



Tax Compliance Benefits of Electronic Filing

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Overview

- **Electronic Tax Return Filing Has Profound Effect on Tax Compliance Risk Assessment**
 - Substantially Reduces Need for Manual Data Processing
 - Makes Feasible Risk Assessment in Context of Broad Business Enterprise, Not Just Tax Return Filing Entity
- **Creation of Enterprise Data Structures in Real Time**
 - Tax Returns, Financial Statements, and Related Entities
 - Open-Source Technology / Minimal Hardware Requirements
 - Electronic Access to All Data and Structure of Data
- **Application of Risk Measures to Data Structures**
 - Audit Planning and Workload Selection
- **Time and Resource Cost Savings**

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Tax Administration Objective

- Allocate Audit Resources to Maximize Voluntary Compliance
 - Audit Planning (Micro Level)
 - Detailed Issue-Specific Risk Measures for Each Taxpayer
 - Workload Selection (Macro Level)
 - Aggregate Taxpayer-Specific Risk Measures
 - Transform Into Resource Allocation Policy
- Data Corollary
 - Collect and Store All Relevant Data on Business Enterprises
 - May Be Multi-Dimensional in Nature
 - Structure May Vary Over Units of Observation (Enterprises)
 - Transform into Rankings Consistent with Resource Allocation Policy

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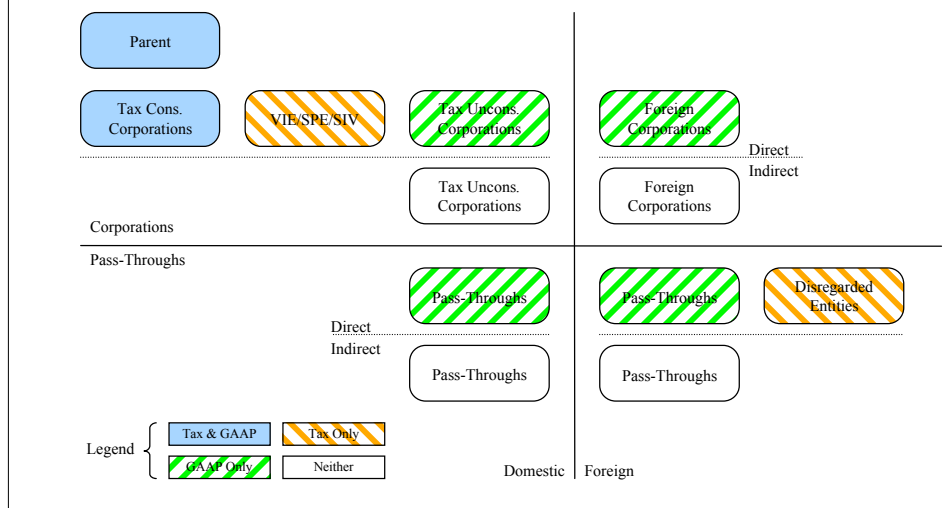


Business Enterprises

- Complexity of Business Enterprises Requires More Holistic Approach to Risk Assessment
 - Need to Consider Broad Business Enterprise
 - Not Just Tax Return Filing Entity
- Enterprise May Be Collection of Related Tax Return Filing Entities Acting for Benefit of a Single Owner
 - Proliferation of Partnerships
 - Tiered Flow-Through Structures
- Ability to Identify Aggressive Transactions Depends on Ability to See All Facets of Transactions
 - Neither Consolidated Tax Returns Nor GAAP Financial Statements Report Whole Story

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Enterprise Structure: Tax vs. GAAP Consolidation



Spyderware

- Software to Risk Assess Electronically Filed Returns
- Creates Enterprise Data Structures in Real Time
 - Tax Return Information
 - Separately Filed Related Entity Tax Return Information
 - Financial Information from SEC
 - Other Information (e.g., Audit History) and Over Time
- Captures Organizational Structure of Enterprise
 - Relationships Among Related Entities
 - May Vary Across Business Enterprises
- Exposes Information to Processing Algorithms
 - Audit Planning: Issue-Specific Tax Compliance Risk
 - Workload Selection: Aggregation and Transformation

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Audit Planning

- Creates PDF Reports on Tax Returns or Enterprises for Field Examiners in Real Time
 - Based on Risk Measures Developed in Cooperation with Experts Familiar with Current and Developing Issues
- Reports Include
 - Detailed Descriptions of Issues
 - Locations of Issues on Returns (e.g., CFCs)
 - Measures of Risk
 - Confidence Levels
 - Materiality Thresholds

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Workload Selection

- Summary Reports on Tax Returns or Enterprises
 - Issue-Specific Information Aggregated By Region, Industry or Other Customized Grouping
- Foundation for Workload Selection System
 - Reports Can Be Sorted or Otherwise Transformed
 - Consideration of Losses and Carryovers (Discount Rate)
 - Indirect Effects of Workload Selection Policy on Compliance
- Address Lack of Complete Information
 - Identification of Risk Strata
 - Select Randomly Within Risk Strata
 - Where Selection Probabilities Vary with Risk
 - Establishes Foundation for Statistical Inference

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Opportunities

- Tax Shelter Detection
 - Search for Organizational Relationships Across Population That Are Indicative of Tax Shelters
- Book-Tax Analysis
 - Reconciliation and 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

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Conclusion

- Electronic Filing Should Increase Accuracy of Tax 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

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