

**The Internal Revenue Service Should
Enhance Processes and Controls To
Protect Taxpayers' Rights When Issuing
Third Party Summonses
and Making Third Party Contacts**

April 2000

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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.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

April 25, 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: Final Audit Report - The Internal Revenue Service Should Enhance Processes and Controls To Protect Taxpayers' Rights When Issuing Third Party Summonses and Making Third Party Contacts

This report presents the results of our review of third party summonses and third party contacts. Our audit objective was to determine whether the Internal Revenue Service's (IRS) processes and controls enable the IRS to protect taxpayers' rights when issuing third party summonses and making third party contacts during tax return examinations and delinquent tax account collections.

In summary, we found that the IRS had implemented many of the provisions of the IRS Restructuring and Reform Act of 1998¹ to protect taxpayers' rights. However, some controls and procedures need to be improved to protect taxpayers' rights when the IRS issues third party summonses and makes third party contacts during the examination and collection processes.

To improve the processes and controls over third party summonses and third party contacts, we recommended the IRS: implement a process to ensure critical initiatives affecting taxpayers' rights are properly controlled and implemented in a timely manner, modify existing computer systems to record and track summonses issued to third parties, and update both the Examination and Collection quality measurement systems

¹ Internal Revenue Service Restructuring and Reform Act, Pub. L. No. 105-206, 112 Stat. 685 (1998)

to evaluate compliance with the new taxpayer rights provisions of third party contacts and third party summonses.

The IRS has responded to this report and its comments have been incorporated into the text where appropriate. The full text of the comments is included as Appendix IV. We agree with the corrective actions outlined in the IRS' response.

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 Walter E. Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs), at (770) 455-2475.

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and Controls To Protect Taxpayers' Rights When Issuing
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Executive Summary

As a normal part of the examination and collection processes, the Internal Revenue Service (IRS) has authority to contact third parties. In some cases, the IRS may have to issue summonses to gather enough information to determine or collect the tax liability. On July 22, 1998, the President signed the IRS Restructuring and Reform Act of 1998¹ (RRA 98), which expanded taxpayers' rights in the following areas when the IRS makes third party contacts or issues third party summonses.

- RRA 98 § 3415 requires the IRS to issue a notice to the taxpayer for a summons issued to any third party. This gives the taxpayer an opportunity to contest any summons issued to a third party.
- RRA 98 § 3416 allows the IRS the option of serving a summons to third party recordkeepers either in person or by certified or registered mail.
- RRA 98 § 3417 requires the IRS to provide to the taxpayer a notice before contacting third parties and a periodic record of persons contacted. This gives taxpayers the opportunity to volunteer information so the third party contacts may not be necessary.

Our audit objective was to determine whether the IRS' processes and controls enable the IRS to protect taxpayers' rights when issuing third party summonses and making third party contacts during tax return examinations and delinquent tax account collections.

Results

The IRS has properly implemented controls and processes to protect many of the taxpayer rights established by the summons and third party contact provisions of the RRA 98. Training was provided to the IRS employees by briefings, group meetings, and formal classroom settings. IRS group managers review both open and closed cases and make visits to monitor compliance with legal and administrative requirements. In addition, the IRS Chief Operations Officer established the National Resource Center RRA 98 Support Site to provide consistent coordination of policy and issues for effective implementation of all RRA 98 provisions. However, the IRS needs to take additional steps to fully protect taxpayers' rights. Specific areas in which controls need to be strengthened include: improving notices used to advise taxpayers of their rights when

¹ Internal Revenue Service Restructuring and Reform Act, Pub. L. No. 105-206, 112 Stat. 685 (1998)

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third party contacts are to be made, recording and tracking the number of third party summonses that are issued, and updating Examination and Collection quality measurement systems to evaluate compliance with the new taxpayer rights provisions for third party contacts and third party summonses.

The Internal Revenue Service Has Been Slow to Develop a Customer-Friendly Notice for Potential Third Party Contacts

In implementing RRA 98 § 3417, the IRS issued a Notification of Potential Third Party Contact (Notice 1219) or a Third Party Notice (Letter 3164) to all taxpayers during the examination and collection processes. This approach resulted in adverse publicity. Taxpayers were very concerned that the IRS routinely contacted third parties, which could have a negative impact on business relationships. The IRS Commissioner responded by taking action to have a more selective process to issue notices only when it is necessary to contact third parties. In addition, in a written press release issued on March 2, 1999, the IRS Commissioner stated that the IRS would revise the notice, and the new version would use clear and direct language to spell out the rights of the taxpayer. The IRS expected the more customer-friendly notice to be available for use within 90 days of the IRS Commissioner's statement. However, the revisions were not completed until November 1999 and are not planned for use until February 2000.

The Internal Revenue Service Does Not Have A System to Record and Track Summonses Issued to Third Parties

A summons is an enforcement tool used by the IRS to obtain needed information from either the taxpayer or third parties related to the determination or collection of tax liabilities. Because of increased concern for taxpayers' rights, RRA 98 § 3415 requires the IRS to notify the taxpayer of almost all third party summonses. This gives the taxpayer an opportunity to initiate action in United States District Court to quash or nullify the summons. Currently, the IRS does not have a system to record and track summonses issued to third parties. However, the IRS could modify a recently developed computer system that is used to record and track third party contacts to also record and track the issuance of third party summonses.

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Neither the Examination nor the Collection Quality Measurement System Evaluates Protection of Taxpayers' Rights When the Internal Revenue Service Contacts Third Parties or Issues Third Party Summonses

As part of the Balanced Measurement System, the Examination and Collection quality measurement systems were redesigned to statistically sample a sufficient number of cases to measure organizational performance in four key quality categories: customer service and observation of taxpayers' rights, technical ability, timeliness of work, and judgment of outcome. However, neither system includes adequate reviews to determine if taxpayers' rights were observed in accordance with legal requirements for third party summonses and third party contacts.

Summary of Recommendations

The IRS needs to improve processes and controls to protect taxpayers' rights when issuing third party summonses and making third party contacts. Specifically, the IRS should: expedite the development and use of a customer-friendly notice to taxpayers when third party contacts are to be made, modify existing computer systems to record and track summonses issued to third parties, and update both the Examination and Collection quality measurement systems to evaluate compliance with the new taxpayer rights provisions of third party contacts and third party summonses.

Management's Response: The Assistant Commissioner (Collection) implemented a process to ensure taxpayers' rights are protected when a new third party contact letter is required. The Chief Information Officer and the Disclosure Officer will determine if the Third Party Contact Command Code Database can be modified to incorporate data regarding third party summonses. In addition, the Assistant Commissioner (Collection) and the Assistant Commissioner (Examination) are working with the Examination Quality Measurement System and Collection Quality Measurement System to incorporate the necessary third party contact and third party summons requirements.

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Objective and Scope

We determined whether the IRS' processes and controls were adequate to protect taxpayers' rights when third party summonses are issued and third party contacts are made.

The overall objective of this audit was to determine whether the Internal Revenue Service's (IRS) processes and controls enable the IRS to protect taxpayers' rights when issuing third party summonses and making third party contacts during tax return examinations and delinquent tax account collections.

We conducted our audit in the Georgia, Kansas-Missouri, and Northern California District Offices; the Kansas City Customer Service Center; the Oakland Automated Collection System (ACS) Call Sites; and the National Office between June and September 1999. 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.

Background

The IRS may contact persons other than the taxpayer under examination (a third party) to obtain information relating to either the determination or collection of tax concerning the taxpayer.

The Examination function is responsible for examining all types of federal tax returns to determine correct tax liabilities. The Collection function is responsible for collecting the proper amount of federal tax from all persons who either have not filed returns or have not paid their taxes. The Internal Revenue Code (I.R.C.), 26 U.S.C. (1986), gives the IRS the authority to make third party contacts and issue third party summonses to obtain information with respect to determining or collecting a tax liability.

The IRS' procedures require employees, if possible, to obtain information voluntarily from the taxpayer before contacting third parties. If information cannot be obtained voluntarily from the taxpayer or by contacting the third party, the IRS has the authority to issue a summons. A summons is a document that requires the

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RRA 98 §§ 3415-3417 give taxpayers specific rights when summonses and third party contacts are used during the examination and collection processes.

taxpayer or third party to provide testimony or specific information such as financial records for the IRS to use in determining or collecting tax.

On July 22, 1998, the President signed the IRS Restructuring and Reform Act of 1998 (RRA 98).¹ This new law gives taxpayers additional rights when the IRS contacts third parties and issues third party summonses. Because of increased concern that obtaining information from third parties could adversely affect taxpayers' business relationships, the Congress included the following changes to protect taxpayers' rights:

- RRA 98 § 3415, with an implementation date of July 22, 1998, amended I.R.C. § 7609² to expand the requirement that the IRS issue a notice to the taxpayer for third party summonses. Previously, the IRS was required to notify taxpayers of only third party *recordkeeper* summonses; now, the IRS must notify taxpayers of all third party summonses. This gives the taxpayer an opportunity to contest any summons issued to a third party in connection with the determination of the taxpayer's liability.
- RRA 98 § 3416, with an implementation date of July 22, 1998, amended I.R.C. § 7603³ to allow the IRS the option of serving a summons to third party recordkeepers either in person or by certified or registered mail.
- RRA 98 § 3417, with an implementation date of January 18, 1999, amended I.R.C. § 7602⁴ to require

¹ Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (1998)

² Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 755, as amended, at 26 U.S.C. § 7609 (1986)

³ Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 756, as amended, at 26 U.S.C. § 7603 (1986)

⁴ Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 757, as amended, at 26 U.S.C. § 7602 (1986)

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that the IRS provide reasonable notice in advance to the taxpayer before contacting any third party. In addition, the IRS is required to periodically provide a record of persons contacted and to give the taxpayer this information upon request. This change allows taxpayers the opportunity to volunteer additional information so the third party contact may not be necessary. Third party contacts by the IRS could hurt a taxpayer's reputation and could have a negative impact on business relationships.

Results

The IRS took steps to control implementation of the numerous RRA 98 tax law changes.

The IRS identified and implemented actions relating to third party summons authority and third party contacts. To implement the action items for RRA 98 §§ 3415-3417, the IRS issued policies and procedures and prepared training material for Examination, Collection, and Customer Service function employees. It used briefings, group meetings, and formal training to present the information. In addition, the IRS implemented policies and procedures to ensure employees comply with the legal and administrative requirements for mailing summonses to third parties. IRS group managers conduct closed case and in-process reviews and make site visitations to monitor employee compliance with legal and administrative requirements.

The IRS took the following steps to control and coordinate the implementation of the RRA 98:

- The Chief Operations Officer, in July 1998, established the National Resource Center RRA 98 Support Site to provide consistent coordination of policy and program issues.
- The Taxpayer Treatment and Service Improvement Program Office established an Internet website to control and monitor implementation of all provisions of the RRA 98.

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- The IRS developed the RRA 98 Provision Report to control the implementation of all RRA 98 tax law changes.

From January to September 1999, IRS employees contacted about 110,000 third parties in connection with determining or collecting tax for about 58,000 taxpayers. To meet the additional recordkeeping provision of RRA 98 § 3417, the IRS designed a Third Party Contact Report Form (Form 12175) and a computer system to capture data from the Forms 12175 to generate annual listings of third party contacts.

Current procedures for completing the Form 12175 meet the legal requirements of the RRA 98, but annual listings sometimes lack specific information.

Form 12175 contains fields to record the third party's name, address, and telephone number. However, the IRS plans to provide to taxpayers only the information recorded in the "name" field. To determine if IRS employees were recording enough information in the "name" field to identify the third party, we selected a sample of 962 of the 9,684 Forms 12175 at 3 district offices and 2 ACS call sites. Incomplete or general information was recorded for the person contacted in 97 of the 962 (10 percent) cases reviewed.

A general description might be sufficient if the IRS recorded more information to identify the third party in the "name" field or expanded the information on the annual listing to include the "address" field. National Office management had originally intended to record this information, but reversed this decision because of privacy concerns. The IRS Office of the Chief Counsel has reviewed this decision and agrees that supplying to taxpayers only the information recorded in the "name" field meets the requirements of the RRA 98. However, unless the IRS records specific identifying information in the "name" field, the information provided will be of little use to the taxpayer.

In addition, the IRS needs to improve the following areas to ensure taxpayers' rights are protected and to provide quality service to taxpayers:

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1. The IRS has been slow to develop a customer-friendly notice for potential third party contacts.
2. The IRS does not have a system to record and track summonses issued to third parties.
3. Neither the Examination nor the Collection quality measurement system evaluates protection of taxpayers' rights when the IRS contacts third parties or issues third party summonses.

The Internal Revenue Service Has Been Slow to Develop a Customer-Friendly Notice for Potential Third Party Contacts

The IRS is required to inform the taxpayer of the possibility that third parties may be contacted.

As of January 18, 1999, the IRS was to provide reasonable notice to the taxpayer before contacting any third party. To meet this requirement, the IRS issued a generic notice, Third Party Notice (Letter 3164) or Notification of Potential Third Party Contact (Notice 1219), to all taxpayers upon initial contact during the examination and collection processes. Taxpayers, tax practitioners, the American Institute of Certified Public Accountants, and the Congress criticized the mailing of a generic notice to all taxpayers because it unnecessarily alarmed taxpayers that the IRS routinely contacted third parties.

The IRS has not revised the third party contact notices.

In response, the IRS Commissioner implemented a more selective process of sending notices to taxpayers when it is necessary to contact third parties. The IRS Commissioner also stated on March 2, 1999, that a revised notice would be developed which would use clear, direct language to spell out the rights of the taxpayer. The IRS expected that the more friendly notice would be completed and available for use within 90 days of the IRS Commissioner's statement. However, the IRS did not provide adequate oversight to ensure the revisions to the notice were completed timely. The notice revisions were not completed until November 1999 and were not planned for use until February 2000.

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Recommendation

1. To ensure taxpayers are not adversely affected, the Deputy Commissioner Operations should implement a process to ensure critical initiatives such as the development of a more customer-friendly third party contact notice are timely developed. The notice should inform taxpayers of their rights and explain the IRS policy of working with the taxpayers to obtain needed information before third parties are contacted.

Management's Response: A group was established to develop a new letter to provide taxpayers with the necessary information. The group used these guiding principles: provide the taxpayer a frame of reference; identify the purpose of the contact; ensure the taxpayer's rights are safeguarded; and work with the taxpayer first. As a result, 13 clearer, specialized Letters 3164 were developed to advise taxpayers of potential third party contacts.

The Assistant Commissioner (Collection) has implemented a process to use when a new third party contact letter is required. The functional areas will use the guiding principles and the current Letters 3164 as a template or guide. The Chief Operations Officer will review the proposed draft. Once the draft has been approved, the functional areas will be responsible for ensuring the new letter is printed and distributed. Currently, the time to draft, approve, and print a new letter is greatly reduced.

The Internal Revenue Service Does Not Have a System to Record and Track Summonses Issued to Third Parties

A summons is an enforcement tool used by the IRS to obtain information from either the taxpayer or third parties. Because of increased concerns for taxpayers'

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The IRS does not have a method to track summonses issued to third parties, to ensure taxpayers' rights are protected.

rights, RRA 98 § 3415 requires the IRS to notify taxpayers when summonses are issued to almost any third party. Receiving the notice gives the taxpayer the opportunity to initiate court proceedings to contest the summons.

The IRS is not required to maintain a centralized system that identifies who the summonses were issued to and the number of summonses issued each year by each IRS office. Therefore, we could not obtain any statistics for the number of summonses issued, nor could we readily identify cases for review to determine if IRS employees were complying with legal and administrative requirements.

Because of Congressional concern over summons power, the IRS should strongly consider establishing an automated system to monitor the number of summonses issued and to readily identify individual summonses. Currently, a copy of the summons is maintained with the case file, but it would require a labor-intensive manual review of every case to identify and retrieve information relating to a specific summons. In addition, this new tool would allow Collection and Examination management to monitor summons usage by district, division, and branch.

We believe that the previously mentioned automated system to record and control Forms 12175 could easily be modified to also identify third party summonses. This would save development costs in designing a new system. We have discussed modification of the system with one of the Information Systems function computer programmers who designed the third party contact computer system. The programmer stated that it would be feasible to modify the system.

Recommendation

2. The IRS should modify the existing system that records Forms 12175 to also record the number of third party summonses issued to third parties.

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Management's Response: The Chief Information Officer and the Disclosure Officer will determine if the Third Party Contact Command Code Database can be modified to incorporate data regarding third party summonses, and what impact this change will have on other priority requests. Any changes to the existing database will require public comment and changes to the existing System of Records for Third Party Contacts. Based on these results, we will determine the impact of implementation of this recommendation.

Neither the Examination nor the Collection Quality Measurement System Evaluates Protection of Taxpayers' Rights When the Internal Revenue Service Contacts Third Parties or Issues Third Party Summonses

Quality review is an important control to provide accurate data to IRS management for their consideration and action.

Quality review is a major control to measure the quality of IRS employees' work and to identify problems for corrective action by IRS management. Closed tax return examinations and delinquent tax accounts are reviewed to measure organizational performance in four key quality categories: customer service and observation of taxpayers' rights, technical ability, timeliness of work, and judgment of outcome. However, neither the Examination Quality Measurement System (EQMS) nor the Collection Quality Measurement System (CQMS) has been properly updated to address compliance with the third party summons and third party contact provisions of the RRA 98.

Neither the EQMS nor the CQMS adequately measures protection of taxpayers' rights when third parties are contacted and third party summonses are issued.

Under the new Balanced Measurement System, both the EQMS and the CQMS have been redesigned to be statistically valid. However, in redesigning the systems, IRS teams did not adequately include reviews and measurements to determine if legal requirements to protect taxpayers' rights were observed when third party contacts were made and third party summonses were issued. As a result, the following specific areas are not addressed:

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- The EQMS and the CQMS do not include a review or measure to ensure a Form 12175 was prepared for every third party contact made, so the IRS can provide a complete listing of third party contacts to taxpayers.
- The EQMS and the CQMS do not include a review or measure to ensure the taxpayer received a notice that a summons was issued to a third party. This notice would allow the taxpayer 23 days to begin court proceedings to quash the summons.
- The CQMS does not include a review or measure to ensure employees issued a notice to the taxpayer that third parties could be contacted in the determination or collection of tax.

As a result, management does not receive feedback on compliance with all the provisions of the RRA 98, and problem areas could go uncorrected.

Recommendation

3. The Chief Compliance Officer should update the EQMS and the CQMS to ensure they review and measure IRS employees' compliance with RRA 98 provisions designed to protect taxpayers' rights when third party contacts are made and third party summonses are issued.

Management's Response: The Assistant Commissioner (Examination) is working on the EQMS to expand the third party contact review requirements and to add third party summons requirements. The Assistant Commissioner (Collection) is working on the CQMS to incorporate the necessary third party contact and third party summons requirements.

Conclusion

The IRS has effectively implemented many processes and controls to protect taxpayers' rights when IRS

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employees issue third party summonses and make third party contacts. However, there are additional steps that the IRS needs to take to fully ensure that taxpayers' rights are protected under the new provisions of the RRA 98. Specifically, the IRS needs to: expedite the process to develop a more customer-friendly third party contact notice, develop a system to record and track summonses issued to third parties, and update both the Examination and Collection quality measurement systems to include measurement of employee protection of taxpayers' rights when third parties are contacted and third party summonses are issued.

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Appendix I

Detailed Objective, Scope, and Methodology

The objective of this audit was to determine whether the Internal Revenue Service's (IRS) processes and controls enable the IRS to protect taxpayers' rights when issuing third party summonses and making third party contacts during tax return examinations and delinquent tax account collections.

We performed the following audit tests to accomplish our objective.

- I. To determine whether the IRS sufficiently developed and effectively completed a plan to implement the provisions of the IRS Restructuring and Reform Act of 1998 (RRA 98)¹ relating to summons authority and third party contacts, we:
 - A. Reviewed the Provision Report for RRA 98 §§ 3415-3417 to determine if the plan contains necessary action items to correctly and timely implement the tax law changes.
 - B. Determined the process used by the Taxpayer Treatment and Service Improvement Program Office to monitor the implementation and to ensure the action items were timely completed.
 - C. Identified significant action items in the Provision Report and determined whether the IRS complied with all legal requirements and the goal of applying the tax law with integrity and fairness to all.
- II. To determine whether the IRS has developed effective policies and procedures and is complying with those procedures to protect taxpayers' rights when employees issue third party summonses and make third party contacts, we:
 - A. Identified current procedures through discussions with National Office Collection, Examination, and Customer Service officials and through research of the Internet. This was to identify interim procedures, Internal Revenue Manual (IRM) procedures, instructional memoranda, notices, and instructions to taxpayers and questions and answers for troublesome areas in implementing RRA 98 provisions. To evaluate the effectiveness of the procedures, we did the following:
 1. Determined if the revised notice to taxpayers of third party contacts adequately explains the criteria and need for the IRS to contact third parties.

¹ Internal Revenue Service Restructuring and Reform Act, Pub. L. No. 105-206, 112 Stat. 685 (1998)

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2. Determined if the IRS correctly changed the IRM procedures to reflect the RRA 98 provisions and the intent of the Congress in changing the law.
 3. Determined IRM requirements for employees to document information in case files concerning the issuance of summonses and third party contacts to enable quality review and IRS managers to determine if employees complied with legal and administrative requirements.
 4. Determined if the IRS has an adequate process for effectively communicating the procedural changes to district office Examination and Collection employees and to Customer Service Automated Collection System employees.
 5. Determined if the IRS has an adequate process to ensure employees comply with legal and administrative requirements for mailing of summonses to taxpayers.
 6. Reviewed the IRS written communication with taxpayers, including publications, notices, etc., to determine if they adequately apprised taxpayers of the RRA 98 changes and taxpayer rights.
 7. Determined if the IRS can track the number of summonses at both the local and national level.
- B. Evaluated the effectiveness of the process for training IRS employees on RRA 98 §§ 3415-3417.
1. Obtained and reviewed the applicable training packages to determine if they sufficiently cover the RRA 98 legal and administrative requirements.
 2. Reviewed the adequacy of the process for scheduling training and identifying individuals to receive the training.
 3. Determined if National Office management is reviewing information and reports produced by the Administrative Corporate Education System (ACES) to ensure that appropriate IRS employees received the applicable RRA 98 training.
 4. Compared ACES electronic data showing certification that employees received the required training with listings of Examination, Collection, and Customer Service groups at the selected districts and customer service sites to determine if all the groups received the required training.
- III. To determine whether the IRS has an effective process, including procedures for managerial approval and reviews, to ensure that IRS employees are following legal and administrative requirements, we:

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- A. Interviewed district office managers in Examination and Collection Division groups at selected districts to obtain and evaluate local procedures and the process they use to approve summonses and to review employees' performance to identify non-compliance with legal and administrative requirements for summonses and third party contacts.
 - B. Reviewed files maintained by managers in selected groups to determine if the required managerial reviews were conducted and if appropriate performance feedback was provided to employees.
 - C. Determined if additional training and procedural guidance was provided to employees when problems were identified in managerial and quality reviews.
- IV. To determine whether the IRS has an adequate process and system for maintaining the necessary records and for providing taxpayers with listings of third parties contacted, we:
- A. Performed a system walk-through and interviewed district/service center Third Party Coordinators who were responsible for maintaining files of Third Party Contact Report Forms (Form 12175) to evaluate the adequacy of the process they use to control and retain the forms and provide taxpayers with listings of third party contacts.
 - B. Reviewed a random sample of 962 of the 9,684 Forms 12175 maintained by third party coordinators in the offices we visited to determine if complete and accurate third party information is being provided to the coordinator.
 - C. Reviewed all taxpayer requests for third party information (13) in the district offices visited to determine whether taxpayers are being provided complete and accurate third party information.
 - D. Evaluated the adequacy of the process for periodically generating taxpayers' listings of third party contacts.
 - E. Reviewed the Request for Information Services to determine if the proposed system will contain the necessary data to control third party contact information and generate required periodic listings to taxpayers.
- V. To determine whether the Collection Quality Review System (CQMS) and the Examination Quality Review System (EQMS) measure whether employees correctly applied the law and identify trends and problems concerning third party summonses and third party contacts, we:
- A. Interviewed National Office managers who are responsible for the CQMS and the EQMS to determine the process they use to measure whether IRS

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employees are correctly complying with the new RRA 98 tax laws. We determined:

1. If any changes were made or are being made to measure employees' compliance with RRA 98 legal requirements for third party summonses and third party contacts.
 2. If third party summonses or third party contacts would be reviewed in sufficient numbers to be able to determine if there is a problem in how the IRS handles these collection tools.
 3. If trend and/or problem reports would be reviewed to determine sufficiency of information to address identified problems.
- B. Reviewed any revised Quality Review IRM and handbook procedures to determine if they are specific enough for quality reviewers to gather information from case files to measure IRS employee compliance with the legal requirements for third party summonses and third party contacts.
- C. Reviewed the adequacy of any changes made to the CQMS and the EQMS check sheets to ensure that sufficient information is recorded in the electronic databases to measure employee compliance with legal requirements.
- D. Interviewed Quality Review managers at the selected districts to determine the process that is used to provide IRS managers with reports concerning trends and problems.
- E. Analyzed the data and any reports that Quality Review at the selected districts is providing managers to determine if the information is sufficient.
- F. Interviewed Quality Review managers to determine if they have implemented any local procedures to gather and record the needed information. Also, determined if the managers have any suggestions on how to improve the CQMS and the EQMS to better measure employee compliance with legal requirements for third party summonses and third party contacts.

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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Deputy Commissioner Operations C:DO

Chief Operations Officer OP

Assistant Commissioner (Collection) OP:CO

Assistant Commissioner (Customer Service) OP:C

Assistant Commissioner (Examination) OP:EX

National Director for Legislative Affairs CL:LA

Audit Liaisons:

Assistant Commissioner (Collection) OP:CO

Assistant Commissioner (Customer Service) OP:C

Assistant Commissioner (Examination) OP:EX

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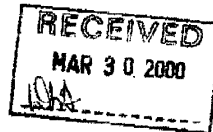
Appendix IV

Management's Response to the Draft Report



COMMISSIONER

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



March 30, 2000

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Charles O. Rossotti *COR*
Commissioner of Internal Revenue

SUBJECT: Draft Audit Report - The Internal Revenue Service Should Enhance Processes and Controls to Protect Taxpayer's Rights When Issuing Third Party Summonses and Making Third Party Contacts -- Urmem 2/23/2000

Thank you for the opportunity to respond to your draft report entitled "The Internal Revenue Service Should Enhance Processes and Controls to Protect Taxpayer's Rights When Issuing Third Party Summonses and Making Third Party Contacts." The objective of the review was to determine whether the Internal Revenue Service's (IRS) processes and controls enable the IRS to protect taxpayer's rights when issuing third party summonses and making third party contacts during tax return examinations and delinquent tax account collections.

In your report, you recognized the policies and procedures that we implemented to comply with the legal and administrative requirements relating to third party summons authority and making third party contacts. We agree with your assessment and plan to use your recommendations to enhance our procedures to protect taxpayer's rights when third party summonses are issued and when third party contacts may be made.

IDENTITY OF RECOMMENDATION # 1

To ensure taxpayers are not adversely affected, the Deputy Commissioner Operations should implement a process to ensure critical initiatives, such as, the development of a more customer-friendly third party contact notice, are more timely developed. The notice should inform taxpayers of their rights and explain the IRS policy of working with taxpayers to obtain needed information before third parties are contacted.

ASSESSMENT OF CAUSE(S)

The initial third party contact notice (Letter 3164) was revised due to concerns raised by taxpayers, tax practitioners, and members of Congress. New letters were developed based on feedback received from tax practitioner groups, the small business community, and members of Congress. The new letters were implemented on February 1, 2000.

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The Internal Revenue Service Should Enhance Processes and Controls To Protect Taxpayers' Rights When Issuing Third Party Summonses and Making Third Party Contacts

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CORRECTIVE ACTIONS

A group was established to develop a new letter to provide taxpayers with the necessary information. The group used these guiding principles: provide the taxpayer a frame of reference; identify the purpose of the contact; ensure the taxpayer's rights are safeguarded; and work with the taxpayer first. As a result, 13 clearer, specialized Letters 3164 were developed to advise taxpayers of potential third party contacts.

We have implemented a process to use when a new third party contact letter is required. The functional areas will use the guiding principles and the current Letters 3164 as a template or guide. The Chief Operations Officer will review the proposed draft. Once the draft is approved, the functional areas will be responsible for ensuring the new letter is printed and distributed. Currently, the time to draft, approve, and print a new letter is greatly reduced.

IMPLEMENTATION DATE:

Already implemented

RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (Collection)

IDENTITY OF RECOMMENDATION # 2

The Chief Operations Officer should modify the existing system that records Forms 12175, Third Party Contact Report Form, to also record the number of third party contact summonses.

ASSESSMENT OF CAUSE(S)

The IRS is not required to maintain a centralized system to identify the number of summonses issued. The Third Party Contact Command Code Database was created as a result of recent legislation and is currently used to record third party contact data from Forms 12175. The Third Party Contact Command Code Database was not designed to record third party summonses data.

CORRECTIVE ACTIONS

The Chief Information Officer and our Disclosure Officer will determine if the Third Party Contact Command Code Database can be modified to incorporate data regarding third party summonses, and what impact this change will have on other priority requests. Any changes to the existing database will require public comment and changes to the existing System of Records for Third Party Contacts. Based on these results we will determine the impact of implementation of this recommendation.

IMPLEMENTATION DATE:

Proposed: January 1, 2001

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RESPONSIBLE OFFICIAL(S)
Assistant Commissioner (Collection)
Assistant Commissioner (Examination)
Chief Information Officer

IDENTITY OF RECOMMENDATION # 3

The Chief Operations Officer should update the Examination Quality Measurement System (EQMS) and the Collection Quality Measurement System (CQMS) to ensure they review and measure IRS employees' compliance with the IRS Restructuring and Reform Act of 1998 provisions designed to protect taxpayer's rights when third party contacts are made and third party summonses are issued.

ASSESSMENT OF CAUSE(S)

Currently, the EQMS contains third party contact review requirements, however, it does not contain third party summonses review requirements. The CQMS does not contain third party contact or third party summonses review requirements.

CORRECTIVE ACTIONS

We are working with EQMS to expand the third party contact review requirements and to add third party summons requirements. We are working with the CQMS personnel to incorporate the necessary third party contact and third party summons requirements.

IMPLEMENTATION DATE:

Proposed: October 1, 2000

RESPONSIBLE OFFICIAL(S)
Assistant Commissioner (Collection)
Assistant Commissioner (Examination)

If you have any questions or need additional information, please call me or a member of your staff may contact Charles W. Peterson, Assistant Commissioner (Collection), at (202) 622-5100.

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