



Treasury Inspector General for Tax Administration Office of Audit

EXAMINERS DID NOT ALWAYS PROPERLY SELECT THE PRIOR AND/OR SUBSEQUENT YEAR TAX RETURNS

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Highlights

Highlights of Report Number: 2009-30-034 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

When a taxpayer's tax return is selected for examination, to improve efficiency and identify additional tax owed, examiners should also inspect and examine, if warranted, prior, subsequent, and related year tax returns. Fourteen (21 percent) of 68 sample cases warranted examination of the prior and/or subsequent year returns but were not selected for examination. When examiners do not make the proper decision to select returns for examination, taxpayers are not provided equitable treatment, and the examination is not as effective for improving taxpayer compliance on future tax returns.

WHY TIGTA DID THE AUDIT

The audit was initiated to determine whether Examination function employees appropriately inspect and examine prior and/or subsequent year tax returns when warranted. The Internal Revenue Service (IRS) policy is that an examination should cover not only the single tax period that initiated the examination, but also any and all open tax periods that affect the taxpayer's return. In addition, examining the prior and/or subsequent year returns and all related tax returns at the same time has greater tax compliance impact.

WHAT TIGTA FOUND

Examiners did not always properly inspect prior and/or subsequent year returns and, therefore, did not make a proper decision to select these returns for examination when warranted. In addition, examiners did not adequately document the decision to examine associated years' tax returns.

In 26 (38 percent) of 68 sampled cases, there was no evidence that examiners inspected either the prior or subsequent year returns to identify similar issues to the year under examination or if large, unusual, or questionable items existed that would have warranted examination. TIGTA identified 14 (21 percent) of

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68 cases that warranted the examination of a prior and/or subsequent year return, but the returns were not selected for examination. Also, in 33 (49 percent) cases, the case files did not include adequate documentation to support the decision for not selecting the prior and/or subsequent year returns for examination.

Unlike field examiners, IRS procedures do not permit campus Correspondence function tax examiners to select associated year returns when they conduct examinations. From an analysis of 68 additional correspondence examination cases, TIGTA identified 31 (46 percent) cases in which tax examiners could have examined the subsequent year tax return because the same issues adjusted on the tax year under examination were present on the subsequent year return.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Director, Examination, Small Business/Self-Employed Division, ensure that group managers place the appropriate emphasis on the requirement to consider selection of prior and/or subsequent year tax returns for examination during documented reviews, discussions, and/or other case related activities with their examiners; ensure that group managers require a clear-cut justification in the workpapers; and require that tax compliance officers use the multi-year lead sheet during examinations. TIGTA also recommended that the Acting Director, Campus Compliance Services, Small Business/Self-Employed Division, determine if there is an opportunity for campus Correspondence function tax examiners to expand examinations to include subsequent year returns for limited issues

In their response to the report, IRS officials agreed with our recommendations. Management plans to reemphasize the requirements for consideration of prior and/or subsequent year returns for examination. In addition, management plans to issue a memorandum requiring that all office examiners use the multi-year lead sheets to document their actions regarding consideration of prior and/or subsequent year returns, revise Form 4700 and related workpapers to correspond with the use of the administrative lead sheets, and update the Internal Revenue Manual. Management also plans to revise campus procedures to ensure that the appropriate analysis is conducted on current year correspondence deficiency case closures to determine if the same issue appears in the subsequent year return. Followup adjustment cases will receive priority in the examination workload assignment plan.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2009reports/200930034fr.pdf>.

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