



*Automated Underreporter Program  
Compliance Activities Were Properly  
Suspended for Taxpayers Affected by  
Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

**August 25, Year**

**Reference Number: 2006-40-104**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

August 25, 2006

**MEMORANDUM FOR** COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION  
COMMISSIONER, WAGE AND INVESTMENT DIVISION

*Michael R. Phillips*

**FROM:** Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers Affected by  
Hurricanes Katrina and Rita, but Notification Could Be Improved  
(Audit # 200640003)

This report presents the results of our review to determine whether Wage and Investment (W&I) Division Automated Underreporter (AUR) Program<sup>1</sup> management ensured compliance actions were suspended for individual taxpayers affected by Hurricanes Katrina and Rita.

This review was conducted in conjunction with the President's Council on Integrity and Efficiency (PCIE)<sup>2</sup> as part of its examination of relief efforts provided by the Federal Government in the aftermath of Hurricanes Katrina and Rita. As such, a copy of the report will be forwarded to the PCIE Homeland Security Working Group, which is coordinating the Inspectors' General reviews of this important subject.

### Synopsis

In response to Hurricanes Katrina and Rita, President Bush issued Federal Disaster declarations covering the States of Alabama, Florida, Louisiana, Mississippi, and Texas. Consequently, the

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<sup>1</sup> The AUR Program matches taxpayer income and deduction information to amounts reported on individual income tax returns. The Internal Revenue Service corresponds with taxpayers when discrepancies are identified.

<sup>2</sup> The PCIE was established by Executive Order 12805 (dated May 11, 1992) to address integrity, economy, and effectiveness issues that transcend individual Federal Government agencies and to increase the professionalism and effectiveness of Inspector General personnel throughout the Federal Government. The PCIE is primarily comprised of the Presidentially appointed Inspectors General.



*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

Internal Revenue Service (IRS) announced administrative tax relief for affected taxpayers in the Federal Disaster Areas.

W&I Division AUR Program management ensured employees took prompt action to suspend compliance activities and prevent notices from being issued to affected taxpayers. AUR Program employees who accessed affected taxpayer cases on the AUR system were notified that the cases had been suspended. The AUR system displayed a warning which stated, "Taxpayer resides in a Zip Code identified as a Natural Disaster Area."

***The AUR system suppressed notices and suspended compliance activities on approximately 27,700 tax cases involving W&I Division taxpayers affected by Hurricanes Katrina and Rita.***

Our review of a judgmental sample of 130 W&I Division AUR Program cases confirmed controls were effective in suspending compliance actions. In 128 cases, AUR Program employees had not taken any compliance actions after the IRS made Hurricane Disaster declarations. In two sample cases, notices were mailed. We estimate that approximately 2,759 notices concerning discrepancies related to Tax Year 2003 were mailed to affected W&I Division taxpayers after Hurricanes Katrina and Rita. However, the Correspondence Production Services (CPS) branch inserted a stuffer with these notices informing taxpayers (1) to contact the IRS if they have been affected by the recent disaster(s) in their area and (2) the IRS may have disaster relief available to assist them. The Disaster Relief Council's instructions required the CPS branch to insert stuffers into notices that were printed prior to the Hurricanes and were ready to be mailed to affected States. The Disaster Relief Council instructed the CPS branch to mail the notices with stuffers rather than reprocessing and/or manually opening each individual envelope trying to identify taxpayers residing in affected zip codes.

Although AUR Program management ensured taxpayer relief was provided by suspending AUR Program compliance activities, not all taxpayers affected by the Hurricanes may be aware of this relief. The IRS communicated the suspension of compliance activities through news releases and its web site (IRS.gov). However, there were approximately 10,863 Hurricane-affected W&I Division taxpayers in the hardest hit areas who had received AUR Program notices concerning discrepancies related to Tax Year 2003 prior to the IRS' Hurricane Disaster declarations. These taxpayers may not have seen the IRS news releases or visited the IRS web site. They may not be aware they do not need to gather supporting documentation concerning the discrepancies by the date specified on the notice. They may also not be aware of available disaster relief or how to obtain additional information. To effectively communicate the tax relief granted during catastrophic disasters, the AUR Program should send a notice directly to the taxpayers who had previously received this correspondence.



*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

---

*Recommendation*

We recommended the Commissioners, Small Business/Self-Employed Division and W&I Division, develop a notice to inform taxpayers when AUR Program compliance activities are being suspended because of a disaster. The notice should be sent to affected taxpayers with unresolved discrepancy notices.

*Response*

IRS management disagreed with our recommendation. Specifically, after a disaster of the magnitude of Hurricanes Katrina and Rita, many families are displaced, sometimes for an extended period of time. While the United States Postal Service (USPS) will hold mail and will also attempt to forward mail, in the aftermath of such a catastrophic event victims do not always provide forwarding addresses. In addition, taxpayers affected by disaster are already overwhelmed with the effects of the disaster. Receiving notices from the IRS, regardless of the intent of the notice, would place additional burden on the taxpayer. Also, if notices provide a specific date for the resumption of compliance activities and that date is extended, the IRS would be required to send even more notices to the taxpayer explaining the extension. Further, some taxpayers may also have other pending IRS actions on their account. The AUR Program should not be singled out to provide notices to the taxpayers. This may cause confusion for taxpayers regarding why notices were sent on some IRS actions and not on others. Finally, the Taxpayer Advocate Service has not received any comments or requests from taxpayers indicating they want or need notices from the IRS that compliance actions have been suspended. Management's complete response to the draft report is included as Appendix V.

*Office of Audit Comment*

We disagree with the IRS' reasons for not developing a notice to inform taxpayers when AUR Program compliance activities are being suspended because of a disaster.

The IRS stated the USPS would not be able to deliver these notices for months or maybe years and taxpayers do not always provide forwarding addresses. Notwithstanding, we believe the IRS should consult with the USPS before reaching this conclusion. According to the USPS, mail service was quickly restored to the Central Gulf Coast region. By September 10, 2005, 8 working days after Hurricane Katrina, the USPS was providing full delivery service to approximately 75 percent of residents and businesses affected by Hurricane Katrina.

We agree with the IRS that suspending compliance activities allows the taxpayers to concentrate on disaster recovery and temporarily relieves them of worry about their tax case. However, we



*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

---

believe that taxpayers would further benefit from a notice informing them of the fact that their compliance activities were suspended.

The IRS could provide a telephone number and IRS web site address on the notice for taxpayers to use to obtain additional information on available IRS disaster relief, updates on further compliance relief, and the status of tax issues the taxpayer may have pending.

Copies of this report are also being sent to the IRS managers affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 622-5916.



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*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

---

## *Table of Contents*

<b>Background</b> .....	Page 1
<b>Results of Review</b> .....	Page 5
Automated Underreporter Program Management Ensured Compliance Activities Were Suspended on Taxpayer Cases Affected by the Hurricanes .....	Page 5
Taxpayers Affected by Disasters Should Be Informed That Automated Underreporter Program Compliance Activities Have Been Suspended .....	Page 6
<u>Recommendation 1:</u> .....	Page 7
<b>Appendices</b>	
Appendix I – Detailed Objective, Scope, and Methodology .....	Page 9
Appendix II – Major Contributors to This Report .....	Page 11
Appendix III – Report Distribution List .....	Page 12
Appendix IV – Outcome Measure .....	Page 13
Appendix V – Management’s Response to the Draft Report .....	Page 14



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*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

---

## *Background*

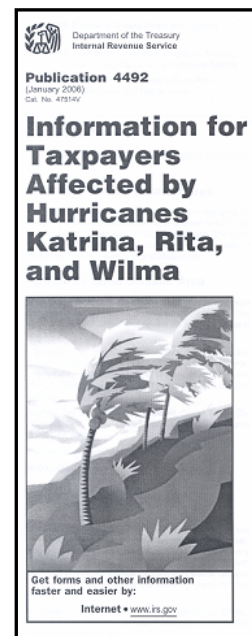
In response to disasters and emergencies, the Internal Revenue Service (IRS) provides disaster relief to taxpayers and tax practitioners, enabling them to meet their tax obligations without being penalized. The IRS has a process in place to determine the tax relief to be granted based on the extent of the disaster and legal guidance.

The National Disaster Assistance Coordinator in the Small Business/Self-Employed Division has overall responsibility for the Disaster Assistance and Relief Program. To address catastrophic disasters, the IRS has established a Disaster Relief Council, which is comprised of the National Disaster Assistance Coordinator and executives/managers from the four IRS operating divisions;<sup>1</sup> the Communications and Liaison function; the Office of Chief Counsel; the Taxpayer Advocate Service; and the Modernization and Information Technology Services organization.

The IRS, under the Disaster Relief Council's guidance, undertook extensive efforts to assist taxpayers affected by Hurricanes Katrina and Rita. The IRS provided taxpayers information on disaster tax relief and assistance in reconstructing tax records.

In response to Hurricanes Katrina and Rita, President Bush issued Federal Disaster declarations covering the States of Alabama, Florida, Louisiana, Mississippi, and Texas. Consequently, the IRS announced administrative tax relief for affected taxpayers in most of the Federal Disaster Areas.

The IRS issued a series of Disaster Relief Memoranda shortly after the Gulf States were devastated by Hurricanes Katrina and Rita. These Disaster Relief Memoranda outlined the tax relief granted, the Federal Disaster Areas covered, and the relief dates. The Disaster Relief Memoranda addressed relief for taxpayers in the States of Alabama, Florida, Louisiana, Mississippi, and Texas. Taxpayers who lived in counties and parishes designated by the Federal Emergency Management Agency (FEMA) for Individual Assistance and/or Public Assistance could be granted tax relief. Among other things, this tax relief involved suspending compliance activities, including activities of the IRS Automated Underreporter (AUR) Program (described in detail later in this section of the report).



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<sup>1</sup> These are the Large and Mid-Size Business Division, the Small Business/Self-Employed Division, the Tax Exempt and Government Entities Division, and the Wage and Investment Division.



*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

On September 2, 2005, the IRS stated it had suspended many compliance activities throughout the affected areas. On the September 21, 2005, the IRS stated, “Based on updated information regarding the impact of the hurricane, the IRS will provide relief from compliance activities until Jan. 3, 2006, in the hardest-hit [sic] areas, specifically those designated by [the] FEMA for ‘individual assistance.’” The tax relief was subsequently extended to February 28, 2006, by the Katrina Emergency Tax Relief Act of 2005.<sup>2</sup> On February 17, 2006, the IRS announced that this tax relief was further extended to August 28, 2006, for seven parishes in Louisiana and three counties in Mississippi. Figure 1 shows the timeline of events for the compliance relief activities related to Hurricanes Katrina and Rita.

**Figure 1: Hurricane Relief Timeline**

<b>Date</b>	<b>Event</b>
August 24, 2005	Hurricane Katrina hits Florida.
August 28, 2005	President Bush declares disaster assistance available for Florida as a result of Hurricane Katrina.
August 29, 2005	Hurricane Katrina hits Alabama, Louisiana, and Mississippi. President Bush declares disaster assistance available for these three States as a result of Hurricane Katrina.
August 30, 2005	IRS Commissioner Everson states, “People affected by Hurricane Katrina have more than enough concerns – taxes shouldn’t be among them.”
September 2, 2005	The IRS states it has suspended many compliance activities throughout the areas affected by Hurricane Katrina.
September 21, 2005	The IRS announces taxpayer relief from compliance activities for Hurricane Katrina’s hardest hit areas until January 3, 2006.
September 23, 2005	Congress passes the Katrina Emergency Tax Relief Act of 2005, thereby extending the taxpayer relief period to February 28, 2006.
September 23, 2005	Hurricane Rita hits Louisiana and Texas.
September 24, 2005	President Bush declares disaster assistance available for Louisiana and Texas as a result of Hurricane Rita.
September 26, 2005	The IRS announces taxpayer relief from compliance activities for Hurricane Rita’s hardest hit areas until February 28, 2006.
February 17, 2006	The IRS announces taxpayer relief is extended to August 28, 2006, for seven Louisiana parishes and three Mississippi counties.

Source: Presidential and IRS Disaster declarations and IRS news releases.

<sup>2</sup> Pub. L. No. 109-73, 119 Stat. 2016.





*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

On September 21, 2005, the Deputy Commissioner for Services and Enforcement issued to operating division executives and managers an internal memorandum concerning tax relief due to Hurricane Katrina. The memorandum stated, “We will provide an extended period of relief for taxpayers who reside or have businesses in the hardest hit areas – generally those designated by [the] FEMA for ‘individual’ relief. These taxpayer accounts will be frozen systemically from August 29, 2005, until January 3, 2006, and generally no compliance actions should take place during that period. The only exceptions will be for exigent circumstances, . . . or when the taxpayer specifically requests an action.”<sup>3</sup> On October 12, 2005, the Deputy Commissioner for Services and Enforcement issued a similar internal memorandum for Hurricane Rita, extending the period of tax relief for taxpayers affected by the Hurricanes in Individual Assistance areas to February 28, 2006. Both memoranda included a suspension of the AUR Program compliance activities. The memoranda stated, “In general, examination actions . . . will not be taken on taxpayers impacted by the Hurricane . . . disaster during the compliance activity suspension period. These actions include, but are not limited to, issuance of notices or letters generated by the AUR Program . . . .”

The AUR Program matches taxpayer income and deduction information to amounts reported on individual income tax returns. Third parties such as banks, brokerage firms, and employers file information returns reporting certain income and deductions.<sup>4</sup> The IRS corresponds with taxpayers when discrepancies are identified. If the taxpayers agree with the third-party information or do not explain the discrepancies, the taxpayers are assessed additional taxes. In Fiscal Year 2005, the IRS corresponded with over 1.7 million taxpayers concerning discrepancies. The AUR Program operates in six IRS campuses<sup>5</sup> and is administered by the Small Business/Self-Employed and the Wage and Investment (W&I) Divisions.

The IRS will issue a series of notices to taxpayers when income and/or

Department of the Treasury  
Internal Revenue Service  
AUR TEST, PA 19154-0021

NOTICE NUMBER: CP-2501  
DATE OF THIS NOTICE: 12/01/2003  
SOCIAL SECURITY NUMBER:  
TAX FORM: 1040 TAX YEAR: 2002  
AUR CONTROL NUMBER:

WHERE YOU MAY WRITE TO US:  
Department of the Treasury  
Internal Revenue Service  
AUR TEST, PA 19154-0021

Be sure to include a  
copy of page one of  
this notice with your  
response.

WHERE YOU MAY CALL US:  
800-123-4567 TOLLFREE  
24 HOURS  
801-555-1212 FAX

WE'RE REQUESTING INFORMATION ABOUT YOUR 2002 TAX RETURN

<sup>3</sup> An exigent circumstance is one involving the loss of opportunity for the Federal Government to collect taxes due, such as the expiration of the statute of limitations, assets being placed beyond the reach of the Federal Government, etc. Managers and employees must exercise good judgment and consider all of the relevant factors to determine that exigent circumstances exist. If exigent circumstances exist, compliance activities may be pursued against a taxpayer with documented managerial approval.

<sup>4</sup> Information returns are submitted by third parties to report certain business transactions to the IRS (e.g., payments made to and from individuals such as dividends, interest, sales of certain assets, and wages). The information is reported to the IRS on various forms such as the Form 1099 series (for various incomes such as Dividend, Interest, Miscellaneous, etc.) and the Wage and Tax Statement (Form W-2).

<sup>5</sup> 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.



*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

---

deduction discrepancies are identified. The first notice (Computer Paragraph (CP) 2501 or CP 2000) informs taxpayers of the discrepancies between the income and/or deductions reported on their tax returns and the amounts reported by third parties. The taxpayers' explanations for the discrepancies dictate whether examiners close the cases with no additional tax assessments (CP 2005) or propose additional taxes (CP 2000, Statutory Notice of Deficiency,<sup>6</sup> etc.).

When IRS Disaster Relief Memoranda require suspension of enforcement actions, AUR Program notices are not to be issued to taxpayers in the covered disaster area. In addition, AUR Program employees will suspend work on any cases in process. If taxpayers respond to notices within the required time periods requesting reasonable additional time, the requests will be approved. The suspension of enforcement actions does not suspend interest or penalties from accruing on these tax assessments in the future.

This review was performed at the W&I Division Headquarters in Atlanta, Georgia, in the Reporting Compliance function; the Atlanta, Georgia, Austin, Texas, and Fresno, California, AUR Program sites; and the Correspondence Production Services (CPS) branch in Detroit, Michigan, and Ogden, Utah, during the period October 2005 through April 2006. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>6</sup> A Statutory Notice of Deficiency is a legal notice which notifies the taxpayer that a tax deficiency exists and the taxpayer is liable for the payment of tax.



*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

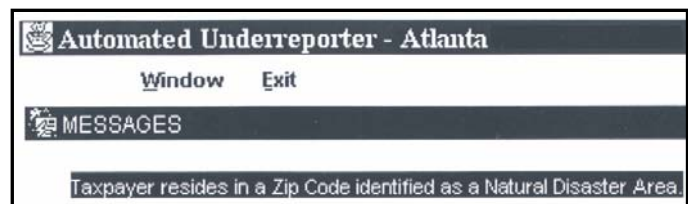
*Results of Review*

**Automated Underreporter Program Management Ensured Compliance  
Activities Were Suspended on Taxpayer Cases Affected by the  
Hurricanes**

W&I Division AUR Program management ensured employees took prompt action to prevent notices from being issued to affected taxpayers. Employees promptly input the Hurricane Disaster Area zip codes and relief dates to the AUR system. The employees input the data within approximately 2 workdays of the issuance of the Hurricanes Katrina and Rita Disaster Relief Memoranda and any subsequent amendments. AUR Program management actions supported IRS Commissioner Everson's position that, "People affected by Hurricane Katrina have more than enough concerns – taxes shouldn't be among them."

The AUR system automatically suppressed notices to taxpayers in Disaster Area zip codes and informed employees of the taxpayers affected by the Hurricanes. This ensured W&I Division AUR Program compliance activities were suspended on approximately 27,700 Tax Year 2003 cases involving taxpayers affected by Hurricanes Katrina and Rita in the Individual Assistance Disaster Areas. AUR

Program employees who accessed affected taxpayer cases on the AUR system were notified that the cases had been suspended. A warning indicated the "Taxpayer resides in a Zip Code identified as a Natural Disaster Area."



Our review of a judgmental sample of 130 W&I Division AUR Program cases from the Hurricanes Katrina and Rita Disaster Area zip codes confirmed that AUR Program controls had suspended compliance actions. In 128 cases, AUR Program employees had not taken any compliance actions and the AUR system had suppressed the notices. In two cases in our sample, AUR Program notices were mailed.

We estimate that approximately 2,759 notices concerning discrepancies related to Tax Year 2003 were mailed to affected W&I Division taxpayers after the IRS Disaster declarations were made for Hurricanes Katrina and Rita. However, the CPS branch inserted a stuffer with these notices informing taxpayers (1) to contact the IRS if they have been affected by the recent disaster(s) in their areas and (2) the IRS may have disaster relief available to assist them. The Disaster Relief Council's instructions required the CPS branch to insert stuffers into notices that were printed prior to the Hurricanes and were ready to be mailed to affected States. The Disaster Relief



*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

Council instructed the CPS branch to mail the notices with stuffers rather than reprocessing and/or manually opening each individual envelope trying to identify taxpayers residing in affected zip codes.

The CPS branch, which prints AUR Program notices, took appropriate actions in response to the Disaster Relief Memoranda. The CPS branch inserted a stuffer with the notice or affixed a label to the envelopes ready to be mailed to affected States. The label instructs taxpayers, “If you have been affected by the disaster in your area, and need more time to deal with the issues in the enclosed notice, please contact us at the telephone number or address on this notice by the requested response date.” The stuffer provided additional information on contact numbers and publications on disaster losses.



***Taxpayers Affected by Disasters Should Be Informed That Automated Underreporter Program Compliance Activities Have Been Suspended***

On September 2, 2005, the IRS announced that it was suspending compliance activities for taxpayers affected by Hurricane Katrina. On September 26, 2005, the information was amended to include Hurricane Rita and extended the compliance activities suspension date to February 28, 2006. The IRS communicated this information to affected taxpayers via news releases and its web site (IRS.gov). W&I Division AUR Program management followed the IRS’ disaster program guidelines to prevent AUR Program notices from being sent to affected taxpayers.

Although W&I Division AUR Program management ensured taxpayer relief was provided by suspending compliance activities, not all taxpayers affected by the Hurricanes may be aware of this relief. Approximately 10,863 W&I Division taxpayers affected by the Hurricanes had received AUR Program notices concerning discrepancies related to Tax Year 2003 prior to the IRS’ Hurricane Disaster declarations. These taxpayers may not have been made aware of the AUR Program compliance relief and may still be concerned about promptly responding to the IRS. Taxpayers may not have seen the IRS news releases or visited the IRS web site. They may not be aware they do not need to gather supporting documentation concerning the discrepancies by the date specified on the notice. They may also not be aware of available disaster relief or how to obtain additional information.



*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

In some instances, the IRS determines that a disaster or emergency is not severe enough to warrant suspending compliance activities. When compliance actions are not suspended, the CPS branch will insert a stuffer (i.e., Notice 1155) with the AUR Program notices addressed to taxpayers in disaster area zip codes. The stuffer informs taxpayers to contact the IRS if they have been affected by the recent disaster in their area and that the IRS may have disaster relief available to assist them. However, if the IRS determines the disasters or emergencies are significant enough to warrant suspending compliance activities, it does not directly inform the affected taxpayers.

Department of the Treasury  
Internal Revenue Service

**Notice 1155**  
(December 2000)

**Disaster Relief From IRS**

We may be able to help you. Please let us know if you need more time to respond to us if you were affected by a recent disaster in your area.

Please contact us before the response date requested in your notice. You may call us at the telephone number shown on your notice, or you may write to us at the address shown on your notice. Also, you may receive free tax assistance at temporary Disaster Recovery Centers in your area.

See other side for further information.

Catalog Number 23672W

You may be able to get an expedited tax refund from the Internal Revenue Service if:

- the President of the U.S. declared your area as a major disaster area, and
- you had property that was damaged or lost.

For more information, please call the toll-free number 1-800-829-3676 and ask for a Disaster Assistance Kit.

To effectively communicate extensions of time to comply with the information requests to taxpayers affected by catastrophic disasters, the IRS should send notices directly to the taxpayers who had previously received AUR Program correspondence. The IRS would need to coordinate with the United States Postal Service (USPS) to determine the timing of mailing notices to affected zip codes, to ensure taxpayers have had adequate time for changes of address to take effect. Notification of tax relief such as these extensions of time to comply would help to reduce burden for affected taxpayers.

## ***Recommendation***

***Recommendation 1:*** The Commissioner, W&I Division, should work with the Commissioner, Small Business/Self-Employed Division, to develop a notice to inform taxpayers when AUR Program compliance activities are being suspended because of a disaster. The notice should be sent to affected taxpayers with unresolved AUR Program discrepancy notices and provide the following information:

- The dates on which compliance activities will be suspended and resumed.
- A telephone number and/or IRS web site address taxpayers could use to obtain additional information on available IRS disaster relief and updates on any further compliance relief extensions.

This notice could also be used by other IRS operating divisions during future catastrophic disasters in which compliance activities are suspended.



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*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

---

**Management's Response:** IRS management disagreed with our recommendation. Specifically, after a disaster of the magnitude of Hurricanes Katrina and Rita, many families are displaced, sometimes for an extended period of time. While the USPS will hold mail and will also attempt to forward mail, in the aftermath of such a catastrophic event victims do not always provide forwarding addresses. In addition, taxpayers affected by disaster are already overwhelmed with the effects of the disaster. Receiving notices from the IRS, regardless of the intent of the notice, would place additional burden on the taxpayer. Also, if notices provide a specific date for the resumption of compliance activities and that date is extended, the IRS would be required to send even more notices to the taxpayer explaining the extension. Further, some taxpayers may also have other pending IRS actions on their account. The AUR Program should not be singled out to provide notices to the taxpayers. This may cause confusion for taxpayers regarding why notices were sent on some IRS actions and not on others. Finally, the Taxpayer Advocate Service has not received any comments or requests from taxpayers indicating they want or need notices from the IRS that compliance actions have been suspended.

**Office of Audit Comment:** We disagree with the IRS' reasons for not developing a notice to inform taxpayers when AUR Program compliance activities are being suspended because of a disaster.

The IRS stated the USPS would not be able to deliver these notices for months or maybe years and taxpayers do not always provide forwarding addresses. Notwithstanding, we believe the IRS should consult with the USPS before reaching this conclusion. According to the USPS, mail service was quickly restored to the Central Gulf Coast region. By September 10, 2005, 8 working days after Hurricane Katrina, the USPS was providing full delivery service to approximately 75 percent of residents and businesses affected by Hurricane Katrina.

We agree with the IRS that suspending compliance activities allows the taxpayers to concentrate on disaster recovery and temporarily relieves them of worry about their tax case. However, we believe that taxpayers would further benefit from a notice informing them of the fact that their compliance activities were suspended.

The IRS could provide a telephone number and IRS web site address on the notice for taxpayers to use to obtain additional information on available IRS disaster relief, updates on further compliance relief, and the status of tax issues the taxpayer may have pending.



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*Automated Underreporter Program Compliance  
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---

## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

The overall objective of this review was to determine whether Wage and Investment (W&I) Division Automated Underreporter (AUR) Program<sup>1</sup> management ensured compliance actions were suspended for individual taxpayers affected by Hurricanes Katrina and Rita. To accomplish this objective, we:

- I. Determined the effectiveness of the systemic actions taken by the Internal Revenue Service (IRS) to suspend AUR Program compliance activities on affected W&I Division taxpayer accounts from the declared Disaster Areas.
  - A. Secured a copy of the Individual Master File (IMF)<sup>2</sup> for Tax Year 2003 AUR Program cases as of December 2005 for the States of Alabama, Louisiana, Mississippi, and Texas. We did a limited validation of the data by matching a judgmental sample of 36 Social Security Numbers to the Integrated Data Retrieval System<sup>3</sup> to determine the accuracy of the taxpayer information and account activity. Our tests of the reliability of the data did not identify any errors.
  - B. Analyzed the IMF data for the Tax Year 2003 AUR Program cases for areas designated by the Federal Emergency Management Agency for Individual Assistance to determine the number of AUR Program discrepancy notices the W&I Division mailed prior to or after the IRS made its Hurricane Disaster declarations.
  - C. Selected a judgmental sample of 130 taxpayers affected by the Hurricanes with AUR Program cases from the counties/parishes designated by the Federal Emergency Management Agency for Individual Assistance in Alabama, Louisiana, Mississippi, and Texas. We judgmentally selected 100 taxpayers from a listing of 3,424 disaster-affected taxpayers provided to us from the IRS. In addition, we also judgmentally selected 30 taxpayers from the 14,822 taxpayers on the IMF extract that had account activities after the Hurricane Disaster declarations.<sup>4</sup> We used judgmental sampling

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<sup>1</sup> The AUR Program matches taxpayer income and deduction information to amounts reported on individual income tax returns. The Internal Revenue Service corresponds with taxpayers when discrepancies are identified.

<sup>2</sup> The IMF is the IRS database that maintains transactions or records of individual tax accounts.

<sup>3</sup> IRS computer system capable of retrieving and updating stored information; it works in conjunction with a taxpayer's account records.

<sup>4</sup> Some of the affected taxpayers were found in both the IRS listing and our IMF extract. However, we did not project the results of our judgmental sample.



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*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

---

because, due to time constraint, we wanted to focus on those accounts with potential activities after the Hurricanes.

- D. Researched the Integrated Data Retrieval System and the AUR system (as necessary) for the judgmental sample of 130 taxpayers to determine if AUR Program compliance activities were properly suspended on each of the cases in our sample.
- II. Determined what actions AUR Program management took to ensure affected W&I Division taxpayers in areas designated by the Federal Emergency Management Agency for Individual Assistance were identified and handled appropriately.
- A. Interviewed and obtained documentation from W&I Division AUR Program management to determine what:
    - 1. Guidance was provided to them by the IRS National Headquarters.
    - 2. Instructions they issued to the AUR Program employees on suspending compliance activities.
    - 3. Impact the Hurricane disasters had on processing AUR Program inventory.
    - 4. Actions were taken to ensure proper identification and control of Hurricane disaster cases.
    - 5. Actions were taken to educate taxpayers on obtaining relief from AUR Program compliance activities.
  - B. Interviewed and obtained documentation from the Atlanta, Georgia; Austin, Texas; and Fresno, California, AUR Program site representatives to identify:
    - 1. Guidance they received from W&I Division AUR Program management on suspending AUR Program compliance activities.
    - 2. Policies and guidance they disseminated to their local staffs.
    - 3. Their processes for handling Hurricane Disaster cases.
  - C. Analyzed the average number of days from the IRS' Hurricane Disaster declarations to input of affected Individual Assistance areas' zip codes to the AUR system to ensure notice suppression.
  - D. Interviewed and obtained documentation from the W&I Division Correspondence Production Services branch about the printing and mailing of AUR Program notices for the Disaster Areas affected by the Hurricanes.





*Automated Underreporter Program Compliance  
Activities Were Properly Suspended for Taxpayers  
Affected by Hurricanes Katrina and Rita, but  
Notification Could Be Improved*

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**Appendix II**

*Major Contributors to This Report*

Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs)

Mary V. Baker, Director

Bryce Kisler, Audit Manager

Julia Tai, Lead Auditor

Gwendolyn Green, Senior Auditor

James Traynor, Senior Auditor

Jean Kao, Auditor



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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner, Small Business/Self-Employed Division SE:S  
Deputy Commissioner, Wage and Investment Division SE:W  
Director, Communications, Liaison, and Disclosure, Small Business/Self-Employed Division  
SE:S:CLD  
Director, Compliance, Wage and Investment Division SE:W:CP  
Director, Strategy and Finance, Wage and Investment Division SE:W:S  
Chief, Performance Improvement, Wage and Investment Division SE:W:S:PI  
Director, Reporting Compliance, Wage and Investment Division SE:W:CP:RC  
Program Manager, Automated Underreporter Program, Wage and Investment Division  
SE:W:CP:RC:AUR  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
    Chief, GAO/TIGTA/Legislative Implementation Branch SE:S:CLD:PSP:GTL  
    Senior Operations Advisor, Wage and Investment Division SE:W:S



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## **Appendix IV**

### *Outcome Measure*

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

#### **Type and Value of Outcome Measure:**

- Taxpayer Burden – Potential; 10,863 taxpayers affected (see page 6).

#### **Methodology Used to Measure the Reported Benefit:**

Based on our Individual Master File<sup>1</sup> extract of open Tax Year 2003 Automated Underreporter Program<sup>2</sup> cases from areas designated by the Federal Emergency Management Agency for Individual Assistance in the States of Alabama, Louisiana, Mississippi, and Texas, we identified approximately 10,863 taxpayers that had received an AUR Program notice prior to the Hurricanes Katrina and Rita Disaster declarations made by the Internal Revenue Service. These taxpayers may not have been made aware of the Automated Underreporter Program compliance relief and may still be concerned about promptly responding to the Internal Revenue Service.

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<sup>1</sup> This is the Internal Revenue Service database that maintains transactions or records of individual tax accounts.

<sup>2</sup> The Automated Underreporter Program matches taxpayer income and deduction information to amounts reported on individual income tax returns. The Internal Revenue Service corresponds with taxpayers when discrepancies are identified.



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**Appendix V**

*Management's Response to the Draft Report*



COMMISSIONER  
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

RECEIVED  
JUL 13 2006

JUL 13 2006

MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard J. Morgante *Richard J. Morgante*  
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Automated Underreported Compliance  
Activities Were Properly Suspended for Taxpayers Affected by  
Disasters, but Notification Could Be Improved (TIGTA Audit #  
200640003)

I have reviewed the subject draft report, and I appreciate your acknowledgement of IRS' extensive efforts to assist taxpayers who were victims of Hurricanes Katrina and Rita. In the aftermath of these disasters, the Automated Underreporter (AUR) Program ensured that employees took prompt action to prevent the issuance of notices to thousands of affected taxpayers. I am pleased your review confirmed these actions were successful and the controls we have in place properly suspended compliance activity on applicable AUR accounts.

Additionally, we took proactive steps to prevent any AUR compliance activity on Tax Year 2004 returns until the tax relief period for these disasters had expired. In preparation for future disasters, we implemented programming changes that enable the immediate transfer of disaster-impacted zip codes into the AUR system, eliminating the need for manual input as well as the associated potential for data entry errors. These actions further enhance our ability to assist taxpayers affected by disasters.

While I appreciate your assessment of our prompt action, I disagree with your recommendation that IRS develop a notice to inform taxpayers in the AUR stream that compliance activity has been stopped on their account. As we saw in the aftermath of Hurricanes Katrina and Rita, many victims of such catastrophic disasters are not able to receive mail. Suspending compliance activity allows the taxpayer to concentrate on disaster recovery and temporarily relieves them of worry about their tax case. Receiving an IRS notice, however, gives most people reason for pause. For someone reeling from a catastrophic disaster, another IRS notice of any kind will likely only cause undue stress. Sending such a notice to AUR taxpayers could also result in disparate



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2

treatment between taxpayers in different compliance streams, unless similar notices are generated for every IRS compliance program, which potentially further increases taxpayer stress as noted above.

Our response to your recommendation is detailed in the attachment. If you have any questions, please contact me at (404) 338-7060, or members of your staff may contact Jim Grimes, Director, Compliance, at (404) 338-9904.

Attachment



*Automated Underreporter Program Compliance  
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Attachment

**RECOMMENDATION**

The Commissioner, W&I Division, should work with the Commissioner SB/SE Division, to develop a notice to inform taxpayers when AUR Program compliance activities are being suspended because of a disaster. The notice should be sent to affected taxpayers with unresolved AUR Program discrepancy notices and provide the following information:

- The dates on which compliance activities will be suspended and resumed.
- A telephone number and/or IRS web site address taxpayers could use to obtain additional information on available IRS disaster relief and updates on any further compliance relief extensions.

**CORRECTIVE ACTION**

We disagree with your recommendation and have decided not to implement it for the following reasons:

1. After a disaster of the magnitude of Hurricanes Katrina and Rita, many families are displaced and unable to return to their homes, in some instances for an extended period of time. The Postal Service does hold mail until it is once again deliverable; however, this could take months or even years. The Postal Service will also attempt to forward mail, provided it has a forwarding address; however, in the aftermath of such a catastrophic event victims do not always provide forwarding addresses to the Post Office.
2. Taxpayers affected by disaster are already overwhelmed with the effects of the disaster. Receiving notices from the IRS, regardless of the intent of the notice, would place additional burden on the taxpayer. In addition, if all IRS programs are required to send notices to taxpayers about suspended actions, some taxpayers may receive more than one notice from the IRS, again placing unnecessary burden on taxpayers who are already overwhelmed by the disaster itself.
3. Oftentimes, because of the severity of the disaster, we must extend several times the date on which compliance activities are to resume. If notices provide a specific date for the resumption of compliance activities and that date is extended, IRS would be required to send even more notices to the taxpayer explaining each extension.
4. Some taxpayers may also have other pending IRS actions on their account. The AUR Program should not be singled-out to provide notices to the taxpayers. This sends an inconsistent message to the taxpayer and may cause confusion regarding why notices were sent on some IRS actions and not on others.



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2

5. Finally, the Taxpayer Advocate Service has not received any comments or requests from taxpayers indicating they want or need notices from the IRS that compliance actions have been suspended.

**IMPLEMENTATION DATE**

Not applicable

**RESPONSIBLE OFFICIAL**

Not applicable

**CORRECTIVE ACTION MONITORING PLAN**

Not applicable