



*Tax Examiners Did Not Always Resolve
Return Delinquency Cases, and Computer
Checks Did Not Identify Unfiled Returns*

December 20, 2007

Reference Number: 2008-30-027

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

3(d) = Identifying Information - Other Identifying Information of an Individual or Individuals



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

December 20, 2007

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Michael R. Phillips

FROM:

Michael R. Phillips

Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Tax Examiners Did Not Always Resolve Return
Delinquency Cases, and Computer Checks Did Not Identify Unfiled
Returns (Audit # 200630008)

This report presents the results of our review of the Return Delinquency Program. The overall objective of this review was to determine whether the Compliance Services Collection Operations administered the Return Delinquency Program in a manner that ensured accurate and timely resolution on Return Delinquency notice responses. This audit was included in the Treasury Inspector General for Tax Administration's Fiscal Year 2007 Annual Audit Plan.

Impact on the Taxpayer

The Internal Revenue Service (IRS) Return Delinquency Program identifies taxpayers who have not filed a tax return by the return due date. The IRS reported it issued more than 1.6 million initial Return Delinquency notices to Business Master File¹ taxpayers in Calendar Year 2006. Some of the Return Delinquency cases we reviewed were not resolved accurately and timely, and the IRS needs to improve its computer program to identify business taxpayers that may be liable for employment taxes. Accurate and timely case actions reduce taxpayer burden and redefined return delinquency identification criteria increase revenue.

Synopsis

We determined some operational internal controls were effectively established. Managers systemically assigned Return Delinquency cases to tax examiners, managers received proper

¹ The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.



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training, and managers at ^{3(d)} ██████████ Campus² conducted required operational and workload reviews.

However, our review determined that tax examiners' actions on 36 (24 percent) of 150 cases reviewed were incorrect, incomplete, or not timely.³ In 23 cases, the tax examiners did not make the correct case resolution decision, inappropriately eliminated future inquiries for missing returns, or did not complete internal processing requirements. The remaining 13 case actions were not completed within the IRS' 45-day time standard.⁴ When Return Delinquency cases are not properly resolved, taxpayers might be unnecessarily burdened with additional notices requesting returns they are not liable for filing. The issues were mainly confined to ^{3(d)} ██████████ Campus and results were similar to prior reviews conducted by IRS management.

Our review identified a serious weakness in which the Return Delinquency computer program did not identify an unfiled Employer's Quarterly Federal Tax Return (Form 941) when an Employer's Annual Federal Unemployment (FUTA) Tax Return (Form 940) was filed. As a result, a significant amount of dollars may not be collected on accounts without corresponding Forms 941.

We identified 28,933 taxpayers on IRS computer records that filed a 2005 Form 940 and reported more than \$3 billion in taxable Federal Unemployment Tax Act⁵ wages, but these taxpayers had not filed Form 941 for any quarter of 2005. Since the Federal Unemployment Tax Act tax is imposed on only the first \$7,000 in wages paid to each employee during the calendar year, the potential amount of unreported wages paid subject to Federal income tax withholding, Social Security, and Medicare taxes could significantly exceed the taxable Federal Unemployment Tax Act wages, and the related unpaid tax could be significant.

An IRS official informed us the current Return Delinquency Program checks the filing requirement of only a specified return type and it cannot cross reference other tax forms for an indicator that a return is due. We were advised that this limitation and other issues prompted IRS management to initiate development of the Case Creation Nonfiler Inventory Program for business taxpayers. When this program is fully developed in Fiscal Year 2008, the IRS official expects to have the ability to cross reference third-party information documents and other tax return filing requirements for indicators a return is due.

² The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

³ We reviewed 50 closures from each of the 2 Taxpayer Delinquency Investigation teams at ^{3(d)} ██████████ Campus and 50 closures from the 1 Taxpayer Delinquency Investigation team at ^{3(d)} ██████████ Campus. See Appendix IV for a breakdown of the 150 cases by type of tax return and type of case resolution.

⁴ We did not determine why the time standard was not met. One of these cases is included in the 23 cases in which the tax examiner did not take all appropriate actions.

⁵ 26 U.S.C. § 3311 (2005).



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Recommendations

We recommended ^{3(d)} [redacted] Campus Compliance Services Collection Operations manager ensure reviews that assess team managers' practices in performing technical case reviews are completed quarterly. The Director, Campus Filing and Payment Compliance, Small Business/Self-Employed Division, should modify the Return Delinquency case creation criteria to ensure delinquency inquiries are made of related tax period Forms 941 and Form 940 and should revise procedures to require full compliance checks for delinquent employment tax returns of "in business" employers.

Response

IRS management agreed with all of our recommendations. IRS officials ^{3(d)} [redacted] have implemented review requirements for front line and department managers. In addition, the IRS Headquarters Office plans to perform an Operational Review in ^{3(d)} [redacted] 2008 to follow-up on their previous recommendations and on the findings in this report. IRS officials also advised that pending changes to the business Return Delinquency case creation program will enable cross checking of Forms 941 and Forms 940 beginning in April 2008. In addition, procedures requiring full compliance checks of "in business" employers when an unemployment tax return has been filed were implemented in November 2007. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-5894.



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Abbreviations

CSCO Compliance Services Collection Operations

IRS Internal Revenue Service



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Background

The Internal Revenue Service (IRS) Return Delinquency Program identifies taxpayers who have not filed a tax return by the return due date. For business taxpayers, the due date for filing returns varies based on the type of return and/or the taxpayer's selected accounting period. Therefore, Business Master File¹ Return Delinquency cases are created throughout the year after the IRS completes processing for a specified type of return. The Return Delinquency computer program identifies a return as delinquent when a filing requirement² exists on a taxpayer's record that does not have the specified return posted. The IRS issues notices requesting original returns from taxpayers whose delinquent return modules are selected by the Return Delinquency Program. The IRS reported it issued more than 1.6 million initial Return Delinquency notices to Business Master File taxpayers in Calendar Year 2006.

The IRS processes taxpayer responses to Business Master File Return Delinquency notices at its five Small Business/Self-Employed Division Compliance Services Collection Operations (CSCO) sites in Holtsville, New York; Cincinnati, Ohio; Memphis, Tennessee; Ogden, Utah; and Philadelphia, Pennsylvania. The CSCO management is responsible for establishing controls to manage the Return Delinquency workload and to ensure resolution actions on Return Delinquency notice responses are completed timely and accurately. The operation and department managers should perform operational reviews at least once a year. These reviews should evaluate both organizational and individual performance in accomplishing Program objectives. Team managers should perform workload reviews to evaluate employee performance, identify training needs, and ensure protection of taxpayer rights.

This review was performed in ^{3(d)} Campus³ ^{3(d)} Campus³ ^{3(d)} during the period November 2006 through July 2007.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit

¹ The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

² A code recorded on the entity section of the Master File to identify the type of return a taxpayer must file. The Master File is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

³ The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



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objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

Some Operational Controls Were Effectively Established

The clerical function in each campus batched Return Delinquency correspondence received from taxpayers and used automation to control either the individual correspondence item or a batch of 25 or fewer items. Team managers systemically assigned the inventory to tax examiners in their groups. Team managers also used the inventory control system and management information reports to monitor inventory activity. The IRS advised us the volume of Return Delinquency correspondence items closed at ^(d) ██████████ Campuses in Fiscal Year 2006 was ^(d) ██████████.

During the last quarter of Fiscal Year 2006, the CSCO conducted comprehensive training in "Employee Performance Feedback for Campus Collection Managers." The training topics reinforced the managers' key role of holding employees accountable for proper management of assigned inventories and for timely and accurate account resolution actions. The training also emphasized the team managers' responsibility for recordation of required workload reviews and for providing evaluative feedback to their employees.

At ^(d) ██████████ CSCO manager and the Return Delinquency department manager documented required reviews of their operations in Fiscal Year 2006. ^(d) ██████████ Campus experienced changes ^(d) ██████████ and there were no operational reviews performed by the CSCO manager or the Return Delinquency department manager in Fiscal Year 2006. The Return Delinquency team managers and the lead tax examiners at both Campuses documented evaluative work reviews in the Embedded Quality Review System.⁴ In addition, the Return Delinquency team managers documented in a written narrative format other types of work reviews performed. Topics in group meeting minutes included case resolution procedures or guidance.

Tax Examiners Did Not Always Take Appropriate Actions When Resolving Return Delinquency Cases

The Return Delinquency computer program identifies tax returns that have not been filed. In those instances in which a return has not posted to the taxpayer's record, a Return Delinquency notice is sent to the taxpayer requesting information about his or her tax return. Tax examiners must review the responses to the Return Delinquency notices, perform appropriate case research,

⁴ The Embedded Quality Review System is an online quality review database team managers use to record case review results and generate employee feedback reports reflecting the quality and accuracy of case processing.



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and apply established case resolution procedures to determine the taxpayers' filing liability. If taxpayers provide new or changed information such as a personal or business telephone number with their responses, tax examiners should update the computer records. Tax examiners should also attempt to resolve all issues on each case during the initial resolution of the taxpayer's inquiry. The IRS goal is to resolve taxpayer correspondence within 45 calendar days after the IRS receives it.

Our review of a random sample of 150 Return Delinquency correspondence cases⁵ showed tax examiners' actions on 36 cases (24 percent) were incorrect, incomplete, or not timely. The 36 cases included 23 instances in which tax examiners did not make the correct case resolution decision, inappropriately eliminated future inquiries for missing returns, or did not complete internal processing requirements. The remaining 13 case actions were not completed within the IRS' 45-day time standard.⁶ The number of days to resolve these cases ranged from 46 to 77 days. When Return Delinquency cases are not properly resolved, taxpayers might be unnecessarily burdened with additional notices requesting returns they are not liable for filing.

Most of the 36 issues occurred in cases worked in ^{(b)(6)} Campus. In discussions about our findings, IRS management advised us that the workload at ^{(b)(6)} Campus had shifted from Individual Master File⁷ to Business Master File work and from the Balance Due Program to the Return Delinquency Program. They attributed the majority of tax examiners' errors to lack of experience with the new workload. They further advised that their local review of closed Return Delinquency cases in March 2007 identified similar errors (e.g., incomplete case actions); and the errors were discussed at team meetings to ensure employees are aware of proper procedures.

These findings are similar to the results of an IRS Headquarters' Campus Compliance Services operational review performed at ^{(b)(6)} Campus in ^{(b)(6)} 2006. The IRS review results indicated cases reviewed had improper closing actions. The review results attributed the cause of the improper closing actions to tax examiners not understanding the taxpayer correspondence. The review results recommended tax examiners receive additional training in interpreting taxpayer correspondence and in other specified problem areas. It also stipulated additional reviews of tax examiners' work should be performed to ensure errors do not continue. A subsequent operational review completed in ^{(b)(6)} 2007 found approximately 26 percent of the cases reviewed had errors. The review results indicated the majority of cases with errors did not receive all of the necessary closing actions to address the taxpayers' responses indicating a change in the entity (e.g., change to another Employer Identification Number) or a change in

⁵ We reviewed 50 closures from each of the 2 Taxpayer Delinquency Investigation teams at ^{(b)(6)} Service Center and 50 closures from the 1 Taxpayer Delinquency Investigation team at ^{(b)(6)} Service Center. See appendix IV for a breakdown of the 150 cases by type of tax return and type of case resolution.

⁶ We did not determine why the time standard was not met. One of these cases is included in the 23 cases in which the tax examiner did not take all appropriate actions.

⁷ The IRS database that maintains transactions or records of individual tax accounts.



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employment tax filing requirements. The review results did not contain any additional recommendations regarding this area.

We did not identify any additional causes for the errors at §(d) Campus. However, the errors identified by our review and internal IRS reviews are a strong indicator of potential weaknesses in the effectiveness of various required managerial reviews. In Fiscal Year 2006, there were no operational reviews of team managers to ensure the effectiveness of their management practices. The IRS' 2006 guidelines on "Employee Performance Feedback for Campus Collection Managers" require that on a quarterly basis, department managers are to ensure team managers are performing technical case reviews. Team manager technical case reviews are essential to maintain and improve employees' job knowledge and skills and to identify performance deficiencies. Team managers are required to perform technical reviews of two of each employee's cases per month. The team managers we interviewed indicated they had not identified any error trends in their reviews. Although we verified that reviews were documented in the Embedded Quality Review System, we could not assess the adequacy of team managers' technical case reviews because taxpayer correspondence on closed cases is normally destroyed after managerial reviews are completed.

In September 2007, §(d) Campus advised us that actions have been initiated to improve the review process by stressing the need for increased technical review and oversight by managers. Management plans to perform quarterly comparisons between the Quality Review and managerial reviews and will require the Department Manager to conduct annual operational reviews of each Department and follow-up reviews until the problems identified are completely addressed.

Recommendation

Recommendation 1: §(d) Campus CSCO manager should ensure reviews of team managers' practices in performing technical case reviews are completed during required quarterly team operations reviews. These reviews should ensure team managers are appropriately selecting random and/or targeted samples of each employee's inventory for technical case reviews. The reviews should include an assessment of whether the team managers are correctly addressing the accuracy of case decisions and closing actions in their reviews.

Management's Response: IRS management agreed with this recommendation. IRS officials §(d) have implemented review requirements for front line and department managers. In addition, the IRS Headquarters Office plans to perform an Operational Review in §(d) 2008 to follow-up on their previous recommendations and on the findings in this report.



Tax Examiners Did Not Always Resolve Return Delinquency Cases, and Computer Checks Did Not Identify Unfiled Returns

A Systemic Problem Caused Unfiled Forms 941 Not to Be Identified

Our review identified a serious weakness in which the Return Delinquency computer program did not identify an unfiled Employer's Quarterly Federal Tax Return (Form 941) when an Employer's Annual Federal Unemployment (FUTA) Tax Return (Form 940) was filed. The Return Delinquency computer program should identify taxpayers with a Form 941 or a Form 940 filing requirement and no return posted to the taxpayer's record for a specified tax period. However, the current computer program does not cross reference both forms to identify a related return that is due but not filed. As a result, a significant amount of dollars may not be collected on accounts where related Forms 941 were not filed.

Business taxpayers who have employees are generally required to file Form 941. These returns must be filed each quarter and include wages paid subject to Federal income tax withholding, Social Security, and Medicare taxes. Generally, gross wages are subject to income tax withholding and Medicare taxes. The maximum wage amount subject to Social Security tax is set by law and was limited to \$90,000 in 2005. Business taxpayers that meet wage payment thresholds are also required to file Form 940 annually and pay taxes that fund unemployment payments to workers who have lost their jobs. Forms 940 are used to report Federal Unemployment Tax Act⁸ taxes that are imposed on the first \$7,000 in wages paid to each employee during the calendar year.

Our sample review of 150 cases included 20 Return Delinquency inquiries for the Form 940. Our analysis of the IRS' records for 13 of these taxpayers identified no related Form 941 was filed and no delinquency inquiry was ever generated for the delinquent quarterly forms. Our analysis not only identified a systemic weakness in the computer selection of Form 941 Return Delinquency cases but also a need for a change in the requirement for employees to perform a full compliance check to ensure taxpayers file all required tax returns.

Tax examiners obtained taxable returns from 3 of the 13 taxpayers that reported a combined total of more than \$177,000 in taxable Form 940 wages. However, these taxpayers did not file the related delinquent Form 941 returns and no Return Delinquency case was computer generated for these taxpayers. Since the Federal Unemployment Tax Act tax is imposed on only the first \$7,000 in wages paid to each employee during the calendar year, the potential amount of unreported wages paid and corresponding taxes reported on Forms 941 could significantly exceed the taxable Form 940 wages. As a result, the liabilities on these missing Form 941 returns could be significant.

To determine the potential universe of taxpayers that filed Forms 940 but did not file any quarterly Forms 941 for Tax Year 2005, we analyzed IRS computer records. Our analyses identified 28,933 taxpayers that had not filed any Forms 941 during Tax Year 2005 but filed Tax Year 2005 Forms 940 reporting a combined total of more than \$3 billion in taxable Federal

⁸ 26 U.S.C. § 3311 (2005).



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Unemployment Tax Act wages.⁹ We cannot reasonably estimate the amount of taxes due on these unfiled Forms 941 because we do not know the total amount of wages paid and potential amounts withheld. However, the amount of Form 941 wages could far exceed the \$3 billion reported on the Forms 940 and the related unpaid tax could be significant.

In addition to the systemic weakness, management's decision to no longer require tax examiners to perform full compliance checks contributed to the Forms 941 not being filed. Prior to September 2006, CSCO employees were required to perform a full compliance check if a taxpayer had other tax periods in a Return Delinquency status and if any missing return was due within 6 years of the current calendar year. New procedures were then established for employees to perform a full compliance check only if the taxpayer's response met specified criteria. Management relied upon the Return Delinquency computer program to identify unfiled Forms 941.

An IRS official informed us the current Return Delinquency Program checks the filing requirement of only a specified return type and it cannot cross reference other tax forms for an indicator that a return is due. We were advised that this limitation and other issues prompted management officials to initiate development of the Case Creation Nonfiler Inventory Program for business taxpayers. When this program is fully developed in Fiscal Year 2008, the IRS official expects to have the ability to cross reference third-party information documents and other tax return filing requirements for indicators a return is due.

Recommendation

Recommendation 2: The Director, Campus Filing and Payment Compliance, Small Business/Self-Employed Division, should modify the Return Delinquency case creation criteria to ensure delinquency inquiries are made of related tax period Forms 941 and Form 940. The Return Delinquency case resolution procedures should be revised to require full compliance checks for delinquent employment tax returns of "in business" employers.

Management's Response: IRS management agreed with this recommendation. IRS officials advised that pending changes to the business Return Delinquency case creation program will enable cross checking of Forms 941 and Forms 940 beginning in April 2008. In addition, procedures requiring full compliance checks of "in business"

⁹ Our criteria for identifying taxpayers that did not file quarterly Forms 941 when Forms 940 were present excluded taxpayers that filed a 2005 Employer's Annual Federal Tax Return for Agricultural Employees (Form 943) and taxpayers identified as subsidiary corporations on the Master File.



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employers when an unemployment tax return has been filed were implemented in November 2007.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the CSCO administered the Return Delinquency Program in a manner that ensured accurate and timely resolution on Return Delinquency notice responses. To accomplish this objective, we:

- I. Evaluated whether management in the campuses¹ we visited had established appropriate controls over the processing of Return Delinquency notice responses.
 - A. Reviewed Internal Revenue Manual procedures for processing notice responses and workflow management.
 - B. Observed the process for receipt, control, batching, and assignment of incoming notice responses and evaluated the adequacy of controls over these processes.
 - C. Determined whether the CSCO manager and the Return Delinquency department manager performed and documented required reviews of the Return Delinquency Program.
 - D. Determined whether team managers performed and documented required reviews of the work assigned to employees and took appropriate actions to ensure the quality of work.
- II. Reviewed random samples of 50 Return Delinquency correspondence closures ^{(b)(3)(d)} Campus and 100 from ^{(b)(3)(d)} Campus to determine whether actions were accurate and completed within the time standard set by the IRS.² We selected samples of Return Delinquency correspondence closures from a population of 1,588 from ^{(b)(3)(d)} Campus and an estimated population of 7,521 from ^{(b)(3)(d)} Campus.³ We used a random sample to ensure each item in the population had an equal opportunity to be selected.

¹ The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

² We reviewed 50 closures from the 1 Taxpayer Delinquency Investigation team at ^{(b)(3)(d)} Campus and 50 closures from each of the 2 Taxpayer Delinquency Investigation teams at ^{(b)(3)(d)} Campus.

³ In December 2006, we requested ^{(b)(3)(d)} Campuses to hold specified Business Master File Return Delinquency correspondence for our review. We visited ^{(b)(3)(d)} Campus in ^{(b)(3)(d)} 2007 ^{(b)(3)(d)} ^{(b)(3)(d)} Campus in ^{(b)(3)(d)} 2007. We counted each item of correspondence from ^{(b)(3)(d)} Campus. The correspondence from ^{(b)(3)(d)} Campus was previously batched and counted; however, we were advised that some documents were removed for additional processing. To estimate the population of correspondence, we relied upon the volume recorded on each batch and auditor judgment.



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- A. Reviewed each case and evaluated whether the closing action was consistent with instructions in the Internal Revenue Manual or other procedures prescribed by the IRS National Headquarters.
- B. Compared the notice response received date and closing action date to determine if actions were completed within the 45-day time period prescribed by the IRS National Headquarters.
- C. Analyzed the IRS' Business Master File⁴ for Tax Year 2005 and determined the potential universe of taxpayers that filed an Employer's Annual Federal Unemployment (FUTA) Tax Return (Form 940) but did not file the related Employer's Quarterly Federal Tax Return (Form 941).
 1. We researched the Integrated Data Retrieval System⁵ for several taxpayer accounts in the universe of accounts that met our analysis criteria. We verified that the taxpayers had filed Form 940 but did not file Form 941.

⁴ The Business Master File is the IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

⁵ The IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.



Tax Examiners Did Not Always Resolve Return Delinquency Cases, and Computer Checks Did Not Identify Unfiled Returns

Appendix II

Major Contributors to This Report

Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs)
Parker Pearson, Director
Edward Gorman, Audit Manager
Doris A. Cervantes, Senior Auditor
Una Smith, Senior Auditor
Stephen A. Elix, Auditor
Judith Harrald, Information Technology Specialist



Tax Examiners Did Not Always Resolve Return Delinquency Cases, and Computer Checks Did Not Identify Unfiled Returns

Appendix III

Report Distribution List

Acting Commissioner C
Office of the Commissioner – Attn: Acting Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Director, Campus Compliance Services, Small Business/Self-Employed Division SE:S:CCS
Director, Campus Filing and Payment Compliance, Small Business/Self-Employed Division SE:S:CCS
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
 Deputy Commissioner for Services and Enforcement SE
 Commissioner, Small Business/Self-Employed Division SE:S



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Appendix IV

Resolution Actions in Sample of Return Delinquency Correspondence

Type of Return	Tax Examiner Case Resolution Decision					Totals
	Taxpayer not liable for return period	Taxpayer no longer liable for return	Taxpayer previously filed return	Taxpayer return secured	Account previously resolved or other actions required	
United States Gift (and Generation-Skipping Transfer) Tax Return (Form 709)					1	1
Quarterly Federal Excise Tax Return (Form 720)	1			1		2
Employer's Annual Federal Unemployment (FUTA) Tax Return (Form 940)	3	5	1	9	2	20
Employer's QUARTERLY Federal Tax Return (Form 941)	13	22	3	39	22	99
U.S. Return of Partnership Income (Form 1065)		2				2
U.S. Corporation Income Tax Return (Form 1120)	15	3		4	3	25
Annual Return for Partnership Withholding Tax (Section 1446) (Form 8804)					1	1
Totals	32	32	4	53	29	150

Source: Treasury Inspector General for Tax Administration analysis of sample results.



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Appendix V

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

RECEIVED
DEC. 13 2007

November 30, 2007

MEMORANDUM FOR MICHAEL PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kathy K. Petronchak *Kathy K. Petronchak*
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Tax Examiners Did Not Always
Resolve Return Delinquency Cases and Computer Checks Did
Not Identify Unfiled Returns (Audit # 200630008)

This memorandum is in response to your report entitled "Tax Examiners Did Not Always Resolve Return Delinquency Cases and Computer Checks Did Not Identify Unfiled Returns". We agree with the recommendations contained in the report.

Increasing voluntary filing compliance is an important component of addressing the tax gap. Your review revealed that some delinquent return cases were not accurately resolved at **(b)(4)** Campus due primarily to review and training shortfalls. These issues have since been addressed.

In addition, your report identified a programming constraint which did not allow for cross-checking of unemployment tax returns (Form 940) with employment tax returns (Form 941). We acknowledge the cross-check of Forms 940 and 941 was not systemically available for the cases created and that procedures regarding full compliance checks need to be revised until the systemic cross-check is available. This same constraint was previously identified by management and resources were allocated for corrective programming. The programming is scheduled for implementation in April 2008.

In the interim, and in accordance with the recommendation in this report, we issued changes to the Internal Revenue Manual (IRM) effective November 5, 2007. These changes require Small Business/Self-Employed (SB/SE) Campus operations to perform a full compliance check for delinquent employment tax returns of in-business employers when an unemployment tax return has been filed. These interim procedures will remain in effect until the programming enhancement is completed.

Attached are detailed comments on the recommendations. If you have any questions, please contact Jeffrey Basalla, Director, SB/SE Campus Compliance Services, Filing and Payment Compliance at 202-283-7399.

Attachment



Tax Examiners Did Not Always Resolve Return Delinquency Cases, and Computer Checks Did Not Identify Unfiled Returns

Attachment

Recommendation 1:

(b) (5) - DPP Campus Compliance Services Collection Operations (CSCO) manager should ensure reviews of team managers' practices in performing technical case reviews are completed during required quarterly team operations reviews. These reviews should ensure team managers are appropriately selecting random and/or targeted samples of each employee's inventory for technical case reviews. The reviews should include an assessment of whether the team managers are correctly addressing the accuracy of case decisions and closing actions in their reviews.

Corrective Action:

(b) (5) - DPP implemented review requirements for front line and department managers prior to issuance of this report. Headquarters has scheduled the FY 2008 Operation Review for the week of (b) (5) - DPP 2008 and will follow-up on the recommendations of the previous Operation Reviews as well as this TIGTA Audit and report findings.

Implementation Date:

March 15, 2008

Responsible Official(s):

Director, Campus Compliance Services, Filing & Payment Compliance
Director, (b) (5) - DPP

Corrective Action Monitoring Plan:

The Filing Compliance Program Manager will monitor the corrective actions and notify the Director, Filing and Payment Compliance of any delays.

Recommendation 2:

The Director, Campus Filing and Payment Compliance, Small Business/Self-Employed Division, should modify the Return Delinquency case creation criteria to ensure delinquency inquiries are made of related tax periods Forms 941 and Form 940. The Return Delinquency case resolution procedures should be revised to require full compliance checks for delinquent employment tax returns of "in business" employers.

Corrective Action:

The business return delinquency case creation program has pending systemic programming changes that completely revamp the method of creating delinquent return cases as well as mailing notices to nonfiling businesses. The campus return delinquency full compliance procedures have been revised to include the requirement for full compliance checks for Form 941 tax returns when a Form 940 delinquent module has been resolved.

Implementation Date:

May 15, 2008



Tax Examiners Did Not Always Resolve Return Delinquency Cases, and Computer Checks Did Not Identify Unfiled Returns

Responsible Official:

Director, SB/SE Campus Compliance Services, Filing & Payment Compliance

Corrective Action Monitoring Plan:

The Filing Compliance Program Manager will monitor the corrective actions and notify the Director, Filing and Payment Compliance of any delays.