



Highlights of GAO-04-50, a report to the Chairman and Ranking Minority Member, Committee on Finance, U.S. Senate

INTERNAL REVENUE SERVICE

Challenges Remain in Combating Abusive Tax Schemes

Why GAO Did This Study

Abusive tax avoidance schemes could threaten our tax system's integrity and fairness if honest taxpayers believe that significant numbers of individuals are not paying their fair share of taxes. Abusive schemes encompass such distortions of the tax system as falsely describing the law (saying, for example, that the income tax is unconstitutional), misrepresenting facts (for instance, promoting the deduction of personal expenses as business expenses), or using trusts or offshore bank accounts to hide income.

As agreed, this report focuses on three objectives. They are to (1) describe the nature and scope of abusive tax avoidance schemes as determined by the Internal Revenue Service (IRS), (2) describe IRS's strategy to combat these schemes and the performance goals and measures IRS uses to track its major effort related to them, and (3) describe how IRS determined the amount and source of staff resources to be devoted to these schemes in the IRS operating division most directly affected.

What GAO Recommends

GAO recommends that when IRS prepares future estimates of the size of the abusive scheme problem, the Commissioner of Internal Revenue document the support underlying the estimates. In written comments on a draft of this report, the Commissioner agreed with this recommendation.

www.gao.gov/cgi-bin/getrpt?GAO-04-50.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Michael Brostek at (202) 512-9110 or brostekm@gao.gov.

What GAO Found

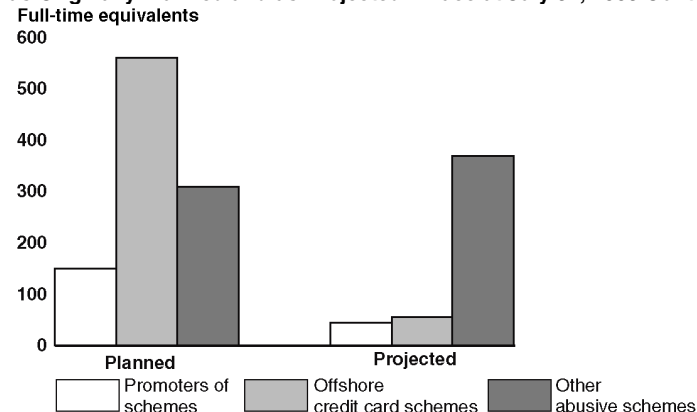
Abusive schemes vary in nature, and new ones continually emerge, making it very difficult to measure their extent. IRS has been gathering information to better define the scope of abusive schemes. In addition to 131,000 participants linked to abusive schemes between October 1, 2001, and mid-August 2003, IRS officials estimated that several hundred thousand others likely are engaged in abusive schemes. However, IRS documented this estimate only when GAO asked. Documentation can help policymakers judge the appropriateness of IRS resources and strategy in combating the high-priority abusive scheme problem.

IRS's broad-based strategy for addressing abusive schemes included:

- targeting promoters to head off the proliferation of abusive schemes and to identify taxpayers taking advantage of them;
- offering inducements to taxpayers to come forth and disclose their use of questionable offshore tax practices; and
- using performance indicators to measure outputs and intending to continue down the path it has started and develop long-term process and results-oriented performance goals and measures linked to those goals. The lack of these latter elements impedes gauging IRS's progress in combating abusive schemes.

Using a systematic agencywide decision-making process, IRS planned to shift significant resources to support its strategy, but the level of resources likely to be used in fiscal year 2003 was less than expected due to overly optimistic workload forecasts caused by inexperience with the types of cases involved. Future resource usage remains to be seen, given uncertainty about how much abusive scheme work IRS will have and how long it will take to close cases. IRS's understanding of how many staff will be needed to address the problem over what period will continue to evolve as IRS gains a better understanding of the problem's scope.

Fiscal Year 2003 Examination Full-Time Equivalent Resources Devoted to Abusive Schemes, as Originally Planned and as Projected If Pace at July 31, 2003 Continued



Source: Compiled by GAO from IRS data.