



Treasury Inspector General for Tax Administration Office of Audit

THE INITIATIVE TO REDUCE COMPLIANCE RISKS ASSOCIATED WITH DELINQUENT INCOME TAX RETURNS FILED AFTER A SUBSTITUTE FOR RETURN ASSESSMENT COULD BE ENHANCED

Final Report issued on March 21, 2011

Highlights

Highlights of Report Number: 2011-30-026 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

The Internal Revenue Service (IRS) identifies billions of dollars in additional taxes owed from audits of nonfilers in which it estimates the taxes owed and prepares "substitute" returns after not receiving responses to contact letters. While billions of dollars are assessed, the amount ultimately collected is considerably lower because many assessments are abated after taxpayers file delinquent returns claiming much less is owed. Ensuring that these delinquent returns receive greater scrutiny might discourage taxpayers, who believe that they can avoid paying taxes and not get caught, from filing delinquent returns to abate assessments.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether the IRS effectively addresses the compliance risks associated with delinquent income tax returns received from individuals following a Substitute for Return assessment. The review was part of our planned Fiscal Year 2011 audit coverage and addresses the major management challenge of Tax Compliance Initiatives.

WHAT TIGTA FOUND

New basis information reporting on stock sales and a multiyear initiative to enhance tax return screening techniques should help the IRS to more effectively address the compliance risk on delinquent returns filed in response to a Substitute for Return assessment.

Specifically, recent legislation to include stock cost basis data in the information return reporting system should help the IRS more effectively detect, prioritize, and pursue those individuals who owe a large amount of taxes from stock sales and are not filing tax returns.

The IRS also has an initiative underway to improve the screening criteria for selecting delinquent returns filed in response to a Substitute for Return assessment. The multiyear initiative is aimed at reducing the compliance risk for delinquent returns that do not contain stock transactions. To their credit, the team evaluating opportunities to improve delinquent return screening criteria recognized the importance of including a pilot test in their effort. While the IRS should be commended for reviewing and evaluating opportunities to improve its delinquent return screening criteria, TIGTA has two recommendations that the IRS may find useful in this initiative as well as in undertaking others in the future.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Director, Exam Policy, Small Business/Self-Employed Division, ensure a framework with detailed steps is established for personnel to follow and document in designing and implementing future process improvement initiatives. In addition, an evaluation plan should be established and executed to accurately and reliably assess the results of this and future pilots.

IRS management agreed with both recommendations and will emphasize the use of existing systems and processes to ensure initiatives are appropriately planned and evaluated. However, IRS management did not specifically commit to evaluating the results from the multiyear initiative discussed in this report. Such an evaluation can provide important information for understanding performance and identifying improvement options. The information would also benefit IRS management in efforts to deal with the challenge of reducing the compliance risk posed by delinquent returns.

READ THE FULL REPORT

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

<http://www.treas.gov/tigta/auditreports/2011reports/201130026fr.pdf>.