documents. Since those documents have been routinely used to enhance compliance audits ever since, the results of that study have never been updated.

10 Feinstein, Jonathan S., "Detection Controlled Estimation," *Journal of Law Economics,* 1990, 33(1) pp. 233-76.

we be able to associate all NRP returns that were examined by the same examiner.[11]

The underreporting gap estimates will be broken down by tax return line item categories as well. That is, we will estimate how much of the underreporting gap is attributable to the underreporting of each of the various sources of income, and to each of the major types of offsets to income (i.e., the various adjustments, deductions, and exemptions), and offsets to tax (i.e., credits).

The third strategic reporting compliance measure is the Net Misreporting Percentage (NMP). The misreporting percentage for a given line item on a given return is the amount misreported on that line item divided by the amount that should have been reported. In essence, the aggregate NMP for that line item is the weighted average of the individual percentages across all returns, weighted by the amount that should have been reported. The absolute value of the correct amount is used so that returns with negative amounts (losses) are weighted on the same basis as those with positive amounts, rather than offsetting each other. The equation for the NMP is:

$$\text{NMP} = \frac{\text{Sum of the amounts misreported on the income or offset item}}{\begin{array}{c}\text{Sum of the absolute values of the amounts that should have} \\ \text{been reported on the income or offset item}\end{array}} \text{ X } 100$$

In the aggregate, income items are typically underreported, and deductions, adjustments and exemptions are typically overstated. Therefore, misreporting for the NMP is defined as understatements net of overstatements for income items, and overstatements net of understatements on offset line items; that is, positive amounts are always in the taxpayer's favor.

Limitations and Challenges

Obviously, the NRP reporting compliance study has numerous analytical purposes. The sample design will yield a wealth of information, but it will not provide enough data to answer all potential questions since there are inherent limitations to any research program. Collecting data to answer all possible questions would be costly, burdensome and time consuming. NRP has confidence in the data that are to be assembled; however, there still will be issues and queries that will go unanswered.

It is also important to realize that the last national compliance study conducted by the IRS was based on Tax Year 1988 filings, and used a completely different method for auditing taxpayers. Furthermore, there have been many tax law changes over the past 13 years, so any trend analyses conducted between the TY1988 and TY2001 data must be viewed with caution.

[11] It is important to note that the key to this exercise is to identify potential noncompliance that the classifiers and examiners did not detect for estimating the underreporting tax gap. It is NOT an exercise in evaluating the performance of the classifiers and examiners. The IRS will set up the study such that the identities of the classifiers and examiners are fully disguised.

Issues Unique to NRP

The NRP study of reporting compliance will provide the IRS with a wealth of information about the reporting characteristics of America's taxpayers. Such an undertaking requires the coordinated efforts of a great many resources within the Service, and that coordination presents a variety of issues and problems/challenges that are unique to NRP.

Privacy and Access Issues

The ability of NRP to maintain the integrity and security of the data it gathers and analyzes is critical to its success. Throughout the NRP process taxpayer privacy will be maintained by collecting only taxpayer data necessary for compliance measurement. It is critical not only from the perspective of data integrity, but the NRP must be able to ensure stakeholders that access and use of this data is only carried out under established IRS guidelines and procedures for securing and using taxpayer data. Processes are in place to ensure accountability and appropriate access and use of data related to NRP. Efforts to address privacy issues include:

- Involvement of the Privacy Advocate (PA) as a member of the NRP Executive Steering Committee and participation of PA Office representatives in the design and implementation of the NRP sample design, system infrastructure, and data needs and requirements.

- Development of a Privacy Impact Assessment (PIA) of the NRP system to ensure the privacy, confidentially, integrity, and availability of information contained in the system are protected and that the Privacy Advocate is involved sufficiently to ensure all the requirements are met.

- All individuals accessing taxpayer data for any NRP purpose must complete the *NRP Tracking Form for Accessing Taxpayer Data*, prior to accessing any internal (IRS) or external (i.e. ChoicePoint) database or application (data source). This form requires employee and manager signature, along with specification of the time period data is to be accessed.

Research vs. Reality

The NRP Office is subject to a natural tension—resulting from the conflicting demands of the IRS research communities and the political and practical constraints on collecting compliance measurement data. Privacy concerns also contribute to this tension.

The Non-filing Tax Gap measure is an excellent example of the conflicting pressures that influence the IRS' efforts to collect compliance data. Since the successful collection of Census data is predicated on the population's expectation that their responses are anonymous, the Bureau of Census is very cautious about the conditions under which it provides data to the IRS for the non-filing tax gap measure. As stated earlier, the IRS and the Bureau of the Census reasonably want to avoid contributing to any misperceptions that could impact the public's trust in providing Census data, and at no time will the IRS have access to any individual's Census data.

From a strategic measurement standpoint, the IRS does not need to know the identities of taxpayers who failed to file timely and voluntarily. The Service, however, would be interested in identifying characteristics of those taxpayers who fail to file timely or even at all. Operational audits could provide information on those late filers, but the IRS has little information on the income and demographic characteristics of the nonfiling or "ghost" population. A more detailed examination of the Exact Match data would provide important information on these segments of the taxpayer populations, but the IRS and Census recognize the paramount importance of the public trust in the Census survey. For this reason, the IRS must forego the opportunity to examine detailed nonfiler information in return for the ability to measure the overall size of the non-filing tax gap.

While the tension exists for each strategic compliance measure, it is greatest within the reporting compliance measure. Reporting compliance cannot be measured in a controlled environment, and taxpayers, who are the primary source of the data, are generally unwilling to participate in a study that requires them to submit to a tax audit, regardless of their level of compliance or the intensity of the audit. Furthermore, the IRS cannot offer any form of compensation to either entice taxpayers to participate in the survey or reduce the objections of study participants.

With the greatest need for Servicewide collaboration, the reporting compliance measures have produced the greatest amount of tension. Given the gap in reporting compliance data from the most recent TCMP study, the IRS research community is naturally enthusiastic about the potential uses of the NRP data. In an ideal world, the NRP study would provide sufficient data to allow IRS researchers to examine reporting compliance characteristics of specific line items; across various income, occupation, and industry segments; and across regions of the country. The sample size to produce such results, however, would be so large that the IRS could never start the program.

An additional problem is that NRP is dependent upon examiner resources from the Small Business/Self-Employed and Wage & Investment Operating Divisions to build and classify each case file in the NRP study and then examine those cases that require further verification. NRP has to consider the burdens this research effort places on these internal resources, and in some cases we have made compromises.

While human error is a potential problem for most research efforts, the consequences of mistakes are magnified in NRP. Gathering reporting compliance data is an inherently human activity, involving the interaction between IRS examiners and taxpayers and/or their representatives. Even during TCMP studies, which required substantiation of entries on each line on a return, "human error" existed, and in some cases examiners failed to uncover unreported income or overstated expenses. To manage the potential for human error while maintaining the importance of minimizing taxpayer burden in the NRP methodology the IRS is developing new or modified systems, processes and employee guidance. Because the methodology is new, the IRS is making every effort to develop training and guidelines that will ensure consistent classification and examination processes. Additionally, the IRS has been conducting simulations of its procedures and developing in-process quality review standards to ensure the effectiveness and consistency of data collection methods.

Internal Communication

Ongoing and extensive internal communication is critical to the successful delivery of NRP. Consistent with the NRP guiding principles, various organizations within IRS have been involved in the development of NRP. However, the challenge of creating a broad awareness and facilitating a correct understanding of the program among IRS employees continues as implementation takes the program from concept to reality. All IRS employees need to understand that NRP is not TCMP and why it is truly different. Compliance employees in particular need to know that participating in NRP will give them an opportunity to develop and use tools and processes that will ultimately make audits easier and more efficient for all examiners.

For the reporting compliance measure, highly skilled examiners are needed to collect data about the accuracy of the returns in the NRP sample – especially the more complex returns. Those examiners who are more experienced may be biased against NRP if they think it is the same as TCMP. These biases can easily be transferred to new examiners since experienced examiners and their managers have the most professional influence over them. Communication, therefore, must be tailored and delivered by vehicles that will best facilitate understanding of the program by examiners with the skill sets necessary to deliver NRP.

<u>Coordination throughout IRS</u>

The NRP Program Office provides program management and oversight, and coordinates and ensures delivery of all of the program's components. Even though the NRP Office was created to ensure a single point of accountability and responsibility for implementing a new compliance measurement program, the NRP Office relies on multiple IRS organizations for implementation, production, and delivery of NRP results. The NRP Office began to involve the IRS Operating Divisions and other interested IRS offices by consulting them throughout the design and implementation of the program regarding:

- information they would like collected as part of the NRP study—particularly reporting compliance;
- roles each organization should play in the program; and
- resources each organization will contribute to NRP.

NRP integrated two components into its program management to formalize the intra-agency relationships vital to NRP development and implementation: The NRP Executive Steering Committee (ESC), and the Examination Advisory Committee (EAC), which has become the NRP Implementation Team. These groups include members from various IRS Operating Divisions and organizations and each supports NRP at a different level.

The ESC is comprised of top-level officials from all of NRP's internal partners and customers, other internal stakeholders such as the Privacy Advocate and Treasury, and external stakeholders such as the IRS Oversight Board. The ESC provides strategic guidance for the program, serves as a governing board for major implementation decisions and makes high level, multi-functional decisions for the NRP.

The NRP Implementation Team was established to complete a number of critical tasks necessary to support the full and timely implementation of NRP. Team members are representative of the employees and managers who will do NRP work including representatives from SB/SE, W&I, NRP, Research and NTEU. They have a broad collective knowledge of the classification and examination processes, as well as prior efforts to measure compliance and other issues. The Implementation Team developed case building, classification, examination and quality review guidelines and procedures. They also developed training materials and Internal Revenue Manuals.

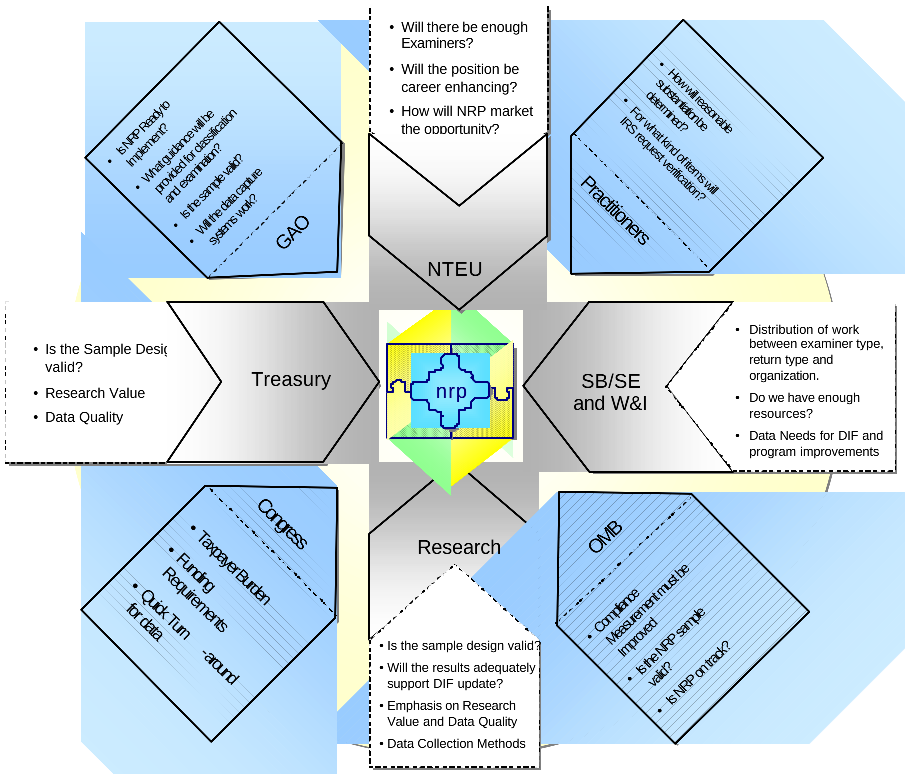
External Communication

Development of ongoing positive relationships with external stakeholders is fundamental to the ability of the NRP Office to carry out its mission. Most stakeholders, internal and external, would agree that some method of tax compliance measurement is necessary to effectively operate and inform strategic decisions about our tax system. However, had NRP not been introduced as a compliance measurement program that is truly different from TCMP, development of NRP may have been shut down completely due to the sensitive nature of compliance measurement and the unpopular history of TCMP. To ensure that the NRP methodology was given sufficient consideration, communications about NRP have been sequenced, and steps have been taken to keep partners and stakeholders involved throughout development, implementation and delivery by:

- obtaining their ideas and suggestions;
- addressing their concerns and objections;
- winning their support and, when necessary, their participation; and
- providing opportunities to comment on training procedures .

The following figure is a depiction of some of the many concerns and influences stakeholders have had, and in some instances continue to have over NRP.

Figure 5: External Influences on the NRP Program



This focus on external stakeholder involvement is reflected in the NRP guiding principles. NRP could not be moved beyond the conceptual framework without the approval of the Administration including OMB, and the IRS Oversight Board and especially Treasury. On December 21, 2001, Secretary O'Neill endorsed the NRP concept and methodology. He confirmed and made public his support in a press release issued January 16, 2002. Without having this approval and without moving beyond a well-developed idea, in addition to creating external opposition to NRP, it would have been difficult to completely engage and secure commitment from our internal partners.

The Secretary's approval made it possible to respond to media inquiries about NRP using specific messages coordinated through the IRS Media Relations office. More importantly it opened the door for the IRS to inform key external stakeholders such as members of Congress, and the practitioner community about NRP and invite their feedback and concerns. Commissioner Rossotti has and continues to meet with members of Congress and practitioner organizations to demonstrate that the IRS is committed to creating a tax compliance measurement program that makes sense, minimizes burden and includes the ideas and concerns of its stakeholders. Although members of Congress generally support NRP, the Senate Committee on Finance requested that the General Accounting Office (GAO) review the IRS' efforts to measure voluntary compliance.

Relationships with External Stakeholders

1. External Assessment—General Accounting Office (GAO)

The NRP Office has been working regularly with the GAO since early 2000 when GAO developed its report: *The Status of IRS' Efforts to Develop Measures of Voluntary Compliance*. GAO agrees that the IRS needs to measure compliance and they are supportive of the NRP methodology.

This positive working relationship with GAO has been instrumental to maintaining a program delivery route that, from a political perspective, is relatively barrier-free. GAO's involvement has helped the NRP Office make considerations and decisions that respond to the concerns of its stakeholders, and improve the quality of the implementation, production processes, and the ability of the NRP Office to deliver its program.

GAO presented preliminary audit findings in December and briefed its requestors on the Senate Committee on Finance on January 14, 2002. GAO will issue their final report on June 27, 2002.

2. Practitioner Community

Just as the Secretary's approval in mid-January triggered meetings with Congress, major practitioner organizations began to request meetings with the Commissioner to express their concerns about NRP. Information about NRP was immediately shared with the practitioner community and at the same time, they were invited to share their comments and concerns. NRP was introduced to the public as a proposal so that stakeholders would know that even though the conceptual framework was for the most part established, adjustments could still be made in response to their feedback. In keeping with the NRP guiding principles, Commissioner Rossotti promised the practitioner community that they would have input into NRP training for examiners. The NRP Office began this process by briefing the national representatives of about 20 organizations during the regularly scheduled March and May 2002 IRS National Public Liaison meeting. This group of representatives will continue to be involved as NRP is implemented and delivered. Their overall response to the program will also be captured as part of NRP customer satisfaction surveys.

USE OF DATA ONCE IT IS COLLECTED

The Business Operating Divisions are partners in the NRP design process and implementation, and they are customers of the results. The collected data will be used in the classification, examination and audit process of the sample-selected taxpayers and the results stored in the NRP database. The NRP databases will consist of tax account and tax return data used by compliance researchers. Database users will be able to query the database and download data to local file servers. NRP compliance data will be made available through processes and systems that provide flexibility for accessing, selecting and analyzing data, and will support the needs of a diverse set of users.

Filing Compliance

The IRS has developed the Filing Rate and the Nonfiling Tax Gap to provide the Commissioner and other senior IRS executives with an indicator of the voluntary and timely filing compliance of individual taxpayers in the U.S. The Filing Rate and Nonfiling Tax Gap will also assist IRS management in the evaluation of efforts to improve voluntary filing compliance. As the IRS creates linkages between operational filing compliance efforts to these strategic measures, the Filing Rate and Nonfiling Tax Gap could provide a means of assessing the effectiveness of those operational measures.

Payment Compliance

The IRS has developed the VPCR to provide the Commissioner and other senior IRS executives with an indicator of the voluntary and timely payment compliance of taxpayers in the U.S., broken down by type of tax and Operating Division. The CPCR will provide information on the subsequent tax revenue flows associated with timely filed returns. The goal of measuring payment compliance is to establish a nationwide baseline of taxpayer compliance with federal requirements for paying voluntarily and timely the income tax reported on timely filed returns.

The VPCR and CPCR will also assist IRS management in the evaluation of efforts to improve voluntary payment compliance. We foresee an eventual linkage between operational payment compliance measures and these strategic measures, and when that occurs, the VPCR and CPCR could provide a means of assessing the effectiveness of those operational measures.

Reporting Compliance

The IRS has developed the VRR and other strategic reporting compliance measures to provide the Commissioner and other senior IRS executives with an indicator of the voluntary and timely reporting compliance of taxpayers in the U.S., broken down by Operating Division and, if possible, line item or category.

The NRP data will allow the IRS to conduct four broad categories of analysis, which are critical to the IRS Mission, and which cannot be accomplished with alternative data sources. These broad categories are:

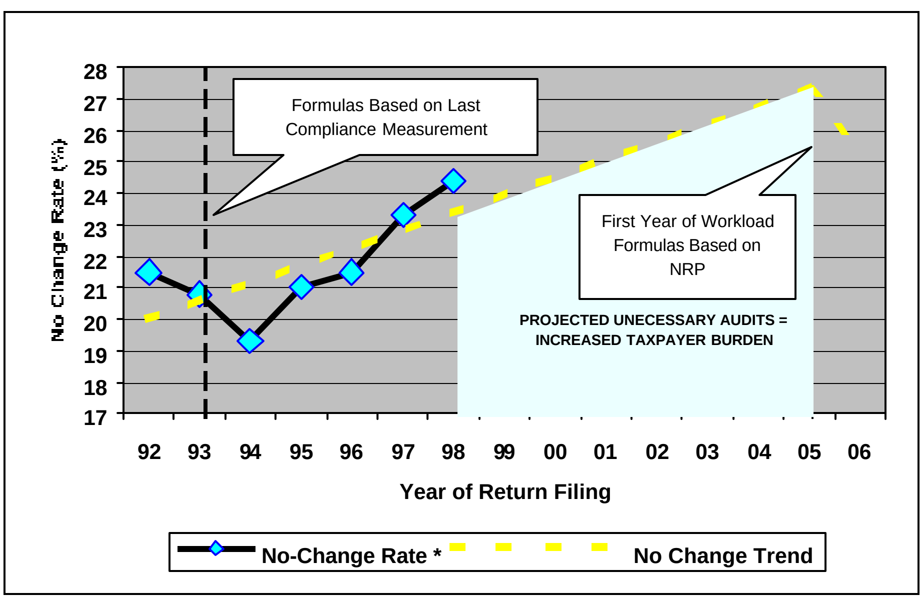
- measuring overall compliance;
- updating existing audit selection and resource allocation systems and developing new ones;
- estimating the impact on compliance and revenue of legislative and administrative changes; and
- identifying potential ways to improve voluntary compliance.

These broad categories of analysis provide a convenient summary of the way the IRS will apply the NRP data to specific compliance issues, at both the Servicewide and Operating Division levels.

The IRS will use the VRR to examine the accuracy of the information taxpayers enter on their timely filed returns. While the National Headquarters Office of Research will focus on the compliance measures for the taxpayer population as a whole, the Operating Divisions will examine the measures for their specific customers, both in terms of overall compliance and specific compliance issues.

Another important way that the NRP data will support the IRS Mission is by providing the basis for selecting the returns and issues most in need of operational audits. As mentioned earlier, the IRS is working with reporting compliance data that is more than a decade old, which has greatly diminished the workload selection formulas' abilities to identify noncompliance among taxpayers (see Figure 6).

Figure 6: As Workload Selection Formulas Age, the Number of No-Change Audits Rise



The IRS knows that the performance of the workload selection formulas increases when it has new compliance data with which to update the formulas, but such efforts require a random sample to allow analysis of the characteristics that distinguish noncompliant taxpayers from those that comply with the tax laws. The IRS needs to strike a balance between burdening compliant taxpayers and conducting research to identify reporting noncompliance. Periodic compliance surveys, such as NRP, are the best way to develop, maintain, and update audit selection systems so that, as much as possible, the returns and issues that are audited are the ones most in need of audit.

Reporting compliance results will be collected using reason codes that will help the IRS identify some of the problems taxpayers have in complying with the tax laws. This will allow the Service to address noncompliance by redesigning forms, suggesting law changes, improving communications with taxpayers and tax preparers, and focusing enforcement on intentionally non-compliant taxpayers.

Changes in the tax law, and in the way IRS administers it, often have a compliance (and, therefore, revenue) impact. Frequently, IRS is asked to estimate the impact of such a proposed change. As with previous compliance surveys, NRP data will be one of the primary basis for such estimates. For example, a proposed new kind of third-party information reporting may be intended specifically to increase compliance. An analysis of NRP data could compare the NMP for amounts that would be subject to the new reporting with the NMPs of similar line items that are already subject to such reporting. Moreover, as subsequent NRP surveys are conducted periodically, it will be possible to show the change in NMP over the time period in which the new requirement was implemented. That will be invaluable in projecting the changes in compliance (and revenue) we might expect in response to similar proposed changes in the future.

Other changes may be motivated by other concerns, but the compliance impact may be decisive. For example, increasing the threshold amount that governs who needs to file a certain form or schedule may reduce taxpayer burden, but it could also increase noncompliance. Analyses of previous compliance data have shown, for example, that those who are required to file Schedule B (to report interest and dividend income in excess of $400) have a much lower NMP than those who are below the threshold. The implication that raising the threshold would cause those who would no longer have to file the schedule to become as noncompliant as those who are below the current threshold—and the easily computed corresponding revenue impact—contributed to the decision not to change the requirement.

NRP data could likewise be crucial for estimating the revenue impact of such proposals as making a particular credit refundable, changing the eligibility for Head of Household filing status, allowing non-itemizers to deduct certain itemized deductions, increasing the percentage of taxpayers who file electronically, or shifting to a “return-free” tax system. The potential compliance ramifications of a proposed change are not always decisive, but they should always be considered. NRP will be the main basis for making such judgments.

Equally important to proposing legislative and administrative changes is identifying ways to improve voluntary compliance given observed patterns of noncompliance. Sometimes, simply doing more of what IRS is already doing (e.g., specific types of taxpayer assistance, enforcement, etc.) is appropriate. Typically, however, the most prominent pockets of noncompliance exist precisely because existing law and IRS efforts are ineffective in promoting voluntary compliance or curbing the noncompliance. Therefore, expanding current programs may often not be the most cost-effective solution to the problem; indeed, that often merely treats the symptoms, instead of solving the underlying compliance problem.

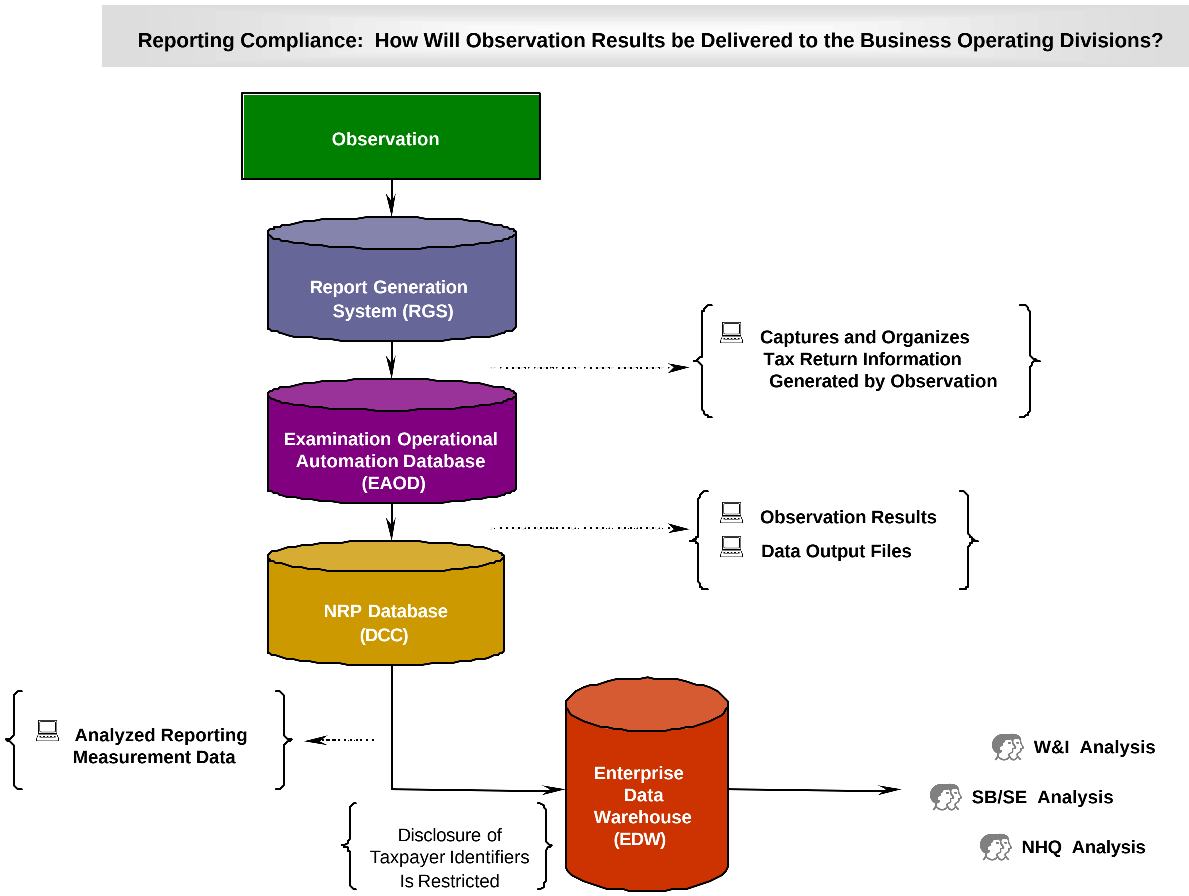
NRP data analysis will be the first step in developing new compliance solutions. Sometimes, as is often the case with needed legislative changes, the solution will be readily apparent. Earlier compliance data, for example, demonstrated that taxpayers often overstated the number of dependent exemptions for which they were eligible. This led to the proposal to require that Taxpayer Identification Numbers (TINs) be reported on the return for each dependent claimed—a requirement that has reduced the number of dependents claimed by millions, and has given rise to very successful programs that contact taxpayers who claim dependents with invalid TINs, or dependents who are also claimed on another return. It also led to Congress giving IRS authority to freeze certain EITC claims while returns are being processed.

Research questions of this type can take many other forms. For example:

- What are the most common errors made on a given type of return? Does it appear that changing the forms, instructions, or other publications might improve compliance?
- To what extent do taxpayers continue to make the same mistakes on their returns, even after an operational audit or other enforcement adjustment to a prior return?
- Is the reporting compliance of those who report a balance due significantly different from those who claim a refund? If so, what kind of IRS interventions might improve this compliance?

The flow chart in Figure 7 below illustrates the delivery of NRP results to the Operating Divisions.

Figure 7: Delivery of NRP Reporting Compliance Data



Appendix: Data Sources of NRP Measures

Filing Compliance

Data Sources

The Filing Rate uses data from two sources: the Current Population Survey (CPS) from the Census Bureau and the Compliance Research Information System (CRIS) database from the IRS. The CRIS data provides an estimate of the number of required returns actually filed timely (the numerator of the Filing Rate), while the CPS data provides an estimate of the number of individuals with a filing requirement (the denominator of the Filing Rate). This strategic measure differs from operational counts of nonfilers in two important ways:

- it excludes from the numerator those who file late, since they have not met the requirement to file timely; and
- it includes in the denominator an estimate of those who are completely unknown to IRS.

The Nonfiling Tax Gap also will use two sources of data that would be a part of an "Exact Match" of Social Security Numbers within IRS and Census Bureau databases[12]. The Census data would be the basis for the first term in the Nonfiling Tax Gap equation, while master file data would provide the amount of tax that those taxpayers paid in a timely manner (such as withheld wages).

Differences Between Strategic Measures and Operational Measures

Much of the work going on in the IRS with regard to filing compliance is operational in nature and, rightly so, is geared toward securing delinquent returns, collecting the tax due, and reducing nonfiling through various pre-filing outreach efforts. For example, an individual taxpayer files one year and then fails to file the following year. W&I would investigate the reasons for that taxpayer's failure to file and would take appropriate actions to collect any/all tax associated with those returns. If a taxpayer requests an Employer Identification Number and then fails to file or pay any employment taxes, SB/SE might investigate whether the taxpayer hired any employees and, if so, would then pursue any employment and income taxes associated with the business. Similarly, LMSB and TE/GE track the filing performance of their respective customers and would investigate the reasons for the noncompliance.

The common threads running through each of the above examples are that the IRS had records related to the nonfiling taxpayer prior to the noncompliant behavior and that the

[12] The IRS would perform none of the work in the Exact Match study and would receive just the summary output of the research effort. At no time would the Exact Match form the basis for any direct compliance effort.

Operating Divisions' efforts are targeted at contacting the taxpayer as appropriate. The Operating Divisions would take similar approaches to late filers.

The primary concern of the strategic filing compliance measures, on the other hand, is not collecting taxes from late or delinquent returns. Instead, the purpose of the Filing Rate is to monitor the percentage of the taxpayer population that files timely. The Nonfiling Tax Gap will estimate the overall shortfall in revenues associated with tax returns that come in late or not at all. These measures are descriptive (e.g., education-oriented) rather than prescriptive (e.g. collection-oriented), and will provide the IRS with a means of evaluating efforts to educate the taxpaying public in its filing responsibilities. These strategic measures will never replace or supplant the operational measures currently in use; nor did NRP intend them to do so.

The major difference between the two types of measures is the population of taxpayers that they cover. Operational measures concentrate on delinquent filers, while strategic measures concentrate on the entire taxpayer population—including those unknown by the IRS. Obviously, programs intended to promote filing among those who are completely unknown to us would be radically different from programs dealing with known nonfilers (or stop filers) and late filers.

Payment Compliance

Data Sources

Both the VPCR and the CPCR will use the IRS master file databases as the source of the data for their calculations. Unlike the filing and reporting compliance measures, the IRS possesses complete payment compliance data for each taxpayer.

Differences Between Strategic Measures and Operational Measures

Of the three strategic-level compliance measures, payment compliance will have the closest relationship between the strategic measure and operational measures. Like filing compliance, much of the work going on in the IRS with regard to payment compliance is operational in nature. The Operating Divisions focus on identifying and collecting unpaid tax balances.

A key difference between the strategic measures and the operational measures is the distinction made between the types of compliance. For example, the VPCR and CPCR focus only on the payments associated with timely filed returns. Most operational measures tracking payment compliance do not distinguish between the two, tracking the payment performance of taxpayers who file returns late, as well as those that file timely. While seemingly a small difference, the distinction is important. The remedial efforts to get timely-filers to pay on time could be very different from the efforts the IRS might use to get taxpayers who file late to pay their tax obligations on time.

Another important difference between strategic and operational payment compliance measures is that the strategic measures are unconcerned with the disposition of any penalties and interest associated with late payments. Operational measures, on the other hand, pay close attention to the IRS's enforcement activities related to tax collection.

Despite these differences, NRP expects the strategic payment compliance measures to provide the Operating Divisions with a summary of the payment compliance performance of their customer base. This summary-level information will provide a baseline for the Operating Divisions to measure their payment collection efforts against. The Operating Divisions will also have the ability to tailor searches of the payment compliance database to target specific pockets on noncompliance.

Reporting Compliance

Data Sources

There are two levels of data sources related to reporting compliance. The first is the source of the data the IRS will use for its case building and classification exercises. The second is the source of the data the IRS will use to create the various strategic reporting compliance measures.

Case building is the process of adding information from a variety of systems and data sources (known as case building tools) to the case file, both from IRS and non-IRS sources, prior to the examiner contacting the taxpayer (if necessary). Some examples of this information are prior year tax returns, banking reports on large cash transactions, and real estate transactions.

Many of the case building tools to be used by NRP are not new, but have been successfully used by various areas of the IRS. What is new and unique about NRP case building is that the data sources are collectively applied to each return in the sample as an investigative tool that facilitates improved analysis and enhanced decision making by NRP examiners. NRP examiners will receive the necessary training to understand and use these tools, along with management support and sufficient time to maximize use of the data. Without these tools an NRP classifier is less likely to be able to confirm the accuracy of the return without increasing taxpayer burden through correspondence or audit. Paramount in the access and use of taxpayer data by NRP examiners is that taxpayer privacy is maintained, and that only the data necessary to help make a compliance determination be used.

The NRP study will use the following items in its case building efforts:

- The sample year tax return and printouts of the tax return from the 3 previous years—this will allow the examiner to develop an overall picture of the taxpayer's return characteristics, including any trends and patterns.

- Information Return (IRP) Transcripts, providing the most up-to-date W-2 and 1040 information for the sample year and 2 previous years—will allow the classifier and examiner to identify discrepancies between the information return and the taxpayer's return, including sources of income.
- Currency and Banking Retrieval System (CBRS)—reports large, individual banking transactions greater than $10,000.
- Dependent Database—contains data identifying custodial parents, from the US Department of Health and Human Services (HHS), and could impact the Earned Income Tax Credit on returns.
- Master File Data (IDRS)—contains all account information including filing and payment history for the sample year and 3 previous years.
- ChoicePoint Database—provides information on real estate and other personal property transactions.

The data quality checks of all NRP case building tools will be reviewed to ensure the accuracy of the data. Additionally, the simulation and assessment (S&A) exercises will provide some guidance for future use of these tools. It is important to note that examiners will use these data sources as investigative tools, and will rely on them as one of several information sources. These case building tools provide valuable hints for classifiers when looking at a return, but examination adjustments should not be made solely based on this data.

The data for the strategic reporting compliance measures will come from the NRP study itself. Since access to the data is fundamental to its use, the IRS plans to ensure that the NRP results are easily accessible to employees as appropriate within the Operating Divisions and National Headquarters, and NRP plans to make available both raw and analyzed data through a planned enterprise data delivery.

Differences Between Strategic Measures and Operational Measures

The primary difference between the strategic reporting compliance measures and the operational measures is the population of taxpayers the IRS subjects to audits. The strategic reporting compliance measures will draw from a sample of the entire population of individual taxpayers regardless of whether any single taxpayer's return exhibits any characteristics indicative of noncompliance. For the most part, the returns used in the operational measures come from a population that the IRS has identified as having potential compliance problems.

Operational audits use the workload selection formulas to identify those taxpayers whose returns display characteristics that are indicative of noncompliance. Like the operational filing measures, these operational audits are focusing on known areas of noncompliance and recovering tax revenues associated with that noncompliance.

While the IRS will use the strategic measures to update the workload selection formulas, reexamining the relationships between return characteristics and existing noncompliance issue is not the sole purpose of the strategic reporting compliance measures. IRS researchers will be using the measures and data to search for and identify emerging issues of noncompliance. The measures and data will also be able to assist the IRS in answering a variety of strategic questions relating to the implementation of new tax laws or education efforts. The operational measures cannot address these issues.

Finally, like the other strategic measures, the reporting compliance measures concentrate on timely filed returns. Timeliness is not necessarily a criterion for selection with regard to operational measures. On the contrary, given that late filing might be an indicator for noncompliance elsewhere on the return, the operational audits may not look at timely filed returns nearly as closely.