

**Terrorist Victims'
Tax Relief Refunds Were Accurate,
but Some Were Delayed**

March 2003

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

March 20, 2003

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Terrorist Victims' Tax Relief Refunds Were Accurate, but Some Were Delayed (Audit # 200240055)

This report presents the results of our review to determine if the Internal Revenue Service (IRS) provided accurate and timely tax relief when processing individual income tax returns for the victims of terrorist attacks. We also determined if the IRS adequately informed victims' families and/or representatives¹ of the actions taken and if victims' returns were identified for special processing as intended.

On September 11, 2001, terrorists attacked the United States of America and thousands of people perished as a result. In order to provide relief to families of the victims of these and certain other acts, the Congress passed the Victims of Terrorism Tax Relief Act of 2001.² This legislation typically exempts victims from income tax for the year of their death and for the prior taxable year. It provides a minimum tax relief benefit of \$10,000 for each deceased victim.

The IRS implemented special procedures to process tax relief refunds for tax returns filed for deceased victims of these terrorist attacks. The program for processing these returns was referred to as the Killed in Terrorist Action (KITA) Program. Employees were to be trained at IRS Campuses³ throughout the country to be prepared and available to work KITA returns. The IRS expected the processing of these highly sensitive KITA returns to be expedited at all times.

¹ Throughout the remainder of this memorandum, use of the term "victims' families" is intended to include surviving spouses and other relatives of the victims. Where applicable, this also includes individuals representing the families.

² Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427.

³ The Campuses are the data processing arm of the IRS. The Campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

The KITA Project Office identified approximately 2,900 KITA victims. When we began our review, approximately 1,500 of these victims had returns that were being processed using the special KITA procedures. During our review, the IRS made special efforts to notify victims' families who had not yet filed KITA returns that tax relief was available. As of October 31, 2002, the IRS had received approximately 4,500 returns for 2,400 victims to be processed in the KITA Program.⁴ Tax relief for processed KITA returns ranged from the \$10,000 minimum to \$11 million per victim.

Based on information submitted by victims' families, IRS employees correctly computed tax relief amounts for returns processed in the KITA Program and issued manual refunds to speed relief to victims' families. However:

- The IRS did not issue 40 percent of the tax relief refunds in our sample within the time period set as a goal by KITA Project management or within a time period that we would consider to be expedited. Of our sample of 156 victims, these refund delays affected 76 victims' families.
- The IRS did not always notify victims' families of the processing results for their tax relief requests. Only one of the six KITA Campuses reviewed⁵ routinely informed victims' families of the amount of tax relief they would receive, the date to expect their refund, and a telephone number to call with any questions. The remaining Campuses provided victims' families with processing results only when the actual refund amounts differed from the requested refund amounts.
- The IRS did not always identify victims' accounts as KITA accounts on its computer system. Of 1,460 victims with no returns included in the KITA Program, we reviewed 92 victims' accounts and identified 7 with no KITA indicator. These 7 victims' families had not yet filed 11 original or amended returns requesting KITA tax relief. Without the KITA indicator on these accounts, the victims' families may not receive KITA tax relief and expedited return processing when these returns are filed.
- The IRS did not always process victims' returns through the KITA Program. Of 1,460 victims with no returns included in the KITA Program, we reviewed 92 victims' accounts and identified 4 returns that went through normal processing rather than KITA processing. In addition, of 1,500 victims with returns included in the KITA Program, we reviewed 160 victims' accounts and identified 1 return that went through normal processing rather than KITA processing. For these 5 returns, the victims' families had not received a total of \$60,000 in tax relief to which they were entitled. We informed KITA employees of these returns, and the employees took actions to process the returns through the KITA Program to allow the tax relief.

Based on our concerns about processing delays and our suggestions to both clarify expected processing time periods and notify victims' families of processing results, KITA

⁴ Most victims would be entitled to tax relief for 2 tax years.

⁵ The Campuses included in our review were Andover, Atlanta, Austin, Fresno, Kansas City, and Philadelphia.

Program management took actions to improve KITA processing during our review. In addition, most returns expected for the KITA Program have already been filed and processed by the KITA Program. Therefore, we limited our report recommendations to those that could affect victims' families that have KITA returns yet to be filed or processed.

To help ensure that victims' families receive the tax relief that the Congress intended and the expedited return processing that the IRS expects, we recommended that the KITA Project Office compare its list of victims to its list of KITA-processed returns and research the accounts with no KITA-processed returns. The KITA indicator should be input to those accounts identified as needing it. In addition, for those same accounts researched, any returns filed where tax relief was not granted should be corrected. We have also included some observations that the IRS could consider in implementing other sensitive programs such as the KITA Program in the future.

Management Response: IRS management agreed with our recommendations. The IRS has completed corrective action for Recommendation 1 and has already begun corrective action for Recommendation 2. Specifically, the IRS has performed necessary research and input the KITA indicator on affected accounts when it sent reminder letters to victims' families that had not filed tax returns. In addition, it has already started to research those victims with no KITA-processed returns to identify and correct any returns filed where tax relief was not granted.

Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

**Terrorist Victims' Tax Relief Refunds Were
Accurate, but Some Were Delayed**

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Terrorist Victims' Tax Relief Refunds Were Accurate, but Some Were Delayed

Background

On September 11, 2001, terrorists attacked the United States of America and thousands of people perished as a result. In order to provide relief to families of the victims of these and certain other acts, the Congress passed the Victims of Terrorism Tax Relief Act of 2001,¹ which the President signed into law on January 23, 2002. This tax relief applies to victims who died as a result of:

- Wounds or injuries incurred from the terrorist attack against the United States on April 19, 1995 (Oklahoma City).
- Wounds or injuries incurred from the terrorist attacks against the United States on September 11, 2001.
- Illnesses incurred as a result of an attack involving anthrax occurring on or after September 11, 2001, and before January 1, 2002.

The Relief Act typically exempts the above victims from income tax for the year of their death and the prior taxable year.² It provides a minimum tax relief benefit of \$10,000 for each victim regardless of the individual's income tax liability for the eligible tax years.

The Internal Revenue Service (IRS) developed Tax Relief for Victims of Terrorist Attacks (Publication 3920) to assist victims' families and representatives³ in filing returns for tax relief. This Publication includes instructions and worksheets for filing returns and computing the tax relief amounts. The IRS mailed this Publication and related tax forms and instructions in March 2002 to identified victims' families.

¹ Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427.

² The law exempts tax for the year of death and prior years beginning with the year before the injury occurred. This involves filing amended returns for Tax Years (TY) 1994 and 1995 for most Oklahoma City victims and filing an amended TY 2000 return and an original TY 2001 return for most victims of the September 11 and anthrax attacks.

³ The term "victims' families" is intended to include surviving spouses and other relatives of the victims. Where applicable, this also includes individuals representing the families.

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The IRS implemented special procedures to process tax relief refunds for tax returns filed for deceased victims of these terrorist attacks. The program for processing these returns was referred to as the Killed in Terrorist Action (KITA) Program. The IRS' goal was to expeditiously process these sensitive KITA returns.

In order to expedite refunds and speed relief to the victims' families, the IRS established a KITA Project Office at the Andover Campus⁴ and provided special Andover mailing addresses for KITA returns. The KITA Project Office in Andover received original and amended returns claiming KITA tax relief, controlled them on the KITA inventory data file, and used express shipping to send the returns to the various KITA Campuses for processing.

Employees were to be trained at IRS Campuses throughout the country⁵ to be prepared and available to work KITA returns. These employees verified the computations of tax relief amounts and issued "manual"⁶ refunds to expedite the refunds. Tax relief for processed KITA returns ranged from the \$10,000 minimum to \$11 million per victim.

This audit was conducted at the national KITA Project Office and at the Andover, Atlanta, Austin, Fresno, Kansas City, and Philadelphia Campuses. The audit was conducted from July through October 2002 in accordance with *Government Auditing Standards*. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁴ The Campuses are the data processing arm of the IRS. The Campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

⁵ These Campuses were Andover, Atlanta, Austin, Brookhaven, Fresno, Kansas City, and Philadelphia. At the time we selected our samples, no KITA returns had been shipped to Brookhaven for processing.

⁶ A manual refund is one that is not generated by normal computer processing. When special circumstances exist, IRS employees can use the manual refund process to bypass normal processing and expedite refunds.

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The Internal Revenue Service Made Special Efforts to Continue to Notify Victims' Families of Available Tax Relief

The KITA Project Office identified approximately 2,900 KITA victims. When we began our review, approximately 1,500 of these victims had returns that were being processed using the special KITA procedures.

Because some victims' families had not filed returns requesting tax relief, KITA Project officials took actions to help ensure victims' families were aware of available relief. The KITA Project Office informed us that reminder notices for the Oklahoma City victims' families were mailed in mid-September 2002 and that reminder notices for other victims' families were planned for early November 2002. These actions were coordinated with state authorities in Oklahoma and New York. As of October 31, 2002, the IRS had received approximately 4,500 KITA returns for 2,400 victims to be processed in the KITA Program.⁷

Employees Correctly Computed Tax Relief Refunds

A number of factors are involved when calculating tax relief amounts. On joint returns, only the decedent's part of the joint income tax liability is eligible for tax relief, which requires an allocation of income and deductions between the spouses. Certain types of income are exempt from tax while other types of income are not exempt and not eligible for tax relief.⁸ In addition, some taxes are not eligible for tax relief (e.g., self-employment tax). Victims whose tax relief for eligible years totals less than \$10,000 are entitled to the \$10,000 minimum tax relief.

After considering the above factors, return preparers completed IRS-required worksheets showing the tax relief calculations and filed the worksheets with the KITA tax returns. IRS employees used the information from the worksheets to verify the accuracy of the requested tax relief amounts.

We reviewed 86 KITA tax returns and did not identify any material problems with the accuracy of IRS employees' calculations of tax relief amounts. Based on the information provided by return preparers, the IRS verified and corrected,

⁷ Most victims would be entitled to relief for 2 tax years.

⁸ For example, death benefits paid because an employee died as a result of a terrorist act are exempt from tax. Death benefits paid regardless of the reason for death are taxable and not eligible for tax relief.

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Forty Percent of the Tax Relief Refunds Were Delayed

as necessary, the requested tax relief amounts. In conjunction with this, “other” taxes were forgiven or not forgiven as appropriate, and the \$10,000 minimum relief was allowed when applicable.

The IRS procedures required employees to expedite KITA tax return processing at all times. To implement this, the KITA Project Office goal was for the KITA Campuses to issue a manual refund within 30 days of receiving a “complete” return – one with all the information needed to process the return. The IRS’ 30-day period began on:

- The date the IRS received the return at the special Andover mailing address designated for filing KITA returns, if a return was complete when filed.
- The date additional information needed to complete the return was received, if the IRS had to request additional information.

However, the 30-day goal did not consider delays to request additional information or routing delays when the IRS received a return at an address other than the designated KITA address. In our review, we used both the IRS’ 30-day goal and an additional goal that, in our opinion, needed to be met to consider a refund to be expedited. We considered a refund delayed if it was issued within the IRS’ 30-day goal, but the total time the IRS spent processing the return was 40 days or more.⁹

To evaluate the timeliness of the KITA refunds, we selected 156 victims who had at least 1 return identified for KITA processing as of June 4, 2002.¹⁰ Of the 272 returns reviewed, a total of 109 returns (40 percent) had delayed refunds. These delays affected 76 victims’ families and involved refunds that totaled \$5 million and averaged \$65,000 per victim.

⁹ We included the days from the IRS return received date to the manual refund date, subtracting any days spent waiting for additional information.

¹⁰ The population from which we selected our sample equaled approximately 50 percent of the total number of returns expected for the KITA Program. Most returns sampled were worked during the first few months of the Program.

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Refunds for the 272 returns reviewed were issued in an average of 24 days from the date the returns were complete. However, 109 returns had delayed refunds.

- Of these, 78 returns (52 taxpayers) were not refunded within the IRS' goal of 30 days from the date the return was complete. See Appendix V for the days, by Campus, from return completion to the manual refund for the 272 returns reviewed.
- Of these, 31 additional returns (24 taxpayers) had refunds issued within the IRS' 30-day goal, but the total IRS processing time was 40 days or more. These included 26 returns where the KITA Campus took 1 week or more after receiving the return to request additional information needed to complete the return. These also included 5 returns incorrectly mailed by victims' families to the Brookhaven Campus, with routing delays contributing to the excessive processing time.

The refund delays occurred for a number of reasons.

Better controls would have helped the KITA Project Office identify and prevent delays

The KITA Project Office could have reduced the number of delayed refunds by:

- Clearly communicating the IRS' 30-day goal to the KITA Campuses early in the Program. The goal was not clearly communicated until late June 2002, after we notified the Project Office of this issue and after many of the returns had been worked.
- Obtaining critical inventory information needed to identify refund timeliness problems.
- Performing timely operational reviews at the KITA Campuses to identify and correct problems that caused delayed refunds. The first documented review was in June 2002, after we advised the Project Office of potential timeliness problems.

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Initial procedures established by the KITA Project Office contributed to the delays

Procedures for working and reviewing the KITA returns caused delays at some Campuses.

- To reduce burden and avoid unnecessary contacts with victims' families, procedures required employees to reconstruct taxpayers' allocations of income and deductions used to compute the tax relief amounts if this information was not provided by the return preparer. Because this information was not required with the return, KITA employees at several Campuses spent a significant amount of time trying to determine the allocations and compute the refunds. After we brought this issue to the attention of the KITA Project Office, these procedures were changed to expedite processing.
- Procedures required the lead tax examiner to thoroughly review each case¹¹ before giving it to the unit manager who approved the manual refund. With only one employee performing this review, backlogs occurred at several Campuses. The Project Office later advised the Campuses that other employees could assist with this review.

Some KITA Campuses did not provide sufficient staffing to timely work the returns

The IRS stipulated that each Campus working KITA returns should have 15 employees available at any given time to process the returns. We analyzed hours applied to the KITA Program for the approximate time period of our sample. The two Campuses with the highest percentages of delayed refunds had significantly fewer than 15 employees working

¹¹ In addition to an original and/or amended tax return, a KITA case might include computations prepared by IRS employees to determine the amount of tax relief, an employee history sheet documenting case actions, the form the employee prepared to input the manual refund, a death certificate, correspondence to and from the victim's family, income information provided by the victim's family or obtained by the employee, the victim's IRS account information, etc.

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full time¹² on KITA cases during this time. We were informed that 1 of these 2 Campuses had only 4 employees trained to work KITA cases by late May 2003, approximately 30 days after the Campus received the majority of its KITA returns. Approximately 2 weeks later, the KITA Project Manager noted in his review of this Campus that only one employee was working KITA cases. The understaffing, in conjunction with the Campuses receiving the majority of their return inventory over a short period of time, caused delays.

Most Victims' Families Were Not Informed of Processing Results for Their Tax Relief Requests

In general, taxpayers who request tax adjustments should be provided with the tax adjustment amount, any applicable refund amount, the anticipated refund date, and a telephone number and address to contact with any questions. The IRS typically mails several million notices every year to provide taxpayers with this information about their tax adjustments. This information helps prevent uncertainty as to whether the IRS has taken needed action, helps prevent unnecessary contact with the IRS, and provides a source to call or write if refunds are not received by the date promised or there are other questions.

After processing KITA returns, the IRS did not provide most KITA victims' families with the basic information described above. Consequently, the IRS did not provide these families with the high level of customer service one would expect for these very sensitive returns. Only one of the six KITA Campuses routinely informed victims' families of the results of their tax relief requests. The other five Campuses did not inform most victims' families of processing results because:

- KITA processing procedures did not require employees to contact victims' families with the results.
- Employees were expected to follow general IRS processing procedures when KITA procedures did not provide guidance on an issue. These general procedures included using codes to suppress normal

¹² We used the weekly KITA Program hours worked at each Campus to calculate the equivalent number of full time employees.

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notices for tax adjustments to decedents' accounts. Consequently, IRS employees would need to contact the deceased taxpayers' families via telephone or letter to inform them of the adjustments. However, the general IRS procedures were not clear and led employees at the five KITA Campuses to believe they needed to make contact only if the actual refund amounts differed from the requested refund amounts.

During our review, we informed the KITA Project Office of our concerns about not notifying victims' families of processing results for their tax relief requests. Based on our concerns, the IRS changed the KITA procedures to require this notification for all tax relief requests. The IRS also clarified its general procedures affecting tax adjustments to all decedents' accounts to require explanations by telephone or letter when notices are suppressed.

Victims' Accounts Were Not Always Identified and Returns Did Not Always Receive Special Processing

The IRS used a special code (the KITA indicator) on the IRS computer system to identify KITA victims' accounts. This indicator allows employees and the IRS computer system to identify victims' tax returns for special KITA processing rather than normal processing. Employees processing KITA returns were to input the indicator if it was not already on the account.

In a previous review,¹³ we reported that the IRS had not always updated KITA victims' accounts with the KITA indicator, and recommended researching identified victims' accounts and inputting the KITA indicator if necessary. The KITA Project Office responded that all updates to its computer records were completed by April 1, 2002.

To determine in this review if the IRS properly coded victims' accounts and identified KITA returns for special processing, we reviewed 92 victims' accounts from 1,460 victims with no returns included in the KITA Program. We also reviewed 160 victims' accounts from

¹³ *Management Advisory Report: Actions Have Been Taken to Prepare for the Processing of Deceased Terrorist Victims' Income Tax Returns, but Additional Work Is Necessary* (Reference Number 2002-10-110, dated August 2002).

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approximately 1,500 victims with returns included in the KITA Program.

We identified victims' accounts without KITA indicators. Although we previously reported this issue, the KITA Project Office did not ensure that all victims' accounts were updated with the KITA indicator. In addition, the IRS did not always process victims' returns through the KITA Program.

Terrorist victims' accounts were not always identified with a KITA indicator

Of the 92 victims with no returns processed in the KITA Program, 7 did not have a KITA indicator on their accounts. Two victims had no indicators on their individual accounts; five victims had no indicators on their joint accounts, even though they had a history of filing joint returns.

For the 7 victims, a total of 11 original or amended tax returns had not been filed to request KITA tax relief at the time of our review. Without the KITA indicator, when these 11 returns are filed, these victims' families may not receive the tax relief and expedited return processing that the KITA process is designed to provide.

Terrorist victims' tax returns were not always processed as KITA returns

Of the 92 victims with no returns processed in the KITA Program, 4 had a Tax Year (TY) 2001 return that went through normal return processing rather than KITA processing. Of the 160 victims with returns included in the KITA Program, 1 had a TY 2001 return that went through normal return processing rather than KITA processing. For these 5 returns, the victims' families had not received a total of \$60,000 in tax relief to which they were entitled. We informed KITA employees of these returns, and the employees took actions to process the returns through KITA to allow the tax relief.

Of the five returns:

- Three were initially prevented from going through normal processing by the KITA indicator, but subsequent employee errors caused the returns to go

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through normal processing rather than the KITA Program.

- One did not have a KITA indicator when the return was processed, allowing it to go through normal processing.
- One had a KITA indicator when the return was processed, but the indicator did not prevent normal processing.

Recommendations

1. The KITA Project Office should compare its list of victims to its list of KITA-processed returns. For those victims with no KITA-processed returns, the related accounts should be researched and the KITA indicator input when necessary.

Management's Response: The KITA Project Office completed this action on November 15, 2002. The IRS completed its research and input the KITA indicator on affected accounts when it sent reminder letters to victims' families who had not filed the tax returns.

2. The KITA Project Office should compare its list of victims to its list of KITA-processed returns. For those victims with no KITA-processed returns, the related accounts should be researched to identify and correct any returns filed where tax relief was not granted.

Management's Response: IRS management agreed with this recommendation and corrective action is already underway.

Issues Encountered Could Provide Useful Guidance for the Future

We had some observations that the IRS may find useful if faced in the future with quickly establishing another sensitive program like the KITA Program. Additional emphasis on management controls could help the IRS avoid potential problems with future programs.

Some delayed refunds might have been avoided if critical program goals had been established and communicated clearly in writing when the Program started. In addition, better inventory information and more timely operational

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reviews would have helped management identify potential delays earlier in the Program.

- Some Campuses did not know the IRS' goal was to issue manual refunds within 30 days of receiving completed returns, and specific time periods for requesting additional information were not set.
- Of our sample returns not refunded within the IRS' 30-day goal, 85 percent were not identified on KITA inventory reports as delayed cases.¹⁴ Better inventory reports could have alerted Program management to the untimely processing.
- Although operational reviews at the various Campuses identified issues causing delays and suggested ways to improve timeliness, the reviews were often performed after the Campuses had already processed a significant percentage of their returns. Earlier operational reviews would have had more impact on improving the processing timeliness.

The IRS required return preparers to file worksheets with the tax returns that partially showed how the tax relief amounts were calculated. However, at times, employees needed more information to determine the accuracy of requested tax relief on joint returns. The KITA employees at some Campuses spent a significant amount of time on joint returns trying to determine how preparers had allocated income and deductions to calculate the tax relief. If the IRS had required allocation information with the return and worksheets, the KITA returns could have been processed more efficiently.

Finally, an existing control can be used to identify certain notices for review and help prevent incorrect notices. Although not required by KITA management, four of the six KITA Campuses used the Local Control File (LCF)¹⁵ to help

¹⁴ This calculation is based on 62 delayed refunds for which this inventory information was available.

¹⁵ The LCF is part of the IRS' Notice Review Processing System used to select and review notices issued when original returns are processed or when certain other adjustments (such as adjustments from amended returns or examined returns) are made to taxpayers' accounts.

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prevent incorrect notices on KITA returns. We did not identify a significant number of incorrect notices issued by the two Campuses not using the LCF. However, its value was illustrated by one Campus that used it to prevent mailing more than 20 incorrect balance due notices totaling over \$600,000 for KITA returns. Controls such as the LCF should be used in the future when warranted by the volume of potentially incorrect notices and/or the program's sensitivity.

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Appendix I

Detailed Objectives, Scope, and Methodology

The overall objective of this review was to determine if the Internal Revenue Service (IRS) provided accurate and timely tax relief when processing individual income tax returns for the victims of terrorist attacks. We also determined if the IRS adequately informed victims' families and/or representatives¹ of the actions taken and if victims' returns were identified for special processing as intended.

As part of our review, we took random samples from two IRS data files. We did not plan to make projections. The sample sizes used were sufficient for our tests and could be analyzed within the time constraints of our audit.

- One sample consisted of 160 victims (281 returns) from approximately 1,500 victims (2,500 returns) on the IRS data file of Killed in Terrorist Action (KITA) returns received and controlled as of June 4, 2002. This data file included KITA returns being processed at the six IRS Campuses² that were working KITA cases³ at that time. We selected an interval sample of 160 victims to ensure we had at least 10 percent of the population to review.
- For the second sample, we matched the IRS' list of victims to the KITA data file of returns received and controlled for KITA processing as of June 28, 2002. From the 1,460 victims where the KITA data file did not reflect any returns in KITA processing, we selected an interval sample of 100.

We performed the following tests to accomplish our objectives:

- I. Determined if the IRS correctly processed the KITA returns.
 - A. Compared the Victims of Terrorism Tax Relief Act of 2001⁴ with Tax Relief for Victims of Terrorist Attacks (Publication 3920) to determine if the Publication computations and related instructions conform to the law.

¹ The term "victims' families" is intended to include surviving spouses and other relatives of the victims. Where applicable, this also includes individuals representing the families.

² The Campuses are the data processing arm of the IRS. The Campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

³ In addition to an original and/or amended tax return, a KITA case might include computations prepared by IRS employees to determine the amount of tax relief, a history sheet prepared by the employee to document actions taken on the case, the form prepared to input the manual refund, a death certificate, correspondence to and from the victim's family, income information provided by the victim's family or obtained by the employee, the victim's IRS account information, etc.

⁴ Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427.

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- B. Reviewed a sample of 86 returns to determine the accuracy of the computations of the tax relief amounts. These 86 returns were randomly selected out of the 281 described above to limit the number reviewed due to time constraints. Reviewed the returns and related KITA case files to determine the accuracy of the tax relief amounts, evaluate the forgiveness of “other” taxes (such as self-employment taxes), and determine if the victims were allowed the minimum \$10,000 tax relief.
- II. Determined if the IRS timely processed KITA returns to expedite tax relief, in the form of manual refunds, to the victims’ families.
 - A. Evaluated the adequacy of the IRS’ criteria for timely processing KITA returns and related refunds.
 - B. Reviewed the 272 returns (for 156 victims) that were available out of our sample of 281 returns (for 160 victims) to evaluate the timeliness of IRS actions from receipt of the return to issuance of the refund.
 - C. Followed up with the six Campuses to determine the reasons for untimely case resolution actions.
 - D. Reviewed inventory and visitation reports to evaluate problem information available to the KITA Project Office.
- III. Evaluated the adequacy of IRS efforts to inform the victims’ families of adjustment actions and manual refunds for tax relief.
 - A. Determined whether contact, by telephone or letter, was made on closed KITA cases to inform the victims’ families of the tax relief amounts; refund information; and name, telephone number, and address of applicable IRS contact persons.
 - B. Evaluated the IRS’ process for preventing incorrect notices to the victims’ families.
- IV. Determined if victims’ accounts were identified as KITA accounts and if victims’ returns were processed as KITA returns. Reviewed the 92 victims’ accounts that could be located from our sample of 100 victims described above (where the KITA data file of returns did not show any of these victims’ returns in KITA processing).
- V. Obtained and reviewed information related to the IRS’ continuing efforts to notify victims’ families of the KITA tax relief available.

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Appendix II

Major Contributors to This Report

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Susan Price, Senior Auditor

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Appendix III

Report Distribution List

Acting Commissioner N:C
Commissioner, Small Business/Self-Employed Division S
Deputy Commissioner, Wage and Investment Division W
Director, Accounts Management W:CAS:AM
Director, Strategy and Finance W:S
Field Director, Accounts Management (Andover) W:CAS:AM:AN
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:F:M
Audit Liaisons:
 Chief, Customer Liaison S:COM
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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; 5 victims' returns went through normal return processing rather than Killed in Terrorist Action (KITA) processing, resulting in over-assessed taxes of \$60,000 (see page 8).

Methodology Used to Measure the Reported Benefit:

The five returns identified were from two different sources. We matched the Internal Revenue Service's (IRS) list of identified victims to the data file of returns received and controlled for KITA processing as of June 28, 2002, and identified 1,460 victims where the KITA data file did not reflect any returns being processed for the victims. We reviewed a random sample of 92 of these victims' accounts and identified 4 returns that were processed normally rather than as KITA returns. From our random sample of 160 victims selected from approximately 1,500 victims with returns controlled by the IRS as KITA returns, we identified the fifth return. We calculated the tax relief amounts that the victims' families would be entitled to for these five returns, estimating the victims' taxes on joint returns based on available income information.

**Terrorist Victims' Tax Relief Refunds Were
Accurate, but Some Were Delayed**

Appendix V

**Timeliness of Refunds
Complete Return to Manual Refund**

Campus	<=20 Days	21 to 30 Days	31 to 40 Days	41 to 50 Days	> 50 Days	Total > 30 Days*	Total Returns
1	42	25	11	13	2	26 (28%)	93
2	8	12	12	6	10	28 (58%)	48
3	12	4	0	0	0	0	16
4	13	14	7	4	5	16 (37%)	43
5	33	7	4	2	2	8 (17%)	48
6	19	5	0	0	0	0	24
Total	127	67	34	25	19	78 (29%)	272

Source: Case reviews performed by Treasury Inspector General for Tax Administration auditors.

*Note: Program goal is 30 days.

Terrorist Victims' Tax Relief Refunds Were Accurate, but Some Were Delayed

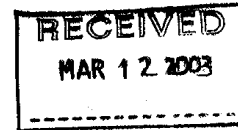
Appendix VI

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

March 12, 2003



MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION

FROM:


John M. Dalrymple
Commissioner, Wage and Investment Division

SUBJECT:

Draft Audit Report – Terrorist Victims' Tax Relief Refunds Were Accurate, but Some Were Delayed (Audit No. 200240055)

A major goal in administering this program was to ensure we accurately processed these returns so that the victims' families received their proper benefits without causing burden. I am pleased your report recognizes the high accuracy level and the challenges we overcame to successfully administer the Victims of Terrorism Tax Relief Act of 2001. Most of these challenges were unique to the tragic events of September 11. Through January 24, 2003, one year and one day since the passage of the Killed in Terrorist Action (KITA) legislation, we have accurately and promptly processed 4,582 KITA returns and issued over \$255 million in refunds to the families of the victims.

Although the scope of your review was limited to the actual processing of these returns, it is important to recognize the wide range of activities that were critical to the success of the relief effort. The KITA Project Office:

- Determined eligibility of victims
- Coordinated activities with state and local officials
- Communicated with CPAs and practitioners providing families with tax assistance
- Sent over 3,000 reminder letters to families to ensure they were aware of their eligibility and filed timely returns
- Established policies and procedures for all aspects of processing returns and communicating with victims' families
- Secured legal opinions from IRS Chief Counsel on unusual situations
- Conducted weekly briefings with KITA processing sites

Terrorist Victims' Tax Relief Refunds Were Accurate, but Some Were Delayed

2

Clearly the project office was involved in many activities, in addition to the actual processing of the returns, which contributed to the success of this effort.

We established a goal to expedite processing and issue a refund within 30 days after receipt of a return that was ready for processing. Unfortunately, we did not meet this goal in every case, particularly in the initial days of processing. However, we did quickly process most of the returns that were properly prepared when submitted. As Appendix V shows, we issued 47 percent of the refunds in less than 20 days and over 71 percent within the 30-day target. Your sample cases showed it took us an average of 24 days from the date the returns were complete until we issued the refund. We agree that in some cases periods of inactivity occurred primarily when we needed to contact the victims' representatives to secure additional information required to complete the return. We also experienced unanticipated staffing problems in one site that affected the timely processing of a small number of returns.

We appreciate the suggestions and observations you made during your review. These early observations helped us improve our initial guidelines and procedures to further improve refund timeliness and enhance communication with the victims' representatives. This was our initial effort to deal with a challenging and sensitive situation; in retrospect we would do some things differently. Your suggestions addressing those areas will help us to better respond to any future need.

We agree with the benefits and recommendations in the report.

If you have any questions, please call me or Ronald S. Rhodes, Director, Customer Account Services, at (404) 338-8910.

Attachment

Terrorist Victims' Tax Relief Refunds Were Accurate, but Some Were Delayed

Attachment

RECOMMENDATION 1

The KITA Project Office should compare its list of victims to its list of KITA-processed returns. For those victims with no KITA-processed returns, the related accounts should be researched and the KITA indicator input when necessary.

ASSESSMENT OF CAUSE

The KITA indicator was not present on some victims' accounts.

CORRECTIVE ACTION

The KITA Project Office completed this action on November 15, 2002. We completed this research and input the KITA indicator on affected accounts when we sent reminder letters to victims' families who had not filed.

IMPLEMENTATION DATE

Completed

RESPONSIBLE OFFICIALS

Director, Accounts Management Center, Andover
Director, Accounts Management
Director, Customer Account Services

RECOMMENDATION 2

The KITA Project Office should compare its list of victims to its list of KITA-processed returns. For those victims with no KITA-processed returns, the related accounts should be researched to identify and correct any returns filed where tax relief was not granted.

ASSESSMENT OF CAUSE

TIGTA identified five returns that we processed using normal procedures. These returns did not receive the tax relief and expedited return processing the KITA Program was designed to provide.

CORRECTIVE ACTION

We agree with this recommendation and this action is already underway.

IMPLEMENTATION DATE

April 25, 2003

RESPONSIBLE OFFICIALS

Director, Accounts Management Center, Andover
Director, Accounts Management
Director, Customer Account Services