



## Treasury Inspector General for Tax Administration Office of Audit

### STEPS CAN BE TAKEN TO ENHANCE THE QUALITY OF AUDITS INVOLVING SMALL CORPORATE RETURNS

Issued on September 29, 2011

## Highlights

Highlights of Report Number: 2011-30-113 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

### IMPACT ON TAXPAYERS

Many corporations in the United States are considered closely held because they are owned by one shareholder or a closely knit group of shareholders. As such, the shareholders typically have a significant amount of control over managing and directing the day-to-day operations of the corporation. This, in turn, provides opportunities to improperly structure transactions so they reduce the income taxes owed by the corporation or the shareholders. Corporations and shareholders that take advantage of such opportunities to understate their tax liabilities can create unfair burden on honest taxpayers and diminish the public's respect for the tax system.

### WHY TIGTA DID THE AUDIT

The overall objective of this review was to determine whether Small Business/Self-Employed Division examiners are conducting audits of corporate tax returns in accordance with Internal Revenue Service (IRS) procedures and guidelines. The review is included in our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

### WHAT TIGTA FOUND

IRS management has established many key procedures and guidelines for auditing corporate returns. This has likely contributed to an upward trend in the amount of recommended additional taxes generated from audits of small corporations.

While the IRS has experienced an increase in the amount of recommended additional taxes from small corporate audits in recent years, additional steps can be taken at the examiner and first-line manager levels to improve the quality of corporate examinations.

TIGTA reviewed a nonstatistical sample of 51 closed corporate audits and found potential quality concerns in 19 of the audits reviewed. Many of the quality concerns

involved issues between the corporate return and other returns that were or should have been filed by the corporation (e.g., information returns and employment tax returns) or that were related to it (e.g., the shareholder's individual tax return).

### WHAT TIGTA RECOMMENDED

TIGTA recommended that the Director, Exam Policy, Small Business/Self-Employed Division, provide additional guidance to first-line managers to improve the feedback provided to field examiners on using the IRS's automated information systems to enhance the quality of their required filing checks during corporate audits.

In their response to the report, IRS officials agreed with the recommendation and plan to issue a memorandum to first-line managers focusing on utilizing automated information systems as a tool to enhance required filing checks. The memorandum will also address feedback provided to field examiners.

### 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/201130113fr.pdf>