

**Fiscal Year 2005 Statutory Audit of
Compliance With Notifying Taxpayers of
Their Rights When Requested to Extend the
Assessment Statute**

July 2005

Reference Number: 2005-40-112

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

July 21, 2005

MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND
ENFORCEMENT

A handwritten signature in black ink, appearing to read "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Fiscal Year 2005 Statutory Audit of
Compliance With Notifying Taxpayers of Their Rights When
Requested to Extend the Assessment Statute
(Audit # 200440053)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) was complying with Internal Revenue Code (I.R.C.) Section (§) 6501(c)(4)(B) (2000), which requires the IRS to provide notice to taxpayers of their rights to decline to extend the assessment statute of limitations or to request that any extension be limited to a specific period of time or to specific issues.

The Treasury Inspector General for Tax Administration (TIGTA) is required to provide information annually regarding the IRS' compliance with I.R.C. § 6501(c)(4)(B).¹ The IRS is required to advise taxpayers of their rights when requesting an extension of the statute of limitations on assessment of additional tax and penalties. In passing this law, the Congress expressed concern that taxpayers were not being adequately advised of their rights to refuse to extend the statute of limitations or to request that a statute extension be limited to a specific period of time or to specific issues.

There was not always documentation in the related case files that taxpayers were advised of their rights regarding assessment statute extensions. The consent forms² used during our period of review did not provide an explanation of the taxpayers' rights to limit or refuse to extend the assessment statute of limitations. In our sample of 215 tax returns, 38 percent of the related case files reviewed did not contain any

¹ I.R.C. § 7803(d)(1)(C) (2000).

² The IRS uses several different types of consents, depending on the type of tax involved. For example, Consent to Extend the Time to Assess Tax (Form 872) is used for income taxes and Consent to Extend the Time to Assess Employment Taxes (Form SS-10) is used for employment taxes.

documentation to support that the taxpayers and/or their representatives had been advised of the taxpayers' rights regarding assessment statute extensions.

Although the IRS had revised its internal procedures over the last few years to help enhance controls, our reviews continued to identify instances in which there is no documentation that taxpayers were advised of their rights. In response to our Fiscal Year 2004 report,³ the IRS revised the various consent forms and incorporated them into the related Internal Revenue Manual⁴ sections. The revised consent forms include a prominent statement informing taxpayers of their rights regarding assessment statute extensions, as provided for in I.R.C. § 6501(c)(4)(B), and provide information on *Extending the Tax Assessment Period* (Publication 1035). In addition, the consent forms include a statement for the taxpayers' representatives to sign, confirming that they have been notified of the taxpayers' rights regarding assessment statute extensions and that the taxpayers have been made aware of the same advice of rights.

Integrating the revised consent forms into the assessment statute extension process should help the IRS eliminate questions concerning whether the taxpayers and/or their representatives are being properly notified of the taxpayers' rights regarding assessment statute extensions. We do not believe any further recommendations are needed at this time.

While we made no recommendations in this report, the review will provide the following measurable benefits on tax administration relative to recommendations made in prior TIGTA reviews: protection of taxpayer rights. This review showed taxpayer rights were potentially affected in 82 tax returns sampled.⁵ Related case files were not documented to show that taxpayers' rights were protected for 30 single individual, business, or exempt organization taxpayer accounts;⁶ 28 joint filer taxpayer accounts;⁷ and 24 taxpayer accounts for which the taxpayers made a declaration of representation.

Management's Response: IRS management was pleased to note we agreed the revisions made to various consent forms should eliminate any questions concerning notification rights. Management's complete response to the draft report is included as Appendix VI.

³ *Fiscal Year 2004 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (Reference Number 2004-40-108, dated June 2004).

⁴ The IRM contains policy, direction, and delegations of authority that are necessary to carry out IRS responsibilities to administer tax law and other legal provisions.

⁵ This number is a unique count of taxpayer accounts. It is made up of single individuals, businesses, exempt organizations, taxpayers who filed a joint tax return, and taxpayers not included in the previous categories that had made a declaration of representation.

⁶ These 30 cases are comprised of 21 cases with no evidence that the taxpayers had ever been advised of their rights and 9 cases with evidence that the taxpayers had been advised of their rights at some point during the examinations but not for the last extensions requested.

⁷ These 28 cases are comprised of 23 cases with no evidence that the taxpayers had ever been advised of their rights and 5 cases with evidence that the taxpayers had been advised of their rights at some point during the examinations but not for the last extensions requested.

Copies of this report are also being sent to the IRS managers affected by the report results. 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.

**Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers
of Their Rights When Requested to Extend the Assessment Statute**

Table of Contents

| | |
|---|---------|
| Background | Page 1 |
| Case Files Did Not Always Contain Documentation That Taxpayers and/or Their Representatives Were Advised of the Taxpayers' Rights Regarding Assessment Statute Extensions | Page 4 |
| Appendix I – Detailed Objective, Scope, and Methodology | Page 9 |
| Appendix II – Major Contributors to This Report | Page 11 |
| Appendix III – Report Distribution List | Page 12 |
| Appendix IV – Outcome Measures | Page 13 |
| Appendix V – Case Review Results by Division | Page 15 |
| Appendix VI – Management's Response to the Draft Report | Page 16 |

Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute

Background

The Internal Revenue Service (IRS) is required by Internal Revenue Code (I.R.C.) Section (§) 6501(c)(4)(B) (2000) to advise taxpayers of their rights when requesting an extension of the statute of limitations on assessment of additional tax and penalties. In the event of multiple extension requests, this I.R.C. section also requires the IRS to notify the taxpayer of his or her rights on each occasion when the taxpayer is requested to consent to an extension. In passing this law, the Congress expressed concern that taxpayers were not being adequately advised of their rights to refuse to extend the statute of limitations or to request that a statute extension be limited to a specific period of time or to specific issues.

Federal regulations require that any notice or other written communication (or copy) required or permitted to be given to a taxpayer in any matter before the IRS must also be given to the taxpayer and to the taxpayer's representative.¹ However, the taxpayer can use the Power of Attorney and Declaration of Representative (Form 2848) to restrict the notices or information the representative is authorized to receive. In addition, the IRS Restructuring and Reform Act of 1998 (RRA 98)² § 3201 requires the IRS to send any notice relating to a jointly filed tax return separately to each individual filing the joint return, whenever practicable.

If the IRS examines a tax return and determines there is an additional tax liability, it generally must be assessed within 3 years from the date the return was due or from the date on which the return was actually filed, whichever is later. This 3-year assessment statute of limitations normally cannot be extended without the taxpayer's written agreement.³

To extend the assessment statute, the IRS asks the taxpayer to sign a statute extension agreement form (i.e., a consent

¹ 26 Code of Federal Regulations § 601.506 (2004).

² Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

³ There are some exceptions to the 3-year statute of limitations. For example, I.R.C. § 6501(c)(1) (2000) extends the assessment statute indefinitely when false or fraudulent tax returns are filed.

Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute

form).⁴ There are two basic kinds of consents: the fixed-date consent and the open-ended consent. The fixed-date consent sets a specific expiration date for the extension of the statute, while the open-ended consent extends the statute for an indefinite length of time. In an open-ended consent, the extension period generally remains open until 90 days after either the taxpayer or the IRS sends the prescribed notice ending the agreement. The statute is usually extended for a period that both the IRS and the taxpayer agree is reasonable to complete the examination. The consent can also be negotiated to apply only to certain examination issues.

A taxpayer might agree to extend the assessment statute of limitations for the following reasons:

- The taxpayer may want to pursue additional examination issues that are in the taxpayer's favor in offsetting a proposed tax or that might allow for a tax refund.
- If the remaining time before the statute expires is too short, the IRS may have to prematurely stop the examination process and issue a notice of deficiency that limits the time for the normal appeals process before the taxpayer must file a petition to the United States Tax Court.

There are also certain circumstances in which a taxpayer may decide to limit or refuse to extend the assessment statute of limitations:

- The taxpayer may not want to provide the IRS more time to consider additional examination issues.
- The taxpayer may not want to allow the IRS the opportunity to further develop examination issues already under consideration after the normal statute period has expired.

The Treasury Inspector General for Tax Administration is required to provide information annually regarding the IRS'

⁴ IRS employees that most often request assessment statute extensions are examiners in the Examination function of the operating divisions and appeals officers in the Office of Appeals.

Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute

compliance with I.R.C. § 6501(c)(4)(B).⁵ This report presents the results of our sixth annual review of the IRS' compliance with the statute extension provisions of the law. In the prior reviews, we evaluated assessment statute extensions processed from January 1 to March 24, 2000; April 1 to September 30, 2000; October 1, 2000, to September 30, 2001; September 30, 2001, to October 5, 2002; and October 6, 2002, to September 27, 2003.

Although the IRS had revised its internal procedures over the last few years to help enhance controls, our reviews continued to identify instances in which there is no documentation that taxpayers were advised of their rights. Therefore, in our Fiscal Year (FY) 2004 report,⁶ we recommended the Deputy Commissioner for Services and Enforcement revise the various consent forms to include a statement that the taxpayers have been informed of their rights regarding assessment statute extensions and have been provided a copy of *Extending the Tax Assessment Period* (Publication 1035).

For the current audit, we reviewed assessment statute extensions processed from September 28, 2003, to June 30, 2004. This review was performed at the Large and Mid-Size Business Division Headquarters, the Office of Appeals Headquarters, and the Tax Exempt and Government Entities Division Headquarters in Washington, D.C., and the Small Business/Self-Employed Division in New Carrollton, Maryland, during the period October 2004 through March 2005.

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.

⁵ I.R.C. § 7803(d)(1)(C) (2000).

⁶ *Fiscal Year 2004 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (Reference Number 2004-40-108, dated June 2004).

Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute

Case Files Did Not Always Contain Documentation That Taxpayers and/or Their Representatives Were Advised of the Taxpayers' Rights Regarding Assessment Statute Extensions

Our review showed taxpayer rights were potentially affected in 82⁷ (38 percent) of 215 tax returns sampled. The consent forms⁸ used during our period of review did not provide an explanation of the taxpayers' rights to limit or refuse to extend the assessment statute of limitations. Therefore, we considered that IRS employees advised taxpayers of their rights if any of the following documentation was found in the related case files:

- A copy of Request to Extend Statute (Letter 907 (L-907)), Letter Transmitting Consent Extending Period of Limitation (Letter 967 (L-967)), or comparable cover letter updated to include an explanation of taxpayer rights addressed to the taxpayer.
- A record that Publication 1035 was provided to the taxpayer, as documented in the examination activity record or as shown as an enclosure on a cover letter. This Publication provides a detailed explanation of taxpayer rights.
- A notation in the examination activity record indicating the taxpayer was given the required notification of rights.

In response to our FY 2004 report, the IRS began revising the various consent forms and incorporating them into the related Internal Revenue Manual (IRM)⁹ sections. The revised consent forms include a prominent statement informing taxpayers of their rights regarding assessment statute extensions, as provided for in I.R.C. § 6501(c)(4)(B), and provide information on Publication 1035. In addition, the consent forms include a statement for the taxpayers'

⁷ This number is a unique count of taxpayer accounts. It is made up of single individuals, businesses, exempt organizations, taxpayers who filed a joint tax return, and taxpayers not included in the previous categories that had made a declaration of representation.

⁸ The IRS uses several different types of consents, depending on the type of tax involved. For example, Consent to Extend the Time to Assess Tax (Form 872) is used for income taxes and Consent to Extend the Time to Assess Employment Taxes (Form SS-10) is used for employment taxes.

⁹ The IRM contains policy, direction, and delegations of authority that are necessary to carry out IRS responsibilities to administer tax law and other legal provisions.

Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute

representatives to sign, confirming that they have been notified of the taxpayers' rights regarding assessment statute extensions and that the taxpayers have been made aware of the same advice of rights.

This year's review continued to confirm IRS employees do not always document that the taxpayers or their representatives were properly advised of the taxpayers' rights regarding assessment statute extensions. As of February 2005, the IRS had completed its revisions of the assessment statute extension consent forms. Integrating the revised consent forms into the assessment statute extension process should help the IRS eliminate questions concerning whether the taxpayers are being properly notified of their rights regarding assessment statute extensions. As a result, we do not believe any further recommendations are needed at this time.

There was not always documentation that single individuals, businesses, and exempt organizations were advised of their rights regarding assessment statute extensions

For 30 (20 percent) of 148 tax returns filed by single individuals, businesses, or exempt organizations in our sample,¹⁰ the related case files did not contain any documentation to support that taxpayers had been properly advised of their rights regarding the IRS' assessment statute extension requests. As a result, we could not determine if the IRS protected the rights of these taxpayers. This occurred because employees were not following IRS internal guidelines.

The IRM and other internal procedures require IRS employees to provide the taxpayer with an L-907 or L-967, with Publication 1035 as an enclosure, and document on an activity record whether the taxpayer was notified of his or her rights every time the IRS requested an assessment statute extension. There could be a violation of taxpayer rights if the taxpayer is not notified of his or her rights to

¹⁰ These 30 cases are comprised of 21 cases with no evidence that the taxpayers had ever been advised of their rights and 9 cases with evidence that the taxpayers had been advised of their rights at some point during the examinations but not for the last extensions requested.

Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute

refuse to extend the period of limitations or to request that any extension be limited to specific issues or to a specific period of time.

There was not always documentation that each taxpayer listed on a jointly filed tax return was advised of his or her rights regarding assessment statute extensions

For 28 (42 percent) of 67 joint tax returns in our sample,¹¹ the related case files did not contain any documentation to support that each taxpayer listed on the tax returns was separately informed of his or her rights (i.e., dual notification) every time the IRS requested an assessment statute extension. This occurred because employees were not following IRS internal guidelines.

The guidelines covering requests for taxpayers to extend the assessment statute require notices relating to joint tax returns be sent to each individual filing the joint return, whenever practicable. Specifically, the IRM requires providing each individual filing a joint tax return with an L-907 or L-967.

In addition, RRA 98 § 3201 requires the IRS to send any notice relating to a jointly filed tax return separately to each individual filing the joint tax return. The Congress intended that separate notices would increase the likelihood that separated or divorced spouses each received such notices, as well as increase the likelihood the IRS will be made aware of address changes that apply to one, but not both, spouses. There could be a violation of taxpayer rights if both taxpayers are not notified of their rights to refuse to extend the period of limitations or to request that any extension be limited to specific issues or to a specific period of time.

¹¹ These 28 cases are comprised of 23 cases with no evidence that the taxpayers had ever been advised of their rights and 5 cases with evidence that the taxpayers had been advised of their rights at some point during the examinations but not for the last extensions requested.

Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute

There was not always documentation that both taxpayers and their representatives were advised of the taxpayers' rights regarding assessment statute extensions

In our sample of 215 tax returns, 138 of the related case files contained an authorization for a third party to represent the taxpayers in front of the IRS. In 75 of the related case files, enough documentation was found to support that both the taxpayers and their representatives had been advised of the taxpayers' rights regarding assessment statute extensions. However, documentation in the remaining 63 (46 percent) of the 138 related case files did not support that both the taxpayers and their representatives were given the same advice of rights. For example, the documentation in:

- Twenty-four of the related case files supported that the IRS had advised the taxpayers of their rights regarding assessment statute extensions but did not mention that their representatives were given the same advice of rights.
- Twenty-five of the related case files supported that the IRS had advised the taxpayers' representatives of the taxpayers' rights regarding assessment statute extensions but did not mention that the taxpayers (including both taxpayers on a jointly filed return) were given the same advice of rights.¹²
- Fourteen of the related case files did not contain any support that the IRS had advised either the taxpayers (including both taxpayers on a jointly filed return) or their representatives of the taxpayers' rights regarding assessment statute extensions.¹³

This occurred because employees were not following IRS internal guidelines. Internal IRS procedures and current

¹² These 25 case files are included in the counts from the previous sections where there was not enough documentation to determine if the IRS properly advised taxpayers of their rights regarding assessment statute extensions.

¹³ These 14 case files are included in the counts from the previous sections where there was not enough documentation to determine if the IRS properly advised taxpayers of their rights regarding assessment statute extensions.

**Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers
of Their Rights When Requested to Extend the Assessment Statute**

Federal Government regulations require that any notice or other written communication (or copy) required or permitted to be given to a taxpayer in any matter before the IRS must also be given, unless restricted by the taxpayer, to the taxpayer's representative.

Taxpayer rights could be affected if the IRS does not follow the Federal Government regulations and notify both the taxpayers and their representatives of the taxpayers' rights to refuse to extend the period of limitations or to request that any extension be limited to specific issues or to a specific period of time.

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Internal Revenue Service (IRS) was complying with Internal Revenue Code Section 6501(c)(4)(B) (2000), which requires the IRS to provide notice to taxpayers of their rights to decline to extend the assessment statute of limitations or to request that any extension be limited to a specific period of time or to specific issues. To accomplish our objective, we:

- I. Determined whether taxpayers were being advised of their rights related to assessment statute extension requests.
 - A. Reviewed the Examination function Internal Revenue Manual (IRM),¹ IRS memoranda and regulations, and the Office of Appeals (Appeals) IRM and other Appeals guidelines to determine the policies and procedures for processing requests to extend the assessment statute of limitations.
 - B. Reviewed a sample of Business Master File (BMF)² and Individual Master File (IMF)³ tax returns with taxpayer consents to extend assessment statutes processed from September 28, 2003, to June 30, 2004.
 1. Obtained BMF and IMF extracts to identify a population of tax returns having extensions of the assessment statute of limitations. The identified tax return populations were 4,647 and 5,685, respectively. We selected those extensions processed from September 28, 2003, to June 30, 2004.
 2. Selected for review a statistical sample of 610 tax returns from the category of cases likely to have statute extensions by taxpayer consent from the Examination function and Appeals processes. We reviewed the 610 tax returns and related case files, eliminating 395 tax returns that did not meet our criteria or because we did not receive all requested tax returns and related case files. Therefore, only 215 reviewed tax returns and related case files met the audit criteria. This was not sufficient for a statistical sample. Within this random sample of 215 tax returns, there were 148 single individual, business, and exempt organization tax returns and 67 joint tax returns. In addition, out of the 215 single individual, business, exempt organization, and joint tax returns, there were 138 tax returns for which the taxpayers had made a declaration of representation.

¹ The IRM contains policy, direction, and delegations of authority that are necessary to carry out IRS responsibilities to administer tax law and other legal provisions.

² The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

³ The IRS database that maintains transactions or records of individual tax accounts.

**Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers
of Their Rights When Requested to Extend the Assessment Statute**

3. Identified which business unit or function requested the extension and discussed any questionable extensions identified with IRS management for concurrence or an explanation of why the IRS believed proper procedures were followed.
 4. Validated the BMF and IMF data on a random sample of 50 of the 10,332 records identified in Step I.B.1. to determine the reliability of the data.
- II. Reviewed the 148 selected tax returns and related case files for documentation verifying that the single individuals, businesses, or exempt organizations were advised of their rights related to assessment statute extensions.
 - III. Reviewed the 67 selected joint tax returns and related case files for documentation verifying that each taxpayer listed on a jointly filed return was separately advised of his or her rights related to assessment statute extensions.
 - IV. Reviewed the 138 selected tax returns and related case files for documentation verifying that both the taxpayers and their representatives were notified of the taxpayers' rights related to assessment statute extensions.
 - V. Determined the status of the IRS corrective actions proposed to address the recommendations presented in prior Treasury Inspector General for Tax Administration audit reports.

Major Contributors to This Report

Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs)

Mary V. Baker, Director

Bryce Kisler, Audit Manager

David Hartman, Lead Auditor

Sharon Summers, Senior Auditor

Julia Tai, Senior Auditor

James Traynor, Senior Auditor

Jean Kao, Auditor

Lynn Ross, Auditor

**Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers
of Their Rights When Requested to Extend the Assessment Statute**

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Commissioner, Large and Mid-Size Business Division SE:LM
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Tax Exempt and Government Entities Division SE:T
Chief, Appeals AP
Deputy Commissioner, Large and Mid-Size Business Division SE:LM
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Communications, Government Liaison, and Disclosure, Small Business/Self-Employed
Division SE:S:CGL&D
Director, Communications and Liaison, Large and Mid-Size Business Division SE:LM:CL
Director, Communications and Liaison, Tax Exempt and Government Entities Division
SE:T:CL
Director, Examination, Small Business/Self-Employed Division SE:S:E
Director, Exempt Organizations, Tax Exempt and Government Entities Division SE:T:EO
Director, Field Specialists, Large and Mid-Size Business Division SE:LM:FS
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 Liaisons:
 Commissioner, Large and Mid-Size Business Division SE:LM:CL
 Commissioner, Tax Exempt and Government Entities Division SE:T:CL
 Chief, Appeals AP
 Acting Chief, Customer Liaison, Small Business/Self-Employed Division SE:S:COM

Outcome Measures

This appendix presents detailed information on the measurable impact that the review results will have on tax administration. While no recommendations were made in this report, the Treasury Inspector General for Tax Administration has made prior recommendations that continue to provide benefits. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 30¹ single individual, business, or exempt organization taxpayer accounts affected (see page 4).
- Taxpayer Rights and Entitlements – Potential; 28² joint filer taxpayer accounts affected (see page 4).
- Taxpayer Rights and Entitlements – Potential; 24 taxpayer accounts affected for which the taxpayers declared a representative (see page 4).

Methodology Used to Measure the Reported Benefit:

We reviewed a random sample of 215 tax returns with consents to extend the assessment statute of limitations period. The returns were identified from the Fiscal Year 2004 Business Master File (BMF)³ and Individual Master File (IMF)⁴ databases. The review showed taxpayer rights were potentially affected in a total of 82⁵ (38 percent) of 215 tax returns sampled.

Related case files were not documented in 30 of 148 single individual, business, and exempt organization taxpayer accounts to show the taxpayers were notified of their rights to refuse or to restrict the scope of the assessment statute extensions. There was no documentation in the related case files that each taxpayer listed on a jointly filed return was separately informed of his or her rights in 28 of 67 joint filer taxpayer accounts.

¹ These 30 cases are comprised of 21 cases with no evidence that the taxpayers had ever been advised of their rights and 9 cases with evidence that the taxpayers had been advised of their rights at some point during the examinations but not for the last extensions requested.

² These 28 cases are comprised of 23 cases with no evidence that the taxpayers had ever been advised of their rights and 5 cases with evidence that the taxpayers had been advised of their rights at some point during the examinations but not for the last extensions requested.

³ The BMF is the IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

⁴ The IMF is the IRS database that maintains transactions or records of individual tax accounts.

⁵ This number is a unique count of taxpayer accounts. It is made up of single individuals, businesses, exempt organizations, taxpayers who filed a joint tax return, and taxpayers not included in the previous categories that had made a declaration of representation.

**Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers
of Their Rights When Requested to Extend the Assessment Statute**

In addition, in our sample of 215 tax returns, 138 of the related case files contained an authorization for a third party to represent the taxpayers in front of the IRS. In 24 of these 138 accounts, the documentation in the related case files supported that the IRS had advised the taxpayers of their rights regarding assessment statute extensions but did not mention that their representatives were given the same advice of rights.

**Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers
of Their Rights When Requested to Extend the Assessment Statute**

Appendix V

Case Review Results by Division¹

Appeals LMSB² SB/SE³ TE/GE⁴ Totals⁵

| Compliance With Requirement to Notify Taxpayers of Their Rights | | | | | |
|---|----|----|----|---|-----------------|
| Number of Cases in Which There Was No Documentation That Single Individuals, Businesses, or Exempt Organizations Were Advised of Their Rights (Applicable Cases: 148) | 14 | 9 | 5 | 2 | 30 ⁶ |
| Number of Cases in Which There Was No Documentation That Separate Notices Were Sent to Both Taxpayers Listed on a Joint Return (Applicable Cases: 67) | 10 | 1 | 17 | 0 | 28 ⁷ |
| Compliance With Internal Guidelines or Regulations | | | | | |
| Number of Cases in Which There Was No Documentation That Notices Were Given to Both Taxpayers and Their Representatives (Applicable Cases: 138) | 23 | 13 | 23 | 4 | 63 ⁸ |

¹ All cases do not have the same requirements. For example, all cases have a documentation requirement; however, not all cases involve taxpayer representatives or taxpayers that file joint tax returns.

² Large and Mid-Size Business Division.

³ Small Business/Self-Employed Division.

⁴ Tax Exempt and Government Entities Division.

⁵ No cases from the Wage and Investment Division occurred in our sample.

⁶ These 30 cases are comprised of 21 cases with no evidence that the taxpayers had ever been advised of their rights and 9 cases with evidence that the taxpayers had been advised of their rights at some point during the examinations but not for the last extensions requested.

⁷ These 28 cases are comprised of 23 cases with no evidence that the taxpayers had ever been advised of their rights and 5 cases with evidence that the taxpayers had been advised of their rights at some point during the examinations but not for the last extensions requested.

⁸ This number includes 39 cases that were also included in the counts from the previous sections where there was not enough documentation to determine if the Internal Revenue Service properly advised taxpayers of their rights regarding assessment statute extensions.

Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers
of Their Rights When Requested to Extend the Assessment Statute

Appendix VI

Management's Response to the Draft Report

RECEIVED

JUL 12 2005



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

July 12, 2005

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kevin M. Brown *Kh2*
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report - Fiscal Year 2005 Statutory Audit of
Compliance With Notifying Taxpayers of Their Rights When
Requested to Extend the Assessment Statute
(Audit # 200440053)

We have reviewed your report and are pleased to note that you agree that the revisions we made to the various consent forms to include a prominent statement of taxpayers' rights should eliminate any questions concerning whether the taxpayers and/or their representatives are being properly notified of the taxpayers' rights regarding assessment statute extensions.

In your memorandum transmitting the subject report, you specifically requested that we include in our response a statement of concurrence or nonconcurrence with the benefits to tax administration of your review described in Appendix IV. We concur with the calculation and manner of presentation in Appendix IV of the benefits.

If you have any questions or need additional information, please contact me at 202-622-0600 or Steve Burgess, Director, Examination, Small Business/Self-Employed Division at (202) 283-6955.