



Treasury Inspector General for Tax Administration Office of Audit

FILING CHARACTERISTICS AND EXAMINATION RESULTS FOR SMALL BUSINESS CORPORATE RETURNS

Issued on June 11, 2010

Highlights

Highlights of Report Number: 2010-30-067 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

The Internal Revenue Service (IRS) examines income tax returns to determine whether corporations and other taxpayers have voluntarily complied with tax laws and reported the proper amount of tax. Despite continuing efforts to improve its examination process, Small Business/Self-Employed Division examiners closed almost one out of every three (32 percent) corporate return examinations in Fiscal Year 2009 without recommending any adjustments. Examinations that result in no change to the tax reported can result in an inefficient use of limited examination resources and place an unnecessary burden on compliant taxpayers.

WHY TIGTA DID THE AUDIT

The overall objectives of this review were to analyze IRS data for Fiscal Years 2005 through 2009 and to identify trends in the filings and audits of conventional small business corporate returns. This audit was part of TIGTA's Fiscal Year 2010 Annual Audit Plan to highlight the important role a National Research Program study could have in understanding what the filings and audits of corporate returns mean for tax compliance. If approved and implemented, the National Research Program study would evaluate the extent to which corporations and their shareholders comply with the tax laws.

WHAT TIGTA FOUND

Between January 2005 and December 2009, the number of corporate returns processed annually by the IRS fell seven percent, from almost 2.2 million to approximately two million. Despite the decrease in the number of filings, the amount of income taxes reported by corporate returns is significant. In Processing Year 2009, IRS records show that approximately \$11 billion in corporate income taxes was reported from about 542,000 corporate returns.

One factor that may be contributing to the modest decline in corporate return filings is the popularity of organizing a business as a partnership or S corporation, which allows the partners and shareholders of these entities to avoid double taxation on business profits. According to the IRS, the number of partnership and S corporation filings is expected to increase by 49 percent and 39 percent, respectively, between 2006 and 2014.

IRS officials told TIGTA that the IRS is not permitted to set a target for the examination no-change rate. However, in 2003, the IRS reported to Congress that a high no-change rate means a significant amount of resources are being devoted to unproductive examinations, and compliant corporations are being unnecessarily burdened by examinations.

The results of the National Research Program study are expected to improve the IRS examination process by helping ensure the taxes on hundreds of billions of dollars of income earned by United States corporations are reported and paid properly. The statistical validity and comprehensiveness of the study is designed to provide the IRS with updated compliance data needed for deciding which corporate returns should be examined and how best to focus examination resources on the most significant areas of noncompliance.

WHAT TIGTA RECOMMENDED

Although TIGTA did not make any recommendations in this report, IRS officials were provided an opportunity to review the draft report. IRS management did not provide any comments on the draft report.

READ THE FULL REPORT

To view the report, including the scope and methodology, go to:

<http://www.treas.gov/tigta/auditreports/2010reports/201030067fr.pdf>

Email Address: inquiries@tigta.treas.gov
Web Site: <http://www.tigta.gov>

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