

**Letter Report: Internal Revenue Service
Efforts to Deal with Executor Commissions
Show Promise**

June 2000

Reference Number: 2000-30-096

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.

Redaction Legend:

2b = Law Enforcement Guideline(s)

2e = Law Enforcement Procedure(s)



INSPECTOR GENERAL
for TAX
ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 19, 2000

MEMORANDUM FOR COMMISSIONER ROSSOTTI

A handwritten signature in black ink that reads "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Letter Report – Internal Revenue Service Efforts
to Deal with Executor Commissions Show Promise

The attached report presents the results of our follow-up review of the steps taken by the Internal Revenue Service (IRS) to reduce the amount of commissions that estate executors did not report on their income tax returns. Our objective was to assess the effectiveness of the corrective actions taken by the IRS in response to a prior audit report titled, *Review of Western Region's Estate and Gift Tax Program* (Reference Number 970803, dated March 24, 1997).

In summary, we found that the early intervention project conducted at the 2b, 2e-----
2b, 2e----- significantly reduced the amount of commissions that estate executors did not report on their income tax returns. We believe the impact on unreported executor commissions could be greater by expanding the effort nationwide.

The IRS' management concurred with our finding and recommendation, but will delay implementation of the recommendation until after the restructuring of the IRS service centers has been completed. Management's comments have been incorporated into the report where appropriate, and the full text of their comments is included in Appendix IV.

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 Gordon C. Milbourn III, Associate Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

Attachments (2)

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We assessed the effectiveness of a corrective action taken in response to a prior audit report.

Objective and Scope

Our objective was to assess the effectiveness of the corrective action taken to increase the number of executors who reported commissions received from estates that the Internal Revenue Service (IRS) did not examine. The corrective action was taken in response to an IRS Inspection Service (now the Treasury Inspector General for Tax Administration) report titled, *Review of Western Region's Estate and Gift Tax Program* (Reference Number 970803, dated March 24, 1997).

The audit was performed in accordance with *Government Auditing Standards* during the period October 1998 through November 1999. We conducted tests in the 2b, 2e-----and the Los Angeles and Central California Districts. Our tests involved analyzing executor accounts to determine the amount of unreported commissions the IRS identified. We also interviewed IRS officials to determine the number of executors contacted through their early intervention efforts and the resources used to make the contacts.

Major contributors to this report are listed in Appendix I. Appendix II contains the Report Distribution List.

Background

Executors are paid millions of dollars in commissions each year for administering estates and distributing the property of decedents. These commissions are deducted on estate tax returns, and the executors are to report the commissions on their individual income tax returns.

The IRS has numerous controls and procedures in place to govern examinations of estate tax returns. Some of these are crucial for ensuring that executor commissions

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deducted on estate tax returns are reported as income on executors' individual income tax returns.

For example, when an estate tax return is examined and found to contain a deduction for executor commissions, the executor is required to submit a declaration of these commissions. The IRS examiner prepares an information report using the information from the declaration and associates both documents with the case file. Since executor commissions are often estimated on the estate tax return at the time of the examination, the documents are later used to identify and monitor the reporting of the actual commission income. However, Inspection's 1997 audit report stated that the IRS 2b, 2e-----

Results

2b, 2e-----

2b, 2e-----
2b, 2e-----

2b, 2e----- This created a special compliance problem considering that estates pay executors millions of dollars in commissions each year 2b, 2e-----

2b, 2e-----

To begin addressing the problem, the IRS implemented a project in the 2b, in Fiscal Year (FY) 1999 that focused on early intervention. Our audit found this project to be successful, identifying \$1.7 million in unreported income which generated \$527,000 of additional recommended taxes and interest liabilities, at a cost basically equivalent to the salary of one GS-7 employee. If early intervention efforts were expanded nationwide, the IRS has the potential to further reduce unreported executor commissions over the next year by approximately \$16 million, which could generate an additional \$4.9 million in recommended taxes and interest liabilities.

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**Early Intervention Efforts Have Reduced the
Amount of Unreported Executor Commissions**

Sample case review results in 1997 found that executors did not report approximately \$755,000 in commissions.

Prior Condition

2b, 2e-----
2b, 2e-----
2b, 2e----- Tests from a sample of 84 estate tax returns from the Central California and Los Angeles Districts found that 41 of the returns contained approximately \$755,000 of unreported executor commissions.

Planned Corrective Actions

The IRS responded that it would monitor the reporting of non-professional executor commissions through a project in the 2b, 2 The project would focus on early intervention by sending inquiry letters to executors who may not have reported their commissions.

Follow-up Results

In FY 1999, the IRS sent letters to executors who may have received commissions from estates that filed returns with the 2b, 2e-----
2b, 2e----- The letters requested the executors to agree to a recommended additional assessment if they had not reported their commissions.

Although the 2b, officials did not track the total number of executors they contacted, they adjusted 161 executor returns for unreported commissions totaling \$1.7 million. The unreported commissions produced an additional \$527,000 in recommended taxes and interest liabilities, of which \$515,000 (98 percent) has been collected.

Expanding early intervention efforts nationwide could reduce unreported executor commissions by approximately \$16 million over the next year.

Based on the latest IRS figures, we estimate that approximately 2b, 2e-----
2b, 2e----- If the unreported commissions identified by officials in the 2b, represent conditions in other locations, the IRS could further reduce unreported executor commissions by approximately \$16 million over the next year by expanding early intervention

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efforts nationwide. The estimated additional recommended taxes and interest liabilities associated with the \$16 million of unreported commissions could total \$4.9 million.

We concluded from our discussions with IRS officials that, compared to the revenues generated, the project's costs were small. According to IRS officials, the primary costs they incurred were salary and benefits that were equivalent to one GS-7 employee.

We estimate that by expanding the effort nationwide, the IRS would incur approximately \$398,000 of additional salary and benefits costs. Other costs that the IRS would incur, which will not likely be as high as the salary and benefits costs, would include training employees and issuing contact letters.

Recommendation

The Assistant Commissioner (Customer Service) should expand early intervention efforts nationwide to further reduce unreported executors' commissions.

Management's Response: IRS management concurred with our finding and recommendation. 2b, 2e-----
2b, 2e-----

Conclusion

A project in the 2b, that focused on early intervention reduced the amount of unreported executor commissions by \$1.7 million in FY 1999. We believe that by expanding early intervention efforts nationwide, the IRS could further reduce unreported commissions over the next year by approximately \$16 million.

Major Contributors to This Report

Gordon C. Milbourn III, Associate Inspector General for Audit (Small Business and Corporate Programs)

Phil Shropshire, Director

Frank Dunleavy, Audit Manager

Stanley Pinkston, Senior Auditor

Anthony L. Snowden, Auditor

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Appendix II

Report Distribution List

Deputy Commissioner Operations C:DO
Commissioner, Small Business and Self-Employed Division S
Chief Operations Officer OP
Assistant Commissioner (Customer Service) OP:C
Regional Commissioner, Western Region RC
Office of the Chief Counsel CC
Office of Management Controls M:CFO:A:M
Office of the National Taxpayer Advocate C:TA
National Director for Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis M:O
Director, Central California District D
Director, Los Angeles District D
Audit Liaisons:
 Chief Operations Officer OP
 Assistant Commissioner (Customer Service) OP:C

Outcome Measures

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

Finding and recommendation:

2b, 2e-----

2b, 2e----- To begin addressing the problem, the IRS implemented a project in the 2b, 2e----- The project focused on early intervention and involved sending letters to executors who may have received commissions from estates 2b, 2e----- The letters requested the executors to agree to a recommended additional assessment if they had not reported their commissions.

Although the 2b, officials did not track the number of executors they contacted, they adjusted 161 executor returns, totaling \$1.7 million, for unreported commissions. We believe that by expanding early intervention efforts nationwide, unreported executor commissions could be further reduced by approximately \$16 million over the next year.

Type of Outcome Measure:

Increased Revenue – Actual
Increased Revenue – Potential

Value of the Benefit:

Early intervention efforts in the 2b, reduced unreported executor commissions by \$1.7 million in Fiscal Year (FY) 1999. The unreported commissions produced an additional \$527,000 in recommended taxes and interest liabilities, of which \$515,000 (98 percent) has been collected. We estimate that the IRS could generate an additional \$2.6 million in recommended taxes and interest liabilities by continuing the monitoring program in the 2b, over the next 5 years.

Methodology Used to Measure the Reported Benefit:

The IRS officials in the 2b, kept records of the number of returns and amount of executor commissions they assess 2e--- FY 1999. We used their records and traced the assessments to the closed audit case files, the Audit Information Management System, and executor tax return accounts to determine the amount of unreported commissions and the additional recommended taxes and interest liabilities.

We used the conditions found in the 2b, to determine the outcome measures for the potential recommended taxes and interest liabilities. In the 2b, 2we determined that the unreported

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executor commissions resulted in actual additional recommended taxes and interest liabilities of \$527,000. The potential outcome of continuing the program in the -----was computed by multiplying the \$527,000 by 5 years to get \$2,635,000, or \$2.6 million^{2b}, 2eated above.

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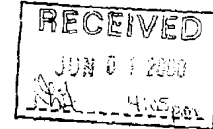
Appendix IV

Management's Response to the Draft Report




COMMISSIONER

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



June 1, 2000

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION

FROM: Charles O. Rossotti 
Commissioner of Internal Revenue

SUBJECT: Draft Letter Report – Internal Revenue Service Efforts to Deal
with Executor Commissions Show Promise (Audit #1998909)

Thank you for the opportunity to respond to your draft report entitled "Internal Revenue Service Efforts to Deal with Executor Commissions Show Promise." We appreciate your recognition of the work performed by the Ogden Service Center's early intervention efforts in improving taxpayer compliance with reporting executor commissions as taxable income.

We agree with your recommendation that expanding early intervention efforts will improve taxpayer compliance in reporting executor commissions nationwide. **2b, 2e**

2b, 2e

We also agree with your assessment that by expanding this initiative nationwide, we could enhance yearly revenue by \$4.9 million in additional taxes and interest. We also agree with your estimate of annual costs of \$398,000 in additional salary and benefits plus other costs, such as postage and training.

Our comments on your specific recommendation in this report follow:

IDENTITY OF RECOMMENDATION/FINDING

The Assistant Commissioner (Customer Service) should expand early intervention efforts nationwide to further reduce unreported executors' commissions.

ASSESSMENT OF CAUSE(S)

The Internal Revenue Service currently does not have a nationwide program to verify that executors reported their commissions from estates that were not examined.

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2

CORRECTIVE ACTIONS

The Internal Revenue Service agrees with this recommendation. **2b, 2e**

2b, 2e

This report will be shared with the Small Business/
Self-Employed Division Modernization Design Team to be included in future
implementation plans.

IMPLEMENTATION DATE:

COMPLETED 5/30/00

RESPONSIBLE OFFICIAL(S)

National Director, Customer Service Compliance and Accounts Division

CORRECTIVE ACTION(S) MONITORING PLAN

Not Applicable

If you have any questions, please call me at (202) 622-9511 or a member of your
staff may contact Robert Wilkerson, Assistant Commissioner (Customer Service), at
(202) 622-5044.