

IRS Newswire

IR-2005-76

July 25, 2005

IRS LAUNCHES STUDY OF S CORPORATION REPORTING COMPLIANCE

WASHINGTON – Internal Revenue Service officials announced today the launch of a study to assess the reporting compliance of S corporations. The study, carried out under the National Research Program (NRP), will examine 5,000 randomly selected S corporation returns from tax years 2003 and 2004.

S corporations are entities whose income and deductions pass through the corporate structure to the shareholders. Since the mid-1980s, the number of S corporations has risen rapidly, growing from 724,749 in 1985 to 3,154,377 in 2002.

The growth rate has been even faster among S corporations with more than \$10 million in assets. From 1985 to 2002, the number of these larger S corporations grew more than ten-fold, from 2,305 to 26,096.

“The use of S corporations has exploded,” said IRS Commissioner Mark W. Everson. “The IRS needs a better understanding of what this means for tax compliance. This research is critical for achieving our strategic goal of ensuring that corporations and high-income individuals are paying their fair share.”

S corporations are now the most common corporate entity. In 2002, the latest year for which data is available, S corporation returns accounted for 59 percent of all corporate returns filed for that tax year. Two million S corporations reported net income of about \$248 billion and 1.2 million S corporations reported net losses of about \$63 billion.

Numerous restrictions and requirements apply to S corporations. For example, an S corporation can have no more than 75 shareholders and none of these can be another corporation or non-resident alien.

Program officials expect these audits to begin later this year. The last reporting compliance study of S corporations involved about 10,000 returns from tax year 1984, prior to the tax law changes that spurred the growth in S corporations. The new NRP initiative will use a study approach designed to reach statistically valid conclusions regarding compliance behavior, while using a smaller sample of returns than in the past.

The results of the NRP study will be used to more accurately gauge the extent to which the income, deductions and credits from S corporations are properly reported on returns filed by the flow through corporations and their shareholders. When completed, this research will assist the IRS in selecting and auditing S corporation returns with greater compliance risk.

The research program on S corporations is a complement to the study of individual reporting compliance completed last year. The preliminary results from that study, announced in March, indicated that the gross tax gap is more than \$300 billion each year. IRS collection and compliance efforts reduce this gap by about \$50 billion each year.

The NRP, created in 2000, is a comprehensive effort by the IRS to measure payment, filing and reporting compliance for different types of taxes and various set of taxpayers.

Administering a tax system that serves America's taxpayers by promoting fairness and operating efficiency and effectiveness is dependent on the agency's ability to measure and distinguish between the many factors that impact compliance with tax laws.

"This research effort provides us the knowledge we need to both improve compliance and reduce unnecessary taxpayer burden," said Everson.

Without reliable measures, the IRS faces major challenges in enhancing its ability to detect noncompliance, improve overall compliance and develop methods for allocating resources more effectively.