

**Most Attachments Submitted With
Individual Taxpayers' Tax Returns
Are Identified and Processed**

September 2004

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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

September 9, 2004

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

Gordon C. Milbourn III

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

SUBJECT: Final Audit Report - Most Attachments Submitted With
Individual Taxpayers' Tax Returns Are Identified and
Processed (Audit # 200440041)

This report presents the results of our review of the identification and processing of attachments submitted with individual income tax returns. The overall objective was to determine whether attachments submitted with individual income tax returns were processed. This audit was included in the Treasury Inspector General for Tax Administration's 2004 Annual Audit Plan.

In summary, the Internal Revenue Service (IRS) appropriately identified and processed the majority of attachments taxpayers submitted with their individual income tax returns. We judgmentally sampled 4,452 individual income tax returns and determined that all attachments with the returns that should have been detached for processing had been detached. In addition, we selected a judgmental sample of 350 attachments that had been detached from the tax returns and routed for processing and determined that 305 (87 percent) had been processed.¹

We made no recommendations. IRS management reviewed the report prior to issuance. However, since no formal response was required, the IRS has agreed that the report will be issued without one.

Copies of this report are also being sent to the IRS managers who are affected by the report finding. Please contact me at (202) 622-6510 if you have questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

¹ Detached and routed or took other appropriate action.

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Most Attachments Submitted With Individual Taxpayers' Tax Returns Are Identified and Processed

Background

The Internal Revenue Service (IRS) Wage and Investment (W&I) Division processes tax returns filed by individual taxpayers. These are taxpayers filing a U.S. Individual Income Tax Return (Form 1040 series) with no accompanying Schedules C, E, or F; no Employee Business Expenses (Form 2106); and no international activity.¹ Most of these taxpayers deal with the IRS only when they file their tax returns; approximately 80 percent receive refunds and are highly compliant.

The W&I Division serves approximately 122 million customers. In addition, the Small Business/Self-Employed (SB/SE) Division estimates that another 33 million individuals are self-employed or receive supplemental income they report using Form 1040.

Returns filed by individual taxpayers in the W&I and SB/SE Divisions are processed in the IRS campuses.² The Code & Edit (C&E) function within each campus is responsible for reviewing all documents submitted with the tax returns. C&E function tax examiners review the tax returns to ensure they are correct, complete, valid, and in the correct order for input to IRS computer systems. They also review any attachments to the tax returns to determine if any additional actions are required.

For example, taxpayers attach forms and documents with their tax returns including related copies of a Wage and Tax Statement (Form W-2), Application for Additional Extension of Time to File U.S. Individual Income Tax Return (Form 2688), and Social Security Benefit Statement (Form SSA-1099). These documents are necessary to process the tax return and are required to stay with the tax return. However, many documents are related to other aspects of a taxpayer's account and must be detached and routed to other functions for processing. Examples of these documents would be Offer in Compromise (Form 656), an

¹ Schedule C – Profit or Loss From Business (Sole Proprietorship); Schedule E – Supplemental Income and Loss; Schedule F – Profit or Loss From Farming.

² Campuses are the data processing arms 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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original or signed photocopy of U.S. Return of Partnership Income (Form 1065), and Request for Innocent Spouse Relief (Form 8857).

When tax examiners detach a document from a tax return, they leave an “action trail” in the margin of the tax return to indicate what form was detached. They also mark the detached document indicating the type of tax return from which it had been detached. These notations can be expressed as, for example, “DT F2848” or “detached F2848,” meaning a Power of Attorney and Declaration of Representative (Form 2848) was detached from the tax return and forwarded for processing. Similarly, the notation on the Form 2848 would be “DT 2003 1040,” meaning the Form 2848 was detached from the Tax Year 2003 individual income tax return. The separated attachments are then gathered, sorted by function and/or campus, and forwarded for additional action and final processing.

In most instances, other functions within the IRS are responsible for processing the attachments removed from the tax returns. However, the scope of this audit did not extend to tracing the attachments to the functions processing them. This review focused on the C&E function to determine whether the documents were appropriately identified and routed for processing.

This review was performed in the W&I Division Headquarters in Atlanta, Georgia, and in the Andover, Massachusetts; Atlanta, Georgia; Austin, Texas; and Kansas City, Missouri, Campuses during the period October 2003 through April 2004. The audit was conducted 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.

Attachments Submitted With Tax Returns Are Appropriately Identified and Processed

The IRS correctly identified and processed³ 305 (87 percent) of the 350 attachments reviewed. We could not verify if appropriate action was taken on 33 (9 percent) of the 350 attachments because the IRS computer systems do not capture the information, the submitted document was

³ Detached and routed or took other appropriate action.

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incomplete or incorrect, or the data would not be available on IRS systems until after our audit period. For 12 (3 percent) of the 350 attachments, there was no evidence the documents had been processed.

Attachments submitted with individual tax returns are being appropriately identified

A review of a judgmental sample of 4,452 Form 1040 series tax returns from the 4 campuses showed that all attachments had been identified and those requiring removal were appropriately removed for additional action to be taken. As tax returns are processed through the campuses, controls are in place to ensure all attachments are properly identified and, if required, removed for additional action to be taken.

Tax examiners in the C&E function are responsible for examining all attachments to tax returns and determining whether the attachments should remain with the returns or be removed and routed elsewhere for processing. After the tax returns leave the C&E function, they are sent to the Data Conversion function, where the information on the tax returns and associated documents is converted to electronic data for posting to the IRS' main computer system. Once tax returns have been processed, they are sent to the IRS records storage facility (Files). Returns obtained from the Files function have been through the entire processing stream and have been filed for later retrieval. No attachments that should have been detached were found on any of the tax returns sampled in these functions in the four campuses.

IRS employees are taking appropriate action on the majority of tax return attachments reviewed

Of the 350 attachments reviewed, the IRS processed or took other appropriate actions on 305 (87 percent) of the attachments taxpayers submitted with their individual income tax returns. The majority of these attachments consisted of:

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- Form 2848.
- Form 2688.
- Application for Automatic Extension of Time to File U.S. Individual Income Tax Return (Form 4868).
- Injured Spouse Claim and Allocation (Form 8379).
- U.S. Individual Income Tax Declaration for an IRS *e-file* Return (Form 8453) or U.S. Individual Income Tax Declaration for an IRS *e-file* Online Return (Form 8453-OL).
- Installment Agreement Request (Form 9465).
- Application for IRS Individual Taxpayer Identification Number (Form W-7).

In addition, there were taxpayer correspondence and requests for acknowledgement that the IRS received the documents.

IRS-wide guidelines provide the functions and campuses instructions on how to process specific forms and attachments submitted with tax returns. C&E function guidelines provide instructions on routing the separated attachments to the appropriate function or campus. C&E function instructions do not require that employees individually control by taxpayer name or Social Security Number (SSN) the attachments removed from tax returns and routed for processing. Although documents sent to other functions within a campus are usually routed individually by attaching an Intra-SC Reject (Form 4227) or Routing Slip (Form 1725), both of which briefly explain why the document is being routed, those routing slips are not controlled.

Documents sent to other campuses are typically sent with a Document Transmittal (Form 3210), but only the total number of documents and the type(s) of documents are listed on the transmittal; taxpayers' names or other identifying information are not included on the Form 3210 because the IRS believes it would be too resource intensive. For example, sending 50 Forms 2848 would be indicated by "50 F2848—POA" on the Form 3210.

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As stated, identifying taxpayer information is not listed on a transmittal. However, even without this control, 87 percent of the attachments reviewed had been processed or had other appropriate actions taken, showing that IRS employees generally follow routing and processing guidelines.

For 33 (9 percent) attachments, we could not determine whether the IRS had taken the appropriate action because IRS computer systems do not capture the information, the submitted document was incomplete or incorrect, or the data would not be available on IRS systems until after our audit period. For example,

- Twenty-two attachments were requests by the taxpayers or the taxpayers' representatives for an acknowledgement that a tax return or attachment had been received.
- Eleven attachments were not completed correctly by the taxpayers, the SSN was not provided or was incorrect, or the information needed to research the document was not available on IRS systems during the period of this audit.

Only 12 (3 percent) of the 350 attachments reviewed showed no evidence of having been processed.⁴ Of the 12 that showed no evidence of having been processed:

- One (8 percent) was a Form W-7. These Forms are processed only by the Philadelphia Campus. Therefore, this attachment would have been shipped to that campus. Shipping adds time to the processing.
- Two (17 percent) documents were correspondence from taxpayers providing additional information necessary for processing the documents properly. These had not been properly identified and coded by the C&E function.

⁴ Subsequent to the end of our audit work, the IRS advised us and we confirmed that 6 of the 12 attachments have since been processed.

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- Three (25 percent) documents consisted of Forms 9465 or correspondence requesting an installment agreement.
- Six (50 percent) documents were tax returns that are processed by the SB/SE Division. Therefore, these returns are required to be shipped to the appropriate SB/SE Division campus for processing. Shipping adds time to the processing.

Since most of the sampled attachments submitted with individual taxpayers' tax returns were identified and processed, we are making no recommendations at this time.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to determine whether attachments submitted with individual income tax returns were processed. Individual income tax returns include U.S. Individual Income Tax Return (Form 1040 series) with no international activity and no accompanying Profit or Loss From Business (Schedule C), Supplemental Income and Loss (Schedule E), Profit or Loss From Farming (Schedule F), or Employee Business Expenses (Form 2106). To accomplish our objective, we:

- I. Determined the procedures for processing attachments submitted with individual income tax returns.
 - A. Obtained and analyzed any relevant Internal Revenue Service (IRS) guidance documents.
 - B. Interviewed Code and Edit (C&E) function managers in the Submission Processing function, Wage and Investment Division, about the procedures for processing attachments submitted with individual income tax returns.
 - C. Conducted a walk-through of the return processing function (submission processing).
 - D. Identified the time standards for processing the attachments sampled.
- II. Determined whether the IRS identified and processed all attachments submitted with individual income tax returns.
 - A. Selected a judgmental sample of 4,452 Form 1040 returns from the C&E, Data Conversion,¹ and Files² functions at 4 campuses:³ Andover, Massachusetts; Atlanta, Georgia; Austin, Texas; and Kansas City, Kansas. We selected these campuses because we had auditors located in each of these campuses.

¹ The Data Conversion function converts tax return information and other documents to electronic data for input to the IRS computer system for posting to the IRS' main computer system.

² The IRS records storage facility. Returns in Files have been through the entire processing stream and have been filed for later retrieval.

³ Campuses are the data processing arms 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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We used the following methodology for selecting the sample of 4,452 Form 1040 returns. Since we could not determine how many returns might be received with attachments (either those remaining with the return or those separated from the return), we selected a judgmental sample of Form 1040 tax returns and reviewed those returns to identify any attachments submitted with the returns. During the survey phase of the audit, we reviewed a cart of returns received and processed by the Atlanta C&E function as well as returns in the Files function. We reviewed 2,300 returns and identified 90 attachments. During the audit phase, we selected judgmental samples of 2,152 returns from the Data Conversion and Files functions and identified 76 attachments or notations that attachments had been removed. In the Data Conversion function at 3 campuses, we reviewed as many returns as possible in ½ day or until 50 returns with attachments were identified. In 1 campus, we reviewed a total of 50 returns in the Data Conversion function. In the Files function at 4 campuses, we reviewed as many returns as possible in 1 full day.

- B. Selected a judgmental sample of 184 attachments that the C&E function had separated from the returns for processing. Since we could not determine which returns would have attachments, for ½ day we copied as many attachments as the C&E function had separated from returns during that time period or until at least 50 attachments were obtained at each of the 4 campuses. The desired number of attachments was not obtained from all campuses because one campus did not have 50 usable separated attachments the day of our visit and some of the attachments copied from other campuses did not meet our sample criteria of being listed on the C&E Attachment Guide.
 - C. Researched the attachments identified with the return or copied from the C&E function to determine whether they had been processed.
- III. Discussed any exception cases (and the effect) with IRS management for agreement and possible explanation for the oversight.

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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

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Director, Customer Account Services, Wage and Investment Division SE:W:CAS
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