Penalty Cases for Failure to Disclose Reportable Transactions Were Not Always Fully Developed

December 10, 2010

Reference Number: 2011-30-004

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1 = Tax return/Return Information

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

Highlights

Final Report issued on December 10, 2010

Highlights of Reference 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.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

December 10, 2010

MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Penalty Cases for Failure to Disclose Reportable Transactions Were Not Always Fully Developed (Audit #201030007)

This report presents the results of our review to evaluate the Internal Revenue Service's effectiveness in identifying, developing, and applying Internal Revenue Code Section 6707A penalties. This audit was part of our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included as Appendix XI.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.

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Abbreviations

BMF	Business Master File
CY	Calendar Year
IMF	Individual Master File
I.R.C.	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
LMSB	Large and Mid-Size Business
OTSA	Office of Tax Shelter Analysis
SB/SE	Small Business/Self-Employed
TE/GE	Tax Exempt and Government Entities

Background

Penalties encourage voluntary compliance by demonstrating the fairness of the tax system to compliant taxpayers and increasing the cost of noncompliance. Penalties impose tangible economic consequences on taxpayers who claim or promote abusive transactions and, thereby, should deter such activity. The Internal Revenue Service's (IRS) administration of penalties will largely determine whether an economic consequence is effectively imposed and sufficient to deter future abuses.

In August 2004, the IRS reissued Policy Statement 20-1 as part of an IRS-wide effort to rebalance enforcement and address the increasing proliferation of abusive tax transactions[1] and shelters. The reissued statement provides that accuracy-related or fraud penalties will be developed in all cases where an underpayment of tax is attributable to a listed transaction. A listed transaction is a transaction that is the same as, or substantially similar to, one of the types of transactions that the IRS has determined to be a tax avoidance transaction (see Appendix IX for the IRS's published record of listed transactions). The reissued statement also says that revenue agents will consider the applicability of penalties to non-listed but potentially abusive transactions and will impose penalties on promoters and preparers involved in abusive tax transaction activities. A non-listed transaction is a potentially abusive, reportable transaction which is not included on the IRS's published record of listed transactions.

The American Jobs Creation Act of 2004[2] added Internal Revenue Code (I.R.C.) Section 6707A (hereafter referred to as §6707A) to provide a monetary penalty for the failure to include on any return or statement any information required to be disclosed under I.R.C. §6011[3] with respect to a reportable transaction. The §6707A penalty applies to tax returns and statements with due dates after October 22, 2004. For failure to disclose a non-listed reportable transaction, the §6707A penalty 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 can be applied in addition to any other penalty imposed and applies regardless of whether the transaction ultimately results in an understatement of tax. Unlike most other penalties, it contains no reasonable cause exception. However, the IRS Commissioner may

> ***For failure to disclose a listed transaction, the §6707A penalty is $100,000 for an individual and $200,000 for any other business or entity.***

[1] See Appendix X for a glossary of terms.
[2] Pub. L. No. 108-357, 118 Stat. 1418.
[3] I.R.C. §6011 requires a taxpayer that has participated in a reportable transaction to disclose certain information with respect to the reportable transaction with his or her tax return.

rescind the penalty for reportable non-listed transactions to promote compliance with the tax laws and effective administration. The penalty cannot be rescinded for listed transactions; only non-listed transactions can be rescinded.

The §6707A penalty cannot be rescinded for listed transactions.

I.R.C. regulations generally require that a taxpayer inform the IRS of participation in a reportable transaction by attaching a Reportable Transaction Disclosure Statement (Form 8886) to his or her tax return or statement for each year of participation in the transaction. In addition, a duplicate Form 8886 must be sent to the Large and Mid-Size Business (LMSB) Division's[4] Office of Tax Shelter Analysis (OTSA) the first time the taxpayer files Form 8886.

IRS field examiners in the Small Business/Self-Employed (SB/SE), LMSB, and Tax Exempt and Government Entities (TE/GE) Divisions have completed approximately 742 examinations for the §6707A penalty from inception of the penalty on October 23, 2004, through December 31, 2009. The IRS has assessed 517 penalties from the 742 examinations which account for $73,856,500 in potential penalty revenue.

On September 27, 2010, H.R. 5297 – The Small Business Jobs Act of 2010 – was signed into law, which included revisions to the §6707A penalty. Specifically, the penalty amount with respect to any reportable transaction shall be 75 percent of the decrease in tax shown on the return as a result of the transaction (or which would have resulted from the transaction with respect to Federal tax purposes). The maximum penalty amount with respect to any reportable transaction shall not exceed $200,000 in the case of a listed transaction ($100,000 in the case of a natural person) or $50,000 in the case of any other reportable transaction ($10,000 in the case of a natural person). The minimum penalty amount shall not be less than $10,000 ($5,000 in the case of a natural person) with respect to any transaction. The effective date of this amendment applies to penalties assessed after December 31, 2006.

This review was performed at the LMSB, SB/SE, and TE/GE Divisions Examination function, Office of Appeals, and Office of Chief Counsel in Washington, D.C.; and the LMSB Division Pre-Filing and Technical Guidance function in Washington, D.C., and Ogden, Utah, during the period October 2009 through June 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

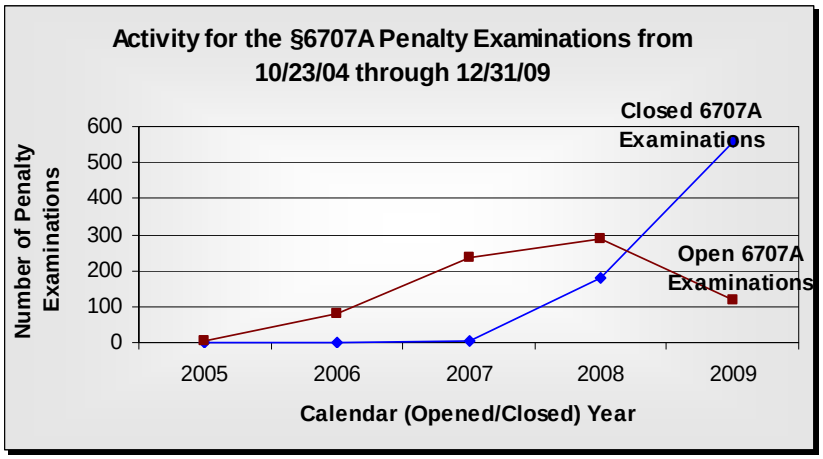
[4] Effective October 1, 2010, the IRS's LMSB Division's name was changed to the Large Business and International Division.

Results of Review

The Internal Revenue Code Section 6707A Penalty Was Substantially Higher Than Many Taxpayers' Additional Tax Assessments

In October 2004, Congress enacted the §6707A penalty for failure to disclose a reportable transaction, with the intent of helping to detect, deter, and shut down abusive tax shelter activity. At the time the penalty was enacted, listed tax shelters involving hundreds of millions of dollars were prevalent and the size of these transactions influenced the size of the disclosure penalty. The penalty resulted in substantially higher disclosure rates to the IRS, which helped to identify and shut down many abusive transactions. In Calendar Year (CY) 2005, the OTSA received approximately 217,000 Forms 8886 compared to approximately 53,000 in CY 2008. Figure 1 shows the activity of open and closed examinations on the §6707A penalty from October 23, 2004, through December 31, 2009.

Figure 1: Open and Closed §6707A Penalty Examinations



Source: Our analysis of the IRS Individual Master File (IMF) and Business Master File (BMF) systems, Examination Return Control System, and Audit Information Management System as of December 31, 2009.

From CYs 2005 through 2008, the number of penalty examinations opened each CY increased and then declined significantly in CY 2009. As of December 31, 2009, there were 120 open and 742 closed[5] examinations for the §6707A penalty.

[5] This is the sum total of closed §6707A examinations for CYs 2005–2009.

In 2004, the IRS determined that some transactions, including certain Section 412(i) Qualified Retirement Plans[6] and Abusive Roth Individual Retirement Arrangement Transactions[7] that had been adopted by some small businesses were listed transactions and thus subject to disclosure. Congress became concerned when it was brought to their attention that §6707A penalties were significantly larger than the tax benefits small business owners received from investment transactions which they thought were legitimate benefits plans. Some of these business owners were not advised by the parties selling the benefits packages that the plans had been identified by the IRS as abusive transactions. They did not learn of this status until they were examined by the IRS and assessed substantial penalties for failing to disclose the transactions on their tax returns. Many §6707A penalties already assessed fall under these categories of transactions and it is likely that more penalties will result from the open §6707A examinations.

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. There were 270 §6707A penalties assessed from October 23, 2004, through June 30, 2009.[8] Figure 2 compares any additional or potential additional tax assessments[9] on the underlying tax returns with the 270 penalty amounts. We attempted to determine the specific tax benefit taxpayers received from their participation in the abusive transactions; however, we could not determine the precise tax benefit because additional tax assessments resulting from the audit of the underlying tax returns could include other tax return issues and/or other types of penalties. The additional assessments could involve issues unrelated to the §6707A transactions, so our comparison conservatively[10] compares tax benefits received with the §6707A penalty assessed.

[6] Revenue Ruling 2004-20, 2004-10, Internal Revenue Bulletin 546, Mar 8, 2004.
[7] Notice 2004-8, 2004-4, Internal Revenue Bulletin 333, Jan 26, 2004.
[8] Our audit field work began in October 2009. Because the IRS temporarily suspended collection enforcement actions on July 7, 2009, we analyzed penalties assessed through June 30, 2009.
[9] Additional or potential additional tax assessments were on the related underlying tax returns of the 270 penalties reviewed. Potential assessments were usually those pending litigation in tax court. Both amounts were identified through the IRS's Integrated Data Retrieval System.
[10] In other words, the additional tax assessment shown is not limited to the §6707A transaction. The assessment based only on participation in the §6707A transaction might actually be less.

Figure 2: §6707A Penalties Compared With Additional Tax Assessments

Category	Total Number of Penalties	§6707A Penalty Amount	Additional Tax Assessment[11]	Difference	Percentage Variance Against Penalty
Cases With No Additional Tax Assessment	145	$26,064,000	$ -	$26,064,000	100%
Cases With Additional Tax Assessment Less Than Penalty	82	$9,950,000	$3,641,161	$6,308,839	63%
Cases With Additional Tax Assessment Greater Than Penalty	43	$4,377,000	$123,162,122	($118,785,122)	-2,714%

Source: Our analysis of 270 assessed §6707A penalties between October 23, 2004, and June 30, 2009.

Our analysis showed that 145 penalties had no additional or potential additional tax assessments but had §6707A penalties of more than $26 million. There were also 82 penalties where §6707A assessments were 63 percent higher than total additional or potential additional tax assessments ($9.9 million in penalties compared with $3.6 million in additional assessments). In contrast, there were only 43 penalties where total additional or potential additional assessments were higher than §6707A penalties.

To obtain a better understanding of how these penalties affected businesses and owners, we selected a sample of assessed §6707A penalties. We focused our sample selection on penalties with multiple tax years and/or related entities. For example, an S Corporation may have received a $200,000 penalty for 2 tax years ($400,000) and 2 of the owners[12] may have received a $100,000 penalty for 2 tax years ($400,000), resulting in a total of 6 penalties in the amount of $800,000 on the same reportable transaction. After grouping the population of assessed §6707A penalties by multiple tax years and/or related entities, we selected all the grouped cases, along with a random sample of individual penalties that did not involve multiple tax years and/or related entities. Overall, we reviewed 114 (75 percent) of the 153 assessed, reviewable[13] §6707A penalties.

Although we did not base our sample selection upon the type of abusive transaction, 104 (91 percent) of the 114 sampled penalties were under Section 412(i) Qualified Retirement Plans and Abusive Roth Individual Retirement Arrangement Transactions. As a result of

[11] Additional tax assessments could include assessments on other types of tax issues and/or other types of penalties.
[12] Owners of an S Corporation would receive the §6707A penalty if they did not report the transaction because income passes through to their individual tax returns.
[13] We chose our sample from 153 of 270 assessed penalties as of June 30, 2009, after we determined that 90 of the 270 penalties were not reviewable due to a lack of documentation in the case files, and 27 penalties were not reviewable because the cases files were never received.

grouping the 114 penalties together, we identified 42 unique[14] cases. Figure 3 compares any additional or potential additional tax assessments[15] on the underlying tax returns with the 114 penalty amounts.

Figure 3: §6707A Penalty Assessments Versus Additional Tax Assessments

Category	Unique Cases	Penalties	§6707A Penalty Amount	Additional Tax Assessment[16]	Difference	Percent Variance against Penalty
Cases With No Additional Tax Assessment	14	18	$3,220,000	-	$3,220,000	100%
Cases With Additional Tax Assessment Less than Penalty	21	80	$11,850,000	$3,301,905	$8,548,095	72%
Cases With Additional Tax Assessment Greater than Penalty	7	16	$1,861,000	$4,239,961	($2,378,961)	(128%)
Total	**42**	**114**	**$16,931,000**	**$7,541,866**	**$9,389,134**	**55%**

Source: Our analysis of 114 assessed §6707A penalties between October 23, 2004, and June 30, 2009.

Our analysis showed that 14 (33 percent) of 42 unique cases had no additional or potential additional tax assessments but had §6707A penalties totaling more than $3.2 million. There were 21 (50 percent) of 42 unique cases where total §6707A penalties assessed were 72 percent higher ($11.8 million versus $3.3 million) than total additional or potential additional tax assessments. In contrast, there were only 7 (17 percent) of the 42 unique cases where total additional or potential additional assessments were higher than §6707A penalties. For all 42 unique cases combined, §6707A penalties were 55 percent ($16.9 million versus $7.5 million) higher than additional or potential additional tax assessments which resulted from audits of the underlying tax returns.

Although the penalty was frequently more than the tax assessments received by the small businesses, it does not appear the penalty was disproportionally assessed on them. We compared the business operating division codes for open and closed §6707A penalty cases with the total

[14] Unique cases are related to a single reportable transaction that may have involved multiple penalties, such as the S Corporation example we cited previously in the report narrative.
[15] Additional or potential additional tax assessments were on the related underlying tax returns of the 114 penalties reviewed. Potential assessments were usually those pending litigation in tax court. Both amounts were identified through the IRS Integrated Data Retrieval System.
[16] Additional tax assessments could include assessments on other types of tax issues and/or other types of penalties.

number of SB/SE and LMSB Division taxpayers.[17] While the majority (96 percent) of the §6707A open and closed examinations were SB/SE Division taxpayers, there are a proportionally higher number of SB/SE Division taxpayers in the overall population of business taxpayers (more than 99 percent).

Processing of Penalties Continued After Collection Enforcement Actions Were Suspended

In June 2009, the Senate Finance Committee requested the IRS suspend "collection efforts" on §6707A liabilities in cases where the annual tax benefits resulting from listed transactions were less than $100,000 for individuals and $200,000 for other cases. This suspension would give temporary relief to affected taxpayers and allow Congress the necessary time to assess the situation and modify the law so that penalty amounts would be more in line with tax benefits taxpayers receive.

As of July 7, 2009, the IRS agreed to temporarily suspend "collection enforcement actions" on these liabilities through September 30, 2009. The IRS informed us that suspension of "collection enforcement actions" means no levy or seizure action will occur. Therefore, the suspension did not preclude the issuance of Notices of Assessment, which are required by law, and adjustment notices, which inform the taxpayer of any account activity. The IRS also made it clear that although collection enforcement actions would stop, examinations and assessments on §6707A issues would continue. From the time collection enforcement actions were stopped through December 31, 2009, the IRS assessed 227 additional §6707A penalties in the amount of $31,957,000. The IRS has extended the suspension of collection enforcement actions every 90 days to allow Congress the time it needs to make legislative changes. On January 12, 2010, the IRS agreed to suspend collection enforcement actions on all §6707A penalties and no longer limited suspension to cases where annual tax benefits thresholds were met.

Our analysis reflects the following actions continued after the IRS suspended collection enforcement actions:

- Collection notices were sent.
- Tax liens were filed.
- Interest continued to accrue on penalties.
- Taxpayers made payments on §6707A penalties.
- The Office of Appeals settled penalties.

[17] Total number of SB/SE and LMSB Division taxpayers was obtained from the IRS's BMF and IMF systems using Tax Year 2008 data as of April 30, 2010.

Collection notices were sent

From the population of all taxpayers with assessed §6707A penalties as of December 31, 2009, we identified 119 collection notices sent to 97 taxpayers[18] after collection enforcement actions were stopped on July 7, 2009. Types of collection notices sent to these taxpayers include Notices of Civil Penalty assessments, Adjustment Notices, Balance Due Notices, and Final Notices of Intent to Levy (see Appendix V for a full list of notices sent and Appendices VI to VIII for examples of the notices). Although notices of assessment are required by law, final notices with intent to levy are required by law only if the IRS intends to levy the taxpayer. The language used in these notices informs the taxpayer he or she owes money and it needs to be paid by a specific date or interest will continue to be charged on the balance and collection actions will continue. In addition, 35 (29 percent) of the 119 notices were 4th Balance Due Notices, which have wording that the IRS has intent to levy any State tax refunds. Seven (6 percent) of the 119 notices were Final Notices With Intent to Levy and Notice of Rights to a Hearing. Fifteen (36 percent) of these 42 notices were issued after December 31, 2009.

IRS management informed us that issuance of a notice is not a violation of the suspension of "collection enforcement actions," and notices are issued to keep the taxpayer apprised of any activity that may have affected his or her case. IRS management advised us they tried to stop the issuance of the final notice and demand, offering the taxpayer his or her due process rights after they realized these notices were still being sent. IRS management advised us the problem was corrected soon after the suspension period began. However, our analysis showed that some of Final Notices With Intent to Levy and Notice of Rights to a Hearing were issued in October 2009 and others were issued in February 2010.

Tax liens were filed

As of December 31, 2009, we identified 13 tax liens filed on taxpayers with §6707A liabilities. Until taxpayers complained about these liens being filed, the Senate Finance Committee was unaware the IRS had continued this collection action. The IRS stated that the suspension of "enforced collection actions" refers to levy and seizure actions, but not liens. The IRS continued to file tax liens in those instances where it felt the Federal Government's interest needed to be protected. At the request of the Senate Finance Committee, the IRS agreed to stop filing liens on these taxpayers after December 22, 2009, but the liens already filed would not be released.

Interest continued to accrue on penalties

Although collection enforcement actions were stopped, the §6707A liabilities previously assessed, as well as some new assessments, continued to accrue interest. We identified 115 penalties that were assessed interest after July 7, 2009. The amount of interest assessed on these accounts after July 7, 2009, through April 19, 2010, was approximately $143,000. IRS

[18] Some taxpayers received more than one collection notice.

management advised us they were not aware of any plans to suspend the interest accrual during the suspension of collection enforcement actions.

Taxpayers made payments on §6707A penalties

Taxpayers also continued to make payments on §6707A liabilities after collection enforcement actions were suspended. We identified 14 subsequent payments[19] in the amount of $1,429,403 for §6707A liabilities as of April 30, 2010. **********1********** ********. However, the majority of payments appear to have been initiated by taxpayers themselves.

The Office of Appeals settled §6707A penalties

Although the IRS Commissioner may not rescind §6707A penalties for listed transactions, the IRS Office of Appeals (Appeals) has the authority to settle or reduce penalties (in whole or in part) for both non-listed and listed transactions. Between October 23, 2004, and December 31, 2009, Appeals offered and taxpayers accepted settlements for 79 (15 percent) of the 517 §6707A penalties, resulting in a total reduction of $3,971,000 in penalty amounts. These settlements were based on "hazards of litigation," which is the risk that a court might decide the IRS had insufficient factual basis to impose the penalty.

Many Internal Revenue Code Section 6707A Penalty Files Were Incomplete or Did Not Contain Sufficient Evidence

Unlike other civil penalties, the §6707A penalty has special processing procedures. The IRS developed these special procedures to enable them to expedite the imposition and potential rescission[20] of the §6707A penalty and facilitate centralized tracking of rescission requests. Interim processing procedures (procedures) require developing the §6707A penalty case file at the beginning of the examination as a separate file and assessing the penalty independently from any underlying tax liability or other penalties. Also, because the statute provides no reasonable cause or other good faith exception to the penalty, field examiners (examiners) must fully develop the relevant facts of the case and include all pertinent documents or other evidence that demonstrates the transaction was a reportable transaction.

[19] Subsequent payments are payments made after the initial tax assessment. These 14 payments were on §6707A penalties assessed from October 23, 2004, though June 30, 2009.

[20] §6707A allows the IRS Commissioner to rescind the imposition of the penalty with respect to reportable non-listed transactions if it would "promote compliance with the tax laws and effective tax administration." The penalty cannot be rescinded with respect to a listed transaction.

To determine if examiners were properly following procedures, we reviewed a sample of assessed §6707A penalties. During our sample selection and review of case files, we identified the following issues:

- Justifications for penalties were missing.
- Audit evidence was not always sufficient.
- Notifications to taxpayers were not always proper.
- Management approvals and power of attorney forms were missing.
- Procedures were not always sufficient or formalized.

Justifications for penalties were missing

Through the IRS's Integrated Data Retrieval System, we ordered all 270 §6707A penalty files closed as of June 30, 2009, by using the Document Locator Number for the corresponding penalty assessment.[21] Our plan was to select a sample from this population; however, we determined 90 (33 percent) of the 270 penalty files could not be reviewed because the examiners' justifications for the penalties were missing from the files.

Procedures instruct examiners to justify the §6707A penalty by explaining the category of the reportable transaction, giving a description and facts of the transaction, explaining the examiner's rationale for concluding that the taxpayer participated in a reportable transaction, and stating whether the taxpayer filed a Form 8886 (usually found on Explanation of Items (Form 886-A) or similar form). Without this documentation in the penalty file, the evidence supporting the §6707A penalties was not available.

Audit evidence was not always sufficient

When tax returns are filed by taxpayers, many of the forms are transcribed into IRS systems for later viewing. However, Forms 8886 are not. Without viewing the original tax return[22] or applicable amended tax return,[23] there is no way to determine if the Form 8886 was attached to the return. Procedures require examiners to order the original tax return and determine whether a disclosure was filed with the return.

[21] §6707A penalty assessments are posted on IRS master file systems with Transaction Code 240 with Reference Code 648.
[22] The original tax return is the first tax return filed for the tax year.
[23] Filing an amended return with a disclosure will not cure the failure to file a disclosure with the original return unless the amended return is filed before the due date of the original return (whether extended or not).

Our review of 114 of the remaining, reviewable penalties[24] showed 61 (54 percent) did not contain a copy of the original tax return or any documentation explaining how the examiner determined the Form 8886 was not filed with the taxpayer's return. Without this documentation in the penalty file, examiners' statements that taxpayers did not file the Form 8886 disclosures, as required, do not have adequate support.

Notifications to taxpayers were not always proper

Examiners are normally required to notify taxpayers of tax deficiencies that will be assessed. The examiners must inform taxpayers of their right to appeal in closing discussions and by issuing a 30-day letter.[25] For taxpayers who do not respond to the 30-day letter, a statutory notice of deficiency is required.[26] However, because the §6707A penalty is not subject to tax deficiency rules (including the requirement to issue a statutory notice of deficiency), the Tax Court generally does not have jurisdiction to review it. Procedures state that in general, a 30-day letter should be issued with at least 6 months remaining on the statute of limitations to allow the taxpayer time to appeal. In addition, the penalty may be assessed before a taxpayer is granted Appeals consideration under certain conditions, such as when the expiration of the period of limitations is imminent and consent to extend that period has not been secured. In these cases, procedures instruct the examiner to assess the penalty, document the file, and inform the taxpayer of the right to appeal.

In 15 (13 percent) of the 114 penalties reviewed, we did not find documentation citing discussions or any written notifications to taxpayers of decisions to assess the penalty, or their right to appeal. In addition, we found documentation was incomplete. The incomplete documentation could have confused taxpayers about the actual penalty amounts. For example, if the penalty is being assessed for an S Corporation and the related owner, there would be two penalties which would require a notification letter to the S Corporation and to the related owner. However, in some cases, notification letters to taxpayers were mailed only to the S Corporation and not to the owner. In addition, the attached correspondence showed the penalty amount for only the S Corporation and, therefore, the related owner would not be informed of the penalty on his or her individual account. In another example, if the penalty was going to be assessed on an individual for 2 tax years, the 30-day letter sent to the taxpayer included only a notice of

[24] We chose our sample from 153 of 270 assessed penalties as of June 30, 2009, after we determined that 90 of the 270 penalties were not reviewable due to a lack of documentation in the case files and 27 penalties were not reviewable because the case files were never received.

[25] The 30-day letter (L-4143) accompanies a report giving a computation of the proposed adjustments to the tax return and informs the taxpayers of the courses of action to take if they do not agree with the proposed adjustments. It also instructs taxpayers they have 30 days from the date of the letter in order to appeal the proposed adjustments with the Office of Appeals.

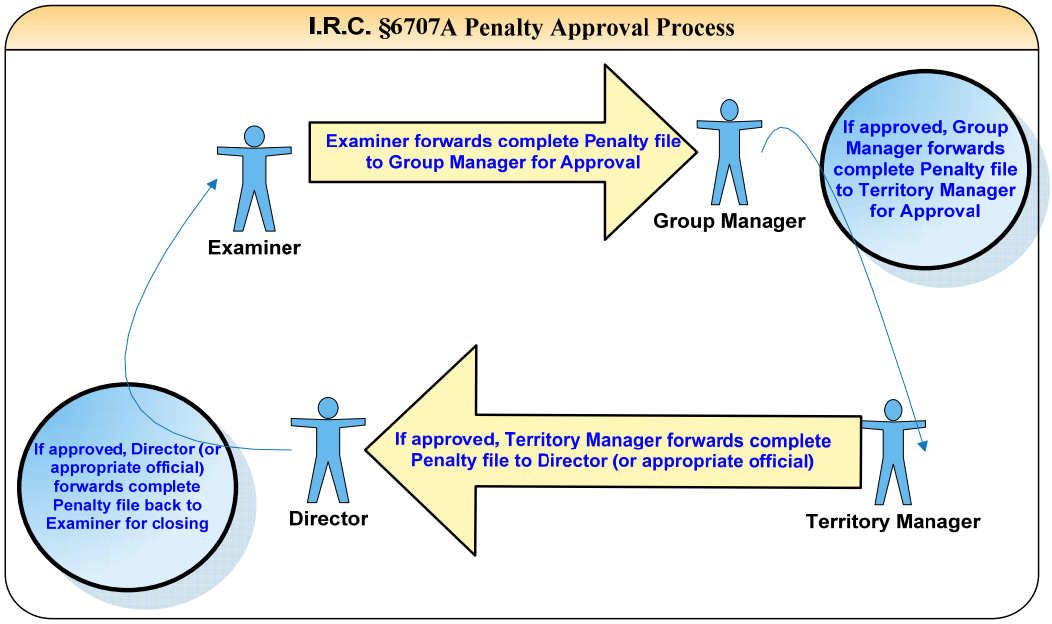
[26] The Statutory Notice of Deficiency is required by law. This notice provides the taxpayer with his or her right to petition the United States Tax Court if he or she disagrees with the deficiency.

assessment for 1 tax year. Without properly notifying taxpayers of penalty assessments and their right to appeal, taxpayer rights were potentially violated in these 15 cases.

Management approvals and power of attorney forms were missing

Because the §6707A penalty has no reasonable cause or other good faith exception, the IRS developed a comprehensive approval process for the §6707A penalty. Figure 4 shows these procedures which are intended to ensure consistent and fair treatment of taxpayers.

Figure 4: Flowchart of §6707A Penalty Approval Process



Source: Our analysis of §6707A processing procedures.

Notwithstanding the requirement for these levels of managerial approval, we identified 12 (11 percent) of 114 penalties that did not have signed approval documents in the case files. For 4 of the 12 penalties, there were related taxpayers who received the §6707A penalty on the same reportable transaction, and the case files for those related taxpayers had signed approval documents. However, the approval documents and their associated examiner's reports did not reference the penalties that were assessed on the four cases without approval documents.

Procedures also require that if a taxpayer's representative is to be included in correspondence or discussions of the §6707A penalty, a revised Power of Attorney and Declaration of Representative (Form 2848) is necessary. The revised Form must include the language, "Income Taxes and Civil Penalties." This revised Form helps to ensure IRS employees do not give protected taxpayer information to unauthorized third parties. Our case review showed 19 (17 percent) of 114 penalties did not have a Form 2848 in the case file even though there was correspondence with the taxpayer's representative.

Further analysis of these cases showed:

- 15 of the 19 penalties had an indicator on IRS computer systems that would have alerted the examiner that the taxpayer had an authorized representative.
- 4 of the 19 penalties had no indicators on IRS computer systems that would have alerted examiners that the taxpayer had an authorized representative.

If the §6707A penalty is not being properly approved or power of attorney forms are not obtained from taxpayer's representatives, the IRS may not be able to ensure examiner decisions are appropriate, taxpayers are receiving fair treatment, and taxpayer information is being protected.

IRS management informed us that our review has made them aware there are some problems with the physical handling of the case files. They believe the documentation in many of the case files was complete at one time. They explained one reason may be the §6707A penalty appeals process is different than regular tax return examinations. Normally, when a taxpayer requests an appeal, the examination would be closed and the case file would be forwarded to Appeals. Appeals would then be responsible for the case file and for obtaining any extensions on expiring statutes of limitations from taxpayers during the appeal investigation. However, for §6707A penalties, although the case file is sent to Appeals, the case remains open in the Examination function and the examiner, not Appeals, is responsible for obtaining extensions from the taxpayer on expiring statutes. After the file comes back from Appeals, which may take a year or more, the penalty either is assessed or not, depending on Appeals' decision. The case is then closed and the penalty file is sent to the Cincinnati (SB/SE or TE/GE Division cases) or Ogden (LMSB Division cases) Campus for filing. IRS management believes documents may be getting lost during the time in Appeals or after they are sent to the Cincinnati or Ogden Campus for filing.

Notably, the TE/GE Division handles the appeals process differently than the SB/SE and LMSB Division Examination functions by requiring a review by a mandatory review office. The mandatory review office sends the original penalty file to Appeals, but keeps a full copy to make it easier to obtain statute extensions, as needed. For all cases, the TE/GE Division sends the assessment documents to the Cincinnati Campus to be processed. After the assessment has posted and a Document Locator Number is assigned, the TE/GE Division sends the entire penalty case file to the Cincinnati Campus so it may be associated with the assessment documents. There is some evidence that documents may be getting lost or separated after TE/GE Division files are sent to the Cincinnati Campus for these purposes. TE/GE Division examiners worked 14 of the 114 penalties we reviewed where documentation was missing from the case file. Although the case files had missing documents, management was able to provide complete copies of the original case files that were maintained by the mandatory review office that controlled the cases. They could not explain why the original files at the Cincinnati Campus did not contain all of the documentation.

Procedures were not always sufficient or formalized

IRS management and employees rely on formalized, written procedures to ensure proper handling and consistent treatment of taxpayers. In addition, written procedures help to ensure consistency when the organization experiences changes to personnel, such as retirements, reassignments, and reorganizations. Our review of the procedures for §6707A penalties identified some weaknesses that could cause confusion and/or inconsistent processing of the penalties. Specifically, management should address procedural weaknesses related to:

- Opening an investigation.
- Assessing a penalty.
- Maintaining documentation in the case files.
- Formalizing procedures in the Internal Revenue Manual (IRM).

When a §6707A penalty investigation is opened, the examiner should notify the taxpayer of the impending examination. Normally, the taxpayers are notified by the examiner who sends an opening letter to the taxpayer. However, our case review identified 22 (19 percent) of 114 penalties which did not contain an opening letter to the taxpayer in the case file or documentation on how the taxpayer was notified. IRS management informed us that opening letters for §6707A penalty examinations were not required in these cases because a tax return examination was already in process and examiners would notify the taxpayer about the §6707A examination during the tax return examination. Although the majority of penalties we reviewed did have underlying tax return examinations, the procedures should be clarified to ensure examiners properly notify taxpayers. The current procedures do not clarify when an opening letter to the taxpayer is required to be used and when other forms of notification and documentation are acceptable.

When assessing the penalty, examiners should send an Assessment and Abatement of Miscellaneous Civil Penalties (Form 8278) with attachments to the OTSA for listed transaction penalties. This procedure was developed because the OTSA is responsible for notifying the Securities and Exchange Commission of a §6707A penalty assessment for taxpayers who have a Securities and Exchange Commission filing requirement. However, our case review identified 91 (80 percent) of 114 penalties that did not have evidence showing that the assessment documents were sent to the OTSA. Management explained these procedures were eliminated for SB/SE Division examiners because most small businesses and owners do not have the Securities and Exchange Commission filing requirement. However, the procedures were never updated to explain for whom and when it is necessary to send the Form 8278 to the OTSA. LMSB Division examiners are still required to send the Form 8278 because of the possibility of a Securities and Exchange Commission filing requirement.

In addition, procedures for processing the §6707A penalty were never formally published in the IRM. The penalty was effective on October 23, 2004, and interim processing and technical

guidance was issued to employees on July 31, 2006, by the Commissioners of the SB/SE, LMSB, and TE/GE Divisions and Chief of Appeals. This interim guidance was updated on September 5, 2008, for SB/SE and LMSB Division examiners. The TE/GE Division and Office of Appeals issued separate interim guidance subsequent to the issuance of the original July 31, 2006, guidance. Although the SB/SE Division noted the updated guidance would be incorporated into the IRM by August 25, 2009, it had not been completed as of June 2010.

Some SB/SE and LMSB Division examiners and group managers informed us that the procedures were not clear about what is required to be in the case file and to what extent the §6707A penalty case should be developed. Both SB/SE and LMSB Division examiners had to search the SB/SE Division Abusive Transaction web site for procedures and contact technical advisors to get more instructions on how to follow the procedures. This situation may have contributed to the number of cases in our sample that had missing or incomplete documents. IRS management informed us that procedures have not been further updated or incorporated into the IRM because of the pending Congressional action on the penalty. However, the penalty has been in effect since CY 2004 (approximately 6 years have passed). We believe the IRS should publish the guidance to help address some of the problems we have identified. If §6707A penalty processing procedures are not sufficient or up-to-date, examiners may continue to experience problems and there is a higher risk for inconsistent treatment of taxpayers.

Recommendations

The Deputy Commissioner for Services and Enforcement should:

Recommendation 1: Revise procedures to ensure that §6707A penalty cases are fully supported and required documents are maintained in the case files.

> ***Management's Response:*** IRS management agreed with this recommendation. They will update the procedures to ensure that proper documentation is maintained in the penalty case files to reflect the elimination of certain procedures in specific situations, to clarify the limited application of certain procedures, and to implement the recent amendment to penalty calculation.
>
> However, IRS management disagreed with the outcome measures we reported. Although management agreed that failing to issue a 30-day letter (which includes information about Appeal rights) or a notification of assessment and failing to obtain a proper power of attorney form would be improper, management believes the missing documentation reflects a case-closing problem rather than a case development problem.
>
> ***Office of Audit Comment:*** The Treasury Inspector General for Tax Administration continues to believe the outcome measure of 19 cases where taxpayer rights were potentially violated is reasonable. The IRS has not provided evidence that SB/SE and

LMSB Division penalty cases have a case-closing problem rather than a case development problem.

Recommendation 2: Formalize §6707A penalty procedures in the IRM to reflect changes in procedures, technical guidance, and amendment to the penalty.

> ***Management's Response:*** IRS management agreed with this recommendation. They will update the IRM with revised procedures and technical guidance to implement the amendment to the §6707A penalty and to reflect other changes in case handling.

Some Processes That Require Coordination Between the Office of Tax Shelter Analysis and Other Functions Need Improvement

Responsibility for identifying, developing, and assessing the §6707A penalty involves a coordination of efforts among employees from the SB/SE, LMSB, and TE/GE Divisions, Office of Appeals, and Office of Chief Counsel. Cross-divisional discussions are often required for various activities such as effective processing and dissemination of Form 8886 disclosures, proper development and updating of procedures, coordination of taxpayer appeals, and timely assistance to field examiners.

In February 2000, the OTSA was created to serve as the focal point for efforts to gather and analyze information relating to tax shelter activity, and to coordinate appropriate responses. One of its primary responsibilities is to review, analyze, disseminate, and report on the Forms 8886 it receives each year. When a taxpayer files the first Form 8886 to disclose a reportable transaction, a duplicate copy must be sent to the OTSA. During discussions with IRS management and our review of 114 assessed §6707A penalties, we identified instances in which the coordination between the OTSA and other functions needed improvement. Specifically, improvements are needed when:

- Identifying and assessing penalties on incomplete Forms 8886.
- Verifying Forms 8886 were filed with the OTSA.

§6707A penalties are not being assessed on incomplete Forms 8886

When a taxpayer files a Form 8886, it must include sufficient information for the IRS to understand the reportable transaction. If disclosures are not completed in accordance with the law and the instructions to the Form, the taxpayer is considered noncompliant with the disclosure requirements. The OTSA is responsible for identifying potentially incomplete Form 8886 disclosures for all taxpayers; however, the OTSA coordinates with the Abusive Transaction Support Unit for SB/SE Division or Wage and Investment Division taxpayers.

The OTSA reviews all Forms 8886 for initial completeness and sends potential incomplete disclosures, related to taxpayers currently under examination, to an LMSB Division examination

team for determination of completeness. For any remaining potentially incomplete disclosures, the OTSA makes contact with the taxpayer using the Incomplete Form 8886 Letter (Letter 4146), which asks for more information concerning the disclosed transaction. After reviewing any additional information provided by the taxpayer and discussions with the Office of Chief Counsel, the OTSA notifies the appropriate examination teams for possible assignment on remaining incomplete disclosures. The assigned examination teams, through consultations with field Counsel, then determine the value of any additional information provided by the taxpayer and whether the disclosure is complete.

In CY 2006, the OTSA identified 160 incomplete Form 8886 disclosures. After more in-depth research, the OTSA identified 70 potentially incomplete disclosures and sent Letters 4146 to these taxpayers for more information on the transactions. Based on the subsequent information received from taxpayers, the OTSA determined the following:

- 43 disclosures did not have a §6707A filing requirement or were determined to be complete.
- 8 disclosures were determined to be "most likely" complete after discussions with taxpayers.
- 5 disclosures where the filing requirement was "questionable" after discussions with taxpayers.
- 9 disclosures involved taxpayers who did not respond to the first or second Letter 4146. Penalties were not pursued for these taxpayers because the assessment statutes were close to expiring and/or Counsel determined the disclosures were complete.
- 5 disclosures where OTSA Special Counsel to the Office of Chief Counsel agreed they were incomplete. The OTSA sent these disclosures to LMSB Division field examination for §6707A penalty consideration, which agreed to work four of these cases. Examiners contacted their local field Counsel who in turn contacted National Office to the Office of Chief Counsel which reviewed the facts of the cases and determined the disclosures were, in fact, complete.

The OTSA did not perform an analysis on the incomplete Form 8886 disclosures in CY 2007 because of processing problems that failed to identify the incomplete disclosures. However, in CY 2008, the OTSA identified 76 incomplete Form 8886 disclosures with no associated open examination, and Letters 4146 were sent to these taxpayers for more information. Based on subsequent information received from taxpayers, the OTSA determined the following:

- 36 disclosures did not have a §6707A filing requirement.
- 27 disclosures are currently under further evaluation by the OTSA, and it is expected that most of these disclosures will be sent to the field for potential §6707A penalty examinations.

- 9 disclosures involved taxpayers who did not respond to the first or second Letter 4146, and the OTSA is considering what additional actions should be taken.
- 4 disclosures had additional issues and were sent to the field for an income and penalty examination.

In our analysis on the incomplete disclosures sent to the field, we determined there were no §6707A penalty examinations opened or penalties assessed. There is a risk that these large companies will continue to participate in abusive tax transactions and not be penalized for incomplete disclosure.

OTSA management explained they are following the legal guidelines and Form 8886 disclosure instructions, but it is ultimately up to field examiners to make the final determination whether disclosures are required and incomplete. In addition, the §6707A penalty investigation is not mandatory work for LMSB Division field examination.

Examiners did not verify that Forms 8886 were filed with the OTSA

Development of the §6707A penalty requires evidence that taxpayers did not file the Form 8886 as required. In some cases, a taxpayer may have filed the Form 8886 disclosure for a reportable transaction with his or her underlying tax return for the first time, but failed to send a duplicate copy to the OTSA as required. In these cases, the penalty can still be assessed. Procedures instruct examiners to verify with the OTSA whether or not a Form 8886 disclosure is on file. However, our case review showed that examiners did follow this procedure in 67 (59 percent) of 114 cases.

IRS management informed us that once examiners determine the Form 8886 has not been filed with the underlying tax return, they have enough evidence to assess the penalty and there is no need to follow through and verify whether the OTSA has a disclosure on file. However, the requirement to verify whether the Form 8886 was filed with the OTSA should not be limited to compiling evidence for assessing penalties. The OTSA is the central clearinghouse for all tax shelter activity affecting the LMSB, SB/SE, and TE/GE Divisions. Their responsibilities include review, analysis, dissemination, and reporting on disclosures and registrations required by law to aid in the identification and development of emerging tax shelters. If examiners do not follow through to verify the OTSA has a Form 8886 on file for these taxpayers, the OTSA may not be aware of all the types of taxpayers and reportable transactions identified by the examiners.

Recommendations

The Deputy Commissioner for Services and Enforcement should:

Recommendation 3: Ensure that incomplete Form 8886 disclosures are properly reviewed for potential §6707A penalty examinations.

> ***Management's Response:*** IRS management agreed with this recommendation. The OTSA will establish procedures for tracking the disposition of potentially incomplete Form 8886 disclosures associated with all taxpayers with ongoing examinations, as well as examinations that may originate to determine the completeness of information on the Form 8886 and potential §6707A penalty.

Recommendation 4: Revise procedures to clarify conditions that require examiners to contact the OTSA to confirm if the Form 8886 disclosure is on file.

> ***Management's Response:*** IRS management agreed with this recommendation. The Director, Pre-Filing and Technical Guidance, LMSB Division, will revise and publish the conditions under which examiners are required to contact the OTSA to confirm if the Form 8886 is on file.

The Office of Tax Shelter Analysis Does Not Have Formal Processing Procedures for Form 8886

Internal control standards require that agencies establish control activities that ensure management's directives are enforced and carried out. Written procedures help define control activities and help ensure consistency in day-to-day operational activities. The LMSB Division's OTSA is responsible for reviewing, analyzing, disseminating, and reporting on Forms 8886. Although the OTSA processes approximately 50,000 to 80,000 disclosures each year, there is no published IRM guidance explaining these procedures. We observed the entire process, which was lengthy and comprised of various detailed tasks. For example, the OTSA is responsible for:

- Separating Forms 8886 into categories of taxpayers and types of transactions.
- Preparing Forms 8886 into batches.
- Scanning Forms 8886 by batch.
- Verifying the integrity of scanned Form 8886 data in the database.
- Identifying and processing incomplete Forms 8886.
- Disseminating Forms 8886 to the other functions.

The OTSA management informed us procedures were not formalized because the process was still being developed and refined, and that responsible employees understand the process.

However, procedures need to be written and published in the IRM so management can ensure the process is being performed properly and effectively. Also, future employees need to have formal guidelines to follow to provide consistency during employee turnover and for training new employees.

Formal procedures are important because informal or interim procedures may not be readily available or adequately disseminated. Notably, in December 2009, we requested copies of any informal or interim written procedures and OTSA managers advised us that they did not have any. After our request, management drafted interim procedures and provided them to us at a later date. However, during our closing meeting, we were advised that informal interim procedures were written and implemented in September 2008 (before we began our review). Since OTSA managers had advised us that they did not have interim procedures in December 2009, it appears that some managers were not aware that these procedures were available. Formal procedures reduce the risk of this kind of miscommunication.

Recommendation 5: The Director, Pre-Filing and Technical Guidance, LMSB Division, should formalize the OTSA procedures for processing Forms 8886.

> ***Management's Response:*** IRS management agreed with this recommendation. Although the OTSA has had internal desk procedures for the processing of Form 8886, they have not been formally published. The OTSA will take action to formally publish the Form 8886 disclosure processing procedures in the IRM.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate the IRS's effectiveness in identifying, developing, and applying I.R.C. §6707A penalties. To accomplish our objective, we:

I. Determined whether the IRS effectively identified potential violations of the requirement to file Reportable Transaction Disclosure Statement (Form 8886).

   A. Reviewed IRM guidelines and discussed with IRS management the procedures and controls used in the identification process, which IRS functions are involved, and what each function is required to do. We held discussions with the LMSB Division's[1] OTSA[2] and SB/SE Division's Office of Abusive Transactions and Field Examination function.

   B. Determined the steps that the OTSA and other functions take to resolve incomplete Forms 8886.

      1. Discussed and performed a walkthrough of the incomplete Forms 8886 processing program, which included incomplete Forms 8886 identification with OTSA management in Ogden, Utah.

      2. Obtained Form 8886 data from the OTSA database for Tax Years 2004 to 2008.

II. Determined whether the SB/SE Division Examination function is properly developing cases and assessing §6707A penalties.

   A. Reviewed IRM guidelines and discussed with SB/SE Division Examination function management the procedures and controls used for case development, assessment, and rescission of the §6707A penalty.

      1. Determined whether there was a lack of coordination between the OTSA and other IRS functions with regard to the §6707A penalty. We discussed coordination with the OTSA; LMSB, TE/GE, and SB/SE Division Examination functions; Office of Appeals; Office of Chief Counsel; and Taxpayer Advocate Service.

      2. Determined why the IRM for §6707A penalty processing procedures had not been completed.

---

[1] Effective October 1, 2010, the IRS's LMSB Division's name was changed to the Large Business and International Division.
[2] See Appendix X for a glossary of terms.

3. Determined why the §6707A penalty is affecting small businesses much more than large and mid-size businesses. We discussed this issue with the OTSA; LMSB and SB/SE Division Examination function management; and the Office of Chief Counsel.

B. Selected a judgmental sample of 114 §6707A penalties for review that were assessed between October 23, 2004, and June 30, 2009. The sample was chosen from a population of 153 assessed penalties.[3] To choose the sample, the Special Handling Notice for Examination Case Processing (Form 3198) was reviewed for the 153 penalty case files to determine whether there were any related tax years or entities being assessed the §6707A penalty. If a penalty had related tax periods or entities with penalties, they were grouped together and all penalties were reviewed. In addition, some individual penalties were randomly selected from those that did not have related tax years or entities.

C. Reviewed sample cases to determine if controls and procedures were properly followed including:

1. Whether the case was developed and evidence was sufficient to assess the penalty.
2. Whether proper management approvals were obtained for assessments.
3. Compared the tax benefits realized by the taxpayer versus the amount of the §6707A penalties assessed.
4. Determined if the §6707A penalty was reduced by Appeals and why.
5. Considered the potential for fraud as cases were reviewed.

D. Discussed the case review results with SB/SE, LMSB, and TE/GE Division management and obtained agreement or disagreement with conclusions.

III. Analyzed §6707A penalty data, including open and closed cases, for trends. Closed data were compiled through the IMF and BMF systems, and open data were collected through analysis of the Exam Return Control System and Audit Information Management System in the Treasury Inspector General for Tax Administration Data Center Warehouse as of December 31, 2009.

A. For closed cases:

1. Determined by tax period the number and dollar amounts of the §6707A penalties.

[3] We chose our sample from 153 of 270 assessed penalties as of June 30, 2009, after we determined that 90 of the 270 penalties were not reviewable due to a lack of documentation in the case files and 27 penalties were not reviewable because cases files were never received.

2. Determined by business units the breakdown for the totals in Step III A.1.
3. Evaluated the types of taxpayers affected by the §6707A penalties.

B. For open cases:

1. Determined the number of open cases as of December 31, 2009.
2. Determined by business units where the cases are located.
3. Determined the time periods the cases have been opened.

C. Determined whether the SB/SE Division Collection function had stopped collection actions after July 7, 2009, on §6707A penalty cases. Specifically, we compared the open and closed §6707A penalty Master File data to Integrated Collection System and Automated Collection System data to determine whether:

- Collection notices were sent to taxpayers as of May 5, 2010.
- Liens were filed as of December 31, 2009.
- Interest was assessed as of April 19, 2010.
- Subsequent payments on §6707A liabilities were made as of April 30, 2010.
- Levies were issued as of April 3, 2010.

IV. Validated data from the IMF and BMF Systems, Exam Return Control System, Audit Information Management System, Integrated Collection System, and Automated Collection Systems by relying on Treasury Inspector General for Tax Administration Data Center Warehouse site procedures that ensure that data received from the IRS are valid. The Data Center Warehouse performs various procedures to ensure that it receives all the records in the IRS databases. Auditors also compared the open and closed §6707A data with data and reports received from the IRS as part of the data validation process.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the policies, procedures, and practices used by the LMSB, SB/SE, and TE/GE Division Examination functions; LMSB Pre-Filing and Technical Guidance function; Office of Appeals; and Office of Chief Counsel as they relate to identifying, developing, assessing, and appealing the §6707A penalty and processing Forms 8886. We evaluated these controls by reviewing applicable manuals and documentation, interviewing management from these functions, and reviewing a judgmental sample of assessed §6707A penalty case files.

Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Commissioner, Large Business and International Division SE:LB
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Tax Exempt and Government Entities Division SE:T
Deputy Commissioner, Large Business and International Division SE:LB
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Communications and Liaison, Tax Exempt and Government Entities Division SE:T:CL
Director, Communications, Liaison, and Disclosure, Small Business/Self-Employed Division SE:S:CLD
Director, Examination, Small Business/Self-Employed Division SE:S:E
Director, Exempt Organizations, Tax Exempt and Government Entities Division SE:T:EO
Director, Field Specialists, Large Business and International Division SE:LB:FS
Director, Pre-Filing and Technical Guidance SE:LM:PFTG
Director, Communication and Liaison, Large Business and International Division SE:LB:M:CL
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:

- Deputy Commissioner for Services and Enforcement SE
- Chief, Appeals AP
- Commissioner, Large Business and International Division SE:LB:CL
- Commissioner, Small Business/Self-Employed Division SE:COM
- Commissioner, Tax Exempt and Government Entities Division SE:T:CL
- Chief, Appeals AP:TP:SS

Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measures:

- Taxpayer Rights – Potential; 15 cases where taxpayers did not receive proper notification of assessments and/or the right to appeal (see page 9).

Methodology Used to Measure the Reported Benefit:

We identified 15 cases where taxpayers did not receive proper notification of assessments and/or the right to appeal. The cases were identified during our review of processing procedures for 114 I.R.C. §6707A penalties. There is no projection because the sample was a judgmental sample.

Type and Value of Outcome Measures:

- Taxpayer Rights – Potential; four cases where Power of Attorney and Declaration of Representative (Form 2848) was not received when there was correspondence with taxpayers' representatives (see page 9).

Methodology Used to Measure the Reported Benefit:

We identified four cases where the Form 2848 was not received when there was correspondence with taxpayers' representatives. The cases were identified during our review of processing procedures for 114 I.R.C. §6707A penalties. There is no projection because the sample was a judgmental sample.

Appendix V

Individual Master File and Business Master File Notices Sent to Taxpayers After Suspension of Collection Enforcement Actions

Notice Number	Name/Description	Count
CP215 (BMF)	Civil Penalty Assessment – This notice is issued to notify the taxpayer a civil penalty was assessed (statutory requirement).	22
CP015 (IMF)	Civil Penalties Notice – This notice is issued to notify the taxpayer a civil penalty was assessed and why it was assessed (statutory requirement).	15
CP128 (BMF)	Balance Due After Offset – This notice is issued to notify the taxpayer of a remaining balance due on a tax module after an incoming offset.	25
CP039 (IMF)	Overpayment Applied to Balance Due - Secondary SSN – This notice is issued to notify the taxpayer that an overpayment for a return, which the taxpayer is the secondary Social Security number, has been applied to the balance due on a joint return for another year.	4
CP049 (IMF)	Overpayment Adjustment-Offset – This notice is issued to notify the taxpayer the overpayment on an individual return was applied to a prior year's unpaid liability.	**1**
CP021 (IMF)	Notice of Data Processing Adjustment or Examination – This notice is issued to inform the taxpayer that an adjustment was made to the tax module.	**1**
CP210 (BMF)	Audit/Data Processing Tax Adjustment – This notice is issued to notify the taxpayer of an Examination or Data Processing tax adjustment notice, resulting in overpayment of $1.00 or more or a zero balance. It is also issued as a return settlement notice when penalties are assessed on overpaid modules.	**1**
CP220 (BMF)	Audit/Data Processing Adjustment – This notice is issued to notify the taxpayer of an Examination and Data Processing tax adjustment resulting in a balance due of $1.00 or more.	**1**
CP503 (IMF)	Individual Master File 2nd Notice - Balance Due – This notice is issued to notify the taxpayer that immediate action is required because no contact was received from previous notices and that the balance is still pending.	**1**

Notice Number	Name/Description	Count
CP504 (BMF and IMF)	Final Notice - Balance Due – This is the final notice to the taxpayer when payment has not been made, and a levy will be placed on certain assets.	35
CP504B (BMF)	Final Notice - Balance Due – This notice is issued specifically to a BMF taxpayer when a new CP504 is requested.	4
CP090 (IMF)	Final Notice of Intent to Levy and Notice of Your Right to a Hearing – This notice is issued to inform the taxpayer of the IRS's intent to levy on certain assets.	6
CP297 (BMF)	Notice of Intent to Levy and Notice of Your Right to a Hearing – This notice is issued to notify the taxpayer of the IRS's intent to levy and of the taxpayer's right to a hearing.	**1**
Total Count		**119**

Source: Our analysis of IMF and BMF taxpayers' accounts on the Integrated Data Retrieval System.

Appendix VI

Second Request Notice – Balance Due (CP 503)

IMPORTANT!!

Immediate action is required.

We previously wrote to you about your unpaid account, but you haven't contacted us about it. Penalties and interest on the unpaid balance are continuing to increase. Please pay the amount you owe within ten days from the date of this notice. If you can't pay now, call us at the number shown below. You may be qualified for an installment agreement or payroll deduction agreement. We want to help you resolve this bill. However, if we don't hear from you, we will have no choice but to proceed with steps required to collect the amount you owe.

If you already paid your balance in full or arranged for an installment agreement, please disregard this notice.

Account Summary

Tax Period: **{date}**

Form: **{form number}**

Current Balance: **{$ amount}**

Includes:

Penalty: **{$ amount}**

Interest: **{$ amount}**

Last Payment: **{$ amount}**

Appendix VII

Final Notice – Balance Due (CP 504)

Urgent!!

We intend to levy on certain assets. Please respond NOW.

Our records indicate that you haven't paid the amount you owe. The law requires that you pay your tax at the time you file your return. This is your notice, as required by Internal Revenue Code Section 6331(d), of our intent to levy (take) any state tax refunds that you may be entitled to if we don't receive your payment in full. In addition, we will begin to search for other assets we may levy. We can also file a Notice of Federal Tax Lien, if we haven't already done so. To prevent collection action, please pay the current balance now. If you've already paid, can't pay, or have arranged for an installment agreement, it is important that you call us immediately at the telephone number show below.

Account Summary

Tax Period: {date}

Form: {form number}

Current Balance: {$ amount}

Includes:

Penalty: {$ amount}

Interest: {$ amount}

Last Payment: {$ amount}

Appendix VIII

Final Notice of Intent to Levy and Notice of Your Right to a Hearing (CP 90)

Please Respond Immediately

We previously asked you to pay the federal tax shown on the next page, but we haven't received your payment. This letter is your notice of our intent to levy under Internal Revenue Code (IRC) Section 6331 and your right to appeal under IRC Section 6330.

We may also file a Notice of Federal Tax Lien at any time to protect the government's interest. A lien is a public notice to your creditors that the government has a right to your current assets, including any assets you acquire after we file the lien.

If you don't pay the amount you owe, make alternative arrangements to pay, or request an appeals hearing within 30 days from the date of this letter, we may take your property, or rights to property. Property includes real estate, automobiles, business assets, bank accounts, wages, commissions, social security benefits, and other income. We've enclosed Publication 594, which has more information about our collection process; Publication 1660, which explains your appeal rights; and Form 12153, which you can use to request a Collection Due Process hearing with our Appeals Office. To preserve your right to contest Appeals' decision in the U.S. Tax Court, you must complete, sign, and return Form 12153 within 30 days from the date of this letter.

To prevent collection action, please send your full payment today.

- Make your check or money order payable to United States Treasury.
- Write your Social Security Number on your payment.
- Send your payment and the attached payment stub to us in the enclosed envelope. The amount you owe is shown on the next page.

If you have recently paid this tax or you can't pay it, call us immediately at the above telephone number and let us know.

The assessed balance may include tax, penalties, and interest you still owe. It also includes any credits and payments we've received since we sent our last notice to you. Penalty and interest charges continue to accrue until you pay the total amount in full. We detail these charges, known as Statutory Additions, on the following pages.

Enclosures:

Copy of this notice

Pub 594, IRS Collection Process

Pub 1660, Collection Appeal Rights

Form 12153, Request for a Collection Due Process Hearing

Envelope

Appendix IX

Internal Revenue Service's Record of Listed Transactions[1]

Listed Transactions	Descriptions
01	Revenue Ruling 90-105 – Certain Accelerated Deductions for Contributions to a Qualified Cash or Deferred Arrangement or Matching Contributions to a Defined Contribution Plan
02	Notice 95-34 – Voluntary Employee Beneficiary Association
03	ASA Investering Partnership v. Commissioner – Transactions similar to that described in the ASA Investering litigation and in ACM Partnership v. Commissioner
04	Treasury Regulation § 1.643(a)-8 – Certain Distributions from Charitable Remainder Trusts
05	Notice 99-59 – Corporate Distributions of Encumbered Property (also known as BOSS)
06	Step Down Preferred/Fast Pay Stock §1.7701(1)-3
07	Revenue Ruling 2000-12 – Debt Straddles
08	Notice 2000-44 – Inflated Partnership Basis Transactions (also known as Son of BOSS)
09	Notice 2000-60 Stock Compensation Stock Compensation Transactions
10	Notice 2000-61 – Guam Trust
11	Notice 2001-16 – Intermediary Transactions
12	Notice 2001-17 – §351 Contingent Liability

[1] See the IRS.gov website for more detailed information on each listed transaction.

Listed Transactions	Descriptions
13	Notice 2001- 45 – §302 Basis-Shifting Transactions
14	Notice 2002-21 – Inflated Basis "Custom Adjustable Rate Debt" Transactions
15	Notice 2002-35 – Notional Principal Contracts
16	Common Trust Fund Straddles (Notice 2003-54), Pass-Through Entity Straddle (Notice 2002-50), and S Corporation Tax Shelter Transaction (Notice 2002-65)
17	Revenue Ruling 2002-69 – Lease In / Lease Out Transactions
18	Revenue Ruling 2003-6 – Abuses Associated with S Corp Employee Stock Ownership Plans
19	Notice 2003-22 – Offshore Deferred Compensation Arrangements
20	Notice 2003-24 – Certain Trust Arrangements Seeking to Qualify for Exception for Collectively Bargained Welfare Benefit Funds under § 419A(f)(5)
21	Notice 2003-47 – Transfers of Compensatory Stock Options to Related Persons
22	Notice 2003-55 – Accounting for Lease Strips and Other Stripping Transactions
23	Notice 2003-77 – Improper use of contested liability trusts to attempt to accelerate deductions for contested liabilities under I.R.C. 461(f)
24	Notice 2003-81 – Major/Minor Tax Avoidance Using Offsetting Foreign Currency Option Contracts
25	Notice 2004-8 – Abusive Roth Individual Retirement Arrangement Transactions
26	Revenue Ruling 2004-4 – S Corporations Employee Stock Ownership Plan
27	Revenue Ruling 2004-20 – Abusive Transactions Involving Insurance Policies in I.R.C. 412(i) Retirement Plans
28	Notice 2004-20 – Abusive Foreign Tax Credit Transactions
29	Notice 2004-30 – S Corporation Tax Shelter Involving Shifting Income to Tax Exempt Organization
30	Notice 2004-31 – Intercompany Financing Through Partnerships

Listed Transactions	Descriptions
31	Notice 2005-13 – Sale-In Lease-Out transactions
32	Notice 2007-57 – Loss Importation Transaction
33	Notice 2007-83 – Abusive Trust Arrangements Utilizing Cash Value Life Insurance Policies Purportedly to Provide Welfare Benefits
34	Notice 2008-34 – Distressed Asset Trust Transaction

Appendix X

Glossary of Terms

Term	Definition
Abusive Tax Shelter	Offers inflated tax savings which are disproportionately greater than the actual investment placed at risk. It exists primarily to reduce taxes unreasonably for tax avoidance or evasion, and is often marketed in terms of how much can be written off in relation to how much is invested.
Abusive Tax Transactions	Transactions or schemes that reduce tax liability by taking a tax position that is not supported by the Internal Revenue Code or by manipulating the law in a way that is not consistent with its intent.
Abusive Transaction Support Unit	The Abusive Transactions Support Unit was established to provide support for the Abusive Transaction Program in the SB/SE Division.
American Jobs Creation Act of 2004	This Act was enacted on October 22, 2004, and added §6707A to the I.R.C. to provide a monetary penalty for failure to include on any return or statement any information required to be disclosed under I.R.C. §6011 with respect to a reportable transaction.
Audit Information Management System	A computer system used by the SB/SE Division Examination Operations function and others to control returns, input assessments/adjustments to the Master File, and provide management reports.
Automated Collection System	A telephone contact system through which telephone assistors collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.
Business Master File	The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.
Business Operating Division Codes	Represents the taxpayer's responsible business unit.
Campus	The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

Data Center Warehouse	A Treasury Inspector General for Tax Administration Office of Information Technology function that obtains and stores numerous IRS data files and makes them available to auditors and investigators via the Treasury Inspector General for Tax Administration Intranet.
Document Locator Number	A unique number assigned to every tax return to assist in controlling, identifying, and locating the return.
Exam Return Control System	An automated inventory management system used by field personnel in both the SB/SE and LMSB Divisions for controlling tax returns and technical time charges from the time returns arrive until they are closed on the Audit Information Management System.
Examination function	The IRS function that examines tax returns to determine whether taxpayers accurately reported their tax liabilities.
Individual Master File	The IRS database that maintains transactions or records of individual tax accounts.
Integrated Collection System	An information management system designed to improve revenue collections by providing revenue officers access to the most current taxpayer information, while in the field, using laptop computers for quicker case resolution and improved customer service.
Integrated Data Retrieval System	IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.
Levy	A method used by the IRS to collect outstanding taxes from sources such as bank accounts and wages.
Lien	An encumbrance on property or rights to property as security for outstanding taxes.
Listed Transaction	A transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction.
Master File	The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
Non-Listed Transaction	Transactions that need to be registered/reported because they have some characteristics of abusive shelters but were not, at least yet, determined to be abusive.

Office of Appeals	An office of the IRS which is responsible for resolving tax controversies, without litigation, on a basis which is fair and impartial to both the Federal Government and the taxpayer in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the IRS.
Office of Tax Shelter Analysis	Serves as a clearinghouse for all tax shelter activity and information affecting the LMSB, SB/SE, and TE/GE Divisions. Its responsibilities include reviewing, analyzing, disseminating, and reporting on disclosures and registrations required by law to aid in the identification and development of emerging tax shelters.
Original Tax Return	The first tax return filed by the taxpayer for a tax year, not amended returns.
Promoter	A person who organizes or assists in the organization of a partnership, trust, investment plan, or any other entity or arrangement that is to be sold to a third party and is designed to be used, or is actually used, by that third party in obtaining tax benefits not allowed by the I.R.C.
Reasonable Cause	This is based on all the facts and circumstances in each situation and allows the IRS to provide relief from a penalty that would otherwise be assessed. Reasonable cause relief is generally granted when the taxpayer exercises ordinary business care and prudence in determining tax obligations but, nevertheless, is unable to comply with those obligations.
Reportable Transaction	Any transaction with respect to which information is required to be included with a tax return or statement because, as determined under regulations prescribed under I.R.C. §6011, such a transaction is of a type which the Secretary of the Treasury determines as having potential for tax avoidance or evasion.
Strict Liability	Sometimes called absolute liability, strict liability is the legal responsibility for damages, or injury, even if the person found strictly liable was not at fault or negligent.

Substantially Similar	A transaction is substantially similar to another transaction if it is expected to obtain the same or similar types of tax consequences and is either factually similar or based on the same or similar tax strategy. Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as or substantially similar to another transaction. Further, the term substantially similar must be broadly construed in favor of disclosure.
Tax Court	Generally, the Tax Court hears cases before any tax has been assessed and paid; however, a taxpayer can pay the tax after the notice of deficiency has been issued and still petition the Tax Court for review.
Tax Period	Refers to each tax return filed by the taxpayer for a specific period (year or quarter) during a calendar year for each type of tax.

Appendix XI

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

RECEIVED
NOV 10 2010

November 10, 2010

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Christopher Wagner
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Penalty Cases for Failure to Disclose Reportable Transactions Were Not Always Fully Developed (Audit # 201030007)

We have reviewed your draft report, "Penalty Cases for Failure to Disclose Reportable Transactions Were Not Always Fully Developed and Penalty Amounts Were Improperly Reduced". We agree that the procedures for developing, assessing and closing Section 6707A penalty cases should be updated and published in the Internal Revenue Manual (IRM).

Upon the enactment of Section 6707A, the Service convened a cross-functional Section 6707A team to develop Servicewide processing and technical guidance and to provide on-going advice regarding penalty application. The guidance was published on a Section 6707A intranet site and our cross-functional Issue Management Teams continue to work with agents in developing each case. Although we suspended efforts to update the IRM when Congress notified the Service of its intent to amend Section 6707A, we continued to provide consistent and fair treatment to all taxpayers through these efforts.

As you acknowledge in your report, the suspension of collection activities, effective June 2009, precluded the issuance of Notices of Levy and seizures, and subsequently, the filing of Notices of Federal Tax Liens. The suspension was not intended to preclude the issuance of any other collection notices, the accrual of interest or certain voluntary payments or refund offsets required under the law.

In this area, the IRS went to extraordinary lengths to accommodate a clear expression of intended legislative action. While there may have been instances evidencing some confusion on the details of how this accommodation was implemented, the IRS at all times adhered to its statutory and regulatory responsibilities. Although TIGTA identified seven cases where a Notice of Intent to Levy was issued after June 2009, our review of those cases reflects that the Revenue Officer, in each case, documented

the file to indicate that he or she was aware of the collection suspension and that the levy did not include the Section 6707A assessment.

Your report states that some case files were missing penalty justifications, taxpayer notifications, Power of Attorney forms and management approval forms. Your report also states that some cases lacked proper support to impose the penalty because they did not contain documentation explaining how the examiner determined that the Form 8886, Reportable Transaction Disclosure Statement, was not attached to the taxpayer's return. Given the required executive level penalty approval, heightened internal and external scrutiny, and specific case evidence, we believe that the missing documentation reflects a case-closing problem and not a case development problem.

Specifically, in an attempt to provide expedited, pre-assessment Appeals consideration and, where applicable, rescission opportunities, Section 6707A penalty procedures depart significantly from normal processing procedures. As acknowledged in the report, these unique procedures increased the chances that documentation was not properly filed upon case closing. Our concurrence review did not reveal any instances where the penalty was imposed without sufficient evidence, improperly developed, or improperly approved. We are taking immediate steps to uncover and rectify the cause of the document filing issue.

We disagree with the Outcome Measures. Although we agree that failing to issue a 30-day letter (which includes information about Appeal rights) or a notification of assessment, and failing to obtain a proper Power of Attorney form would be improper, as explained previously, we believe the missing documentation reflects a case-closing problem rather than a case development problem.

Attached is a detailed response outlining our corrective actions. If you have any questions, please contact me, or a member of your staff may contact Monica Baker, Director, Examination at (202) 283-7660.

Attachment

Attachment

RECOMMENDATION 1:
Revise procedures to ensure that §6707A penalty cases are fully supported and required documents are maintained in the case files.

CORRECTIVE ACTION:
We concur with this recommendation. We will update the procedures to ensure that proper documentation is maintained in the penalty case files; to reflect the elimination of certain procedures in specific situations; to clarify the limited application of certain procedures; and to implement the recent amendment to penalty calculation.

IMPLEMENTATION DATE:
September 15, 2011

RESPONSIBLE OFFICIAL:
Director, Abusive Transactions and Technical Issues (SB/SE Division)

CORRECTIVE ACTION(S) MONITORING PLAN:
The IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:
Formalize §6707A penalty procedures in the Internal Revenue Manual (IRM) to reflect changes in procedures, technical guidance, and, if applicable, amendment to the penalty.

CORRECTIVE ACTION:
We concur with this recommendation. We will update the IRM with revised procedures and technical guidance to implement the amendment to the Section 6707A penalty and to reflect other changes in case handling.

IMPLEMENTATION DATE:
June 15, 2012

RESPONSIBLE OFFICIAL:
Director, Abusive Transactions and Technical Issues (SB/SE Division)

CORRECTIVE ACTION MONITORING PLAN:
The IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 3:
Ensure that incomplete Form 8886 disclosures are properly reviewed for potential §6707A penalty examinations.

2

CORRECTIVE ACTION:
We concur with this recommendation. The Office of Tax Shelter Analysis (OTSA) will establish procedures for tracking the disposition of potentially incomplete Form 8886 disclosures associated with all taxpayers with ongoing examinations, as well as examinations that may originate to determine the completeness of information on the Form 8886 and potential 6707A penalty.

IMPLEMENTATION DATE:
September 15, 2011

RESPONSIBLE OFFICIAL:
Director, Pre-Filing and Technical Guidance (LB&I Division)

CORRECTIVE ACTION MONITORING PLAN:
The IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 4:
Revise procedures to clarify conditions that require examiners to contact the OTSA to confirm if the Form 8886 disclosure is on file.

CORRECTIVE ACTION:
We concur with this recommendation. The Director, Pre-Filing and Technical Guidance will revise and publish the conditions under which examiners are required to contact OTSA to confirm if the Form 8886 is on file.

The OTSA will represent LB&I and work with SBSE to establish appropriate conditions for OTSA contact.

The OTSA will work to revise the IRM 4.32.2.3.3 (and other sections that may apply) to include these specific guidelines.

IMPLEMENTATION DATE:
June 15, 2012

RESPONSIBLE OFFICIAL:
Director, Pre-Filing and Technical Guidance (LB&I Division)

CORRECTIVE ACTION MONITORING PLAN:
The IRS will monitor this corrective action as part of our internal management system of controls.

3

RECOMMENDATION 5:
The Director, Pre-Filing and Technical Guidance, LMSB Division should formalize the OTSA procedures for processing Forms 8886.

CORRECTIVE ACTION:
We concur with this recommendation. Although the Office of Tax Shelter Analysis (OTSA) has had internal desk procedures for the processing of Form 8886, they have not been formally published. The OTSA will take action to formally publish the Form 8886 disclosure processing procedures in the Internal Revenue Manual.

IMPLEMENTATION DATE:
June 15, 2012

RESPONSIBLE OFFICIAL:
Director, Pre-Filing and Technical Guidance (LB&I Division)

CORRECTIVE ACTION MONITORING PLAN:
The IRS will monitor this corrective action as part of our internal management system of controls.