Treasury Inspector General for Tax Administration
Office of Audit

PENALTY CASES FOR FAILURE TO DISCLOSE REPORTABLE TRANSACTIONS WERE NOT ALWAYS FULLY DEVELOPED

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Highlights

Highlights of Report Number: 2011-30-004 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

In October 2004, the Internal Revenue Code Section 6707A (§6707A) penalty was enacted for failure to disclose a reportable transaction, with the intent of helping to detect, deter, and shut down abusive tax shelter activity. However, the procedures for documenting and assessing the penalty were not sufficient or formalized, and cases are not fully developed. These conditions increase the risk that taxpayers will not receive consistent and fair treatment.

WHY TIGTA DID THE AUDIT

This audit was initiated to evaluate the Internal Revenue Service's (IRS) effectiveness in identifying, developing, and applying the §6707A penalty. In addition, the Senate Finance Committee has concerns about whether the penalty amounts are fair when compared to the tax benefit taxpayers receive from participation in abusive transactions.

WHAT TIGTA FOUND

The §6707A penalty for failure to disclose a non-listed reportable transaction is $10,000 if the taxpayer is an individual and $50,000 for any other business or entity. If the violation involves a listed transaction, the penalty is $100,000 for individuals and $200,000 for any other business or entity.

The §6707A penalty is a stand-alone penalty and does not require an associated income tax examination; therefore, it applies regardless of whether the reportable transaction results in an understatement of tax. TIGTA determined that, in most cases, the §6707A penalty was substantially higher than additional tax assessments taxpayers received from the audit of underlying tax returns. On July 7, 2009, at the request of Congress, the IRS agreed to suspend collection enforcement actions. However, this did not preclude the issuance of notices of assessment that are required by law and adjustment notices which inform the taxpayer of any account activity.

In addition, taxpayers continued to receive balance due and final notices of intent to levy and pay §6707A penalties.

TIGTA reviewed 114 assessed §6707A penalties and determined many §6707A penalty files were incomplete or did not contain sufficient audit evidence. TIGTA also identified instances in which the coordination between the IRS's Office of Tax Shelter Analysis and other functions needs improvement. In addition, although the Office of Tax Shelter Analysis is responsible for reviewing, analyzing, disseminating, and reporting on thousands of Reportable Transaction Disclosure Statements (Form 8886) each year, it does not have formal processing procedures.

WHAT TIGTA RECOMMENDED

TIGTA made several recommendations to fully develop, document, and properly process §6707A penalties.

In their response to the report, IRS officials agreed with the recommendations and plan to take appropriate corrective actions.

READ THE FULL REPORT

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

http://www.treas.gov/tigta/auditreports/2011reports/201130004fr.pdf.