



August 2013

CORPORATE TAX COMPLIANCE

IRS Should Determine Whether Its Streamlined Corporate Audit Process Is Meeting Its Goals

GAO Highlights

Highlights of [GAO-13-662](#), a report to congressional requesters

Why GAO Did This Study

IRS audits of the tax returns filed by large corporations take four years, on average, to complete. Additional years can be spent in appeals. This is costly to IRS and creates years of uncertainty about a large corporation's actual tax liability. In response, IRS developed CAP in 2005. Under this process, IRS and taxpayers agree on how to report tax issues before the return is filed: compliant and cooperative taxpayers can get a streamlined IRS review of their tax return in a phase called Compliance Maintenance. GAO was asked to assess this process. In this report, GAO (1) describes the goals and potential benefits of the process, (2) assesses IRS's efforts to determine whether these goals are met, (3) assesses IRS's readiness to move more taxpayers into Compliance Maintenance, and (4) describes IRS's efforts to coordinate the process with its existing compliance processes. GAO reviewed IRS documentation and data, interviewed IRS officials and corporate tax experts, and held focus groups with tax executives of large corporations and with IRS audit staff.

What GAO Recommends

GAO recommends that IRS evaluate the process, develop measures and targets for the goals, consistently capture data to track goal progress, track resolution of tax issues and resource savings, develop a plan to expand Compliance Maintenance, and verify that audit staff understand attempts to clarify related guidance. In written comments, IRS agreed with our recommendations.

View [GAO-13-662](#). For more information, contact James R. White at (202) 512-9110 or whitej@gao.gov.

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What GAO Found

Officials GAO interviewed inside and outside of the Internal Revenue Service (IRS) generally agreed on the potential major benefits of the Compliance Assurance Process (CAP) to taxpayers and IRS as reflected in its goals. These goals include saving IRS time and resources to use for other audits while ensuring compliance, and reducing taxpayer burden while increasing certainty on tax amounts now owed.

Contrary to its guidelines, IRS has not evaluated whether the goals are being achieved or the process should be expanded. IRS officials told GAO that IRS will start developing an evaluation plan in 2013, but did not provide dates for when an evaluation would be completed. IRS cannot show the extent to which the goals are being met for two reasons.

- Some goals do not have measures and none have targets. Although developing measures and setting targets for goals (such as ensuring taxpayer compliance) can be difficult, not doing so limits IRS's ability to determine whether the process is working as intended.
- IRS does not have consistent and complete data for CAP. Inconsistent data make some analyses difficult to do. For instance, the average annual staff hours spent auditing a return could not be analyzed because the code to track staff time charges sometimes included non-CAP time charges. Incomplete data did not allow IRS to track progress for some goals. While IRS audit teams document tax issues in case files, IRS does not compile the data to track issue resolution. As a result, IRS cannot readily determine whether audit teams are resolving issues uniformly or identifying emerging tax compliance issues. Similarly, IRS does not have a system to track resource savings. Without a system, IRS cannot know the amount of saved resources or plan for their reallocation.

IRS has been moving taxpayers into Compliance Maintenance without documenting a plan to ensure, among other things, that IRS has the capacity to assimilate these taxpayers in an expedited fashion, as intended. In addition, IRS audit staff had concerns about guidance on moving taxpayers in and out of this phase. IRS clarified the guidance in May 2013, but has not verified whether the audit staff understand it. Without verification, IRS does not have reasonable assurance that the audit staff understand which taxpayers are right for Compliance Maintenance and when it would be appropriate to remove them.

IRS is addressing difficulties in coordinating CAP with other compliance processes. Difficulties include resolving some complex tax issues within the expedited time frames, and ensuring that all IRS specialists who assist audit teams understand the process. It is too early to tell whether IRS's efforts will work.

Contents

Letter		1
	Background	3
	Significant Benefits Are Envisioned from CAP As Reflected in Its Goals	9
	IRS Has Not Evaluated Whether CAP Is Meeting Its Intended Goals, Has Not Established a Full Suite of Performance Measures and Targets, and Has Not Developed Consistent and Complete Data	12
	IRS's Readiness to Further Expand Compliance Maintenance Is Unclear	20
	CAP Taxpayers and Auditors Use IRS Compliance Processes in the Same Manner as Traditional Audits but Coordination Difficulties Exist	23
	Conclusions	25
	Recommendations for Executive Action	27
	Agency Comments and Our Evaluation	27
Appendix I	Objectives, Scope, and Methodology	30
Appendix II	Comments from the Internal Revenue Service	32
Appendix III	GAO Contact and Staff Acknowledgments	36
Related GAO Products		37
Tables		
	Table 1: Eligibility Criteria for Each Compliance Assurance Process (CAP) Phase	6
	Table 2: Not all Compliance Assurance Process (CAP) Goals Have Measures or Targets	13

Figures

Figure 1: Average Months Spent on Traditional Audits under Coordinated Industry Cases (CIC) and Industry Cases (IC) for Large Corporations before Appeals, Fiscal Year 2012	4
Figure 2: Number of Compliance Assurance Process (CAP) Taxpayers by Tax Year	7

Abbreviations

APA	Advance Pricing Agreement
APMA	Advance Pricing and Mutual Agreement
CAP	Compliance Assurance Process
CIC	Coordinated Industry Case
GPRA	Government Performance and Results Act
IC	Industry Case
IDR	Information Document Request
IMS	Issue Management System
IPG	Issue Practice Group
IRS	Internal Revenue Service
LB&I	Large Business and International
MOU	Memorandum of Understanding
RAS	Research, Analysis, and Statistics
SEC	Securities and Exchange Commission
TIGTA	Treasury Inspector General for Tax Administration
UTP	Uncertain Tax Position

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August 22, 2013

The Honorable Max Baucus
Chairman, Committee on Finance
United States Senate
The Honorable Dave Camp
Chairman, Committee on Ways and Means
House of Representatives

In fiscal year 2012, the Internal Revenue Service (IRS) collected about \$282 billion in gross federal income tax from corporations. To ensure compliance, IRS examines (audits) corporate tax returns of the largest corporations every year.¹ IRS views the continuous audits as necessary because the largest corporations regularly engage in complex business transactions for which determining the correct tax requires careful interpretation of the tax code. Through these audits, IRS proposed assessments of \$20.1 billion in additional tax in fiscal year 2012.²

While resulting in billions of dollars of additional tax assessed, traditional corporate audits usually start months or years after a tax return is filed and can take years to complete. Even after completion, more years usually elapse before appeals are resolved and final tax assessments are determined. For corporations, the traditional audit process leads to years of uncertainty about their actual tax liabilities, uncertainty that must be reflected on financial statements. For IRS, the process is costly and can result in delays in uncovering new types of transactions that evade or misinterpret the tax laws.

In an attempt to improve the traditional corporate audit process, IRS developed the Compliance Assurance Process (CAP) as a pilot program in 2005. Managed by IRS's Large Business and International Division (LB&I), IRS examiners and participating large corporations work to reach agreement on how to report tax issues before their tax returns are filed.

¹IRS defines large corporations as having assets greater than \$10 million. For purposes of this report, we will focus on the largest corporations which IRS defines as having assets of at least \$250 million.

²Taxpayers may appeal proposed assessments of additional tax amounts before any such amounts are actually assessed as owed.

To the extent CAP works as intended, taxpayers should achieve tax certainty sooner with less administrative burden compared to traditional post-filing audits, allowing taxpayers to better manage tax reserves and more precisely report earnings on financial statements.³ In addition, IRS intends for CAP to foster tax compliance while reducing its cost for corporate audits. IRS also intends that any resources saved, particularly in a streamlined review CAP phase known as Compliance Maintenance, be devoted to auditing other corporations, thereby increasing audit coverage.

You asked us to assess CAP. This report (1) describes the goals and potential benefits of CAP, (2) assesses IRS's efforts to determine whether CAP is meeting its goals, (3) assesses IRS's readiness to expand Compliance Maintenance, and (4) describes IRS's efforts to coordinate CAP with existing processes for large corporate compliance. To address these objectives, we reviewed IRS documentation, our prior work, and other relevant literature. We also assessed IRS's efforts on CAP with criteria in the Government Performance and Results Act (GPRA) of 1993,⁴ GPRA Modernization Act of 2010,⁵ and the *Standards for Internal Control in the Federal Government*.⁶ We attempted to replicate IRS's analysis of CAP and do separate analyses of CAP taxpayers. We interviewed IRS officials responsible for managing CAP and conducting exploratory CAP research. In addition, we interviewed 11 corporate tax experts, including former IRS officials who were familiar with or had experience with CAP. We held six focus groups with a total of 22 account coordinators who are the primary IRS representative for CAP audits,⁷ two focus groups with a total of 11 managers of IRS's Issue Practice Groups who are responsible for providing guidance and advice to CAP audit teams on resolving tax issues, and one focus group with 12 tax

³Corporations may set aside tax reserves for current, deferred, and potential or contingent tax liabilities.

⁴Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 (Aug. 3, 1993).

⁵GPRA Modernization Act of 2010, Pub. L. No. 111-352, 124 Stat. 3866 (Jan. 4, 2011).

⁶GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

⁷We selected account coordinators for our focus groups from an IRS list of account coordinators.

executives of large corporations to understand their experiences using CAP.⁸ For details on our scope and methodology, see appendix I.

We conducted this performance audit from July 2012 to August 2013 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

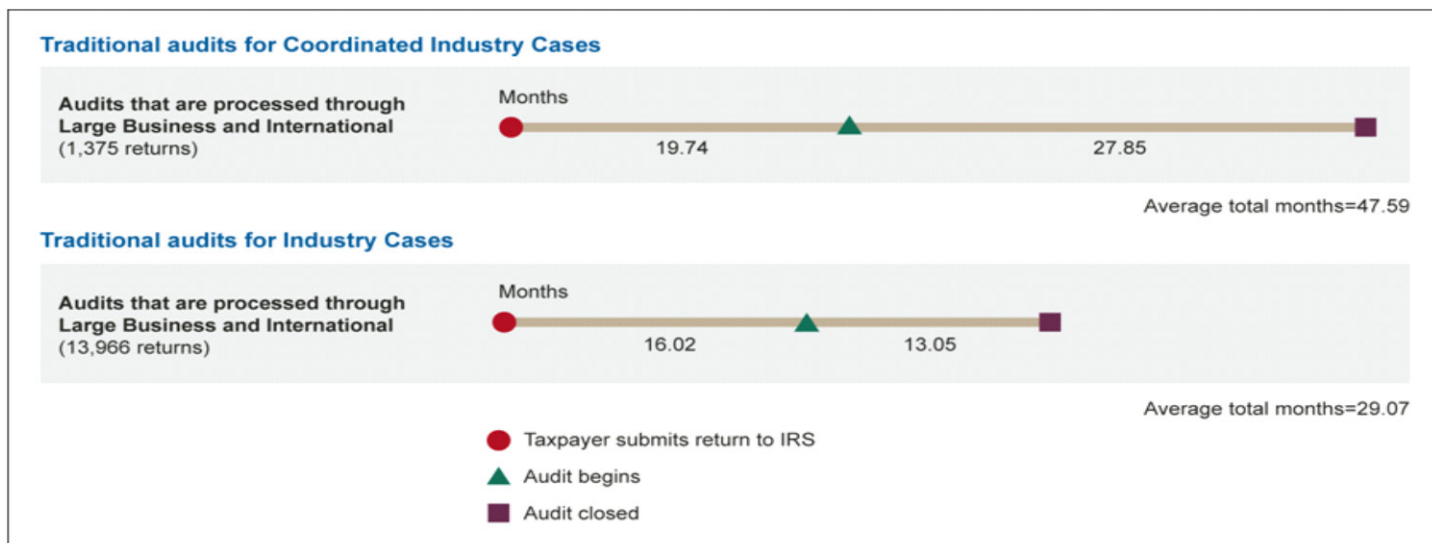
IRS has two categories of traditional audits for large corporations: Coordinated Industry Cases (CIC) and Industry Cases (IC). CAP includes both CICs and ICs, with the majority being CICs (about 88 percent). The distinction between CIC and IC is based on criteria such as the amount of gross assets, amount of gross receipts, number of operating entities, multiple industry status, total foreign asset amounts, and amount of foreign taxes paid. All corporations that are designated as CICs are audited every year by a team of IRS staff while corporations that are designated as ICs are not held to the same requirement.

Before IRS created CAP, large corporations waited about 50 months on average from the time a tax return was filed to IRS closing of the traditional audit under CIC. This did not include additional time after the audits were closed to resolve any appeals of the audit results—a process that usually took another 2 or 3 years. Therefore, obtaining certainty about the status of tax issues reported on the tax return for a given tax year may have taken 6 or 7 years—if not longer. This created significant burdens and problems for taxpayers and IRS. As already noted, taxpayers had to reflect uncertainty about their tax liability on their financial statements. This meant that taxpayers had to put aside reserves in a provisional account meant for changes in taxes owed after an audit. Large corporation tax officials we spoke to said that when corporations have a large reserve, it lowers their expected profits. In addition, IRS might not become aware of emerging tax issues associated with new

⁸Because the focus groups included non-probability selections of managers and coordinators, the results cannot be used to make inferences about the populations.

types of business transactions or products for years. Traditional audits of large corporations still take years, as shown in figure 1.

Figure 1: Average Months Spent on Traditional Audits under Coordinated Industry Cases (CIC) and Industry Cases (IC) for Large Corporations before Appeals, Fiscal Year 2012



Source: GAO analysis of IRS data.

Note: Figure 1 does not include the number of months and associated returns that are appealed after traditional audits are closed. IRS provided such a number for all Large Business and International audits, including Compliance Assurance Process and traditional audits. In fiscal year 2012, the average number of months to finish appeals after taxpayers filed their return was 83.6 months for CICs and 50.9 months for ICs.

IRS launched CAP in March 2005 as a pilot program to assess its viability as an alternative approach to large corporate tax administration. For the pilot, IRS selected voluntary, corporate taxpayers based on factors including their working relationship with IRS, a history of not taking aggressive tax positions, and not having major tax litigation under way.

IRS created pre-filing and post-filing stages for CAP. In pre-filing, a taxpayer works with the CAP team to resolve issues of tax controversy and to determine the appropriate tax treatment of completed transactions before filing the tax return. CAP requires contemporaneous exchange of information about a taxpayer's completed transactions and other events that may affect tax liability. In post-filing, the CAP audit team reviews the tax return to confirm adherence to agreements on how tax issues should be reported. In exchange for increased cooperation and transparency, the

taxpayer may attain tax certainty sooner and with less administrative burden, compared to traditional post-filing audits.

After 6 years of experience with the CAP pilot, IRS management decided to make CAP permanent in March 2011.⁹ IRS had received positive feedback from taxpayers and employees on the CAP pilot, indicating they wanted CAP to continue. Officials who had worked at IRS told us that IRS did exploratory research on the pilot's impacts on timeliness as well as on other areas.

In making CAP permanent, IRS created three phases by adding the Pre-CAP and Compliance Maintenance phases to the existing CAP phase. To avoid confusion, we will refer to the entire CAP program (all three phases) as CAP to distinguish it from the CAP phase defined below.

Pre-CAP phase: To enter CAP, all audits for prior tax years must be resolved. The large corporate taxpayer and IRS work together in the traditional post-file audit process to close audits of tax returns filed for previous tax years within agreed upon time frames. Closing these audits can take significant time if, as suggested by figure 1, audits are open for many tax years.

CAP phase: The large corporate taxpayer and IRS work to identify tax issues and resolve how they are to be reported for the current tax year in the pre-filing stage. IRS then confirms these issues are reported as agreed upon during the post-filing review.

Compliance Maintenance phase: Large corporate taxpayers who continue to meet the CAP phase eligibility requirements and expectations may progress to Compliance Maintenance after at least 1 year in the CAP phase. Taxpayers must continue to be compliant and transparent in filing tax returns and pose no new tax compliance risks. IRS intends to spend less time examining these returns when filed as well as significantly reducing the scope and depth of the pre-filing review. IRS's guidance explains that the criteria for considering a taxpayer for Compliance Maintenance include the complexity and number of issues, and the taxpayer's history of CAP compliance, cooperation, and transparency.

⁹IRS made CAP permanent in March 2011, applying to taxable years after December 31, 2011.

Taxpayers are expected to continue disclosing completed business transactions, information on material items and issues that occur during the CAP year, and their proposed tax positions on these disclosed items. The Internal Revenue Manual states that taxpayers can be removed from Compliance Maintenance depending on the complexity, number of issues, or other factors.

Not every large corporation is eligible for CAP. Table 1 shows the criteria for each phase.

Table 1: Eligibility Criteria for Each Compliance Assurance Process (CAP) Phase^a

Pre-CAP phase	<ul style="list-style-type: none"> • Assets of \$10 million or more. • If publicly-held, has complied with legal requirements to submit Form 10K, 10Q, 8K, or 20F to the Securities and Exchange Commission or other regulatory body.^a • If privately held, must agree to provide certified, audited financial statement or equivalent on a quarterly basis. • Not under investigation by or in litigation with IRS or other federal or state agencies that would limit access to tax records.
CAP phase	<ul style="list-style-type: none"> • Same as Pre-CAP, and • If under examination, taxpayer can have no more than one filed return that has not been closed and one unfiled return for the year most recently ended, the return for which is not yet due.
Compliance Maintenance phase	<ul style="list-style-type: none"> • Taxpayer maintains honest communication with CAP team and consistency in tax department personnel. • Taxpayer fully discloses all material and significant transactions. • Taxpayer has good internal controls. • Historically, taxpayer has low risk transactions and limited controversy. • Taxpayer has minimal noncomplex issues anticipated for the CAP year (meaning no major new transactions for the coming year).

Source: GAO analysis of IRS documents.

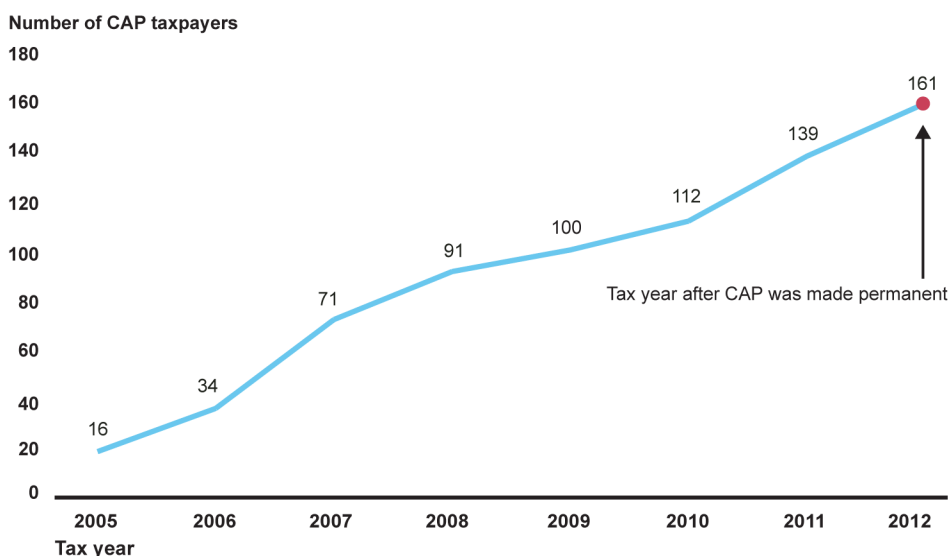
^aThe federal securities laws require publicly traded companies to disclose information to the Securities and Exchange Commission (SEC) on an ongoing basis. Domestic issuers must submit annual reports on Form 10-K and quarterly reports on Form 10-Q. The annual report on Form 10-K provides a comprehensive overview of the company's business and financial condition and includes audited financial statements. Form 8-K is the current report companies must file with the SEC to announce major events that shareholders should know about. Form 20-F is for foreign companies.

Taxpayers must sign a memorandum of understanding (MOU) that outlines their agreement to meet the CAP requirements. For Pre-CAP, the MOU will be effective for the first Pre-CAP year and continue until audits of tax returns for all transition years are closed and the CAP phase selection criteria are fulfilled. For the CAP phase, the MOU applies to a single tax year known as the CAP year. For Compliance Maintenance, the CAP phase MOU is used. To continue in the CAP and Compliance

Maintenance phases, taxpayers must reapply and execute a new MOU for each CAP year.

Of about 60,000 large corporate taxpayers considered for audit in fiscal year 2012, 161 were in CAP. Figure 2 shows the growth of CAP since its inception in 2005.

Figure 2: Number of Compliance Assurance Process (CAP) Taxpayers by Tax Year



Source: IRS.

CAP taxpayers work with team and account coordinators who serve as the primary IRS representative for all federal tax matters. In the Pre-CAP phase, taxpayers work with an assigned team coordinator; in the CAP phase or Compliance Maintenance phase, taxpayers work with an assigned account coordinator. Other IRS team members include IRS examiners, the team manager, the territory manager, and the Director of Field Operations, as well as various IRS specialists (as needed) who offer technical knowledge about tax issues and large corporations.

CAP work on a tax return may be concluded in one of three ways:

1. Full Acceptance Letter—IRS provides the taxpayer with a full acceptance letter if the pre-filing stage concludes with a taxpayer fully complying with the MOU and with resolutions of all identified items and issues through factual clarification, closing agreement(s), issue

resolution agreement(s), or a combination of these.¹⁰ The letter constitutes written confirmation that IRS will accept the taxpayer's return if it is filed consistent with those resolutions and no additional items or issues are discovered during the post-filing review that were not previously disclosed.

2. Partial Acceptance Letter—IRS provides the taxpayer with a partial acceptance letter if the pre-filing stage concludes with a taxpayer fully complying with the MOU, but IRS and the taxpayer cannot resolve all identified items or issues before the tax return is filed. The letter constitutes written confirmation that IRS will accept the taxpayer's return for the resolved items and issues if the post-filing review shows the return is filed consistent with the agreement(s).
3. Termination Letter—IRS can issue a termination letter at any time, which results in the case being withdrawn from CAP and transferred to a traditional post-filing examination. This can happen for several reasons, including the taxpayer:
 - not adhering to information document request (IDR)¹¹ response times, not responding to IDRs, or not providing complete IDR responses;
 - not engaging in meaningful or good-faith issue resolution discussions;
 - failing to thoroughly disclose prior, concurrent, and ongoing transactions;
 - failing to disclose a tax shelter or listed transaction;
 - failing to disclose an investigation or litigation that limits access by the IRS to current corporate records; or
 - not adhering to any other MOU commitment(s).

Two other new reporting requirements, one financial and one tax, have been introduced since the 2005 pilot and may reinforce CAP. The first, Financial Accounting Standards Board Interpretation Number 48, *Accounting for Uncertainty in Income Taxes*, implemented in June 2006, requires public and private corporations subject to the U.S. Generally Accepted Accounting Principles to disclose uncertain tax positions. Several of the tax experts we spoke to said this gives IRS an additional

¹⁰IRS drafts an issue resolution agreement for each item or issue that is resolved with the CAP taxpayers during the pre-filing stage, except for items or issues that are resolved through simple factual clarification.

¹¹According to the *Internal Revenue Manual 4.46.4*, IDRs are used by examination teams to gather information. The process is intended to encourage collaboration between the taxpayer and IRS to provide information needed to support an audit.

source for verifying the completeness of the disclosures that corporations make in the CAP phase. The second, *Schedule UTP, Uncertain Tax Position Statement*, has a similar disclosure purpose. IRS implemented it in 2010 as required reporting by taxpayers that have assets equaling or exceeding \$50 million.¹² Along with their tax returns, these taxpayers are to disclose information on the Schedule UTP about tax positions that may affect federal income tax liabilities or are included in audited financial statements. According to the August 2011 UTP guidance and procedures for CAP, CAP teams should compare the list of taxpayer disclosures made to them during the CAP year to the issues identified on the Schedule UTP to verify that the disclosures match.

Significant Benefits Are Envisioned from CAP As Reflected in Its Goals

IRS envisioned that CAP would yield significant benefits to participating taxpayers and IRS by resolving tax issues in a pre-filing environment. IRS's vision is reflected in the following seven CAP goals:

- ensure taxpayer compliance;
- reduce overall examination time;
- increase currency for taxpayers (e.g., working on the unfiled return for the most recent tax year during the CAP pre-filing stage);
- enhance the accurate, efficient, and timely resolution of complex tax issues;
- increase audit coverage by providing more efficient use of resources;
- reduce taxpayer administrative burden; and
- increase certainty for taxpayers.

IRS account coordinators for CAP cases, other IRS officials, and non-IRS officials (such as corporate tax experts and large corporation tax officials) told us what they believe the benefits of CAP are if its goals are achieved.¹³ Because the goals are not all mutually exclusive, some benefits can be perceived as relating to more than one goal.¹⁴

¹²For 2010 and 2011, taxpayers that had assets equaling or exceeding \$100 million were required to report uncertain tax positions on Schedule UTP. The asset threshold decreased from assets that equal or exceed \$100 million to assets that equal or exceed \$50 million for 2012.

¹³Examples we cited in this section were derived from interviews or focus groups with IRS and non-IRS officials.

¹⁴Those we interviewed did not point to benefits from reducing overall examination time.

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- **Ensure taxpayer compliance:** IRS and non-IRS officials indicated that compliance may be higher under CAP. Specifically, transactions disclosed by taxpayers in CAP may not have been disclosed or otherwise detected during traditional audits. For example, some account coordinators and large corporation tax officials who participated in our focus groups said that the risk of getting removed from CAP sometimes prompts large corporations to over-disclose issues and transactions.
 - **Increase currency for taxpayers:** IRS and non-IRS officials generally agreed that CAP increases currency. Some of the officials informed us that currency reduces taxpayers' cost to retrieve information as well as their interest expenses on unpaid tax liabilities. Currency means that the appropriate documents and corporate staff knowledgeable about a particular transaction are more likely to be available for consultation.
 - **Enhance the accurate, efficient, and timely resolution of complex tax issues:** IRS and non-IRS officials generally agreed that currency could also enhance the resolution of disputes over tax issues for the reasons given above. Having documents and responsible corporate staff available should make it easier for IRS to understand the tax implications of a transaction. In addition, a full or partial acceptance letter can speed the post-filing review of resolved issues.
 - **Increase audit coverage by providing more efficient use of IRS resources:** IRS and non-IRS officials generally agreed that CAP has the potential to reduce IRS resources spent auditing large corporations relative to what would have been spent on traditional audits. Some of the officials stated that most of the resource savings would occur in the Compliance Maintenance phase. Any resources saved through Compliance Maintenance could be reinvested in increasing the audit coverage of CAP and non-CAP taxpayers. As an example of resource savings, an account coordinator informed us that she was able to devote more time and resources to other audits because one of her taxpayers was in Compliance Maintenance.
 - **Reduce taxpayer administrative burden:** CAP taxpayers who participated in IRS's 2012 survey responded that they were satisfied that CAP had reduced their administrative burden compared to traditional post-file audits. While CAP may reduce taxpayer administrative burden over time, corporate tax experts indicated that CAP requires significant upfront investment from taxpayers because

all audits for prior tax years must be resolved.

- **Increase certainty for taxpayers:** IRS and non-IRS officials we spoke with generally agreed that CAP can increase the certainty that taxpayers have about their tax obligations when tax returns and financial statements are filed. They specifically emphasized the value to corporations of not having to maintain reserves for potential future tax liabilities. A corporate tax expert told us that certainty is so valuable to corporations that they may be willing to concede certain tax issues to achieve it. Increased certainty has other effects, such as making it less likely that state tax returns will need to be amended, which also saves time and resources.

Both IRS officials and corporate tax experts informed us that for CAP to achieve such benefits, taxpayers must be willing to disclose transactions to IRS. For this reason, transparency and communication are emphasized in the MOU. The corporate tax experts we interviewed readily acknowledged that not all large corporate taxpayers may be good candidates for CAP. As examples, they mentioned corporations that consistently take aggressive tax positions, have numerous complex transactions, or are unwilling to be cooperative and transparent with IRS.

IRS Has Not Evaluated Whether CAP Is Meeting Its Intended Goals, Has Not Established a Full Suite of Performance Measures and Targets, and Has Not Developed Consistent and Complete Data

Although CAP started 8 years ago and IRS is looking to further expand CAP, IRS has not evaluated CAP's effectiveness, whether its goals are being accomplished, or whether it should be expanded and if so, to what extent. The evidence in the preceding section about the benefits of CAP is based on viewpoints of those in our focus groups which cannot be generalized to the entire population of IRS and non-IRS officials. The Senate Committee on Appropriations, in June 2012, urged IRS to develop additional performance measures to evaluate the effectiveness of CAP.¹⁵ The Treasury Inspector General for Tax Administration (TIGTA) in February 2013 recommended that IRS develop an evaluation plan for CAP and IRS agreed to do so in responding to TIGTA's report.¹⁶ IRS officials stated in May 2013 that they will start to develop a plan for evaluating CAP during the fourth quarter of fiscal year 2013 but they did not state when the plan would be completed or the evaluation would be done.

IRS faces challenges in evaluating CAP. For example, it is not easy to measure compliance by large corporations or concepts like certainty and administrative burden. IRS has attempted exploratory research on the impacts of CAP but these efforts were not conclusive. However, without evaluations of CAP or its expansion, IRS does not have a credible base of information for understanding the current effectiveness of CAP such as for saving resources or for making decisions about any future expansion of CAP.

IRS has guidelines for conducting program evaluations that could be applied to CAP.¹⁷ According to the guidelines, a program evaluation attempts to provide accurate, objective, and trustworthy information about program performance and to help assess the quality or value of a program. Conducting a program evaluation can help answer questions decision makers have about the basic reasons the program exists and the continuing need for it. The guidelines also allow for evaluating the costs and benefits of continuing, revising, or ending a program.

¹⁵S. Rep. No. 112-177, at 28 (June 14, 2012).

¹⁶TIGTA, *The Compliance Assurance Process Has Received Favorable Feedback, but Additional Analysis of Its Costs and Benefits Is Needed*, Reference Number 2013-30-021 (Washington, D.C.: Feb. 22, 2013).

¹⁷IRS, *Guidelines for Conducting Program Evaluations* (Washington, D.C.: May 2012).

IRS Has Created Some Performance Measures, but Has No Targets to Measure Progress Towards CAP Goals

The Government Performance and Results Act of 1993 (GPRA), as enhanced by the GPRA Modernization Act of 2010, requires agencies to set results-oriented goals, establish performance measures and related performance indicators with targets in meeting such goals,¹⁸ and report progress.¹⁹ Performance measures and targets are established so that actual results can be compared to planned performance or goals.

As shown in table 2 and discussed below, IRS cannot show the extent to which CAP goals are being met because some goals do not have measures and none have specific targets.

Table 2: Not All Compliance Assurance Process (CAP) Goals Have Measures or Targets

CAP goal	IRS measure	Target
Ensure taxpayer compliance	None	None
Reduce overall examination cycle time	Overall examination cycle time, although data are inconsistent	None
Increase currency for taxpayers	None	None
Enhance accurate, efficient, and timely resolution of complex tax issues	None	None
Increase audit coverage by providing more efficient use of resources	Partial—average staff hours for pre- and post-filing	None
Reduce taxpayer administrative burden	Partial—taxpayer satisfaction on burden of CAP compared to traditional audits	None
Increase certainty for taxpayers	Taxpayer assessment of extent to which certainty increased and percentage of full acceptance or no change letters	None

Source: GAO analysis of IRS data.

Note: Partial means that the measure does not fully address the goal.

¹⁸According to the GPRA Modernization Act of 2010, a performance indicator is a particular value or characteristic used to measure output or outcome, and common federal government performance indicators with quarterly targets are to be used in measuring or assessing, among other things, overall progress toward each federal government performance goal. GPRA Modernization Act of 2010, Pub. L. No. 111-352, 124 Stat. 3866, 3868-3871 (Jan. 4, 2011).

¹⁹Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 (Aug. 3, 1993). GPRA Modernization Act of 2010, Pub. L. No. 111-352, 124 Stat. 3866 (Jan. 4, 2011).

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- **Ensure taxpayer compliance:** IRS officials we interviewed said that, despite multiple attempts, they do not have measures or targets related to CAP taxpayer compliance because of the difficulty of measuring it. IRS has directly measured compliance for different groups of taxpayers in the past, such as through audits of randomly-selected taxpayers. IRS has not used this approach with large corporations because it may be a burden both for IRS and taxpayers.

An alternative to measuring the direct impact of CAP on compliance is the use of proxy measures.²⁰ During the pilot as well as after making CAP permanent, IRS tried various approaches to measure a proxy for compliance in paying taxes owed, such as the taxes paid before and after audit by CAP taxpayers compared to non-CAP taxpayers. One approach attempted to create peer groups for CAP taxpayers to compare taxes paid by CAP taxpayers with those paid by non-CAP peers. Another approach explored ways to estimate the impact of CAP on effective tax rates. However, the results were not conclusive because of the challenges of controlling for other factors that could affect taxes paid.²¹ IRS has not researched the potential use of another proxy measure for compliance: using the results from measuring the quality of work by CAP teams to identify material tax issues and to develop support for how these issues should be reported on tax returns. Without compliance measures or related proxy measures and accompanying targets, it will be difficult for Congress and IRS to know whether CAP is meeting its goal for ensuring taxpayer compliance.

- **Reduce overall examination cycle time:** IRS has defined a measure for this goal but its related data are inconsistent. This measure combines IRS's traditional cycle time metric—the number of months or years it takes to close an audit after a tax return is filed—with the number of months for pre-filing work. Measuring the pre-filing time could provide insights on whether a taxpayer is a good candidate for CAP. For example, a long pre-filing period could be an indicator of

²⁰A proxy measure is an attempt to indirectly measure a variable that is difficult to directly measure. GAO, *Informing Our Nation: Improving How to Understand and Assess the USA's Position and Progress*, GAO-05-1 (Washington, D.C.: Nov. 10, 2004).

²¹The IRS research completed to date has not used data that reflect the factors that IRS uses to select corporations for CAP; this omission could affect the results as well as whether the results can be generalized to potential CAP participants.

complex tax issues or delays in providing information to IRS. However, as discussed in the next section, we found inconsistencies in the CAP data for use in measuring this goal. In particular, we could not resolve inconsistencies in the reporting of cycle time data by different sources.

- **Increase currency for taxpayers:** LB&I has data on currency for all CIC audits, but it has not broken out currency data for CAP pre-filing work or post-filing audits. IRS officials stated that they believe that all CAP cases are current (which could be a CAP target). However, they had no measures for either the pre-filing or post-filing stages or related targets.
- **Enhance the accurate, efficient, and timely resolution of complex tax issues:** IRS does not have a measure or target for this goal. IRS knows that CAP taxpayers are satisfied with their issue resolutions. According to IRS's 2012 taxpayer satisfaction survey,²² 80 percent of the CAP respondents were satisfied with issue resolution in CAP.²³ It is useful to know how taxpayers feel about issue resolution; however, IRS does not have a system to track issues that are being audited and resolved to provide data to help assess the goal. For example, IRS does not track whether the same issues repeat year after year or whether IRS and the CAP taxpayer agreed on a method to be used to resolve the issue in future tax years. Having such tracking to measure success in meeting this issue resolution goal could reduce the costs of future audits.
- **Increase audit coverage by providing more efficient use of resources:** IRS partially measures this goal by tracking certain CAP resources spent, such as the average staff hours for pre-filing and post-filing activities, but does not measure whether any savings are used to increase audit coverage.

²²Pacific Consulting Group, Internal Revenue Service Taxpayer Satisfaction Survey: *Large Business and International (LB&I), Compliance Assurance Process (CAP) Taxpayer Satisfaction Report Covering 2012* (November 2012). Taxpayers who were in CAP for the 2012 tax year were surveyed.

²³In terms of how significant issues were resolved, 82 percent of CAP respondents were "somewhat" or "very satisfied" with resolutions before filing their return and 80 percent were "somewhat" or "very satisfied" with resolutions after filing their return.

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- **Reduce taxpayer administrative burden:** IRS partially measured this goal through its 2012 customer satisfaction survey to determine whether CAP taxpayers believed that the administrative burden had decreased. However, IRS does not have a measure of the actual burden on CAP taxpayers because it has not been able to identify how to capture taxpayer burden (other than relying on survey responses). IRS has been attempting to more directly measure how CAP affects taxpayer burden but has faced challenges. In 2013, IRS's Research, Analysis, and Statistics (RAS) division analyzed whether CAP taxpayers were less likely to use outside tax preparation services. While RAS concluded that payments for such services were significantly lower for corporations that had been in CAP for at least a year, this result might indicate that CAP corporations choose to use more in-house staff and fewer outside experts for work related to taxes rather than from being in CAP. RAS also analyzed responses to its tax year 2009 tax compliance cost survey to compare compliance costs for CAP and non-CAP corporations while controlling for other factors that might influence the costs. The results of this analysis were inconclusive.
 - **Increase certainty for taxpayers:** IRS relies on its customer satisfaction survey to measure whether taxpayer certainty has increased. In its 2012 survey, 90 percent of CAP respondents said that tax certainty has increased "somewhat" or "a lot" for their corporations. In addition, an IRS official informed us in June 2013 that IRS has begun to use data it has been collecting on the percentage of taxpayers that are issued full acceptance or no change letters by tax and fiscal years to reflect certainty.

IRS officials stated that the measures being used for CAP, such as cycle time, staff hours, and taxpayer satisfaction, are derived from the traditional LB&I balanced measures related to business results and customer satisfaction for all of its audits. These traditional balanced measures do not directly link to all CAP goals.

According to an IRS official, IRS has not identified targets for any of its CAP measures because it does not traditionally set official targets for pilot programs. The official informed us in July 2013 that IRS is developing targets, which may be in place by the start of fiscal year 2014 pending approval by LB&I leadership. Even if IRS implements targets, IRS does not have an objective basis for determining whether CAP is effective because some goals do not have measures.

IRS Does Not Have Consistent and Complete Data for CAP

To implement a performance measurement system, it is necessary to collect the right data and ensure its accuracy. *Standards for Internal Control in the Federal Government* calls for a variety of control activities for data being collected to help ensure that actions are taken to reduce risk.²⁴ Even though some CAP measures exist, the IRS data being collected are not consistent or complete to use in determining whether the CAP goals are met.

Such inconsistencies arise in part from data collection processes. An IRS official indicated that data used by IRS to manage CAP are manually transferred from multiple databases into an excel spreadsheet. Without controls or documentation to ensure and validate their consistency, we could not be assured of the validity and accuracy of the data that IRS uses to create the CAP report used by LB&I leadership. Furthermore, this limits the ability to do analyses, such as:

- measuring the average hours spent to close a tax return and staff time charges for a tax year by pre-filing and post-filing activities. Specifically, tracking staff time charges on pre-filing activities for CAP could not be done because the code used by IRS to track some charges also included non-CAP activities; doing an analysis of CAP time charges would help determine whether CAP saves resources compared to traditional audits.
- comparing taxpayer's returns filed before and after they entered CAP to analyze any similarities and differences, accounting for when taxpayers entered CAP and moved from the Pre-CAP phase to the CAP phase. Doing an analysis may help IRS determine whether the right taxpayers are in CAP.
- replicating IRS management reports and TIGTA data tables on the total number of CAP taxpayers, using taxpayer identification numbers, tax years, and form types.
- reconciling differences in the reported number of months for cycle time. An IRS official provided a report used by LB&I leadership involved with CAP showing that the average cycle time for closed CAP audits is about 20 months for both pre-filing and post-filing work,

²⁴GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

with more than half of this time spent on post-filing work rather than pre-filing work. However, TIGTA reported average cycle time for closed audits to be about 24 months with more than half of this time spent on pre-filing work rather than post-filing (over 15 months and about 8.5 months, respectively).²⁵

IRS's Issue Management System (IMS)²⁶ has a field for the type of issues audited, but IRS officials said that they did not have assurance that the issue data were consistent and complete. When CAP audit teams entered issue data into IMS, IRS did not know whether the teams were consistently selecting the proper issue codes. IRS officials indicated that entering the issue into IMS can be a significant burden because IRS has tens of thousands of issue codes to consider and one issue can be associated with multiple codes from which to choose. Furthermore, IRS does not require this issue field to be completed and does not know whether CAP teams entered all issues audited. As a result, the risk increases that data are not consistent and complete. Thus, neither we nor IRS could determine the number, types, and dollar amounts of recommended tax changes for issues addressed in CAP.

In addition, data in CAP case files are not tracked and thus are not readily available to assess whether the issue resolution goal is being met. IRS has not created a system to compile data from the issue resolution agreements between CAP teams and taxpayers to guide how issues are to be reported on tax returns when corporations file; instead, these agreements are kept in a case file for each CAP taxpayer. An IRS official agreed to attempt to start electronically tracking issues reported on issue resolution agreements and said in July 2013 that the mandatory entry of data from the issue resolution agreements into the IMS would be recommended to the LB&I Business Review Board in late July 2013.²⁷ Thus, the date and methodology for starting to track the issues resolved during pre-filing are not known. Even if implemented, the planned tracking

²⁵Analysis covered fiscal years 2007 through 2011. TIGTA, *The Compliance Assurance Process Has Received Favorable Feedback, but Additional Analysis of Its Costs and Benefits Is Needed*, Reference Number 2013-30-021 (Washington, D.C.: Feb. 22, 2013).

²⁶According to IRS, IMS is an automated tool that collects issue-based information on audits in a way that makes it available centrally for audit monitoring and strategy development.

²⁷The LB&I Business Review Board includes LB&I management and National Treasury Employees Union officials.

would not cover all other audited issues and whether they were resolved during post-filing. Without such CAP-wide data, it will be difficult for IRS to know whether it is resolving issues uniformly across CAP taxpayers for a current tax year or addressing the same complex tax issues year after year for a CAP taxpayer.

Even if IRS compiled and tracked data on all audited issues, whether or not resolved, IRS does not have a way to identify and track emerging tax issues. Compared to traditional audits, CAP could help identify new issues sooner for multiple CAP taxpayers because CAP occurs in real-time.²⁸ Without this tracking, IRS cannot readily determine how quickly new issues are identified or resolved in CAP. Thus, IRS could miss opportunities to detect new types of noncompliance earlier and to share the information IRS-wide. Account coordinators in our focus groups informed us they used an informal process to relay information on emerging issues, such as to the local office counsel, but the extent to which this information circulates across IRS is not known.

Similarly, as of May 2013, IRS was not tracking data on its CAP goal for resource savings to invest in increased audit coverage. Without the data on the savings and a related plan for using any savings to increase audit coverage, IRS cannot be assured that the saved resources are invested effectively on either CAP or non-CAP taxpayers with high compliance risks. IRS officials explained that a possible way to track the effect of the saved resources would be to count the number of cases that account coordinators work, expecting that some coordinators will be able to work non-CAP cases that would not have been worked.²⁹

²⁸These new tax issues may emerge from how CAP taxpayers interpreted the tax impacts from new laws or changes to the laws as well as from changes in the business environment and new products or activities. An example includes new tax credits such as for hiring new employees.

²⁹IRS provided summary information in June 2013 on the workload for 10 account coordinators working CAP cases in the Compliance Maintenance phase. However, the results only showed a very minor increase in the number of cases worked by account coordinators.

IRS's Readiness to Further Expand Compliance Maintenance Is Unclear

IRS has been moving taxpayers into the Compliance Maintenance phase. In this phase, IRS intends to save resources by streamlining its reviews of corporate tax returns. IRS expects that Compliance Maintenance will start generating resource savings in 2014. The number of taxpayers in Compliance Maintenance has increased from 10 in early fall 2012 to 44 as of June 2013.

Although Compliance Maintenance is growing, IRS has not assessed whether it is working as intended and has not developed a plan to expand it. Standards for program management state that specific desired outcomes or results should be conceptualized, defined, and documented in the planning process as part of a road map, along with the appropriate steps and time frames needed to achieve those results. The standard practices also call for assigning responsibility and accountability for ensuring the results of program activities.³⁰

Such a plan also could discuss how IRS will assimilate these taxpayers and ensure that IRS has the capacity to manage the increased workload within the expedited time frames envisioned for corporate taxpayers placed into Compliance Maintenance. Without such an assessment and plan to guide expansion, IRS will not know whether Compliance Maintenance will help meet CAP goals, such as reducing the resources devoted to pre- and post-filing, or increasing audit coverage while maintaining compliance.

The lack of a documented plan for expanding Compliance Maintenance could create risks for CAP in ensuring that this phase includes the right types of taxpayers. Our reviews of IRS documents and our focus groups held with account coordinators indicated that confusion exists about how IRS would monitor taxpayers in Compliance Maintenance and how it would remove taxpayers that no longer qualify. Account coordinators that we included in our focus groups expressed uncertainty over how IRS would monitor CAP taxpayers, given that some taxpayers could potentially "game" Compliance Maintenance because this phase requires a lighter review using less resources than the CAP phase. Account coordinators were also uncertain about the process and criteria for removing taxpayers when we spoke to them in March and April 2013. In

³⁰Project Management Institute, *The Standard for Program Management* (Newtown Square, PA: 2006).

addition, they told us that a taxpayer that had been accepted into Compliance Maintenance for tax year 2013 was expected to remain in Compliance Maintenance until all of the work was completed for that tax year, regardless of whether their circumstances changed (such as tax personnel changes in the taxpayer's business or discovery of new complex tax issues).

We brought the concerns from account coordinators that participated in our focus groups to the attention of IRS. In response, IRS management informed us that they revised their draft user guide for Compliance Maintenance at the end of May 2013 and clarified the process and criteria for moving taxpayers from Compliance Maintenance back to the CAP phase. An IRS official explained that moving a taxpayer out of Compliance Maintenance would require a serious compliance risk. According to the May 2013 draft user guide, taxpayers would remain in Compliance Maintenance for the entire pre-filing phase. If their compliance risk changes,³¹ such taxpayers will remain in Compliance Maintenance for that calendar year but may be moved back to the CAP phase in the next year. Additionally, a March 2013 notification letter to CAP taxpayers approved for Compliance Maintenance highlighted that if changes occurred (such as to transparency, cooperation, or tax return filing activity) IRS might revisit whether they should remain in Compliance Maintenance.

IRS has not yet verified whether these recent changes are uniformly understood by account coordinators and resolve their concerns, which they shared in our focus groups during March and April 2013. At the end of June 2013, IRS indicated agreement that verifying the changes to the guidance may help address the account coordinators' concerns. Verifying that the changes it took resolved account coordinators' concerns could provide IRS with reasonable assurance that its staff are including the right types of taxpayers in Compliance Maintenance and are monitoring and removing them appropriately.

The potential savings from Compliance Maintenance relate to multiple CAP goals, such as increased audit coverage and taxpayer certainty, as well as reduced overall examination cycle time. CAP may not achieve its

³¹Events that may change risk include the number of high-risk and material transactions reported, breakdown in personnel relations, change in tax department personnel that significantly impacts timeliness of review, and taxpayer relocation.

intended goals if IRS does not have a clear plan or criteria for how it would expand Compliance Maintenance and monitor and ensure that the right taxpayers are in this phase.

CAP Taxpayers and Auditors Use IRS Compliance Processes in the Same Manner as Traditional Audits but Coordination Difficulties Exist

Regardless of whether taxpayers are in CAP, they have access to other existing IRS processes to help resolve tax issues with IRS. Examples include accelerated issue resolution,³² advance pricing agreements (APA) to help resolve transfer pricing issues,³³ Appeals,³⁴ early referral to Appeals,³⁵ fast track settlement,³⁶ industry issue resolution,³⁷ and settlement authority for coordinated issues.³⁸ For example, CAP taxpayers retain the same appeal rights as non-CAP taxpayers if they disagree with IRS's audit findings. As for IRS staff, both CAP and traditional audit teams can contact Issue Practice Groups (IPG) for technical advice on specific tax issues.³⁹ IPGs are designed to foster effective collaboration and sharing of knowledge and expertise across LB&I and Chief Counsel. In our focus groups, account coordinators that requested assistance from IPGs generally reported that IPGs responded

³²Accelerated issue resolution is an examination process to apply the resolution of the same or similar issues arising for an examination of an LB&I taxpayer from one or more tax periods to other tax periods.

³³In advance of a taxable transaction, taxpayers voluntarily use APAs to help resolve transfer pricing issues in a cooperative manner with IRS and with countries that have a tax treaty with IRS. A transfer price is the price charged by one company for a product or service supplied to a related company, such as the price a parent corporation charges its wholly-owned subsidiary. Any company that has a related company with which it transacts business establishes transfer prices for those intercompany transactions.

³⁴Appeals is independent of any other IRS office and serves as an informal administrative forum for a taxpayer who disagrees with an IRS determination. Appeals provide a venue where disagreements concerning the application of tax law can be resolved on a fair and impartial basis for both the taxpayer and the government.

³⁵Early referral is an optional process to resolve cases faster through LB&I and Appeals working simultaneously. This process may be requested by any taxpayer. A taxpayer may request early referral for one or more unresolved issues.

³⁶Taxpayers can request the use of fast track settlement if they cannot resolve issues identified. For CAP, fast track can be used on an issue-by-issue basis during the pre-filing and post-filing periods. However, if a taxpayer elects to use fast track in pre-filing, it cannot be used for the same issue during the post-filing period.

³⁷The Industry Issue Resolution Program resolves frequently disputed or burdensome tax issues that affect a significant number of business taxpayers through the issuance of guidance.

³⁸Settlement authority covers coordinated issues with Appeals Settlement Guidelines. Settlement authority is available for these types of issues, regardless of the amount of the adjustment.

³⁹IRS has 15 IPGs for issues related to accounting, corporate issues, credits, and penalties, among others.

in a timely manner and prioritized their inquiry over non-CAP audits, even though IRS does not formally require that priority.

CAP's Expedited Time Frames Pose Coordination Difficulties for Some Tax Issues Which IRS Is Addressing

According to IRS account coordinators for CAP cases, other IRS officials, corporate tax experts, and large corporation tax officials that we interviewed or that participated in our focus groups, the expedited nature of a CAP audit has led to difficulties in coordinating IRS reviews of APAs and research credits—both take longer to complete than the pre-filing time frame of CAP allows.⁴⁰ IRS has initiated some efforts to address such difficulties:

- For APAs, IRS highlighted in the 2013 CAP MOU that complex transfer pricing issues may require additional time beyond the typical CAP time frame to reach an agreement and consequently, could result in a partial acceptance letter. The MOU also states that the account coordinator is responsible for contacting the appropriate Advance Pricing and Mutual Agreement (APMA) Team to ensure ongoing coordination between the CAP and APMA programs.
- For research credits, IRS implemented the General Business Credits IPG, which consists of IRS's technical experts on corporate tax credit issues, to provide assistance in reaching a resolution.

As mentioned previously, IRS does not systematically track tax issues for CAP in a centralized manner. To the extent IRS begins tracking how long it takes to audit and resolve specific tax issues, IRS would have data to assess the effectiveness of these efforts to better coordinate CAP with APAs and research credit claims.

⁴⁰Research credits allow taxpayers to claim tax credits in the amounts they paid for supplies used when conducting qualified research. Clarifying the type of supplies that qualify for the credit can be very difficult.

IRS Is Working to Ensure CAP's Culture of Cooperation and Transparency Is Understood Throughout IRS

IRS and non-IRS officials highlighted the need for IRS specialists to better understand the cooperative and transparent culture necessary for CAP to succeed. For example, in IRS's 2012 survey of taxpayers, the most frequently cited barriers to the CAP review process were the lack of training and urgency by specialists that CAP teams rely on for advice. Specifically, CAP taxpayers in the survey perceived a lack of urgency and cooperation by the specialists working on CAP audits. Moreover, account coordinators we included in our focus groups expressed some concerns that the need for cooperation between IRS and the taxpayer in the CAP environment had not been fully adopted by specialists throughout IRS.

Without a cooperative and transparent environment, CAP teams are hindered in coordinating with specialists, which may affect IRS's ability to achieve its goals. To address these concerns, IRS is acting on the following efforts to improve coordination with these IRS specialists:

- Joint training is being conducted on CAP to include all CAP team members, specialists, and taxpayers.
- Monthly meetings on CAP are being set up with the Tax Executives Institute, which represents the tax executives of large corporations, to discuss common concerns and practices, such as those with specialists.
- Procedures are being updated to help with transparency. For example, CAP teams, including specialists, must discuss IDRs with the taxpayer before they are filed.
- Work is being done to improve specialists' knowledge of the corporations whose audits they are involved in, as well as their methods of communication with such corporations.

IRS officials indicated that they have taken these actions to ensure that coordination has improved between taxpayers and CAP teams (including specialists), and to monitor whether taxpayer concerns about specialists have been addressed. However, it is too early to tell whether IRS's efforts will work.

Conclusions

CAP is an ambitious effort to improve tax audits of large corporations. It holds the promise of significant benefits for participating corporations in the form of increased certainty about tax liability and reduced administrative burden. It also has the potential to save IRS resources,

which could be reallocated to increase audit coverage. Attracted by these benefits, IRS has been expanding the number of taxpayers in CAP and the related Compliance Maintenance phase. However, despite several efforts, IRS has not succeeded at assessing whether or not CAP is achieving its goals. While anecdotal evidence indicates that CAP may be effective at ensuring compliance, increasing certainty, saving resources, and achieving other goals, a CAP-wide assessment could validate these results and help ensure that support for CAP, both inside and outside IRS, does not wane.

The lack of a CAP assessment is related to missing or incomplete performance measures, nonexistent targets for the CAP goals, and incomplete or inconsistent data. Without a full suite of measures and targets as well as appropriate data for program evaluation, fully assessing whether CAP is achieving its goals is not possible. The consequences of not establishing performance measures and not collecting the data needed to track performance can be significant. For example, one CAP goal is to resolve complex tax issues, but IRS does not track whether they are being resolved. As a result, IRS will not be able to tell whether CAP is dealing with disputes over the same issues year after year. Similarly, IRS does not track whether CAP is identifying emerging tax issues. Without such tracking, IRS cannot share information about emerging issues across IRS, creating a risk that some IRS audits might miss the issue or treat taxpayers inconsistently. For its goal on increasing audit coverage by saving resources through CAP, IRS did not have a way to collect data on the resources saved. Without that data, IRS cannot readily plan for how any savings will be used to increase audit coverage.

Finally, without an assessment and plan for expansion, the rationale and pathway for expanding Compliance Maintenance are missing. In addition, the extent to which CAP staff understand how taxpayers are to be monitored and, if necessary, removed from Compliance Maintenance has not been verified. Absent a clear plan for expanding Compliance Maintenance and ensuring that account coordinators clearly understand guidance on monitoring and removing taxpayers, it will be difficult for IRS to provide reasonable assurance that Compliance Maintenance accepts the most compliant and cooperative corporate taxpayers, which is necessary for this phase to work as intended and to contribute to CAP goals, such as generating resource savings to increase audit coverage.

Recommendations for Executive Action

To ensure that IRS is meeting the stated goals of CAP, we recommend that the Principal Deputy Commissioner of Internal Revenue and Deputy Commissioner for Services and Enforcement take the following seven actions:

- Develop an evaluation plan for CAP, using IRS's guidelines for conducting program evaluations, that can
 - track progress against the goals, and
 - determine whether and how much to expand CAP.
- Develop measures for each CAP goal and set related targets.
- Consistently and completely capture data needed to track progress against the CAP goals.
- Track all CAP tax issues and at a minimum, identify
 - whether they are resolved or not resolved, and
 - whether any are new or emerging issues that should be shared IRS-wide.
- Track savings from Compliance Maintenance and CAP overall and develop a plan for reinvesting any savings.
- Develop a plan for expanding Compliance Maintenance.
- Verify that the updated guidance for Compliance Maintenance on monitoring and removing CAP taxpayers has resolved CAP staff concerns about how these tasks are to be accomplished.

Agency Comments and Our Evaluation

We provided a draft of this report to IRS for review and comment. The Acting Deputy Commissioner for Services and Enforcement at IRS provided written comments, which are reprinted in appendix II. IRS plans to implement all seven of our recommendations but was not clear on the extent to which its plans will fully address our first six recommendations, as highlighted below.

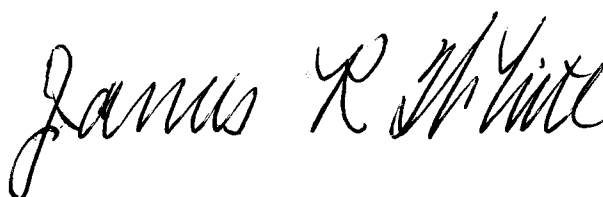
- For the first recommendation, IRS stated that it would develop and execute a program evaluation for CAP by June 30, 2014. However, IRS did not state whether the plan would track progress against goals and determine whether and how to expand CAP.
- For the second recommendation, IRS stated that it will develop a balanced measures scorecard for CAP, but it is unclear whether IRS intends to develop measures for each CAP goal and set related targets as part of this action.
- For the third recommendation, IRS stated that it will capture additional data points to track progress on the CAP goals, but did not indicate how it will ensure that the data are consistent and complete, accounting for problems we discussed in this report.

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- For the fourth recommendation, IRS stated that it will mandate use of the Issue Resolution Agreement tool to track CAP issues, but did not clarify how it will track CAP issues that were not resolved.
 - For the fifth recommendation, IRS stated that it will identify resource savings from CAP by June 30, 2014, but did not mention how it will develop a plan for reinvesting any savings.
 - For the sixth recommendation, IRS stated that it annually evaluates whether a CAP taxpayer should be included in the CAP Compliance Maintenance phase. However, IRS did not list actions it will take to develop a plan for expanding this phase. This report provides details on what a plan might cover (such as steps to be taken at certain times by specified parties to achieve desired results) as well as IRS's capacity to assimilate more CAP taxpayers and manage the workload within expedited time frames for this phase.

IRS also provided technical comments on the draft report, which we incorporated as appropriate.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the Chairmen and Ranking Members of other Senate and House committees and subcommittees that have appropriation, authorization, and oversight responsibilities for IRS. We are also sending copies of the report to the Principal Deputy Commissioner of Internal Revenue and Deputy Commissioner for Services and Enforcement, the Secretary of the Treasury, and other interested parties. In addition, this report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions or wish to discuss the material in this report further, please contact me at (202) 512-9110 or whitej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix III.

A handwritten signature in black ink that reads "James R. White". The signature is written in a cursive style with a large, stylized initial "J".

James R. White
Director, Tax Issues
Strategic Issues Team

Appendix I: Objectives, Scope, and Methodology

The objectives of this report were to (1) describe the goals and potential benefits of the Compliance Assurance Process (CAP), (2) assess the Internal Revenue Service's (IRS) efforts to determine whether CAP is meeting its goals, (3) assess IRS's readiness to expand Compliance Maintenance, and (4) describe IRS's efforts to coordinate CAP with existing processes for large corporate compliance.

To address these objectives, we reviewed IRS's strategic plan from 2009 to 2013, IRS's guidance for CAP and conducting program evaluations, a CAP management report, CAP research studies, results from IRS's 2012 CAP taxpayer survey, IRS documents pertaining to other compliance processes, our prior work on corporate audits and the tax gap, and other relevant literature. We also assessed IRS's efforts on CAP by comparing them with criteria in the Government Performance and Results Act (GPRA) of 1993, GPRA Modernization Act of 2010, and the *Standards for Internal Control in the Federal Government*. We also attempted to replicate analysis of IRS's data and tried to conduct our own analyses of CAP taxpayers but could not do so because of inconsistent data sources from multiple systems.

Further, we interviewed officials from IRS's Large Business and International Division, who were responsible for managing CAP; Research, Analysis, and Statistics Division, who were responsible for conducting exploratory CAP research studies; and the Treasury Inspector General for Tax Administration. In addition, we interviewed 11 corporate tax experts, including former IRS employees who were familiar with CAP or had some experience with CAP. We also conducted one focus group with tax executives of 12 large corporations to understand their experiences using CAP; six focus groups with 22 account coordinators responsible for being the primary IRS representative for CAP audits; and two focus groups with 11 managers of IRS's Issue Practice Groups responsible for providing guidance and advice to CAP teams on resolving complex tax issues. To select the 22 CAP account coordinators for our six focus groups, we received a list from IRS and drew a random sample to ensure a variety of independent viewpoints of those employees who work on different accounts in varied locations.¹

¹Results from nongeneralizable samples cannot be used to make inferences about a population.

We conducted this performance audit from July 2012 through August 2013 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Internal Revenue Service



DEPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

August 9, 2013

Mr. James R. White
Director, Tax Issues
Strategic Issues Team
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. White:

Thank you for the opportunity to review and provide comments on your draft report entitled, *Corporate Tax Compliance: IRS Should Determine Whether Its Streamlined Corporate Audit Process Is Meeting Its Goals*. We appreciate the considerable time the Audit Team spent assessing the benefits of the Compliance Assurance Process (CAP) Program and our efforts to meet the CAP goals, expand the Compliance Maintenance Phase, and coordinate our CAP efforts with other existing compliance processes to resolve complex tax issues.

As your report indicates, the CAP Program is an ambitious effort to improve tax audits of large corporations. Based on positive feedback from employees and taxpayers participating in the CAP pilot, the IRS made the CAP a permanent program effective March 31, 2012. The program provides significant benefits in terms of increased certainty about tax liability and reduces administrative burden, and it has the potential to save IRS resources, which can be used for other audits.

The Large Business and International Division has a full set of balanced measures for the CAP, which provides a framework for measuring the success of the program. These measures have been in place since the inception of the CAP pilot. In addition to using our in-place balanced measures, we will continue to develop strategic indicators to enhance our measures and ensure that the CAP does not erode compliance efforts. We will continue to collaborate with the Research, Analysis, and Statistics organization on developing innovative methods for gaining insights into the benefits of the CAP to taxpayers and IRS administration.

Your findings indicate that improvements are needed with respect to the assessment of CAP goals, performance measures, data capturing, identification of emerging issues, and program expansion and coordination with other compliance processes in place. We appreciate the audit recommendations and plan to implement them as described in the attached action plan.

2

We invite you to revisit this program in a year to evaluate our progress.

If you have any questions, please contact me, or a member of your staff may contact Deborah Palacheck, Acting Director, Pre-Filing and Technical Guidance at (202) 515-4748.

Sincerely,



Heather C. Maloy
Acting Deputy Commissioner for
Services and Enforcement

Enclosure

Enclosure

To ensure that IRS is meeting the stated goals of the CAP Program, GAO recommends that the Commissioner of Internal Revenue take the following seven actions.

RECOMMENDATION 1:

Develop an evaluation plan for CAP, using IRS's guidelines for conducting program evaluations that can: track progress against the goals; and, determine whether and how much to expand CAP.

MANAGEMENT RESPONSE:

The Large Business & International Division (LB&I) will develop and execute a program evaluation for CAP in accordance with our *Guidelines for Conducting Program Evaluations*. This will begin in Fiscal Year 2013, and a report will be issued by June 30, 2014.

RECOMMENDATION 2:

Develop measures for each CAP goal and set related targets.

MANAGEMENT RESPONSE:

LB&I will develop a Balanced Measures Scorecard for CAP in accordance with Internal Revenue Manual 1.5.1, The IRS Balanced Performance Measurement System.

RECOMMENDATION 3: Capture data needed to track progress against the CAP goals consistently and completely.

MANAGEMENT RESPONSE:

LB&I will capture additional data points for CAP on a monthly basis to track progress to ensure the goals of the program are fulfilled.

RECOMMENDATION 4:

Track all CAP tax issues and at a minimum, identify: whether they are resolved or not resolved; and, whether any are new or emerging issues that should be shared IRS wide.

2

MANAGEMENT RESPONSE:

We will make use of the Issue Resolution Agreement (IRA) tool in our Issue Management System (IMS) mandatory. We will also monitor issues on CAP cases and ensure that any new or emerging issues identified are shared appropriately.

RECOMMENDATION 5:

Track savings from Compliance Maintenance and CAP overall, and develop a plan for reinvesting any savings.

MANAGEMENT RESPONSE:

We will conduct an analysis of CAP cases to identify resource savings by June 30, 2014.

RECOMMENDATION 6:

Develop a plan for expanding Compliance Maintenance.

MANAGEMENT RESPONSE:

Annually, each CAP taxpayer is evaluated on a case-by-case basis for inclusion in the CAP Maintenance Phase. This is based on a number of factors including a history of transparency and cooperation in CAP, past tax return filings, and significant current year transactions.

RECOMMENDATION 7:

Verify that the updated guidance for Compliance Maintenance on monitoring and removing CAP taxpayers has resolved CAP staff concerns about how these tasks are to be accomplished.

MANAGEMENT RESPONSE:

We are updating our guidance on Compliance Maintenance. The updated guidance will address these concerns in a session with all Account Coordinators, which is planned by no later than January 30, 2014. The guidance will also be incorporated into future CAP training.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

James R. White, (202) 512-9110 or whitej@gao.gov

Staff Acknowledgments

In addition to the contact named above, Tom Short (Assistant Director); Ben Crawford; Sara Daleski; Amy Radovich; Susan Sato; Jehan Chase; Edward Nannenhorn; and Cynthia Saunders made key contributions to this report.

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Tax Policy: The Research Tax Credit's Design and Administration Can Be Improved. [GAO-10-136](#). Washington, D.C.: November 6, 2009.

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