Treasury Inspector General for Tax Administration
Office of Audit

ADDITIONAL IMPROVEMENTS ARE NEEDED TO MEASURE THE SUCCESS AND PRODUCTIVITY OF THE PARTNERSHIP AUDIT PROCESS

Issued on March 18, 2015

Highlights

Highlights of Report Number: 2015-30-004 to the Internal Revenue Service Commissioners for the Large Business and International and the Small Business/Self-Employed Divisions.

IMPACT ON TAXPAYERS

To report income for Federal tax purposes, partnerships are required to file a Form 1065, *U.S. Return of Partnership Income*, which shows the partnership's income, loss, gains, deductions, and credits. Partnerships are not taxed directly; instead, the partners are responsible for reporting their share of partnership items on their respective tax or information returns. The IRS's partnership audit process is intended to help ensure tax compliance among partners. However, due to the complexity of many partnerships, it is difficult for the IRS to evaluate the ultimate effect of its audit activity on the tax liability of partners.

WHY TIGTA DID THE AUDIT

This audit was initiated to identify the types of noncompliance the IRS has detected among partnerships and evaluate the progress the IRS has made toward addressing this noncompliance. The review addresses the major management challenge of Tax Compliance Initiatives.

WHAT TIGTA FOUND

The IRS has taken actions to help improve the partnership audit process; however, it does not know the extent of partnership tax compliance. While partnership audits have resulted in billions of dollars in partnership audit adjustments, the IRS does not know how much additional tax is ultimately assessed to the taxable partners as a result of the adjustments made to the partnership returns.

TIGTA also found that the IRS does not have a process to adequately measure the performance of the function responsible for assessing tax to certain partners. Improvements are needed to ensure that taxable partners are assessed the correct tax. Since Fiscal Year 2010, the IRS has failed to assess taxable partners approximately $14.5 million in taxes, interest, and penalties resulting from audits of partnership returns.

The lack of adequate performance measures and the fact that it has been more than 20 years since the IRS conducted a comprehensive compliance study on partnerships is a concern. Without this information, it is difficult to gauge the productivity and success of the IRS's partnership audit process. There have been legislative proposals designed to help streamline auditing large partnerships that may help mitigate some of the challenges of these audits.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) develop a strategy to measure the success and productivity of all partnership audits; 2) develop a system that will determine the amount of taxes assessed as a result of all partnership audits; 3) ensure that audit closing and assessment efforts are included in productivity measurements; 4) update audit report writing software to accommodate certain types of adjustments and calculations to avoid inaccurate assessments; and 5) coordinate with the Department of the Treasury to assess the impact that proposed changes to the tax laws would have on the IRS's partnership audit process.

In their response, IRS officials agreed with all five recommendations and stated that they plan corrective actions to address two of the recommendations. However, IRS officials stated that they could not commit to making the recommended improvements for the remaining three recommendations because of a lack of available funding. The IRS's Fiscal Year 2016 Budget Request did not include funding for a new system to address the issues discussed in this report. As such, the problems reported will remain and possibly increase in scope.

READ THE FULL REPORT

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

http://www.treas.gov/tigta/auditreports/2015reports/201530004fr.pdf.