



Treasury Inspector General for Tax Administration Office of Audit

INTERNAL CONTROLS FOR SURVEYING TAX RETURNS WITH ABUSIVE TAX AVOIDANCE TRANSACTIONS NEED TO BE STRENGTHENED

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Highlights

Highlights of Report Number: 2010-30-118 to the Internal Revenue Service Commissioners for the Large and Mid-Size Business Division and the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Combating Abusive Tax Avoidance Transactions (ATAT) is one of the Internal Revenue Service's (IRS's) highest priorities. Some tax returns with ATAT issues do not warrant examination and are surveyed prior to taxpayer contact. Surveying tax returns with an ATAT issue without proper justification or approval could be counterproductive to the IRS's goal to combat abusive schemes. In addition, this approach can erode the public's confidence in the IRS's ability to enforce tax laws in a fair, equitable, and consistent manner.

WHY TIGTA DID THE AUDIT

This audit was initiated because identifying tax avoidance schemes is one of the IRS's major initiatives. Our objective was to evaluate the effectiveness of controls and procedures used by the Large and Mid-Size Business and the Small Business/Self-Employed Divisions to ensure tax returns with ATAT issues are properly examined for abusive tax avoidance schemes.

WHAT TIGTA FOUND

IRS employees made decisions to survey tax returns without proper approval. From a statistical sample of 311 surveyed tax returns, TIGTA determined that 246 required the Planning and Special Programs function to concur with the group manager's decision to survey the tax return. However, group managers did not follow guidelines and surveyed 238 (97 percent) tax returns without approval from the Planning and Special Programs function. Additionally, in 88 instances, TIGTA could not determine why the tax returns were surveyed because justification was not included in the case files or did not support the decisions to survey the tax returns. TIGTA projected the IRS could have examined 840 additional tax returns and proposed additional tax assessments totaling \$1.7 million over a five-year period.

For 278 (89 percent) of the 311 surveyed tax returns, TIGTA found that IRS employees did not follow procedures when surveying tax returns with ATAT issues. TIGTA projected 196 taxpayers' rights could have been jeopardized under Internal Revenue Code Section 7605(b) because the IRS surveyed tax returns after contacting taxpayers. Furthermore, surveyed tax returns with ATAT issues are not subject to the quality review process.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Large and Mid-Size Business Division, and the Commissioner, Small Business/Self-Employed Division, develop internal controls and provide employee training to ensure that justification to survey tax returns with an ATAT issue is included in the case files. Also, an independent function should review the tax return and concur or disagree with the group manager's decision. In addition, the Small Business/Self-Employed Division should ensure that tax returns with ATAT issues (surveyed as excess inventory) can be readily identified, and examinations are completed once taxpayers are contacted. Furthermore, procedures should be developed to ensure surveyed tax returns are included as part of the quality review process.

In their response to the report, IRS officials stated they agreed with two recommendations, but disagreed with our other two recommendations concerning the strengthening of existing controls and developing procedures to include surveyed tax returns as part of the quality review process. TIGTA continues to believe that the breakdown in controls for the approval process indicate that tax returns surveyed without documentation may have yielded examination results.

The IRS also disagreed with our outcome measures. TIGTA computed the outcomes conservatively using historical data from the Examination program. TIGTA maintains that the potential \$1.7 million of increased revenue and 840 impacted taxpayers is reasonable considering the assumptions used to calculate the estimate. TIGTA also maintains 196 taxpayers' rights may have been jeopardized.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2010reports/201030118fr.pdf>