United States General Accounting Office

GAO

Briefing Report to the Chairman, Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate

April 1992

TAX ADMINISTRATION

IRS' Efforts to Improve Corporate Compliance

146800

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GAO/GGD-92-81BR

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United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-248257.1

April 17, 1992

The Honorable Sam Nunn
Chairman, Permanent Subcommittee
on Investigations
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

In April 1991, we testified before your Subcommittee on our initial observations on the Internal Revenue Service's (IRS) program to audit tax returns of the nation's largest corporations--the Coordinated Examination Program (CEP).[1] We also reported on the unprecedented drop in small corporation tax compliance.

This briefing report covers the second phase of our work on these topics and provides (1) trends in CEP examination results, (2) CEP audit coverage estimates, (3) a profile of CEP taxpayers, and (4) information on IRS' efforts to address the drop in small corporate compliance. The results of this work were presented to the Subcommittee in an April 2, 1992, briefing. The third phase of our work, now underway, includes determining the portion of CEP-recommended taxes that are actually collected and factors that affect the collection rate.

CEP-RECOMMENDED TAXES PER CEP HOUR REMAINED STEADY FROM 1987 TO 1990 AND INCREASED IN 1991

We found that CEP-recommended taxes per direct examination hour remained fairly steady from fiscal years 1987 through 1990 (see app. II). The term "recommended tax" refers to the amount of additional tax that an examiner concludes should have been paid based on the examination, together with any associated penalties. If the taxpayer agrees with this recommended amount, it is assessed; if not, the taxpayer may appeal it. For CEP, IRS estimates that taxpayers currently appeal about 90

[1]IRS' Efforts to Ensure Corporate Tax Compliance (GAO/T-GGD-91-21, Apr. 17, 1991).

percent of the tax recommended and that about 25 percent of appealed recommendations are actually assessed.[2]

In fiscal year 1987, IRS recommended $4,372 in additional tax per direct examination hour and in fiscal year 1990, $4,268 per hour. In fiscal year 1991, the measure jumped to $6,875 per hour because of the impact of one case worth $6.5 billion in recommended tax. Excluding that case, however, CEP produced $4,460 per hour in fiscal year 1991--an amount that closely parallels recommended tax per hour for the previous four fiscal years.

IRS officials said that trends in CEP-recommended taxes can be used as one indicator of IRS' success in improving large corporations' voluntary compliance. If voluntary compliance increases, IRS officials said that ideally there should be a decrease in CEP-recommended taxes.

Total recommended taxes from fiscal years 1987 to 1991 increased 167 percent, from $7 billion to $18 billion, including the $6.5 billion case. Excluding this case, total recommended taxes increased by 71 percent--from $7 billion to $11.5 billion. Part of the increase may be due to the greater resources devoted to this program over the same period. (See p. 21.) Other trends in CEP operations are included in appendix II.

For perspective, appendix II also includes related trends for non-CEP corporate examinations. We make no conclusions regarding the allocation of IRS' resources between CEP and non-CEP corporate examination programs.

IRS "AUDITED" 69 PERCENT OF CEP RETURNS IN FISCAL YEAR 1990, 77 PERCENT IN 1991

As part of our trend analysis, one of our objectives was to determine how widely CEP corporations were audited, given that they are the nation's largest and most complex corporations. At the Subcommittee's April 1991 hearing on corporate tax compliance, the Commissioner of IRS testified that "with large corporations, we audit virtually every CEP taxpayer every year." We found that IRS does not audit every CEP return, but IRS officials said they do carefully review a return for revenue potential before deciding to exclude it from audit.

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[2]This estimate of 25 percent is based on the judgment of IRS officials knowledgeable about the program. IRS does not currently have empirical data on the percent of appealed recommendations that are assessed.

IRS generally calculates audit coverage for each tax class[3] by dividing the number of examinations completed in a fiscal year by the number of tax returns filed the previous year. We used this method to calculate CEP audit coverage and found it ranged from 66 to 69 percent in fiscal years 1987 through 1990 and 77 percent in fiscal year 1991. This measure includes tax returns that are opened to resolve an issue that was carried forward or carried back from another tax year. IRS officials said they do not believe that an audit coverage measure is applicable to the CEP program because every CEP taxpayer's return is reviewed.

The audit coverage has implications for IRS' estimates of the tax gap for large corporations. The tax gap is the difference between the amount of income tax owed for one tax year and the amount paid voluntarily. IRS attributed a $15.8 billion tax gap in 1987 to large corporations (which includes those in CEP). IRS based part of this estimate on examination results from CEP. Thus, IRS' estimate of the tax gap for large corporations is understated to the extent that IRS did not include any estimate of noncompliance for non-audited returns. IRS officials said, however, that these returns were not audited because in their judgment, the returns lacked revenue potential. Thus, according to IRS, if the skipped returns were audited, the impact on the tax gap would not be significant. Nonetheless, IRS officials told us they have not audited a sample of the skipped returns to test their judgment regarding the returns' revenue potential.

The tax gap may also be understated to the extent that IRS does not detect all noncompliance during an audit. For fiscal years 1987 through 1991, IRS applied about one direct examination staff year[4] to each CEP return examined. This modest level of effort to audit complex corporations with billions of dollars in assets and income will undoubtedly miss some noncompliance. However, the 1987 tax gap estimate may be overstated to the extent that IRS' CEP recommendations that were appealed by the corporation were not sustained through the appeals process. In the final

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[3]A tax class is a grouping of returns on the basis of return type, such as individual or estate; source of income, such as farm or business; and level of income. Corporate tax classes are based on total assets.

[4]A direct examination staff year refers to a full staff year applied directly to the examinations of tax returns by IRS' technical staff. It does not include time for training, leave, or managers. There are between 2,000 and 2,016 direct examination hours per direct examination staff year.

analysis, the large corporation tax gap is an estimate, not a precise measure.

PROFILE OF CORPORATIONS IN CEP

To create a profile of CEP corporations, we matched a list of CEP taxpayers in 1991 to IRS records of 1988 corporate income tax returns. We obtained complete records for 1,329 taxpayers and used those records to summarize profile data.

Based on their 1988 tax returns, we found that the majority of CEP corporations in our sample were in manufacturing, finance/insurance, or transportation industries (see app. III). Average reported assets were $6.5 billion. CEP corporations' 1988 tax returns reported an average of about $1.5 billion in total income and $179 million in taxable income. They reported an average income tax of $61 million based on taxable income. After claiming tax credits and other tax adjustments, they reported an average net tax liability of $42 million, or 23 percent of average taxable income. The foreign tax credit was the largest tax credit claimed, worth an average of $18 million per CEP return. Other profile information on CEP corporations is in appendix III.

IRS CONTINUES TO STUDY AN ALARMING DROP IN SMALL CORPORATE TAX COMPLIANCE

At the April 1991 hearing, we testified that new IRS Taxpayer Compliance Measurement Program (TCMP) audit results showed that 2.3 million small corporations (about 80 percent of all corporations) voluntarily paid an estimated 61 percent of the tax they owed in 1987. For 1980, just 7 years earlier, IRS' TCMP audit results showed this voluntary compliance to be 81 percent. IRS estimates voluntary compliance for small corporations (i.e. with assets of $10 million or less) by auditing every line on a random sample of their tax returns. To compute the 61 percent, IRS summarized the results of the 19,000 1987 tax returns it audited and projected these results to all small corporations. About half of the noncompliance was due to unreported income ($15.4 billion) and half was due to overstated deductions ($14.9 billion). The comparable figures for 1980 returns were about $5 billion and $6 billion respectively.

At the hearing, the Commissioner cautioned that the small corporation compliance data was preliminary and that IRS had not finished reviewing it. After completing their review, IRS officials acknowledge that the drop in compliance occurred.

While the reasons for this unprecedented decline in compliance are not known, our April 1991 testimony noted that one possible cause might be the decline in IRS audit coverage for small corporations. From 1980 to 1987, it declined from 6.1 percent to 1.1 percent. This concerns us because new research results show that small business compliance rates are affected by their owners' perceived risk of being audited.[5]

Although IRS increased audit coverage from 1.1 percent in 1987 to 1.8 percent in 1991 and 2.8 percent in 1992 (planned), this is still less than half the 6.1 percent audit coverage in 1980. IRS officials said they increased audit coverage due to an ongoing concern over small corporation compliance and prior to receiving the 1987 TCMP data.

Since the April 1991 hearing, IRS has continued to study the data on the drop in compliance but has not yet initiated special compliance programs. Four IRS studies should provide information helpful in targeting such programs--one is complete and the rest are scheduled to be completed in the next few years.

The first study, completed in December 1991, found that a large part of the 39 percent non-compliance found in the TCMP audits for tax year 1987 was caused by a relatively small subset of the 19,000 small corporations audited. Specifically, 5 percent of the corporations accounted for 23.3 percentage points of the 39 percent non-compliance. Of these 23.3 percentage points, only 1 percent of the corporations accounted for 14 percentage points. The study also found that certain attributes of the small corporations were "superb" indicators of non-compliance. The study stated that these attributes were intended to be used by IRS examiners to develop strategies for selecting small corporations to be audited. However, we are not describing these attributes because small corporations may use the information to avoid IRS examinations.

The second study, scheduled to be completed in December 1993, will analyze payers' voluntarily filed information returns on interest and dividend payments made to corporations. The study's objective is to identify ways for IRS and corporations to use these information returns and to encourage payers to file more returns voluntarily.

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[5]Peggy Hite, Bryan C. Cloyd, and F. Toby Stock. "Reasons for Preparer Usage by Small Business Owners: How Compliant Are They?" (Paper prepared for presentation at the 1991 IRS Research Conference in Washington, D.C.).

After our testimony last year, we completed our analysis of the potential benefits of a corporate document matching program.[6] We concluded that such a program held great promise for improving the corporate compliance rate. IRS opposes such a program but continues to study elements of it--as in the second study described above.

The third study, part of a continuous series of related studies, will attempt to identify the factors that caused small corporate compliance to drop and to find ways to improve it. Particular attention will be given to finding effective corrective measures, other than through more enforcement, such as more information reporting. After corrective IRS measures have been found and applied to selected corporations, IRS plans to measure whether the corrections increased compliance.

The fourth study, scheduled to be completed in three years, will analyze corporate compliance to develop a new strategy for selecting returns to be audited. The study will attempt to identify "market segments" within the population of corporations that have certain common attributes related to non-compliance.

This briefing report includes appendixes that (1) describe our objectives, scope, and methodology, (2) document trends in IRS' audits of CEP and non-CEP corporate taxpayers including audit coverage rates, and (3) provide summary information on characteristics of CEP taxpayers. The report incorporates, where appropriate, IRS' comments on the data reported.

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As agreed with the Subcommittee, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of its issuance. At that time, we will send copies of this briefing report to the Commissioner of Internal Revenue and other interested parties. We will also make copies available to others upon request.

[6] Tax Administration: Benefits of a Corporate Document Matching Program Exceed the Costs (GAO/GGD-91-118, Sept. 27, 1991).

Major contributors to this briefing report are listed in appendix IV. If you have any questions, please call me on (202) 275-6407.

Sincerely yours,

Jennie S. Stathis

Jennie S. Stathis
Director, Tax Policy and
Administration Issues

C O N T E N T S

ABBREVIATIONS

AIMS	Audit Information Management System
CEP	Coordinated Examination Program
IRS	Internal Revenue Service
SOI	Statistics of Income
TCMP	Taxpayer Compliance Measurement Program

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Document 1987-1991 trends for CEP and non-CEP corporate examination programs

Develop a profile of CEP taxpayers

Determine the status of IRS' efforts to improve small corporation compliance

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to (1) document trends in productivity indicators for IRS' examination of CEP and non-CEP corporate income tax returns, (2) develop a profile of CEP taxpayers, and (3) determine the status of IRS' efforts to improve small corporation compliance.

To develop trend information, we used data from IRS National Office officials and IRS' Audit Information Management System (AIMS)--the system IRS uses to report examination accomplishments to Congress. This data base includes closing records from all examinations closed during a given fiscal year. Fiscal year 1987 records are the first to identify CEP examination results separately.

For examinations closed from fiscal years 1987 through 1991, we obtained summary data on additional tax recommended, tax decreases recommended, the number of returns closed, and direct examination hours for examinations of CEP returns. For perspective, we obtained the same data for examinations of non-CEP corporate income tax returns. We then calculated productivity measures such as tax recommended per return, tax recommended per hour, and examination hours per return. To calculate CEP audit coverage, we used IRS' method of dividing the number of audits completed in a given fiscal year by the number of returns filed the previous year. IRS officials provided audit coverage statistics for non-CEP corporations.

All trends reported that relate to tax liability are based on recommendations made at the close of the examination. Most CEP taxpayers appeal these recommendations to IRS Appeals; generally, the tax actually assessed at the end of the appeals process will differ from the tax recommended. IRS estimates that taxpayers appeal about 90 percent of the amount recommended and that about 25 percent of the appealed recommendations are actually assessed. In the final phase of our CEP review, scheduled for completion in June 1993, we will calculate the rate at which dollars recommended get assessed and will identify factors that cause low assessment rates.

To get IRS' perspective on the trends reported, we discussed our findings with officials at IRS' national office and 10 district offices: Boston, Chicago, Dallas, Hartford, Houston, Laguna Niguel, Los Angeles, Manhattan, Nashville, and Newark. We selected these districts because they accounted for 50 percent of all CEP examination hours and 65 percent of additional tax recommended in fiscal year 1991. IRS' comments are included where appropriate.

To create a profile of CEP taxpayers, we obtained a computerized data base of 1988 corporate income tax return information, the most recent data available, from IRS' Statistics of Income Division (SOI). We matched a list of 1,672 taxpayers in the CEP program in May 1991 to the records in the SOI data base. This data match resulted in usable records for 1,329 CEP taxpayers, 80 percent of the May 1991 universe of CEP taxpayers. IRS officials told us that corporate mergers and acquisitions between 1988 and 1991 would account for the discrepancy in our computer match. Using this information, we summarized data on items including type of business, income, tax credits, and tax assessment.

To follow up on IRS' response to a drop in voluntary compliance by small corporations, we reviewed IRS data documenting the drop in compliance and interviewed responsible IRS officials regarding IRS programs to reverse this trend.

We did our work in Washington, D.C., and Kansas City from June 1991, to March 1992, in accordance with generally accepted government auditing standards.

TRENDS IN CEP AND NON-CEP CORPORATE EXAMINATION PROGRAMS

Summary of 5-Year Trends

Table II.1: Summary of Trends for CEP and Non-CEP Corporate Examinations, 1987-1991

Trend	Direction of CEP Trend	Direction of non-CEP trend
Audit coverage	Up	Fluctuated
Direct examination hours	Up	Fluctuated
Additional tax recommended	Up	Fluctuated
Number of examinations closed	Up	Fluctuated
Additional tax recommended per hour	Steady[a]	Fluctuated
Direct examination hours per return	Fluctuated	Fluctuated
Additional tax recommended per return	Fluctuated	Fluctuated

[a]Additional tax recommended per hour increased in fiscal year 1991 when calculated including one large case worth $6.5 billion in recommended tax. Excluding that case, recommended tax per hour parallels that of earlier years.

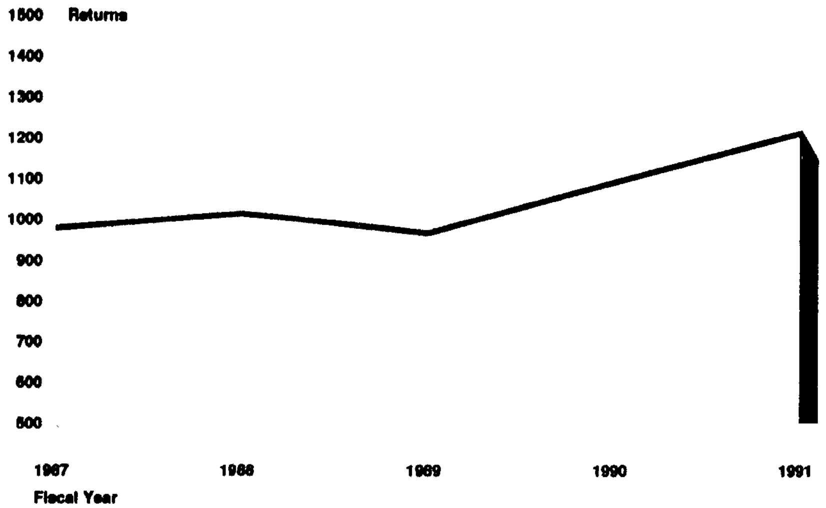
SUMMARY OF 5-YEAR TRENDS

Our analysis of trends for 4 key program results--audit coverage, direct examination hours, additional tax recommended, and number of returns examined--for CEP and non-CEP corporate examinations for fiscal years 1987-91 shows that IRS has consistently increased CEP resources while resources spent for non-CEP corporate audits fluctuated.

Although all 4 CEP program results increased during the 5-year period, the 3 key CEP productivity measures--additional tax recommended per hour, direct examination hours per return, and additional tax recommended per return--have either remained steady or fluctuated. For non-CEP corporate audits, all productivity measures fluctuated.

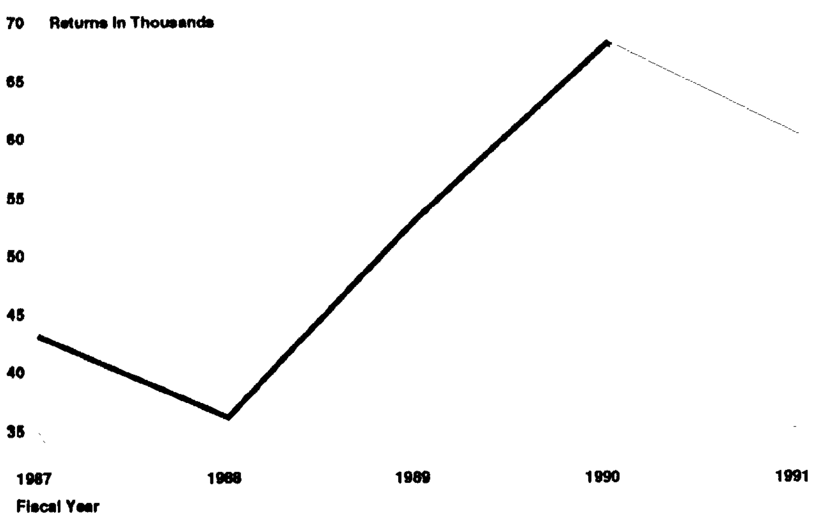
Number of Returns Examined

Figure II.1: Number of CEP Returns Examined



Source: IRS data.

Figure II.2: Number of Non-CEP Returns Examined



Source: IRS data.

NUMBER OF RETURNS EXAMINED

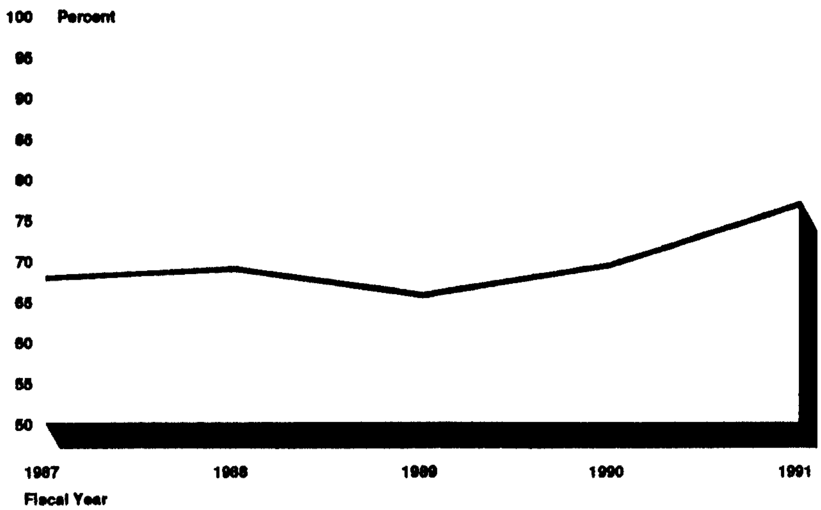
IRS structures its audits of CEP taxpayers as "cases." Each case usually includes tax returns from 2 or 3 years that are audited simultaneously; the audit time for a case is generally 2 to 3 years. Our analysis is based on the number of tax returns included in the CEP cases closed in fiscal years 1987 to 1991.

As shown in figure II.1, IRS closed examinations on 975 CEP returns in fiscal year 1987 and 1,209 in fiscal year 1991, a 24 percent increase. Over the 5-year period, IRS examined an average of 1,049 CEP returns per year.

The number of non-CEP returns examined showed greater variation, as indicated in table II.2. IRS examined 42,870 non-CEP corporate income tax returns in fiscal year 1987. Returns examined declined to a 5-year low of 35,954 in fiscal year 1988, peaked with 67,841 in fiscal year 1990, and moved to 60,169 in fiscal year 1991, a 40 percent increase over fiscal year 1987. The fiscal year 1990 figure reflects a peak because of TCMP activity.

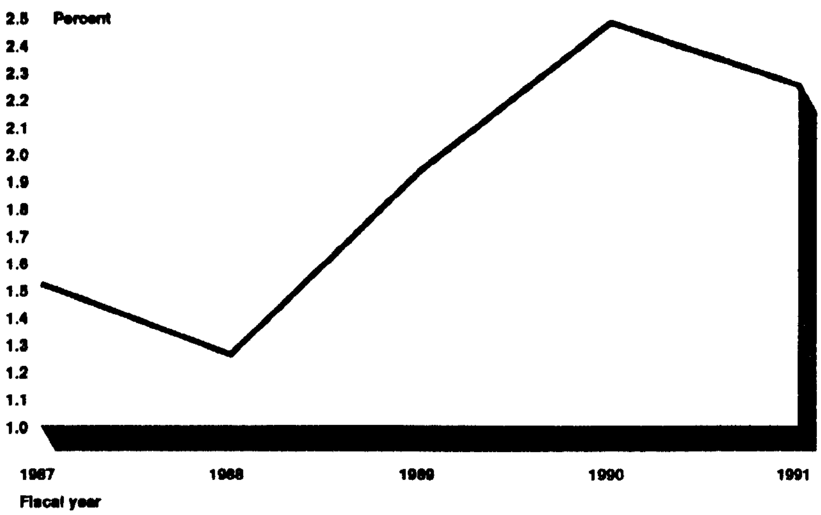
Audit Coverage

Figure II.3: Audit Coverage for CEP Corporate Income Tax Returns



Source: IRS data.

Figure II.4: Audit Coverage for Non-CEP Corporate Income Tax Returns



Source: IRS data.

AUDIT COVERAGE

On April 17, 1991, IRS' Commissioner testified that IRS audits virtually every CEP taxpayer every year. We found that IRS does not audit every CEP return, but IRS officials said they do carefully review a return's revenue potential before deciding to exclude it from audit.

Following IRS' method of calculating audit coverage for other tax classes,[1] we used the number of closed CEP primary tax return audits divided by the number of CEP returns filed the previous year to calculate audit coverage rates for fiscal years 1987 through 1991. As shown in figure II.3, audit coverage ranged between 66 and 69 percent for fiscal years 1987 through 1990 and increased to 77 percent in fiscal year 1991. Over that 5-year period, CEP taxpayers filed an average of about 1,540 primary tax returns and IRS closed examinations on an average of 1,050 returns per year.

IRS officials said they do not believe that audit coverage is a measure applicable to the CEP program. They acknowledged that IRS does not audit all CEP returns, but said that IRS excludes CEP returns from audit only after careful review of their revenue potential. Because all CEP returns are reviewed, if not audited, IRS officials said the agency's traditional method of calculating audit coverage is inappropriate for CEP.

As shown in figure II.4, audit coverage for non-CEP corporations fluctuated from 1987 to 1991, ranging from a low of 1.3 percent in fiscal year 1988 to a high of 2.5 percent in fiscal year 1990. IRS completed an average of about 52,000 examinations per year from fiscal years 1987 through 1991 from an average universe size of about 2.8 million corporate returns filed. IRS officials told us that audit coverage was higher in fiscal year 1990 because they were completing audits for the Taxpayer Compliance Measurement Program (TCMP)--a program for which IRS audits every line item on a random sample of tax returns. In other examination programs, including CEP, IRS audits only selected line items of selected returns.

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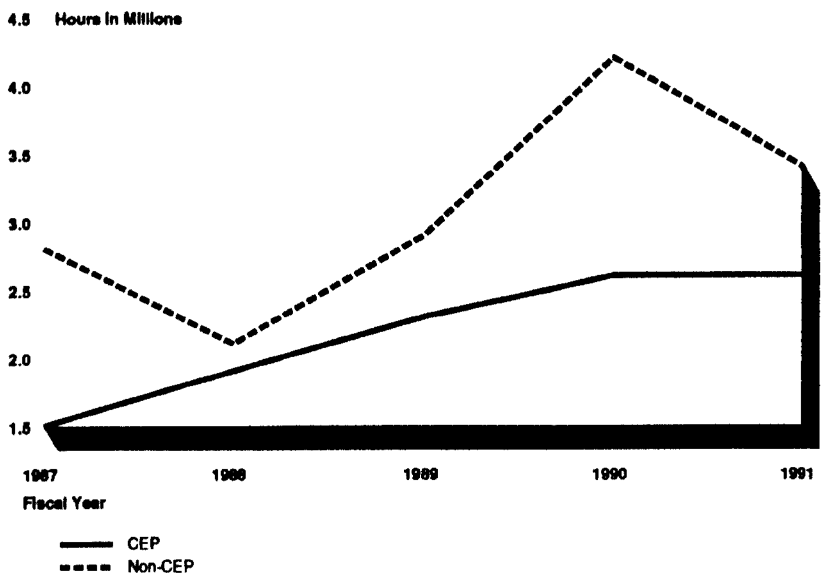
[1]A tax class is a grouping of returns on the basis of return type, such as individual or estate; source of income, such as farm or business; and level of income. Corporate tax classes are based on total assets.

Direct Examination Hours

Figure II.5: Direct Examination Hours for Audits of CEP and Non-CEP Corporate Income Tax Returns



Source: IRS data.

DIRECT EXAMINATION HOURS

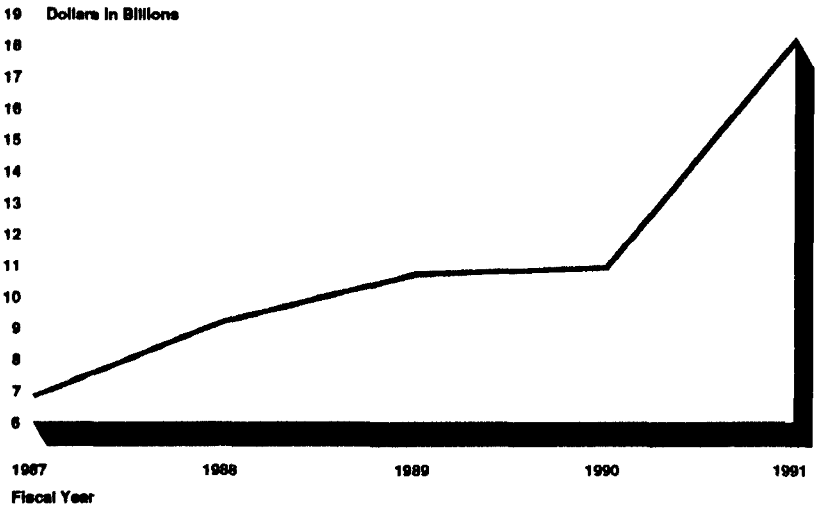
As shown in figure II.5, CEP direct examination hours increased steadily from fiscal year 1987 to fiscal year 1991. IRS devoted 2.6 million staff hours (or 1,313 staff years[2]) directly to examinations of CEP corporate income tax returns in fiscal year 1991, a 70 percent increase over 1987 when IRS used 1.5 million staff hours (772 staff years). Over the 5-year period, IRS devoted a yearly average of 2.2 million hours or 1,090 direct examination staff years to CEP audits. CEP direct examination hours accounted for 44 percent of all corporate examination hours in fiscal year 1991.

Direct examination hours for non-CEP corporate income tax returns increased by 24 percent during that period from 2.8 million hours (1,376 staff years) in fiscal year 1987 to 3.4 million hours (1,702 staff years) in fiscal year 1991. However, this was not a steady increase. As shown in figure II.4, non-CEP examinations hours reached a low of 2.1 million hours in fiscal year 1988 and a high of 4.2 million hours in fiscal year 1990. IRS officials said that TCMP-related audit activity accounted for the increase in fiscal year 1990.

[2]A direct examination staff year refers to a full staff year applied directly to the examination of tax returns by IRS' technical staff. It does not include time for training, leave, or managers. There are between 2,000 and 2,016 direct examination hours per direct examination staff year.

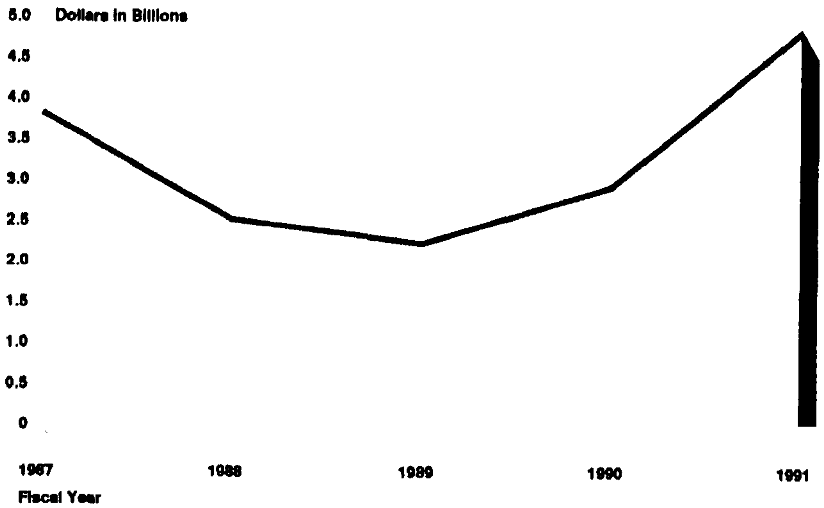
Additional Tax Recommended

Figure II.6: Additional Tax Recommended from CEP Audits



Source: IRS data.

Figure II.7: Additional Tax Recommended from Non-CEP Audits



Source: IRS data.

ADDITIONAL TAX RECOMMENDED

On the basis of examinations closed in fiscal year 1991, IRS revenue agents recommended that CEP taxpayers pay an additional $18.1 billion in corporate income tax[3]. $6.5 billion of that amount is from one large case. Including the one large case, recommended taxes increased by 167 percent over 1987; excluding the large case, recommended taxes increased by 71 percent. Recommended tax from audits of CEP returns accounted for 80 percent of tax recommended from audits of all corporate income tax returns in fiscal year 1991.

IRS will not collect all of the tax recommended. According to IRS, CEP taxpayers appeal 90 percent of all recommended tax. After the appeals process, IRS estimates that it will actually assess only about 25 percent of the recommended amount.

IRS recommended $3.8 billion in additional income tax for non-CEP corporations in fiscal year 1987, $2.9 billion in fiscal year 1990, and $4.8 billion in 1991.

According to IRS national and district office officials, CEP and non-CEP trends in tax revenues recommended are often affected by audits with abnormally high dollar adjustments which drive up recommendations in the year the audit is closed. For CEP, audit closures of the largest corporations are cyclical and occur about every 3 years. Thus, years before and after the closure of the abnormal audit appear to be less productive. The $6.5 billion case closed in fiscal year 1991 is an extreme example of one case distorting national trends.

Because of the 1986 Tax Reform Act, IRS expects a downward trend in recommended tax to occur when it begins closing CEP and non-CEP audits for tax years after 1985. The 1986 tax law changes decreased tax rates and eliminated significant tax deductions. Both factors should reduce the amount of tax recommended from audits.

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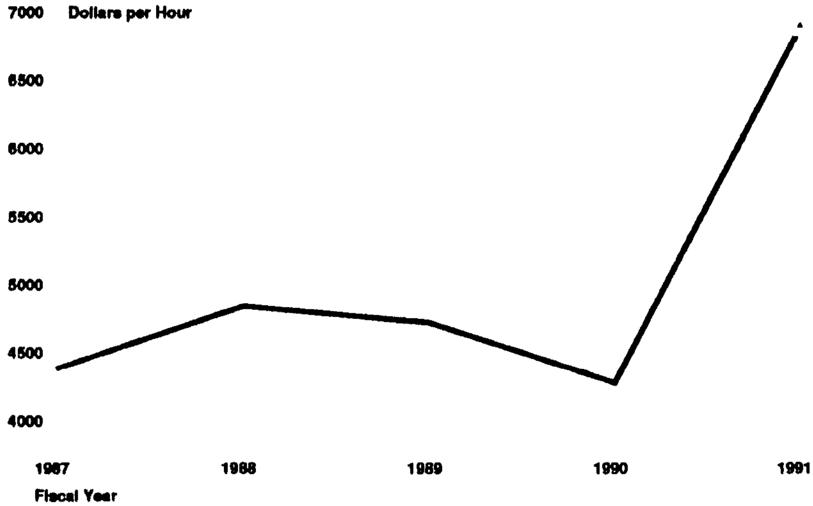
[3]At the close of an examination, IRS may also recommend a tax decrease (overassessment). In keeping with IRS' reporting practices, however, we are not offsetting the amount of recommended tax increases by the amount of recommended tax decreases because decreases account for a small percentage of recommended changes to tax. In fiscal year 1990 for example, IRS recommended $452 million in tax decreases, or 4 percent of the $10.9 billion tax increases recommended.

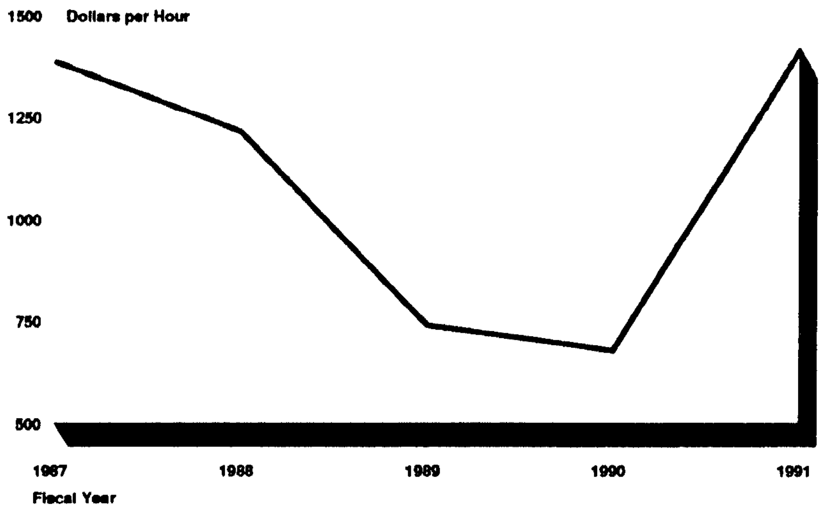
Additional Tax Recommended per Hour

Figure II.8: Additional Tax Recommended per CEP Direct Examination Hour



Source: IRS data.

Figure II.9: Additional Tax Recommended per Non-CEP Direct Examination Hour



Source: IRS data.

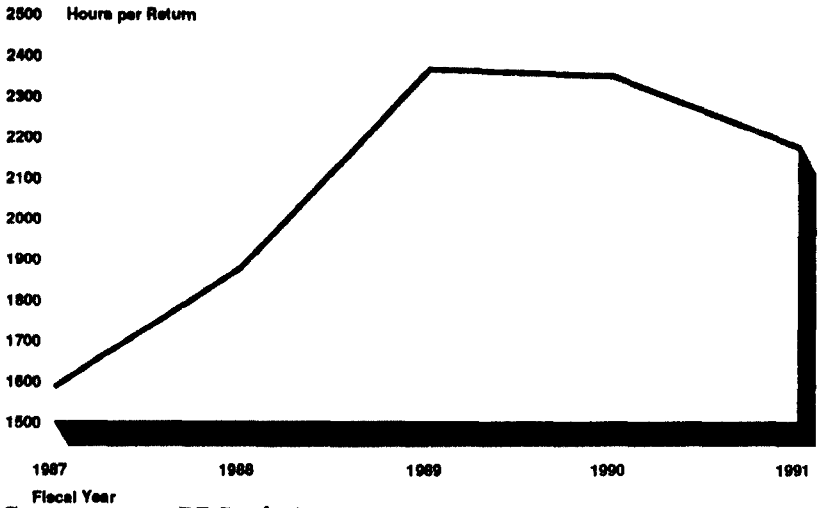
ADDITIONAL TAX RECOMMENDED PER HOUR

From fiscal year 1987 to 1990, productivity as measured by tax recommended per direct examination hour remained fairly constant for CEP examinations. In fiscal year 1987, IRS recommended $4,372 in additional tax per direct examination hour and in fiscal year 1990, $4,268 per hour. In fiscal year 1991, the measure jumped to $6,875 per hour because of the impact of one case worth $6.5 billion in recommended tax. Excluding that case, however, CEP produced $4,460 per hour in fiscal year 1991--an amount that closely parallels recommended tax per hour for the previous four fiscal years.

For non-CEP returns, recommended tax per hour declined steadily from $1,385 per hour in fiscal year 1987 to $677 per hour in fiscal year 1990. The measure increased to a 5-year high of $1,409 per hour in fiscal year 1991. According to IRS officials, recommendations per hour were low in fiscal year 1990 because IRS completed a large number of TCMP audits that yielded only $108 per hour.

Direct Examination Hours per Return

Figure II.10: Direct Examination Hours per CEP Return



Source: IRS data.

Figure II.11: Direct Examination Hours per Non-CEP Return

Source; IRS data.

DIRECT EXAMINATION HOURS PER RETURN

IRS used 1,584 direct examination hours (about three quarters of a direct examination staff year) to complete a CEP primary tax return in fiscal year 1987. Examination hours per return increased to a high of 2,364 in fiscal year 1989 and declined to 2,172 hours (a little over one staff year) in fiscal year 1991.

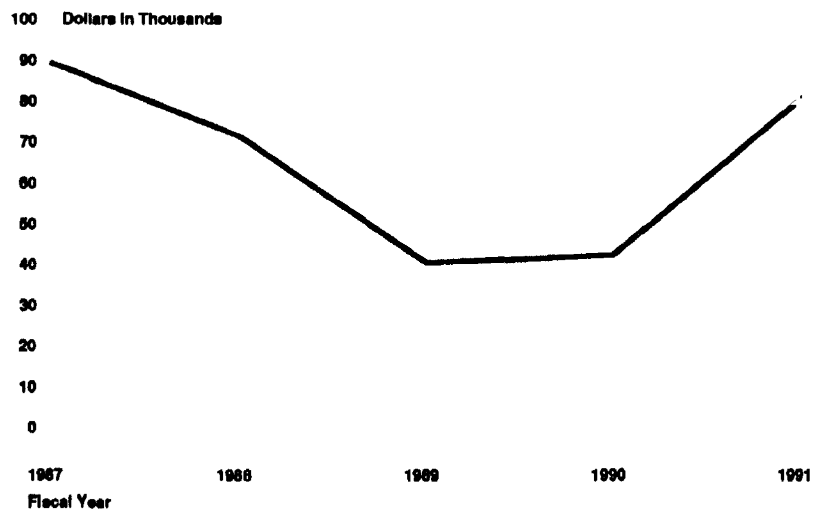
Hours per return also fluctuated for non-CEP corporate examinations. It took IRS 64 hours to complete a non-CEP corporate return in fiscal year 1987, 55 hours in fiscal year 1989, and 57 hours in fiscal year 1991.

Additional Tax Recommended per Return

Figure II.12: Additional Tax Recommended per CEP Return

Source: IRS data.

Figure II.13: Additional Tax Recommended per Non-CEP Return



Source: IRS data.

ADDITIONAL TAX RECOMMENDED PER RETURN

CEP examinations yielded $6.9 million per return in fiscal year 1987. Recommended tax per return increased to $11.1 million in fiscal year 1989, then declined to $10 million in fiscal year 1990. In fiscal year 1991, CEP produced $14.9 million in recommended tax per return including one large case worth $6.5 billion in recommended tax. Excluding that case, CEP audits yielded $9.5 million per return.

For non-CEP returns, tax recommended per return declined from about $89,000 in fiscal year 1987 to a low of about $40,000 in fiscal year 1989, and increased to about $80,000 in fiscal year 1991.

IRS COMMENTS

IRS Comments

IRS pleased with CEP and non-CEP trends

Initiatives underway to improve productivity

IRS COMMENTS

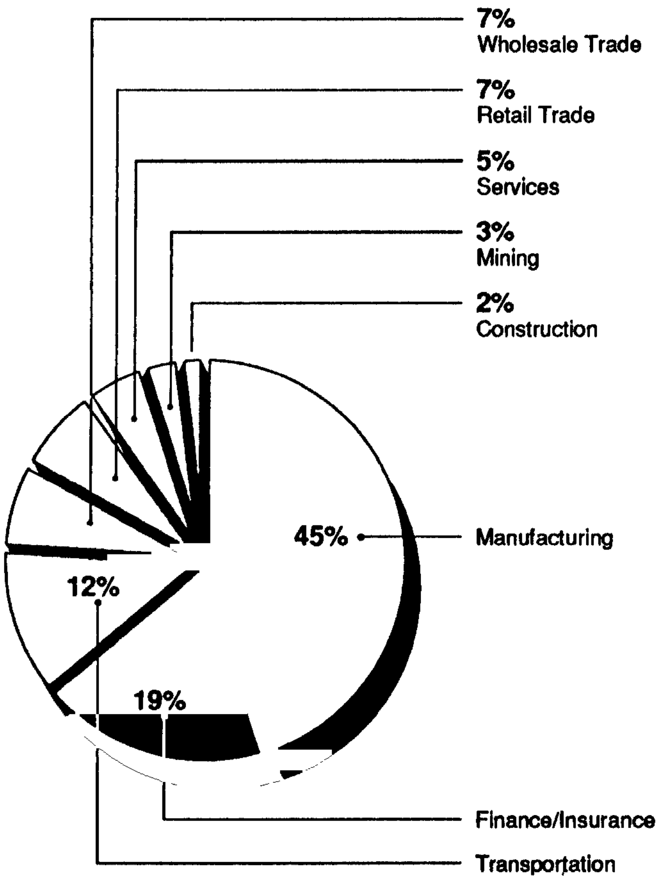
According to National Office CEP program officials, CEP examiners are currently productive and doing a very good job. IRS has initiatives underway that are targeted to improve the current level of performance. We will be reviewing the impact of these changes in the CEP program during the next phase of our work.

National Office officials knowledgeable about non-CEP examinations said that they are pleased with the trends in both tax recommended and examination hours, but continue to look for ways to achieve even greater improvements. IRS has projected a 3 percent productivity improvement for non-CEP examinations in fiscal year 1992, but expects that improvement to be offset to some extent by the impact of the Tax Reform Act of 1986.

PROFILE OF CEP TAXPAYERS

CEP Taxpayers by Type of Industry

Figure III.1: CEP Taxpayers by Type of Industry



Source: IRS data.

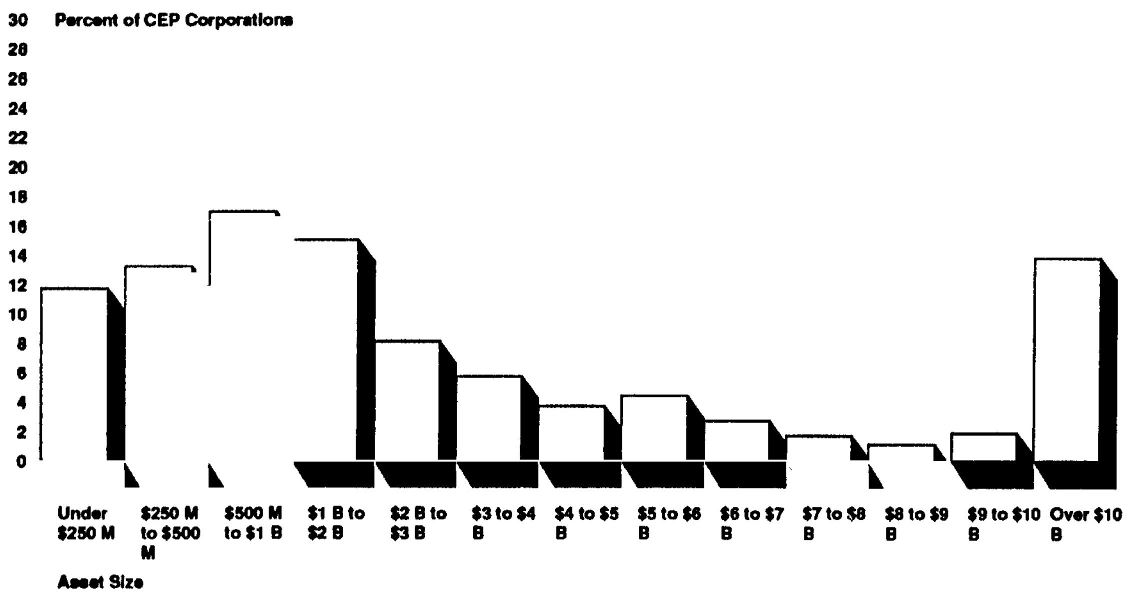
CEP TAXPAYERS BY TYPE OF INDUSTRY

To create a profile of CEP taxpayers, we matched a list of 1,672 taxpayers in the CEP program in May 1991 to records of 1988 corporate income tax returns from an IRS Statistics of Income Division data base. This data match resulted in usable records for 1,329 CEP taxpayers, or 80 percent of the May 1991 universe of CEP taxpayers. IRS officials told us that corporate mergers and acquisitions between 1988 and 1991 would account for much of the discrepancy. The data reported in this appendix are summaries based on tax return information from the 1,329 CEP corporations.

Most CEP taxpayers in our sample are in the following industries: manufacturing (45 percent), finance and insurance (19 percent), or transportation and public utilities (12 percent). Of the 596 corporations involved in manufacturing, the majority are in chemical (13 percent), electrical (12 percent), machinery (11 percent), food (9 percent), printing (6 percent), or petroleum (6 percent) related businesses. Of the 257 corporations in finance or insurance, the majority are in banking (42 percent) and insurance (31 percent) businesses. Of the transportation and public utility corporations, 56 percent are in electrical, gas, or sanitary services, 28 percent are in transportation businesses, and the remainder are in communication services.

CEP Corporations by Asset Size

Figure III.2: CEP Corporations by Asset Size



Source: IRS data.

CEP CORPORATIONS BY ASSET SIZE

CEP Corporations generally have assets greater than $250 million. In 1988, 12 percent of the CEP corporations in our sample reported assets less than $250 million while almost 60 percent reported assets greater than $1 billion. Twenty-six percent reported assets greater than $5 billion. The average asset size reported by all corporations in our sample is $6.5 billion. Figure III.2 shows CEP corporations by asset size as reported on their 1988 tax returns.

Income and Tax Reported

Table III.1: Income and Tax Reported by 1,329 CEP Corporations on 1988 Tax Returns

(Dollars in Millions)

	Total	Average	Minimum	Maximum
Total income	1,935,254	1,465	-3	52,050
Taxable income	237,779	179	0	8,693
Income tax	80,910	61	0	2,956
Net tax	55,342	42	0	1,426

Source: GAO analysis based on IRS data.

INCOME AND TAX REPORTED

The CEP corporations in our sample declared an average of about $1.5 billion in total income on their 1988 income tax returns. After deductions, they declared an average of $179 million in taxable income, with a range of $0 to $8.7 billion. The average net operating loss deduction across all returns was $12 million.

Income tax as reported on corporate income tax returns is the amount of tax owed based on taxable income. On their 1988 returns, CEP corporations in our sample reported an average income tax of about $61 million. The minimum income tax reported was $0, the maximum was $3 billion. After deducting tax credits and making other tax adjustments, CEP corporations owed an average net income tax of about $42 million--23 percent of reported taxable income.

Tax Credits

Table III.2: Tax Credits Claimed by 1,329 CEP Corporations on 1988 Income Tax Returns

(Dollars in Thousands)

Type of credit	Total	Average	Minimum	Maximum
Foreign tax	23,865,167	17,957	0	2,904,038
General business	4,181,462	3,146	0	363,149
Prior year minimum tax	294,585	222	0	27,399
Non-conventional fuel source	35,978	27	0	5,487
Orphan drug	5,192	4	0	2,390
Total credits	28,382,384	21,356	0	2,904,038

Source: GAO analysis based on IRS data.

TAX CREDITS

On their corporate income tax returns, corporations can take tax credits, or direct reductions in tax liability. The credits and reductions include taxes paid to foreign countries, production of orphan drugs, use of nonconventional fuel, payment of minimum taxes in the prior year, and other selected business expenses. Table III.2 shows the value of credits claimed by corporations in our sample.

The 1,329 CEP corporations in our sample took a grand total of $28 billion in tax credits on their 1988 tax returns, with an average of $21 million per corporation. The largest tax credit taken by CEP corporations was the foreign tax credit. For the corporations in our sample, the foreign tax credit amounted to a total of $24 billion, or about 85 percent of total credits, with an average of $18 million per corporation.

APPENDIX IV

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