



Treasury Inspector General for Tax Administration Office of Audit

ADDITIONAL STEPS ARE NEEDED TO BETTER ENSURE AUDITS ARE EXPANDED TO PRIOR AND/OR SUBSEQUENT YEAR RETURNS WHEN SUBSTANTIAL TAXES MAY BE OWED

Final Report Issued on September 9, 2011

Highlights

Highlights of Report Number: 2011-30-084 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Internal Revenue Service (IRS) estimates show that \$197 billion of the \$345 billion of taxes that should have been paid on time but were not (the Tax Gap) is caused by individuals underreporting their income tax liabilities. TIGTA evaluated single-year audits of individual returns for which the taxpayers involved agreed they understated their tax liabilities by more than \$4,400. Although similar tax issues may have existed on the returns these individuals filed for the prior and/or subsequent tax years, the audits were not expanded to these other returns in 48 of the 100 sample cases TIGTA reviewed. As a consequence, opportunities may have been missed to address the noncompliance that contributes to the Tax Gap and promote tax system fairness among the vast majority of taxpayers who properly report and pay their taxes year in and year out.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether tax compliance officers in the Small Business/Self-Employed Division are conducting required filing checks in accordance with IRS policies and procedures. The review is part of our planned Fiscal Year 2011 audit coverage and addresses the major management challenge of Tax Compliance Initiatives.

IRS examiners complete certain filing checks to determine that the taxpayer under audit is complying with all Federal tax return filing requirements. Examiners are also required to evaluate the returns for potential areas of noncompliance. If poorly performed, filing checks can diminish the effectiveness of a process that is designed to ensure voluntary compliance and increase the overall compliance coverage of every audit.

WHAT TIGTA FOUND

TIGTA identified three factors that likely contributed to our concerns with expanding audits. First, the IRS strives to keep its audit inventories free of old tax year returns. As a result, tax compliance officers seldom expand an audit to a taxpayer's prior year return. Second, case file documentation does not indicate that tax compliance officers are taking full advantage of the IRS's internal sources of information when conducting required filing checks. Third, the IRS's performance feedback mechanisms are not always taken advantage of to hold tax compliance officers accountable for the quality of their filing checks.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Director, Exam Policy, Small Business/Self-Employed Division, provide: 1) detailed examples to tax compliance officers on when it would be appropriate to expand audits to prior and/or subsequent year returns, 2) information to tax compliance officers that focuses on using the IRS's automated information systems to enhance the quality of required filing checks, and 3) additional guidance to first-line managers to improve the feedback provided to tax compliance officers on the quality of required filing checks.

In their response to the report, IRS officials agreed with the recommendations and plan to: 1) provide examples in internal publications that show when it is appropriate to expand audits, 2) conduct a workshop on using IRS automated systems, and 3) improve the feedback provided to tax compliance officers on the quality of their filings checks. Although IRS officials agreed with all three recommendations, they did not agree with the potential monetary benefits associated with the recommendations.

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/201130084fr.pdf>