Treasury Inspector General for Tax Administration
Office of Audit

AUTOMATED UNDERREPORTER TAX ASSESSMENTS HAVE INCREASED SIGNIFICANTLY; HOWEVER, ACCURACY-RELATED PENALTIES WERE NOT ALWAYS ASSESSED WHEN WARRANTED

Issued on May 8, 2015

Highlights

Highlights of Report Number: 2015-30-037 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

The Automated Underreporter Program matches taxpayer income and deductions submitted on information returns by third parties (*e.g.,* employers, banks, brokerage firms) against amounts reported by taxpayers on their individual income tax returns to identify discrepancies. The Automated Underreporter Program routinely identifies more than 20 million individual tax returns with discrepancies each year and, when warranted, assesses additional taxes as well as interest and penalties.

WHY TIGTA DID THE AUDIT

The overall objectives of this audit were to determine the type and extent of noncompliance addressed by the Automated Underreporter Program and whether additional steps could be taken to enhance program accomplishments. This review is part of our Fiscal Year 2015 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

WHAT TIGTA FOUND

TIGTA found that Automated Underreporter Program tax assessments increased significantly in recent years, from $4.24 billion in Fiscal Year 2006 to $7.84 billion in Fiscal Year 2013, an increase of 85 percent. During Fiscal Year 2013, the Automated Underreporter Program also assessed approximately $708 million in accuracy-related penalties; however, TIGTA found that such penalties were not always assessed when warranted. For instance, the Automated Underreporter Program's system does not apply the negligence penalty provided for by law unless the taxpayer has repeated the same type of income omission within four consecutive tax years. Additionally, TIGTA's review of Fiscal Year 2012 closed cases found that examiners were incorrectly waiving accuracy-related penalties, which resulted in about $3.25 million in lost penalty revenue. TIGTA also found that, due to an inaccurate programming condition, approximately $2.66 million in accuracy-related penalties were not assessed.

Also, after an in-depth study, a number of revisions were made to the taxpayer notice which alerts taxpayers that additional taxes may be owed as a result of underreporting. Although the revised taxpayer notice was implemented in Fiscal Year 2013, the IRS has not evaluated, or established plans to evaluate, the effectiveness of the revised notice on reducing taxpayer underreporting.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) implement controls to ensure that accuracy-related penalties are assessed when warranted and only waived in accordance with applicable policies and procedures, 2) address system issues to ensure that accuracy-related penalties are accurately assessed when warranted, 3) continue to research and take action on cases TIGTA identified as having potentially inaccurate accuracy-related penalty amounts, 4) address negligence as it occurs rather than when a taxpayer repeats noncompliance, and 5) evaluate the effectiveness of the revised taxpayer notice.

In response to the report, IRS management agreed with four of our five recommendations. They disagreed that they should address negligence when it occurs and stated that they will continue with their current policy of waiting until taxpayers repeat noncompliance. TIGTA contends this policy may contribute to further noncompliance and that addressing negligence when it occurs would promote fair and consistent treatment of all taxpayers.

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/201530037fr.pdf.