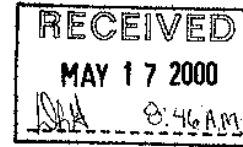


Report Reference 2000-30-077, dated May, 2000
Management's Response to Draft Report



COMMISSIONER

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



May 12, 2000

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION

FROM:

Charles O. Rossotti *Bobulenzel*
Commissioner of Internal Revenue

Subject:

Draft Audit Report – The Internal Revenue Service Can
Improve Treatment of Taxpayers During Examinations

Thank you for the opportunity to respond to your draft report entitled "The Internal Revenue Service Can Improve Treatment of Taxpayers During Examinations." I appreciate your acknowledgement we handled most of the reviewed cases appropriately and properly limited the use of intrusive, indirect methods to verify income. Our goal is to decrease taxpayer burden and provide taxpayers with fair and consistent treatment.

I believe that proper consideration, documentation and assessment of penalties, as well as our quality review controls also contribute to meeting our customer service goals.

RECOMMENDATION: The Assistant Commissioner (Examination) should require that group manager reviews include an assessment of penalty documentation and the fairness of penalty assertions.

ASSESSMENT OF CAUSE: In 75 of 180 cases reviewed by Treasury Inspector General for Tax Administration (TIGTA) (42 percent), examiners did not fully document an explanation for asserting a penalty (40 cases) or not asserting a penalty (35 cases) when the case history indicated an explanation was necessary. Without adequate documentation, there is no assurance examiners were fair and consistent in their decision to assert or not assert penalties.

CORRECTIVE ACTIONS: The Office of Interest and Penalty Administration is currently developing procedures for managers and examiners to address this section of the law. The procedures will require managers to approve all penalties asserted by the examiner and to make a positive comment in the workpapers relative to the documentation and reason for the penalty assertion. Thus, the case file will contain documentation from the manager on the accuracy of the assertion of the penalty.

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IMPLEMENTATION DATES: The Restructuring and Reform Act of 1998 (RRA 98) Section 3306 is effective after December 31, 2000. Penalty assertion training for all examiners will be completed by January 1, 2001.

RESPONSIBLE OFFICIALS: Assistant Commissioner (Examination) and National Director, Specialty Taxes.

CORRECTIVE ACTIONS MONITORING PLAN: The Examination Quality Measurement System (EQMS), specifically Element 6C, "Were penalties considered and applied as warranted?" will be used to track the effectiveness of the corrective actions.

RECOMMENDATION: The EQMS Office Director should reevaluate the EQMS rating criteria to ensure that the application and documentation of penalties is given adequate consideration when determining whether cases meet quality standards.

ASSESSMENT OF CAUSE: EQMS has critical and key elements for penalty considerations that are more heavily weighted than the other elements. Element 6C "Were penalties considered and applied as warranted?" is one of the standards under the key element "Application of Law/Tax Determination." Reviewers use their judgment to determine whether Element 6C not being met affected the overall quality of tax law application and determination.

CORRECTIVE ACTIONS: The EQMS Office Director is currently reevaluating EQMS, including the scoring methodology, to recommend changes to the Assistant Commissioner (Examination) for improving the system.

IMPLEMENTATION DATE: Recommendations will be submitted to the Assistant Commissioner (Examination) by July 1, 2000.

RESPONSIBLE OFFICIALS: Assistant Commissioner (Examination) and National Director, Compliance Specialization.

CORRECTIVE ACTION MONITORING PLAN: EQMS results will be monitored to determine if changes to the EQMS system improve the quality of cases for EQMS Element 6C.

RECOMMENDATION: The Assistant Commissioner (Examination) should require examiners or support personnel to use IRS locator services and the Internet early in the examination process to locate and contact taxpayers who do not respond to the notice of audit. These steps should be taken before examiners propose audit assessments. In addition, the steps taken to locate and contact taxpayers should be documented in the case file.

ASSESSMENT OF CAUSE: Examiners did not use available resources to locate and contact taxpayers in 112 of 123 sample cases (91 percent) before assessing taxes and penalties. In 44 of 112 cases (39 percent), TIGTA identified addresses or telephone numbers that were more current by using IRS locator services and public Internet resources.

CORRECTIVE ACTIONS: The Assistant Commissioner (Examination) will issue a memorandum requiring address research on cases where the taxpayer does not respond to the initial appointment letter.

IMPLEMENTATION DATE: The memorandum will be issued by June 1, 2000.

RESPONSIBLE OFFICIALS: Assistant Commissioner (Examination) and National Director, Compliance Specialization.

CORRECTIVE ACTIONS MONITORING PLAN: Existing management information systems will be used to monitor the number of cases closing with Examination Technique Code 6, No Show/No Response.

RECOMMENDATION: The EQMS Office Director should periodically assess whether examiners are taking the necessary actions to contact taxpayers. This could be accomplished by annually reviewing a national sample of cases in which taxpayers have not responded to a notice of audit.

ASSESSMENT OF CAUSE: EQMS does not include in the sample cases where we did not contact the taxpayer, cases where an appointment was scheduled and the taxpayer did not show for the appointment, or cases where the taxpayer has not responded to the appointment letter. These cases are not included in the sample because they are a unique subset of cases and many of the EQMS standards do not apply. The EQMS standards were designed to measure the quality of a case where an interview has been conducted. However, we agree the practice of assessing tax without taking adequate steps to locate taxpayers adds burden to taxpayers.

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CORRECTIVE ACTION: The EQMS Office Director will conduct an annual quality review of a sample of cases where we did not contact the taxpayer. We will develop standards to measure the quality of these cases and determine whether the examiner has taken adequate steps to locate the taxpayer.

IMPLEMENTATION DATE: Proposed date for beginning the first annual quality review is September 1, 2000.

RESPONSIBLE OFFICIALS: Assistant Commissioner (Examination) and National Director, Compliance Specialization.

CORRECTIVE ACTION MONITORING PLAN: We will develop a database to capture results of the quality review. We will analyze the results and share them with management. We will also provide guidance regarding necessary actions for improving case quality.

RECOMMENDATION: The EQMS Office Director should update the EQMS database to include necessary information to identify which cases have been reviewed, and implement a review process to ensure consistency and reliability of EQMS reports. (It does not appear in the recommendation, but our discussions with the auditors indicated they wanted to be able to pull the cases from the EQMS database by taxpayer identifier. They wanted to do this so they could look at the same cases that the reviewers did.)

ASSESSMENT OF CAUSE: The EQMS database does not include any taxpayer identification information. The reason is EQMS results are not to be used for evaluating employees. If taxpayer identification information was included in the database, results could be used inappropriately.

CORRECTIVE ACTIONS: However, each EQMS site has a separate inventory control system. This system can be used to identify cases that are included in the EQMS sample so that a validation review can be conducted. Numerous actions have been implemented to improve the consistency and reliability of EQMS data.

- 1) Each EQMS site conducts consistency meetings regularly (biweekly has been recommended by the EQMS Office Director). Also, it has been recommended that regional consistency meetings be conducted quarterly, subject to funding availability. The purpose of these meetings is to develop consistency in the application of the standards.
- 2) The EQMS Office Director conducts quarterly meetings of EQMS Branch Chiefs, Sections Chiefs, and Regional Analysts. Consistency of EQMS reviews is always a priority topic.

- 3) A Consistency Clearinghouse team meets at least quarterly to review questions from each of the EQMS sites on the application of the standards. The team then issues the answers to these questions to all sites.
- 4) An annual validation review process is in place. A validation review team reviews EQMS sampled cases from each of the EQMS sites. Results of the team's reviews are compared to the EQMS reviewer's case reviews to identify inconsistencies in application of the standards. The results of these reviews are shared with the EQMS sites to improve consistency in application of the standards.

IMPLEMENTATION DATE: All actions are implemented.

RESPONSIBLE OFFICIAL: Assistant Commissioner (Examination) and National Director, Compliance Specialization.

CORRECTIVE ACTION MONITORING PLAN: EQMS data is monitored to measure improvement in consistent application of the standards. Also, validity reviews measure improvement in consistent application of the standards.