



Treasury Inspector General for Tax Administration Office of Audit

LIMITATIONS IN THE SAMPLE SIZE FOR THE INTERNAL REVENUE SERVICE'S EMPLOYMENT TAX STUDY MAY IMPACT THE ABILITY TO DETERMINE COMPLIANCE LEVELS

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Highlights

Highlights of Report Number 2011-10-034 to the Internal Revenue Service Director for the Office of Research, Analysis and Statistics.

IMPACT ON TAXPAYERS

The Internal Revenue Service (IRS) Office of Research, Analysis and Statistics initiated the Employment Tax Study (the Study) to update estimates of the Tax Gap (the difference between taxes owed and taxes timely paid) attributable to business employers. However, the audit results for the taxpayers included in the Study may not enable IRS management to fully estimate compliance levels for business taxpayers. Having a more complete understanding of these filers is essential for the IRS to focus its limited resources in areas where it could be most productive, which should ultimately reduce the burden on compliant taxpayers and result in more accurate Tax Gap data.

WHY TIGTA DID THE AUDIT

This audit was initiated because employment taxes are a major source of revenue for the Federal Government, and it has been more than 25 years since the IRS conducted a comprehensive review of employer tax compliance. Some IRS officials believe the current Tax Gap estimate is significantly understated. In February 2010, the IRS began its first Employment Tax Study to better estimate the Tax Gap for underreported employment taxes and determine compliance rates for business taxpayers.

Results from other studies indicate there are several underlying factors that contribute to the underreporting of employment taxes. As a result, the employment tax audits included in the Study are expected to be comprehensive in nature.

The overall objective of this review was to determine whether the sampling methodology developed by the Office of Research, Analysis and Statistics to conduct the Study will provide a valid representation of employment tax compliance rates for business taxpayers.

WHAT TIGTA FOUND

The IRS selected the sample of employers to include in the Study based on available resources. However, the audit results for the sampled taxpayers may not enable IRS management to fully estimate compliance levels for business taxpayers. As a result, IRS management indicated that additional audits may be required after the Study is completed.

In addition, the IRS plans to sample only 50 large/international business taxpayers in each year of the Study, which may be too small of a sample to provide meaningful compliance estimates for these taxpayers. Further, IRS management specifically excluded some larger employers due to the time necessary to complete these complex audits. As a result, the Study will not provide any information about the compliance levels of these employers.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS develop an action plan for any future employment tax study that outlines management's strategy to achieve their goal of updating the employment Tax Gap estimates, determine the percentage of the total population that the excluded entities represent, and evaluate whether future employment tax studies should include the large employers excluded in this Study.

In their response to the report, IRS officials agreed with our recommendations. IRS management agreed to develop goals and project plans during the design phase of every IRS reporting compliance research study. In addition, they plan to document the findings related to the excluded entities as companion data to the Study results. Finally, management agreed to reevaluate whether future employment tax studies should include the large employers.

READ THE FULL REPORT

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

<http://www.treas.gov/tigta/auditreports/2011reports/201110034fr.pdf>

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