



Electronic Tax Return Filing, Enterprise Data Structures and Tax Compliance Risk Assessment

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Introduction

- Electronic Filing Changes LMSB Risk Assessment
 - Allows Risk Assessment of Business Enterprise
 - As Opposed to Tax Return Filing Entity
- Enterprise Data Structures In Real Time
 - Using Open-Source XML and Object-Oriented Technologies
 - Programmatic Access to All Data and Structure of Data
 - Tax Returns, Financial Statements and Related Entities
- Opportunities
 - Tax Shelter Detection
 - Book-Tax Analysis
 - Simulation Modeling



LMSB Objective

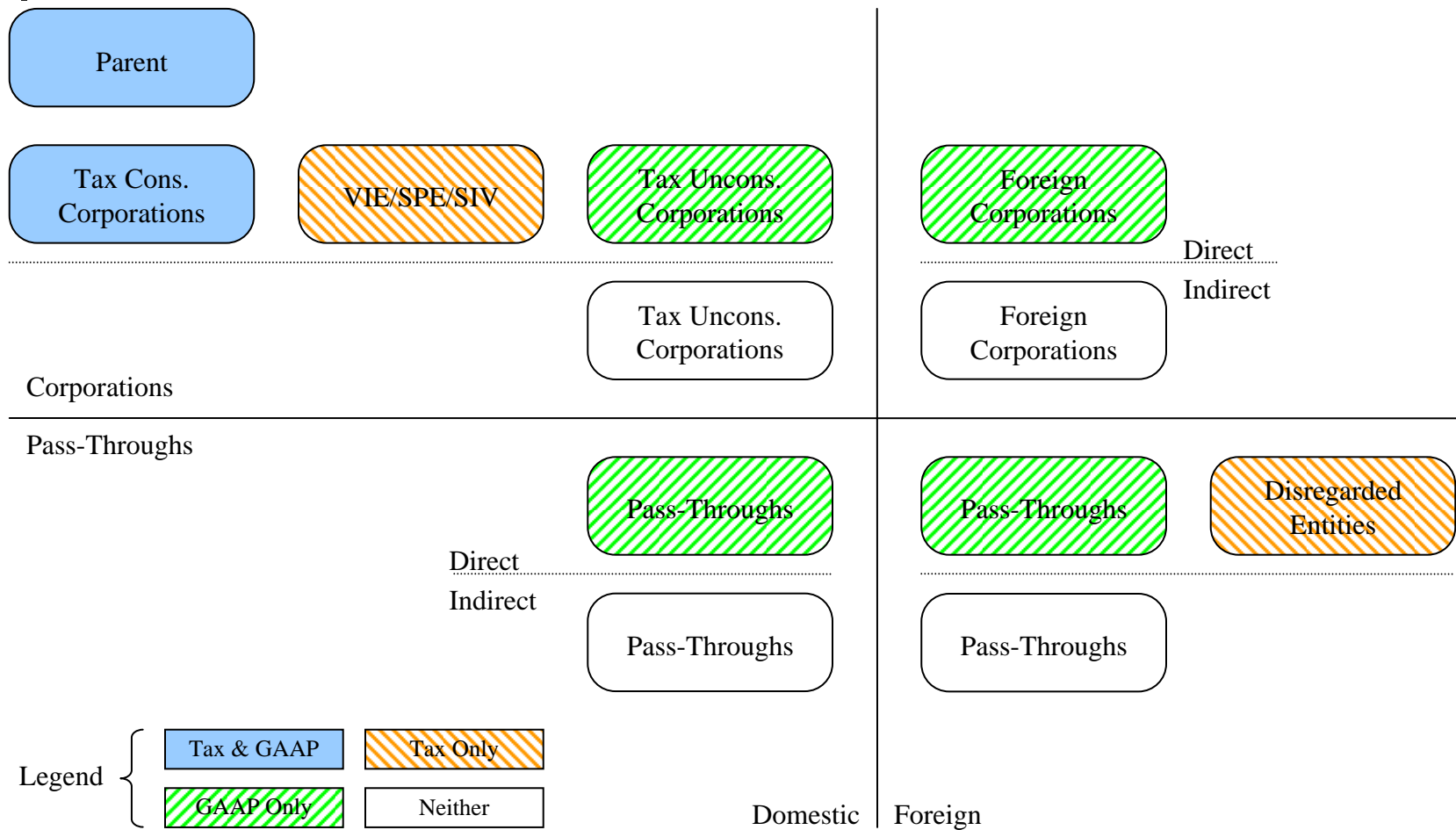
- Allocate LMSB Audit Resources to Maximize Long-Run Voluntary Compliance
 - Estimate Issue-Specific Compliance Risk for Each Taxpayer
 - Transform Risk Measures into Resource Allocation Policy
- Data Corollary
 - Collect and Store All Relevant Data on Business Enterprise to Fully Understand Compliance Risk
 - Data May Be Multi-Dimensional in Nature
 - Structure of Data May Vary Over Units of Observation
 - Transform Data into Vector of Rankings Reflecting Resource Allocation Policy



Complex Business Enterprises

- LMSB Needs to Assess Compliance Risk in Context of the Broad Business Enterprise, Not Tax-Filing Entity
- Enterprise is Collection of Related Entities
 - Under Common Control
 - Acting for Benefit of Owners of Enterprise
- Proliferation of Partnerships Among LMSB Population
 - LLCs as Substitutes for Corporate Subsidiaries
 - Tiered Flow-Through Structures
- Ability of LMSB to Identify Aggressive Transactions Depends on Ability to See All Sides of Transaction
- Neither Consolidated Tax Returns Nor GAAP Financial Statements Report Whole Story

Enterprise Structure: Tax vs. GAAP Consolidation





Electronic Filing

- LMSB Corporations Required to File Returns in XML Format for Tax Years Ending on or After 12-31-05
- XML (eXtensible Markup Language)
 - Character-Based and Platform-Independent
 - Excels at Representing Hierarchically-Structured Data
 - Using Nested Tags
 - Can Represent Complex Business Enterprises
- Availability of Open-Source XML Technologies
 - To Convert, Combine and Restructure XML Data
- XML is Foundation for Analyzing Complex Business Enterprises and Their Features

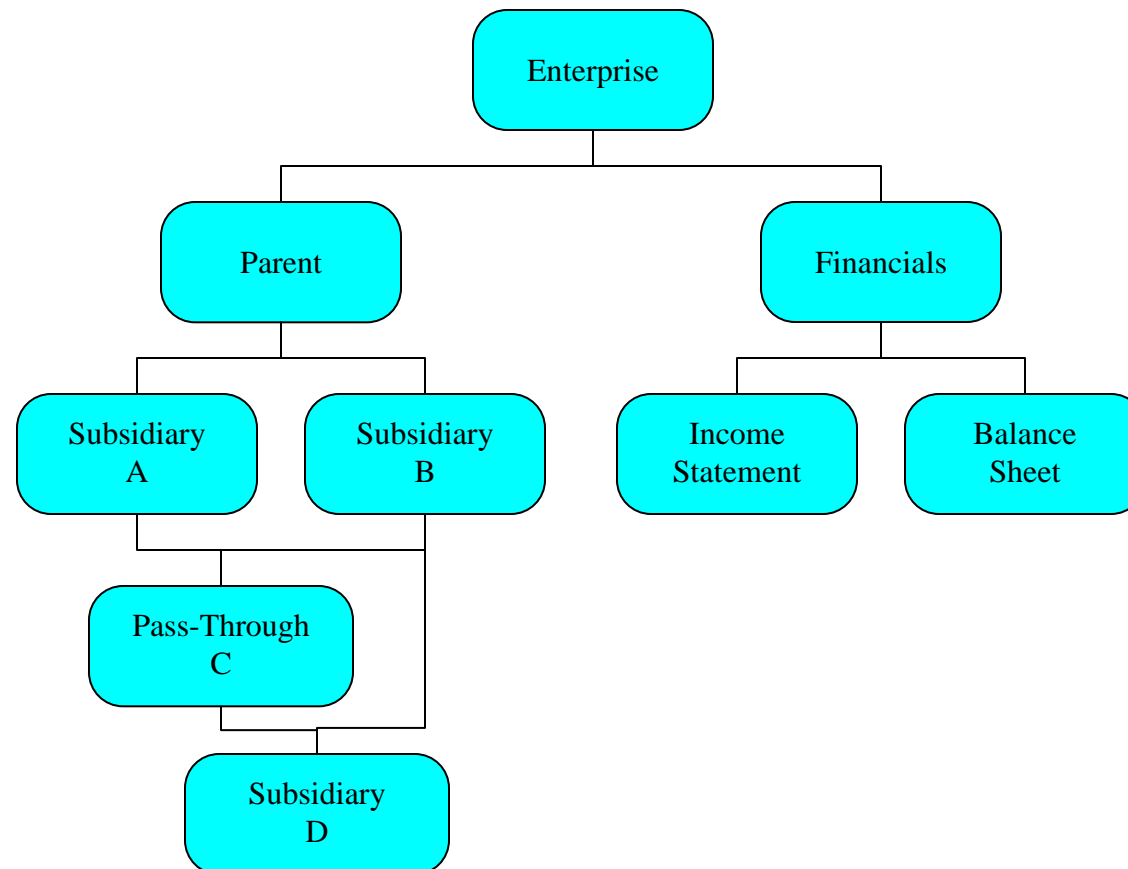


Object-Oriented Technology

- Object-Oriented Technology Can Transform XML Enterprise Documents into Analytic Form
 - XML is Character-Based and Not Conducive to Analysis
- Can Create Enterprise Object Models
 - Comprised of Objects Representing Structural Components of Enterprise (e.g., Parents, Subsidiaries, Flow-Throughs)
 - Ownership Objects Keep Track of Entity Relationships
 - Risk Assessment Objects Compute Risk Measures Over Varied Enterprise Structures
- Can Access All Data and Structure of the Data



Stylized Enterprise Structure





AICS Application

- Automated International Classification System (AICS) Team Has Developed Application
 - Reads Return and Creates Enterprise Object in Real Time
 - Form 1120, 926, 1118, 5471, 5472, 8858 and 8865 Objects
 - Does Not Yet Include Financial Data or Related Entity Data
- Risk Assessment Objects for International Issues and Schedule M-3
- Results Represented in XML Compatible Format
 - Transformed into PDF Reports
 - Possible to Represent Results in XHTML Format
- Supports Several Compliance Initiative Projects

- LMSB
 - Enterprise
 - Return
 - RelatedReturns
 - RelatedReturn
 - ein
 - name
 - RelatedReturn
 - ein
 - name
 - Financials
 - IncomeStatement
 - SALE
 - COGS
 - DP
 - XINT
 - PI
 - TXT
 - NI
 - BalanceSheet
 - AT
 - LT
 - SEQ
 - CompleteFiling

Maple Finance Incorporated

1213 Wilson Drive

Washington, DC 20599

2005-12-31

Sample

000000000

FilterName

Filter Description

Total Risk

Certainty

Threshold

NOL Carryover

Excess Foreign Taxes

\$0

\$0



AICS Application: Next Steps

- Incorporate Financial Statement and Related Entity Data into XML and Enterprise Objects
 - Identification of Related Entities from Schedule K-1 (and Other Sources)
 - Forms 1120 and 1065 to Require Ownership Information for Tax Years Ending On or After 12-31-08
 - Recursive Process Needed to Incorporate Chains of Related Entities
 - Set Ownership/Control Parameters and Stopping Rules
 - Resolve Complex Entity Relationships



Opportunities

- Tax Shelter Detection
 - Search for Conditions (e.g., Structural) Across Population
 - Analytic Version of YK1 Tool
- Book-Tax Analysis
 - Risk Assessment of Book-Tax Consolidation Differences
- Simulation Modeling
 - Simulate Changes in Features (e.g., Structure) of Profit-Maximizing Enterprise as Basis for Risk Assessment
 - Distinguish Economic- from Tax-Motivated Behavior
 - Alternative to Statistical Risk Assessment Models



Conclusion

- Electronic Filing Should Increase Accuracy of LMSB's Compliance Risk Models
 - Access to Data on the Broad Business Enterprise
 - Including Structural Relationships Among the Component Entities
 - Ability to Perform Compliance Risk Assessment When Return is Filed
- Should Also Lead to More Efficient Workload Allocation Process
 - Better Targeted and More Informed Examinations
 - Reduced Burden on More Compliant Taxpayers