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GAO
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Highlights

Highlights of GAO-09-567, a report to the Committee on Finance, U.S. Senate

TAX ADMINISTRATION

IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts

Why GAO Did This Study

Civil tax penalties are an important tool for encouraging compliance with tax laws. It is important that the Internal Revenue Service (IRS) administers penalties properly and determines the effectiveness of penalties in encouraging compliance.

In response to a congressional request, GAO determined (1) whether IRS is evaluating penalties in a manner that supports sound penalty administration and voluntary compliance and, if not, how IRS may be able to do so, and (2) whether IRS's guidance for a new penalty for failure to disclose reportable transactions was issued in a timely manner and was useful to affected parties, and whether and how IRS has assessed the penalty. GAO reviewed IRS documents and guidance, and interviewed IRS officials and tax practitioners.

What GAO Recommends

The Commissioner of Internal Revenue should direct the Office of Servicewide Penalties (OSP) to evaluate penalty administration and penalties' effect on voluntary compliance and develop a plan to focus its efforts. The Commissioner also should use IRS's standard outreach methods to again alert taxpayers of the need to disclose reportable loss transactions.

In commenting on a draft of this report, IRS concurred with GAO's recommendations, and summarized the actions it plans to take.

To view the full product, including the scope and methodology, click on GAO-09-567. For more information, contact Michael Brostek (202) 512-9110 or brostekm@gao.gov.

What GAO Found

OSP does not comprehensively evaluate the administration of civil tax penalties or their impact on voluntary compliance, but a plan could help it do so. OSP has responsibility for administering penalty programs and determining the action necessary to promote voluntary compliance. According to IRS policy, OSP should collect information to evaluate penalties and penalty administration and to determine the effectiveness of penalties in promoting voluntary compliance. This policy is consistent with positions expressed in 1989 by both an IRS Task Force report and by Congress when reforming penalties in 1989, and more recently by the National Taxpayer Advocate. OSP does not fulfill the responsibilities specified in IRS policy. Rather, OSP analysts focus on short-term issues, such as sudden spikes in assessments or abatements. OSP officials said that they have not done more to evaluate the administration of penalties and their effect on voluntary compliance because of resource constraints, methodological barriers, and limitations in available databases.

A plan could help IRS focus its efforts and address the constraints to evaluating penalties. In developing a plan, IRS could identify the analyses it should do and the resources needed to do them. OSP could then determine what resources are available to assist it and what additional resources, if any, are needed. A plan also could lay out feasible research for evaluating the effect of penalties on voluntary compliance. For example, fairness is believed to undergird voluntary compliance. Thus, analyses that determine whether penalties are being consistently applied across IRS would provide pertinent information. Data limitations could be addressed in a plan, as well. The Enforcement Revenue Information System (ERIS) contains substantial data on IRS enforcement activities, but does not include all of the information recommended by the 1989 IRS Task Force report. For example, ERIS does not include readily usable information related to taxpayer income that could be used to determine equitable treatment of taxpayers.

IRS issued guidance regarding its implementation of a penalty for failure to disclose reportable transactions— transactions IRS identified as tax avoidance transactions—within 3 months of the provision's passage. IRS officials said that their criterion for issuing timely guidance is whether it was released in time to meet customers' needs. Tax practitioners from two leading practitioner organizations said the guidance was issued timely and included information they needed. However, the practitioners said more targeted outreach about the penalty was needed, specifically regarding reportable loss transactions caused by the current economic climate in which many taxpayers may experience losses that could trigger the reportable transaction requirements. IRS officials recognize the need to further raise awareness of the penalty, but their planned efforts would reach only a small portion of tax return preparers and taxpayers. As of January 2009, IRS has assessed 98 penalties for $13.7 million. In addition, 1,188 returns had been assigned to field groups.