

**The Internal Revenue Service Successfully
Processed Schedules K-1 for Its Matching
Program, However, Tax Form Changes Would
Reduce Unnecessary Notices to Taxpayers**

July 2002

Reference Number: 2002-30-141

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

July 30, 2002

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION
COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Internal Revenue Service Successfully
Processed Schedules K-1 for Its Matching Program, However,
Tax Form Changes Would Reduce Unnecessary Notices to
Taxpayers (Audit # 200130051)

This report presents the results of our review of the processing of paper filed *Beneficiary's Share of Income, Deductions, Credits, etc.* (Form 1041,¹ Schedule K-1); *Partner's Share of Income, Credits, Deductions, etc.* (Form 1065,² Schedule K-1); and *Shareholder's Share of Income, Credits, Deductions, etc.* (Form 1120S,³ Schedule K-1) for purposes of matching with individual income tax returns. The overall objective of this review was to determine if the Internal Revenue Service (IRS) had controls in place to ensure accurate and timely processing of these Schedules K-1.

Because of a mandate from the Senate Committee on Finance, the IRS will match information reported to taxpayers on Schedules K-1 to the taxpayers' individual income tax returns. The IRS estimates that in 2001, shareholders, beneficiaries, and partners will have approximately \$850 billion reported to them on Schedules K-1. The IRS further estimates that between 6 and 15 percent of these taxpayers are omitting this income from their individual tax returns.

Tax professionals and others have expressed serious concerns about the difficulty in matching information from Schedules K-1 to individual income tax returns. Because of

¹ U.S. Fiduciary Income Tax Return (for Estates and Trusts).

² U.S. Return of Partnership Income.

³ U.S. Income Tax Return for an S Corporation.

these concerns, the IRS must ensure Schedules K-1 are accurately processed to reduce the risk of erroneous matching results, which could both impair the IRS' compliance efforts and lead to the issuance of unnecessary notices to taxpayers.

Although we followed *Government Auditing Standards*, we encountered a scope limitation by not having sufficient, competent, relevant, and timely information to allow us to confidently project the accuracy of data entered from Schedules K-1 to the IRS' computer system.

In summary, we found that Schedules K-1 were processed timely, and that the IRS had taken steps to capture information to evaluate the effectiveness of the Schedule K-1 matching process. Over 96 percent of Tax Year 2000 Schedules K-1 included in our judgmental sample were processed accurately; however, we cannot confidently project this accuracy rate to the population of Schedules K-1 overall. In cases included in this sample where materially incorrect amounts had been entered in the IRS' database, the IRS' Underreporter Program's processing procedures should mitigate the type of errors we identified and prevent incorrect notices from being issued.

Minor changes to one tax schedule could improve the matching process. Over half of all income reported by partnerships and S Corporations is from ordinary business and rental activities. During the IRS' Underreporter Program matching process, mismatches are prone to occur on this type of income because of offsets such as depletion, passive activity loss limits, and unreimbursed expenses that taxpayers take before putting Schedule K-1 amounts on their individual *Supplemental Income and Loss* (Form 1040,⁴ Schedule E). Manual screening of mismatched returns with business or rental activity income can sometimes detect these offsets, but this type of review is more time consuming and increases the potential for error.

The IRS should make changes to the Schedule E, as recommended in a July 2000 Illinois District Office Research and Analysis study. The changes recommended would require taxpayers to separately list the original amounts reported on the Schedules K-1 and the amount by which they are offsetting this income. By doing this, more of the matching could be automated, manual screening would be easier and more accurate, and the potential for unnecessary notices would be reduced.

Management's Response: The IRS' Small Business/Self-Employed Division agreed that they should consider changes to improve the automated Schedules K-1 matching process. They agreed to analyze the data collected from ongoing Schedules K-1 matching efforts and establish a cross-functional work group to identify and evaluate potential improvements to the Schedules K-1 matching process. The work group will consider changes to the Schedule E as part of its mission. Management's complete response to the draft report is included as Appendix IV.

⁴ U.S. Individual Income Tax Return.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Gordon C. Milbourn III, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

Attachment

**The Internal Revenue Service Successfully Processed Schedules K-1
for Its Matching Program, However, Tax Form Changes
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**The Internal Revenue Service Successfully Processed Schedules K-1
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Background

Beneficiary's Share of Income, Deductions, Credits, etc. (Form 1041,¹ Schedule K-1); *Partner's Share of Income, Credits, Deductions, etc.* (Form 1065,² Schedule K-1); and *Shareholder's Share of Income, Credits, Deductions, etc.* (Form 1120S,³ Schedule K-1) are information returns filed by fiduciaries, partnerships, and S Corporations. They report the share of income, losses, deductions, and credits attributable to each beneficiary, partner, or shareholder. The majority of Schedules K-1 received are associated with individual taxpayers, who report the amounts flowing through on their *U. S. Individual Income Tax Return* (Form 1040).

Beginning in Fiscal Year 2001, Schedules K-1 not filed electronically were entered into Internal Revenue Service (IRS) computers for use in the IRS' Information Returns Program (IRP). The main justification for the cost incurred to enter the data from these schedules is the compliance benefits that will be achieved through the Underreporter Program, where the Schedule K-1 information will be matched against the tax returns of the individual partners, shareholders, and beneficiaries. In addition, the information should benefit the examination and correspondence examination programs, collection programs, and taxpayer education and outreach programs.

The IRS has not processed paper Schedules K-1 since 1995, when a percentage of these returns were included in its Underreporter Program. However, the IRS has since received a mandate from the Senate Committee on Finance to process all Schedules K-1 for inclusion in the matching program. In March 2001, Senator Charles E. Grassley, then Chairman of the Committee on Finance, urged⁴ Commissioner Rossotti to make a priority of having a computer program in place to match income reported on the Schedules K-1. He also stressed the risks caused by

¹ U.S. Fiduciary Income Tax Return (for Estates and Trusts).

² U.S. Return of Partnership Income.

³ U.S. Income Tax Return for an S Corporation.

⁴ Letter to the Commissioner, March 28, 2001.

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extensive use of partnerships and other flow-through entities in the area of tax schemes. At the same time, tax professionals and oversight organizations have expressed serious concern about the difficulty in matching Schedule K-1 information with tax returns. They believe taxpayers will suffer significant burden resolving erroneous notices that are likely to be issued by the IRS. Because of these conflicting concerns, the IRS must ensure Schedules K-1 are accurately processed to reduce the risk of erroneous matching results, which could both impair the IRS' compliance efforts and lead to the issuance of unnecessary notices to taxpayers.

The IRS estimates that in Tax Year 2001, 8.5 million of these flow-through returns will report \$850 billion to approximately 19 million shareholders, beneficiaries, and partners on Schedules K-1. They also estimate that between 6 and 15 percent of the taxpayers are currently omitting their taxable flow-through income from their individual returns. In evaluating the costs and benefits of the Schedule K-1 processing and matching program, the IRS projects that a 1 percent change in the voluntary compliance level will make a difference of approximately \$500 to \$750 million in tax annually, which would justify the cost of the Schedule K-1 processing and matching program.

The project completion date for transcribing the Schedules K-1 was December 15, 2001. Initial matching against individual taxpayer returns is already in progress.

This audit was conducted in accordance with *Government Auditing Standards* between August 2001 and March 2002 at the Ogden Submission Processing Center and the IRS National Headquarters. Although we followed *Government Auditing Standards*, we encountered a scope limitation by not having sufficient, competent, relevant, and timely information to allow us to confidently project the accuracy of data entered from Schedules K-1 to the IRS' computer system.

Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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**Initial Processing of Paper
Schedules K-1 Was Completed
Timely and Steps Are Being
Taken to Evaluate the
Effectiveness of the Matching
Process**

Based on our review of the IRS' processing statistics, it appears that Schedules K-1 were processed in a timely manner. The IRS' production reports showed that approximately 14.6 million returns were transcribed and entered in the IRS' computer system as of December 22, 2001. These information returns have been incorporated into the IRS' IRP database for use in the Underreporter Program, currently in progress.

The IRS' Compliance functions identified information that they needed to monitor and evaluate the effectiveness of the Schedule K-1 matching process. A letter of understanding was drafted with programmers in the Underreporter Section at the Western Development Center in Ogden, Utah, to ensure this information is captured. This should provide the IRS with information associated with the processing of related Schedule K-1 Underreporter cases to evaluate the effectiveness and efficiency of that portion of the program.

**Limited Review of Paper
Schedules K-1 Found No
Indication of Significant
Processing Inaccuracies**

For the IRS' matching program to be successful, data must be entered accurately from Schedules K-1 to the IRS' computer system. Erroneous data entered into IRS computers from Schedules K-1 could have significant impact on taxpayers and on the IRS' compliance programs. Accordingly, we reviewed a judgmental sample of 118 Tax Year 2000 Schedules K-1 to determine the accuracy of the payee/payer information and the related tax data. As discussed in Appendix I, we were not able to obtain a statistically valid sample and, accordingly, we cannot make any projections from our results to the entire universe of Schedules K-1. However, the results of our review of these cases were generally positive.

We found few errors, and those we did find will be mitigated by Underreporter Program matching procedures designed to correct the type of errors we encountered and prevent incorrect notices from being issued. Of the 118 Schedules K-1 reviewed, only 4 (3.4 percent) had material errors in the dollar amounts entered into the IRS' computer system by IRS employees. Most of the errors were the result of a positive amount being entered when the actual amount should have been a negative figure.

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We discussed the errors involving incorrect positive values with the Underreporter analyst at the Ogden Submission Processing Center. The Ogden Underreporter function had previewed a small number of cases and had also identified two cases that appeared to be the result of this type of input error. The IRS is taking actions to help prevent these types of errors, and their adverse consequences, in the future.

- Changes to next year's processing procedures should reduce the number of these cases. First year procedures required tax examiners in the Code and Edit function to bracket negative amounts. In our error cases, the tax examiners had not bracketed the negative figures, so data transcribers subsequently input positive amounts. In the future, data transcribers will determine the correct value (i.e., positive or negative) and input it accordingly, rather than rely on the Code and Edit function to bracket negative amounts during pre-input reviews.
- Underreporter screening instructions help ensure that erroneous notices do not go to taxpayers when the IRS makes such input errors.

Another error occurred because the IRS employee entered less than the correct income amount. This year's matching is focusing on understated income. If the taxpayer in this situation properly reported the Schedule K-1 income, the difference would appear to be an overstatement of income and no notice would be generated.

Because of data limitations, we could not confidently project the quality of input for the entire population of processed Schedules K-1. However, our judgmental sample did not indicate a significant problem with quality that would result in inaccurate notices. Because even a small percentage error rate in processing these 14 million Schedules K-1 could result in numerous erroneous notices being issued, the IRS should still monitor the quality of notices issued and take corrective actions as soon as possible, should any problems become apparent.

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**Forms Should Be Changed to
Separately List Amounts as
Originally Reported on
Schedules K-1**

For the matching program to be effective, the IRS needs to be able to readily determine whether amounts from Schedules K-1 are reported on individual tax returns. This process is most efficient when the match can be performed by computer with little or no manual screening required.

Significant numbers of Schedules K-1 contain some interest or dividend income. The places where taxpayers may report such income on their individual returns are limited, making these items relatively easy to match during the IRS' Underreporter Program matching process. Interest and dividend income shown on Schedule K-1 is combined with the interest and dividend income from other sources and compared to amounts on the individual tax returns. Similar matching is performed for other forms of portfolio income, such as capital gains and royalties.

However, over half of all income reported by partnerships and S Corporations is from ordinary business and rental activities. Various income and loss amounts can often be summed and compared to corresponding totals on *Supplemental Income and Loss* (Form 1040, Schedule E). Mismatches are prone to occur on this type of income as the result of offsets due to passive activity loss limits, depletion, or unreimbursed partner expenses that taxpayers take before putting Schedule K-1 amounts on their Schedules E. In addition, details regarding the Schedule K-1 information, if any, are often on supplemental schedules provided by tax preparers. Manual screening of mismatched returns with business or rental activity income can sometimes detect these offsets, but this type of review is more time consuming and increases the potential for error.

Because of this difficulty in identifying Schedule K-1 business and rental income on taxpayers' individual Schedules E, the IRS estimates these cases will require a higher percentage of taxpayers to be contacted than cases for other sources of income, such as wages and interest. They expect approximately 60 percent of the notices issued on these Schedule K-1 cases will be "no change" cases, as compared to the 25 percent "no change" rate for other Underreporter Program cases.

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An Illinois District Office Research and Analysis (DORA) study (Project ID Number 50.13, dated July 2000) recommended making changes to Form 1040, Schedule E to address the cause of this problem by clarifying reporting and facilitating verification of Schedules K-1. Basically, by changing Schedule E to separately list the original amount reported on the Schedule K-1 and the amount by which this income is offset, much of the matching could be automated. The Underreporter Analyst at the Ogden Submission Processing Center also believes manual screening of cases would be easier and more accurate if these changes were made to the Schedule E. By resolving more cases automatically and by reducing the potential for errors during the screening process, the number of unnecessary (erroneous) notices would be reduced for Schedule K-1 related income mismatches. This is especially significant because of the high dollar amount reported in this section of the Schedule E (over \$240 billion for Tax Year 1998).

Recommendation

1. The Director, Compliance, Small Business/Self-Employed (SB/SE) Division, should work with the Director, Tax Forms and Publications, Wage and Investment Division, to make changes to the Form 1040, Schedule E as recommended in the DORA study. Consideration should be given to classifying and reporting pass through income to facilitate easier comparisons to Schedules K-1 and to make the matching program more effective and less subject to extensive manual screening.

Management's Response: The SB/SE Division agreed that they should consider changes to improve the automated Schedules K-1 matching process. They will continue to focus their efforts on improving the processing and reducing the transcription errors. During the ongoing matching process, the SB/SE Division will collect data to discover why cases identified with a mismatch during computerized matching are subsequently screened-out during manual screening or not changed after a notice is issued.

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The Division will establish a cross-functional work group to identify and evaluate potential improvements to the Schedule K-1 matching process. This work group will consider changes to the Schedule E as part of its mission.

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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine if the Internal Revenue Service (IRS) had controls in place to ensure the accuracy and timeliness of paper filed *Beneficiary's Share of Income, Deductions, Credits, etc.* (Form 1041,¹ Schedule K-1); *Partner's Share of Income, Credits, Deductions, etc.* (Form 1065,² Schedule K-1); and *Shareholder's Share of Income, Credits, Deductions, etc.* (Form 1120S,³ Schedule K-1) processed for purposes of matching with taxpayer returns.

To accomplish our objective we:

- I. Evaluated the quality of transcribed Schedule K-1 data on the Information Return (IRMF) portion of the IRS' Master File.⁴
 - A. Reviewed relevant Internal Revenue Manual (IRM) sections to determine the adequacy of controls over transcription accuracy.
 - B. Discussed transcription controls with IRS personnel.
 - C. Obtained a computer file containing approximately 850,000 Schedules K-1 input to the IRS' IRMF. We reviewed a judgmental sample of 118 of these Schedules K-1. We compared data input for these 118 Schedules K-1 to the original return (Form 1041, 1065, or Form 1120S) filed by the taxpayer to determine processing accuracy. (We selected our sample by using computer software to identify 280 cases at random and reviewed all cases for which we had received tax returns by our fieldwork completion date. See scope limitation on page 9.)
 - D. Determined the number of invalid Taxpayer Identification Numbers eliminated from the pool of matchable returns.
- II. Determined whether transcription of Schedules K-1 was completed in a time frame that allowed timely filed Schedules K-1 to be included in the Information Returns database used for matching against individual returns.
 - A. Monitored the IRS' production reports to determine the number of Schedules K-1 processed.

¹ U.S. Fiduciary Income Tax Return (for Estates and Trusts).

² U.S. Return of Partnership Income.

³ U.S. Income Tax Return for an S Corporation.

⁴ The IRS' Master File is its main computer system containing taxpayer records.

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- B. Determined whether the majority of processed Schedules K-1 were available for Underreporter Program matching routines.
- III. Determined what tests had been conducted to ensure the usability of transcribed Schedule K-1 data.
 - A. Discussed with IRS personnel the Schedule K-1 data used in the Underreporter Program and the results of Schedule K-1 usability tests.
 - B. Reviewed a letter of understanding to ensure that the IRS was developing information to track the results of the Schedule K-1 matching.
- IV. Determined if Schedule K-1 matching program results could be evaluated to ensure costs associated with processing Schedules K-1 were outweighed by the benefits.
 - A. Discussed plans to evaluate underreporter results of Schedule K-1 related cases with Underreporter Program analysts and reviewed work schedule.
 - B. Reviewed the Letter of Understanding regarding information that would be obtained to evaluate results of Schedule K-1 matching.

Scope Limitation: We were unable to obtain sufficient, competent, relevant, and timely information to confidently project the accuracy of data entered from Schedules K-1 to the IRS' computer system because:

- The data to be tested was obtained from the IRS' computer input files, which were created over several months. Some of the input files were erased before we could access them.
- Some of the information we did obtain was taken from an error file, rather than an initial input file.
- The time required to obtain data from other sources, which could be used to select a statistically valid sample, was significant, and we believed it was more important to communicate the results we had than to delay the report to obtain new data.

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Appendix II

Major Contributors to This Report

Gordon C. Milbourn III, Assistant Inspector General for Audit (Small Business and Corporate Programs)

Richard J. Dagliolo, Director

Kyle R. Andersen, Audit Manager

L. Jeff Anderson, Senior Auditor

Greg Schmidt, Senior Auditor

W. George Burleigh, Auditor

Layne D. Powell, Computer Specialist

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Appendix III

Report Distribution List

Commissioner N:C
Deputy Commissioner N:DC
Deputy Commissioner, Small Business/Self-Employed Division S
Deputy Commissioner, Wage and Investment Division W
Director, Compliance, Small Business/Self-Employed Division S:C
Director, Customer Account Services, Small Business/Self-Employed Division S:CAS
Director, Customer Account Services, Wage and Investment Division W:CAS
Director, Tax Forms and Publications, Wage and Investment Division W:CAR:MP:FP
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:F:M
Audit Liaisons:
 Commissioner, Small Business/Self-Employed Division S
 Commissioner, Wage and Investment Division W

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Appendix IV

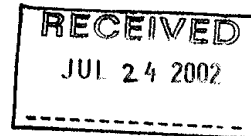
Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

JUL 19 2002



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *for* Joseph G. Kehoe *Richard J. Morgante*
Commissioner, Small Business/Self-Employed

SUBJECT: Draft Audit Report – The Internal Revenue Service
Successfully Processed Schedules K-1 for Its Matching
Program, However, Tax Form Changes Would Reduce
Unnecessary Notices to Taxpayers (#200130051)

The purpose of your audit was to determine if we had controls to ensure the accuracy and timeliness of data collected from paper-filed Schedules K-1 for use in our Information Report Matching programs, including Automated Underreporter (AUR). You based your recommendation on an Illinois District Office Research and Analysis (DORA) study (ID Number 50.13 dated July 2000) that recommended making changes to Form 1040, Schedule E to improve the matching process.

Schedules K-1 are our link between partnerships, trusts, and S Corps (collectively known as flow-through entities) and the partners, beneficiaries, and shareholders who report income and deductions passed through to them on Schedules K-1. We were given funding to transcribe all paper Schedules K-1 we receive. Beginning in 2001, we processed 19 million Schedules K-1 passing through more than \$1.1 trillion of income to their beneficiaries, partners, and shareholders. Schedules K-1 data received and transcribed electronically goes into the Information Returns Master File (IRMF) and is used by Compliance, Research, Information Matching, Taxpayer Education and Communications, and Customer Service program areas.

The Automated Underreporter Program (AUR) matches IRMF data to individual tax returns and identifies discrepancies between information returns issued to and income reported by the recipients. The initial AUR match is automated; however, tax examiners review any discrepancies. They resolve discrepancies by looking at the individual tax return. When we cannot resolve a discrepancy, the examiner mails an adjustment notice to the taxpayer. The taxpayer can then explain the discrepancy or agree to the proposed adjustment.

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Out of 19 million Schedules K-1 captured in the IRMF, 14 million (more than 70%) were transcribed from paper documents. Without accurate transcription, Schedules K-1 data is unreliable and cannot be used. As you recognized in your report, we worked hard to ensure accuracy in processing year 2001. We continued our efforts to prepare for the 2002 processing year as follows:

- Revision to IRM 3.0.101, Schedule K-1 Processing: We revised procedures in the IRM to ensure more Schedules K-1 could be transcribed. Processing changes include:
 1. In the past when an operating division requested the parent return, the Partners returns were also forwarded. As a result, Schedules K-1 were not transcribed. Now if an operating division requests the parent return for review, information, or examination, Schedules K-1 are no longer sent until they have been transcribed.
 2. We could not process Schedules K-1 with zeroes, blanks or dashes in all transcribed money lines. Now, an entry of \$1 in one line item is input to allow us to process these "zero-balance Schedules K-1". Also, we asked for a programming change for 2003 so we can process "zero-balance Schedules K-1" with zeros.
 3. In the past the transcribers relied on Code and Edit's brackets to indicate negative money amounts. These brackets were frequently missing. Now Code and Edit will no longer bracket negative money amounts. Data transcribers will now determine if a number should be input as positive or negative.
- Processing Centralization: To ensure consistent processing, only two campuses (Ogden and Cincinnati) are transcribing Schedules K-1 in 2002. All 10 campuses transcribed Schedules K-1 in 2001.

Although we agree we should consider changes to improve the automated Schedules K-1 matching process, we disagree that changing Schedule E is necessarily the best or only solution. We will continue to focus our efforts on improving the processing and reducing the transcription errors. In addition, the Schedules K-1 matching process is underway, and we will collect data to discover why cases identified with a mismatch during computerized matching are subsequently screened-out (surveyed) during manual screening or not changed after a notice is issued. We will make a decision after we complete our analysis. Finding the best solution will require a cross-functional effort involving Compliance, Submissions Processing, Forms & Publications, Taxpayer Education and Communication (TEC), and the Office of Taxpayer Burden Reduction.

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RECOMMENDATION

The IRS should make changes to the Schedule E, as recommended in a July 2000 Illinois District Office Research and Analysis Study. The changes recommended would require taxpayers to separately list the original amounts reported on the Schedules K-1 and the amount by which they are offsetting this income.

ASSESSMENT OF CAUSE

Schedules K-1 income includes ordinary income, real estate income, other rental income and guaranteed payments to partners that individual Schedules K-1 recipients report on Schedule E. Computerized matching compares the sum of these Schedules K-1 line items to total gains and losses reported on Schedule E, but Schedule E totals may be a net of Schedules K-1 amounts reduced by passive activity loss (PAL) carryovers, at-risk limitation carryovers, depletion, unreimbursed expenses and a variety of other items. These reductions look like underreported income to the computer.

Manual screening can identify the reductions, if IRS Form 1040 provides the detail behind the netted numbers and the Schedules K-1 amount is reported. If Form 1040 does not provide adequate detail, we issue a notice to the taxpayer. Schedule E and Schedule K-1 instructions tell taxpayers to separately state some flow-through items, but the amount of detail taxpayers provide is not consistent.

CORRECTIVE ACTION

We are requesting additional time to evaluate the feasibility of implementing this recommendation. We will analyze the data collected from current Schedules K-1 matching efforts. In addition, we will establish a cross-functional work group to identify and evaluate potential improvements to the Schedule K-1 matching process. The work group will consider changes to the Schedule E as part of its mission.

Improving the matching process demands a balance between IRS and taxpayer burden. Under our current system, some taxpayers are burdened with responding to AUR notices, but their numbers are smaller compared to the total population of taxpayers filing Schedule E. If we change Schedule E, the total filing population will be burdened with providing additional information. If we do not change Schedule E, fewer taxpayers will be burdened because we will be dealing only with the discrepant cases.

We will continue to focus our efforts on improving processing and reducing transcription errors. After the 2002-processing year, we will evaluate the impact of our changes.

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IMPLEMENTATION DATE

September 30, 2003

RESPONSIBLE OFFICIAL

Director, SB/SE Compliance Policy, Reporting Enforcement

CORRECTIVE MONITORING PLAN

Director, Reporting Enforcement will advise the Deputy Director, Compliance Policy of any delay, change, or problem with implementation.

If you have any questions, please call me at (202) 622-0600 or Joseph Brimacombe, Deputy Director, Compliance Policy, Small Business/Self-Employed, at (202) 283-2200.