TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Opportunities Exist for the IRS to Develop a More Coordinated Approach to Examination Workplan Development and Resource Allocation

February 8, 2023

Report Number: 2023-30-008

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HIGHLIGHTS: Opportunities Exist for the IRS to Develop a More Coordinated Approach to Examination Workplan Development and Resource Allocation

Final Audit Report issued on February 8, 2023 **Report Number 2023-30-008**

Why TIGTA Did This Audit

This audit was performed in response to a request by a previous IRS Deputy Commissioner for Services and Enforcement, who asked that TIGTA review the IRS's process for making resource allocation decisions. The overall objective of this audit was to review the process used by the IRS to allocate resources to the Examination function.

Impact on Tax Administration

The IRS's Examination function plays a vital role in ensuring the accomplishment of the IRS's goals and priorities through the examination of tax returns of individual taxpayers, businesses, and other types of organizations to detect noncompliance. The IRS has four different business operating divisions that perform examination work: 1) Wage and Investment, 2) Small Business/ Self-Employed, 3) Large Business and International, and 4) Tax Exempt and Government Entities. Each division covers different segments of taxpayers and performs various types of examinations.

What TIGTA Found

The IRS does not have a multiyear Examination Strategic Plan for allocating resources. The IRS has a general five-year strategic plan with broad goals for the agency; however, the strategic plan does not contain the detail needed for the compliance functions, such as Examination, to most effectively allocate resources. Creating a multiyear, comprehensive Examination Strategic Plan would provide IRS management with clear direction on how to allocate Examination resources.

In addition, the IRS does not have a coordinated approach for developing an annual enterprise-wide Examination workplan that considers the various strategic and operational risks of all the Examination functions. Examination management from the four business operating divisions independently develop their annual workplans to determine how to allocate resources in their own work areas. The IRS would also benefit from having an annual enterprise-wide Examination workplan. This would help to ensure a consistent, strategic approach and transparency for allocating resources in the Examination areas with the most significant needs.

The IRS does not use Tax Gap estimates to determine where Examination should allocate resources in its work planning. IRS management informed TIGTA that ongoing research on complex areas of noncompliance and planned future changes to the Tax Gap methodology should make the Tax Gap more useful for informing resource allocation decisions through enterprise examination planning.

What TIGTA Recommended

TIGTA recommended that the IRS should: 1) consider adopting a multiyear, comprehensive Examination Strategic Plan; 2) establish a documented annual enterprise-wide examination planning process, 3) establish a process to use Tax Gap data annually to identify opportunities to better align resources that more effectively narrow the net Tax Gap; and 4) develop a tool to consider risk and other relevant variables to inform examination resource allocation decisions, then expand its use to include Examination workstreams from all divisions. IRS management agreed with all four of the recommendations.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20024

February 8, 2023

MEMORANDUM FOR: ACTING COMMISSIONER OF INTERNAL REVENUE

Heather Hill

FROM: Heather M. Hill
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Opportunities Exist for the IRS to Develop a More Coordinated Approach to Examination Workplan Development and Resource Allocation (Audit # 202130032)

This report presents the results of our review of the process used by the Internal Revenue Service to allocate resources to the Examination function. This review was part of our Fiscal Year 2022 Annual Audit Plan and addresses the major management and performance challenge of *Improving Tax Reporting and Payment Compliance to Reduce the Tax Gap*.

Management's complete response to the draft report is included as Appendix II. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

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Background

This audit was performed in response to a request by a previous Internal Revenue Service (IRS) Deputy Commissioner for Services and Enforcement (DCSE), who asked for the Treasury Inspector General for Tax Administration (TIGTA) to review the IRS's process for making resource allocation decisions. The overall objective of this audit was to review the process used by the IRS to allocate resources to the Examination function.

The difference between the estimated amount of tax legally owed by a taxpayer and the amount they voluntarily and timely pay for a tax year is known as the Tax Gap, which gives a broad view of the Nation's compliance with Federal tax laws.[1] The IRS's Tax Gap estimate for Tax Year (TY) 2014 through TY 2016 indicates that approximately 80 percent of the gross Tax Gap results from the underreporting of tax liabilities on filed returns, representing the highest potential for noncompliance.[2] Research shows that audits have a strong, positive impact on reporting compliance.[3] The IRS's primary objective in selecting returns for examination is to promote the highest degree of voluntary compliance.[4]

The IRS's Examination function plays a vital role in ensuring the accomplishment of the IRS's goals and priorities through the examination of tax returns of individual taxpayers, businesses, and other types of organizations to detect noncompliance. The IRS has four different business operating divisions (BOD) that perform examination work: 1) Wage and Investment (W&I), 2) Small Business/Self Employed (SB/SE), 3) Large Business and International (LB&I), and 4) Tax Exempt and Government Entities (TE/GE). Each division covers different taxpayer segments and performs various types of examinations. The following is a short description of each of the Examination functions' program areas:

- **W&I Division** – The majority of the examinations in the W&I Division are conducted by Refundable Credits Examination Operations and involve the Earned Income Tax Credit (EITC) and related issues. The Refundable Credits Examination Operations program conducts prerefund examination activities and all pre and post-refund EITC compliance activities of individual tax returns via correspondence.
- **SB/SE Division Campus** – Tax examiners in SB/SE Division Campus Examination primarily support two functions: 1) Correspondence Examination, which performs examinations by mail on single-issue audits and 2) Automated Underreporter (AUR) programs, which match taxpayer income and deductions submitted by third parties against amounts reported on individual income tax returns.[5] Employees then correspond with taxpayers to offer an explanation or obtain documentation to substantiate items of income or expense from the tax return.

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[1] See Appendix III for the Glossary of Terms.

[2] Publication 1415, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014 - 2016* (Rev. 10-2022).

[3] *The Impact of the IRS on Voluntary Tax Compliance: Preliminary Empirical Results*, by Alan H. Plumley, Technical Advisor, IRS National Headquarters Office of Research, National Tax Association 95th Annual Conference on Taxation, Orlando, Florida, November 14 - 16, 2002.

[4] Internal Revenue Manual 1.2.1.5.10(2) (June 1974).

[5] AUR contacts are not considered examinations.

- **SB/SE Division Field** – Revenue agents conduct examinations of individual and business income tax returns to determine the correct tax liability and identify situations with unreported income and other inaccuracies presented on or omitted from the tax return. Tax compliance officers conduct face-to-face examinations in an IRS office setting.
- **LB&I Division** – The LB&I Division generally examines C corporations, S corporations, and partnerships with assets greater than $10 million and individual taxpayers with international-related issues on their tax returns. These businesses typically employ large numbers of employees, involve complicated issues involving tax law and accounting principles, and conduct business in an expanding global environment.
- **TE/GE Division** – The TE/GE Division's examination responsibilities include organizations exempt from income tax under Internal Revenue Code § 501 including charities, private foundations, and other types of exempt organizations such as business leagues, labor unions, and veterans' organizations; political organizations described in Internal Revenue Code § 527; and Federal, State, and local governments. The TE/GE Division's Office of Exempt Organizations and Government Entities conducts examinations of returns filed by tax-exempt organizations and government entities. Exempt Organizations and Government Entities work involves determination letter requests, voluntary correction programs, examining tax and employment returns, compliance checks, tax administration and enforcement activities, and knowledge management. The TE/GE Division's Office of Employee Plans conducts examinations to ensure that qualified retirement plans comply with qualification, reporting/disclosure, and excises related to pension plans. Employee Plans examination programs include audits and compliance contacts, and encourages plan sponsors to voluntarily comply in their plan operations.

The IRS has various methods to identify taxpayers with potentially underreported income, such as by third-party information reporting and data-driven algorithms. According to the IRS, it attempts to allocate its limited examination resources in the most efficient way possible to promote the highest degree of voluntary compliance while also meeting the IRS's objectives of fairness and balanced coverage.

The IRS's budget formulation and appropriation processes

Resource allocation relies on budget funding, which starts with the IRS's budget formulation process. The IRS Chief Financial Officer's (CFO) Budget Formulation function is responsible for developing and submitting the annual IRS budget request. The budget request includes a justification of the resources that the IRS needs for IRS base programs and new priority programs. The general steps for the IRS budget process are as follows:

- The Budget Formulation process begins in December with the issuance of the Commissioner's priorities and guidance for initiative development three years prior to the year of the budget being formulated.[6] For example, the Fiscal Year (FY) 2024 budget process would have started in December of 2021. This guidance is the starting point of the base funding levels.

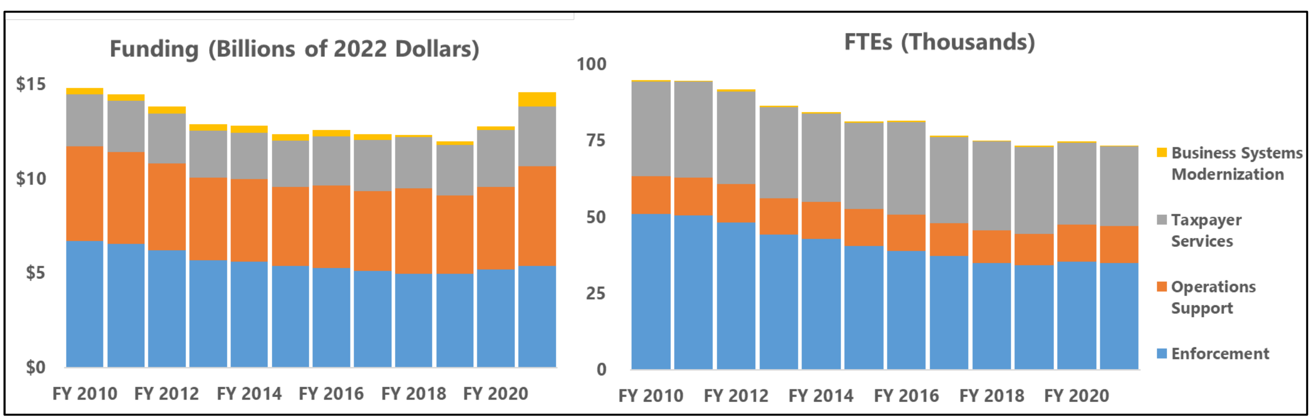
[6] The initiative process is the basis for requesting and justifying additional funding.

- The IRS's base funding level is determined using the current-year enacted budget, plus any base-level adjustments due to permanent changes occurring during budget execution that may impact the current-year enacted budget.
- Adjustments to the base funding level (referred to as Maintaining Current Levels) include increases that account for inflation, for example, pay raises, increased benefits costs, and non-labor inflation (travel, training, *etc.*).

- Initiatives from individual BODs are required to be submitted to Budget Formulation the following March and should include the appropriate support costs. In addition, the initiatives must include all expected performance measures, potential congressional mandates, and program increases. At the end of February/early March, the initiatives are presented to the Strategy and Resource Committee and Deputy Commissioners for prioritization.
- The budget development process begins after the initiative process is completed. The budget process allows the IRS an opportunity to communicate its priorities to external stakeholders that can influence the process.
- The CFO Budget Formulation Office directs the budget formulation cycle through budget submissions to the Department of the Treasury (hereafter referred to as the Treasury Department), the Office of Management and Budget, and Congress. The final submission is known as the Congressional Budget Justification. Once submitted, it is then debated by both the House of Representatives and the Senate and passed with any agreed upon changes in the Treasury Department's Appropriations Act.

Nearly all of the IRS's funds are appropriated by Congress. Figure 1 shows IRS funding in inflation-adjusted 2022 dollars and the number of full-time equivalents (FTE) by the IRS's four appropriation accounts for FY 2010 through FY 2021.

Figure 1: IRS Funding Versus FTEs - FY 2010 Through FY 2021



Source: CFO - Operating Plan - Budget and FTE (with inflation-adjusted to 2022 dollars).

Financial data show that the overall appropriations to the four IRS accounts (Enforcement, Operations Support, Taxpayer Services, and Business Systems Modernization) generally declined from FY 2010 until funding started to consistently increase in FY 2020 through FY 2021, although the increases have not been sufficient to return to FY 2010 inflation-adjusted levels. The overall budget has been reduced from approximately $14.8 billion to $12 billion over the FY 2010 through FY 2019 period, representing a decrease of 19.2 percent, based on inflation-adjusted dollars. The Enforcement account absorbed some of this decline in funding, with a 26 percent drop overall. In addition, the FTEs funded by the Enforcement account absorbed a 33 percent reduction between FY 2010 and FY 2019. The drop in funding resulted in a decline in the number of IRS employees, particularly those funded by the Enforcement account, which provides resources primarily to the Collection and Examination functions. Enforcement funding increased 8.7 percent based on inflation-adjusted dollars from $4.95 billion in FY 2019 to $5.38 billion in FY 2021; however, due to increased costs and wages, the FTEs increased by only 2.3 percent from 34,186 in FY 2019 to 34,989 in FY 2021.

For FY 2021, Congress appropriated $14.3 billion (an 18 percent increase) to the IRS allocated among the four accounts, of which $5.3 billion (37 percent) was for Enforcement. The appropriated IRS funding of $14.3 billion included funding supplements for the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) and the American Rescue Plan Act of 2021 (ARPA).[7] Enforcement provides funding to various Examination programs such as: Document Matching, Correspondence Examination, and Field Examination. In FY 2021, approximately $2.1 billion funded all of the Examination functions responsible for the examination of tax returns.

On August 16 2022, the Inflation Reduction Act of 2022 was enacted into law, which appropriates, in addition to amounts otherwise available, over $45 billion in enforcement funding and over $3.1 billion in taxpayer service funding through September 30, 2031.[8]

Examination BOD budget allocations and hiring

Once an appropriation is enacted and funding mechanisms have allocated funds to the IRS, the IRS's CFO delivers the funds through the Integrated Financial System to the different BODs, including each of their Examination functions. Normally, the IRS does not get funding exactly in line with its request. If the funding is in line with the request, the allocation to the BODs is aligned as closely as possible to the original request. When the enacted level is above or below the request amount, the difference is allocated to the BODs based on the leadership's priorities. If there are no appropriations for additional investments, the funding is enacted at flat levels and the funding to the BODs is allocated based on the employees on roll who have already been hired.[9] In an environment of flat level budgets, if the IRS wanted to shift resources from one division to another to prioritize different types of work, IRS management would have to wait for employees to leave the organization through attrition and then reassign any available funding to a different division. The BODs have the discretion to spend their funding in the most effective manner to achieve the mission by working with their own financial budget function. As shown in Figures 2 and 3, we analyzed high-level FTE and budget allocations from each of the BODs for Examination for trends.

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[7] Pub. L. No. 116-136 (March 2020); The CARES Act, signed into law on March 27, 2020, provided an over $2 trillion stimulus package to aid response efforts and ease the economic impact of the Coronavirus Disease 2019 pandemic. Pub. L. No. 117-2 (March 2021); The ARPA provided $1.9 trillion in stimulus to aid in the Coronavirus Disease 2019 pandemic, included program changes and tax policies to eligible State, local, Territorial, and tribal governments. The appropriated amount for the CARES Act was $509,000,000, and for the ARPA, it was $1,861,700,000.

[8] Pub. L. No. 117-169, § 10301 (HR 5376) (August 2022).

[9] Flat funding levels are based on initial budget planning by each BOD, which starts with the assumption that the budget is the same amount as prior years.

Figure 2: FTE Allocation for Examination

BOD	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
SB/SE	11,400	11,218	10,385	9,586	9,058	9,095	8,927
LB&I	5,598	5,006	4,704	4,438	4,273	4,366	4,448
W&I	1,468	1,150	1,130	1,123	1,166	1,131	1,186
TE/GE	1,145	1,101	1,028	919	1,026	1,033	1,024
Totals	**19,611**	**18,475**	**17,247**	**16,066**	**15,523**	**15,625**	**15,585**

Source: CFO – Operating Plan Pivot for FY 2015 to FY 2021.

The total Examination FTEs declined from FY 2015 through FY 2019, with a slight increase in FY 2020 and then a slight decrease in FY 2021. This generally occurred across all of the Examination BODs, with the highest percentage FTE declines experienced in the SB/SE and LB&I Divisions. These FTE allocation trends are similar to the budget allocation trends in Figure 3, except in FY 2021 when the budget allocation increased.

Figure 3: Budget Allocation for Examination in Millions of Dollars

BOD	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
SB/SE	$1,148	$1,175	$1,087	$1,076	$1,054	$1,068	$1,059
LB&I	$785	$746	$732	$700	$688	$739	$756
TE/GE	$148	$148	$140	$133	$142	$144	$145
W&I	$104	$87	$89	$92	$93	$97	$102
Totals	**$2,185**	**$2,156**	**$2,048**	**$2,001**	**$1,977**	**$2,048**	**$2,062**

Source: CFO – Operating Plan Pivot for FY 2015 to FY 2021.

The total Examination budget allocation declined from FY 2015 through FY 2019, with slight increases in both FY 2020 and FY 2021. This generally occurred across all of the Examination BODs budgets, except for TE/GE and W&I, which started to increase in FY 2019. In addition, the data show that as the budgets of the BODs increased, the FTE did not increase proportionally. IRS management stated that one of the reasons for this is that although the budget may have increased, it does not necessarily increase the FTEs, due to a constant increase in average salaries that result from mandatory increases such as pay raises and benefit costs. The FTEs for Examination have consistently decreased, except in FY 2020, in which minimal hiring occurred to replace lost tax examiners. However, the enactment of the Inflation Reduction Act of 2022 will allow the IRS to make significant gains in enforcement hiring.

According to the FY 2020 IRS Congressional Budget Justification, the IRS's workload and responsibilities increased due to an increase in the total number of tax returns filed and the number of information returns filed, while staffing levels have declined, primarily in Enforcement. To reduce and control labor and labor-related costs, which account for much of the IRS's budget allocations, the IRS reduced its staff by establishing a hiring freeze in FY 2011. During the hiring freeze period, the IRS was strictly funding on rolls staff for the Examination functions. The process froze replacement of employees lost to attrition in most program areas; therefore, staffing decreased significantly due to the inability to keep up with attrition. During that period, the Examination function was unable to hire to back-fill attrition, which resulted in fewer FTEs available to work examination cases. IRS management stated that the hiring freeze was lifted in November 2017. However, the available funding was not enough to do a significant amount of enforcement hiring, and with an aging staff and increased attrition, it will take considerable time and funding to increase the IRS's enforcement staffing by any significant level. With the ability to undertake enforcement hiring under the Inflation Reduction Act of 2022, the IRS needs a more strategic approach to the allocation of Examination resources.

Results of Review

The IRS Does Not Have a Multiyear, Comprehensive Examination Strategic Plan for Allocating Resources

During the course of our review, the IRS had a general five-year strategic plan for FY 2018 through FY 2022 that included six broad strategic goals for the agency. Two of these strategic goals generally apply to the IRS Examination function, as follows:

- Goal 2 - Protect the Integrity of the Tax System by Encouraging Compliance through Administering and Enforcing the Tax Code.
- Goal 5 - Advance Data Access, Usability, and Analytics to Inform Decision-Making and Improve Operational Outcomes.

The strategic guidance provided under these goals is broad and high level, and therefore is not specific to each BOD and does not contain the detail needed for the compliance functions to plan for the next five years.

The IRS proposed an organizational redesign in response to the TFA, making a shift from the current hierarchical structure to a flatter Headquarters leadership structure and decision-making body. This change presents an opportunity for IRS leadership to create a multiyear, comprehensive Examination Strategic Plan and for the Examination functions to develop a more coordinated enterprise-wide approach for annual workplan development and resource allocation. During the Examination strategic planning process, IRS management should decide the appropriate objective of the Examination function.

The IRS Strategic Plan is broad and does not provide comprehensive examination program guidance

The IRS lacks a multiyear, comprehensive Examination Strategic Plan for the Examination function. The IRS Strategic Planning website states that strategic planning is a management activity to identify an organization's priorities and develop an action plan with stakeholder input to work towards the organization's mission and goals. The purpose of strategic planning is to provide the organization with a clear strategy at all levels of the organization and to allocate resources based on priority. The Government Performance and Results Act of 2010 details best practices for strategic planning and establishes strategic planning requirements for Federal agencies.[10] The Treasury Department issues guidance to its bureaus to adhere to strategic planning best practice processes. Creating a multiyear, comprehensive Examination Strategic Plan that is based on an appropriate objective for the Examination function would provide IRS

[10] Pub. L. No. 111–352 (Jan. 4, 2011).

management with clear direction on where to allocate Examination resources considering priorities from all the Examination divisions.

The IRS overall Strategic Plan for FY 2018 through FY 2022 has six broad strategic goals.[11] For example, the second strategic goal applies to all IRS compliance functions, including Examination, which is to "Protect the Integrity of the Tax System by Encouraging Compliance through Administering and Enforcing the Tax Code." The goal has the following broad, high-level guidance:

- Identify and plan for compliance risks proactively.
- Reduce the time between filing and compliance issue resolution.
- Match potential compliance issues to the most appropriate solution informed by behavioral insights.

However, the IRS Strategic Plan for FY 2018 through FY 2022 does not have guidance that considers all the different types of filers and potential reporting noncompliance, *e.g.,* individuals, corporations, partnerships, *etc.*, that the Examination function should address. Although the IRS may not want to publicly provide the roadmap of how it is going to conduct enforcement activities, the IRS does not have an internal comprehensive Examination-specific strategic plan because the majority of work prioritization is handled separately by each Examination BOD. IRS management stated that the IRS NEXT Office may consider the IRS's overall compliance approach as part of its efforts to improve the taxpayer experience and build upon modernization efforts in the future.[12]

In regards to BOD-specific strategic plans, IRS management stated that each BOD may identify its own Examination Strategic Plans in the format that is most appropriate for its own programming needs. The following information was provided as examples of each BOD's strategic plans; however, they were not all specific to Examination:

- The LB&I Division prepares an Annual Program Plan to plan for allocation of resources by each compliance program.
- The TE/GE Division creates an Annual Program Letter explaining how its priorities align to the IRS Strategic Plan.
- The SB/SE Division publishes the SB/SE Focus Guide to lay out the key focus areas for the organization, both in terms of compliance and overall strategic issues.

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[11] Publication 3744, *IRS Strategic Plan (Fiscal Years 2018 - 2022)* (Rev. 4-2018) was in place during the fieldwork of our review. An updated Strategic Plan, Publication 3744, *IRS Strategic Plan (FY 2022 – 2026)* (Rev. 7-2022) was issued in July 2022. Similar to the FY 2018 through FY 2022 Strategic Plan, the new version does not have guidance that considers all the different types of filers and potential reporting noncompliance, *e.g.*, individuals, corporations, partnerships, *etc.*, that the Examination function should address.

[12] According to the IRS, the mission of the IRS NEXT Office is to instill pride and confidence in the Nation's tax system by developing a strategy for continuously improving the taxpayer experience and an organizational structure that enables seamless taxpayer interactions.

- The W&I Division holds annual Dependent Database meetings where the effectiveness of compliance filters is evaluated to ensure that returns with the highest likelihood of noncompliance are selected.[13]

However, we determined that these examples are not multiyear, comprehensive strategic plans for each Examination BOD. Instead, they are broad guidance documents, workplans, or meetings that are prepared or held annually. In addition, they do not consider all of the complexities and risks of the different workstreams from each division, and risks are not ranked and prioritized from an enterprise-wide perspective. In addition, in the Taxpayer First Act (TFA) Report to Congress, the IRS determined that its present structure is siloed and lacks enterprise-wide strategies. The siloed operation and lack of enterprise-wide strategies apply to Examination as well.

If the Examination program does not have a multiyear, comprehensive Examination Strategic Plan to communicate how and where resources should be allocated, there is a risk that resources will not be used effectively and efficiently. Each of the BODs currently have different processes on how they allocate their resources among their programs.

The IRS's response to the TFA further indicates the need for a multiyear, comprehensive strategic plan

The TFA was enacted on July 1, 2019, to strengthen taxpayer rights and modernize the IRS. TFA § 1302, *Modernization of the Internal Revenue Service Organizational Structure*, is one of the TFA's main focuses and a foundation for all other TFA provisions.[14] The TFA directs the IRS to submit a comprehensive redesign plan to Congress in order to better meet those objectives. The IRS submitted the plan to Congress on January 11, 2021, in accordance with TFA § 1302(a) (hereafter referred to as the *TFA Report to Congress*).[15] The *TFA Report to Congress* presented the IRS's high-level recommendations for redesigning the organization of the agency. In order to improve operational efficiencies, the IRS recommended the consolidation of previously segmented examination operations into one centralized Examination function within the newly created Compliance Division.

TFA § 1302(b) provided that one year after the IRS's submission of the plan described in subsection (a), the Restructuring and Reform Act of 1998 restriction on the organizational structure of the IRS would cease to apply.[16] Therefore, the submission of the *TFA Report to Congress* on January 11, 2021, addressed TFA § 1302(b). This means the Restructuring and Reform Act of 1998 restriction on the organizational structure ceased to apply on January 11, 2022.

[13] The Dependent Database is a rules-based selection application that is designed to identify potentially ineligible tax returns claiming the EITC and other refundable credits, *e.g.*, Premium Tax Credit, Additional Child Tax Credit, and American Opportunity Tax Credit.

[14] Pub. L. No. 116-25, § 1302 (July 2019).

[15] Pub. L. No. 116-25, § 1302(a) (July 2019).

[16] Pub. L. No. 116-25, § 1302(b) (July 2019). Repeal of Restriction on Organizational Structure of Internal Revenue Service.—Paragraph (3) of section 1001(a) of the IRS Restructuring and Reform Act of 1998 shall cease to apply beginning one year after the date on which the plan described in subsection (a) is submitted to Congress.

A recent TIGTA report found that the IRS's *TFA Report to Congress* does not contain specific and measurable performance goals or expected outcomes to help measure progress.[17] It also reported that implementation of structural changes without sufficient detailed supporting analysis could lead to an inefficient use of resources. Potential effects may include higher costs from unnecessary changes; inefficiencies related to the selection of a lesser alternative; and organizational misalignment with the IRS's strategic plan, goals, and measures.

The TIGTA report assessed the IRS's reorganization as a whole, but the conclusions can also be applied to the Compliance Division. Although the Examination functions are currently stove-piped between the different BODs, the plan proposed to restructure them into a centralized Examination function under the Compliance Division. The IRS indicated that this consolidation should reduce internal duplication and fragmentation of activities and provide consistent outcomes for resolving taxpayer compliance issues. The *TFA Report to Congress* does state that the Chief Compliance Officer would work directly with the other leadership members of the Compliance Division to develop an integrated, comprehensive compliance strategy and Examination plan. However, details of whether a top-down approach would drive this plan or whether it would be a compilation of existing BOD plans are not yet available.

The Deputy Commissioner for Services and Enforcement should:

Recommendation 1: Consider adopting a multiyear, comprehensive Examination Strategic Plan that addresses all workstreams from all divisions to rank them by risk and priority that can be used to guide resource allocation. In addition, the plan should contain specific and measurable performance goals or expected outcomes to help measure progress.

> **Management's Response:** IRS management agreed with this recommendation, stating that as part of Inflation Reduction Act implementation, the IRS is identifying opportunities to incorporate an enterprise perspective in the prioritization of work while ensuring agility to allow for flexible responses to evolving strategic goals and emerging issues. The Inflation Reduction Act funding is intended for critically needed transformations at the IRS, and efforts are already underway to create a Strategic Operating Plan for delivery to the Treasury Department Secretary. The Inflation Reduction Act Strategic Operating Plan will consider a comprehensive examination strategic plan that will align the agency's strategic priorities and enable a more coordinated and cohesive approach to resource allocation, which is expected to be completed by April 15, 2024.

Annual Examination Workplan and Resource Allocation Is Not Performed at the Enterprise-Wide Level

The IRS does not have a coordinated approach to develop an enterprise-wide Examination workplan that considers the various strategic and operational risks of all the Examination functions. Rather, Examination management from the four BODs (SB/SE, LB&I, TE/GE, and W&I)

[17] TIGTA, Report No. 2022-15-031, *Redesign Efforts for Most Taxpayer First Act Section 1302 Requirements Were Planned or Completed; However, Implementation Schedules and Reorganization Plans Need to Be Finalized* (Mar. 2022).

independently develop their annual workplans to determine how to allocate resources in their own work areas.

In addition to having a multiyear, comprehensive Examination Strategic Plan to align resources from the top down, the IRS would also benefit from having an annual enterprise-wide Examination Workplan, encompassing the entire Examination function and aligning to the Examination Strategic Plan. This would help to ensure a consistent, strategic approach and transparency for allocating resources in the Examination areas with the most significant needs. Having the right resources at the right time is critical to meeting Examination goals.

During interviews with Examination management, we learned that each separate Examination function from the IRS BODs sets its own workplans. However, there is not a specific top-down vision for how the IRS plans examinations from an enterprise-wide perspective. In January 2021, we questioned the then DCSE about the resource allocation process in the Examination functions, how the DCSE is involved, and how the workplans are developed. We were informed that the DCSE did not assume a substantive role in establishing the BODs' Examination workplans. The DCSE stated that, with the exception of a few issues which receive specific emphasis, generally the IRS Commissioner wants to have coverage across examination issues to have a deterrence effect.[18] The remaining prioritization of work is left up to each separate Examination BOD.

A prior attempt at annual enterprise-wide examination work planning was disbanded

The IRS prepared an internal analysis in August of 2007 to compare the TY 2001 Underreporting Tax Gap Estimates to the allocation of FY 2006 FTEs. The analysis resulted in the following Opportunities and Recommendations:

- Opportunities:
  - Enterprise examination planning as an ongoing activity.
  - A coordinated approach for addressing emerging issues and complex tax avoidance relationships that cross the BODs.
- Recommendations:
  - Establish a Reporting Compliance Governance Council to build consolidated workplan; work through barriers; ensure that cases are worked in the appropriate area; and sponsor research to improve workload identification, selection, and routing to optimize resource allocation.
  - Realign work to cost-effective workstreams.

The IRS concluded from the review that there was an opportunity to implement enterprise examination planning as an ongoing activity. The IRS implemented an enterprise-wide examination planning process and an Examination Enforcement Governance Council in FY 2009. However, the enterprise-wide examination workplan and the Governance Council ceased to exist after FY 2015. IRS management stated that the Governance Council disbanded primarily due to

[18] For example, the IRS Commissioner issued a directive in the summer of 2019 to audit 100 percent of top-tier partnerships for TY 2017 and TY 2018 with Conservation Easement issues. A qualified conservation easement contribution is the contribution of a qualified real property interest, *i.e.*, a restriction granted in perpetuity on the use which may be made of the real property, to a qualified organization, exclusively for conservation purposes.

the challenges faced by the organization in developing a truly enterprise-wide Examination Workplan and because it lacked the authority to effectively implement changes. The Governance Council was located within the SB/SE Division and did not have authority over the other BODs. As a result, the Governance Council's responsibilities became more focused on information gathering, rather than direction setting. After the enterprise-wide examination workplan ceased to exist, each BOD was responsible for its own workplans and reporting starting in FY 2016.

In order for an annual enterprise-wide examination workplan to be productive, it must be based on feedback from the top down, and management should establish an organizational structure and assign responsibility to ensure that the functions under them are meeting objectives.[19] In addition, management should define the workplan's objectives in specific terms so they are understood at all levels of the entity. This involves clearly defining what is to be achieved, who is to achieve it, how it will be achieved, and the time frames for achievement. Also, management should design control activities to achieve the plan's objectives and respond to risks, such as performing top-level reviews of actual performance and management of human capital.

IRS management stated they believe that efforts are made to ensure that there is adequate audit coverage on the various types of taxpayers and to ensure that audit coverage is not overlapping between the IRS BODs. For example, the recent Treasury Department mandate to have the IRS examine a particular percent of high-income taxpayers resulted in a coordinated effort across the SB/SE, LB&I, and W&I Divisions to ensure that the IRS was meeting that mandate as best as possible.[20] These three BODs each committed resources to specifically work high-income taxpayer cases in order to address the Treasury Department mandate starting in FY 2021.

Although some coordination is occurring for specific issues, an annual enterprise-wide examination workplan would ensure that all divisions are involved in allocating resources to the proper risks and priorities and not just a select few issues. Previously, the SB/SE Division led the enterprise-wide examination planning effort. To avoid the potential of being discontinued again, the annual enterprise-wide examination planning responsibility should be assigned to the Deputy Commissioner level through documented procedures. This would help to ensure continuity of operations and that documentation of decision-making is preserved.

The Deputy Commissioner for Services and Enforcement should:

Recommendation 2: Establish a documented annual enterprise-wide examination planning process that aligns with the multiyear, comprehensive Examination Strategic Plan.

> **Management's Response:** IRS management agreed with this recommendation, stating that the IRS is developing an iterative process to establish, document, and implement enterprise-wide examination planning. This process will include considerations around available resources and will help to identify hiring, staffing, and training needed to further support the agency's strategic priorities, and is expected to be completed by September 15, 2024.

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[19] Government Accountability Office, GAO-14-704G, *Standards for Internal Control in the Federal Government* (Sept. 2014).

[20] Steven T. Mnuchin, *Importance of Audit Procedures*, Department of Treasury Memo, February 10, 2020.

The Tax Gap Estimates Are Not Used to Inform Examination Resource Allocation, and Further Research Is Needed to Make Them More Useful

According to the IRS, it does not use Tax Gap estimates to determine where Examination should allocate resources in its work planning because of limitations with the estimates. While we agree that improvements to the Tax Gap estimates in certain categories of noncompliance would make the estimates more useful for resource planning, current estimates still provide a valuable strategic resource to determine areas of noncompliance among taxpayers and could be used to inform the enforcement priorities of the IRS. IRS management stated that ongoing research to identify the examinations that would yield a return on investment, detect complex areas of noncompliance, and planned future changes to the Tax Gap methodology should make the Tax Gap more useful for informing resource allocation decisions through enterprise examination planning.

The general five-year IRS Strategic Plan from FY 2018 through FY 2022 states that the IRS will pursue innovative approaches to understand, detect, and resolve potential noncompliance.[21] Historically, every three to four years, the IRS's Research, Applied Analytics, and Statistics (RAAS) creates an estimate of the Tax Gap or the amount of true tax liability not paid on time. The Tax Gap uses statistical samples of tax examinations for the individual income tax and employment tax components, operational audits for the other components, and complex analytics to estimate the difference between the amount of tax owed and the amount of tax collected. The Tax Gap is estimated across types of taxpayers and return types.

The most recent Tax Gap estimate, issued in November 2022, was based on TY 2014 through TY 2016 tax returns and estimated that the gross Tax Gap was $496 billion for that time frame.[22] The IRS estimated that it would eventually recover about $68 billion of this amount through late payments and enforcement actions, leaving a net Tax Gap of $428 billion. The estimated underreporting portion of the gross Tax Gap for individual income tax and self-employment tax was $331 billion. Moving forward, the IRS intends to begin releasing updated Tax Gap estimates and projections on an annual basis. The projected annual gross Tax Gap for TY 2017 through TY 2019 is $540 billion. The IRS estimated that it would eventually recover $70 billion leaving a net Tax Gap of $470 billion.

If the IRS's Tax Gap estimates included more information about areas of unreported income, such as instances of sophisticated underreporting of income, then they would be more useful for informing potential resource allocation. When estimating the individual income tax underreporting Tax Gap, the IRS uses a technique called Detection Controlled Estimation to account for the amounts of underreported income that examiners do not detect, but it does not account for all underreporting that goes undetected.[23] A recent paper from the National Bureau of Economic Research (NBER) claimed that the audit techniques used for estimating the Tax Gap,

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[21] Publication 3744, *IRS Strategic Plan (Fiscal Years 2018 - 2022)* (Rev. 4-2018).

[22] Publication 1415, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014-2016* (Rev. 10-2022). Our analysis found in Figures 4 through 6 is based off of the TY 2011 through 2013 Tax Gap estimates, which were the most current during the fieldwork of our review, and can be found in Publication 1415, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011 - 2013* (Rev. 9-2019).

[23] An econometric technique developed by Jonathan Feinstein in the late 1980s that is used to estimate undetected income.

even though well designed, do not detect sophisticated evasion strategies, such as undeclared foreign bank accounts and pass-through businesses.[24] The research paper estimated that 36 percent of unpaid Federal income taxes are owed by the top 1percent of the true income distribution and that collecting all unpaid taxes from this population would increase Federal revenues by about $175 billion.[25]

Upon request, the RAAS provided us with a paper documenting the Individual Income and Self-Employment Tax Underreporting portions of the Tax Gap by income distribution based on the previous TY 2011 through TY 2013 Tax Gap estimates.[26] The information was categorized by IRS Activity Codes that are used to group taxpayers for examination planning and tracking purposes. Figure 4 provides the details of these results showing the distribution of TY 2011 through TY 2013 individual income and self-employment tax underreporting Tax Gap by Activity Code.

[24] NBER-John Guyton, Patrick Langetieg, Daniel Reck, Max Risch; Gabriel Zucman, *Tax Evasion at the Top of the Income Distribution: Theory and Evidence,* (March 2021).

[25] IRS management stated that the $175 billion estimate does not directly relate to the TY 2011 through 2013 Tax Gap estimates because it is based on TY 2019, it is based on a true income instead of reported income, and it is calculated using an older Detection Controlled Estimation methodology. True income is the correct taxable income that was actually received by a taxpayer and should be reported on the tax return for it to be accurate. This may be higher than the taxable income actually reported on the tax return by a taxpayer.

[26] Publication 5161, *Distribution of Tax Year 2011-2013 Individual Income Tax and Self-Employment Tax Underreporting Tax Gap* (Rev. 8-2021). RAAS management explained that the Tax Gap methodology was not designed to get granular to less than 1 percent of the population.

Figure 4: Distribution of TY 2011 Through TY 2013 Individual Income and Self-Employment Tax Underreporting Tax Gap by Activity Code[27]

Return Category	Individual Income Tax and Self-Employment Tax Underreporting Tax Gap ($B)	Percentage of Underreporting Tax Gap
270: EITC Present & Total Positive Income (TPI) <$200K and Total Gross Receipts <$25K	$58.9	20.3%
271: EITC Present & TPI <$200K and Total Gross Receipts >=$25K	$23.2	8.0%
272: TPI <200K and No Schedule C, E, F, or Form 2106	$36.3	12.5%
273: TPI <200K and No Schedule C or F	$38.8	13.4%
274: Non-Farm Business With Total Gross Receipts <$25K and TPI <$200K	$34.7	11.9%
275: Non-Farm Business With Total Gross Receipts $25K <$100K and TPI <$200K	$23.1	8.0%
276: Non-Farm Business With Total Gross Receipts $100K <$200K and TPI <$200K	$10.5	3.6%
277: Non-Farm Business With Total Gross Receipts >$200K or More and TPI <$200K	$14.6	5.0%
278: Farm Business Not Classified Elsewhere and TPI <$200K	$8.3	2.9%
Total Positive Income Below $200,000	**$248.4**	**85.5%**
279: No Schedule C or F Present and TPI >$200K and <$1M	$15.5	5.3%
280: Schedule C or F Present and TPI >$200K and <$1M	$19.0	6.5%
Total Positive Income $200,000 To Less Than $1,000,000	**$34.5**	**11.9%**
281: Total Positive Income >= $1,000,000	$7.5	2.6%
Total Positive Income Greater Than Or Equal To $1,000,000	**$7.5**	**2.6%**
Totals	**$290.4**	**100.0%**

Source: Publication 5161, Table 3.4.2.

The Activity Code 281 category for taxpayers with TPI greater than or equal to $1 million contains the individual taxpayers with the highest reported income. The category accounted for $7.5 billion (2.6 percent) of the estimates. The $7.5 billion estimate is much lower than what the NBER paper estimates the unpaid taxes to be for the upper distribution. In contrast, the results show that the categories of taxpayers with TPI of less than $200,000 account for $248.4 billion (85.5 percent) of the estimates.

IRS management stated that the NBER paper is identifying potential detection issues in examination regarding offshore accounts and pass-through businesses. However, they said the paper uses broad assumptions and indicates the need for a specific study to develop an estimate based on direct evidence. Also, management stated that they do not have sufficient data for the offshore accounts and pass-through business categories, which means those

[27] Percentages may not equal due to rounding. Total Gross Receipts is the sum of gross receipts from farm and nonfarm businesses calculated by adding the positive values of gross receipts and other income from Schedule C and gross income (which can be positive or negative) from Schedule F. Total Positive Income is the sum of all positive amounts shown for the various sources of income reported on an individual income tax return and, thus, excludes losses.

categories have not yet been considered explicitly in management's marginal revenue per cost analysis to determine if they would be beneficial to align resources to.[28] Finally, management conveyed that such noncompliance will be exceedingly difficult to address with additional resources alone, indicating that legislative remedies and multinational efforts will likely also be necessary. However, because the IRS does not currently have the operational audit data for such categories, resources should be allocated to obtain the data to complete the research and then develop processes to identify, select, and work those cases effectively. We believe that this additional research could provide a more complete picture of the components of the Tax Gap and how IRS actions can most effectively support compliant filing, reporting, and paying behaviors, and allow it to be used to inform examination resource allocation.

The Tax Gap estimates are not used to inform examination resource allocation

There is a disparity between the older TY 2011 through TY 2013 Tax Gap estimates and the recently issued NBER paper that considers offshore accounts and pass-through businesses. The paper estimates the TY 2019 Tax Gap for the top 1 percent of individual taxpayers when ranked by true income to be $175 billion. The results indicate a need for more complete, current, and timely Tax Gap estimates that can be used to develop strategic plans and to inform resource allocation decisions.

The IRS used the income distribution of the Tax Gap internally once before in FY 2007 to see how resource allocation aligned with the Tax Gap estimates. Using the TY 2011 through TY 2013 Tax Gap estimate when arrayed by the reported income distribution along with FTE results provided by the IRS for FY 2019 through FY 2020, we compiled a similar analysis comparing the Tax Gap estimates to resource allocation. Figure 5 shows the TY 2011 through TY 2013 Tax Gap estimate distribution arrayed with the total FTEs for each category for FY 2019 and FY 2020.

[28] IRS management's research on marginal revenue per marginal cost is intended to help the IRS move closer to optimal resource allocation by maximizing the amount of revenue that is collected net of administrative costs.

Figure 5: TY 2011 Through TY 2013 Tax Gap Estimate Distribution Arrayed With FTEs for FY 2019 and FY 2020[29]

Category	TYs 2011 - 2013 Underreporting Tax Gap ($B)	Percentage of Underreporting Tax Gap	FY 2019 FTEs	Percentage of Total	FY 2020 FTEs	Percentage of Total
Low Reported TPI (<$200K) Returns	$248.4	70.3%	4,487	51.7%	4,688	55.7%
High Reported TPI (>$200K<$1M) Returns	$34.5	9.8%	1,317	15.2%	1,132	13.5%
High Reported TPI ($1M+) Returns	$7.5	2.1%	718	8.3%	727	8.6%
Total Individual Income Tax	**$290.4**	**82.2%**	**6,523**	**73.9%**	**6,548**	**76.7%**
Small Corporations	$11.0	3.1%	666	7.7%	440	5.2%
Large Corporations	$26.0	7.4%	909	10.5%	907	10.8%
Total C Corporation Income Tax	**$37.0**	**10.5%**	**1,575**	**18.1%**	**1,347**	**16.0%**
Employment Tax	$25.0	7.1%	360	4.1%	327	3.9%
Estate Tax	$1.0	0.3%	220	2.5%	192	2.3%
Total Specialty Taxes	**$26.0**	**7.4%**	**580**	**6.7%**	**519**	**6.2%**
Totals	**$353.4**	**100.0%**	**8,677**	**100.0%**	**8,414**	**100.0%**

Source: TIGTA analysis of IRS-provided Tax Gap estimates and FTE data.

Our analysis found that for the Total Individual category, the IRS has proportionally allocated fewer FTEs compared to the percentage of the Tax Gap estimate each year. When looking at the separate dollar levels, compared to the percentage of the Tax Gap estimated each year, the IRS proportionally allocated more FTEs for High Reported TPI returns and less FTEs for Low Reported TPI returns. For the Total C Corporation category, the IRS has proportionally allocated more FTEs compared to the percentage of the Tax Gap estimate, and the results are the same when looking at the separate categories for Small and Large Corporations. For the Total Specialty category, the IRS proportionally allocated slightly less FTEs than the percentage of the Tax Gap estimate each year. However, the IRS allocates proportionally less FTEs to the Employment Tax Category and more to the Estate Tax Category than the percentage of the Tax Gap estimate.

IRS management stated that resources for the different categories of work are not interchangeable, so it is not possible to quickly shift resources to different categories, *i.e.*, between different BODs or workstreams. For example, a Grade-5 tax examiner in the W&I Division could not move into a Grade-12 revenue agent position in the SB/SE Division, due to the differences in the complexity of the work. Additionally, they stated that the Tax Gap is not used for resource allocation for several reasons. First, the Tax Gap data are dated, and therefore, the reality of where tax noncompliance exists currently has potentially shifted. Second, the Tax Gap estimates do not include all unreported income because IRS examiners may be unable to identify all underreporting when completing examinations. Additional research into previously undetected income in the more challenging areas of noncompliance would potentially provide

[29] Percentages and totals may not equal due to rounding. IRS management stated that FTEs are not comparable across these categories, since FTEs are far more expensive among high-income and corporation audits because the auditors there are at a much higher grade.

examiners with tools to identify this income. This research will have important practical implications because examinations that accurately identify areas of noncompliance, such as income underreporting, are known to improve voluntary compliance.

IRS management stated that rather than considering the Tax Gap for resource allocation, they consider marginal revenue per marginal cost. Marginal revenue per marginal cost ratios can be used to allocate resources to maximize the amount of revenue that is collected net of administrative costs. RAAS management provided examples of research to illustrate a growing body of evidence about the merits of equalizing the marginal revenue per marginal cost ratios, which in theory is intended to maximize total revenue. However, the optimization example in a paper provided by IRS management only considers correspondence audits, which are just one piece of the Examination function, and it suggests shifting resources from higher income workstreams to lower income workstreams to maximize revenue. Shifting resources to lower income workstreams may not align with the current interests of stakeholders to not increase audit coverage for taxpayers with incomes under $400,000 relative to historic levels. IRS management further stated that the optimization paper based on correspondence audits was the beginning of the research and that they intend to develop revenue per cost estimates for all enforcement programs.

However, based on the analysis in Figure 5 and the analysis described subsequently in Figure 6, the IRS should consider enhancing the sophistication of the Tax Gap estimates and move towards increasing the allocation of resources for Individual Income Tax Examinations and reducing the allocation for C Corporation Income Tax Examinations. This would take a coordinated approach, considering both expected attrition and how much funding is available for hiring. We agree that additional data and research are needed for the offshore account and pass-through business categories of noncompliance to make the Tax Gap estimates more useful for resource planning. This research could inform the enforcement priorities of the IRS and legislative options to assist in accomplishing its mission. However, we are not making a recommendation in this report specific to improvements that could be made to the Tax Gap estimates with respect to noncompliance associated with offshore accounts and pass-through businesses. A forthcoming TIGTA report related to our assessment of the IRS's process for developing the Tax Gap estimates contains numerous recommendations for improving the Tax Gap estimates and associated processes and procedures.[30]

Additional data and research would make the Tax Gap estimates more useful for informing Examination resource allocation

As discussed in the prior section, the NBER paper concluded that audits do not effectively identify tax evasion issues for high-income taxpayers and suggests using administrative resources and data beyond the conventional audits, particularly from operational audits, to identify these high-risk cases.[31] The essence of the paper is that high-income taxpayers have the most opportunity for underreporting. The paper focused on unlawful tax evasion schemes using pass-through businesses, *i.e.*, entities, such as partnerships, S corporations, and limited

[30] TIGTA, Audit No. 202210010, *Actions Are Needed to Improve the Completeness, Development, and Review of IRS Tax Gap Estimates*.

[31] NBER-John Guyton, Patrick Langetieg, Daniel Reck, Max Risch, Gabriel Zucman, *Tax Evasion at the Top of the Income Distribution: Theory and Evidence* (March 2021).

liability companies, for which the tax consequences pass through to the partners, members, or shareholders. Researchers concluded that tax noncompliance through offshore accounts and pass-through business transactions generally is not identified through IRS audits.[32]

The results described previously with respect to Figure 5 would look different if the Tax Gap estimate for all the Individual Income Tax categories accounted for more sophisticated tax evasion. We are unable to make a reasonable assumption about the size of the partnership portion of the Tax Gap, but we are able to consider the results of the NBER paper for a hypothetical example for illustration. As shown in Figure 6, we created a hypothetical example of the Tax Gap comparison with changes made to the Individual Income Tax categories based on results of the NBER paper.[33]

Figure 6: Hypothetical TY 2011 Through TY 2013 Tax Gap Estimate With NBER Paper Adjustments Arrayed With the FTEs for FY 2019 and FY 2020[34]

Category	TYs 2011-2013 Underreporting Tax Gap ($B)	Percentage of Underreporting Tax Gap	FY 2019 FTEs	Percentage of Total	FY 2020 FTEs	Percentage of Total
Low Reported TPI (<$200K) Returns	$249.4	64.5%	4,487	51.7%	4,688	55.7%
High Reported TPI (>$200K<$1M) Returns	$41.0	10.6%	1,317	15.2%	1,132	13.5%
High Reported TPI ($1M+) Returns	$33.0	8.5%	718	8.3%	727	8.6%
Total Individual Income Tax	**$323.4**	**83.7%**	**6,523**	**75.2%**	**6,548**	**77.8%**
Small Corporations	$11.0	2.8%	666	7.7%	440	5.2%
Large Corporations	$26.0	6.7%	909	10.5%	907	10.8%
Total C Corporation Income Tax	**$37.0**	**9.6%**	**1,575**	**18.1%**	**1,347**	**16.0%**
Employment Tax	$25.0	6.5%	360	4.1%	327	3.9%
Estate Tax	$1.0	0.3%	220	2.5%	192	2.3%
Total Specialty Taxes	**$26.0**	**6.7%**	**580**	**6.7%**	**519**	**6.2%**
Totals	**$386.4**	**100.0%**	**8,677**	**100.0%**	**8,414**	**100.0%**

Source: TIGTA analysis of IRS-provided Tax Gap estimates, NBER paper adjustments, and FTE data.

The data show that the High Reported TPI ($1M+) category FTE proportion increased 302 percent compared to the data in the Figure 5 proportion. The significant increase in the proportion of the category illustrates the potential impact that additional research for offshore accounts and pass-through businesses will have on Tax Gap estimates in years to come. For the Total Individual category, the IRS has proportionally allocated fewer FTEs compared to the proportion of the Tax Gap estimate each year. For the Total C Corporation category, the IRS has

[32] Audits in this context generally mean National Research Program audits.

[33] The IRS provided us with estimates for the sophisticated tax evasion that could be added to the Individual Income Tax categories based on Table A6 from the NBER paper. The Low Reported TPI (<$200K) Returns category was increased by $1 billion. The High Reported TPI (>$200K<$1M) Returns category was increased by $6.5 billion. The High Reported TPI ($1M+) Returns category was increased by $25.5 billion.

[34] Percentages and totals may not equal due to rounding.

proportionally allocated more FTEs compared to the proportion of the Tax Gap estimate, and the results are the same when looking at the separate categories for Small and Large Corporations. The results in Figure 6 demonstrate that the IRS should consider enhancing the sophistication of the Tax Gap estimates and continue to monitor how resources compare to the proportions of the Tax Gap.

Whether due to complex partnerships, offshore accounts, digital currencies, or other income types associated with high-income taxpayers, identifying and assessing underreported taxes for emerging issues is not a simple task. RAAS management stated that even if they had perfect knowledge of the Tax Gap based on very robust studies, the largest proportional Tax Gap components would remain to be significant because the IRS does not currently have a way to detect and prevent those areas. The Acting Chief, RAAS, recently explained during his testimony that in terms of what makes up the Tax Gap, the underreporting of business income by individual taxpayers, *e.g.*, income of sole proprietors and those earning rental, royalty, partnership, and S Corporation income, accounted for $110 billion of the total $441 billion in the TY 2011 through TY 2013 period. The main reason for this portion of the underreporting Tax Gap is the lack of reliable and comprehensive third-party information reporting and withholding for business income received by individuals.[35]

However, reducing the net Tax Gap has been a topic of interest for many IRS stakeholders. In addition, the IRS Commissioner stated in a letter dated April 23, 2021, that "reducing the Tax Gap and improving compliance is a central part of the IRS mission." A FY 2019 SB/SE Division Annual Report explained that understanding the elements of the Tax Gap enables policymakers and tax administrators to make better decisions regarding how to allocate resources used to administer the Tax Code.[36] In addition, all initiatives by the IRS to improve tax collection are intended to narrow the Tax Gap and increase compliance. These estimates also inform policymakers of potential areas that need to be addressed in other ways.

Additionally, the Acting Chief, RAAS, explained during his testimony that the Tax Gap estimates do not include offshore accounts and certain other international transactions. He explained that using 2017 estimates, U.S. taxpayers have approximately $3.7 trillion in overseas accounts with approximately $2 trillion of the total being held in traditional tax haven countries. Finally, the Acting Chief, RAAS, believes that the IRS Commissioner's assertion that the actual Tax Gap approximates $1 trillion annually is reasonable given the growth of new financial tools in the economy since the last Tax Gap estimates, *e.g.*, virtual currency, and other taxable income that is not measured, such as income derived from illegal activity.[37]

A Government Accountability Office (GAO) report found that due to the complexity of the tax system, reducing the Tax Gap will not likely be achieved through a single solution.[38] Rather, the Tax Gap must be addressed on multiple fronts and with multiple strategies over a sustained period of time. The IRS's ability to reduce the net Tax Gap through enforcement and other

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[35] Senate Finance Subcommittee Hearing, *Offshore Tax Evasion*, Testimony of Barry Johnson, Acting Chief, Research Applied Analytic, and Statistics (May 11, 2021).

[36] Publication 5409, *2019 Small Business/Self Employed Annual Report* (Rev. 6-2020).

[37] Senate Finance Subcommittee Hearing, *Offshore Tax Evasion*, Verbatim Testimony of Barry Johnson, Acting Chief, Research Applied Analytics, and Statistics in response to questions (May 11, 2021).

[38] GAO, GAO-13-151, *Tax Gap: IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources* (Dec. 5, 2012).

activities depends partly on its budget and staff. A key component in promoting the highest degree of voluntary compliance by taxpayers is enforcement of the tax law. The IRS has documented the importance of understanding the components of the Tax Gap for informing resource allocation decisions. However, the IRS has not actively worked towards finding ways to make resource allocation decisions using the Tax Gap estimates. IRS management asserts that the Tax Gap components should not be used to dictate how much of the IRS's resources should be devoted to each program. We understand that it would not be advisable or feasible to exactly align resource allocation to the proportions of the Tax Gap categories. However, we believe the Tax Gap could and should be used to inform resource allocation so that high-risk populations of noncompliance are addressed.

The Tax Gap should be a useful tool to guide resource allocation. The hypothetical example shown in Figure 6 illustrates the potential for understating the impact of high-income taxpayers on the Tax Gap estimates. If the examination planning process does not use estimates of noncompliance to inform resource allocation, there is a risk that the process will not address a sufficient portion of the highest noncompliant taxpayers. There is also the risk of over-examining lower risk populations. We believe that the IRS should do more research so that the Tax Gap can be a more complete and current tool that is relevant for resource allocation.

We are not suggesting that the Tax Gap information should be the sole tool for Examination resource allocation; however, it is not clear that IRS Examination functions use the Tax Gap information in any way at all. In its current form, the Tax Gap numbers could be used, for example, to inform whether the IRS has the right mix of individual audits versus C corporation audits because the individual portion of the underreporting Tax Gap is consistently the largest part of the Tax Gap. Additionally, as discussed previously, if the Tax Gap information is broken out by income and made more complete by developing a current estimate of the offshore accounts and pass-through business portions, the Tax Gap information would be much more useful.

The Chief Research and Analytics Officer, RAAS, should:

Recommendation 3: Establish a process to use Tax Gap data annually to identify opportunities to better align resources that more effectively narrow the net Tax Gap.

> **Management's Response:** IRS management agreed with this recommendation. The IRS plans to release annual updates to the Tax Gap estimates and then compare the updated Tax Gap estimates to the allocation of resources and assess whether there are opportunities to better align resources to more effectively narrow the net Tax Gap, which is expected to be completed by October 15, 2023. Along with the Tax Gap estimates, the IRS will consider other compliance research that can help inform the efficient allocation of resources, such as conducting research into estimating the marginal revenue per marginal cost of examination activities.

The IRS Has Recently Developed an Optimization Tool for Resource Allocation, but Further Development and Expansion Are Needed

Although the IRS has developed a resource optimization tool, it is only being used by the SB/SE Division and does not consider enterprise-wide examination resources. When organizations have to make decisions about questions that involve multiple factors, an optimization model can be used to capture key components to build a mathematical model of the business situation. An optimization model is a translation of the key characteristics of the business problem that is being solved. A model consists of three elements: the objective function, decision variables, and business constraints. The IRS has recently been working towards developing a front-end optimization tool for resource planning known as the Program Assessment Model (PAM) Optimizer.

The PAM Optimizer is a resource planning tool for front-end FTE allocation used only by the SB/SE Division to create simulations for management to determine where to best allocate new FTEs that are projected for the next fiscal year. The SB/SE Division has been in the process of developing the PAM Optimizer to make resource allocation decisions based on a data-driven approach to estimate the impact of new hires across both Examination and Collection. The PAM Optimizer was first designed in Calendar Year 2018 as a proof of concept to determine where to allocate the FTEs to increase nonfiler work. The tool was expanded later in Calendar Year 2018 to include additional SB/SE Division workstreams, and results were tested in Calendar Years 2019 and 2020 to present to management. The PAM Optimizer was most recently used to provide management with results based on different assumptions regarding projected new FTEs for FY 2022.

According to IRS management, the tool is intended to be used by senior management to inform decision-making, is flexible, and can be adapted to shifting priorities. It provides management with information on optimal FTE allocation based on two priorities of (1) maximizing on collected revenue and (2) call volume level of service.[39] Although it was built for the SB/SE Division, IRS management stated the PAM Optimizer can be developed further to include other BOD workstreams. Due to the anticipated creation of the Compliance Division outlined in the *TFA Report to Congress*, the PAM Optimizer team has not expanded the tool to include other BODs.

The PAM Optimizer considers potential or actual new FTEs, and provides results for the workstreams or programs to allocate resources to Examination or Collection. When the PAM Optimizer was run using revenue and level of service variables, without minimum constraints for higher cost programs such as Field Examination that addresses higher risk cases, the results from the tool suggest allocating the majority of resources to lower cost programs such as Document Matching (AUR) that address lower risk cases. The IRS will use the PAM Optimizer to show different scenarios based on changing one or more of the variables to assist management with making FTE allocation decisions. In these scenarios, the SB/SE Division considers both Collection and Examination, because they have the ability to hire FTE resources between those functions.

Because the tool only optimizes on the two priorities, maximizing revenue or level of service, risk is not an automated consideration in the tool. In order to use the PAM tool for the purpose of making resource allocation decisions based on risks, the IRS would need to further develop the tool. IRS management can manually consider risk by putting constraints on specific

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[39] Revenue applies to both SB/SE Division Collection and Examination: maximizing on revenue through revenue assessments (Examination) and revenue collected (Collection). Level of service applies to only SB/SE Division Collection: maximizing level of service would mean increasing the number of taxpayers who reach a live assistor versus the number of calls the IRS system routes to live assistors.

workstreams in the tool. For example, if management wanted to make sure that new FTEs are allocated to positions that work higher risk cases, like Field Examination, a specific minimum constraint for the number of FTEs would have to be input in the tool. Figure 7 shows an example of a manual maximum constraint on AUR document matching FTEs, capping AUR FTEs at a predetermined amount based on FY 2022 hiring potential in order to illustrate the impact that would have on FTE allocations to the other Collection and Examination workstreams versus the tool being run with no constraints.[40]

Figure 7: PAM Optimizer Results With No Constraints Versus an AUR Constraint

Program	No Constraints	AUR Constraint
Automated Collection System and Correspondence Collection	2,472	1,665
Field Collection	0	804
Total Collection	**2,472**	**2,469**
Specialty Exam FTEs	329	421
Document Matching FTEs	3,175	626
Correspondence Exam FTEs	0	666
Field Exam FTEs	0	1,794
Total Examination	**3,504**	**3,507**
Overall Total	**5,976**	**5,976**

Source: IRS presentation of PAM Optimizer SB/SE Division results from May 2021.

When no constraints were used, the results show that the PAM Optimizer allocated most FTEs to the Automated Collection System and Correspondence Collection, as well as Document Matching; no FTEs were allocated to Correspondence or Field Examination. However, when an AUR constraint was applied capping document matching FTEs at the FY 2022 hiring potential level of 626 FTE, the PAM Optimizer allocated more FTEs to the other areas, particularly Correspondence and Field Examination. This illustrates that risk is not considered in the calculations in the tool because higher risk programs (such as Field Examination) were allocated zero resources when no constraints were used.

According to the IRS's Tax Gap Visibility Chart, income subject to substantial information reporting is estimated to be reported at a 95 percent accuracy rate and accounts for $12 billion of the Tax Gap, while income subject to little or no information reporting is estimated to be reported at a 45 percent accuracy rate and accounts for $109 billion.[41] Therefore, optimizing mainly on cost effectiveness could be influencing management to allocate more resources to a program such as AUR that is lower risk in terms of the size ($12 billion) of the component of the Tax Gap because taxpayers have already potentially reported the majority of their income (95 percent). Constraints to provide coverage of a specific program can be input, but those have to be manually input and decided upon by management versus being automated in the tool.

[40] Figure 7 uses the staffing estimates from the FY 2022 Hiring Potential determination for the optimization, as of May 2021, based on maximizing revenue collected and a 75 percent level of service.

[41] Publication 1415, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011 - 2013* (Rev. 9-2019).

IRS management stated that the PAM Optimizer results can be used to inform discussions for resource allocation, but SB/SE Division leadership makes the final resource allocation decisions. However, the point of an optimization tool is to use technology to assist management with considering multiple variables, rather than having to consider variables manually. The tool currently does not have all variables developed, including risk, and needs further development. For example, there are many additional constraints that also prevent the IRS from allocating optimally, such as a limited number of specialized employees in a critical location, a limit on the number of new employees who can be trained in a year as well as the desire to maintain coverage in each segment of the population to foster voluntary compliance and a sense of fairness. We believe that the IRS should develop a tool that includes additional variables, such as risk, so that it can be a more useful resource allocation tool without the need for manual constraints. Then, expand its use to other divisions' workstreams so that it can help to inform their resource allocation as well.

The Deputy Commissioner for Services and Enforcement should:

Recommendation 4: Develop a tool to consider risk and other relevant variables to inform examination resource allocation decisions, then expand its use to include Examination workstreams from all divisions.

> **Management's Response:** IRS management agreed with this recommendation, stating that in support of an expanded enterprise perspective, the IRS will analyze existing models, many of which already include risk analysis and the analysis of other important variables. From this, the IRS will develop recommendations to expand these models, identifying gaps and determining what is needed to support of the agency's strategic priorities, which is expected to be completed by April 15, 2024.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to review the process used by the IRS to allocate resources to the Examination function. To accomplish our objective, we:

- Identified the current overall resource allocation procedures and guidelines to determine how funding is allocated among the various Examination programs.
- Determined how the Examination workplans were developed.
- Reviewed the allocation of budget funding and FTE trends for Enforcement for FY 2015 through FY 2021.
- Determined how the Tax Gap underreporter data compared to the allocation of Examination resources.

Performance of This Review

This review was performed with information obtained from the DCSE; the LB&I, SB/SE, TE/GE, and W&I Divisions; the CFO's Office, and the RAAS, during the period May 2021 through September 2022. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Major contributors to the report were Matthew Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations); Phyllis Heald-London, Director; Autumn Macik, Audit Manager; Heath Sollak, Lead Auditor; and Doris Cervantes, Senior Auditor.

Validity and Reliability of Data from Computer-Based Systems

We obtained the individual income tax underreporting Tax Gap data broken out by income from the RAAS and compared it to the Tax Gap methodology to determine that the information was valid and reliable. We obtained FTE data from BOD Examination contacts and compared the results to CFO and Finance FTE data to determine that the information was valid and reliable.

Internal Controls Methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: CFO; SB/SE, LB&I, TE/GE, and W&I Divisions; DCSE; and RAAS policies, procedures, and practices related to allocating resources to the Examination function. We evaluated these controls by identifying and conducting a high-level overall review of the appropriate internal procedures and guidelines, and interviewing relevant management.

Appendix II

Management's Response to the Draft Report

DEPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

January 23, 2023

MEMORANDUM FOR HEATHER M. HILL
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Melanie R. Krause Melanie R. Krause Digitally signed by Melanie R. Krause Date: 2023.01.23 08:34:27 -05'00'
Acting Deputy Commissioner for Services and Enforcement

SUBJECT: Draft Report – Opportunities Exist for the IRS to Develop a More Coordinated Approach to Examination Workplan Development and Resource Allocation (Audit #202130032)

Thank you for the opportunity to review your draft report titled: *Opportunities Exist for the IRS to Develop a More Coordinated Approach to Examination Workplan Development and Resource Allocation.* We requested that TIGTA perform this audit to assess the IRS's process for making resource allocation decisions for examination purposes. The efficient and effective use of taxpayer dollars by the Internal Revenue Service's examination programs is critical to the success of the organization in properly serving compliant taxpayers and upholding the nation's tax laws. We face tough choices each year regarding where to deploy our resources given the breadth of our responsibilities, but these choices are guided by fair and impartial audit plans throughout the process.

The Taxpayer First Act's Report to Congress discusses the potential shift toward centralizing examination under a single compliance organization. The investment in the IRS through the Inflation Reduction Act of 2022 (IRA 2022) furthers our ability to consider how resources are best aligned to achieve tax administration in the best service to taxpayers.

Establishing a multiyear strategic plan may provide the IRS with a more coordinated and cohesive approach to resource allocation and examination efforts. However, such a plan will need to be informed by corresponding considerations such as recruiting, hiring, training, and staffing needs in areas of competing priority. Further, a multi-year strategic plan will require agility to address new and emerging issues, legislative changes, and shifts in priorities and resources.

Recent discussions of audits of high-income taxpayers and efforts to address abusive syndicated conservation easement transactions are two examples of where the IRS's ability to flexibly respond to areas of interest is critical to meeting the strategic priorities of the organization. The IRS has established the Joint Strategic Emerging Issues Team (JSEIT) consisting of representatives from business units, Chief Counsel, and other supporting organizations. JSEIT facilitates cross-business unit collaboration by providing an opportunity for representatives from across the agency to regularly partner to address significant compliance risk. While a multi-year comprehensive examination strategic plan is a good idea, such a plan must be distinct from a document that addresses all workstreams from all divisions to rank them by risk and priority leaving opportunity for adjustment and addressing new and emerging risks as they arise.

Establishing a documented annual service-wide examination planning process represents an opportunity to better align resources with needed compliance activities. This is not a new concept, as TIGTA mentions there were prior attempts to establish this level of planning, and the notion of enterprise-wide planning is something the IRS has contemplated again recently, even before the passage of IRA 2022. There are immediate challenges that need to be overcome, namely reconciling that all functions do not currently use the same systems, workstream definitions, or metrics to evaluate efficacy. Different divisions today also serve different types of taxpayers and require employees with differing skill levels. Further, a unified planning process would also need to include a governance and data analysis structure to support decision making. Despite these constraints and dependencies, there is still an opportunity to take steps to better identify shared priorities across the agency and improve the cross-functional collaboration to achieve those goals.

We appreciate TIGTA's recognition that Tax Gap information should not be the sole tool for Examination resource allocation and that it would not be advisable or feasible to align resource allocation in direct proportion to the Tax Gap categories. While valuable, Tax Gap information must be used in conjunction with other priorities, directives, and new emerging issues. For example, with IRA 2022, Treasury Secretary Yellen has directed the IRS to prioritize compliance efforts directed at taxpayers earning more than $400,000.

Finally, the development of an enterprise examination planning process requires a clear understanding of existing data points and systems that can be appropriately expanded or otherwise applied broadly. As TIGTA points out, much of the agency's planning is conducted discretely by operation. Standardizing workstream definitions across the agency would support assessment of enterprise-wide examination resources which factor in various risks and related variables. Although some tools currently used in resource planning were not developed to factor in risks or other variables, the agency also applies other methods and tools that do consider risk, such as the Enterprise Planning Scenario Tool (ESPT). As data and technology become more readily available, the IRS will seek to expand opportunities to better assess and apply risks and related variables in resource planning. Support for agency-wide allocation decisions would generally require a variety of tools working together in synchronicity, a goal that may be achieved by improving and expanding what is in place paired with exploring new methodologies available.

We appreciate the opportunity to review and comment on the draft report. Attached is a detailed response to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Carollynn Lear at 202-830-7833.

Attachment

Attachment

Corrective Actions for TIGTA Audit Draft Report – Opportunities Exist for the IRS to Develop a More Coordinated Approach to Examination Workplan Development and Resource Allocation (Audit #202130032)

RECOMMENDATION 1:
The Deputy Commissioner for Services and Enforcement should: Consider adopting a multiyear, comprehensive Examination Strategic Plan that addresses all workstreams from all divisions to rank them by risk and priority that can be used to guide resource allocation. In addition, the plan should contain specific and measurable performance goals or expected outcomes to help measure progress.

CORRECTIVE ACTION:
As part of IRA implementation, the IRS is currently identifying opportunities to incorporate an enterprise perspective in the prioritization of work while ensuring agility to allow for flexible responses to evolving strategic goals and emerging issues. The IRA funding is intended for critically needed transformations at the IRS and efforts are already underway to create a Strategic Operating plan for delivery to the Treasury Secretary. The IRA Strategic Operating Plan will consider a comprehensive examination strategic plan that will align the agency's strategic priorities and enable a more coordinated and cohesive approach to resource allocation.

IMPLEMENTATION DATE: 4/15/2024

RESPONSIBLE OFFICIAL(S): Deputy Commissioner for Services and Enforcement

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:
The Deputy Commissioner for Services and Enforcement should: Establish a documented annual enterprise-wide examination planning process that aligns with the multi-year, comprehensive Examination Strategic Plan.

CORRECTIVE ACTION:
The IRS is developing an iterative process to establish, document, and implement enterprise-wide examination planning. This process will include considerations around available resources and will help to identify hiring, staffing, and training needed to further support the agency's strategic priorities.

IMPLEMENTATION DATE: 9/15/2024

RESPONSIBLE OFFICIAL(S): Deputy Commissioner for Services and Enforcement

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 3:
The Chief Research and Analytics Officer, Research, Applied Analytics & Statistics Division, should: Establish a process to use Tax Gap data annually to identify opportunities to better align resources that more effectively narrow the net Tax Gap.

CORRECTIVE ACTION:
The IRS plans to release annual updates to our tax gap estimates. We will compare the updated tax gap estimates to the allocation of resources and assess whether there are opportunities to better align resources to more effectively narrow the net tax gap. Along with the tax gap estimates, we will consider other compliance research that can help inform the efficient allocation of resources, such as our research into estimating the marginal-revenue/marginal cost of examination activities.

IMPLEMENTATION DATE: 10/15/2023

RESPONSIBLE OFFICIAL(S): Chief Data and Analytics Officer, RAAS

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 4:
The Deputy Commissioner for Services and Enforcement should: Develop a tool to consider risk and other relevant variables, to inform examination resource allocation decisions, then expand its use to include Examination workstreams from all divisions.

CORRECTIVE ACTION:
In support of an expanded enterprise perspective, the IRS will analyze existing models, many of which already include risk analysis and the analysis of other important variables. From this we will develop recommendations to expand these models, identifying gaps and determining what is needed to support of the agency's strategic priorities.

IMPLEMENTATION DATE: 4/15/2024

RESPONSIBLE OFFICIAL(S): Deputy Commissioner for Services and Enforcement

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

Appendix III

Glossary of Terms

Term	Definition
Appropriation	Statutory authority to incur obligations and make payments out of Department of the Treasury funds for specified purposes.
Automated Underreporter	Matches items reported on an individual's income tax return to information supplied to the IRS from outside sources, *e.g.*, employers, banks, credit unions, to determine if the taxpayer's tax return reflected the correct amounts, thereby ensuring that the tax amount is correct.
Budget Justification	For any given fiscal year, the budget request is submitted to the IRS Oversight Board, the Department of the Treasury, the Office of Management and Budget, and Congress; this is referred to as the Congressional Justification. Revisions are made to the budget request throughout this process based on approved funding levels from these external entities prior to the final Congressional Justification.
Business Operating Division	A title for major IRS organizations such as Appeals, W&I Division, Office of Professional Responsibility, and Information Technology.
Calendar Year	The 12-consecutive-month period ending on December 31.
Campus Examination	Correspondence audits typically begin with the IRS mailing a computer-generated letter to a taxpayer that outlines the audit process, identifies one or more items on the tax return that are being questioned, and requests supporting information to resolve the questionable items.
Chief Financial Officer	The individual primarily responsible for managing the financial risk of an enterprise.
Earned Income Tax Credit	A tax credit used to offset the impact of Social Security taxes on low-income families and to encourage them to seek employment.
Examination	Field examinations of individuals, partnerships, and corporations that occur either at the taxpayer's place of business or through interviews at an IRS office.
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

Term	Definition
Full-Time Equivalent	A measure of labor hours in which one FTE is equal to eight hours multiplied by the number of compensable days in a particular fiscal year.
Integrated Financial System	Contains the IRS's core financial systems, including expenditure controls, accounts payable, accounts receivable, general ledger, and budget formulation. The system includes a managerial cost accounting capability that enables the IRS to make informed and timely performance-based business and budgetary decisions.
Large Business and International Division	Serves corporations, subchapter S corporations, and partnerships with assets greater than $10 million. These entities typically have large numbers of employees, deal with complicated issues involving tax law and accounting principles, and conduct their operations in an expanding global environment.
Level of Service	The primary measure of service to taxpayers. It is the relative success rate of taxpayers who call for live assistance on the IRS toll-free telephone lines. The IRS's measure is titled Customer Service Representative Level of Service.
Net Tax Gap	The annual difference between what taxpayers owe and what they pay voluntarily less collections through enforcement.
Office of Management and Budget	Federal agency that oversees the preparation and administration of the Federal budget and coordinates Federal procurement, financial management, information, and regulatory policies.
Research, Applied Analytics, and Statistics	Leads a data-driven culture through innovative and strategic research, analytics, statistics, and technology services to support effective and efficient tax administration in partnership with internal and external stakeholders.
Revenue Agent	Employees in the Examination function who conduct face-to-face examinations of more complex tax returns, such as businesses, partnerships, corporations, and specialty taxes.
Small Business/ Self-Employed Division	The IRS organization that services self-employed taxpayers and small businesses by educating and informing them of their tax obligations, developing educational products and services, and helping them understand and comply with applicable tax laws.
Tax Compliance Officer	An employee in the Examination function who primarily conducts examinations of individual taxpayers through interviews at IRS field offices.

Term	Definition
Tax Examiner	An employee located in a field office who conducts examinations through correspondence. However, the tax examiner position is also used for many other types of positions located in various IRS offices.
Tax Exempt and Government Entities Division	Serves charities, small local community organizations, major universities, large pension funds, small business retirement plans, local and State governments, participants in complex tax-exempt bond transactions, and Indian tribal governments and tribal associations. External customers are divided into three segments: Employee Plans, Exempt Organizations, and Government Entities.
Tax Gap	The estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.
Tax Year	A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.
Total Gross Receipts	The sum of gross receipts from farm and nonfarm businesses calculated by adding the positive values of gross receipts and other income from Schedule C and gross income (which can be positive or negative) from Schedule F.
Total Positive Income	The sum of all positive amounts shown for the various sources of income reported on an individual income tax return and, thus, excludes losses.
True Income	The correct taxable income that was actually received by a taxpayer and should be reported on the tax return for it to be accurate. This may be higher than the taxable income actually reported on the tax return by a taxpayer.
Wage and Investment Division	Administers tax laws governing individual wage earners and annually processes more than 154 million individual tax returns and 49 million business returns, including more than 130 million electronically filed returns.

Appendix IV

Abbreviations

ARPA	American Rescue Plan Act of 2021
AUR	Automated Underreporter
BOD	Business Operating Division
CARES Act	Coronavirus Aid, Relief, and Economic Security Act
CFO	Chief Financial Officer
DCSE	Deputy Commissioner for Services and Enforcement
EITC	Earned Income Tax Credit
FTE	Full-Time Equivalent
FY	Fiscal Year
GAO	Government Accountability Office
IRS	Internal Revenue Service
LB&I	Large Business and International
NBER	National Bureau of Economic Research
PAM	Program Assessment Model
RAAS	Research, Applied Analytics, and Statistics
SB/SE	Small Business/Self-Employed
TE/GE	Tax Exempt and Government Entities
TFA	Taxpayer First Act
TIGTA	Treasury Inspector General for Tax Administration
TPI	Total Positive Income
TY	Tax Year
W&I	Wage and Investment

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