

**Information Provided to Taxpayers When
Requesting Extensions of the Assessment
Statute of Limitations Can Be Improved**

September 2000

Reference Number: 2000-10-142

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 29, 2000

MEMORANDUM FOR COMMISSIONER ROSSOTTI

A handwritten signature in cursive script that reads "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Information Provided to Taxpayers When
Requesting Extensions of the Assessment Statute of Limitations
Can Be Improved

This report presents the results of our review of the Internal Revenue Service's (IRS) compliance with assessment statute extension provisions of the IRS Restructuring and Reform Act of 1998 (RRA 98).¹ Because the effective date of the new law was not until January 1, 2000, we focused our review on the IRS' readiness to implement the new RRA 98 requirements.

In summary, we found that in most cases we reviewed, examiners properly advised taxpayers of their right to refuse or restrict the scope of the statute extension. However, in some cases (five percent of our sample) examiners did not indicate in case files whether taxpayers were advised of these rights. We recommended that IRS management revise existing guidelines to require group managers to review case documentation to ensure that taxpayers have been notified of their rights before approving statute extension agreements.

We also found that additional information should be provided in the IRS publication titled, Extending the Tax Assessment Period (Publication 1035). We recommended that the publication be revised to more fully explain the terms of restricted and unrestricted assessment statute extension agreements and the process to limit the scope of these

¹ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. App., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

agreements. We also recommended that all prior versions of Publication 1035 be replaced after the updated publications are distributed.

IRS management agreed with the issues and recommendations in this report. The full text of their comments is included as an appendix.

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 your staff may call Maurice S. Moody, Associate Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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Executive Summary

If the Internal Revenue Service (IRS) audits a tax return and determines there is an additional tax liability, it generally must be assessed within 3 years of the date that a return was due or the date that the return was actually filed, whichever is later. This 3-year assessment statute of limitations normally cannot be extended without the taxpayer's written agreement.¹ The IRS Restructuring and Reform Act of 1998 (RRA 98)² § 3461 requires the IRS to advise taxpayers of their rights whenever requesting an extension of the statute of limitations on assessment of additional tax and penalties. In passing this law, the Congress expressed concern that taxpayers were not being adequately advised of their rights to refuse to extend the statute of limitations or to request that a statute extension be limited to a specific period of time or to only specific issues. This provision became effective on January 1, 2000.

The Congress also required the Treasury Inspector General for Tax Administration to annually evaluate the IRS' compliance with this statute provision.³ The overall objective of this audit was to determine whether the IRS provided taxpayers an explanation of their rights to decline to extend the assessment statute of limitations or to request that any extension be limited to a specific period of time or to specific audit issues. Because the effective date of this law was not until January 1, 2000, we focused our review on the IRS' readiness to implement the new RRA 98 requirements.

Results

In most of the cases we reviewed with assessment statute extensions, examiners properly advised taxpayers of their right to refuse or restrict the scope of the statute extension. However, in some cases (five percent of our sample) examiners did not indicate in case files whether taxpayers were advised of these rights. As a result, in these cases, we could

¹ There are several exceptions to the 3-year statute of limitations. For example, Internal Revenue Code (I.R.C.) § 6501(c)(1) (1994) extends the assessment statute indefinitely in cases of filing false or fraudulent returns, and I.R.C. § 6503(a) (1994 and Supp. IV 1998) generally suspends the statute during the period when assessment is prohibited by I.R.C. § 6213(a) (Supp. IV 1998), effectively suspending the statute for 150 days after a notice of deficiency is issued, and if petitioned to the Tax Court, until the Tax Court decision becomes final.

² Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. App., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

³ I.R.C. § 7803(d)(1)(C) (Supp. IV 1998).

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not determine if the IRS protected the taxpayer's right to be advised of these statute extension options.

During our review, the IRS distributed guidance to its employees so they would be aware of the new requirements of the law. This guidance should help to ensure that the IRS complies with the law in the future. However, additional information should be provided to taxpayers to adequately explain the potential for additional issues to be audited and the process to limit extensions to specific issues.

Some Examination Case Files Did Not Indicate Whether Taxpayers Had Been Advised of Their Rights

To determine whether the IRS advised taxpayers of their rights when requesting extensions of the assessment statute of limitations, we reviewed a judgmental sample of 203 open examination files that contained a request made after January 1, 2000, to extend the assessment statute of limitations. In most of the cases we reviewed (193 of 203), examiners properly advised taxpayers of their right to refuse or restrict the scope of the statute extension. In 10 cases (5 percent), the examination files did not contain any record that the taxpayers had been advised of their rights to refuse or to restrict the request for an assessment statute extension. An IRS internal survey conducted from March to June 2000 identified that 35 case files did not indicate whether taxpayers had been advised of their rights. It would be a potential violation of taxpayers' rights if the IRS did not notify taxpayers of their options when requesting assessment statute extensions. If taxpayers were not notified of their rights, extensions granted by taxpayers in these instances may not be valid.

Because revised guidance about the RRA 98 requirements was not distributed timely, some examiners in the district offices were not aware until well after the effective date that new guidance and documentation requirements had been implemented. This guidance included the use of a revised cover letter for examination statute extension requests and a revised publication *Extending the Tax Assessment Period* (Publication 1035) to advise taxpayers of their rights.

However, the new guidelines do not require Examination group managers to review the case file documentation to ensure examiners had properly advised taxpayers of their rights before approving the statute extension agreement. Because the extension agreement may not be valid if taxpayers have not been notified of their rights, this should be a condition of approval to ensure this requirement is met and there is proper documentation of the notification to the taxpayer.

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Extending the Tax Assessment Period (Publication 1035) Can Be Improved to More Adequately Explain the Purpose and Process for Limiting the Assessment Statute

Publication 1035 is the primary source used by the IRS to inform taxpayers about their rights and the procedures for extending the assessment statute of limitations. The IRS made revisions to this Publication in December 1999 to provide additional information on taxpayers' rights regarding limiting the length or scope of a statute extension. However, the new Publication does not contain certain information that would assist taxpayers in determining whether to request a restricted extension and also what action to take to ensure the restriction is legally binding.

The new Publication does not adequately explain that if a taxpayer consents to an extension that is not restricted to specific issues, the IRS could use the additional time to examine other items on the return which were not previously considered. The Publication also does not completely explain the process for restricting the statute extension to specific issues. It does not explain that the restrictive language must be included on the consent form to ensure that it is legally valid and that the language and terms of the restriction must be approved by IRS Counsel. Both National Headquarters and field Examination managers stated that this information would be helpful to taxpayers in understanding the requirements for inclusion of restrictive language on the consent form.

In addition, after the December 1999 revision of Publication 1035, the Examination Division did not ensure that all examiners were providing taxpayers with the updated Publication and cover letter. It is important that the IRS timely provide updated and complete information to taxpayers about their rights when requesting assessment statute extensions. This information could affect a taxpayer's decision on whether to ask that the scope of the extension be limited to specific issues.

Summary of Recommendations

We recommend that the Assistant Commissioner (Examination) revise existing guidelines to require group managers to review case documentation to ensure that taxpayers have been notified of their rights before approving statute extension agreements. Publication 1035 should also be revised to more fully explain the terms of restricted and unrestricted assessment statute extension agreements and the process to limit the scope of these agreements. All prior versions of Publication 1035 should be replaced once the revisions are completed.

Management's Response: IRS management agreed with the issues and recommendations in this report. Guidelines will be revised to require group managers to verify that

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documentation is present indicating that taxpayers have been advised of their rights before approving statute extension agreements. Management will also revise Publication 1035 to advise taxpayers of the additional information included in our recommendation and will notify all appropriate Operating Divisions to exclusively use the revised Publication 1035.

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

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Objective and Scope

The Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98)¹ § 3461 requires the IRS to advise taxpayers of their rights whenever requesting an extension of the statute of limitations on assessment of additional tax and penalties. In passing this law, the Congress expressed concern that taxpayers were not being adequately advised of their rights to refuse to extend the statute of limitations or to request that a statute extension be limited to a specific period of time or to only specific issues. This provision became effective on January 1, 2000.

The overall objective of this audit was to determine whether the IRS is complying with the RRA 98 requirement to provide taxpayers an explanation of their rights to decline or limit extensions to the assessment statute of limitations.

The RRA 98 also requires the Treasury Inspector General for Tax Administration (TIGTA) to provide information annually regarding the IRS' compliance with this provision to provide taxpayers an explanation of their rights to decline or limit extensions to the assessment statute of limitations.² The overall objective of this audit was to determine whether the IRS provides taxpayers an explanation of their rights to decline to extend the assessment statute of limitations or to request that any extension be limited to a specific period of time or to specific audit issues. Because the effective date of this law was not until January 1, 2000, we focused our review on the IRS' readiness to implement the new RRA 98 requirements. This is the TIGTA's first review of this area.

¹ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. App., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

² Internal Revenue Code (I.R.C.) § 7803(d)(1)(C) (Supp. IV 1998).

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The IRS does not have a system to track statute extension requests and cannot identify the total number of statute extensions based upon taxpayer consents to extend statutes for any given period.

The IRS does not have a system to track statute extension requests or whether they were accepted, declined, or restricted by the taxpayer. In addition, the IRS cannot identify the total number of statute extensions based upon taxpayer consents to extend statutes for any given period. We identified open audits, for which it was likely that the taxpayer had signed a consent to extend the statute of limitations, by analyzing the computer records of all assessment statutes that had been adjusted between January 1 and March 24, 2000. Assessment statutes could be adjusted on taxpayer accounts for several reasons, such as:

- Corrections to the original statute date.
- Statutory provisions extending the statute of limitations, including:
 - issuance of a legal notice of tax deficiency giving the taxpayer 90 days within which to appeal to the United States Tax Court.
 - fraud and substantial underreporting of income.
- Taxpayers consenting to extend the statute.

If a consent for extension is requested, the IRS generally asks taxpayers to extend the statute to the end of the calendar year or to the end of a filing season month and often extends the statute for at least 6 months at a time.

We selected tax cases to review, which involved the third reason, statutes extended by the consent of taxpayers. We reviewed examination files for tax cases in the Los Angeles, Manhattan, Midwest, Southern California, and Southern Florida District Offices during April and May 2000. The District Offices were selected based on those having the highest numbers of extensions to the statute of limitations.

This audit was performed in accordance with *Government Auditing Standards*. Details of our audit objective, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

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Background

The IRS generally must complete an audit of an income tax return and assess any proposed additional tax within 3 years of the date that a return was due or the date that the return was actually filed, whichever is later.

A taxpayer might want to agree to extend the assessment statute of limitations for several reasons.

If the IRS audits a tax return and determines there is an additional tax liability, it generally must be assessed within 3 years of the date that a return was due or the date that the return was actually filed, whichever is later. This 3-year assessment statute of limitations normally cannot be extended without the taxpayer's written agreement.³ When more time is needed to complete an audit, the IRS may ask the taxpayer to sign a statute extension agreement form (consent). The consent can be negotiated between the IRS and the taxpayer to extend the assessment statute of limitation to a specific period of time or the statute can be extended for an unlimited, indefinite period. The statute is usually extended for a period that both parties agree is reasonable to complete the audit. The consent can also be negotiated to apply only to certain audit issues.

A taxpayer might want to agree to extend the assessment statute of limitations for the following reasons.

- The taxpayer may want to pursue additional audit issues that are in the taxpayer's favor in offsetting proposed tax or that might allow for a tax refund.
- If the remaining statute for assessment is too short, the IRS may have to prematurely stop the audit process and issue a notice of deficiency in order to protect the government's interest in assessing a proposed tax. This notice of deficiency limits the time for the normal appeals processes before the taxpayer must file a petition to the United States Tax Court.

³ There are several exceptions to the 3-year statute of limitations. For example, I.R.C. § 6501(c)(1) (1994) extends the assessment statute indefinitely in cases of filing false or fraudulent returns, and I.R.C. § 6503(a) (1994 and Supp. IV 1998) generally suspends the statute during the period when assessment is prohibited by I.R.C. § 6213(a) (Supp. IV 1998), effectively suspending the statute for 150 days after a notice of deficiency is issued, and if petitioned to the Tax Court, until the Tax Court decision becomes final.

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There are also certain instances in which a taxpayer may not want to extend the assessment statute of limitations.

There are also certain instances in which a taxpayer may want to limit or refuse to extend the assessment statute of limitations.

- The taxpayer may not want to provide the IRS additional time to consider additional audit issues.
- The taxpayer may not want to allow the IRS the opportunity to further develop audit issues already under consideration after the normal statute period has expired.

RRA 98 § 3461 requires the IRS to advise taxpayers of their rights to refuse to extend the statute of limitations or to request that a statute extension be limited to a specific period of time or to specific issues.

Results

In most cases, examiners properly advised taxpayers of their right to refuse or restrict the scope of the statute extension. However, in some cases, examiners did not indicate in case files whether taxpayers were advised of these rights.

In most of the cases we reviewed with assessment statute extensions, examiners properly advised taxpayers of their right to refuse or restrict the scope of the statute extension. However, in some cases (five percent of our sample) examiners did not indicate in case files whether taxpayers were advised of their rights to refuse to extend or to limit extensions of the assessment statute of limitations to a specific period of time or to only specific issues. As a result, we could not determine if the IRS always protected the taxpayer's right to be advised of these statute extension options.

An IRS publication should clarify the potential for additional issues to be audited and the process to limit extensions to specific issues.

During our review, the IRS distributed guidance to its employees to make them aware of new procedures to comply with the new requirements of the law. This guidance should help to ensure that the IRS complies with the law in the future. However, additional information should be provided to taxpayers to adequately explain the potential for additional issues to be audited and the process to limit extensions to specific issues.

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We were unable to determine whether the IRS properly accepted or denied requests for restricted statute extensions.

We were unable to determine whether taxpayers requested restrictions in the scope of statute extensions because the IRS case files we reviewed did not contain any documentation indicating that taxpayers made such a request, except for one case in which the restriction was allowed. Therefore, we could not evaluate whether requests for these types of restrictions were properly accepted or denied.

Some Examination Case Files Did Not Indicate Whether Taxpayers Had Been Advised of Their Rights

We reviewed a judgmental sample of 203 accounts in 5 district offices, which had consent forms solicited after January 1, 2000.

From a computer extract of taxpayer accounts, we identified approximately 4,000 individual tax returns and approximately 7,000 business tax returns reflecting adjustments of the statute of limitation in the first quarter of calendar year 2000 that were likely to have resulted from taxpayer consents to extend the statute period. We reviewed the case files for a judgmental sample of 333 of these accounts in 5 IRS district offices during April and May 2000. Of the 333 case files we reviewed, 98 percent were statute extensions resulting from taxpayer consents and 203 had associated consent forms that were solicited after January 1, 2000, the effective date of the RRA 98 statute provisions.

We determined whether there was any indication that the taxpayer had been advised of their statute extension rights.

We reviewed the case files to determine whether there was any indication that taxpayers had been advised of their statute extension rights. Taxpayers were considered to have been advised of their rights if any of the following records were found in the audit file.

- A copy of the cover letter (updated to include an explanation of taxpayer rights) used to request the extension.
- A record that Extending the Tax Assessment Period (Publication 1035) was provided to the taxpayer as indicated by the audit contact record or as shown as an enclosure on a cover letter.

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In most cases we reviewed (193 of 203), examiners properly advised taxpayers of their right to refuse or restrict the scope of the statute extension. In 10 cases (5 percent), the examination case files did not contain any record that the taxpayer had been advised of these rights.

- The audit contact record stated that the taxpayer was given a verbal explanation of his/her rights.

In most cases we reviewed (193 of 203), examiners properly advised taxpayers of their right to refuse or restrict the scope of the statute extension. In 10 of 203 cases (5 percent), we found that the examination case files did not contain any record that the taxpayers had been advised of their rights to refuse or to restrict the request for a statute extension. As a result, for these cases, we could not determine if the IRS protected the taxpayer's right to be advised of these statute extension options. It would be a potential violation of taxpayers' rights if the IRS did not notify taxpayers of their options when requesting assessment statute extensions. If taxpayers were not notified of their rights, extensions granted by taxpayers in these instances may not be valid.

The Internal Revenue Manual (IRM), as revised January 1, 2000, requires that IRS employees record in the audit case file whether taxpayers have been advised of their rights. On December 21, 1999, the Assistant Commissioner (Examination) issued a memorandum advising employees that new procedures would be in effect for statute extensions secured after December 31, 1999. This memorandum also advised that the cover letter used for examination statute extension requests and the Publication 1035 had been revised to conform to the RRA 98 requirements.

However, in the district offices we visited, the Examination Division personnel did not know of the new IRM requirements and new publications until well after the effective date of the statute extension provisions of the RRA 98. The memorandum was not distributed in a timely manner to all Examination managers and employees.

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An IRS survey compiled in June 2000 indicated that there were 35 tax cases nationally in which the examiners did not document whether taxpayers had been advised of their rights. However, we identified additional cases of missing documentation that were not reported in this survey.

To determine whether RRA 98 procedures were being followed, the Assistant Commissioner (Examination) issued a memorandum on March 27, 2000, requesting all district offices to review open examination files having statute extension requests made after January 1, 2000. The district offices were to respond with the number of case files that did not have a record of the taxpayers being advised of their rights as required by the RRA 98.

The results of their survey were compiled in June 2000 and indicated that there were a total of 35 tax cases nationally in which the examiners did not document in the case files whether taxpayers had been advised of their rights. However, we identified additional cases that were not reported in this survey. For example, we identified that seven individual income tax returns in our sample from five districts did not have documentation that taxpayers were advised of their rights. The IRS survey did not report any cases of inadequate documentation for individual taxpayers.

The new IRM requirements do not require Examination group managers to review the case file documentation to ensure examiners properly advised taxpayers of their rights before approving the statute extension agreement. Because the extension agreement may not be valid if taxpayers have not been notified of their rights, this should be a condition of approval to ensure this requirement is met and there is proper documentation of the notification to the taxpayer.

Recommendation

1. The Assistant Commissioner (Examination) should revise the IRM to require Examination group managers to review the case file documentation to ensure examiners properly advised taxpayers of their rights before approving statute extension agreements.

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Management's Response: IRS management will revise guidelines to require group managers to verify that documentation is present indicating that taxpayers have been advised of their rights before approving statute extension agreements.

Extending the Tax Assessment Period (Publication 1035) Can Be Improved to More Adequately Explain the Purpose and Process for Limiting the Assessment Statute

Publication 1035 is the primary source for taxpayers to obtain information about their rights and procedures for extending the assessment statute of limitations.

Publication 1035 is the primary written source for taxpayers to obtain detailed information about their rights and procedures for extending the assessment statute of limitations. The IRM, as revised January 1, 2000, requires that this Publication be given to all taxpayers from whom the IRS is requesting an extension of the assessment statute of limitations. The Publication was updated effective December 1999 to explain revised (less restrictive) conditions under which the IRS is likely to grant a taxpayer's request to restrict a statute extension to specific issues. For example, previously, a restricted consent would not be allowed unless the audit was substantially completed; this is no longer required.

The revised Publication 1035 eliminated information explaining that if the taxpayer signed an unconditional consent, the IRS could use the additional time to examine other items on the return.

While the revised Publication more clearly explained certain aspects of the process, it also eliminated an important item of information. Both the old and new versions of Publication 1035 advise taxpayers that an unconditional consent provides the IRS with the same "examination authority" as under the original statutory period. However, the prior Publication went further to explain what is meant by "examination authority" and stated that if a taxpayer consents to an extension that is not restricted to specific issues, the IRS may use the additional time to examine other items on the return which were not previously considered.

The IRS removed this specific information to conserve space in the Publication and considered the general

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In addition, the Publication does not clearly explain the procedures for requesting that a consent be limited to specific issues.

Examination managers stated that additional explanations would be helpful to taxpayers in understanding the requirements for restricting statute consent forms.

information to be adequate for the purposes of the new law. Nonetheless, without this specific information, taxpayers might assume that the consent is being granted to continue the audit for only the issues currently open. Taxpayers may not understand that they are granting authority to the IRS to audit new issues past the normal statute period. For example, these new issues could include additional income, expenses, or deductions that were not questioned previously during the audit.

In addition, the Publication does not clearly explain the procedures for requesting that a consent be limited to specific issues. The Publication states that taxpayers may negotiate the items for restriction and that both parties must agree on the terms of the consent, but there is no direction in the publication as to what form the agreement must take. The Examination Division explained that further details on procedures for requesting restricted consents had not been considered. The IRM states that any language to restrict a consent to specific issues must be reflected on the consent document and must first be approved by the Examination group manager and IRS Counsel. However, the IRM is primarily for IRS internal information and is not being provided to taxpayers along with the statute extension request.

Both National Headquarters and field Examination managers stated that this information would be helpful to taxpayers in understanding the requirements for inclusion of restrictive language on the consent form. Otherwise, taxpayers and representatives may improperly believe that requesting restrictive language in correspondence to the IRS is sufficient.

Furthermore, it is important that Examination Division replace prior versions of the Publication 1035, as well as the statute extension cover letter. After the December 1999 revision of Publication 1035, the Examination Division did not ensure that all examiners were providing the updated Publication and cover letter to taxpayers. In the sample of cases we reviewed, 121 of 203 taxpayers (60 percent) were initially

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provided the previous versions of the Publication and cover letter even though the new versions were available. The Examination Division did not timely replace the prior versions (including paper versions and computer templates) of these documents in all of its offices.

In our review of 203 examination cases, we found that only 1 consent form (0.5 percent) had been restricted to specific audit issues.

It is important that the IRS timely provide updated and complete information to taxpayers when requesting assessment statute extensions. This information could affect a taxpayer's decision on whether to ask that the scope of the extension be limited to specific issues. IRS managers and employees in the districts we reviewed estimated that less than five percent of the taxpayers who signed a consent to extend the statute of limitations after January 1, 2000, requested to have the extension limited to specific issues. In our review of 203 examination cases having statute extensions requested and secured after January 1, 2000, we found that only 1 consent form (0.5 percent) had been restricted to specific audit issues. However, we do not know the number of taxpayers who requested a restriction in the terms of the extension because the case files we reviewed did not contain any documentation on whether taxpayers made such a request.

Recommendations

We recommend that the IRS add additional information to the primary publication used to help taxpayers better understand their rights and the process for legally restricting an extension of the assessment statute of limitations.

2. The Assistant Commissioner (Examination) should revise the Publication 1035 to advise taxpayers of the following:
 - The IRS may open new audit issues under the extended statute period if the taxpayer does not restrict the statute extension to specific issues.
 - Specific restrictive language is required on the statute extension consent form in order for the restrictions to be valid.
 - The terms and restrictive language added to the consent form must be approved by IRS Counsel.

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Management's Response: IRS management will revise Publication 1035 to advise taxpayers of the additional information included in this recommendation/finding.

3. The Assistant Commissioner (Examination) should timely distribute notification of the revisions to all Examination Division offices and distribution centers and emphasize that prior versions of the Publication 1035, including local computer templates, must be replaced.

Management's Response: IRS management will issue a memorandum to advise the appropriate Operating Divisions that a new Publication 1035 is available for immediate and exclusive use, with direction to disseminate the memorandum to all field personnel as quickly as possible. The memorandum will be posted on the Web sites for all Operating Divisions for immediate availability.

Conclusion

In most of the cases we reviewed with assessment statute extensions, examiners properly advised taxpayers of their right to refuse or restrict the scope of the statute extension. However, in some cases, examiners did not indicate in case files whether taxpayers were advised of their rights to refuse to extend or to limit extensions of the assessment statute of limitations to a specific period of time or to only specific issues. As a result, we could not determine if the IRS always protected the taxpayer's right to be advised of these statute extension options.

During our review, the IRS distributed guidance to its employees so they would be aware of the new requirements of the law. This guidance should help to ensure that the IRS complies with the law in the future. However, additional information should be provided to taxpayers to adequately explain the potential for additional issues to be audited and the process to limit extensions to specific issues.

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We recommend the IRS add additional information to the primary publication used to help taxpayers better understand their rights and the process for legally restricting an extension of the assessment statute of limitations.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall audit objective was to determine whether the Internal Revenue Service (IRS) provided taxpayers an explanation of their rights to decline to extend the assessment statute of limitations or to request that any extension be limited to a specific period of time or to specific audit issues. To complete this objective, we performed the following audit tests:

- I. Determined whether the IRS provided adequate training to Examination employees on the new procedures for advising taxpayers of their rights related to assessment statute extension requests.
 - A. Reviewed nationally distributed IRS Restructuring and Reform Act of 1998 (RRA 98)¹ training material.
 - B. Reviewed national and local memoranda related to statute extension procedures.
 - C. Reviewed the current Internal Revenue Manual and any revisions that are in process.
- II. Determined whether taxpayers are being advised of their rights related to assessment statute extension requests.
 - A. Reviewed a judgmental sample of cases that had extended assessment statutes to determine if the cases contained documentation that taxpayers were advised of their rights before signing the statute extension request.
 - 1) Obtained Individual Masterfile,² Business Masterfile,³ and Audit Information Management System databases to identify a population of open audits having assessment statutes extended during the period January 1 to March 24, 2000.
 - 2) Identified and extracted data for cases in which the statute period was likely to have been extended by the consent of taxpayers. Cases were extracted in which the statutes were extended for at least 6 months and to the end of the calendar year or to the end of a filing season month.

¹ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. App., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

² The IRS database that maintains transactions or records of individual tax accounts.

³ The IRS database that consists of federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

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- 3) Selected and reviewed a judgmental sample of open case files for taxpayer cases in five district offices, based on the sites having the largest numbers of statute extensions from January through March 2000, to determine whether taxpayers had been advised of their right to refuse or limit the scope of the extension.
 - B. Reviewed the sample of case files to determine whether there was any indication that the taxpayers had requested restrictions in the scope of the extensions.
 - C. Interviewed Examination group managers to determine how they process taxpayers' requests for scope limitations on statute extensions.
- III. Determined whether taxpayer contact letters, forms, and publications had been revised to adequately advise taxpayers of rights to refuse to extend the assessment statute of limitations and to request that any extension be limited in scope to specific audit issues or to a particular period of time.
 - A. Reviewed the RRA 98 § 3461 law, analysis, and congressional committee reports to identify criteria for required notice to taxpayers of their rights when they are requested to extend the assessment statute of limitations.
 - B. Reviewed prior and new national IRS letters, forms, and publications related to assessment statute extension requests for field, office, and correspondence examination.
 - C. Determined whether new letters and forms had been distributed at each district office visited.

**Information Provided to Taxpayers When Requesting Extensions
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Appendix II

Major Contributors to This Report

Maurice S. Moody, Associate Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

Nancy A. Nakamura, Director

Michael E. McKenney, Audit Manager

Daniel M. Quinn, Senior Auditor

Julia M. Collins, Auditor

Cindy L. Wright, Auditor

**Information Provided to Taxpayers When Requesting Extensions
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Appendix III

Report Distribution List

Deputy Commissioner Operations C:DO
Commissioner, Small Business/Self-Employed Division S
National Taxpayer Advocate C:TA
Office of the Chief Counsel CC
Office of Management Controls CFO:A:M
Assistant Commissioner (Examination) OP:EX
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis M:O
District Director, Los Angeles District
District Director, Manhattan District
District Director, Midwest District
District Director, South Florida District
District Director, Southern California District
Audit Liaisons:
 Deputy Commissioner Operations C:DO
 Chief Operations Officer OP
 Commissioner, Small Business/Self-Employed Division S
 Office of the Chief Counsel CC
 Assistant Commissioner (Examination) OP:EX
 Director, Legislative Affairs CL:LA

Information Provided to Taxpayers When Requesting Extensions of the Assessment Statute of Limitations Can Be Improved

Appendix IV

Outcome Measures

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

Finding and recommendation:

Some examination case files did not indicate whether taxpayers had been advised of their rights to refuse or to restrict the request for a statute extension (see page 6). This report recommends that the Assistant Commissioner (Examination) revise the IRM to require Examination group managers to review the case file documentation to ensure examiners properly advised taxpayers of their rights before approving statute extension agreements.

Type of Outcome Measure:

Taxpayer Rights – Potential

Value of the Benefit:

In at least 43 cases, group managers would have ensured that taxpayers were properly advised of their rights and that this notification was properly documented before approving agreements to extend the assessment statute.

Methodology Used to Measure the Reported Benefit:

Through a survey of all district offices, the IRS identified a total of 35 tax cases nationally in which the examiners did not document in the case files whether taxpayers had been advised of their rights as required by the RRA 98. Of these cases, 33 were not included in our sample. Our judgmental sample of cases in five districts identified 10 additional tax cases in which the examiners did not document in the case files whether taxpayers had been advised of their rights. (33 tax cases + 10 tax cases = 43 tax cases).

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Appendix V

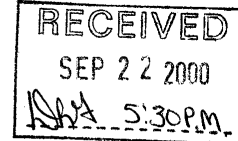
Management's Response to the Draft Report



COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

September 22, 2000



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:

for Charles O. Rossotti *Charles O. Rossotti*
Commissioner of Internal Revenue

SUBJECT:

Draft Audit Report – Information Provided to Taxpayers When
Requesting Extensions of the Assessment Statute of Limitations
Can Be Improved

Thank you for the opportunity to review and comment on your recent draft report titled "Information Provided to Taxpayers When Requesting Extensions of the Assessment Statute of Limitations Can Be Improved." This report, in accordance with the IRS Restructuring and Reform Act of 1998 (RRA), is a review of our compliance with the statute provision requiring us to advise taxpayers of their rights whenever they request an extension of the statute of limitations on assessment of additional tax and penalties. Because the effective date of this provision was January 1, 2000, the focus of this review was our readiness to implement these new requirements.

We were pleased to note you observed that examiners properly advised taxpayers of their right to refuse or restrict the scope of the statute extension in most cases you reviewed. We share your concern that some of the files reviewed contained no documentation that taxpayers were advised of their rights causing an inability to determine if the rights were protected. Appropriate case documentation is an area that we will continue to stress in all future procedural guidance provided to field personnel. We are committed to taking whatever steps are necessary to ensure the protection of taxpayer rights and we agree the recommendations in your report will help ensure we protect taxpayer rights related to securing statute extensions.

We would like to take this opportunity to share with you some of the steps we have taken since the enactment of RRA to ensure that IRS employees are advising taxpayers of their rights when requesting an extension of the statute of limitations on assessment of additional tax and penalties. These steps include:

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- RRA training in summer and fall 1998.
- Revision of Letter 907, Request to Extend Statute, and Publication 1035, Extending the Tax Assessment Period, in January 2000 to improve the explanation of taxpayers rights.
- A memorandum to the field offices on December 21, 1998 to remind personnel of the new procedures and to alert them of the availability of the new letter and publication.
- Additional implementation guidance issued to the field offices via e-mail and in memorandum form in March 2000 to provide clarification of the procedures.
- A new manual (IRM 121.2, Statute of Limitations Handbook) released in January 2000 and Chapter 22, Statute Extensions by Consent, giving comprehensive guidance for ensuring taxpayer rights were protected.
- A new job aid, Ensuring the Protection of Taxpayers' Rights: Responsibilities of Examination Employees, distributed to all examiners in July 2000 contain a section on soliciting extensions to the statute of limitations by agreement.

Based on feedback we have received from the staff of the Office of the Assistant Chief Counsel (Administrative Provisions and Judicial Proceedings), their position related to the possible validity of extensions secured without first advising taxpayers of their rights under 6501(c) differs from your interpretation. The full text of their comments (including some proposed changes) is attached. The attached Assistant Chief Counsel feedback also includes a technical correction to footnote 1 on page i of the Executive Summary and footnote 3 on page 3 of the report.

The following responses are provided to the recommendations contained in the draft report:

IDENTITY OF RECOMMENDATION/FINDING # 1

The Assistant Commissioner (Examination) should revise the IRM to require Examination group managers to review the case file documentation to ensure examiners properly advised taxpayer of their rights before approving statute extension agreements.

Information Provided to Taxpayers When Requesting Extensions of the Assessment Statute of Limitations Can Be Improved

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ASSESSMENT OF CAUSE(S)

Although manual guidance does exist covering procedures (including documentation requirements) for employees to follow when soliciting statute extensions, employees may not always document these procedures. The need for increased documentation for all actions related to ensuring taxpayer rights needs ongoing emphasis. While examiners may in fact be advising taxpayers of their rights, the failure to adequately document these actions undermines the ability to certify that the notification occurred.

CORRECTIVE ACTION(S)

The Assistant Commissioner (Examination)/Commissioner, Small Business/Self-Employed Division (SB/SE) will provide guidance in the appropriate examiner and manager manuals to require the following:

- Before signing the statute extension agreement, managers will verify that documentation is present on Form 9984, Examining Officer's Activity Record, indicating that taxpayers have been advised of their rights related to extending the statute.

IMPLEMENTATION DATE

January 1, 2001

RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (Examination)/Commissioner, SB/SE

CORRECTIVE ACTION(S) MONITORING PLAN

As part of the ongoing revision process for the IRM, we will solicit feedback from field employees to ensure the IRM guidance is complete and clear. In addition, we will review EQMS results to determine the level of compliance with documentation requirements.

IDENTITY OF RECOMMENDATION/FINDING # 2

The Assistant Commissioner (Examination) should revise the Publication 1035 to advise taxpayers of the following:

- The IRS may open new audit issues under the extended statute period if the taxpayer does not restrict the statute extension to specific issues.
- Specific restrictive language is required on the statute extension form in order for the restrictions to be valid.
- The terms and restrictive language added to the consent form must be approved by IRS Chief Counsel.

Information Provided to Taxpayers When Requesting Extensions of the Assessment Statute of Limitations Can Be Improved

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ASSESSMENT OF CAUSE(S)

In the recent revision of Publication 1035 we added new information to more fully explain taxpayer rights related to requesting statute extensions without expanding the length of the publication. Conservation of space was the primary reason why the above information was not included.

CORRECTIVE ACTION(S)

The Assistant Commissioner (Examination)/Commissioner, SB/SE will revise Publication 1035 to advise taxpayers of the additional information included in this recommendation/finding.

IMPLEMENTATION DATE

January 1, 2001

RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (Examination)/Commissioner, SB/SE

CORRECTIVE ACTION(S) MONITORING PLAN

Management officials from Headquarters Examination/SB/SE will monitor the progress of the revision during the publication process and ensure that it is printed and distributed in an expeditious manner.

IDENTITY OF RECOMMENDATION/FINDING # 3

The Assistant Commissioner (Examination) should timely distribute notification of the revisions to all Examination Division offices and distribution centers and emphasize that prior versions of the Publication 1035, including local computer templates, must be replaced.

ASSESSMENT OF CAUSE(S)

The communication of any information to all examiners is difficult in the current organization, since we still primarily rely on the distribution of memoranda and other information in paper form. Since the organization is so large and geographically dispersed, this process can often take as long as 60 days or more. This issue of timely communication can contribute to a period of inconsistency in the use of new forms/letters/publications. This communication issue will need to be addressed in a more global way after the reorganization stand-up is complete. The corrective actions identified below represent an interim approach to improved communication for the revision of Publication 1035 only.

**Information Provided to Taxpayers When Requesting Extensions
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CORRECTIVE ACTION(S)

The Assistant Commissioner (Examination)/Commissioner, SB/SE will:

- Advise in memorandum from the Area Managers in SB/SE and Headquarters staff of the other Operating Divisions that a new Publication 1035 is available for immediate and exclusive use, with direction to disseminate the memorandum to all field personnel as quickly as possible.
- Ensure that the memorandum is posted on the Web sites for all Operating Divisions for immediate availability.

IMPLEMENTATION DATE:

February 1, 2001

RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (Examination)/Commissioner, SB/SE

CORRECTIVE ACTION MONITORING PLAN

During February 2001, staff from the Office of the Commissioner, SB/SE will randomly survey field personnel to verify that the staff is aware of the new revision of Publication 1035 and understands that only this new revision should be used.

We have also reviewed the report from a disclosure perspective, and we do not find any information in the report that warrants protection.

If you have any questions, please call Thomas R. Hull, Acting Assistant Commissioner (Examination), at (202) 622-4400.

Attachment

**Information Provided to Taxpayers When Requesting Extensions
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ROUTING AND TRANSMITTAL SLIP

Date: August 30, 2000

TO	ROOM	ACTION	INITIALS	DATE
Daniel Quinn TIGTA Audit Staff	2			

1 Per Conversation	3 Approval	5 Information	7 Signature	9 Note and Return	11 File
2 As Requested	4 Comment	6 Correction	8 Initials	10 Necessary Action	12 Other

Please Respond By:

REMARKS: Discussion Draft Report: Information Provided to Taxpayers
When Requesting Extensions of the Assessment Statute of
Limitations Can Be Improved (Audit 199910113)

We have reviewed the discussion draft report furnished by your office on August 9, 2000. We wish to furnish the following comments.

On page ii of the Executive Summary, under the heading "Some Examination Case Files Did Not Indicate Whether Taxpayers Had Been Advised of Their Rights," the first paragraph ends with the sentence: "If taxpayers were not notified of their rights, extensions granted by taxpayers in these instances may not be valid." This sentence also appears on page 6 of the report. Two paragraphs below that sentence on page ii of the executive summary, the second sentence of the second paragraph reads: "Because the extension agreement is not valid if taxpayers have not been notified of their rights, this should be a condition of approval to ensure this requirement is met and there is proper documentation of the notification to the taxpayer." The same sentence appears on page 7 of the report.

The two sentences quoted above appear to characterize an extension secured without notification of the section 6501(c)(4)(B) rights as invalid in all cases. Depending on the facts and circumstances presented by the case and the communications exchanged between the taxpayers and the examining agent, however, the Chief Counsel's position is that an extension secured without first advising taxpayers of their rights under section 6501(c)(4)(B) may be valid. For example, although Service personnel may not have advised a taxpayer of the section 6501(c)(4)(B) rights, the taxpayer may request a consent restricted to certain issues. The Chief Counsel believes that the legislative purpose behind section 6501(c)(4)(B) has been fulfilled when the facts and

FROM: Sara M. Coe Chief, Branch 3 Assistant Chief Counsel (Administrative Provisions and Judicial Proceedings)	Room: 4135
	Phone No.: 202-622-7940

Information Provided to Taxpayers When Requesting Extensions of the Assessment Statute of Limitations Can Be Improved

circumstances demonstrate that the taxpayer or his representative is aware of his rights with respect to the statute of limitations. We suggest that the sentence on page ii of the Executive Summary should read: "If taxpayers were not notified of their rights, or the circumstances surrounding the case do not show that the taxpayers were aware of their rights, extensions granted by taxpayers in this instance may not be valid." We suggest that the sentence on page 8 of the report should read: "Because the extension agreement may not be valid if taxpayers have not been notified of their rights, or are otherwise not shown to be aware of their rights, before executing the extension agreement on behalf of the Service, Examination group managers should ascertain whether the taxpayers were properly advised of their rights. If there is no documentation establishing that the rights advice was given, group managers should determine whether the circumstances surrounding the case demonstrate that the taxpayers are aware of their rights. In cases where the circumstances must be analyzed to determine whether the taxpayers are aware of their rights, Group Managers should consult Area Counsel for assistance."

Footnote 1 on page i of the Executive Summary and footnote 3 on page 3 of the report both say that I.R.C. § 6503(a) suspends the statute of 150 days to allow taxpayers time to petition the United States Tax Court. This statement is inaccurate; we recommend, instead, that the footnote state: "I.R.C. § 6503(a) generally suspends the statute during the period when assessment is prohibited by I.R.C. § 6213(a), effectively suspending the statute for 150 days after a notice of deficiency is issued, and if petitioned to the Tax Court, until the Tax Court decision becomes final."

If there are questions, please contact Blaise G. Dusenbery at 202-622-7421.