

**The Use of Anti-Money Laundering Referrals
and Currency Transaction Information in the
Income Tax Examination Process Could Be
Improved**

March 2004

Reference Number: 2004-30-074

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



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

March 30, 2004

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Use of Anti-Money Laundering Referrals
and Currency Transaction Information in the
Income Tax Examination Process Could Be Improved
(Audit # 200330012)

This report presents the results of our review of the Internal Revenue Service's (IRS) use of Anti-Money Laundering (AML)¹ Program referrals and currency transaction information in the income tax examination process. Our overall objective was to determine whether the IRS effectively used the referrals and information in that process.

The Bank Secrecy Act (BSA)² requires banks and nonbank financial institutions, such as check cashing businesses and casinos, to file information reports regarding significant currency transactions. Pursuant to 31 C.F.R. Section 103.56(b)(8) and Treasury Directive 15-41 (December 1, 1992), the authority to examine nonbank financial institutions for compliance with the reporting requirements of the BSA was delegated to the IRS. The IRS performs compliance checks of nonbank financial institutions as part of its AML Compliance Program.³ If during the performance of an AML compliance

¹ The term "money laundering" refers to the activities and financial transactions that are undertaken specifically to hide the true source of the income.

² Pub. L. No. 91-508, 84 Stat. 1114 to 1124 (1970) (codified as amended in scattered sections of 12 U.S.C., 15 U.S.C., and 31 U.S.C.). Regulations for the BSA, and other related statutes, are 31 C.F.R. § 103.11-103.77 (2002). The Secretary of the Treasury has delegated the authority to administer Title II of the BSA to the Director of the Financial Crimes Enforcement Network.

³ The IRS is a partner in the nation's AML efforts, whose goal is to increase compliance with AML laws and to identify, detect, and deter money laundering, whether it is in furtherance of a criminal enterprise, terrorism, tax evasion, or other unlawful activity.

check IRS examiners encounter large and suspicious currency transactions⁴ between the businesses under examination and their customer(s), an AML referral is prepared. AML referrals are forwarded to the Small Business/Self-Employed (SB/SE) Division Planning and Special Programs (PSP) function for consideration as an income tax examination.

Nationwide, income tax examinations based on AML referrals declined significantly in 2003. In the 3 Area Offices⁵ that we tested, income tax examinations based on AML referrals declined 57 percent from June 2002 to June 2003. A key reason for this decline was the refocusing of the IRS' examination efforts on seven compliance priorities beginning in mid-2002. AML referrals were not one of the seven priority areas.

In addition, AML referrals were not always comprehensively reviewed and selected for examination. None of the 32 referrals we judgmentally sampled had evidence to support that they were thoroughly reviewed for consideration for an income tax examination. The 32 referrals each had \$100,000 or more in documented suspicious cash transactions, but were not selected for an income tax examination. Fourteen (44 percent) of the 32 referrals involved taxpayers that did not file a tax return for the period in which the suspicious cash activity occurred. The total documented suspicious cash activity in the 32 referrals was \$11 million.

We informed the IRS of our concerns regarding AML referrals in July 2003. Based on this information, along with its own observations and ongoing concerns, the IRS has already initiated a number of corrective actions. AML referrals were established as a separate priority area for Fiscal Year (FY) 2004. In addition, draft procedures have been prepared requiring that the disposition of referral reviews be documented and referrals not selected for examination be maintained in searchable order for 26 months from the date of review.

Currency transaction information reports from financial institutions, trades, and businesses could also be more effectively used in the identification of taxpayers for potential income tax examinations. These reports are included in the Currency Banking Retrieval System (CBRS).⁶ The IRS estimates there were over 300,000 potential nonfilers with \$22 billion in currency transaction activity in Tax Year 2002. Although the IRS revised its priority examination areas to include AML referrals for FY 2004, it still does not consider all currency transaction information in the selection process. For example, the selection of nonfiling taxpayers for examination is based on the amount of known potential income, such as wages and dividends, and does not specifically consider whether the taxpayer also has large amounts of cash activity. While the filing of a currency transaction report may not equate to unreported income, the presence of

⁴ Suspicious transactions include large cash deposits with inadequate records and any transaction that indicates the correct amount of income may not be reported.

⁵ The SB/SE Division Compliance Field function is geographically organized into 15 Area Offices serving taxpayers nationwide and 1 Area Office serving international taxpayers.

⁶ The CBRS is a system of databases operated by the Detroit Computing Center which contains Information Returns required under 26 U.S.C., such as Reports of Cash Payments Over \$10,000 Received in a Trade or Business (Form 8300) and Currency Transaction Reports (Form 4789) required under 31 U.S.C. Chapter 53.

large transactions does indicate the individual deals in large amounts of cash and may be involved in some type of ongoing business activity.

We recommended the Director, Centralized Workload Selection and Delivery, SB/SE Division, develop a referral review checklist or other similar methodology to assist in ensuring all relevant factors, including nonfiled tax returns, are considered in evaluating AML referrals. We also recommended the Director, Centralized Workload Selection and Delivery, SB/SE Division, begin using currency transaction information to aid in the selection of individuals and businesses (both nonfilers and potential underreporters) for income tax examinations.

Management's Response: The IRS agreed with the recommendations presented in the report. The Director, Centralized Workload Selection and Delivery, SB/SE Division, will issue to the PSP Territory Managers written instructions with screening and case-building procedures for AML referrals. Also, the IRS noted all field inventory that is case-built by PSP function offices or the campus⁷ includes specific information to ensure consistency in classification and selection. CBRS information for each taxpayer is used during the classification and selection process. Field inventory is currently case-built for training returns and all strategic priority inventory. In addition to using the CBRS to supplement case file information, the Examination Return Selection function has been using CBRS analysis as a source for identifying workload. Management's complete response to the draft report is included as Appendix IV.

Office of Audit Comment: Although SB/SE Division management agreed with our recommendations, the proposed corrective action for Recommendation 2 does not fully address the recommendation. The corrective action indicated does not specifically provide for the consideration of CBRS information during the initial identification of nonfiler inventory. Rather, the corrective action discusses the subsequent consideration of CBRS information by classifiers in determining which of the selected cases should be examined and references the general use of CBRS data as a source for identifying workload. It is our opinion that the consideration of CBRS information in the initial identification of nonfiler inventory will help ensure the best cases are provided to the classifiers for examination consideration. As such, we believe our recommendation is worthwhile in its entirety; however we do not intend to elevate our disagreement to the Secretary of the Treasury for resolution.

Copies of this report are also being sent to IRS officials who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Richard Dagliolo, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs), at (631) 654-6028.

⁷ A campus is 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.

**The Use of Anti-Money Laundering Referrals and Currency Transaction Information in
the Income Tax Examination Process Could Be Improved**

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The Use of Anti-Money Laundering Referrals and Currency Transaction Information in the Income Tax Examination Process Could Be Improved

Background

Businesses and individuals conduct numerous financial transactions on a daily basis. To aid in the tracking of financial transactions and to help the Internal Revenue Service (IRS) ensure compliance with Federal tax laws, the Congress enacted the Bank Secrecy Act (BSA).¹ The BSA requires the filing of information reports, by both banks and nonbank financial institutions such as check cashing businesses and casinos, regarding currency transactions exceeding \$10,000. Internal Revenue Code (I.R.C.) Section (§) 6050I² requires trades or businesses not previously covered by the BSA, such as automobile and boat dealerships, to also keep records and file reports regarding large transactions. These records and reports are critical to the detection of illegally obtained funds as they move through financial institutions in an effort to appear unrelated or untraceable to illegal activities, which is commonly called money laundering. These records are also useful as an indicator of potentially unreported income.

Pursuant to 31 C.F.R. § 103.56(b)(8) and Treasury Directive 15-41 (December 1, 1992), the authority to examine nonbank financial institutions for compliance with the reporting requirements of the BSA was delegated to the IRS. IRS examiners perform compliance checks of nonbank financial institutions as part of its Anti-Money Laundering (AML)³ Compliance Program. These reviews seek to determine whether the businesses are complying with their obligations under the BSA to file information reports.

¹ Pub. L. No. 91-508, 84 Stat. 1114 to 1124 (1970) (codified as amended in scattered sections of 12 U.S.C., 15 U.S.C., and 31 U.S.C.).

Regulations for the BSA, and other related statutes, are 31 C.F.R. § 103.11-103.77 (2002). The Secretary of the Treasury has delegated the authority to administer Title II of the BSA to the Director of the Financial Crimes Enforcement Network.

² 26 U.S.C. § 6050I (1984), returns relating to cash received in a trade or business.

³ The IRS is a partner in the nation's AML efforts, whose goal is to increase compliance with AML laws and to identify, detect, and deter money laundering, whether it is in furtherance of a criminal enterprise, terrorism, tax evasion, or other unlawful activity.

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During these reviews, examiners may encounter large and suspicious⁴ currency transactions between the businesses under examination and their customers. If so, the examiner is required to prepare an AML referral, which is forwarded to the Small Business/Self-Employed (SB/SE) Division Planning and Special Programs (PSP) function. The PSP function is responsible for evaluating referrals for potential selection of individuals and businesses for an income tax examination.

In addition to receiving information from AML referrals, the IRS has access to the Currency Banking Retrieval System (CBRS)⁵ records of currency transactions from both bank and nonbank financial institutions. CBRS information can be useful in identifying cash activity that may not be accurately reported on the income tax return. In addition, it may lead the income tax examiner to discover sources of unreported income, sometimes derived from illegal activity.

This review was performed at the SB/SE Division Headquarters in New Carrollton, Maryland, and in the New York, New York; Los Angeles, California; and Philadelphia, Pennsylvania, SB/SE Division Area Offices.⁶ We performed the audit from May through December 2003 in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁴ Suspicious transactions include large cash deposits with inadequate records and any transaction that indicates the correct amount of income may not be reported.

⁵ The CBRS is a system of databases operated by the Detroit Computing Center which contains Information Returns required under 26 U.S.C., such as Reports of Cash Payments Over \$10,000 Received in a Trade or Business (Form 8300) and Currency Transaction Reports (Form 4789) required under 31 U.S.C. Chapter 53.

⁶ The SB/SE Division Compliance Field function is geographically organized into 15 Area Offices serving taxpayers nationwide and 1 Area Office serving international taxpayers.

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Significantly Fewer Income Tax Examinations Are Being Initiated As a Result of Anti-Money Laundering Program Referrals

The purpose of AML Program compliance checks is to ensure entities, such as check cashing companies, comply with their obligation to file information reports regarding currency transactions. When unusual cash activity regarding a particular individual or business is identified during an AML compliance check, an AML referral for the initiation of a potential income tax examination is prepared.

In the 3 Area Offices included in our review, income tax examinations based on referrals from the AML Program compliance checks declined 57 percent in 1 year, from 321 active examinations in June 2002 to 139 in June 2003. In the 3 Area Offices, 1,314 referrals were submitted for consideration during this period. Nationwide, income tax examinations that were the result of AML referrals declined 47 percent during the same period.

A key reason for the decline in income tax examinations based on referrals from AML compliance checks was the refocusing of the IRS' examination priorities in 2002. Specifically, in July 2002, the IRS Commissioner presented seven new compliance priority areas and noted that Tax Year (TY) 2003 would be a year of transition. As existing examination inventories were closed, new workloads were to be assigned within one of the following priority areas:

- Abusive tax schemes and promoter investigations.
- Misuse of devices, such as offshore accounts, to hide or improperly reduce income.
- Abusive corporate tax avoidance transactions.
- High-risk, high-income individuals.
- Offshore credit card abuses.
- Unreported Income Discriminate Index Function.
- The National Research Program.

Integrating income tax examinations of AML referrals into the new priority-based approach, however, was sometimes problematic. While AML referrals are useful as indicators of potentially unreported income, they generally do not contain enough detailed information to allow them to be easily associated with one of the particular examination priorities.

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In addition, referrals that could not be readily associated with a specific strategic priority were to be forwarded to the Brookhaven Campus⁷ for further review. The IRS informed us the review of referrals that could not be associated with a specific priority was delayed due to other priority work. At the time of our review, the Brookhaven Campus had a significant backlog of referrals awaiting review.

We informed the IRS of our concerns regarding the AML referral program in July 2003. Based on this information, along with its own observations and ongoing concerns, the IRS initiated a number of corrective actions. Specifically:

- The AML Compliance Program was established as a separate priority area for Fiscal Year (FY) 2004.
- Draft procedures were prepared designating Area Office PSP AML Coordinators as responsible for selecting AML referrals for examination in conjunction with the AML Compliance Program.

Anti-Money Laundering Referrals Involving Significant Suspicious Cash Transaction Activity Were Not Always Effectively Reviewed and Selected for Examination

Controls over the review and evaluation of AML referrals need to be improved. From the 3 Area Offices included in our review, we judgmentally sampled 32 referrals, each involving \$100,000 or more in suspicious cash transactions, which had not been selected for an income tax examination. We determined that all had indicators of examination potential, but the case files did not document why the 32 referrals were not selected. In fact, we could not even determine whether the referrals had been reviewed by the PSP function. The sampled referrals were submitted for consideration during the period January 2002 through June 2003.

The 32 referrals had \$11 million in documented suspicious cash activity. The referrals included the following information, which indicates that the taxpayers may not have reported of all their income:

- Fourteen of the 32 referrals involved taxpayers that did not file a tax return for the period in which the

⁷ A campus is 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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suspicious cash activity occurred. In 1 of the 14 referrals, the taxpayer also made substantial mortgage payments.

- Twenty-six of the 32 referrals involved businesses which negotiated checks totaling \$7 million for cash at check cashing companies or liquor stores rather than depositing the checks in a business bank account. The businesses included construction, trucking, and garment companies.
- Six of the referrals involved businesses and individuals that made cash purchases of telephone calling cards from telecommunication companies. The cash purchases totaled \$3 million.

AML-related referrals are required to be reviewed within 30 days of receipt to determine whether there is sufficient basis to warrant an income tax examination. This review is required to include a check for unfiled tax returns. PSP function managers informed us their primary focus is the assignment of new workload within the seven compliance strategy areas as outlined by the IRS Commissioner in mid-2002. A case would usually not be selected if it did not meet one of the seven priority areas. As discussed previously, AML referrals were not specifically identified as one of the seven original priority areas and were often not easily associated with a priority area.

AML referrals contain indicators of suspicious cash activity that may be indicative of unreported income and, if not timely and comprehensively reviewed, could have a material effect on the IRS' taxpayer compliance efforts. Two of the three PSP function offices we reviewed also informed us they routinely dispose of AML referrals that are not selected for an income tax examination. In addition, none of the three Area Offices keep sufficiently detailed records to determine how many referrals were forwarded to a campus. As a result, we could not readily determine the disposition of 1,861 (87 percent) of the 2,144 AML referrals submitted from January 2002 through June 2003 at the 3 Area Offices.

We informed the IRS of our concerns regarding the AML referrals in July 2003. Based on this information along with

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its own observations and ongoing concerns, the IRS has already prepared draft procedures requiring that the disposition of referral reviews be documented and referrals not selected for examination be maintained in searchable order for 26 months from the date of review. While the new procedures should result in better record retention practices, additional case file documentation is needed to ensure all required factors, including nonfiled tax returns, are considered in evaluating AML referrals.

Recommendation

1. The Director, Centralized Workload Selection and Delivery, SB/SE Division, should develop a referral review checklist or other similar methodology to assist in ensuring all required factors, including nonfiled tax returns, are considered in evaluating AML referrals.

Management's Response: The Director, Centralized Workload Selection and Delivery, SB/SE Division, will issue to the PSP Territory Managers written instructions with screening and case-building procedures for AML referrals. The IRS has already provided draft procedures for screening referrals to the PSP Territory Managers for implementation.

Further Improvement Is Needed in Integrating Currency Transaction-Related Information in the Examination Selection Process

Currency transaction information from Currency Transaction Reports (Form 4789)⁸ and Reports of Cash Payments Over \$10,000 Received in a Trade or Business (Form 8300)⁹ could be more effectively used in the identification of taxpayers for income tax examinations. These documents are included in the CBRS.

As discussed previously, the IRS revised its priority examination areas to include AML referrals for FY 2004. Additionally, an addendum to the FY 2004 priorities, known as the substantial noncompliance factors, was developed. This document provides that a case with significant civil tax potential should still be considered for examination even

⁸ 31 C.F.R. § 103.22 requires most financial institutions to file Form 4789 when receiving or disbursing cash in excess of \$10,000.

⁹ I.R.C. § 6050I requires that any person engaged in a trade or business that receives cash in excess of \$10,000 in 1 transaction, or 2 or more related transactions, must file Form 8300.

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though it does not specifically fall within a priority area. This approach, for example, expands the FY 2003 nonfiler priority area, which previously focused only on nonfilers with known sources of income such as wages and dividends over a certain dollar amount. The factors now include cases with less than the designated dollar amount in known income, if there is a significant potential for civil tax.

However, while it is a worthwhile enhancement, the strategy addendum relies primarily on referrals and informant claims¹⁰ in evaluating the possibility of substantial tax potential on a tax return. Neither the selection criteria for the priority areas nor the recently added substantial noncompliance factors addendum specifically consider currency transaction information from the CBRS in the examination selection process.

While the filing of a Form 4789 or 8300 may not equate to unreported income, the presence of large transactions does indicate the individual deals in large amounts of cash and may be involved in some type of ongoing business activity. The IRS informed us it estimates there were over 300,000 potential nonfilers with \$22 billion in currency transaction activity in TY 2002.¹¹ Including currency transaction activity in the return selection process would help ensure the IRS selects the best returns possible for examination and improve compliance with tax laws.

Recommendation

2. The Director, Centralized Workload Selection and Delivery, SB/SE Division, should begin using currency transaction information to aid in the selection of individuals and businesses (both nonfilers and potential underreporters) for income tax examinations. The selection process should focus on those individuals with a large dollar amount of transactions.

Management's Response: All field inventory that is case-built by PSP function offices or the campus includes

¹⁰ Unsolicited information, regarding alleged tax law violations, that is received via telephone calls, office visits, and correspondence.

¹¹ Unvalidated data provided by the IRS.

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specific information to ensure consistency in classification and selection. CBRS information for each taxpayer is used during the classification and selection process. Field inventory is currently case-built for training returns and all strategic priority inventory. In addition to using the CBRS to supplement case file information, the Examination Return Selection function has been using CBRS analysis as a source for identifying workload.

Office of Audit Comment: Although SB/SE Division management agreed with our recommendations, the proposed corrective action for Recommendation 2 does not fully address it. The corrective action indicated does not specifically provide for the consideration of CBRS information during the initial identification of nonfiler inventory. Rather, the corrective action discusses the subsequent consideration of CBRS information by classifiers in determining which of the selected cases should be examined and references the general use of CBRS data as a source for identifying workload. It is our opinion that the consideration of CBRS information in the initial identification of nonfiler inventory will help ensure the best cases are provided to the classifiers for examination consideration. As such, we believe our recommendation is worthwhile in its entirety.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether currency transaction information and Anti-Money Laundering (AML)¹ Program referrals were effectively used in the income tax examination process. To accomplish this objective, we:

- I. Determined whether the Small Business/Self-Employed (SB/SE) Division's Compliance function Headquarters (HQ) effectively provided oversight and monitored referrals from the AML Program.
 - A. Interviewed AML and SB/SE Division Planning and Special Programs (PSP) HQ management to discuss and review the process for monitoring referrals from the AML Program.
 - B. Identified Management Information System data that Area Offices² forward to the HQ regarding the AML Program.
 - C. Evaluated the methodology employed at the national level and determined the effectiveness of income tax examinations of AML referrals.
- II. Determined whether the SB/SE Division Examination function had effective controls over the evaluation of referrals received from the AML Program.
 - A. Interviewed HQ and selected Area Office PSP function management and determined what procedures were employed to identify, classify, and examine taxpayers with referrals received from the AML Program.
 - B. Interviewed three Area Office AML Coordinators to determine if referrals were screened or prioritized for potential income tax examination. We selected the three audit sites for the work in this audit step, as well as C and D below, because we were advised they were representative of the AML Program nationwide.
 - C. Interviewed three AML group managers on the policies and procedures for preparing and forwarding referrals to the PSP function.
 - D. Selected a judgmental sample of 32 referrals having over \$100,000 in cash activity that were not selected for examination and evaluated the reason they were not selected. We used this sampling methodology to allow for the onsite review of referral case files within the constraints of our available staffing. The cases were

¹The Internal Revenue Service is a partner in the nation's AML efforts, whose goal is to increase compliance with AML laws and to identify, detect, and deter money laundering, whether it is in furtherance of a criminal enterprise, terrorism, tax evasion, or other unlawful activity.

²The SB/SE Division Compliance Field function is geographically organized into 15 Area Offices serving taxpayers nationwide and 1 Area Office serving international taxpayers.

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chosen from the inventory of all cases physically located in the selected offices at the time of our review. However, because two of the three sites frequently disposed of nonselected referrals, we were unable to reliably establish the case population.

- III. Determined whether the Examination function had effective controls over the identification and examination of taxpayers having Currency Banking Retrieval System (CBRS)³ information on file.
 - A. Interviewed selected field personnel and determined the methodology used in identifying tax returns with CBRS data on file.
 - B. Ascertained whether examiners were required to research the CBRS for information as part of the examination case-building process.
- IV. Determined whether the HQ used CBRS information to identify nonfilers.
 - A. Interviewed HQ PSP function personnel and determined how CBRS information was used in the SB/SE Division's high-income nonfiler strategy.
 - B. Determined to what extent high-income nonfilers with Currency Transaction Report records on file with the CBRS were considered for examination.

³The CBRS is a system of databases operated by the Detroit Computing Center which contains Information Returns required under 26 U.S.C., such as Reports of Cash Payments Over \$10,000 Received in a Trade or Business (Form 8300) and Currency Transaction Reports (Form 4789) required under 31 U.S.C. Chapter 53.

Major Contributors to This Report

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Rashme Sawhney, Auditor

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Appendix III

Report Distribution List

Commissioner C

Office of the Commissioner – Attn: Chief of Staff C

Deputy Commissioner for Services and Enforcement SE

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Acting Director, Compliance, Small Business/Self-Employed Division SE:S:C

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 Commissioner, Small Business/Self-Employed Division SE:S

 Deputy Director, Compliance Policy, Small Business/Self-Employed Division

 SE:S:C:CP

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Appendix IV

Management's Response to the Draft Report



SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

MAR 22 2004

RECEIVED

MAR 24 2004

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION

FROM: Dale F. Hart 
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – The Use of Anti-Money Laundering
Referrals and Currency Transaction Information in the Income
Tax Examination Process Could be Improved (Audit #
200330012)

I have reviewed your draft report and agree with your recommendations. I appreciate your acknowledgement of the actions we have already taken to improve the effective use of Anti-Money Laundering (AML) referrals and currency transaction information in the examination process.

We are improving the process of screening the AML referrals by providing the Planning and Special Programs (PSP) Territory Managers with specific screening criteria. This will ensure consistent evaluation of referrals and take into consideration screening criteria that have a significant potential for additional civil tax assessments. We are currently centralizing the case building of this workload into one Campus location and using subject matter experts to classify returns.

We have been able to increase our effectiveness in using Currency Transaction Reports (Form 4789) and Reports of Cash Payments Received in a Trade or Business (Form 8300). We've been performing case building activities since mid-2002 as a result of an exam reengineering recommendation. We have established flow charts and non compliance classification factors to assist in our workload selection. As part of the regular case building process we research CTR data from the Currency and Bank Retrieval System (CBRS) and other data gathering sources for use in the classification of returns and the selection of strategic priority inventory. The CTR information and other case building data is reviewed and evaluated against return information, if selected for exam it is tracked and forwarded to the field.

Our comments on the recommendations in this report are as follows:

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RECOMMENDATION 1

The Director, Centralized Workload Selection and Delivery, Small Business/Self-Employed (SB/SE) Division, should develop a referral review checklist or other similar methodology to assist in ensuring all required factors, including non-filed tax returns, are considered in evaluating AML referrals.

CORRECTIVE ACTION

The Director, Centralized Workload Selection and Delivery, SB/SE Division will issue to the PSP Territory Managers written instructions with screening and case building procedures for AML referrals. We have already provided draft procedures for screening referrals to the PSP Territory Managers for implementation.

IMPLEMENTATION DATE

July 15, 2004

RESPONSIBLE OFFICIAL(S)

Director, Centralized Workload Selection and Delivery, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

Program Manager, Examination Return Selection and PSP Area Managers will advise the Director, Centralized Workload Selection and Delivery, SB/SE Division of corrective action delays.

RECOMMENDATION 2

The Director, Centralized Workload Selection and Delivery, SB/SE Division should begin using currency transaction information to aid in the selection of individuals and businesses (both non-filers and potential under reporters) for income tax examinations. The selection process should focus on those individuals with a large dollar amount of transactions.

CORRECTIVE ACTION

All field inventory that is case-built by the PSP offices or the Campus includes specific information to ensure consistency in classification and selection. CBRS information for each taxpayer is used during the classification and selection process. Field inventory is currently case-built for training returns and all strategic priority inventory including Abusive Tax Avoidance Transactions, High Income Non-Filers, High Income Taxpayers, and Unreported Income-Discriminant Function (UI-DIF).

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3

In addition to using CBRS to supplement case file information, Examination Return Selection has been using CBRS analysis as a source for identifying workload.

IMPLEMENTATION DATE

Completed

RESPONSIBLE OFFICIAL(S)

Director, Centralized Workload Selection and Delivery, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

Program Manager, Examination Return Selection and PSP Area Managers will advise the Director, Centralized Workload Selection and Delivery, SB/SE Division of corrective action delays.

If you have any questions, please call me at (202) 622-0600 or Robert L. Hunt, Acting Deputy Director, Compliance Policy, Small Business/Self-Employed Division, at (202) 283-2200.