

**The Lead Development Center Effectively  
Researched Abusive Tax Scheme Leads but  
Could Be More Proactive in Identifying  
Promoters**

**April 2004**

**Reference Number: 2004-30-087**

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DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

April 16, 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 Lead Development Center Effectively  
Researched Abusive Tax Scheme Leads but Could Be More  
Proactive in Identifying Promoters (Audit # 200330033)

This report presents the results of our review of the Internal Revenue Service's (IRS) Lead Development Center (LDC). Our overall objective was to determine whether the Small Business/Self-Employed (SB/SE) Division LDC effectively identified, assigned, and researched abusive tax scheme leads and monitored any resulting investigations.

Increases in both noncompliance with Federal tax laws and abusive tax schemes<sup>1</sup> are concerns to the IRS, the Congress, and the taxpaying public. The increase in abusive tax schemes has been one of the most significant tax compliance problems addressed in several hearings by the Senate Finance Committee.<sup>2</sup> Over the past few years, the IRS SB/SE Division has developed some new approaches to deal with the highest risk areas of noncompliance, including abusive tax schemes.

The IRS recognizes that the key to the fight against abusive tax schemes is to better identify their promoters.<sup>3</sup> The Abusive Tax Avoidance Transactions (ATAT) and Promoters area was one of the IRS' strategic priorities in 2003. To better address these promoters, the SB/SE Division established a LDC in its Compliance function in April

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<sup>1</sup> This term generally includes a partnership, trust, investment plan, or any other entity or arrangement which is sold to a third party and is designed to be used or is actually used by that third party in obtaining tax benefits not allowed by law.

<sup>2</sup> United States Senate Committee on Finance hearings: April 1, 2003; October 21, 2003; and December 19, 2003.

<sup>3</sup> A promoter is a person who organizes or assists in the organization of a partnership, trust, investment plan, or any other entity or arrangement that is to be sold to a third party and is designed to be used or is actually used by that third party in obtaining tax benefits not allowed by the Internal Revenue Code.

2002<sup>4</sup> to centralize the receipt and development of all potential leads on ATATs used by promoters/preparers. The LDC also authorizes and monitors on a national level abusive tax promoter investigations (also called Internal Revenue Code [I.R.C.] § 6700<sup>5</sup> investigations) assigned to the Compliance field offices.

In summary, the LDC has sufficient procedures in place to control and monitor the promoter investigations from start to finish. Our reviews of 58 leads showed these procedures were effectively used. The LDC is making the proper determinations to accept or reject leads involving I.R.C. § 6700 investigations. The LDC also has procedures in place to refer the clients of these promoters for further action by the IRS.

The LDC effectively coordinates with the Criminal Investigation function and obtains concurrence from IRS Office of Chief Counsel on the recommendations for I.R.C. § 6700 investigations. In addition, the SB/SE Division's Taxpayer Education and Communication function informs the public about the IRS' abusive tax schemes programs and how to report those types of activities.

The initial results from the LDC program are positive. As of September 30, 2003, there had been 666 leads recommended for I.R.C. § 6700 investigations. As of November 24, 2003, legal action had been initiated on 17 promoters identified from the leads:

- Four promoters had permanent injunctions granted by the Federal court.
- Five promoters had preliminary injunctions granted by the Federal court.
- Eight promoters had injunctions requested by the Department of Justice (DOJ) that are pending Federal court approval.

An additional 29 cases were pending in the DOJ, and the remaining leads were still being worked in the Compliance field offices at the time of our review. The injunctions order the promoters to stop organizing, promoting, marketing, or selling any abusive tax schemes.

One of the main reasons the LDC was created is to systemically monitor the Internet to identify leads and detect sites, promoters, and promotional materials that market abusive tax schemes over the Internet. Our review showed the LDC is not performing Internet research, independent of referred leads, to identify promoters. LDC management decided not to take this step earlier so the LDC could quickly address existing and incoming leads and the behavior of the known promoters. However, proactively monitoring the Internet will help the LDC meet its goal to identify abusive tax

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<sup>4</sup> There is also an LDC within the Criminal Investigation (CI) function whose current role is predominantly to research investigative leads provided by the CI function field offices and fraud referrals that come from the Compliance functions. This audit report refers only to the LDC in the SB/SE Division.

<sup>5</sup> I.R.C. § 6700 (1994) imposes a penalty on any person who promotes (organizes, assists in the organization of, or participates in) abusive tax shelters, etc. Therefore, these promoter investigations are called "I.R.C. § 6700 investigations." The penalty rate is the lesser of \$1,000 per activity or 100 percent of the gross income from each activity.

schemes earlier. If the Internet is not routinely monitored, the LDC may not be timely identifying and detecting sites of a significant number of promoters of abusive tax schemes.

We recommended the Director, Compliance, SB/SE Division, ensure the LDC becomes more proactive in researching the Internet to independently identify promoters of abusive tax schemes.

Management's Response: The Commissioner, SB/SE Division, agreed with our recommendation. The SB/SE Division LDC Program Manager will continue to work with the SB/SE Division Strategy, Research, and Performance Management function to complete the current research study involving evaluation of LDC needs, identification of software, testing of software, and review of software suitability. Also, the SB/SE Division LDC Program Manager will implement a process within the LDC to research the Internet and independently identify promoters of abusive tax schemes. Management's complete response to the draft report is included as Appendix IV.

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

**The Lead Development Center Effectively Researched Abusive Tax Scheme Leads  
but Could Be More Proactive in Identifying Promoters**

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## The Lead Development Center Effectively Researched Abusive Tax Scheme Leads but Could Be More Proactive in Identifying Promoters

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### Background

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Increases in both noncompliance with Federal tax laws and abusive tax schemes<sup>1</sup> are concerns to the Internal Revenue Service (IRS), the Congress, and the taxpaying public. The increase in abusive tax schemes has been one of the most significant tax compliance problems addressed by the Senate Finance Committee<sup>2</sup> since it was raised as a problem 2 years ago. The Senate Finance Committee has had hearings on the subject, recently stated the Congress cannot ignore the problem any longer, and pushed for legislation to stop these schemes.

The Department of the Treasury has asked the Congress to assist by passing legislation to strengthen certain provisions of the Internal Revenue Code (I.R.C.) to allow the IRS to be more effective in curtailing abusive transactions. The Senate Finance Committee committed to providing the IRS the legislative tools it needs to fight the problem.

Over the past few years, the IRS Small Business/Self-Employed (SB/SE) Division has developed some new approaches to deal with the highest risk areas of noncompliance, including identifying and combating abusive tax schemes. The IRS recognizes that the key to the fight against abusive tax schemes is to better identify their promoters.<sup>3</sup> The Abusive Tax Avoidance Transactions (ATAT) and Promoters area was one of the IRS' strategic priorities in 2003. To better address these promoters, the SB/SE Division established the Compliance function Lead Development Center (LDC) in April 2002.<sup>4</sup> Its purpose is to

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<sup>1</sup> This term generally includes a partnership, trust, investment plan, or any other entity or arrangement which is sold to a third party and is designed to be used or is actually used by that third party in obtaining tax benefits not allowed by law.

<sup>2</sup> United States Senate Committee on Finance hearings: April 1, 2003; October 21, 2003; and December 19, 2003.

<sup>3</sup> A promoter is a person who organizes or assists in the organization of a partnership, trust, investment plan, or any other entity or arrangement that is to be sold to a third party and is designed to be used or is actually used by that third party in obtaining tax benefits not allowed by the I.R.C.

<sup>4</sup> There is also an LDC within the Criminal Investigation (CI) function whose current role is predominantly to research investigative leads provided by the CI function field offices and fraud referrals that come from the Compliance functions. This audit report refers only to the LDC in the SB/SE Division.

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centralize the receipt and development of all potential leads on ATATs used by promoters/preparers. The LDC also authorizes and monitors on a national level abusive tax promoter investigations (also called I.R.C. § 6700<sup>5</sup> investigations) assigned to the Compliance field offices.

The LDC receives leads about promoters of abusive tax schemes from various internal and external sources, and then inputs the information into a database. Sources can be from field agents, revenue officers, tax professionals, investors, and the public. An LDC employee conducts basic research to screen and classify the lead. Based upon certain criteria, the employee determines whether information is sufficient to assign the lead for further development by an LDC agent. If there is not enough information, the lead is rejected and filed in the LDC archives.

Once a lead is assigned, an LDC agent develops the lead by conducting more in-depth research using a variety of research systems to identify the nature of the scheme and potential harm to the Federal Government. The agent researches the Internet looking for the promoter's web site and performs additional research using the IRS computer systems. If an I.R.C. § 6700 investigation is recommended, the LDC obtains concurrence from the IRS Office of Chief Counsel and coordinates authorization of the civil investigation with the Criminal Investigation (CI) function. The LDC then forwards the lead to an SB/SE Division Compliance field office where an examiner contacts the promoter and completes the investigation.

This review was performed at the SB/SE Division Compliance Policy, Reporting Enforcement Office, in Laguna Niguel, California, during the period August through December 2003. The audit was conducted in accordance with *Government Auditing Standards*. Data used in this report came from the LDC database. We did not conduct tests to validate the data.

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<sup>5</sup> I.R.C. § 6700 (1994) imposes a penalty on any person who promotes (organizes, assists in the organization of, or participates in) abusive tax shelters, etc. Therefore, these promoter investigations are called "I.R.C. § 6700 investigations." The penalty rate is the lesser of \$1,000 per activity or 100 percent of the gross income from each activity.

## **The Lead Development Center Effectively Researched Abusive Tax Scheme Leads but Could Be More Proactive in Identifying Promoters**

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### **The Lead Development Center Effectively Developed, Assigned, and Monitored Abusive Tax Scheme Leads**

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Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The LDC has sufficient procedures in place to control and monitor promoter investigations from start to finish. Our review showed the procedures were effectively used and the LDC made proper determinations on whether to recommend the I.R.C. § 6700 investigation. In addition, the initial program results are successful.

#### **The LDC's procedures are effective**

The LDC program manager designed effective procedures for processing, classifying, developing, and case building all leads received. Our reviews of 58 leads (28 unassigned/archived and 30 assigned leads) showed these procedures were effectively used.

An LDC employee screens the leads and conducts basic research to identify the source, description, issue, and classification of the lead. Once cases are assigned to LDC agents, the agents record their actions, results obtained, and contacts on a case history sheet and use a case-processing checklist to record the dates of actions taken.

Desk guides provide adequate instructions on how to 1) develop and build the leads including the research tools, 2) issue recommendation memoranda to accept or reject the leads, and 3) conduct manager reviews and obtain approval memoranda. In addition, the manager uses various biweekly and monthly reports, such as inventory levels and case movement, workload by SB/SE Division Area Office, and LDC work in process.

An LDC database is used to enter and control leads as they are received and is updated on a continuous basis. The database tracks the dates of actions taken throughout the process of the investigation and is used to record various data such as the source of the lead and the disposition reason. Also, the database captures the information about a lead once it is sent to an SB/SE Division Compliance field office for investigation. The LDC program manager continues to monitor the status of the lead and follows up if needed.

## **The Lead Development Center Effectively Researched Abusive Tax Scheme Leads but Could Be More Proactive in Identifying Promoters**

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LDC employees effectively coordinate with the CI function and obtain concurrence from IRS Office of Chief Counsel on the recommendations for I.R.C. § 6700 investigations. After an LDC agent determines that an I.R.C. § 6700 investigation should be pursued, the agent contacts the CI function and IRS Office of Chief Counsel to determine whether a particular promotion is already under scrutiny and whether a CI function criminal investigation would be hindered by a parallel civil SB/SE Division examination. Decisions are made on a case-by-case basis after mutual agreement is obtained from both divisions.

The LDC also works with the SB/SE Division Taxpayer Education and Communication (TEC) function. The TEC function informs the public about abusive tax schemes and how to report their promoters and activities. To reach a maximum number of taxpayers, the IRS recognizes the importance of partnering with external stakeholders, such as the practitioner community. Therefore, the TEC function developed a series of toolkits to assist external stakeholders in educating the public about abusive tax avoidance schemes and how to report scheme promoters and/or any new schemes identified to the IRS Abusive Schemes LDC. The TEC function has issued several news releases alerting the public that abusive promotions are being marketed and that those who become involved run the risk of being identified and criminally prosecuted. In addition, the IRS web site provides a hotline number through which to report suspected tax fraud activity. Information obtained from this hotline number related to promoters is forwarded to the LDC.

### **The LDC is making the proper determinations to accept or reject leads for I.R.C. § 6700 investigations**

Before a lead is assigned to an LDC agent, an LDC employee checks the lead against the database to ensure it is new information, acknowledges the receipt of the lead, and requests any additional data necessary from the originator of the lead to verify the name of the promoter. Then, another employee does basic research to screen the lead, classify it, and prioritize it according to criteria set by the LDC. The criteria include whether potential harm to the Federal Government exists, the scheme is abusive in nature, and

## The Lead Development Center Effectively Researched Abusive Tax Scheme Leads but Could Be More Proactive in Identifying Promoters

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there is money exchanged for the services. During this process, any leads with insufficient information to proceed are rejected and filed in the LDC archives, thereby reducing the time spent on unproductive leads.

Our review of 28 unassigned/archived leads showed enough information was obtained through preliminary and basic research to support the determination to reject the lead or accept it for further development. In addition, the leads were properly and consistently classified and prioritized before they were assigned for development.

After a lead is assigned to an LDC agent for further development, the agent develops the lead by conducting Internet research using several public search engines<sup>6</sup> to determine whether the promoter has a presence on the Internet. The agent also uses other internal research methods such as the Integrated Data Retrieval System (IDRS)<sup>7</sup> and ChoicePoint® Public Records.<sup>8</sup> The evidence obtained from this research is used to support whether an I.R.C. § 6700 investigation should be recommended.

Our review of 30 assigned leads closed by LDC agents showed the LDC agent recommended an I.R.C. § 6700 investigation for 20 of the leads. In all 20 leads, the agent obtained enough information to properly develop the 6 factors to support the recommendations for assigning cases for investigation: the type of scheme being promoted, past activity of the promoter, size of the promotion, tax law impact, possible tax violation, and favorable public impact and/or compliance impact. The LDC agent made the proper determination not to recommend an I.R.C. § 6700 investigation on the other 10 of 30 assigned leads because involvement in abusive promotion and possible harm to the Federal Government were not indicated.

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<sup>6</sup> Search engines are computer databases available on the Internet for searching nationwide information.

<sup>7</sup> The IDRS is the IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

<sup>8</sup> ChoicePoint® Public Records is a public sector database containing a wide range of public record information.

## **The Lead Development Center Effectively Researched Abusive Tax Scheme Leads but Could Be More Proactive in Identifying Promoters**

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### **Program results are successful**

The initial results from the LDC program are very positive. The success of the program can be seen by the resolution of the investigations of the leads sent to the SB/SE Division Compliance field offices. Between April 1, 2002 (when the LDC started) and September 30, 2003, the LDC had recommended 666 leads for I.R.C. § 6700 investigations. As of November 24, 2003, legal action had been initiated on 17 promoters identified from the leads:

- Four promoters had permanent injunctions granted by the Federal court.
- Five promoters had preliminary injunctions granted by the Federal court.
- Eight promoters had injunctions requested by the Department of Justice (DOJ) that are pending Federal court approval.

An additional 29 cases were pending in the DOJ, and the remaining leads were still being worked in the SB/SE Division Compliance field offices at the time of our review. The injunctions order the promoters to stop organizing, promoting, marketing, or selling any abusive tax schemes.

It is critical to the success of any promoter investigation to address the noncompliance by the participants of the promotion. Therefore, it is fundamental to secure the participant list as early into the investigation of the promoter as possible. Our review indicated the SB/SE Division Compliance function has procedures to refer the clients of these promoters to the Ogden Campus<sup>9</sup> Fraud Referral Program section for further action.

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**The Lead Development Center  
Could Be More Proactive in  
Identifying Abusive Tax Scheme  
Promoter Leads**

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One of the main reasons the LDC was created is to systemically monitor the Internet to identify leads and detect sites, promoters, and promotional materials that market abusive tax schemes over the Internet. Our review showed the LDC was not performing Internet research, independent

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<sup>9</sup> 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 Lead Development Center Effectively Researched Abusive Tax Scheme Leads but Could Be More Proactive in Identifying Promoters

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of referred leads, to identify promoters. Currently, the majority of the leads worked are identified from sources within the IRS.

IRS employees from other functions submit leads directly to the LDC, and sources outside of the IRS such as tax return representatives submit their leads through the TEC function. Our review showed most of the 2,154 leads received in the LDC were from sources within the IRS. For example:

- From revenue agents – 40 percent.
- From other programs – 21 percent.
- From the Offshore Compliance Program – 13 percent.
- From an issue specialist – 5 percent.
- From outside sources – 3 percent.
- Could not be determined – 10 percent.

The remaining 8 percent were leads the LDC identified, but these were related to an existing lead and were found while conducting Internet research on that existing lead. LDC employees did not identify any leads by just monitoring the Internet for abusive tax scheme promoters.

The primary reason for not proactively monitoring the Internet is that leads received from other sources provided sufficient work for the LDC staff. LDC management decided not to monitor the Internet earlier so that the LDC could quickly address existing and incoming leads and the behavior of known promoters. In addition, the LDC personnel use “stand-alone”<sup>10</sup> computers to query the Internet, but they do not have specialized search software which would make such reviews more productive.

The SB/SE Division Strategy, Research, and Performance Management function recently completed a study, *Using the Internet to Find Promoters of Abusive Tax Schemes*,<sup>11</sup> showing that unknown promoters could be identified

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<sup>10</sup> Stand-alone computers function independently from the IRS-based systems.

<sup>11</sup> Ft. Lauderdale/Greensboro Fiscal Year 2003 Research Project 04.09.002.03; June 2, 2003.

## The Lead Development Center Effectively Researched Abusive Tax Scheme Leads but Could Be More Proactive in Identifying Promoters

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through Internet searches but that these searches do take a large amount of time. The report also suggested the LDC evaluate specific software to determine how successful it is in identifying promoters of abusive tax schemes. LDC management had commissioned this study to gather information about systemically monitoring the Internet.

Proactively monitoring the Internet could help the LDC meet its goal to identify abusive tax schemes earlier. If the Internet is not routinely monitored, the LDC may not be timely identifying and detecting sites of a significant number of promoters of abusive tax schemes.

### Recommendation

1. The Director, Compliance, SB/SE Division, should ensure the LDC becomes more proactive in researching the Internet to independently identify promoters of abusive tax schemes. To make this process more effective and efficient, the Director should evaluate the need for specialized software that may make the process of searching the Internet more effective.

Management's response: The SB/SE Division LDC Program Manager will continue to work with the SB/SE Division Strategy, Research, and Performance Management function to complete the current Research study. The study involves evaluation of LDC needs, identification of software, testing of software, and review of software suitability. The SB/SE Division LDC Program Manager will implement a process within the LDC to research the Internet and independently identify promoters of abusive tax schemes, using the appropriate software, if available, and then review and revise the process as necessary.

## The Lead Development Center Effectively Researched Abusive Tax Scheme Leads but Could Be More Proactive in Identifying Promoters

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### Appendix I

#### Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether the Small Business/Self-Employed (SB/SE) Division Lead Development Center (LDC) effectively identified, assigned, and researched abusive tax scheme leads and monitored any resulting investigations. To accomplish this objective, we:

- I. Determined whether the LDC made the proper determination to accept or reject leads.
  - A. Identified the program's procedures and guidelines to accept and reject leads for investigation.
  - B. Determined how effectively and consistently the LDC screened the leads before an LDC agent further developed them.
    1. Analyzed the LDC's inventory to identify the sources for the leads and the number of leads that were archived, and determined how long leads remained in unassigned inventory before being assigned to an LDC agent.
    2. Determined whether proper determinations were made to archive or proceed with the investigations during the screening process.
      - a. From the population of 262 unassigned and archived leads as of September 30, 2003, we selected a judgmental sample of 28 (14 archived and 14 unassigned) leads. We used a judgmental sample because we could not independently identify the population of leads received in the LDC or validate the data we obtained.
      - b. Determined whether sufficient information was obtained through preliminary research.
      - c. Determined whether leads were properly and consistently classified and prioritized.
  - C. Determined whether the LDC properly researched and appropriately closed the leads by either accepting or rejecting them for referral to the field.

## **The Lead Development Center Effectively Researched Abusive Tax Scheme Leads but Could Be More Proactive in Identifying Promoters**

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1. Determined whether any “best practices” were established to ensure consistency in the determination of the Internal Revenue Code (I.R.C.) § 6700<sup>1</sup> investigation.
  2. From the population of 904 leads closed as of September 30, 2003, we selected a judgmental sample of 30 closed leads including Approved and Not Approved leads for the I.R.C. § 6700 investigation with a variety of sources and disposal reasons. We used a judgmental sample because we could not independently identify the population of leads received in the LDC or validate the data we obtained.
  3. Reviewed the histories of selected cases for actions taken on the leads. Issues reviewed included the following: were internal and external research tools used, was sufficient evidence used to make the decision to accept or reject the lead, was it properly reviewed and approved by the program manager, was it timely worked and closed, and were the Criminal Investigation (CI) function and the IRS Office of Chief Counsel involved.
- II. Determined whether the LDC’s procedures effectively monitored the progress and results of the promoter investigations.
- A. Identified procedures to control and monitor the investigations from start to finish, including once they were assigned to the SB/SE Division Compliance field offices.
  - B. Evaluated the inventory from the LDC database and determined whether the LDC had controls to identify the timeliness of leads worked, the resolution of the leads, the SB/SE Division Compliance field offices to which the leads were referred, and the current status of the leads.
- III. Determined how the SB/SE Division is addressing the clients of these promoters.
- IV. Determined the effectiveness of the coordination among the LDC, IRS Office of Chief Counsel, CI function, and SB/SE Division field offices for the promoter investigations by reviewing procedures and guidelines. We considered issues such as parallel investigations or conflicts with the CI function, concurrence with the IRS Office of Chief Counsel, and the Taxpayer Education and Communication function’s outreach programs.

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<sup>1</sup> I.R.C. § 6700 (1994) imposes a penalty on any person who promotes (organizes, assists in the organization of, or participates in) abusive tax shelters, etc. Therefore, these promoter investigations are called “I.R.C. § 6700 investigations.” The penalty rate is the lesser of \$1,000 per activity or 100 percent of the gross income from each activity.

**The Lead Development Center Effectively Researched Abusive Tax Scheme Leads  
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**Appendix II**

**Major Contributors to This Report**

Richard J. Dagliolo, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs)

Parker F. Pearson, Director

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Joseph Cooney, Senior Auditor

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Cristina Johnson, 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  
Acting Deputy Commissioner, Small Business/Self-Employed Division SE:S  
Acting Director, Compliance, Small Business/Self-Employed Division SE:S:C  
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 Management Controls OS:CFO:AR:M  
    Audit Liaison: Commissioner, Small Business/Self-Employed Division SE:S

The Lead Development Center Effectively Researched Abusive Tax Scheme Leads  
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Appendix IV

Management's Response to the Draft Report



COMMISSIONER  
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

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APR 12 2004

APR -7 2004

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – The Lead Development Center Effectively  
Researched Abusive Tax Scheme Leads but Could Be More  
Proactive in Identifying Promoters (Audit #200330033)

I have reviewed your draft report on the Lead Development Center (LDC). I agree with your findings and we have already started implementation of the recommendation. The LDC was established in April 2002 to identify, research and authorize investigations on abusive tax scheme leads. I appreciate your acknowledgement of the new approaches we have taken to better identify promoters of Abusive Tax Avoidance Transactions (ATAT). I am pleased you found the LDC to have sufficient procedures in place to control and monitor the promoter program and that we are making proper determinations to accept or reject leads.

As your audit indicates, the initial results from the LDC Program are very positive; these positive results are continuing. Since your review we have authorized the start of an additional 234 I.R.C Section 6700 "Promoting Abusive Tax Shelter" penalty investigations. We have also referred an additional 50 promoters to the Department of Justice (DOJ) during the first six months of this fiscal year for possible injunctive action. In this six month period, DOJ has also initiated legal actions against 31 additional promoters we previously referred to them. We are continuing to work our leads to ensure compliance and combat the abusive tax schemes plaguing our tax system.

Since moving the LDC to Laguna Niguel in August of 2002, we have also taken several steps to start the process of systemically monitoring the Internet to identify ATAT promoters. As you know, one of these steps was the initiation of a Small Business/Self-Employed Division (SB/SE) Research Study, *Using the Internet to Find Promoters of Abusive Tax Schemes*. The LDC has implemented all of the recommendations proposed in this study. The LDC has integrated these processes into the LDC Desk Guide. In the fall of last year, the LDC coordinated with the National Research Office to identify software products that the LDC might use to research the Internet to identify additional ATAT promoters. No cost effective, pre-identified products were available. Therefore, the LDC began working with SB/SE Research in January of this year to

## The Lead Development Center Effectively Researched Abusive Tax Scheme Leads but Could Be More Proactive in Identifying Promoters

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identify a software product that would meet our needs and budget. As you note in your report, the LDC did not take this last step earlier because they first needed to address existing and incoming leads quickly. In your report you recommend that we continue these efforts and we have.

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

### **RECOMMENDATION**

The Director, Compliance, SB/SE Division, should ensure the LDC becomes more proactive in researching the Internet to independently identify promoters of abusive tax schemes. To make this process more effective and efficient, the Director should evaluate the need for specialized software that may make the process of searching the Internet more effective.

### **CORRECTIVE ACTION**

The SB/SE LDC Program Manager will continue to work with SB/SE Research to complete the current Research study. This study involves evaluation of LDC requirements, identification of software, testing of software, and review of software suitability. The SB/SE LDC Program Manager will implement a process within the LDC to research the Internet and independently identify promoters of abusive tax schemes, using the appropriate software, and then review and revise the process as necessary.

### **IMPLEMENTATION DATE**

July 15, 2004

### **RESPONSIBLE OFFICIAL**

Director, Reporting Enforcement, Small Business/Self-Employed Division

### **CORRECTIVE ACTION MONITORING PLAN**

The SB/SE LDC Program Manager will advise the Director, Reporting Enforcement of any delays in implementation.

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, at (202) 283-2200.