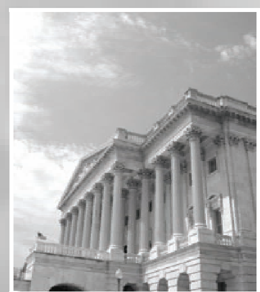
Treasury Inspector General for Tax Administration

Semiannual Report to Congress

April 1, 2006 through September 30, 2006



We are more heavily taxed by our idleness, pride and folly than we are taxed by government.

~ Benjamin Franklin

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Inspector General's Message to Congress

Our nation's government depends on an effective, efficient, and equitable tax system. Especially during times of such great demand on Federal resources, Americans must have faith that their tax dollars are fairly assessed, and that the tax laws are enforced effectively and fairly. The Treasury Inspector General for Tax Administration (TIGTA) is charged with ensuring that these responsibilities are met, and I remain dedicated to upholding this important mission.

I am proud of our accomplishments and pleased to present TIGTA's Semiannual Report to Congress. Once again, TIGTA has excelled in its effort to ensure the integrity and fairness of the Federal tax system. This report highlights our most notable audit and investigative work conducted from April 1, 2006, through September 30, 2006, and summarizes the statistical results of our work. Over the last six months, TIGTA has completed 118 audits that identified more than $258 million in total cost savings and $1.4 billion in increased or protected revenue. In addition, TIGTA's Office of Chief Counsel has reviewed and made recommendations on the impact of 177 proposed or existing regulations and laws affecting tax administration.

The Internal Revenue Service (IRS) continues to face many challenges. I have identified my priorities for TIGTA based on those challenges. They include: overseeing IRS efforts to modernize technology; enhancing TIGTA's ability to protect tax administration from corruption; and monitoring IRS initiatives to improve tax compliance, which now includes the use of private debt collection agencies.

As the IRS modernizes its systems through the Business Systems Modernization (BSM) program, it is essential that contractor performance and accountability be effectively managed. The BSM program is a complex effort to modernize the IRS' technology and related business processes. This program is in its eighth year and has cost approximately $2.1 billion. However, recent contractor failures to implement a redesigned Electronic Fraud Detection System (EFDS) demonstrated the significant consequences of inadequate supervision of IRS contractors. TIGTA's review determined that this failure resulted in the inefficient use of more than $20 million in contractor payments, and left the IRS unable to identify potentially millions of dollars in fraudulent refunds during the 2006 filing season.

Protecting tax administration from corruption remains one of TIGTA's highest priorities. Over the last six months, TIGTA's Office of Investigations opened 1,669 cases and closed 1,694. Millions of taxpayers entrust the IRS with sensitive financial and personal data stored and processed by IRS computer systems. Recent reports of identity theft in both the private and public sectors have heightened awareness of the need to protect this data. An integral part of TIGTA's Office of Investigations' employee integrity program involves the identification and investigation of unauthorized access (UNAX) to confidential taxpayer records. Highlights of several of these investigations included in this report demonstrate that UNAX violations continue to pose a serious threat to the security of taxpayer data.

TIGTA has expanded its oversight capabilities to enhance its performance. Through its outreach initiatives, TIGTA continues to educate a vast number of IRS employees and tax professionals. In addition, TIGTA has proactively addressed issues facing taxpayers. For example, this year, TIGTA successfully responded when the IRS was targeted by a variety of Internet "phishing" scams designed to emulate IRS operations. Through TIGTA's efforts, many of these Internet sites were shut down, minimizing victims' losses and protecting against the misuse of the IRS symbol. TIGTA's active presence in the media alerted the public to these schemes, explaining what actions people should take if they are targeted.

Improving tax compliance and closing the tax gap, which the IRS estimates at $345 billion, is critical to collecting sufficient revenue to finance the many demands being placed on the Federal Government. The IRS is striving to find an appropriate balance between enhanced taxpayer assistance and effective enforcement.

The IRS is adapting its enforcement activities to better target corporations and high-income individuals who fail to meet their tax obligation. However, TIGTA continues to identify the need for improvement in taxpayer services provided through toll-free, face-to-face, and electronic methods. In addition, TIGTA found that despite its recent effort to update the tax gap estimate, the IRS still does not have sufficient information to completely and accurately assess the overall gap and voluntary compliance rate.

During this reporting period, the IRS began implementing its private debt collection initiative, designed to contract out the collection of delinquent tax debt to private collection agencies. TIGTA has a multi-year strategy for overseeing this important and highly visible initiative. TIGTA has played a critical role in the initial implementation of the program by providing oversight, input, and support to the IRS. TIGTA is working with the IRS on concerns regarding background investigations of contractor employees; physical security; selection criteria and distribution of cases to contractors; contract employee training; and the processes and requirements for reporting improprieties to TIGTA. This is a high-risk area for the IRS, and TIGTA's continued oversight will help ensure that taxpayers' rights are protected.

To enhance TIGTA's ability to respond quickly to changing events, TIGTA established an Inspections and Evaluation (I&E) unit during this reporting period. This unit was tested during a pilot program earlier this year. Throughout the project, the I&E group provided TIGTA with the flexibility to perform work in areas that span the broad spectrum of tax administration. The I&E group provides regular status reports on the IRS' private debt collection initiative and, during this reporting period, produced an analysis related to the recent flooding of IRS headquarters.

The IRS will continue to face formidable challenges as it strives to administer an efficient, effective, and equitable tax system. TIGTA is committed to working with the IRS, Congress and other stakeholders to ensure that these challenges are met.

Sincerely,

J Russell George

J. Russell George
Inspector General

TIGTA's Profile

The Treasury Inspector General for Tax Administration (TIGTA) provides independent oversight of Treasury Department matters involving IRS activities, the IRS Oversight Board, the National Taxpayer Advocate, and the IRS Office of Chief Counsel. Although TIGTA is placed organizationally in the Treasury Departmental Offices and reports to the Secretary of the Treasury and to Congress, TIGTA functions independently from the Departmental Offices and all other offices and bureaus within the Department.

TIGTA's work is devoted to all aspects of activity related to the Federal tax system as administered by the IRS. By identifying and addressing the IRS' management challenges, implementing the *President's Management Agenda* and the priorities of the Department of the Treasury, and overseeing the IRS as it strives to achieve its strategic goals, TIGTA protects the public's confidence in the tax system.

TIGTA's primary functional offices are the Office of Audit (OA) and the Office of Investigations (OI). TIGTA's Offices of Chief Counsel, Information Technology, and Management Services support OA and OI efforts. (See organizational chart on page 4.)

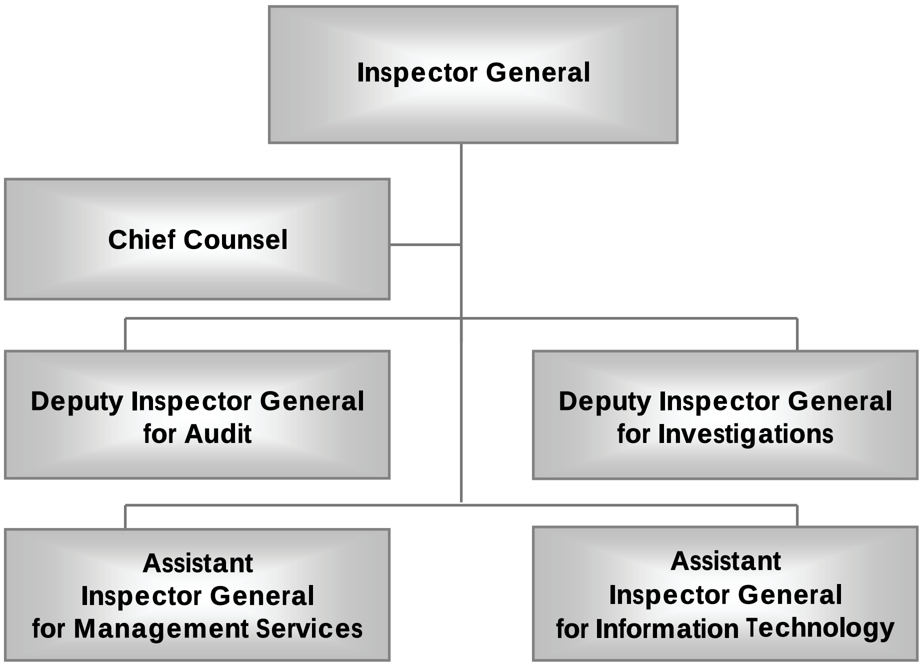
TIGTA conducts audits and investigations designed to:

- promote the economy, efficiency, and effectiveness of tax administration; and
- protect the integrity of tax administration.

TIGTA's Statutory Mandate

- **Protect** against external attempts to corrupt or threaten IRS employees.
- **Provide** policy direction and conduct, supervise, and coordinate audits and investigations related to IRS programs and operations.
- **Review** existing and proposed legislation and regulations related to IRS programs and operations and make recommendations concerning the impact of such legislation or regulations.
- **Promote** economy and efficiency in the administration of tax laws.
- **Prevent** and detect fraud and abuse in IRS programs and operations.
- **Inform** the Secretary of the Treasury and Congress of problems and deficiencies identified and of the progress made in resolving them.

TIGTA's Organizational Structure



Authorities

TIGTA has all of the authorities granted under the Inspector General Act of 1978, as amended.[1] TIGTA has access to tax information in the performance of its tax-administration responsibilities. TIGTA also has the obligation to report potential criminal violations directly to the Department of Justice. TIGTA and the Commissioner of Internal Revenue have established policies and procedures delineating responsibilities to investigate potential criminal offenses under the internal revenue laws. In addition, the IRS Restructuring and Reform Act of 1998 (RRA 98)[2] amended the Inspector General Act of 1978 to give TIGTA statutory authority to carry firearms, execute and serve search and arrest warrants, serve subpoenas and summonses, and make arrests as set forth in Section 7608(b)(2) of the Internal Revenue Code (I.R.C.).

[1] 5 U.S.C.A. app. 3 (West Supp. 2005)

[2] Public Law No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 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 I.R..C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

Promote the Economy, Efficiency and Effectiveness of Tax Administration

TIGTA's Office of Audit (OA) strives to promote the economy, efficiency, and effectiveness of tax administration. TIGTA provides recommendations to improve IRS systems and operations, while ensuring fair and equitable treatment of taxpayers. TIGTA's comprehensive, independent performance and financial audits of IRS programs and operations focus on mandated reviews and high-risk challenges facing the IRS.

The IRS' implementation of audit recommendations results in cost savings and increased or protected revenue; reduction of taxpayer burden; and protection of taxpayer rights and entitlements, taxpayer privacy and security, and IRS resources.

Each year, TIGTA identifies and addresses the major management challenges facing the IRS. TIGTA places audit emphasis on statutory coverage required by RRA 98, as well as areas of concern to Congress, the Secretary of the Treasury, the Commissioner of Internal Revenue, and other key stakeholders.

For this reporting period, several audits focused on the key areas of security, hurricane relief, the tax gap, business systems modernization, taxpayer service, and tax-exempt organizations. Many of TIGTA's on-going audits continue to focus on these areas and their findings will be included in future reports.

Audit Emphasis Areas

- Security of the IRS
- Hurricane Relief
- Tax Gap
- Systems Modernization of the IRS
- Providing Quality Taxpayer Service Operations
- Tax Exempt Organizations

The following summaries highlight significant audits that TIGTA completed in each of the above areas of emphasis during this six-month reporting period.

(Click on report references on following pages to go to Web links for audit reports.)

Security of the Internal Revenue Service

Millions of taxpayers entrust the IRS with sensitive financial and personal data stored on and processed by IRS computer systems. Recent reports of identity theft in both the private and public sectors have heightened awareness of the need to protect data. The risks that sensitive data or computer systems could be compromised and computer operations could be disrupted continue to increase. These risks stem from internal factors such as increased connectivity of computer systems and increased use of portable laptop computers, and external factors such as volatile environmental threats related to increased terrorist and hacker activity.

The IRS is making steady progress toward improving computer security; however, much work needs to be done. The IRS has identified the security of its computer systems as a high priority in its *2005-2009 Strategic Plan* and has designated computer security as a material weakness under the Federal Managers' Financial Integrity Act of 1982.[3] TIGTA's audits continue to show that managers throughout the IRS view security as the responsibility of IRS executives, but not that of all employees. While IRS executives are responsible for establishing policies and providing oversight, they must rely on all employees to provide security for the IRS' infrastructure and business applications. Many of the technical vulnerabilities identified can be attributed to the lack of training provided for employees with key security responsibilities.

[3] 31 U.S.C. §§ 1105, 1113, 3512 (2000).

Federal Information Security Management Act (FISMA) Compliance

Each year, Inspectors General are required to evaluate agencies' compliance with the Federal Information Security Management Act (FISMA).[4] TIGTA's annual assessment showed that the IRS had made progress in complying with FISMA requirements since their enactment in 2002. The IRS has assessed the risks of its systems and significantly improved its process to certify and accredit the security of those systems. TIGTA, however, has reported that IRS business units have not carried out their responsibilities for testing systems on an annual basis. TIGTA also reported that the IRS needs to improve its tracking of actions to correct security vulnerabilities, incident reporting, and training for employees with key security responsibilities.
Report Reference No. 2006-20-179

Electronic Fraud Detection System (EFDS)

In 2006, the IRS certified and accredited a major change to its Electronic Fraud Detection System (EFDS). The EFDS contains the IRS' second largest repository of taxpayer information, making it paramount that the information is protected. Tests of the older EFDS to support the certification were inadequate because the implementation date for the new system was imminent. In addition, prior certification testing for the EFDS had been inadequate. As a result, system owners formally accepted the risks of the system with only limited assurance that security controls protected taxpayer

[4] The FISMA is part of the E-Government Act of 2002, codified at Pub. L. No. 107-347, Title III, 116 Stat. 2946.

information from being inappropriately accessed and misused. The new version of the EFDS was scheduled to be operational in January 2006, but functional problems prevented it from being implemented. As a result, it was too late to restore the prior version of the system, so the IRS went through the 2006 Filing Season without the benefit of a system to prevent and detect tax refund fraud. The IRS plans to restore the old version of the EFDS for the 2007 Filing Season.

TIGTA recommended that the IRS conduct a complete test of security controls of the old system before implementation. IRS management agreed with the recommendation and is taking corrective action.
Report Reference No. 2006-20-178

The IRS' Office of Privacy

During the last two years, the IRS' Office of Privacy has maintained and enhanced the IRS' privacy program. A working group reviews privacy and disclosure issues and has created an online privacy training segment for IRS employees. TIGTA's review showed that the IRS is still not complying with the legislative privacy requirements. The E-Government Act of 2002[5] and IRS guidelines require every computer system that collects personal information to have a current privacy impact assessment on file. TIGTA was unable to locate these assessments for 130 (54 percent) of the 241 IRS computer systems that collect and process sensitive data. Those that were located were not always properly documented and completed. In addition, reviews had not been conducted to validate the accuracy and completeness of the privacy impact assessments that were completed.

TIGTA recommended that the IRS establish a central repository of all privacy impact assessments in a searchable, electronic format and verify the accuracy of the inventory on a quarterly basis; initiate a program to evaluate employee training activities relating to privacy requirements; reinforce the importance of adequate documentation to support assessments; and implement a compliance review process. IRS management agreed with the recommendations and is taking corrective action.
Report Reference No. 2006-20-166

Employee Browsing

The Integrated Data Retrieval System (IDRS) contains sensitive information such as taxpayers' names, Social Security numbers, birth dates, addresses, and income. Because of the sensitivity of this data, the IDRS routinely generates reports to identify unauthorized access to taxpayer accounts, thus ensuring that employees who violate the Taxpayer Browsing Protection Act of 1997[6] are identified and appropriate actions are taken.

TIGTA reported that only 42 percent of managers reviewed these reports during TIGTA's review period. As a result, employees may be browsing taxpayers' information with little chance of detection. The IRS has not sufficiently emphasized the importance of these reports and has not held managers accountable for reviewing

[5] Pub. L. No. 107-347, § 208, 116 Stat. 2946.

[6] Codified at I.R.C. §§ 7213, 7213A. This Act makes it a criminal offense to access or inspect tax information without proper authorization. This legislation focuses on the IRS ensuring that its employees access taxpayer data for official purposes only.

them. In addition, systemic problems prevented some managers from retrieving the reports, and slow response times hindered managers from timely identifying unauthorized accesses. The IRS paid a contractor $2.4 million over three years to develop a system to deliver the reports to managers, but the system is still not fully operational. The contract, which expired in September 2005, was not renewed.

TIGTA recommended that the IRS emphasize the need for managers to review IDRS security reports and include compliance with this requirement in operational reviews. To reduce the burden on managers, TIGTA recommended eliminating one of the reports that appeared to be duplicative. TIGTA also recommended that priority be placed on hiring a new contractor to address systemic weaknesses. IRS management agreed with most of the recommendations and is taking corrective action.
Report Reference No. 2006-20-111

Detecting Improper Activity on Modernized Systems

The Customer Account Data Engine (CADE) system[7] has its own audit trail;[8] audit trails for all other IRS modernized systems are combined in the Security Audit and Analysis System (SAAS). TIGTA's review showed that the IRS did not adequately monitor audit trails on these systems. As a result, browsing of taxpayer accounts, inappropriate actions, and security intrusions may have occurred but were not identified. The IRS did not recognize a need to maintain and review CADE audit trails. SAAS audit trails were not reviewed because the data were inaccurate, unreliable, and incomplete.

TIGTA reviewed more than three million audit trail records and found that 48 percent of the data entries required by IRS policy contained missing or inaccurate information. Even if the data were usable, reports and procedures for reviewing them were not yet available, making it unlikely that SAAS users could identify inappropriate activity on modernized systems. Although the IRS accepted the SAAS in Fiscal Year (FY) 2002, the system requirements were still inadequate because much of the SAAS development effort to date had been focused on replacement of the Audit Trail Lead Analysis System.[9] TIGTA's audit results also indicated that the problems associated with the SAAS, which TIGTA reported in August 2004,[10] had not been adequately addressed, despite claims by the IRS that the SAAS was functioning well.

TIGTA recommended that the IRS establish a review process for CADE audit trails. For the SAAS, TIGTA recommended that the IRS take steps to ensure the reliability of SAAS audit trail data, assess SAAS requirements, and develop processes that incorporate SAAS requirements. IRS management agreed with the recommendations and is taking corrective action.
Report Reference No. 2006-20-177

[7] The CADE system currently contains sensitive information for 1.4 million tax returns. Eventually it will house taxpayer accounts and tax return data for more than 135 million taxpayers.
[8] An audit trail is a chronological log on a computer system that is used to detect improper activities.
[9] This is an IRS system that aids TIGTA in researching unauthorized access of taxpayer data by IRS employees.
[10] *The Audit Trail System for Detecting Improper Activities on Modernized Systems Is Not Functioning* (Reference Number 2004-20-135, dated August 2004).

Volunteer Income Tax Assistance (VITA) Program Compliance

Key controls designed by the IRS to account for computers that were provided to volunteers in the VITA Program[11] were not being followed consistently. TIGTA reported in August 2002[12] that the IRS did not have adequate internal controls and accountability for these computers.

Though the IRS accounted for 97 percent (191 of 197) of the computers sampled, repeated attempts were necessary to locate the computers. In addition, the IRS did not ensure that required procedures were followed when disposing of computers. The reports used to document the disposal of assets did not contain proper authorizations, did not detail the specific actions taken to locate the computers, and did not contain the required statement on whether or not taxpayer data were at risk.

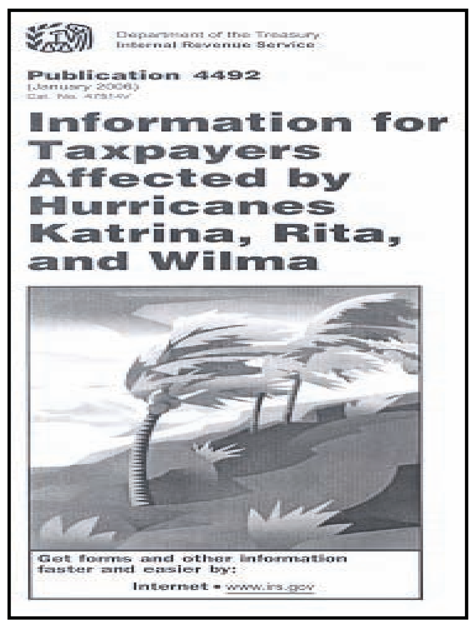
Also, the IRS was unable to provide documentation to demonstrate that VITA Program computers had been consistently included in the IRS' annual certification of its computer inventory. The VITA Program computers were also not included in the Government Accountability Office's annual audits of the IRS' financial statements for FYs 2003 through 2005.

TIGTA recommended that the IRS perform a physical inventory and reconciliation of computers and ensure that VITA Program computers were included in the required annual certification of computer inventory. IRS management agreed with the recommendations and is taking corrective action.

Report Reference No. 2006-40-172

Hurricane Relief

Hurricanes Katrina, Rita, and Wilma struck the United States Gulf Coast region between August and October 2005. The aftermath of the hurricanes resulted in an unprecedented need for Federal assistance to taxpayers who lived in the affected areas, as well as to others who may have been adversely impacted by these storms.



Implementation of Hurricane Tax Law Changes

The 2006 Tax Filing Season presented unusual challenges for the IRS due to the significant tax law changes enacted to assist taxpayers who were adversely affected by

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[11] The VITA Program provides free tax help to people for whom professional assistance may be too expensive. The IRS partners with the military, community-based organizations, and the American Association of Retired People to assist individuals with the preparation of basic income tax returns.

[12] *Computers Used to Provide Free Tax Help and That Contain Taxpayer Information Cannot Be Accounted For* (Reference Number 2002-40-144, dated August 2002).

the hurricanes. The Katrina Emergency Tax Relief Act of 2005 (KETRA)[13] was signed into law on September 23, 2005, and contained $3.3 billion in estimated tax relief for FY 2006. The Gulf Opportunity (GO) Zone[14] legislation followed in December 2005, with an additional $3.9 billion in estimated tax relief for 2006.[15] These tax law changes involved:

- an additional exemption for housing for individuals displaced by Hurricane Katrina;
- temporary suspension of limitations on charitable contributions and personal casualty losses;
- tax-favored withdrawals from retirement plans for qualified hurricane distributions;
- a special rule for determining earned income for taxpayers whose main home was in a disaster area; and
- an expansion of the Hope Scholarship and Lifetime Learning Credit for students in the GO Zone.

TIGTA's review of key tax law changes for the 2006 Filing Season showed that, overall, the tax law provisions enacted to provide relief to those affected by the hurricanes were implemented correctly. There were no audit recommendations.

Report Reference No. 2006-40-088

[13] Pub. L. No. 109-73, 119 Stat. 2016 (to be codified in scattered sections of 26 I.R.C.).
[14] The GO Zone covers certain counties in the states of Alabama, Louisiana, and Mississippi as determined by the Federal Emergency Management Agency to be eligible for either individual only or both individual and public assistance from the Federal Government.
[15] Public Law No. 109-135, 119 Stat. 2577 (to be codified in scattered sections of 26 U.S.C. and at 19 U.S.C. § 4033)

Oversight for Charitable Organizations Supporting Hurricane Relief

On September 6, 2005, the IRS announced it would expedite the processing of applications for tax-exempt status of new organizations providing relief for victims of Hurricane Katrina.[16] The Exempt Organizations (EO) function quickly processed and approved new hurricane-relief organizations' Applications for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code (I.R.C.) (Form 1023). These approvals better positioned the organizations to raise funds and provide relief to hurricane victims. TIGTA evaluated three aspects of this process,[17] including whether the EO function properly approved requests for expedited processing of Forms 1023, followed procedures designed to ensure that Forms 1023 contained the necessary information for determining tax-exempt status, and took actions to ensure that the public was timely notified of hurricane-relief organizations that were granted tax exempt status. In all three areas, the EO function effectively and timely completed its processing.

In addition, the EO function established procedures to ensure that referrals of potentially abusive exempt organizations were reviewed to determine if the allegations should be sent to an EO

[16] The IRS extended this treatment to organizations seeking tax-exempt status to provide relief to victims of Hurricanes Rita and Wilma. Hurricane Wilma made landfall in Florida on October 24, 2005.
[17] Although the IRS included Hurricane Wilma in the expedited processing of Forms 1023 and review of referrals of potentially abusive exempt organization activity, TIGTA focused on the EO function's processing of Forms 1023 and referrals of potential abuse relating to hurricane disaster relief for Hurricanes Katrina and Rita only.

Examinations function group for further development. Referrals related to Hurricanes Katrina, Rita, and Wilma were sent to the Financial Investigations Unit for review. This unit developed draft procedures to identify potentially abusive fundraising schemes, determined if the schemes involved an exempt organization(s), and took action to refer the organization(s) to the EO Examinations function, the EO Determinations function, or another IRS division, as appropriate.

TIGTA made no recommendations in this report; however, key IRS management officials reviewed the report prior to issuance and agreed with the information presented.
Report Reference No. 2006-10-089

Disaster Relief Indicators for Taxpayers Affected by Hurricanes

The IRS has correctly identified taxpayers affected by the hurricanes and placed disaster indicators on their accounts. The IRS has the authority to grant extensions to file certain tax returns and pay certain taxes, waive penalties, and abate interest for taxpayers affected by natural disasters such as hurricanes. To provide this tax relief, the IRS identifies taxpayers residing in a disaster area based on their zip codes, and then uses a computer application to place a disaster indicator on their accounts.[18] Disaster indicators properly prevented balance-due notices from being issued to affected taxpayers.

While most of the indicators were generated by a computer application, a small number of indicators (less than 0.1 percent of the total) were input manually. The manual indicators often had an incorrect disaster period beginning or ending date for the tax relief period. TIGTA analyzed 1,150 manually input disaster indicators and identified 779 (68 percent) with an incorrect beginning and/or ending date. In addition, when the IRS extended the relief ending date, accounts with manually input indicators were not updated. This occurred because the computer program used for the update identified only those accounts with systemically placed indicators. As a result, the ending date for 748 disaster indicators[19] was not properly extended, and the taxpayers with these indicators on their accounts did not receive the full benefit of the disaster relief provisions. TIGTA advised the IRS of this concern during the review, and IRS management took action to identify and manually input disaster indicators with corrected ending dates to these taxpayer accounts. TIGTA also recommended that the IRS provide employees with a regularly updated job aid for disaster indicators that are input manually and emphasize the importance of using the correct dates for interest and penalty calculations. IRS management agreed with the additional recommendation and is taking corrective action.
Report Reference No. 2006-40-109

Automated Underreporter (AUR) Program Compliance Activities

The IRS took prompt action to suspend Automated Underreporter (AUR) Program compliance activities and prevent notices

[18] TIGTA refers to these computer-generated disaster indicators as "systemically placed indicators."

[19] Some of these indicators could also be included in those previously mentioned that were input incorrectly.

from being issued on approximately 27,700 tax cases involving taxpayers affected by Hurricanes Katrina and Rita. Despite these efforts, TIGTA believes that the IRS could improve notification to taxpayers who had already received AUR notices to advise them of the tax relief period and suspended compliance activities. Affected taxpayers may not have seen news releases or accessed the IRS Web site (IRS.gov) to obtain this information. To effectively communicate the tax relief granted during catastrophic disasters, TIGTA recommended that the AUR Program send a notice directly to taxpayers who had previously received AUR correspondence, notifying them that compliance activities had been suspended.

IRS management disagreed with this recommendation, stating that disaster victims do not always provide forwarding addresses; receiving notices from the IRS may place additional burden on them; and some may have other pending IRS actions on their account. IRS management officials further stated that the AUR Program should not be singled out to provide notices to taxpayers and may confuse taxpayers regarding why notices were sent on some IRS actions and not on others.

TIGTA disagrees with the IRS' reasons and believes that the IRS should consult with the United States Postal Service (USPS) before reaching any type of a conclusion about mail delivery. According to the USPS, mail service was restored quickly to the Central Gulf Coast region. TIGTA agrees with the IRS that suspending compliance activities allows taxpayers to concentrate on disaster recovery and temporarily relieves them of worry about their tax obligations. TIGTA believes that taxpayers would further benefit from a notice telling them that their compliance activities were suspended. **Report Reference No. 2006-40-104**

Taxpayer Carryback Loss Claims

When taxpayers incur a significant loss from business activities or natural disasters, to the extent their deductions exceed their income, they can opt to carry the loss back to prior tax years and obtain a refund of taxes paid in those prior years by filing an Application for Tentative Refund (Form 1045) or an Amended U.S. Individual Income Tax Return (Form 1040X). The KETRA and GO Zone laws include provisions that eliminate the limitations on personal casualty or theft losses caused by these hurricanes. The GO Zone Act also allows taxpayers affected by Hurricane Katrina who live in the GO Zone to carry certain qualified losses back five years.

TIGTA's review of the IRS' processing of carryback claims indicated that the IRS was sometimes not processing claims and issuing refunds within 45 calendar days of the form's received date or the due date of the loss year's return as required to avoid paying interest on the refund amounts. An analysis of a statistical sample of 499 carryback claims[20] showed that 120 (24 percent) of the claims were not processed within the 45-day, interest-free period. As a result, the IRS paid interest totaling approximately $1.8 million. Based on this sample, about 5,700 claims were not processed timely and interest of approximately $20.3 million was paid unnecessarily. If this condition is not

[20] TIGTA's sample was taken from claims posted to the IRS Master File between August 1, 2004, and July 30, 2005.

corrected, it could affect approximately 28,400 taxpayers, and the IRS could pay unnecessary interest totaling over $101.7 million over the next five years.

TIGTA's concern in this area is heightened because the volume of carryback claims the IRS receives is likely to increase as a result of the hurricanes. The National Hurricane Center estimated the personal damages suffered by victims of the 2005 Gulf Coast to be nearly $100 billion. The impact of inefficiencies in the IRS' procedures will be compounded as the inventory of claims grows. The IRS is also going to have fewer locations available to receive and process these claims as it continues to close Submission Processing sites. TIGTA made a number of recommendations to help improve the identification and processing of these claims. IRS management agreed with the recommendations and is taking corrective action.
Report Reference No. 2006-40-139

Tax Gap

The timely filing of required tax returns is critical to the United States' system of voluntary compliance. Individuals, businesses, and other taxable entities with income over certain threshold amounts are required to file income tax returns. Most individuals and businesses comply. The IRS considers non-filing to be an egregious problem because it may cause compliant taxpayers to lose faith in the fairness of the tax system. When taxpayers pay their taxes, they want to be confident that their neighbors and competitors are doing the same. One goal in the IRS' *2005-2009 Strategic Plan* is to discourage and deter noncompliance with emphasis on corrupt activity by corporations, high-income individual taxpayers, [21] and other contributors to the tax gap.

Tax Gap Assessment

The IRS still does not have sufficient information to assess completely and accurately the overall tax gap and voluntary compliance rate. The IRS faces significant challenges in both obtaining complete and timely data and in developing methods for interpreting the data. It is important to tax administration and tax policy decision-makers that a tax gap estimate be developed that is within tolerable parameters. Otherwise, inappropriate decisions can be made on how to address the tax gap. If one assumes that in Tax Year (TY) 2010 the total tax liability is the same as it was in TY 2001, noncompliant taxpayers would have to pay timely and voluntarily an additional $134 billion to reach a 90 percent voluntary compliance rate by 2010.

TIGTA recommended that the IRS continue to conduct reviews on a regular basis for major segments of the tax gap

[21] The IRS considers high-income taxpayers to be those who file a U.S. Individual Income Tax Return (Form 1040) with Total Positive Income (TPI) of $100,000 or more and those business taxpayers who file a Form 1040 with Total Gross Receipts of $100,000 or more on an attached Profit or Loss From Business (Schedule C) or Profit or Loss From Farming (Schedule F). Generally, the TPI is calculated by using only positive income values from specific income fields on the tax return and treats losses as a zero. For example, a tax return filed with wages of $90,000, interest of $12,000, and a $25,000 loss from an interest in a partnership would have a TPI totaling $102,000 and be considered a high-income tax return by the IRS.

and that it consider establishing a tax gap advisory panel that includes tax and economic experts to identify ways to improve the methods to measure voluntary compliance. IRS management agreed with the recommendations.
Report Reference No. 2006-50-077

Examinations of High-Income Taxpayers

The IRS has increased its examination coverage rate[22] of high-income taxpayers. The increased coverage has been due largely to an increase in correspondence examinations,[23] which limit the tax issues the IRS can address in comparison to face-to-face examinations. In addition, the compliance effect may be limited because more than one-half of all high-income taxpayer examination assessments are not collected timely. The examination coverage rate of high-income taxpayers increased from 0.86 percent in FY 2002 to 1.53 percent in FY 2005. While face-to-face examinations increased by 25 percent from FY 2002 to FY 2005, correspondence examinations increased by 170 percent over the same period. As a result, the percentage of all high-income taxpayer examinations completed through the Correspondence Examination Program grew from 49 percent in FY 2002 to 67 percent in FY 2005.

[22] The examination coverage rate is calculated by dividing the number of examined returns in a category by the number of returns in the same category filed in the previous year.
[23] Correspondence examinations are important compliance activities focusing on errors and examination issues that typically can be corrected by mail. They are conducted by sending the taxpayer a letter requesting verification of certain items on the tax return. These examinations are much more limited in scope than office and field examinations in which examiners meet face to face with taxpayers to verify information.

In FY 2004, the IRS assessed over $2.1 billion in additional taxes on high-income taxpayers through its Examination program. This figure includes assessments of $1.4 billion (66 percent) on taxpayers who did not respond to the IRS during correspondence examinations. Based on TIGTA's statistical sample of cases,[24] approximately $1.2 billion[25] (86 percent) of the $1.4 billion had been either abated[26] or not collected after an average of 608 days from the date of assessment. The Examination and Collection programs for high-income taxpayers may not be positively affecting compliance given the substantial assessments that have been abated or not collected.

TIGTA recommended that the IRS complete its plan to maximize the compliance effect of high-income taxpayer examinations. This should include the mixture of examination techniques, issues examined, and collection procedures. IRS management agreed with the recommendation and is taking corrective action.
Report Reference No. 2006-30-105

The IRS' Tip Program

Although the IRS has made some enhancements to the Tip Program since TIGTA's prior review,[27] additional

[24] TIGTA's sample was selected from cases completed in FY 2004 to provide sufficient time for collection activities.
[25] Margin of error is ± 5.05 percent.
[26] Abatement occurs when the IRS reduces an assessment, in this case from reversing examination findings that had uncovered apparent misreported income, deductions, credits, exemptions, or other tax issues.
[27] *Opportunities Exist to Improve the Tip Rate Education and Determination Program* (Reference Number 2001-30-076, dated May 2001).

improvements could help achieve a higher level of tip income reporting compliance. The IRS could potentially achieve $342 million in additional tax assessments over five years if it resumes soliciting new tip agreements with the cosmetology industry and expands to the taxi/limousine industry. In addition, the IRS has not consistently monitored establishments in the food and beverage and cosmetology industries that have entered into tip agreements since FY 2000 to determine if the secured agreements actually increased tip income for these establishments. Disparity over the number of tip agreements secured in various locations across the country continues to be an issue. The IRS does not plan to solicit actively any new tip agreements beyond the gaming industry in FY 2006.

The IRS has not yet established an automated system to identify business entities required to file an Employer's Annual Information Return of Tip Income and Allocated Tips (Form 8027).[28] The IRS manually matched the Employer's Quarterly Federal Tax Return (Form 941) data to the database of TY 2004 Forms 8027, identifying 33,685 employers as potential Form 8027 non-filers. The Form 8027 database data fields were not always accurate, and only the first quarter of TY 2004 Forms 941 had been matched to this database.

The IRS has automated the tracking of tip agreements for the food and beverage and cosmetology industries. This automated database is part of a system that is not fully operational but is now funded with a tentative date of FY 2008 for full implementation. The gaming tip agreements are maintained in a separate database that does not accommodate all necessary information, preventing consistent use of the information. The IRS has developed a procedure to address some small businesses in the food and beverage industry but a similar procedure is needed for small businesses in other industries.

TIGTA recommended that the IRS ensure that adequate staffing is available for monitoring tip agreements for all industries and use results of the monitoring to measure compliance; prepare a workforce plan to determine the necessary staffing levels needed to accomplish goals; and ensure that the automated tracking system remains funded and, once fully operational, includes gaming tip agreements. TIGTA also recommended that once the procedure is tested with the food and beverage industry for a year, the IRS consider developing a similar procedure for small businesses in other industries. IRS management agreed with the recommendations and is taking corrective action.
Report Reference No. 2006-30-132

Private Debt Collection Program

Overall, the IRS has taken positive steps to plan and implement effectively certain aspects of the Private Debt Collection Program. Legislation enacted in 2004[29] permits private collection agencies (PCAs) to help collect Federal tax debts. The law allows PCAs to locate and contact any

[28] Form 8027 is an information return filed by large food and beverage establishments when the employer is required to make annual reports to the IRS on receipts from food or beverage operations and tips reported by employees. Generally, a large employer is one who employs more than 10 employees on a typical business day.

[29] The American Jobs Creation Act of 2004 created the new I.R.C. Section (§) 6306 (2004).

taxpayer specified by the IRS, request full payment of the amount of Federal tax due, and obtain financial information with respect to that taxpayer.

According to the IRS, the initiative to use PCAs will help reduce a significant and growing amount of tax liability deemed uncollectible due to IRS collection and resource priorities; help maintain confidence in the tax system; and enable the IRS to focus its existing collection and enforcement resources on more difficult cases and issues. The IRS projects that over the next 10 years, PCAs could collect about $1.4 billion in overdue taxes.

During TIGTA's review, the IRS planned to place 45,300 cases with PCAs starting in June through September 2006. TIGTA advised the IRS that the volume of available cases was not sufficient to fill this particular placement plan. Approximately 72 percent of the cases available for placement in the program contained a balance due that was over two years old. The IRS has since revised its placement plan, including the process used for its case selection criteria.

The IRS has a long-term strategy in place to include more current cases in the initiative. The new Filing and Payment Compliance project currently limits its ability to accomplish this strategy. For the initial phase of the initiative, the IRS wanted to place simpler cases with PCAs, such as those in which the taxpayer has filed all returns due. Contrary to IRS intentions, the case selection criteria currently in place would allow certain nonfiler cases to be assigned to PCAs. TIGTA discussed its concerns and IRS management agreed to conduct further review of nonfiler conditions to determine whether or not the nonfiler cases should be excluded from inventory.
Report Reference No. 2006-30-064

Systems Modernization of the Internal Revenue Service

Modernization of the IRS includes both computer systems and business structure (reorganization) modernization. Both aspects have their own set of challenges, and both must succeed to fully modernize the IRS. According to the IRS, the Business Systems Modernization (BSM) will involve integrating thousands of hardware and software components. All of this must be done while replacing outdated technology and maintaining the current tax system.

In the past, the IRS' approach to modernizing was an enormous development effort aimed at replacing its current business systems. The IRS is now focusing on using current business systems, as well as current and future information technology investments, to accomplish modernization. Instead of scrapping and replacing the capabilities of hundreds of current IRS systems, the IRS will have existing systems evolve into reusable services. While the BSM Program shows signs of improvement, the IRS needs to overcome several challenges to deliver a successful modernization effort. As discussed below, the IRS needs to improve its ability to deliver smaller-scale systems such as the EFDS and the Tax Exempt Determinations System (TEDS) that have experienced systems development challenges similar to the BSM Program.

Annual Assessment of the BSM Program

The BSM Program is in its eighth year and has received approximately $2.1 billion for contractor services. This past year, the IRS began taking dramatic action by restructuring and redesigning significant areas within the BSM Program. For example, the IRS took over the role of systems integrator from the PRIME contractor[30] and changed its approach from completely replacing current business systems to using current business systems to accomplish modernization.

The IRS and its contractors have completed modernized projects that provide significant benefits to taxpayers. The IRS and its contractors have struggled to develop mature management capabilities and implement defined and repeatable processes necessary for effective and efficient systems development. As a result, the BSM Program has experienced project cost increases and schedule delays. Due to the complexity of BSM projects, it is unrealistic to think that every project will meet its exact cost and schedule estimates. Currently, several project segments are meeting cost and schedule estimates or are within a 10 percent threshold. Therefore, if the BSM Program continues to show improvement, TIGTA believes that additional funding should be considered as long as the funding increases do not exceed the IRS' ability to manage the BSM Program effectively and efficiently.

Since FY 2002, TIGTA's BSM annual assessments have cited four specific challenges the IRS needs to overcome to deliver a successful modernization effort:

- implement planned improvements in key management processes and commit necessary resources to enable success,
- manage the increasing complexity and risks of the BSM Program,
- maintain continuity and strategic direction with experienced leadership, and
- ensure that contractor performance and accountability are effectively managed.

The IRS is at a juncture where it can build upon the successes and lessons learned from the first eight years of the BSM Program. TIGTA continues to believe that the eventual success of the modernization effort will depend on how well the IRS deals with these four specific challenges. TIGTA also believes that systems modernization should remain a material weakness for the IRS because of open modernization corrective actions and the significance of the BSM Program to external stakeholders.

IRS management responded that it was pleased that this report recognized the significant action the IRS has taken to meet the BSM Program's many challenges. In addition, the IRS provided some of the benefits BSM projects are accruing to both taxpayers and the IRS. **Report Reference No. 2006-20-102**

[30] The PRIME contractor is the Computer Sciences Corporation, which heads an alliance of leading technology companies brought together to assist with the IRS' efforts to modernize its computer systems and related information technology. TIGTA is currently performing an audit of the IRS' efforts to transition activities away from the PRIME contractor.

Electronic Fraud Detection System (EFDS)

The IRS was unable to use the Electronic Fraud Detection System (EFDS) to prevent fraudulent refunds during 2006. As a result, an estimated $318.3 million in fraudulent refunds may have been issued, resulting in lost revenue to the Federal Government. The EFDS is the primary information system used to support the IRS' Criminal Investigation Division's Questionable Refund Program, a nationwide program established to detect and stop fraudulent claims for refunds on income tax returns. In 2002, the IRS initiated an effort to redesign the EFDS to improve system performance, reliability, and availability. The redesigned EFDS Web-based application (Web EFDS)[31] was to be implemented in January 2005. Due to system development problems, program implementation was delayed until January 2006. At that time, the contractor again failed to deliver a functional Web EFDS. Without sufficient time to restore the prior version of the EFDS, the IRS had to operate in the 2006 Processing Year without a program to identify fraudulently issued refunds. On April 19, 2006, the IRS stopped all Web EFDS development activities and focused all efforts on restoring the old EFDS for use in January 2007.

As of April 24, 2006, more than $37 million had been paid to the primary contractor for EFDS operations, maintenance, and enhancements, including $18.5 million for developing the Web EFDS. Two other contractors were paid approximately $2 million for Web EFDS development work, bringing the total Web EFDS cost to $20.5 million.[32]

The lack of adequate executive oversight and monitoring of the Web EFDS project contributed to the EFDS not being implemented for 2006. Although numerous indications of potential risks and problems were raised throughout the project, effective corrective actions were not taken. In addition, there were numerous changes in project management and executives responsible for overseeing the Web EFDS project as well as excessive turnover of contractor employees working on the project. Despite these problems, contingency plans were not developed to ensure that the old EFDS could be used if the Web EFDS was not completed timely.

TIGTA also determined that the contractor's performance and the progress of the project were not effectively monitored or documented. In addition, the IRS used cost-reimbursement contracts without performance-based requirements, which makes it difficult to determine whether deliverables were satisfactorily completed.

TIGTA recommended several actions to address these issues, including:

- assigning the EFDS project to an Executive Steering Committee for improved monitoring;
- ensuring that other projects managed under the new Applications Development organization are assigned to the appropriate oversight process;

[31] The system development effort will allow users to access the system via the IRS Intranet.

[32] The $18.5 million and $20.5 million amounts are based on OA's analysis of the total costs obtained from the EFDS Project Office and the IRS' Web-based requisition tracking system.

- properly identifying and addressing project risks using the appropriate system development life cycle methodology;
- ensuring that contractors are held accountable for performance;
- initiating discussions with the contractor to recover the funds paid to the contractor for additional costs resulting from non-delivery of a functional Web EFDS; and
- deferring additional work on the Web EFDS until the IRS decides who will perform the EFDS work.

IRS management agreed with the recommendations and is taking corrective action.
Report Reference No. 2006-20-108

Tax Exempt Determinations System (TEDS)

The implementation of TEDS Release 1 was expected to provide significant benefits to both the IRS' Employee Plans (EP) function and other Tax Exempt/Governmental Entities (TE/GE) Division programs. The delivery of TEDS Release 1 on March 16, 2004, did not significantly improve the TE/GE Division's processing of determination applications or assist in providing electronic EP determination information to other TE/GE Division programs as originally envisioned. In addition, because it was implemented a couple of months after the remedial amendment period[33] and the EP function had already started to receive a large number of applications, the EP function would not have realized the full benefits of the system even if it had been working effectively. In addition, while electronic information was available to TEDS' users, its impact was limited since the use of electronic images had not been fully incorporated into TE/GE Division operating procedures.

Investments associated with the development of TEDS Release 1 were not appropriately tracked. This prevented TE/GE Division management officials from receiving the information needed to evaluate their investment in TEDS effectively. The actual costs to develop, implement, and maintain TEDS Release 1 (through February 17, 2006) were approximately $2.3 million higher than estimated in August 2003. The TEDS Business Case was not appropriately updated to reflect the increased costs. As a result, TE/GE Division management could not use the TEDS Business Case to evaluate its investment decisions fully. This is critical because TEDS Release 2 is already under development.

TIGTA recommended that the IRS ensure that tasks needed for future releases are clearly established and that there are processes in place to ensure that the most current information is available to make informed investment decisions. IRS management agreed with the recommendations and has taken corrective action.
Report Reference No. 2006-10-174

[33] A favorable determination letter may no longer apply if there is a change in a statute, regulation, or revenue ruling applicable to pension plans. When this occurs, the plan must be amended to comply with the new requirements. The IRS allows plan sponsors time, called the "remedial amendment period," to incorporate tax law changes without a penalty or sanction. The remedial amendment period ended on January 31, 2004.

Providing Quality Taxpayer Service Operations

According to the IRS, its first strategic goal is to improve taxpayer service. Helping people understand their tax obligations and making it easier to participate in the tax system is the first step toward improving voluntary compliance. Each year, millions of taxpayers contact the IRS seeking assistance to understand the tax law and to meet their tax obligations by either calling the various toll-free telephone assistance lines, accessing IRS.gov, or visiting an IRS Taxpayer Assistance Center (TAC). For the 2006 Filing Season, approximately 4 million taxpayers were served at TACs, with approximately 600,000 taxpayers seeking tax law assistance.

Customer Service at Taxpayer Assistance Centers

Overall, the IRS had a successful 2006 Filing Season. TAC assistors answered 73 percent of tax law questions correctly, compared to 66 percent in the prior filing season. The IRS reported that its telephone assistors continued to answer over 90 percent of taxpayers' tax law and tax account questions correctly.

TAC assistors answered some questions incorrectly because they did not use the required tools. Other contributing factors included the complexity of the tax law and the number of potential questions assistors needed to be prepared to answer. When TAC assistors did not or could not answer questions and/or refer taxpayers to other IRS sources, taxpayers ultimately were provided with no service. In addition, taxpayers making payments were not given priority at the TACs, with average wait times of 23 minutes. As a result, TIGTA recommended that the IRS develop or modify procedures to ensure that assistors provide answers to taxpayers' tax law questions, and develop guidelines and provide training to TAC managers and assistors on how to manage customer traffic and wait times. IRS management agreed with the recommendations and is taking corrective action.
Report Reference No. 2006-40-122

Volunteer Income Tax Assistance (VITA) Program

Although return preparation at VITA sites has improved, significant barriers continue to reduce the IRS' ability to provide quality customer service at VITA sites and to measure the accuracy of prepared tax returns. Volunteers and their partner organizations play a significant role in the IRS' tax return preparation program. Relying on volunteers to deliver the program, however, has inherent risks.

The IRS must balance the needs and desires of the volunteers with its mission and goals. As it strives to achieve its mission and goals and provide accountability for its operations, the IRS needs to continually assess and evaluate its internal control structure to ensure that the VITA Program is providing accurate and reliable measurements, particularly measurements related to the accuracy of prepared tax returns. TIGTA recommended that the IRS establish a process to ensure that accuracy results are verifiable and validated; ensure that training continues to emphasize the need to use various quality assurance tools; and develop a process to verify periodically

whether or not VITA site information is entered accurately into the system. IRS management agreed with the recommendations and is taking corrective action.
Report Reference No. 2006-40-125

2006 Filing Season Toll-Free Telephone Assistance

The IRS planned and met its 2006 Filing Season toll-free telephone performance measurement goals: 81.8 percent Level of Service,[34] 295 seconds Average Speed of Answer, and 15 million Customer Account Services Assistor Calls answered. Nevertheless, the Level of Service is still below that provided during the 2004 Filing Season. In an attempt to reduce taxpayers' time waiting to speak to assistors, the IRS blocked more taxpayer calls in the 2006 Filing Season than in the 2005 Filing Season.[35] Although more callers waited less time to speak with assistors and fewer calls were abandoned while on hold, more taxpayers disconnected prior to receiving assistance.

The IRS stated that additional costs were incurred because it was not able to reduce the toll-free telephone hours of operation as planned while trying to maintain the same Level of Service during the 2006 Filing Season. The IRS had planned to reduce the toll-free telephone hours of operation from 15 hours to 12 hours, thereby requiring fewer assistors to answer toll-free telephone calls. Congress enacted legislation on November 30, 2005, restricting the IRS from reducing taxpayer services until TIGTA had completed a study of the proposed changes.[36] Nonetheless, TIGTA recommended that the IRS review all toll-free telephone information for opportunities to educate taxpayers or to inform them of self-help services on IRS.gov. IRS management agreed with the recommendation and is taking corrective action.
Report Reference No. 2006-40-162

2006 Filing Season Implementation

During the 2006 Filing Season, the IRS completed processing returns on schedule and issued refunds within the required 45 calendar days. Through May 26, 2006, the IRS had processed approximately 118.9 million individual income tax returns, including 70.9 million (59.6 percent) electronically. Most key tax law changes for the 2006 Filing Season were implemented correctly, even though the filing season was unusual due to significant tax law changes to assist taxpayers adversely affected by the devastation caused by the hurricanes that struck the Gulf Coast States in August and October 2005. In addition, significant tax law changes were included in provisions of the Working Families Tax Relief Act of 2004[37] and other legislation that became effective for the 2006 Filing Season.

[34] Level of Service is the primary measure of providing taxpayers with access to a live assistor and has been consistent over the last three filing seasons.
[35] A blocked call is one that cannot be connected immediately because either no circuit is available at the time the call arrives (e.g., the taxpayer receives a busy signal) or the system is programmed to block calls from entering the queue when the queue backs beyond a defined threshold (e.g., the taxpayer receives a recorded announcement to call back at a later time).
[36] The Transportation, Treasury, Housing and Urban Development, the Judiciary, the District of Columbia, and Independent Agencies Appropriations Act, Pub. L. No. 109-115, 119 Stat. 2396 (2006).
[37] Pub. L. No. 108-311, 118 Stat. 1166 (2004).

TIGTA made recommendations to improve the processing and accuracy of returns containing the following tax provisions:

- taxpayers over the age of 70½ receiving improper Individual Retirement Account deductions;
- eligible taxpayers not taking full advantage of the sales tax deduction; and
- single taxpayers continuing to claim a non-permissible "dual benefit" by taking both the tuition and fees deduction and the Education Credit.

IRS management agreed with most of the recommendations and is taking corrective action.
Report Reference No. 2006-40-164

The IRS' Free File Alliance

Although 6 percent more taxpayers filed electronically during the 2006 Filing Season than during the 2005 Filing Season, changes to the Free File Program reduced the number of taxpayers eligible to use the program. The Free File Program provides free online tax return preparation and filing services through IRS.gov but is limited to specific taxpayers. The October 2005 agreement between the IRS and tax software companies eliminated roughly 39 million taxpayers from eligibility for the program during 2006 by limiting it to those with an adjusted gross income[38] of $50,000 or less. As of the end of April 2006, participation in the program had dropped nearly 23 percent compared to the same time in the prior year.

The income limit was not the only factor affecting the success of the Free File Program. A significant number of taxpayers continue to prepare their returns electronically but file the returns on paper. In 2005, 72.5 percent of the 62 million taxpayers who filed their returns on paper actually prepared their returns on computers. If these taxpayers had filed electronically, the IRS could save approximately $106.7 million in processing costs. Many of the issues affecting the program are the result of the IRS having to work through the tax preparation industry to provide the Free File Program.

TIGTA's review of the Free File Program Internet page found that it could be confusing or difficult for some taxpayers to use. TIGTA recommended that the IRS expand the *Guide Me To A Service* tool to include a summary of the services available from the Alliance member companies and provide a direct link to a Spanish version of the Free File Program webpage. The Spanish version of the page should include basic information about the program and its benefits as well as a tool similar to *Guide Me To A Service* that will help Spanish-speaking taxpayers identify a provider. IRS management agreed with the recommendations and is taking corrective action.
Report Reference No. 2006-40-171

The IRS' Reduction in Toll-Free Telephone Hours of Operation

The IRS does not always have reliable management information needed to make sound business decisions. For example, the data the IRS used to make its decision to reduce toll-free telephone operating hours shows a savings of approximately

[38] Adjusted gross income is income less certain deductions and/or expenses.

$18 million, or 410 Full Time Equivalents (FTEs),[39] for FY 2004. Using FY 2005 data, the most current complete data available, TIGTA determined that the savings potential was considerably less, approximately $914,000, or 20 FTEs. The savings are reduced because the IRS implemented cost-saving measures and realized efficiency gains after FY 2004. TIGTA could not duplicate or validate many of the assumptions used to calculate the savings. The IRS also did not obtain taxpayer feedback or conduct focus groups to determine caller preferences or the impact that changing the hours of operation would have on taxpayers.

TIGTA recommended that the IRS update the proposal to change toll-free hours of operation with the most current data available, and provide the updated information to external stakeholders before proceeding with any of these changes. The IRS should also complete the Taxpayer Assistance Blueprint, the five-year study the IRS is undertaking to improve taxpayer service, before taking any action to change toll-free telephone hours so that taxpayer preferences and needs can be taken into consideration. It should also maintain complete documentation to support significant business decisions, particularly those affecting taxpayer services. IRS management agreed with the recommendations and is taking corrective action.
Report Reference No. 2006-40-169

[39] An FTE is a measure of labor hours in which one FTE is equal to eight hours multiplied by the number of compensable days in a particular fiscal year. For FY 2006, one FTE is equal to 2,080 staff hours.

Automated Underreporter (AUR) Toll-Free Telephone Operations

While the IRS is improving taxpayer services, a number of challenges remain, including its ability to provide an adequate Level of Service on its AUR toll-free telephone operations. Since 1998, the IRS has been providing direct AUR toll-free telephone service to taxpayers who have questions about AUR Program notices that they receive. The IRS has implemented a new Universal Call Routing system that allows for more efficient use of available telephone assistors and improved automated menus and messages to address customer concerns raised about their effectiveness.

The AUR Program established a 75 percent Level of Service goal for FY 2006; however, for the first six months of FY 2006, it averaged only a 61 percent Level of Service. An increase in the number of AUR notices sent to taxpayers and the resulting unanticipated increase in call volume appear to have contributed to the lower Level of Service in the second quarter of FY 2006.

In addition, the AUR Program has not established goals for monitoring the Level of Service provided to Spanish-speaking callers, who were often unable to obtain access to bilingual assistors. During FYs 2003-2005, only 40 percent of the callers requesting a Spanish-speaking assistor were able to speak with one. TIGTA recommended that the IRS increase the Level of Service goal for AUR toll-free telephone operations and increase the number of bilingual AUR Program assistors available to handle the demand from Spanish-speaking taxpayers. IRS management agreed with some of the

recommendations and is taking corrective action.
Report Reference No. 2006-40-138

Tax Exempt Organizations

Taxpayers, organizations, and the general public rely on the IRS to ensure that tax-exempt entities operate in a manner consistent with their tax-advantaged status. The IRS is working to enhance its enforcement of tax laws impacting the tax-exempt sector, but it continues to face challenges in ensuring that these organizations comply with applicable laws and regulations to qualify for tax-exempt status.

Abuses in the Tax Exempt Credit Counseling Industry

According to the IRS, the focus of the credit counseling industry has shifted over the past several years from providing education or charitable service to enrolling debtors inappropriately in proprietary debt management plans and credit-repair schemes for a fee.

In response to concerns that many credit counseling organizations were in violation of I.R.C.§ 501(c)(3) requirements, in FY 2003, the IRS began to address abuses by tax-exempt credit counseling organizations, including revoking tax-exempt status for some organizations. TIGTA's review of the IRS' plans to address these abuses identified the need to improve the IRS' inventory of credit counseling organizations. An accurate inventory would enable the IRS to ensure that its efforts can adequately cover the industry. Specifically, TIGTA found 162 (21 percent) of the 788 organizations contained on the Exempt Organizations (EO) function's inventory of credit counseling organizations may not have been properly identified.

As part of the Credit Counseling Compliance Project, EO function management developed some guidelines on how to process requests for tax-exempt status from credit counseling organizations. These guidelines were generally informal in nature.

TIGTA recommended that the IRS take necessary action to ensure that the inventory system contained accurate information related to tax-exempt credit counseling organizations and finalize and implement a plan for addressing current and future credit counseling activities. TIGTA also recommended that the IRS update and formalize application processing procedures and related training guides to ensure the consistent processing of applications for tax-exempt status by credit counseling organizations. IRS management agreed with the recommendations and is taking corrective action.
Report Reference No. 2006-10-081

Customer Identification

To effectively ensure compliance with the I.R.C., the IRS' Federal, State, and Local Governments (FSLG) office determined that it needed to identify its customer base. TIGTA determined that the manual process used to code some governmental entities has caused IRS publications to be issued unnecessarily. In addition, tax delinquency notices may have been issued to some Federal entities, which may have increased taxpayer burden.

In a prior audit,[40] TIGTA reviewed the office's initial attempts to identify its customers and reported that it needed to take a more structured approach to ensure success. At that time, the FSLG office had obtained a download of the United States Census Bureau's 2002 Government Integrated Directory (Census Bureau database) to use in identifying incomplete or inaccurate customer information on the IRS computer system. Both databases used a different format for entities' names and addresses, which made a systemic match difficult.

Since the prior audit, the FSLG office has continued to identify customers both by matching the Census Bureau database to the IRS Returns Inventory and Classification System[41] and through additional research. FSLG office management has made limited progress. Results of the address match of organizations need further analysis to ensure that the organizations are recorded correctly on the IRS computer system and coded properly as FSLG office customers.

TIGTA noted that the FSLG office had not coded any additional entities as Federal, State, or local governments on the IRS computer system from the comparison of the Census Bureau database to the IRS database. This effort was delayed because of limited resources and management turnover. Other efforts to identify government entities resulted in 1,183 additional Federal, State, and local governments being manually coded as such on the IRS computer system. Efforts to code some customers accurately were hindered by computer programming limitations. The FSLG office was aware of some of the programming limitations and attempted to overcome them manually.

TIGTA recommended that the IRS determine the best method to proceed with identification of Federal, State, and local governments and then develop a detailed action plan that includes tasks to be accomplished, responsible personnel, deadlines for completion of each task, and methods to monitor progress. In addition, the IRS should request additional computer programming changes to allow for accurate coding of customers on the IRS computer system. The IRS should also request that written IRS procedures be updated to reflect the revised process for coding Federal, State, and local governments on the IRS computer system. IRS management agreed with the recommendations and is taking corrective action.
Report Reference No. 2006-10-124

[40] *The Federal, State, and Local Governments Office Is Taking Action to Identify Its Customers, but Improvements Are Needed* (Reference Number 2004-10-104, dated May 2004).
[41] The Returns Inventory and Classification System provides users access to return and filer information related to the filing and processing of employee plans, exempt organizations, and government entities forms.

The power of taxing people and their property is essential to the very existence of government.

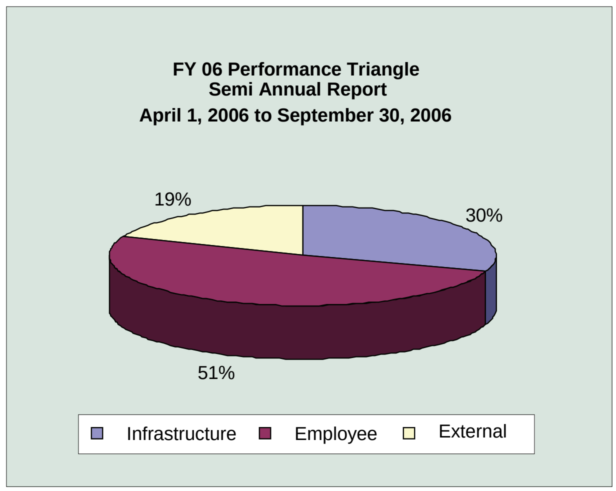
~ James Madison

Protect the Integrity of Tax Administration

TIGTA is statutorily charged with protecting the integrity of tax administration. TIGTA accomplishes this through its Office of Investigations (OI) by conducting proactive and reactive criminal and administrative investigations involving internal issues (IRS employee misconduct) and external threats or interference. OI utilizes unique strategies, tools, and methods to detect fraud, waste, and abuse, and to protect the integrity of the tax system.

Performance Model

Consistent with OI's mission of protecting tax administration and in response to the President's Management Agenda, OI created a progressive performance measurement process for its law enforcement operations. A noteworthy aspect of the performance measurement process involves OI's use of a performance model that both guides the activities of OI personnel and demonstrates the value of its accomplishments to external stakeholders. The Performance Model (illustrated on page 28) identifies the three primary areas of investigation: employee integrity; employee and infrastructure security; and external attempts to corrupt tax administration. OI opened 1,669 investigations in these three primary areas during this reporting period. The model is a valuable tool that allows OI to identify where resources are being allocated, and to ensure that OI continues to focus its investigative efforts on its core mission.



Faced with the traditionally difficult challenge of measuring the value of law enforcement activities, TIGTA created a formula for identifying positive investigative results stemming from its law enforcement activities. Rather than simply tracking the number of investigations, TIGTA's performance model measures the ratio of total investigations conducted that had a positive impact on IRS operations or the protection of tax administration.


TIGTA's
Investigative
Mission
Criminal and Administrative
Investigations
Employee Integrity
Integrity Program
Complaints Processed
External Attempts
to Corrupt Tax
Administration
Employee and
Infrastructure Security
Bribery -
Non Employee
Threat and Assault
Investigations
Manipulation/Corruption
of IRS Systems
Fraud and Other Nexus
Related Crimes
Threat Assessments
Security Advisories
Computer Intrusion
Security Assessments

Examples of some of OI's investigative activities that are factored into the performance model include:

- reports of investigation that enable the IRS to adjudicate an employee misconduct allegation;
- investigations that provide enough evidence to result in a successful criminal prosecution; and
- security advisories that notify the IRS of potential threats to its employees or infrastructure.

The performance measurement system provides relative performance information necessary for OI to effectively manage its seven investigative field divisions which cover diverse geographic and demographic areas. Through the use of the performance model, OI executives and senior managers are able to set and adjust performance expectations for each field division that account for operational conditions unique to that specific field division. Each field division plays a part in contributing its individual performance results to the organization's overall goal, thus empowering every employee to be a contributor to the agency's success. The system has proven to be an outstanding tool for managing a large, complex law enforcement organization, such as TIGTA's.

The OI performance model, which is focused on core mission-related objectives, has been used effectively for gauging almost every aspect of OI's operations. In addition to quantifying productivity, the model is a reliable source for determining budget, training, and staffing needs. OI's budget submissions are driven by the model and based on information derived from completed work products. Special agent training courses are focused specifically on investigative matters with a clear nexus to TIGTA's core mission. Any imbalance in human capital resources is detectable through the study of specific performance results. Information regarding staffing needs and geographic realignment determinations is readily available, if necessary. Management responsibility and span of control has been increased without negatively impacting the level of high-quality productivity. The value added by OI's performance measurement model illustrates comprehensible and measurable results.

Protecting Sensitive Taxpayer Information

The IRS is entrusted with maintaining sensitive taxpayer information, including personal identity information that, if misused, could result in identity theft and other fraudulent activity. OI ensures the privacy and security of taxpayer information by detecting and deterring:

- unauthorized access (UNAX) to taxpayer information by IRS employees; and
- individuals, both inside and outside of the IRS, who attempt to gain unauthorized access to IRS computer systems.

OI's Strategic Enforcement Division (SED) utilizes a variety of audit trail and forensic data analysis tools to proactively identify potential UNAX violators as well as systemic problems and weaknesses. Investigative leads developed by SED are currently substantiated as actual UNAX violations more than 90 percent of the time. As the IRS continues its efforts to modernize and expand services to taxpayers through the development of new automated systems, UNAX will be an ever-increasing threat to the security of taxpayer data. The IRS has identified more than 260 applications that will be created under this modernization effort and is working to ensure that each will have audit trail capabilities. The availability of these audit trails will provide OI with a unique opportunity to identify potential UNAX violations and properly investigate misconduct. In this reporting period, OI closed 317 UNAX investigations, of which 18 cases resulted in criminal prosecutions, and 239 cases resulted in adverse disciplinary action against IRS employees.

TIGTA has also coordinated efforts with the IRS to protect taxpayer data through a computer security program designed to secure IRS systems and equipment from unauthorized access. The TIGTA computer intrusion unit, identified as SINART (System Intrusion Network Attack Response Team), provides computer security and intrusion prevention and response capabilities for all IRS information systems, hardware, telecommunications, networks, internet sites, and vendor-supplied software products.

OI works closely with the IRS to identify incidents involving lost or stolen Government computers that contain sensitive taxpayer or personal identification information, and aggressively pursue the responsible individuals. During this semiannual reporting period, TIGTA and the IRS Computer Security Incident Response Center (CSIRC) entered into a collaborative venture in response to increased reports of theft of Government-owned computers. This TIGTA-initiated working group coordinates activities with the IRS CSIRC to mitigate any adverse impact on tax administration resulting from these computer or data thefts. The cooperative effort includes a process to accurately report and document lost and/or stolen IRS Information Technology (IT) assets. TIGTA will provide a daily electronic download to CSIRC informing them of any IT asset losses reported to TIGTA. CSIRC will also provide TIGTA with similar information reported to their network operations center. This immediate notification process will promote a swift response, and possibly preemptive measures, to protect sensitive information maintained by the IRS.

Former IRS Employee Pleads Guilty to Unauthorized Inspection of Returns or Tax Return Information

According to court documents, Mary Mattinson, a former IRS employee, was sentenced in August 2006 to 12 months of probation, 150 hours of community service, and a $25 special assessment after pleading guilty to the unauthorized inspection of tax return information. Between July 2002 and November 2004, Mattinson intentionally inspected the tax return information of six taxpayers. The taxpayers were all individuals with whom Mattinson had a personal relationship.

IRS Employee Pleads Guilty to the Unauthorized Inspection of Tax Returns and Tax Return information

In May 2006, IRS employee Edward James Goolsby pled guilty to unlawfully accessing taxpayer financial information. According to court documents, Goolsby, intentionally and unlawfully accessed IRS computers to obtain taxpayer information on a relative who was seeking custody of Mr. Goolsby's children.

Former IRS Employee Pleads Guilty to Making False Entries into IRS Databases to Hide Poor Job Performance

According to a plea agreement filed in U.S. District Court, Diana Nicholson, a former IRS employee, pled guilty in May 2006 to making false entries into IRS databases in a matter within the jurisdiction of a Government agency, and aiding and abetting. Nicholson, while employed by the IRS, was responsible for verifying electronic employer tax withholding documents known as “W-2s” for fraudulent activity. Between January 2005 and August 2005, Nicholson made numerous false entries into IRS databases concerning the W-2 records she was assigned to verify. Nicholson admitted to TIGTA that she entered false names of contact persons, false earned income, and false employment status information on the W-2 records to hide the fact that she failed to perform her duties, and to eliminate her assigned work. According to court documents, in August 2006, Nicholson was sentenced to five years supervised probation, 500 hours of community service, and a $100 special assessment.

Former IRS Employee Charged with Fraudulently Obtaining Federal Income Tax Refunds and Social Security Benefits

According to an indictment filed in U.S. District Court, Christina Lane Unser, a former IRS employee, was indicted for exceeding her authorized access to an IRS computer in order to fraudulently obtain over $11,900 in Federal income tax refunds between February 2002 and May 2004. Unser was also charged under the indictment with possessing and using the name and Social Security number of another person to fraudulently obtain approximately $43,174 in Social Security benefits. As part of Unser’s scheme to fraudulently obtain these benefits, she used someone else’s identity on documents that she signed and submitted to the Social Security Administration.

Former IRS Employee Pleads Guilty to Unauthorized Access to IRS Database

According to a plea agreement filed in U.S. District Court, Hazel Leora Jones pled guilty in April 2006 to unauthorized computer access. While an employee of the IRS, Jones accessed an IRS computer database containing taxpayer information in order to search for taxpayers with the same first and last name as one of her relatives. By means of the unauthorized computer access, Jones was able to create a list of dozens of taxpayers with the same name as her relative, with a corresponding Social Security number for each of the taxpayers. Jones provided the list to her relative knowing that he intended to use the information to commit financial fraud through identity theft for private financial gain.

Former Supervisory IRS Employee Sentenced for Exceeding Authorized Access to IRS Computers

After pleading guilty to exceeding her authorized access to IRS computers and obtaining taxpayer information from the IRS for personal benefit, former IRS employee Janine Turner was sentenced in May 2006 to one year and a day incarceration, followed by two years' supervised release, and a $3,000 fine.

Court documents indicated that between January 2000 and November 2003, Turner unlawfully accessed IRS computers on approximately 150 separate occasions for private financial gain. During the timeframe that Turner was making the accesses in question, she was employed by the IRS in a supervisory capacity with oversight responsibilities for access and disclosure of restricted taxpayer information.

Threat/Assault Investigations

IRS employees are entrusted with promoting tax compliance and enforcing the tax code. With that responsibility comes certain challenges and potential dangers. It is important that employees be able to perform their jobs without fear of retribution, and that the administration of the tax system proceeds without obstruction.

OI conducts investigations of alleged assaults, threats, interference, and potential threats against IRS employees and infrastructure, and refers the related reports to the IRS Office of Employee Protection (OEP), which is responsible for administering the Potentially Dangerous Taxpayer (PDT) program. The PDT program was established to help the IRS identify taxpayers who present a potential danger to employees attempting to do their jobs. The Caution Indicator (CAU) system was also put in place for taxpayers who did not reach the PDT threshold, but who nevertheless warranted caution upon contact. OEP is responsible for the overall operation, management, and oversight of the PDT and CAU programs.

OI maintains a cooperative relationship with OEP, and monitors the placement of PDT and CAU indicators on taxpayers as a result of OI's investigations. OI has worked together with OEP to ensure that the appropriate designations are being placed on the accounts of taxpayers who threaten the safety of IRS employees. During the reporting period, OI referred 306 cases to OEP. Additionally, 502 of the cases reviewed by OEP during the reporting period resulted in PDT or CAU designations.

TIGTA Arrests Individual for Making Threats against IRS Employee

Timothy Watson was arrested by TIGTA special agents for making threats against an IRS employee in July 2006. According to court documents, an IRS Revenue Officer reported that he received a voicemail message from Watson containing several threatening statements. Watson left the message in response to the IRS employee taking collection enforcement action against him. The criminal complaint filed against Watson noted that during an interview with TIGTA special agents, Watson acknowledged that he called the IRS employee and left him a voicemail message in which Watson made comments to the effect of cutting heads off and blowing up buildings. Subsequent to being advised by the TIGTA special agents about the seriousness and possible consequences of making threats against IRS employees, Watson contacted the same IRS employee by telephone and made additional threats.

Individual Sentenced for Threatening TIGTA Special Agent

In April 2006, David D'Addabbo was indicted for corruptly endeavoring to obstruct and impede the due administration of the Internal Revenue laws, mailing threatening communications, and threatening Federal officials. According to court documents, D'Addabbo allegedly signed and filed a petition in September 2005 with the U.S. Tax Court threatening an IRS employee. D'Addabbo allegedly stated in the petition that if the IRS employee persisted in his efforts to collect income taxes from another individual, the IRS employee would be tried by a jury and a penalty of death by firing squad would "be sought." D'Addabbo also allegedly filed a second petition with the U.S. Tax Court in October 2005 that purported to order the IRS to return all monies collected from another individual and to stop all liens and levies. In this second petition, D'Addabbo allegedly made statements warning that anyone attempting to collect taxes would be "tried by a jury of common people," and "could be found guilty of treason and taken immediately to a firing squad."

According to court documents, after being arrested by TIGTA special agents in connection with his alleged threats to the IRS employee, and while being transported to a correctional facility, D'Addabbo threatened to assault and murder two of the TIGTA special agents.

In August 2006, D'Addabbo pled guilty to threatening a Federal official. D'Addabbo was sentenced to time already served in prison, and three years supervised release conditional on his participation in anger management counseling and adherence to his prescribed medication regimen. D'Addabbo also was ordered to pay a special assessment fee of $100.

Fraud Investigations

OI special agents investigated a number of fraud cases during this reporting period. The following are examples of cases that involved particularly egregious fraudulent activity:

IRS Employee Sentenced for Defrauding FEMA of Hurricane Katrina Aid

In May 2006, IRS employee Barney Spears was sentenced after pleading guilty to making a false claim with the Federal Emergency Management Agency (FEMA) for Hurricane Katrina disaster relief benefits.

According to court documents, Spears was indicted for fraudulently obtaining FEMA funds after he filed a claim with FEMA stating that he resided in New Orleans, Louisiana, and had an "essential need for food, shelter, and clothing." Spears actually worked and resided in Houston, Texas. Spears received a $2,000 payment from FEMA as a direct result of the fraudulent information he provided to FEMA.

Spears was sentenced to six months in prison, three years of supervised release, and restitution payments to the U.S. Government in the amount of $4,358.

Individual Pleads Guilty to Conspiracy to Defraud IRS

According to a plea agreement filed in U.S. District Court, in April 2006, Russell Bradd II pled guilty to the charge of conspiracy to defraud the Government concerning his involvement in a scheme to obtain payments from the IRS after filing fraudulent Federal income tax refund claims. According to court documents, Bradd operated a financial services firm which purported to provide income tax related services to some of its clients. Bradd would solicit these clients to join a "tax investment program." Once the client signed up for the program, Bradd would provide that client's tax-related information to another individual involved in the scheme. The other individual would then prepare and file false tax returns or false amended tax returns claiming false and fictitious credits and deductions on behalf of the clients.

At least one hundred fraudulent returns were filed by the individual's firm using these fraudulent practices. The total amount of the refunds claimed was at least $362,691, and the IRS actually issued payments of approximately $275,182. The clients involved in the scheme typically would not see the tax returns that were filed and would only be contacted when the refund checks arrived. The clients were told that the proceeds from the checks would be split between them and the individual; however, in many instances, the clients did not receive any payments resulting from the tax returns filed under their names. In September 2006, Bradd was sentenced to 18 months in prison, three years of supervised release, and restitution payments to the U.S. Government in the amount of $275,182.

Individual Sentenced for Fraud in Scheme Involving False Representations about Ability to "Fix" Pending Criminal Tax Investigation

In August 2006, Greg Takesian was sentenced after pleading guilty in May 2006 to wire fraud. Between October 2002 and April 2003, Takesian and two co-schemers participated in a plan to obtain money from a taxpayer by fraudulently representing their ability to "fix" a pending criminal tax investigation against the taxpayer. Takesian, upon learning that the taxpayer was the subject of a criminal tax investigation, informed the taxpayer that he had a friend who knew someone who could help the taxpayer. The taxpayer provided Takesian with a check for $20,000, which Takesian deposited in his bank account. In November 2002, Takesian wired $15,000 from his bank account to the bank account of one of the co-schemers.

In December 2002, Takesian and his two co-schemers met with the taxpayer. During the meeting, one of the co-schemers stated that he was a former IRS special agent and the he would soon bring the investigation against the taxpayer to an end.

In August 2006, Takesian was sentenced in U.S. District Court to a term of two years of probation, the first two months of which were to be under home confinement, a special assessment of $200, and a fine of $3000.

Individual Indicted in Wire Fraud Scheme Using Fraudulent IRS Documents

In May 2006, Christopher Wade was charged by a Federal grand jury with wire fraud in a scheme involving fraudulent IRS documents. According to court documents, Wade defrauded several people by representing to the victims that he would purchase vehicles for them at an IRS auction, when in fact there was no such auction. On one occasion, Wade even produced a letter on fabricated IRS letterhead as part of his scheme to defraud one of his victims. The letter detailed the vehicles Wade purportedly purchased from the IRS on behalf of the victim. Wade is known to have obtained more than $38,000 from various victims, including about $10,250 wired to him via Western Union by one of the victims.

Private Collection Agencies

An emerging issue impacting OI is the IRS Private Debt Collection (PDC) initiative, designed for contracting with Private Collection Agencies (PCAs) for the collection of delinquent Federal tax debts, as authorized by the 2004 American Jobs Creation Act. The law intends to subject the PCAs to the same stringent taxpayer protection and privacy rules under which IRS employees currently work. The IRS also developed guidelines for the PCAs, including background checks on all personnel associated with the project and completion of a mandatory training program directed by the IRS. The PCAs will receive tax collection cases from the IRS in which the taxpayer has not disputed the liability. The PCAs will not be authorized to take enforcement actions (liens, levies, or seizures), or work on technical issues (offers in compromise, bankruptcies, hardships, or litigation). Over the course of 10 years, the IRS expects to contract with as many as 10 private collection firms to help collect $1.4 billion in outstanding taxes.

Consistent with TIGTA protecting tax administration, OI has played a critical role in the implementation of the PDC initiative by providing oversight, input, and support to the IRS. OI reviewed the procurement documents used by the IRS during the bid solicitation phase that resulted in the IRS awarding PCA contracts to three companies. This review allowed OI to address concerns with the IRS about:

- the background investigation process for PCA employees;
- physical security issues;
- IRS' distribution of cases to the PCAs;
- processes and requirements for PCAs to report issues concerning improprieties to TIGTA; and
- the content and method for training PCA employees.

OI also participated in the production of a training video to be used in required PCA employee training. During this reporting period, OI made on-site visits to the PCAs, and provided presentations to 139 PCA employees and managers. OI's Strategic Enforcement Division (SED) also collaborated with the IRS Computer Security Incident Response Center (CSIRC) to conduct on-site vulnerability tests of the computer systems maintained by the three PCAs that received contracts from the IRS.

As a result of the PDC initiative, OI anticipates an increase in overall workload arising from complaints concerning contract employees violating taxpayer rights or privacy, complaints about taxpayers offering bribes, assaults and/or threats, and issues regarding contract/procurement fraud, as well as the increased need for TIGTA to provide integrity awareness briefings to contract employees.

Procurement Fraud Investigations

OI's Procurement Fraud Section (PFS), located within the Special Inquiries and Intelligence Division (SIID), is committed to the identification and investigation of procurement fraud within the IRS. PFS plays a valuable role in protecting the integrity of IRS procurements. Currently, the combined value of active IRS procurements, accounting for each contract's base and option years, is $22 billion. Special agents within the PFS possess the specialized skills necessary to identify contract fraud and ensure that individuals and businesses responsible for such fraud are held accountable. These investigations, while very labor and time intensive, relate directly to TIGTA's core mission of preventing external attempts to corrupt the IRS' ability to administer the tax laws effectively. These types of investigations often result in criminal indictments, civil complaints, administrative adjudications, debarments from Government contracting, and referrals to the Office of Audit. The PFS achieves its goals in this area through proactive and reactive investigations, fraud awareness presentations, investigative initiatives, data analysis, and liaison.

Federal Government Contractor Sentenced for Submitting False Claims

Fulton & Associates, Inc. (FAI), a U.S. Government contractor, pled guilty in May 2006 to submitting false claims to the U.S. Government. According to court documents, in 2000, FAI, a certified Section 8(a) Small Business Government Contractor, entered into a contract with the IRS to provide telecommunication software designed to integrate a myriad of the IRS' telecommunication network systems. The contract was in place until 2005. During 2001, FAI submitted several invoices to the IRS for payment when there was no reasonable basis to believe that the labor listed on the invoice had been performed on the contract. These false claims resulted in a loss to the IRS of approximately $6,854.22. As part of the plea agreement, FAI agreed to pay a fine of $8,000 and provide restitution to the IRS in the amount of $6,854.22, and a $400 special assessment.

High-Tech Crime Fighting

The use of high-tech crime fighting equipment is essential to modern law enforcement's efforts to conduct criminal investigations. OI, through its Technical and Firearms Support Division (TFSD), places a high priority on making available and employing high-tech equipment to assist TIGTA special agents in their investigations.

An example of one of the technologies available to TIGTA special agents through TFSD involves the use of video-over-Internet technology. This technology allows law enforcement authorities, using a computer and a secure Internet connection, to remotely view images captured by surveillance cameras. OI was able to utilize this technology when an unknown substance/hazardous material incident occurred in an IRS Service Center's Receipt and Control Extraction Unit. The technology allowed OI to obtain information regarding the nature of the threat in an accurate and timely fashion.

OI has also successfully utilized this technology during investigations to identify individuals involved in the theft of money and/or equipment from Government employees. Hidden surveillance cameras equipped with motion sensors that send alarms and images to investigators via the Internet can be set up at the site of suspected ongoing criminal activity. The video stream of the perpetrator committing the crime can be recorded digitally and used for criminal prosecution. The use of covert surveillance cameras that enable real-time video to be monitored from remote locations enhances OI's investigative capacity to identify and arrest thieves.

OI has also used video technology along with specially programmed computers to catch individuals stealing Government computers. These computers are programmed to receive a signal from a remote location and send a response if they are still in place. If the computer does not respond to the signal, OI will be alerted to the possible theft. If stolen and used to access the Internet from another site, the computers have a special program that automatically notifies OI investigators of the Internet address of their new location. This technology has enabled OI to identify criminal suspects, and recover stolen Government property.

OI's high-tech crime-fighting equipment also includes advanced tools for forensic analysis of evidence. TIGTA's Forensic Science Laboratory (FSL) was established in 1981 and provides timely crime laboratory services in direct support of TIGTA investigations and ensures that OI receives responsive and high-quality crime laboratory services. These services include**:**

- handwriting/hand printing analysis;
- document identification and analysis;
- printing and paper analysis;
- latent print processing;
- fingerprint database searches;
- digital image processing/visual information; and
- expert witness testimony.

Additionally, the FSL provides guidance on:

- proper evidence collection and handling methods;
- forensic science training;
- assistance with crime scene processing;
- informational bulletins related to the forensic sciences; and
- liaison with other forensic science laboratories.

During the reporting period, TFSD successfully employed technologies such as covert video surveillance cameras and Global Position System technology in support of OI investigations. FSL also provided valuable forensic support to an investigation by conducting a latent fingerprint examination of documents associated with a theft. Some examples of cases in which TFSD and FSL assisted OI special agents in resolving their investigations include:

Individual Pleads Guilty to Theft of Federal Government Property and Embezzlement by Bank Employee

Ursula Nicole Moore was indicted and arrested in June 2006 for theft of Government property and embezzlement by a bank employee. According to court documents, Moore was employed by a bank at an IRS lockbox facility that received taxpayer remittance checks. Between approximately February 2006 and April 2006, Moore embezzled several checks and a money order made payable to the IRS, with an approximate value of $29,770. In August 2006, Moore pled guilty to one count of theft of U.S. Government property.

Individual Pleads Guilty to Paying Gratuity to IRS Official

In August 2006, Thanh Nguyen was sentenced to pay a fine of $2,000 and a special assessment fee of $100. According to a plea agreement filed in U.S. District Court, Nguyen pled guilty to a one count Information charging him with paying a gratuity to an IRS representative. In March 2005, after he learned that his 2002 individual income tax return was being reviewed by the IRS, Nguyen paid the IRS representative $2,000 in exchange for a "no change" letter from the IRS indicating that the IRS would not seek to impose any additional taxes or penalties for the period being reviewed.

Former IRS Employee Pleads Guilty to Theft of IRS Computers

According to a plea agreement filed in U.S. District Court, Scottie J. Ware, a former IRS employee, pled guilty in June 2006 to one count of theft of a U.S. Government laptop computer. Ware was originally charged with the theft of four U.S. Government laptop computers and one personal digital assistant (PDA) with a cumulative value of approximately $9,004. The computers and the PDA were in Ware's possession by virtue of his employment as an Information Technology Specialist with the IRS.

Former IRS Employee Pleads Guilty to Making False Statements to TIGTA Special Agent

In August 2006, former IRS employee Joseph Yan pled guilty to making false statements and representations to a TIGTA special agent. According to a plea agreement filed in U.S. District Court, Yan, who was employed by the IRS at the time, made false statements and representations to a TIGTA special agent that he had not prepared, signed, or filed certain U.S. Individual Income Tax Returns for several tax years.

Combating "Phishing" Schemes

OI has been diligent in combating a multitude of recent "phishing" schemes designed to emulate IRS operations. These scams consist of e-mail messages sent to taxpayers claiming to be from the IRS and promising a tax refund once the recipients provide personal identity and financial information. The e-mail directs the taxpayer to either submit personal information directly or visit a Web site where they are asked to update their personal information. The type of information that is often requested includes passwords, Social Security numbers, and bank and credit card account information. These fraudulent Web sites bear no connection to actual IRS operations and are specifically designed to trick taxpayers into providing their personal and financial information. Once the taxpayers provide this information, they are further victimized when their identities are used to perpetrate other crimes or funds are stolen directly from their bank accounts. TIGTA worked closely with the IRS to create a joint IRS-TIGTA reporting site and by September 2006, 13,860 complaints had been received which identified 145 separate schemes traceable to 28 different countries. OI worked aggressively to shut down several of the related Web sites to minimize the loss to taxpayers and protect the reputation of the IRS.

To alert taxpayers to potential identity theft involved in phishing schemes, TIGTA's Inspector General (IG) recorded a public service announcement for radio broadcast that explained the details of this type of scam, and informed taxpayers about what to do if they were to receive a related e-mail or fall victim to these schemes. Additionally, the Deputy Inspector General for Investigations appeared on MSNBC and NBC to help the American public understand phishing schemes and to identify what taxpayers should do if they become the target of a fraudulent e-mail message. TIGTA also issued a Computer Security Bulletin on its Web site addressing this issue. The media, including major newspapers such as the *Washington Post*, *Washington Times*, *New York Daily News*, and *Chicago Tribune*, helped to spread the message about these schemes and TIGTA's role in combating them.

Criminal Intelligence Program

The Inspector General Act (5 U.S.C. app. 3 § 8D(k)(1)(C)), along with Treasury Order 115-01, charged TIGTA with "protecting the Internal Revenue Service against external attempts to corrupt or threaten employees ..." In response, OI established the Criminal Intelligence Program (CIP), another tool used to protect the administration of taxes. The overall purpose of the CIP is to prevent individuals and groups from threatening, assaulting, intimidating, or otherwise impeding IRS employees in the performance of their duties, or obstructing the administration of the internal revenue laws. The CIP focuses on proactively identifying persons or groups that advocate activities against IRS employees or facilities, or against the Federal Government in general. This generally involves the activities of groups or individuals involved in domestic terrorism but could also involve trans-national terrorist activities. The CIP also conducts counter-terrorism investigations of individuals and associated anti-government groups identified through proactive intelligence-gathering efforts. Through the CIP, OI works closely with other Federal, State and local law enforcement organizations, IRS personnel, open source media, and other entities to accomplish its mission. OI uses information obtained from these sources to evaluate whether there is a basis for further inquiry or investigation. OI's involvement with the Joint Terrorism Task Force (JTTF) is a prime example of the methods used by OI to exchange information in support of the CIP. OI has agents assigned to the JTTF on full-time and part-time bases to enhance the United States' capability to deter, defeat, and respond vigorously to terrorism. This also provides OI with a means of effectively and efficiently obtaining information related to individuals and groups that pose a threat to the safety of IRS employees and facilities.

The CIP is also responsible for developing and disseminating Security Advisories that advise TIGTA and IRS management officials of any significant activities by anti-government individuals or groups that may threaten the safety of IRS personnel and facilities. CIP Security Advisories also educate OI special agents about officer safety issues. To date, TIGTA CIP has issued eight of these Security Advisories in 2006. The information contained in the advisories is generally shared by OI special agents with other law enforcement entities.

Cease and Desist Letters

Another valuable tool used by OI resulted from the Secretary of the Treasury delegating to TIGTA the authority to investigate violations of Title 31 U.S.C. § 333, Misuse of Treasury Name or Symbol. Through this newly delegated authority, TIGTA is able to investigate private entities that make false representations intimating an affiliation with the IRS to deceive taxpayers into believing that the entity is actually endorsed by the IRS. The delegation included the ability to assess civil penalties, and issue cease and desist letters to violators. Cease and desist letters instruct the addressee to immediately terminate conduct that violates the statute.

During this reporting period, OI issued four cease and desist letters to individuals and/or businesses, directing them to discontinue their illegal use of IRS or Treasury names or symbols on advertisements or solicitations.

Title 31 U.S.C. § 333. Prohibition of misuse of Department of the Treasury names, symbols, etc.

(a) General Rule— No person may use, in connection with, or as a part of, any advertisement, solicitation, business activity, or product, whether alone or with other words, letters, symbols, or emblems:

(1) the words "Department of the Treasury," or the name of any service, bureau, office, or other subdivision of the Department of the Treasury,

(2) the titles "Secretary of the Treasury" or "Treasurer of the United States" or the title of any other officer or employee of the Department of the Treasury,

(3) the abbreviations or initials of any entity referred to in paragraph (1),

(4) the words "United States Savings Bond" or the name of any other obligation issued by the Department of the Treasury,

(5) any symbol or emblem of an entity referred to in paragraph (1) (including the design of any envelope or stationery used by such an entity), and

(6) any colorable imitation of any such words, titles, abbreviations, initials, symbols, or emblems, in a manner which could reasonably be interpreted or construed as conveying the false impression that such advertisement, solicitation, business activity, or product is in any manner approved, endorsed, sponsored, or authorized by, or associated with, the Department of the Treasury or any entity referred to in paragraph (1) or any officer or employee thereof.

Proactive Investigative Initiatives

OI uses proactive investigative initiatives, known as Local Investigative Initiatives (LII) and National Investigative Initiatives (NII), to seek out and identify potential fraud, waste and abuse.

Proactive investigative initiatives examine systemic weaknesses or potential program vulnerabilities. They are based on fraud identified during an investigation or designed to detect violations that may otherwise go undetected. An LII or NII may identify perpetrators, generate investigations, or result in referrals to the IRS or other TIGTA components. Proactive investigative initiatives are conducted on internal and external targets or issues, and generally are predicated on intelligence information indicating that an operation or procedure is vulnerable to fraud or abuse.

The objective of an LII is to probe for potential systemic weaknesses, fraud, abuse, or tax administration vulnerability within IRS operations, and to identify individuals who are exploiting IRS programs or procedures. An NII is initiated when TIGTA has identified a systemic weakness and/or fraud through an LII that has significant national implications.

In June 2006, OI initiated an NII to investigate IRS employees throughout the country who may have fraudulently obtained Federal Section 8 housing assistance benefits. The impetus for the NII came from previous OI investigative efforts that identified several IRS employees who had provided false information and submitted false documentation to local housing authorities to obtain Federal housing subsidies in the amount of $42,924. As a result of these initial investigations, OI initiated an LII to identify other potential subjects with the assistance of the U.S. Department of Housing and Urban Development Office of the Inspector General (HUD OIG). In April 2006, HUD OIG provided data to OI concerning IRS employees nationwide who may have fraudulently received Federal housing subsidies. This prompted the initiation of an NII. To date, 64 leads have been generated from the NII, resulting in the initiation of 31 investigations of IRS employees.

Former IRS Employee Sentenced for Fraudulently Obtaining Federal Housing Benefits

In June 2006, Waconda Nolan was sentenced after pleading guilty to submitting a document containing false information to obtain benefits under the Federal Section 8 housing assistance program. Nolan, who worked for the IRS at the time, falsely reported to the Atlanta Housing Authority that she only worked 24 to 30 hours per week and that her gross earnings in the preceding 12 months were only $14,016. In actuality, Nolan worked more hours than she reported, and her gross earnings for the 12 month period "were materially more than $14,016." According to court documents, Nolan was sentenced in Federal District Court to a term of five years' probation, restitution to the U.S. Department of Housing and Urban Development in the amount of $13,260, and 40 hours of community service.

Former IRS Employee Sentenced After Providing Fraudulent Information to Obtain Federal Housing Benefits

In June 2006, Kelly M. Summerour was sentenced after pleading guilty to submitting a document containing false information to obtain benefits under the Federal Section 8 housing assistance program. According to court documents, Summerour, who worked for the IRS at the time, falsely reported to the Decatur/DeKalb Housing Authority located in Georgia that her total household income was $22,614, when in fact her base salary from her employment with the IRS was substantially in excess of that amount. Summerour was sentenced to a term of five years' probation and restitution to the U.S. Department of Housing and Urban Development in the amount of $9,551.

Individual Indicted for Theft of Tax Remittances

According to an indictment filed in U.S. District Court, in August 2006, Fred I. Ibia, who formerly worked at an IRS lockbox center, was indicted by a Federal grand jury for theft of Government property and embezzlement by a bank employee. Ibia was employed by a subcontractor to one of the commercial banks utilized by the IRS to operate its lockbox centers across the U.S. As part of his job duties, Ibia was responsible for processing tax remittance checks sent by taxpayers to the lockbox center where he was employed. According to court documents, Ibia was charged with the theft and embezzlement between February 2005 and September 2005 of 22 taxpayer remittance checks with a cumulative value of $543,865.

Outreach

Outreach initiatives by OI represent another example of proactive efforts that have proven to be very effective in producing results. OI's outreach initiatives are an integral part of its operational strategy. They allow TIGTA to educate and have contact with large segments of the IRS workforce and other external entities regarding the prevention of fraud in the tax system. They also allow TIGTA to develop relationships with these groups that assist in the identification of crimes against the IRS and taxpayers. During the reporting period, TIGTA provided presentations to more than 54,000 IRS employees, external entities including tax professional organizations, and briefings for cognizant entities within the IRS, such as the Office of Employee Protection and the Commissioner of Internal Revenue.

OI has invested in the education of IRS employees by providing integrity and fraud awareness presentations to Revenue Officers and Revenue Agents at their Continuing Professional Education (CPE) conferences. During the reporting period, OI provided 79 awareness presentations to 1,643 Revenue Officers and 225 integrity and awareness presentations to 10,165 Revenue Agents. OI's outreach efforts also include involvement with other organizations within the IRS, such as the Hispanic Internal Revenue Employees, Association for the Improvement of Minorities, and the Asian Pacific Internal Revenue Employees. OI also interacts with other external entities through job fairs and other events involving associations possessing multi-agency law enforcement memberships.

OI's outreach strategy includes an effort to partner with the tax preparer and practitioner community in preventing fraud in the tax system. OI worked diligently to educate tax professionals by providing 32 awareness presentations to 2,894 tax practitioners and preparers at professional conferences during the reporting period. OI also provided input to publications utilized by the tax professional community.

OI continues to foster its relationship with U.S. Attorneys' offices (USAOs) throughout the nation. OI makes a significant effort to share its expertise and increase awareness among the various USAOs concerning criminal threats against the integrity of the tax system. These efforts have resulted in more cases being accepted for prosecution by the USAOs, especially for those crimes involving unauthorized access by IRS employees to confidential taxpayer information.

Awards and Special Achievements

TIGTA Director of Human Capital, Ken Casey (right), accepts Tele-Vision Award from Eric Dunham of GSA.

TIGTA Recognized for Excellence in Telework Leadership

At the Telework Exchange Town Hall meeting held on Thursday, June 15, 2006, in Washington, DC, TIGTA received the 2006 Tele-Vision Award for Excellence in Telework Leadership. This marks the third time TIGTA has been singled out for its outstanding achievement in the telework field. Ken Casey, joined by Donna Leach and Ben Trapp, accepted the award for TIGTA, which was presented by Eric Dunham, Acting Deputy Associate Administrator for Real Property Management at the General Services Administration. The Tele-Vision Award recognizes excellence in Government Telework programs that demonstrate a sound, sustainable approach to telework while supporting agency goals and objectives and leveraging industry standards.

TIGTA Employee Receives Future HR Leaders Award

During the reporting period, Donna Leach, Human Resource Specialist, was selected as a recipient for the Future HR Leaders Award by the Human Capital Magazine. The Human Capital Magazine recognizes the contribution of human resources professionals who are making significant contributions within their organizations and to the human resources profession. Donna was selected for her outstanding contributions to the Telework and

Hoteling programs. Her efforts contributed to TIGTA's earned recognition for excellence in its Telework and Hoteling programs. The award presentation was given at the Society for Human Resources Management Conference held at the Washington Convention Center.

TIGTA Employees Selected for PCIE Awards for Outstanding Achievement

The President's Council on Integrity and Efficiency/Executive Council on Integrity and Efficiency (PCIE/ECIE), which is comprised of Inspectors General appointed by the President, annually recognizes those in the Inspector General community who have made outstanding audit, inspection, investigative, or information technology achievements. Three individuals and eight teams from TIGTA were selected as recipients of Awards for Excellence. In addition, three TIGTA employees served on inter-agency teams that were selected as Award for Excellence recipients.

- Ms. Doris Cervantes, Senior Auditor, Plantation, FL
- Mr. Darryl J. Roth, Senior Auditor, St. Louis, MO
- Mr. William Tran, Senior Auditor, Los Angeles, CA
- Customer Service Audit Team
- Excise Files Information Retrieval Systems Audit Team
- Inspections and Evaluations Team
- Prisoner Refund Fraud Team
- Section 527 Filing Compliance Audit Team
- Tax Practitioner Audit Team
- Development Environment Virtualization
- Atlanta Field Division and Technical and Firearms Support Division
- Philadelphia Earnings Integrity Team (inter-agency)
- Travel Rebates Investigations Team (inter-agency team that included TIGTA Special Agent Lisa Pace)

Congressional Testimony

Inspector General J. Russell George appeared before Congress four times during this semiannual reporting period. The following are summaries of his testimony.

On **April 6, 2006,** Mr. George testified before the House Committee on Ways and Means' Subcommittee on Oversight regarding the IRS' Fiscal Year 2007 appropriations request. Mr. George noted that the IRS' planning for the 2006 tax season had been unusually difficult due to the tax law changes enacted in response to Hurricanes Katrina and Rita. Nevertheless, the IRS had accurately updated its tax products and computer programming to incorporate these and other changes for the 2006 filing season.

Mr. George also told the subcommittee that the IRS has seen steady growth in electronic filing of income tax returns and expects that growth to continue. TIGTA found that the increase in electronic filing during the 2006 filing season appears to be the result of a greater number of taxpayers paying for online filing services because of income restrictions placed on taxpayer use of the IRS' Free File Program. This, along with other factors, may slow down the anticipated growth in electronic filing.

On **April 27, 2006**, Mr. George testified before the Senate Committee on Appropriations' Subcommittee on Transportation, Treasury, the Judiciary, Housing and Urban Development, and Related Agencies regarding the IRS' Fiscal Year 2007 appropriations request. Mr. George discussed the IRS' taxpayer assistance programs, specifically the IRS' plans to close some Taxpayer Assistance Centers and reduce the operating hours of its toll-free telephone service. Mr. George told the subcommittee that TIGTA auditors concluded that the IRS did not have sufficient or reliable data to determine the effects on taxpayers of the proposed closures or cutbacks. In addition, Mr. George said that although the IRS' Business Systems Modernization Program is attempting to address major challenges, the program remains behind schedule, over budget, and is not delivering all of the promised functionalities.

Regarding the IRS' initiative to use private debt collection agencies to help collect tax debt, Mr. George noted that TIGTA is working closely with the IRS to address concerns about security, the protection of taxpayers' rights and privacy, and the development of integrity and fraud awareness training for contract employees. While discussing the tax gap, Mr. George said that TIGTA's evaluation of the IRS's estimated tax gap found that the IRS does not have sufficient information to assess accurately the overall tax gap or the voluntary compliance rate.

On **July 26, 2006**, Mr. George testified extensively on the tax gap before the Senate Finance Committee's Subcommittee on Taxation. He told the subcommittee that the IRS lacks new information about employment, corporate, and other taxpayer segments. Among his recommendations for closing the tax gap, Mr. George said that third-party reporting could significantly impact the tax gap, noting that the IRS estimates that compliance rates are as high as 96 percent when third-party reporting is involved. Mr. George noted that under-reporting by individuals with business income accounts for over 40 percent, or approximately $130 billion, of the annual tax gap. Mr. George said that IRS compliance efforts are limited by the lack of available information on the cost basis of investments, which could be used to verify investment gains or losses.

Mr. George told the subcommittee that to address the tax compliance challenges presented by those who make foreign investments, TIGTA has recommended that the IRS make better use of foreign source income information. On a final note, Mr. George addressed IRS staffing levels. He said that the enforcement staffing level is not much higher today than the 10-year low it experienced in 2003.

On **September 26, 2006**, Mr. George testified before the Senate Committee on Homeland Security and Governmental Affairs' Subcommittee on Federal Financial Management, Government Information, and International Security during its hearing on uncollected taxes and issues of transparency. Mr. George pointed out that the three primary sources of the tax gap are under-reporting, non-payment, and non-filing. Third-party reporting and mandatory withholding of non-employee compensation payments could significantly address the under-reporting and non-filing segments of the gap, he said. In addition, improvement is needed to address inaccurately reported Taxpayer Identification Numbers by independent contractors.

Mr. George also noted that investments made abroad by U.S. residents have nearly tripled in recent years. To address this compliance challenge, TIGTA has recommended that the IRS make better use of foreign-source income information received from tax treaty countries. In summary, Mr. George said that a massive change in voluntary compliance is unlikely to be achieved without significant changes to the tax system.

Audit Statistical Reports

Reports with Questioned Costs

TIGTA issued six audit reports with questioned costs during this semiannual reporting period.[1] The phrase "questioned cost" means a cost that is questioned because of:

- an alleged violation of a provision of a law, regulation, contract, or other requirement governing the expenditure of funds;
- a finding, at the time of the audit, that such cost is not supported by adequate documentation (an unsupported cost); or
- a finding that expenditure of funds for the intended purpose is unnecessary or unreasonable.

The phrase "disallowed cost" means a questioned cost that management, in a management decision, has sustained or agreed should not be charged to the Government.

Reports with Questioned Costs			
Report Category	**Number**	**Questioned Costs (in thousands)**	**Unsupported Costs (in thousands)**
1. Reports with no management decision at the beginning of the reporting period	8	$15,619	$3,280
2. Reports issued during the reporting period	6	$153,110	$82,197
3. Subtotals (Item 1 plus Item 2) [2]	**14**	**$168,729**	**$85,477**
4. Reports for which a management decision was made during the reporting period[3]			
a. Value of disallowed costs	2	$10	$1
b. Value of costs not disallowed	4	$3,251	$2,623
5. Reports with no management decision at the end of the reporting period (Item 3 minus Item 4)	**9**	**$165,468**	**$82,853**
6. Reports with no management decision within six months of issuance	6	$12,855	$684

[1] See Appendix II for identification of audit reports involved.
[2] Difference due to rounding
[3] Includes one report in which IRS management disallowed part of the questioned cost.

Reports with Recommendations That Funds Be Put To Better Use

TIGTA issued four reports with recommendations that funds be put to better use during this semiannual reporting period.[1] The phrase "recommendation that funds be put to better use" means a recommendation that funds could be used more efficiently if management took actions to implement and complete the recommendation, including:

- reductions in outlays;
- deobligations of funds from programs or operations;
- costs not incurred by implementing recommended improvements related to operations;
- avoidance of unnecessary expenditures noted in pre-award reviews of contract agreements;
- preventing erroneous payment of the following refundable credits: Earned Income Tax Credit and Child Tax Credit; and
- any other savings that are specifically identified.

The phrase "management decision" means the evaluation by management of the findings and recommendations included in an audit report, and the issuance of a final decision concerning its response to such findings and recommendations, including actions concluded to be necessary.

Reports with Recommendations That Funds Be Put To Better Use

Report Category	Number	Amount (in thousands)
1. Reports with no management decision at the beginning of the reporting period	0	$0
2. Reports issued during the reporting period	4	$105,449
3. Subtotals (Item 1 plus Item 2)	**4**	**$105,449**
4. Reports for which a management decision was made during the reporting period[2] a. Value of recommendations to which management agreed		
i. Based on proposed management action	2	$102,196
ii. Based on proposed legislative action	0	$0
b. Value of recommendations to which management did not agree	2	$3,253
5. Reports with no management decision at end of the reporting period (Item 3 minus Item 4)	**0**	**$0**
6. Reports with no management decision within six months of issuance	0	$0

[1] See Appendix II for identification of audit reports involved.

Reports with Additional Quantifiable Impact on Tax Administration

In addition to questioned costs and funds put to better use, the Office of Audit has identified measures that demonstrate the value of audit recommendations to tax administration and business operations. These issues are of interest to IRS and Treasury executives, Congress, and the taxpaying public, and are expressed in quantifiable terms to provide further insight into the value and potential impact of the Office of Audit's products and services. Including this information also promotes adherence to the intent and spirit of the Government Performance and Results Act (GPRA).

Definitions of these additional measures are:

Increased Revenue: Assessment or collection of additional taxes.

Revenue Protection: Proper denial of claims for refunds, including recommendations that prevent erroneous refunds or efforts to defraud the tax system.

Reduction of Burden on Taxpayers: Decreases by individuals or businesses in the need for, frequency of, or time spent on contacts, record keeping, preparation, or costs to comply with tax laws, regulations, and IRS policies and procedures.

Taxpayer Rights and Entitlements at Risk: The protection of due process rights granted to taxpayers by law, regulation, or IRS policies and procedures. These rights most commonly arise when filing tax returns, paying delinquent taxes, and examining the accuracy of tax liabilities. The acceptance of claims for and issuance of refunds (entitlements) are also included in this category, such as when taxpayers legitimately assert that they overpaid their taxes.

Taxpayer Privacy and Security: Protection of taxpayer financial and account information (privacy). Processes and programs that provide protection of tax administration, account information, and organizational assets (security).

Inefficient Use of Resources: Value of efficiencies gained from recommendations to reduce cost while maintaining or improving the effectiveness of specific programs; resources saved that would be available for other IRS programs. Also, the value of internal control weaknesses that resulted in an unrecoverable expenditure of funds with no tangible or useful benefit in return.

Reliability of Management Information: Ensuring the accuracy, validity, relevance, and integrity of data, including the sources of data and the applications and processing thereof, used by the organization to plan, monitor, and report on its financial and operational activities. This measure will often be expressed as an absolute value (i.e., without regard to whether a number is positive or negative) of overstatements or understatements of amounts recorded on the organization's documents or systems.

Protection of Resources: Safeguarding human and capital assets, used by or in the custody of the organization, from inadvertent or malicious injury, theft, destruction, loss, misuse, overpayment, or degradation.

The number of taxpayer accounts and dollar values shown in the following chart were derived from analyses of historical data, and are thus considered potential barometers of the impact of audit recommendations. Actual results will vary depending on the timing and extent of management's implementation of the corresponding corrective actions, and the number of accounts or subsequent business activities impacted from the dates of implementation. Also, a report may have issues that impact more than one outcome measure category.

Reports with Additional Quantifiable Impact on Tax Administration			
Outcome Measure Category	**Number of Reports[1]**	**Number of Taxpayer Accounts**	**Dollar Value (in thousands)**
Increased Revenue	6	2,337	$1,084,070
Revenue Protection	3	17,076	$324,005
Reduction of Burden on Taxpayers	9	568,981	$0
Taxpayer Rights and Entitlements at Risk	11	754,203	$12,733
Taxpayer Privacy and Security	0	0	$0
Inefficient Use of Resources	4	0	$21,733
Reliability of Management Information	9	116,117	$21,252
Protection of Resources	0	0	$0

[1] See Appendix II for identification of audit reports involved.

Management did not agree with the outcome measures in the following reports:

- Increased Revenue: Reference Number 2006-30-075, 2006-30-132, and 2006-30-168.
- Taxpayer Burden: Reference Numbers 2006-40-104 and 2006-40-138.
- Taxpayer Rights and Entitlements: Reference Number 2006-40-163.
- Inefficient Use of Resources: Reference Number 2006-30-168.
- Reliability of Management Information: Reference Numbers 2006-10-086 and 2006-40-169.

The following reports contained quantifiable impacts in addition to the number of taxpayer accounts and dollar value:

- Taxpayer Rights and Entitlements: Reference Number 2006-30-094.
- Taxpayer Burden: Reference Numbers 2006-40-122 and 2006-40-165.
- Reliability of Management Information: Reference Numbers 2006-40-098 and 2006-10-170.

Investigations Statistical Reports

Significant Investigative Achievements April 1, 2006 – September 30, 2006	
Complaints/Allegations Received by TIGTA	
Complaints against IRS Employees	2,111
Complaints against Non-Employees	1,992
Total Complaints/Allegations	**4,103**
Status of Complaints/Allegations Received by TIGTA	
Investigations Initiated	1,569
In Process within TIGTA[1]	239
Referred to IRS for Action	355
Referred to IRS for Information Only	760
Referred to a Non-IRS Entity[2]	12
Closed with No Referral	972
Closed with All Actions Completed	196
Total Complaints	**4,103**
Investigations Opened and Closed	
Total Investigations Opened	1,669
Total Investigations Closed	1,694
Financial Accomplishments	
Embezzlement/Theft Funds Recovered	$1,265,769
Court Ordered Fines, Penalties and Restitution	$34,934,248
Out-of-Court Settlements	0
Total Financial Accomplishments	**$36,200,017**

[1] Complaints for which final determination had not been made at the end of the reporting period.
[2] A non-IRS entity includes other law enforcement entities or Federal agencies.
Note: The IRS made 44 referrals to TIGTA that would more appropriately be handled by the IRS, and therefore were returned to the IRS. These are not included in the total complaints shown above.

Status of Closed Criminal Investigations			
Criminal Referrals[1]	**Employee**	**Non-Employee**	**Total**
Referred – Accepted for Prosecution	39	60	**99**
Referred – Declined for Prosecution	417	324	**741**
Referred – Pending Prosecutorial Decision	18	35	**53**
Total Criminal Referrals	**474**	**419**	**893**
No Referral	406	468	**874**

[1] Criminal referrals include both Federal and State dispositions.

Criminal Dispositions[2]			
	Employee	**Non-Employee**	**Total**
Guilty	29	73	**102**
Nolo Contendere (no contest)	0	2	**2**
Pre-trial Diversion	5	0	**5**
Deferred Prosecution[3]	2	4	**6**
Not Guilty	1	0	**1**
Dismissed[4]	2	5	**7**
Total Criminal Dispositions	**39**	**84**	**123**

[2] Final criminal dispositions during the reporting period. This data may pertain to investigations referred criminally in prior reporting periods and do not necessarily relate to the investigations referred criminally in the Status of Closed Criminal Investigations table above.
[3] Generally in a deferred prosecution, the defendant accepts responsibility for his/her actions, and complies with certain conditions imposed by the court. Upon the defendant's completion of the conditions, the court dismisses the case. If the defendant fails to fully comply, the court reinstates prosecution of the charge.
[4] Court dismissed charges.

Administrative Dispositions on Closed TIGTA Investigations[5]	
	Total
Removed, Terminated or Other	284
Suspended/Reduction in Grade	89
Oral or Written Reprimand/Admonishment	113
Closed – No Action Taken	103
Clearance Letter Issued	138
Employee Resigned Prior to Adjudication	106
Non-Internal Revenue Service Employee Actions[6]	313
Total Administrative Dispositions	**1,187**

[5] Final administrative dispositions during the reporting period. This data may pertain to investigations referred administratively in prior reporting periods and does not necessarily relate to the investigations closed in the Investigations Opened and Closed statistics on page 53.
[6] Administrative action taken by the IRS against non-IRS employees.

Appendix I Statistical Reports - Other

Audit Reports with Significant Unimplemented Corrective Actions

The Inspector General Act of 1978 requires identification of significant recommendations described in previous semiannual reports for which corrective actions have not been completed.[1] The following list is based on information from the IRS Office of Management Control's automated tracking system maintained by Treasury management officials

Reference Number	IRS Management Challenge Area	Issued	Projected Completion Date	Report Title and Recommendation Summary (F = Finding No., R = Recommendation No., P = Plan No.)
2001-30-052	Tax Compliance Initiatives	March 2001	01/01/07	***Program Improvements Are Needed to Encourage Taxpayer Compliance in Reporting Foreign Sourced Income*** F-3, R-1, P-1, P-2. Improve systems that process data the IRS receives on foreign sourced income.
2002-30-156	Tax Compliance Initiatives	September 2002	01/15/07	***The Internal Revenue Service Does Not Penalize Employers that File Wage and Tax Statements with Inaccurate Social Security Numbers*** F-1, R-1, P-1. Ensure that the IRS initiate, as proposed in their response to our memorandum dated February 1, 2002, a regularly scheduled program for proposing penalties for Forms W-2 with inaccurate name/SSN combinations.
2003-10-054	Using Performance and Financial Information for Program and Budget Decisions	March 2003	10/01/07	***The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses*** F-1, R-3, P-1. Ensure that the ability to record and report trust fund administrative expenses, as currently envisioned in the IFS development plans, is properly implemented.

[1] For TIGTA Audit Reports Number 2004-20-131, 2004-20-155, and 2005-20-024: recommendation is being addressed in the IRS Security Material Weakness Plan.

Reference Number	IRS Management Challenge Area	Issued	Projected Completion Date	Report Title and Recommendation Summary *(F = Finding No., R = Recommendation No., P = Plan No.)*
2003-10-094	Erroneous and Improper Payments	March 2003	01/15/07	***Improvements Are Needed in the Monitoring of Criminal Investigation Controls Placed on Taxpayers' Accounts When Refund Fraud is Suspected*** F-1, R-2, P-1. Ensure that regular reviews of the Questionable Refund Program are conducted to assess compliance with procedures and that feedback is provided regarding program effectiveness. Also, analyses of the FDCs' control listing data should be analyzed to ensure reviews are done and accounts are resolved.
2003-40-139	Tax Compliance Initiatives	June 2003	10/15/07	***Opportunities Exist to Improve the Administration of the Earned Income Tax Credit*** F-1, R-2, P-1. Establish a consistent method to measure progress toward the EITC Program's long-term goals.
2003-20-118	Security of the IRS	July 2003	01/15/08	***Security Over Computers Used in Telecommuting Needs to Be Strengthened*** F-1, R-6, P-1. Require front-line managers to periodically check their employees' laptop computers to ensure that sensitive data are being stored and encrypted properly.
2003-30-162	Tax Compliance Initiatives	August 2003	12/15/06	***The Regulations for Granting Extensions of Time to File are Delaying the Receipt of Billions of Tax Dollars and Creating Substantial Burden for Compliant Taxpayers*** F-1, R-1, P-1. Revise the tax regulations applicable to individual taxpayers.
2003-30-176	Tax Compliance Initiatives	August 2003	12/15/07	***Interest Paid to Large Corporations Could Significantly Increase Under a Proposed New Revenue Procedure*** F-1, R-2, P-1. Gather pertinent information concerning the affected proposed procedure to reduce the length of examinations and interest costs by conducting a pilot program to demonstrate the actual benefits that could be achieved.
2003-10-212	Human Capital	September 2003	10/01/07	***Information on Employee Training Is Not Adequate to Determine Training Cost or Effectiveness*** F-3, R-2, P-2. Ensure that IRS training and financial systems can provide information needed for the IRS to assess its own training efforts.
2004-20-001	Systems Modernization of the IRS	October 2003	12/31/10	***Risks Are Mounting As the Integrated Financial System Project Team Strives to Meet An Aggressive Implementation Date*** F-2, R-1, P-1. Ensure that the disaster recovery environment is completely built-out and tested.

Reference Number	IRS Management Challenge Area	Issued	Projected Completion Date	Report Title and Recommendation Summary (*F = Finding No., R = Recommendation No., P = Plan No.)*
2004-40-013	Providing Quality Taxpayer Service Operations	November 2003	01/01/07	***Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud*** F-1, R-2, P-1. Enhance the screening procedures for E-File Providers to include sending scanned fingerprints to the FBI electronically.
2004-30-038	Tax Compliance Initiatives	January 2004	01/15/07	***Access to the Toll-Free Telephone System Was Significantly Improved in 2003, but Additional Enhancements Are Needed*** F-3, R-1, P-1. Develop an activity-based costing system that reliably captures and reports both the total cost and the cost-per-call of providing services on each toll-free product line.
2004-30-068	Tax Compliance Initiatives	March 2004	01/15/07 04/15/07	***Additional Efforts Are Needed to Improve the Bank Secrecy Act Compliance Program*** F-2, R-1, P-1. Develop standard risk-based case selection criteria that would provide minimum requirements and parameters for case selection. F-2, R-2, P-1. Reinforce the importance of case documentation with specific instructions or case models and implement a centralized quality review process.
2004-40-098	Erroneous and Improper Payments	May 2004	12/15/06	***Better Use of the National Account Profile During Returns Processing Can Eliminate Erroneous Payments*** F-2, R-1, P-1. Conduct studies on the accuracy of EITC claims on tax returns for individuals who have been claimed for EITC purposes that are 20 or more years older than the primary taxpayer, or are listed as children that are up to 19 years older than the primary taxpayer.
2004-20-131	Security of the IRS	September 2004	11/01/06	***The Use of Audit Trails to Monitor Key Networks and Systems Should Remain Part of the Computer Security Material Weakness*** F-2, R-4, P-1. Develop and implement a reasonable approach for reviewing audit trails over major applications.
2004-20-155	Security of the IRS	September 2004	10/15/06	***Computer Security Roles and Responsibilities and Training Should Remain Part of the Computer Security Material Weakness*** F-3, R-3, P-1. Ensure that employees with key security responsibilities are adequately trained to perform security duties and tasks.
2004-10-182	Using Performance and Financial Information for Program and Budget Decisions	September 2004	10/01/06	***The Internal Revenue Service Faces Significant Challenges to Reduce Underused Office Space Costing $84 Million Annually*** F-2, R-3, P-1. Consider allocating rent funds to the operating divisions to help ensure more efficient use of space and more communication between the facility managers and the local operating divisions; consider incentives and consequences to ensure better cooperation.

Reference Number	IRS Management Challenge Area	Issued	Projected Completion Date	Report Title and Recommendation Summary *(F = Finding No., R = Recommendation No., P = Plan No.)*
2005-40-026	Providing Quality Taxpayer Service Operations	February 2005		***Processes Used to Ensure the Accuracy of Information for Individual Taxpayers on IRS.GOV Need Improvement***
			P-2: 10/01/06 P-4: 12/31/10	F-1, R-1, P-2, P-4. Develop a process to ensure that only authorized personnel have access to IRS.gov content.
			P-1, P-2: 12/31/10	F-1, R-2, P-1, P-2. Enhance the IRS' content management software application to provide the ability to identify specific content accessed or revised by individual users.
2005-20-024	Security of the IRS	March 2005		***The Disaster Recovery Program Has Improved, But It Should Be Reported as a Material Weakness Due to Limited Resources and Control Weaknesses***
			12/31/10	F-1, R-1, P-1, P-5. Report a disaster recovery program material weakness to the Department of the Treasury as part of the IRS' Federal Managers' Financial Integrity Act of 1982 annual evaluation of controls and include any new or currently underway activities in the corrective action plan.
2005-30-048	Tax Compliance Initiatives	March 2005		***Stronger Sanctions Are Needed to Encourage Timely Filing of Pass Through Returns and Ensure Fairness in the Tax System***
			02/15/07	F-1, R-3, P-1. Develop a legislative proposal to be submitted to the Department of the Treasury that would amend I.R.C. § 6698 to increase the penalty for late-filed partnership returns from $50 per partner per month to $200 per partner per month.
			02/15/07	F-1, R-4, P-1. Develop a legislative proposal to be submitted to the Department of the Treasury that would amend I.R.C. § 6698 to remove the five-month limitation on the number of months of delinquency that the late-filing penalty is assessed on partnership returns.
			02/15/07	F-1, R-5, P-1. Develop a legislative proposal to be submitted to the Department of the Treasury that would amend I.R.C. § 6698 to make all requirements of the law applicable to S corporations as well as partnerships.
			02/15/07	F-1, R-6, P-1. Develop a legislative proposal to be submitted to the Department of the Treasury that would amend I.R.C. § 6721 to require the assessment of a $200 penalty per Schedule K-1 for the failure to timely provide Schedules K-1 to the IRS when a partnership or S corporation return is filed late.
			02/15/07	F-1, R-7, P-1. Develop a legislative proposal to be submitted to the Department of the Treasury that would amend I.R.C. § 6722 to require the assessment of a $200 penalty per Schedule K-1 for the failure to timely provide Schedules K-1 to payees when a partnership or S corporation return is filed more than seven days beyond the return due date.
			02/15/07	F-1, R-8, P-1. Conduct a study to determine whether fixed-dollar penalties set at a $200 level in I.R.C. § 6698, 6721, and 6722 will be effective in ensuring future compliance or whether other penalty types and/or higher amounts would be more effective.

Reference Number	IRS Management Challenge Area	Issued	Projected Completion Date	Report Title and Recommendation Summary (*F = Finding No., R = Recommendation No., P = Plan No.)*
2005-10-070	Human Capital	March 2005		***The Human Resources Investment Fund is Not a Cost-Effective Method of Providing Tuition Assistance***
			01/15/07	F-2, R-1, P-1. Consider eliminating the HRIF Program and providing tuition assistance through alternative means such as the Individual Development Plan process and the Career Transition Assistance Program.
2005-10-107	Human Capital	July 2005		***Improved Policies and Guidance Are Needed for the Telework Program***
			03/15/07	F-1, R-1, P-1. Ensure an IRS-wide Flexiplace Program policy is developed and implemented that addresses all the elements recommended by the OPM.
			03/15/07	F-2, R-1, P-1. Implement guidelines to assist managers in evaluating employees' abilities to participate in the Flexiplace Program without a loss in productivity.
			03/15/07	F-2, R-2, P-1. Ensure that Flexiplace Program training is provided as needed to help address productivity concerns.
			03/15/07	F-2, R-3, P-1. Assess the logistical support and equipment needs of Flexiplace Program participants to help ensure there is no loss in productivity.
2005-20-108	Security of the IRS	July 2005		***More Management Attention Is Needed to Protect Critical Assets***
			11/30/06	F-1, R-2, P-1. Coordinate with all business units at least annually to confirm that the IRS' list of critical assets is accurate and complete.
2005-40-110	Providing Quality Taxpayer Service Operations	July 2005		***The Effectiveness of the Taxpayer Assistance Center Program Cannot Be Measured***
			10/15/07	F-1, R-1, P-1. Enhance the management information system to capture the number of taxpayers served, the number and types of services provided, and the related resources.
			10/15/06	F-1, R-2, P-1. Develop a Service Delivery Plan for the short-term and long-term direction of the TAC Program based on business cases and customer input.
			10/15/06	F-1, R-3, P-1. Develop a process that includes routine assessments of TAC operations to ensure that the TACs are optimally located and the services provided at the TACs are the most effective and cost efficient.
2005-30-126	Tax Compliance Initiatives	August 2005		***Additional Work Is Needed to Determine the Extent of Employment Tax Underreporting***
			10/15/06	F-1, R-1, P-1. Develop methodologies designed to evaluate the extent of underreporting by employers.

Reference Number	IRS Management Challenge Area	Issued	Projected Completion Date	Report Title and Recommendation Summary (F = Finding No., R = Recommendation No., P = Plan No.)
2005-10-129	Providing Quality Taxpayer Service Operations	September 2005		***Progress Has Been Made, but Further Improvements Are Needed in the Administration of the Low-Income Taxpayer Clinic Grant Program***
			05/15/07	F-1, R-1, P-2. Establish goals and performance measures for the LITC program to assist the Congress and IRS in evaluating the success of the program.
			03/15/07	F-3, R-2, P-1. Develop a method to obtain information necessary to verify clinics are following all LITC program requirements.
			01/15/07	F-4, R-1, P-4. Establish procedures to check for tax compliance before awarding LITC program grants, and consider periodic tax compliance checks during the grant period.
2005-30-140	Tax Compliance Initiatives	September 2005		***Improved IRS Coordination Is Needed to Resolve Large Volumes of Fraudulent Schedule C Refund Returns***
			P-1: 10/15/06 P-2, P-3: 10/15/07 P-4: 10/15/06	F-1, R-1, P-1, P-2, P-3, P-4. Develop an overall compliance strategy for Schedules C with fraudulent refunds, especially when large volumes of returns are involved.
			P-1: 10/15/06 P-2, P-3: 10/15/07 P-4: 10/15/06	F-1, R-2, P-1, P-2, P-3, P-4. Identify potential computerized methods incorporating possible math error authority to temporarily stop refunds for cases meeting the characteristics of those in this scheme or other large Schedule C refund schemes.
2005-10-149	Human Capital	September 2005		***The Internal Revenue Service Does Not Adequately Assess the Effectiveness of Its Training***
			04/15/07	F-1, R-1, P-1, P-2. Require all business units to follow the training assessment and develop requirements, and properly document this process.
			10/15/06	F-2, R-1, P-1, P-2. Ensure that all IRS components follow established procedures to evaluate training in order for the IRS to comply with the training assessment requirement of the Federal Workforce Flexibility Act of 2004.
			04/15/07	F-3, R-1, P-1. Use the numerical scores from the Employee Satisfaction Survey training question in addition to narrative comments.
2005-30-154	Processing Returns and Implementing Tax Law Changes During the Tax Filing Season	September 2005		***The Clarity of Math Error Notices Has Been Improved, but Further Changes Could Enhance Notice Clarity and Reduce Unnecessary Notices***
			P-1: 04/15/07	F-1, R-2, P-1. Revise tax statement tables contained on notices to include specific amounts from at least some line items on which taxpayers made errors on their tax returns.
			P-1: 04/15/07 P-2: 11/15/06	F-1, R-3, P-1, P-2. Revise CP16 to present information in a manner consistent with the other notices sent to individual taxpayers including the location of the error explanation and tax statement, and the wording of the taxpayers' rights to appeal with the math error adjustment..
			01/15/07	F-1, R-5, P-1. Ensure employees perform research and suppress notices from going to taxpayers who paid the proper amounts.

Reference Number	IRS Management Challenge Area	Issued	Projected Completion Date	Report Title and Recommendation Summary (*F = Finding No., R = Recommendation No., P = Plan No.)*
2006-40-005	Erroneous and Improper Payments	November 2005		***Enhancements Could Be Made to Minimize Internal Revenue Service Employee and Volunteer Return Preparation Program Participant Integrity Issues***
			11/15/06	F-2, R-1, P-2. Enhance training materials and information provided to participants, reminding them that Government computers should not be used for personal business and that payments should not be accepted for preparing tax returns.
2006-30-006	Taxpayer Compliance Initiatives	November 2005		***The Internal Revenue Service Needs a Coordinated National Strategy to Better Address an Estimated $30 Billion Tax Gap Due to Non-Filers***
			07/15/07	F-2, R-2, P-1. Consider a study to devise an effective outreach and education strategy.
2006-40-007	Erroneous and Improper Payments	November 2005		***Efforts to Prevent Improper Tax Benefits Resulting from Multiple Uses of Taxpayer Identification Numbers Can Be Improved***
			01/15/07	F-1, R-1, P-2. Lead a collaborative effort to identify a workable solution to resolve multiple identification number use cases in which an identification number is used as a primary identification number on one return and a secondary identification number on another return.
			01/15/07	F-1, R-2, P-1. Evaluate the IRS' strategy for educating taxpayers and tax preparers on the proper use of an identification number when couples either separate or divorce during the tax year.
2006-40-024	Processing Returns and Implementing Tax Law Changes During the Tax Filing Season	December 2005		***Individual Income Tax Returns Were Timely Processed in 2005; However, Implementation of Tax Law Changes Could Be Improved***
			04/15/07	F-3, R-1, P-1. Implement a computer check that would identify questionable large-dollar entries for review and resolution for both paper and electronic individual income tax returns.
			12/15/06	F-5, R-1, P-1. Revise Form 8863 to combine and include applicable information for the tuition and fees deduction and Education Credit to ensure compliance and promote simplicity and fairness.
2006-20-031	Security of the IRS	February 2006		***Secure Configurations Are Initially Established on Employee Computers, but Enhancements Could Ensure Security Is Strengthened After Implementation***
			11/01/07	F-1, R-2, P-1. Require system administrators to run the IRS' configuration checking program on a sample of workstations on a periodic basis to ensure security is maintained.
			10/01/06	F-1, R-5, P-1. Use software application to identify possible unauthorized software installed on employee computers.
			01/02/07	F-2, R-2, P-1. Assign monitoring responsibilities for significant cost software licenses to ensure purchases are justified and needed.

Reference Number	IRS Management Challenge Area	Issued	Projected Completion Date	Report Title and Recommendation Summary *(F = Finding No., R = Recommendation No., P = Plan No.)*
2006-40-061	Providing Quality Taxpayer Service Operations	March 2006		***The Taxpayer Assistance Center Closure Plan Was Based on Inaccurate Data***
			10/15/06	F-1, R-1, P-1. Ensure that data used in the model or any decision-making tool are accurate and reliable and have been validated before using them to make decisions regarding the TAC Program.
			10/15/06	F-1, R-2, P-1. Include in the model or any decision-making tool data to identify customer characteristics and capture customer input to effectively measure the impact any results might have on taxpayer service and compliance.
2006-30-065	Taxpayer Compliance Initiatives	March 2006		***The Settlement Initiative for Investors in a Variety of Bond and Option Sales Strategies Was Successful and Surfaced Possible Next Steps for Curtailing Abusive Tax Shelters***
			11/15/06	F-1, R-2, P-1. Designate a study group to evaluate the IRS' overall performance in resolving the Son of Boss abusive tax shelter.
2006-10-066	Erroneous and Improper Payments	March 2006		***The Office of Professional Responsibility Can Do More to Effectively Identify and Act Against Incompetent and Disreputable Tax Practitioners***
			10/15/06	F-1, R-1, P-1, P-2. Work to improve the referral process by obtaining timely, relevant conviction information for tax crimes and State or Federal convictions involving dishonesty and breach of trust in a useful format.
			04/15/07	F-1, R-2, P-1. Develop a process to obtain relevant information on State disciplinary actions by coordinating with State licensing authorities.
			09/15/07	F-1, R-3, P-1. Develop a method to identify representatives on the Centralized Authorization File that does not require representatives to use Social Security numbers on Form 2848.
			06/15/07	F-2, R-1, P-1. Implement recommendations from the prior audit. This should include employing the case management system to provide data on the use of program resources and performing an annual workload and staffing analysis to help prioritize and allocate resources.

Other Statistical Reports

The Inspector General Act of 1978 requires Inspectors General to address the following issues:	
Issue	**Result for TIGTA**
Access to Information Report unreasonable refusals of information available to the agency that relate to programs and operations for which the Inspector General has responsibilities.	As of September 29, 2006, there were no instances in which information or assistance requested by the Office of Audit was refused.
Disputed Audit Recommendations Provide information on significant management decisions in response to audit recommendations with which the Inspector General disagrees.	As of September 29, 2006, no reports were issued in which significant recommendations were disputed.
Revised Management Decisions Provide a description and explanation of the reasons for any significant revised management decisions made during the reporting period.	As of September 29, 2006, no significant management decisions were revised.
Audit Reports Issued in the Prior Reporting Period With No Management Response Provide a summary of each audit report issued before the beginning of the current reporting period for which no management response has been received by the end of the current reporting period.	As of September 29, 2006, there were no prior reports in which management's response was not received.
Review of Legislation and Regulations Review existing and proposed legislation and regulations, and make recommendations concerning the impact of such legislation or regulations.	TIGTA's Office of Chief Counsel reviewed 177 proposed regulations and legislative requests during this reporting period.

No government can exist without taxation. This money must necessarily be levied on the people; and the grand art consists of levying so as not to oppress.

~ Frederick the Great

Appendix II
Audit Products

April 1, 2006 – September 30, 2006

Inspector General Congressional Testimony	
Reference Number	**Hearing Title**
	April 2006
2006-OT-118	2006 Tax Return Filing Season and the 2007 Budget Proposal for the IRS
2006-OT-082	Hearing on the IRS' Fiscal Year 2007 Budget
	July 2006
2006-OT-119	A Closer Look at the Size and Sources of the Tax Gap
	September 2006
2006-OT-180	Deconstructing the Tax Code: Uncollected Taxes and Issues of Transparency

Audit Products	
Reference Number	**Report Title**
	April 2006
2006-10-070	There Was One Administrative Action with Respect to Violations of Fair Tax Collection Practices in Calendar Year 2005
2006-50-077	Some Concerns Remain About the Overall Confidence that Can Be Placed in Internal Revenue Service Tax Gap Projections
2006-30-064	Management Needs to Continue Monitoring Some Case Selection Issues as the Private Debt Collection Program Is Implemented
2006-1C-037	Report on the Audit of Adequacy and Compliance of the Contractor's Disclosure Statement Revision 15, Effective January 1, 2005
2006-1C-041	TIRNO-95-D-00057 and TIRNO-00-D-00009 Incurred Cost Audit for Fiscal Year Ended August 31, 2002
2006-20-054	Enhancements to Transition Management Guidance Will Enable Efficient and Effective Modernization Project Implementation

2006-10-073	The Federal, State, and Local Governments Office Can Improve the Workload Selection Process to Increase Effectiveness
2006-10-078	The Revised Private Debt Collection Request for Quotation Adequately Addressed Prior Deficiencies in the Solicitation Methodology
	May 2006
2006-1C-040	TIRNO-95-D-00057 and TIRNO-00-D-00009 Incurred Cost Audit for Fiscal Year Ended August 31, 2001
2006-20-080	The Enterprise-wide Implementation of Active Directory® Needs Increased Oversight
2006-20-056	Improvements in Mainframe Computer Storage Management Practices and Reporting Are Needed to Promote Effective and Efficient Utilization of Disk Resources (Funds Put to Better Use: $1.4 million; Inefficient Use of Resources: $626,866)
2006-30-075	Automating the Penalty-Setting Process for Information Returns Related to Foreign Operations and Transactions Shows Promise, but More Work Is Needed (Increased Revenue: $301 million) Note: monetary benefit projected over a five-year period.
2006-1C-043	Report on Compliance of Cost Accounting Standard 418, Allocation of Direct and Indirect Costs
2006-10-074	Statistical Portrayal of the Criminal Investigation Function's Enforcement Activities From Fiscal Year 2000 Through Fiscal Year 2005
2006-20-079	The Business Systems Modernization Program Is Receiving Value from Contract Work; However, Monitoring Can Be Strengthened (Inefficient Use of Resources: $31,000)
2006-1C-042	Audit of Preaward Survey of Prospective Contractor's Accounting System
2006-40-088	Tax Products and Computer Programs for Individual Income Tax Returns Were Accurately Updated for the 2006 Filing Season
2006-10-081	Abuses in the Tax-Exempt Credit Counseling Industry Are Being Addressed, but Further Actions Are Needed to Ensure Overall Industry Compliance (Reliability of Information: 227 inaccurate inventory entries)
2006-10-085	Financial Controls Over the Health Coverage Tax Credit Advance Payment Process Need to Be Enhanced
	June 2006
2006-10-089	The Exempt Organizations Function Effectively Processed Requests for Tax-Exempt Status From Charitable Organizations Supporting Hurricane Relief (Taxpayer Burden: one organization's city corrected in the IRS' publication)
2006-1C-039	Civil Division Incurred Cost Audit for Fiscal Year 2003 (Questioned Costs: $120,218,040)
2006-30-092	The Informants' Rewards Program Needs More Centralized Management Oversight
2006-40-095	Fiscal Year 2006 Statutory Audit of Compliance with Legal Guidelines Restricting the Use of Records of Tax Enforcement Results
2006-10-084	Financial Management Controls Are Generally Adequate, but Opportunities Exist to Improve the Accountability over Depreciable Assets
2006-10-086	Invoice Audit of the Microsoft Consulting Services Contract – TIRNO-03-K-00191 (Reliability of Information: $444,430 of charges associated with work done by contractor personnel whose resumes were not presented)
2006-30-090	The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities (Increased Revenue: $558,000 impacting seven taxpayers)
2006-10-087	Voucher Audit of the Infrastructure Shared Services Task Order of Contract TIRNO-99-D-00001 (Questioned Costs: $8,187)
2006-30-091	The Internal Revenue Service Complied with New Approval Requirements for Jeopardy Assessments

2006-30-094	Fiscal Year 2006 Statutory Review of Compliance with Lien Due Process Procedures (Taxpayer Rights and Entitlements: 23,825 lien notices untimely mailed & proof of mailing not located)
2006-20-076	Focusing Management Efforts on Long-Term Project Needs Will Help Development of the Customer Account Data Engine Project
2006-20-102	Annual Assessment of the Business Systems Modernization Program
	July 2006
2006-30-097	Although Improvements Have Been Made, More Can Be Done to Identify Businesses by Their Principal Business Activity (Reliability of Information: 111,790 returns with missing Principal Business Activity codes)
2006-40-103	Controls Can Be Improved to Ensure Advance Earned Income Credit Reported on Individual Income Tax Returns Is Accurate (Taxpayer Rights and Entitlements: 228 taxpayers paid $443,589 in taxes not owed)
2006-40-098	Fiscal Year 2006 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations (Taxpayer Rights and Entitlements: 287 taxpayers improperly identified; Reliability of Information: 1 Internal Revenue Manual subsection with prohibited reference to Illegal Tax Protester Designations)
2006-30-100	The Offer in Compromise Program Is Beneficial but Needs to Be Used More Efficiently in the Collection of Taxes
2006-30-099	The Large and Mid-Size Business Division Has Effectively Implemented Its Human Capital Initiatives
2006-40-107	Data Used to Report Toll-Free Telephone Quality Are Reliable, but Internal Controls Need to Be Documented
2006-20-111	Increased Managerial Attention Is Needed to Ensure Taxpayer Accounts Are Monitored to Detect Unauthorized Employee Accesses
2006-30-105	While Examinations of High-Income Taxpayers Have Increased, the Impact on Compliance May Be Limited
2006-40-112	Analysis of Individual Income Tax Credits
2006-30-106	Examinations of Partnerships Often Do Not Follow All Procedures Required by the Tax Equity and Fiscal Responsibility Act of 1982
2006-40-109	Taxpayers Residing in the Hurricanes Katrina and Rita Disaster Areas Were Accurately Identified for Tax Relief (Taxpayer Rights and Entitlements: 1,470 taxpayers whose accounts contain incorrect disaster period dates)
2006-20-110	Inappropriate Use Of Email by Employees and System Configuration Management Weaknesses Are Creating Security Risks
	August 2006
2006-30-101	Fiscal Year 2006 Statutory Review of Compliance with Legal Guidelines When Issuing Levies
2006-20-108	The Electronic Fraud Detection System Redesign Failure Resulted in Fraudulent Returns and Refunds Not Being Identified (Revenue Protection: $318.3 million; Questioned Costs: $459,718; Inefficient Use of Resources: $20.5 million)
2006-30-113	Fiscal Year 2006 Statutory Review of Compliance with Legal Guidelines When Conducting Seizures of Taxpayers' Property (Taxpayer Rights and Entitlements: 25 taxpayers for whom the IRS did not follow all legal and internal guidelines or that internal guidelines can be improved)
2006-30-120	A Formal Program to Identify Artwork Donations Reported on Tax Returns Is Not Necessary, but Examination Procedures Need to Be Strengthened
2006-30-117	Requests for Employer Identification Numbers Were Processed Correctly and Unused Numbers May Not Pose As Great a Risk As Anticipated
2006-10-121	Statistical Portrayal of the Indian Tribal Government Office's Enforcement Activities From Fiscal Year 2002 Through Fiscal Year 2005

2006-10-115	The Technical and Cost Risks of Replacing the Electronic Travel System Need to Be Resolved
2006-10-116	Trends in Employee Plans Function Enforcement Activities for Fiscal Years 2000 – 2005
2006-1C-044	Report on Examination of Fiscal Year 2003 Incurred Costs and Indirect Expense Rates
2006-1C-045	Report on Application of Agreed-Upon Procedures
2006-1C-046	Report on Audit of Information Technology System General Internal Controls
2006-1C-047	Report on Audit of Compensation System Internal Controls
2006-1C-051	Audit of Timekeeping Practices for Fiscal Year 2004
2006-40-104	Automated Underreporter Program Compliance Activities Were Properly Suspended for Taxpayers Affected by Hurricanes Katrina and Rita, but Notification Could Be Improved (Taxpayer Burden: 10,863 taxpayers not notified of Automated Underreported Program compliance relief)
2006-10-126	Tax-Exempt and Government Entities Division Customers Receive Adequate Service During Most Processing Activities; However, Remittances May Not Be Deposited Timely (Increased Revenue: $112,055)
2006-30-114	Filing Characteristics and Examination Results for Partnerships and S Corporations
2006-40-135	Fiscal Year 2006 Statutory Review of Disclosure of Collection Activity with Respect to Joint Returns
2006-40-136	Fiscal Year 2006 Statutory Review of Restrictions on Directly Contacting Taxpayers
2006-40-134	Individual Income Tax Return Information Was Successfully Posted to the Latest Release of the Customer Account Data Engine
2006-40-122	Customer Service at Taxpayer Assistance Centers Showed Improvement During the 2006 Filing Season (Taxpayer Burden: 29 incorrect answers to tax questions)
2006-40-125	Oversight and Accuracy of Tax Returns Continue to Be Problems for the Volunteer Income Tax Assistance Program
2006-10-128	Insufficient Controls Resulted in Significant Delays in Processing Tax-Exempt Bond Payments and Some Unreliable Payment Posting Dates (Revenue Protection: $4,000; Taxpayer Burden: 13 accounts incorrectly posted)
2006-10-129	Compliance With Freedom of Information Act Requirements Has Increased (Taxpayer Rights and Entitlements: 969 IRS responses to FOIA, Privacy Act and I.R.C. Section 6103 requests that improperly withheld information or were not timely)
2006-40-133	Processes to Resolve Undelivered and Expired Refunds Are Generally Effective (Taxpayer Burden: 113,225 could receive reissued refunds more quickly)
2006-40-139	Untimely Processing of Taxpayer Carryback Loss Claims Resulted in Significant Interest Costs (Funds Put to Better Use: $101.7 million; Taxpayer Burden: 28,370 taxpayers with delayed refunds) Note: monetary benefit projected over a five-year period.
2006-10-140	Voucher Audit of the Federally Funded Research and Development Center Contract – TIRNO-99-D-00005 (Questioned Costs: $28,449)

	September 2006
2006-1C-050	Report on Audit of Compliance with Cost Accounting Standard 410, Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives
2006-1C-141	Audit of Timekeeping Practices for Fiscal Year 2003
2006-10-131	The Indian Tribal Governments Office's Administration of the Tip Compliance Program for Its Customer Base Increased Voluntary Compliance
2006-1C-143	Report on Fiscal Year 2005 Labor Floor Checks
2006-10-124	Resource and Computer Programming Limitations Have Hindered the Progress of the Federal, State, and Local Governments Office in Identifying Its Customers (Taxpayer Burden: filing requirements incorrectly applied or removed from 34 accounts)

2006-10-127	Compliance with Statutory Provisions Regarding the Use of Tax Information in Nontax Criminal Investigations Cannot Be Verified
2006-40-138	The Wage and Investment Division Automated Underreporter Telephone Operations Could Improve Service to Taxpayers (Taxpayer Burden: increasing the level of Service would provide access for 416,475 taxpayers over 5 years)
2006-40-162	Appropriate Actions Were Taken to Maintain Taxpayers' Level of Service, but Access Is Lower Than That in Prior Years
2006-30-132	Additional Enhancements Could Improve Tax Compliance of Employees Who Receive Tips (Increased Revenue: $342 million) Note: monetary benefit projected over a five-year period.
2006-10-093	Confirmation of Tax Noncompliance Issues Among Low-Income Taxpayer Clinics
2006-30-130	Information Report Referrals Are Properly Evaluated, but Processing Controls Need to Be Improved
2006-30-161	Efforts to Identify and Process Potential Joint Committee on Taxation Cases Can Be Improved
2006-20-179	Treasury Inspector General for Tax Administration – Federal Information Security Management Act Report for Fiscal Year 2006
2006-10-123	The Office of Appeals Should Continue to Strengthen and Reinforce Procedures for Collection Due Process Cases (Increased Revenue: 1,113 taxpayers impacted; Taxpayer Rights and Entitlements: 10,637 Closed Collection Due Process and Equivalency Hearing cases that did not contain required or sufficient documentation)
2006-30-160	Requiring Personal Identification Numbers for Electronically Filed Returns Could Improve Tax Administration and Reduce Costs (Funds Put to Better Use: $1.83 million)
2006-40-164	Individual Tax Returns Were Timely Processed in 2006, but Opportunities Exist to Improve Verification of Certain Tax Deductions (Revenue Protection: $5.7 million impacting 17,076 taxpayers; Taxpayer Rights and Entitlements: 735,415 eligible taxpayers that did not benefit from the State sales tax deduction)
2006-40-137	Improvements Are Needed to Better Identify and Prevent Erroneous Refunds
2006-40-163	Fiscal Year 2006 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute (Taxpayer Rights and Entitlements: 494 taxpayer and taxpayer representative case files not adequately documented)
2006-40-165	Taxpayers That Call Local Taxpayer Assistance Center Telephone Numbers Are Unable to Schedule Appointments to Resolve Tax Account Issues (Taxpayer Burden: 31 instances in which an appointment could not be scheduled)
2006-20-167	Uninstalled Computer Security Patches Continue to Put Computer Systems at Risk
2006-40-169	The Savings Used to Recommend Reducing Toll-Free Telephone Hours of Operation Are Not As Significant As Projected (Reliability of Information: $17.5 million in potential savings was calculated from outdated data)
2006-10-157	Trends in Exempt Organizations Function Enforcement Activities for Fiscal Years 2001-2005
2006-30-158	Many Taxpayers That Could Benefit From the Income Averaging Provision for Fishermen Are Not Using It (Taxpayer Rights and Entitlements: 4,627 taxpayers overpaid their taxes by $12.3 million by not income averaging)
2006-20-166	The Monitoring of Privacy over Taxpayer Data Is Improving, Although Enhancements Can Be Made to Ensure Compliance With Privacy Requirements
2006-1C-048	Audit of Cost Accounting Standard 409, Depreciation of Tangible Capital Assets Noncompliance
2006-1C-049	Report on Compliance of Cost Accounting Standard 409, Depreciation of Tangible Capital Assets
2006-1C-142	Civil Division Incurred Cost Audit for Fiscal Year 2002 (Questioned Costs: $32,373,751)

2006-1C-144	Report on Audit of the Contractor's Purchasing System
2006-1C-145	Report on Audit of Direct and Indirect Costs for Contractor's Fiscal Year 2004 (Company 1)
2006-1C-146	Report on Compliance of Cost Accounting Standard 410, Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives
2006-1C-150	Report on Audit of Adequacy of the Contractor's Fiscal Year 2006 Revised Disclosure Statement, Effective October 3, 2005
2006-1C-151	Contractor's Labor Cost Charging and Allocations
2006-1C-152	Report on Audit of Purchasing System and Related Internal Controls
2006-1C-153	Audit Report on Contractor's Proposed Corrective Action for Cost Accounting Standard 409 Noncompliance
2006-30-159	The Schedule K-1 Matching Program Has Been Improved, but More Can Be Done to Increase Its Effectiveness
2006-40-172	Accountability over Volunteer Income Tax Assistance Program Computers Continues to Be a Problem
2006-10-174	The Tax Exempt Determination System Release 1 Delivered Only a Small Portion of the Expected Benefits and Significantly Exceeded Cost Estimates (Reliability of Information: $2.3 million in cost overrun information not available for management's use)
2006-10-173	The Redesign of the Learning and Education Activity Involved Unnecessary Delays, Additional Costs, and Delayed Savings
2006-30-168	Currently Not-Collectible Decisions on Delinquent Accounts Were Appropriate; However, Closing Actions Need to Be Improved (Increased Revenue: $4440.4 million impacting 1,217 taxpayers; Inefficient Use of Resources: $574,983)
2006-1C-147	Report on Audit of the Contractor's Fiscal Year 2003 Incurred Cost (Questioned Costs: $22,099)
2006-1C-148	Civil Information Technology Segment Disclosure Statement, Revision Number 10
2006-1C-149	Fiscal Year 2006 Civil Information Technology Segment Cost Accounting Standard 414, Compliance Audit Cost of Money as an Element of the Cost of Facilities Capital
2006-1C-154	Report on the Contractor's Compliance with Requirements of Office of Management and Budget Circular A-133 and Report on Audit of Incurred Costs for the Period October 1, 2001, through December 20, 2002
2006-10-175	Staff Reductions in Support Operations Did Not Result in Significant Increases in Mission Critical Positions (Funds Put to Better Use: $453,559; Reliability of Information: $1 million in employee buyouts not identified in plan approved by OMB)
2006-10-170	The Office of Professional Responsibility Does Not Always Ensure Enrolled Agents Are Qualified, and System Limitations Prevented Identification of Ineligible Representatives (Reliability of Information: 4,239 Enrolled Agents in good standing who failed to renew their licenses or were not tax compliant)
2006-40-171	Use of the Free File Program Declined After Income Restrictions Were Applied
2006-10-176	Employee Training Data Have Not Improved Enough to Determine Training Cost or Effectiveness
2006-20-177	Improvements Are Needed to Ensure the Use of Modernization Applications Is Effectively Audited
2006-20-178	A Complete Certification and Accreditation Is Needed to Ensure the Electronic Fraud Detection System Meets Federal Government Security Standards

Appendix III
TIGTA's Statutory Reporting Requirements

TIGTA issued 26 audit reports required by statute dealing with the adequacy and security of IRS technology during this reporting period. In FY 2006, TIGTA completed its eighth round of statutory reviews that are required annually by the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98). TIGTA also completed an annual review of the Federal Financial Management Improvement Act of 1996 (FFMIA). The following table reflects the status of the FY 2006 statutory reviews.

Reference to Statutory Coverage	Explanation of the Provision	Comments/TIGTA Audit Status
Enforcement Statistics Internal Revenue Code (I.R.C.) § 7803(d)(1)(A)(i)	Requires TIGTA to evaluate the IRS' compliance with restrictions under section 1204 of RRA 98 on the use of enforcement statistics to evaluate IRS employees.	***Reference No. 2006-40-095, June 2006*** IRS first-line managers had appropriately not used records of tax enforcement results or production quotas or goals when evaluating employees. First-line managers also appropriately certified that they had not used records of tax enforcement results in a prohibited manner. TIGTA believes that the IRS' efforts to ensure that managers are not using records of tax enforcement results or production goals or quotas to evaluate employees are generally effective and are helping to protect the rights of taxpayers.
Restrictions on Directly Contacting Taxpayers I.R.C. § 7803(d)(1)(A)(ii)	Requires TIGTA to evaluate the IRS' compliance with restrictions under I.R.C. § 7521 on directly contacting taxpayers who have indicated they prefer their representatives be contacted.	***Reference No. 2006-40-136, August 2006*** This is the eighth year that TIGTA could not determine whether IRS employees followed proper procedures to stop an interview if the taxpayer requested to consult with a representative. Neither TIGTA nor the IRS could readily identify cases in which a taxpayer requested a representative or the IRS contacted the taxpayer directly and bypassed the representative. IRS management information systems do not separately record or monitor direct contact requirements, and Congress has not explicitly required the IRS to do so. TIGTA does not recommend the creation of a separate tracking system.

Reference to Statutory Coverage	Explanation of the Provision	Comments/TIGTA Audit Status
Filing of a Notice of Lien I.R.C. § 7803(d)(1)(A)(iii)	Requires TIGTA to evaluate the IRS' compliance with required procedures under I.R.C. § 6320 upon the filing of a notice of lien.	***Reference No. 2006-30-094, June 2006*** TIGTA's review of a statistically valid sample of 150 Notices of Federal Tax Lien (NFTL) identified 7 NFTLs (4.67 percent) for which the IRS correctly mailed the lien notices; however, it did not mail the lien notices timely as required by I.R.C. § 6320. In addition, for another 2 NFTLs (1.33 percent), TIGTA could not determine if the IRS complied with the law because the IRS could not provide proof of timely mailing. In addition, the IRS did not follow its own internal guidelines when issuing lien notices, including the guidelines for notifying taxpayer representatives and resending lien notices when they are returned as undeliverable. In 34 (75.6 percent) of 45 NFTLs for which the taxpayer had a representative, the IRS did not notify the taxpayer representatives of the filing of the lien.
Extensions of the Statute of Limitations for Assessment of Tax I.R.C. § 7803(d)(1)(C) I.R.C. § 6501(c)(4)(B)	Requires TIGTA to include information regarding extensions of the statute of limitations for assessment of tax under I.R.C. § 6501 and the provision of notice to taxpayers regarding the right to refuse or limit the extension to particular issues or a particular period of time.	***Reference No. 2006-40-163, September2006*** There was not always documentation in the related case files that taxpayers were advised of their rights regarding assessment statute extensions. The IRS used both prior versions of the consent forms and the newly distributed revised consent forms that provide an explanation of the taxpayers' rights to limit or refuse to extend the assessment statute of limitations. In TIGTA's sample of 201 tax returns, 17 percent of the related case files reviewed did not contain sufficient documentation to support that the taxpayers had been advised of their rights regarding assessment statute extensions. In 13 percent of the case files with authorizations for third-party representation, the IRS did not document that the representatives were separately notified of the written communications advising taxpayers of their rights.
Levies I.R.C. § 7803(d)(1)(A)(iv)	Requires TIGTA to evaluate the IRS' compliance with required procedures under I.R.C. § 6330 regarding levies.	***Reference No. 2006-30-101, August 2006*** The IRS has effective controls over the issuance of systemically generated and manually prepared levies in both the Automated Collection System and the Integrated Case Processing System to prevent a levy from being generated unless there were at least 30 days between the date taxpayers received notice of their appeal rights and the date of the proposed levy. TIGTA's review of 60 systemically generated levies and 69 manually prepared levies showed that taxpayers received notification of their appeal rights at least 30 days prior the levy.

Reference to Statutory Coverage	Explanation of the Provision	Comments/TIGTA Audit Status
Collection Due Process I.R.C. § 7803(d)(1)(A)(iii) and (iv)	Requires TIGTA to evaluate the IRS' compliance with required procedures under I.R.C. §§ 6320 and 6330 regarding the taxpayers' rights to appeal lien or levy actions.	***Reference No. 2006-10-123, September 2006*** The IRS could not locate six percent of the closed Appeals Collection Due Process cases and 10 percent of closed Equivalent Hearing cases sampled. In addition, 81 percent of the Collection Due Process cases and 86 percent of the Equivalent Hearing cases received were missing at least one of the key documents needed to support and present Appeals' hearing results. Consequently, TIGTA could not determine if the IRS complied with legal guidelines and required procedures to protect taxpayer rights. The IRS also misclassified some requests for Collection Due Process and Equivalent hearings, causing taxpayers to receive the wrong type of hearing. In addition, TIGTA identified errors in suspending collection activity during hearings. Finally, some cases did not have documentation to support hearing officers' impartiality and decisions.
Seizures I.R.C. § 7803(d)(1)(A)(iv)	Requires TIGTA to evaluate the IRS' compliance with required procedures under I.R.C. §§ 6330 through 6344 when conducting seizures.	***Reference No. 2006-30-113, August 2006*** The IRS did not always comply with legal provisions and internal procedures when conducting seizures. A review of a random sample of 50 of 515 seizures conducted between July 1, 2004, and June 30, 2005, identified 15 instances in 13 of the seizures in which the IRS did not fully comply with the I.R.C. While the review did not identify any instances where the taxpayers were adversely affected, not following legal and internal guidelines could result in abuses of taxpayers' rights. In addition, TIGTA identified three areas in which internal guidelines for conducting seizures can be improved to help prevent possible abuses of taxpayers' rights.
Taxpayer Designations – Illegal Tax Protester Designation and Nonfiler Designation I.R.C. § 7803(d)(1)(A)(v)	An evaluation of IRS' compliance with restrictions under section 3707 of RRA 98 on designation of taxpayers.	***Reference No. 2006-40-098, July 2006*** In general, the IRS is in compliance with the prohibition on using Illegal Tax Protester (ITP) or similar designations. The IRS has not reintroduced past ITP codes on the Master File and has not reassigned any similar ITP designations to formerly coded ITP taxpayer accounts. Although one unique reference remains, the IRS has initiated steps to remove ITP references from the various formats of the Internal Revenue Manual. However, IRS employees continue to use ITP or similar designations in isolated instances in case narratives.

Reference to Statutory Coverage	Explanation of the Provision	Comments/TIGTA Audit Status
Disclosure of Collection Activities With Respect to Joint Returns I.R.C. § 7803(d)(1)(B) I.R.C. § 6103(e)(8)	Requires TIGTA to review and certify whether the IRS is complying with I.R.C. § 6103(e)(8) to disclose information to an individual filing a joint return on collection activity involving the other individual filing the return.	***Reference No. 2006-40-135, August 2006*** This is the eighth year that TIGTA could not determine whether the IRS is complying with the statutory requirements for responding to written collection activity information requests from joint filers. Neither TIGTA nor the IRS could readily identify any joint filer requests received nationwide. IRS management has decided not to develop a new management control process to track joint filer requests. IRS management information systems do not separately record or monitor joint filer requests, and Congress has not explicitly required the IRS to do so. TIGTA does not recommend the creation of a separate tracking system.
Taxpayer Complaints I.R.C. § 7803(d)(2)(A)	Requires TIGTA to include in each of its *Semiannual Reports to Congress* the number of taxpayer complaints received and the number of employee misconduct and taxpayer abuse allegations received by IRS or TIGTA from taxpayers, IRS employees and other sources.	Statistical results on the number of taxpayer complaints received are shown on page 53.
Administrative or Civil Actions With Respect to the Fair Tax Collection Practices Act of 1996 I.R.C. § 7803(d)(1)(G) I.R.C. § 6304 Section 3466 of RRA 98	Requires TIGTA to include information regarding any administrative or civil actions with respect to violations of the fair debt collection provision of I.R.C. § 6304, including a summary of such actions, and any resulting judgments or awards granted.	***Reference No. 2006-10-070, April 2006*** TIGTA's review of 45 cases closed during the period January 1 through December 31, 2005, that were coded as Fair Tax Collection Practices violations, and an additional 169 employee misconduct cases that were similar in nature to Fair Tax cases, identified 1 administrative action with respect to violations of Fair Tax Collection Practices. The employee left the IRS in lieu of removal. There were no civil actions that resulted in the IRS paying monetary settlements to taxpayers because of a Fair Tax Collection Practices violation.

Reference to Statutory Coverage	Explanation of the Provision	Comments/TIGTA Audit Status
Denial of Requests for Information I.R.C. § 7803(d)(1)(F) I.R.C. § 7803(d)(3)(A)	Requires TIGTA to include information regarding improper denial of requests for information from the IRS, based on a statistically valid sample of the total number of determinations made by the IRS to deny written requests to disclose information to taxpayers on the basis of I.R.C. § 6103 or 5 U.S.C. § 552(b)(7).	***Reference No. 2006-10-129, August 2006*** In 6.1 percent of the Freedom of Information Act (FOIA) and Privacy Act of 1974 (PA) cases sampled, the IRS did not provide complete responses and improperly withheld information from requestors. This represents a lower percentage of improper withholdings than reported in TIGTA's FY 2005 audit report (7.1 percent). In addition, the IRS improperly withheld information from requestors in 2.3 percent of the I.R.C. § 6103 cases sampled where information was denied or the IRS replied responsive records were not available. This represents a slightly lower percentage of improper withholdings than the 3.1 percent reported last year. The percentage of untimely responses to FOIA and PA requests also decreased to 7.3 percent in this year's sample, as compared with the untimely rates in previous audit reports, which ranged from 13.1 to 43.5 percent.
Adequacy and Security of the Technology of the IRS I.R.C. § 7803(d)(1)(D)	Requires TIGTA to evaluate the IRS' adequacy and security of its technology.	***Information Technology Reviews:*** Reference Number 2006-20-001, October 2005 Reference Number 2006-20-002, October 2005 Reference Number 2006-20-003, November 2005 Reference Number 2006-20-009, December 2005 Reference Number 2006-20-026, December 2005 Reference Number 2006-20-051, March 2006 Reference Number 2006-20-059, March 2006 Reference Number 2006-20-063, March 2006 Reference Number 2006-20-054, April 2006 Reference Number 2006-20-056, May 2006 Reference Number 2006-20-079, May 2006 Reference Number 2006-20-076, June 2006 Reference Number 2006-20-102, June 2006 Reference Number 2006-20-108, August 2006 ***Security Reviews:*** Reference Number 2006-20-071, October 2005 Reference Number 2006-20-021, December 2005 Reference Number 2006-20-031, February 2006 Reference Number 2006-20-068, March 2006 Reference Number 2006-20-080, May 2006 Reference Number 2006-20-110, July 2006 Reference Number 2006-20-111, July 2006 Reference Number 2006-20-166, September 2006 Reference Number 2006-20-167, September 2006 Reference Number 2006-20-177, September 2006 Reference Number 2006-20-178, September 2006 Reference Number 2006-20-179, September 2006

Reference to Statutory Coverage	Explanation of the Provision	Comments/TIGTA Audit Status
Federal Financial Management Improvement Act of 1996 31 U.S.C. § 3512	Requires TIGTA to evaluate the financial management systems to ensure compliance with Federal requirements, or establishment of a remediation plan with resources, remedies, and intermediate target dates to bring the IRS into substantial compliance.	***Reference No. 2006-10-069, March 2006*** TIGTA determined that no intermediate target dates were missed on the 38 open remedial actions; however, 23 dates were extended. The IRS has reasonable explanations for these extensions, and properly obtained concurrence from the Office of Management and Budget on corrective actions that extend beyond three years. The timely completion of up to 25 open remedial actions is in jeopardy due to significant funding shortfalls, including resources needed to further develop the Custodial Detail Data Base and the Integrated Financial System, two key financial management systems that address longstanding financial management weaknesses. These delays and funding shortfalls could further hinder the IRS' ability to timely resolve the issues that cause its noncompliance with the FFMIA.

Appendix IV
Section 1203 Standards

In general, the Commissioner of Internal Revenue shall terminate the employment of any IRS employee if there is a final administrative or judicial determination that, in the performance of official duties, such employee committed any misconduct violations outlined below. Such termination shall be a removal for cause on charges of misconduct.

Misconduct violations include:

- Willfully failing to obtain the required approval signatures on documents authorizing the seizure of a taxpayer's home, personal belongings, or business assets;
- Providing a false statement under oath with respect to a material matter involving a taxpayer or taxpayer representative;
- Violating, with respect to a taxpayer, taxpayer representative, or other employee of the IRS, any right under the Constitution of the United States, or any civil right established under Title VI or VII of the Civil Rights Act of 1964; Title IX of the Education Amendments of 1972; Age Discrimination in Employment Act of 1967; Age Discrimination Act of 1975; Section 501 or 504 of the Rehabilitation Act of 1973; or Title I of the Americans with Disabilities Act of 1990;
- Falsifying or destroying documents to conceal mistakes made by any employee with respect to a matter involving a taxpayer or taxpayer representative;
- Committing assault or battery on a taxpayer, taxpayer representative, or other employee of the IRS, but only if there is a criminal conviction, or a final judgment by a court in a civil case, with respect to the assault or battery;
- Violating the Internal Revenue Code of 1986, Treasury regulations, or policies of the IRS (including the Internal Revenue Manual) for the purpose of retaliating against, or harassing a taxpayer, taxpayer representative, or other employee of the IRS;
- Willfully misusing provisions of Section 6103 of the Internal Revenue Code of 1986 for the purpose of concealing information from a Congressional inquiry;
- Willfully failing to file any return of tax required under the Internal Revenue Code of 1986 on or before the date prescribed therefore (including any extensions), unless such failure is due to reasonable cause and not to willful neglect;
- Willfully understating Federal tax liability, unless such understatement is due to reasonable cause and not to willful neglect; and
- Threatening to audit a taxpayer for the purpose of extracting personal gain or benefit.

The Commissioner of Internal Revenue may mitigate the penalty of removal for the misconduct violations outlined above. The exercise of this authority shall be at the sole discretion of the Commissioner and may not be delegated to any other officer. The Commissioner, in his/her sole discretion, may establish a procedure that will be used to determine whether an individual should be referred to the Commissioner for determination. Any mitigation determination by the Commissioner in these matters may not be appealed in any administrative or judicial proceeding.

The wisdom of man never yet contrived a system of taxation that would operate with perfect equality.

~ Andrew Jackson

Appendix V
Data Tables Provided by the IRS

The memorandum copied below is the IRS transmittal to TIGTA. The tables that follow the memorandum contain information as provided by the IRS to TIGTA and consist of IRS employee misconduct reports from the IRS Automated Labor and Employee Relations Tracking System (ALERTS). Also, data concerning substantiated I.R.C. § 1203 allegations are included. IRS management conducted inquiries into the cases reflected in these tables.

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

HUMAN CAPITAL OFFICE

October 4, 2006

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

FROM: Barbara B. Pabotoy for
Director, Workforce Relations Division

SUBJECT: Input for the Treasury Inspector General for Tax Administration (TIGTA) Semiannual Report to Congress

In response to your memorandum of August 3, 2006 to the Commissioner, I am providing the following information to you to meet your reporting requirements as defined in 26 U.S.C. §7803(d)(1)(E) and 26 U.S.C. §7803(d)(2)(A)(ii) for the period April 1, 2006 to September 30, 2006.

- Report of Employee Misconduct by Disposition Groups
- Report of Employee Misconduct – National Summary
- Summary of Substantiated Section 1203 Inquiries Recorded in ALERTS

The attached tables contain information concerning alleged misconduct reported to IRS managers, the disposition of the allegations that were resolved during the period, and the status of the inventory as of September 30, 2006. The tables contain information about alleged misconduct that was investigated by both TIGTA and IRS management. The IRS received these allegations from taxpayers, IRS employees and other sources, and recorded them in the Automated Labor and Employee Relations System (ALERTS).

The Summary of Substantiated §1203 Allegations contains information on the disposition of substantiated §1203 allegations. During this period, IRS managers substantiated 216 §1203 allegations and removed 34 employees. In four of the removals IRS managers acted based on a TIGTA investigation. Twenty-one employees retired or resigned prior to a final administrative action by management. The Commissioner mitigated proposed removals in 68 cases. There are an additional ten cases to be reviewed by the Commissioner for mitigation.

If you have any questions or need additional information, please call me at 622-6383, or a member of your staff may contact Christine Adams at 622-9363.

Attachments (3)

cc: Commissioner
Deputy Commissioner Services and Enforcement
Deputy Commissioner Operations Support
National Taxpayer Advocate
Chief, EEO & Diversity
Chief, Communications & Liaison
Associate Chief Counsel (GLS)

Report of Employee Misconduct for the Period April 01, 2006 through September 30, 2006 Summary by Disposition Groups (Table provided by the IRS)

Disposition	TIGTA Investigations	Administrative Cases	Employee Tax Matter Cases	Background Investigations	Total
Removal	43	197	32	7	**279**
Separation of Probationary Employees	3	112		8	**123**
Separation of Temporary Employees	2	37	7	7	**53**
Resignation/Retirement	69	174	38	14	**295**
Suspensions	80	276	82	8	**446**
Reprimands	109	496	200	23	**828**
Counseling		362	216	71	**649**
Alternative Discipline	20	96	25		**141**
Clearance	129	117	8		**254**
Closed Without Action	193	289	56	163	**701**
Closed Without Action (Caution Statement)	101	121	38	92	**352**
Forwarded to TIGTA		7			**7**
Suspended – Waiting Supplemental	7				**7**
Termination for Abandonment of Position		3			**3**
Case Suspended Pending Employee Return To Duty	2	1	4		**7**
Prosecution Pending for TIGTA ROI's	6				**6**
Total	**764**	**2,288**	**706**	**393**	**4,151**

Source: Automated Labor and Employee Relations Tracking System (ALERTS)
This report is being produced in accordance with 26 USC § 7803(d)(2) and § 4(a)2 of Treasury Delegation Order 115-01, January 14, 1999 Extract Date: Sunday, October 01, 2006 Report ID = T1R3a

Report of Employee Misconduct for the Period April 01, 2006 through September 30, 2006 National Summary (Table provided by the IRS)

Case Type	Opening Inventory	Conduct Cases Received	Cases Closed			Closing Inventory
			Conduct Issues	Duplicates	Non-Conduct Cases	
TIGTA Investigations ROI[1]	595	743	(764)	(5)	(0)	**569**
Administrative Case[2]	1,085	2,017	(2,288)	(27)	(5)	**782**
Employee Tax Compliance Case[3]	622	726	(706)	(28)	(0)	**614**
Background Investigations[4]	153	375	(393)	(1)	(0)	**134**
Total	**2,455**	**3,861**	**(4,151)**	**(61)**	**(5)**	**2,099**

Source: Automated Labor and Employee Relations Tracking System (ALERTS)

This report is being produced in accordance with 26 USC § 7803(d)(2) and § 4(a)2 of Treasury Delegation Order 115-01, January 14, 1999

Extract Date: Sunday, October 01, 2006 Report ID = T1R1

[1] TIGTA Investigations (ROI) - Any matter involving an employee in which TIGTA conducted an investigation into alleged misconduct and referred a Report of Investigation (ROI) to IRS for appropriate action.
[2] Administrative Case - Any matter involving an employee in which management conducted an inquiry into alleged misconduct.
[3] Employee Tax Compliance Case - Any conduct matter that is identified by the Employee Tax Compliance program which becomes a matter of official interest.
[4] Background Investigation - Any matter involving an NBIC investigation into an employee's background that is referred to management for appropriate action.

Summary of Substantiated I.R.C. § 1203 Allegations Recorded in ALERTS for the Period April 01, 2006 through September 30, 2006 (Table provided by the IRS)

§ 1203 Violation	Removals[1]	Resigned/ Retired	Probation Separation	Removed On Other Grounds	Penalty Mitigated	In Personnel Process	Total
Seizure Without Approval	0	0	0	0	0	0	**0**
False Statement Under Oath	0	0	0	0	0	0	**0**
Constitutional & Civil Rights Issues	0	0	0	0	0	0	**0**
Falsifying or Destroying Records	0	1	0	0	1	1	**3**
Assault or Battery	0	0	0	0	0	0	**0**
Retaliate or Harass	0	0	0	0	0	1	**1**
Misuse of §6103	0	0	0	0	0	0	**0**
Failure to File Federal Tax Return	13	9	0	3	33	40	**98**
Understatement of Federal Tax Liability	21	11	0	3	34	45	**114**
Threat to Audit for Personal Gain	0	0	0	0	0	0	**1**
Totals	**34**	**21**	**0**	**6**	**68**	**87**	**216**

Source: Automated Labor and Employee Relations Tracking System (ALERTS) and § 1203 Review Board records.

Extract Date: Sunday, October 01, 2006

[1] The cases reported as "Removals" and "Penalty Mitigated" do not reflect the results of any third-party appeal.