

# **Improvements Have Been Made to Eliminate Illegal Tax Protester Designations**

**September 2001**

**Reference Number: 2001-10-141**

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.

**Redaction Legend:**

1 = Tax return/Return Information



INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

September 25, 2001

MEMORANDUM FOR COMMISSIONER ROSSOTTI

*Pamela J. Gardiner*

FROM: Pamela J. Gardiner  
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Improvements Have Been Made to Eliminate  
Illegal Tax Protester Designations

This report presents the results of our review of the Internal Revenue Service's (IRS) compliance with the IRS Restructuring and Reform Act of 1998 (RRA 98)<sup>1</sup> Section 3707 and internal IRS guidelines which prohibit the IRS from using Illegal Tax Protester (ITP) or any similar designation.

In summary, we found the IRS is in compliance with the prohibition on using the ITP designation or any similar designation. Past ITP codes were not reintroduced on the IRS' Masterfile, former ITP taxpayer accounts on the IRS' Masterfile<sup>2</sup> were not reassigned to a similar ITP designation, and employees made very few references to taxpayers as ITPs in taxpayer case files. In addition, the IRS removed and is systematically preventing ITP codes from one computer case inventory system. However, the IRS needs to remove and prevent ITP codes on two other computer case inventory systems. Also, the IRS needs to continue its efforts to remove ITP references from the Internal Revenue Manual and other publications. The IRS was in the process of taking corrective actions to address these issues at the time of our review based on recommendations from a prior Treasury Inspector General for Tax Administration report.

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<sup>1</sup> Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 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.).

<sup>2</sup> The IRS database that stores various types of taxpayer account information, which includes data for individuals and businesses.

Management's Response: Management's response was due on September 12, 2001. As of September 19, 2001, management had not responded to the draft report.

Copies of this report are also being sent to the appropriate IRS managers. Please contact me at (202) 622-6510 if you have questions or John R. Wright, Acting Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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### Background

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The Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98)<sup>1</sup> Section (§) 3707 prohibited the IRS from designating taxpayers as Illegal Tax Protesters (ITP) or any similar designation. The RRA 98 specifically required the removal of all existing ITP designations from the IRS' Masterfile<sup>2</sup> and instructed the IRS to disregard any such designation not located on the Individual Masterfile.

Prior to the RRA 98, taxpayers were referred to the ITP Program when their tax returns or correspondence contained specific indicators of noncompliance with the tax law, such as the use of arguments which had been repeatedly rejected by the courts. Once a taxpayer's account was coded as an ITP, certain tax enforcement actions were accelerated. The designation was also intended to alert IRS employees to be cautious so they would not be drawn into confrontations. Concerns were raised by the Congress that some taxpayers were permanently labeled and stigmatized by the ITP designation. Taxpayers who subsequently complied with the tax laws could continue to be labeled as ITPs, which could bias IRS employees and result in unfair treatment.

The United States Code (U.S.C.) requires the Treasury Inspector General for Tax Administration (TIGTA) to annually evaluate the IRS' compliance with the prohibition against using the ITP or a similar designation.<sup>3</sup> The TIGTA reviewed this RRA 98 provision during Fiscal Year (FY) 1999<sup>4</sup> and FY 2000.<sup>5</sup> These TIGTA reviews identified areas for improvement to help the IRS comply with the prohibition on the ITP or any similar designation.

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<sup>1</sup> Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 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.).

<sup>2</sup> The IRS database that stores various types of taxpayer account information, which includes data for individuals and businesses.

<sup>3</sup> 26 U.S.C. § 7803(d) (1998).

<sup>4</sup> *The Internal Revenue Service Is Addressing the Use of the Illegal Tax Protester and Nonfiler Designations* (Reference Number 1999-10-080, dated September 1999).

<sup>5</sup> *Additional Action Is Needed to Eliminate Illegal Tax Protester Designations* (Reference Number 2000-10-119, dated September 2000).

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We conducted our review using information from national databases, web sites, discussions with IRS employees, and visitations at field office sites. The office site reviews were performed at the Cincinnati, Grand Rapids, Ogden, Portland, Sacramento, and Sarasota IRS offices. Fieldwork was performed between February and June 2001. This audit was conducted in accordance with *Government Auditing Standards*.

There were two scope limitations for this year's review.

- Some Criminal Investigation cases were not available for our review because they were in Grand Jury status. Per Federal Rules of Criminal Procedure,<sup>6</sup> case information that is in Grand Jury status cannot be disclosed. Criminal Investigation representatives stated that 15,821 of the 22,422 active cases on the Criminal Investigation Management Information System (CIMIS) at the end of February 2001 were in Grand Jury status and could not be provided for our review.
- Information on the Integrated Collection System (ICS) could not be obtained in time for the issuance of this report. As a result, our review of collection cases was comprised of cases only on the Automated Collection System (ACS).

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

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### Illegal Tax Protester Codes Are Not Used on the Masterfile

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In FY 1999, the TIGTA reported that the IRS had removed the ITP designation from the Masterfile as required by the RRA 98. In the TIGTA's FY 2000 review, we confirmed that the ITP designation was not reintroduced on the Masterfile and that the IRS had computer validity checks to prevent the use of this code. In addition, the IRS computer system does not archive ITP designations on retention files so that the designation is not available when archived taxpayer accounts are called back to the Masterfile.

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<sup>6</sup> 18 U.S.C. § 3322 (2000).

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We obtained a computer extract of the individual and business portions of the Masterfile, as of December 2000, to determine if the ITP designation was reintroduced on the Masterfile. There were no taxpayer accounts with the ITP designation on the Masterfile.

Since the RRA 98 also prohibited using any designation similar to the ITP, we reviewed the approximately 57,000 taxpayer accounts formerly coded as ITPs for movement to any other Masterfile designation. The prior ITP designation was one of eight designations used to accelerate enforcement action on tax accounts. In addition, the IRS uses a Potentially Dangerous Taxpayer designation to identify individuals who have assaulted or threatened bodily harm to IRS employees. There were no reassignments of the approximately 57,000 taxpayer accounts to these other Masterfile designations.

The IRS created a new program in FY 2000, known as the Frivolous Return Program to address taxpayers who do not comply with the tax law by purposely making arguments that have been repeatedly rejected by the courts. This program addresses some of the same tax compliance problems that were previously addressed by the ITP program. The TIGTA did not review the Frivolous Return Program or its associated codes and designations in this year's review but does plan to review the program to ensure it is not similar to the ITP designation.

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### **The Audit Information Management System and the Examination Returns Control System Contain Illegal Tax Protester Codes on Some Accounts**

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In addition to the Masterfile, the IRS uses other computer systems to manage taxpayer case inventories. Although the RRA 98 did not require the removal of ITP codes on these other computer systems, the IRS issued directives to prohibit the use of ITP codes on these systems to ensure compliance with RRA 98 § 3707. However, in TIGTA's FY 2000 review, there were three computer inventory systems that still contained ITP codes: the Taxpayer Advocate Management Information System (TAMIS), the Audit Information Management System (AIMS), and the Examination Returns Control System (ERCS).

During this year's review, we followed up on the TAMIS and found that the Taxpayer Advocate had taken appropriate and timely corrective actions to both remove ITP codes

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from active cases on the TAMIS and to prevent the use of ITP codes on the TAMIS in the future. Based on our review of a March 2001 computer extract of the TAMIS, none of the approximately 52,000 active cases on the TAMIS contained the previously reported ITP codes. In addition, to prevent the reintroduction of the ITP codes, the Taxpayer Advocate initiated a computer check to reject any attempt to use the prior ITP codes. The Taxpayer Advocate also initiated a review to remove ITP codes from inactive cases.

We also followed up on the AIMS and the ERCS and found that both still contained ITP codes. Based on a December 2000 AIMS computer extract and case research, the AIMS contained ITP codes for 68 active cases involving 30 taxpayers. Based on a December 2000 computer extract and case research, the ERCS had ITP codes for 127 active cases involving 84 taxpayers.

In FY 2000, the TIGTA recommended that the IRS review and remove any remaining ITP codes from active taxpayer files on the AIMS and the ERCS. The IRS responded that a Request for Information Services (RIS) would be submitted to invalidate and remove the ITP codes on the AIMS. The planned completion date for this RIS was originally in January 2002. However, the IRS determined resources were available in April 2001 and stated the RIS was completed. Because the RIS was completed after our review of these systems, its effectiveness could not be reviewed in time for inclusion in this report.

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### **The Internal Revenue Manual Contains Illegal Tax Protester References**

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To help promote compliance with RRA 98 § 3707, the IRS issued directives to review and update its various publications to eliminate references to ITP terminology and programs. The TIGTA review in FY 1999 identified 50 Internal Revenue Manual (IRM) subsections containing references to ITPs on an IRS Intranet site called the Compliance Automated Research Tool System (CARTS). Management responded that the ITP references on the CARTS would be removed by February 2000. However, the TIGTA's FY 2000 review identified in March 2000 that the CARTS still contained 19 of the 50 previously identified IRM subsections with ITP references. Further research found 115 additional IRM subsections with ITP references.

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In addition, versions of the IRM published on different Intranet sites and media types (paper, CD-ROM) also contained ITP references.

During this year's review, we researched the CARTS IRS Intranet site in March 2001 and identified 58 subsections with uncorrected references. In addition, there were another 14 new IRM subsections on the CARTS with ITP references. We also researched other IRS Intranet web sites called the Servicewide Policy, Directive and Electronic Research (SPDER), the Servicewide Electronic Research Program (SERP), and the Electronic Publishing, which had 51, 4, and 70 IRM subsections, respectively, with ITP references that should be revised or deleted. The IRS web site available to the public on the Internet, *The Digital Daily*, had 50 IRM subsections with ITP references that should be revised or deleted. References to ITPs were also found on other media types (paper, CD-ROM). Paper IRM versions that were ordered and received in March 2001 contained 49 subsections with ITP references. In a CD-ROM IRM version dated October 2000, there were 48 subsections with ITP references.

In March 2001, the IRS responded to the TIGTA's FY 2000 report stating that the remaining ITP references in the IRM would be identified by Multimedia Publishing, which would, in turn, follow up with the responsible functions. The IRS also stated in its response to the TIGTA that it is still the responsibility of the IRM functional owners to ensure their sections meet the applicable legal requirements, including the provisions of the RRA 98. The planned completion date for this corrective action was July 2001. The effectiveness of this corrective action could not be reviewed in time for inclusion in this report.

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### Internal Revenue Service Publications Contain Illegal Tax Protester References

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Although IRS management issued directives to review and update its various publications to eliminate references to ITP terminology and programs, the TIGTA reported in FY 2000 that 15 publications still contained ITP references in the titles. The IRS issued its response in March 2001 and stated the 15 publications with ITP references in the titles would be revised or labeled as obsolete by July 2001.

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In March and May 2001, we reviewed the 15 publications with ITP references and determined all had been revised or labeled as obsolete. However, we identified two additional publications with ITP references. Neither had been revised or labeled obsolete. The availability of these publications increases the potential of using ITP designations.

The Customer Assistance, Relationships and Education Director is revising or making obsolete the two newly identified publications and is determining if ITP references can be systematically identified in the content of publications. In addition, the IRS plans to notify employees who have the responsibility of reviewing publications that they are required to review for ITP references.

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### There Were Few Instances of the Use of Illegal Tax Protester References in Case Files

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In FY 2000, the TIGTA reported that IRS employees were making references or designating taxpayers as ITPs in case files after the effective date of the provision. In a judgmental sample of 974 paper case activity files, there were 96 with ITP designations or references. Additionally, one computer system contained approximately 450 case records with ITP designations or references.

During this year's review, we sampled several computer systems and paper case files used by IRS employees to document case activity. This included functional activity for collection, examination, Taxpayer Advocate, Appeals, and Criminal Investigation. In the reviews of sample cases, there were only 1

The results of each system are shown below.

- ACS: We reviewed a national random sample of 299 cases from the population of approximately 2.7 million cases on the ACS.<sup>8</sup> None contained ITP

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<sup>7</sup> Based on our random discovery samples of computer case files, we are 95 percent confident that the actual occurrence rate of ITP references is less than 1 percent for each computer system. We do not make projections on the paper case files reviewed because we used a judgmental sampling technique.

<sup>8</sup> This was the only collection system reviewed. Information on the Integrated Collection System could not be obtained in time for the issuance of this report.

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designations or references in the computer case activity files.

- TAMIS: We reviewed a national random sample of 298 cases from the population of approximately 52,000 open cases on the TAMIS. None contained ITP designations or references in the computer case activity files.
- Appeals Consolidated Data System (ACDS): We reviewed a national random sample of 298 cases from the population of approximately 67,000 cases on the ACDS. None contained ITP designations or references in the computer case activity files.
- Examination cases: We reviewed a judgmental sample of 427 examination cases at six IRS sites (see Appendix I for the sites). Only

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Criminal Investigation cases: We reviewed a judgmental sample of 57 Criminal Investigation cases at four IRS sites (see Appendix I for the sites). None contained ITP designations or references in the paper case activity files.

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### Appendix I

#### Detailed Objective, Scope, and Methodology

The objective of this review was to determine if the Internal Revenue Service (IRS) complied with the provisions of the IRS Restructuring and Reform Act of 1998 (RRA 98)<sup>1</sup> and internal IRS guidelines which prohibit the designation of a taxpayer as an Illegal Tax Protester (ITP) or any similar designation. To complete this objective, we performed the following tests:

- I. Determined if the IRS' Masterfile<sup>2</sup> contained ITP designations.
  - A. Obtained, validated, and reviewed a computer extract of all Individual Masterfile and Business Masterfile taxpayer entities with Accelerated Issuance Codes as of December 23, 2000, to determine if they contained any former ITP codes. The former ITP code was one of the Accelerated Issuance Codes used by the IRS.
  - B. Matched the computer extract of Accelerated Issuance Codes with a historic computer extract of taxpayers designated as ITPs before the RRA 98 was enacted to identify whether these taxpayers now were reclassified with a different Accelerated Issuance Code. The historic computer extract was obtained during the Treasury Inspector General for Tax Administration's (TIGTA) Fiscal Year (FY) 1999 review before the IRS removed the ITP code from Masterfile.
  - C. Used a historic computer extract of approximately 57,000 taxpayers designated as ITPs before the RRA 98 was enacted to select a judgmental sample of 100 taxpayers. The current Masterfile account transcripts as of February 2001 were reviewed for any common codes that indicated that these taxpayers had been reclassified to another Masterfile designation.
  - D. Matched an extract of Potentially Dangerous Taxpayers (PDT) as of January 20, 2001, with a historic computer extract of taxpayers designated as ITPs before the RRA 98 was enacted to identify any current PDT taxpayers that may have been previously classified as ITPs.
- II. Determined if ITP codes on the IRS' Audit Information Management System (AIMS), the Examination Returns Control System (ERCS), and the Taxpayer Advocate Management Information System (TAMIS) were removed and whether controls were implemented to prevent their future use.

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<sup>1</sup> Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 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.).

<sup>2</sup> The IRS database that stores various types of taxpayer account information, which includes data for individuals and businesses.

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- A. Reviewed a computer extract of the AIMS as of December 31, 2000, for any active cases with project code "085." For active cases identified, we validated and confirmed the information by researching the AIMS directly for the taxpayer's data.
  - B. Reviewed a computer extract of the ERCS as of December 31, 2000, for any active cases with project code "085." For active cases identified, we validated and confirmed the information by researching the ERCS directly for the taxpayer's data.
  - C. Reviewed a computer extract of the TAMIS as of March 12, 2001, for active cases containing Application for Taxpayer Assistance Order code "01" with sub-code "A."
- III. Determined if the IRS' Internal Revenue Manual (IRM) as of March 2001 contained ITP references by reviewing IRM sections previously identified by the TIGTA as containing ITP references. In addition, we searched other IRS Intranet/Internet sites and other IRM sources for ITP references.
- IV. Determined if other IRS publications as of March 2001 and May 2001 contained ITP references by reviewing the publications previously identified by the TIGTA as containing ITP references in the title. In addition, we searched other publications for ITP references in the titles.
- V. Determined if employees used ITP designations or references within taxpayer case histories.
- A. Obtained a computer extract of 2,696,259 active Automated Collection System (ACS) records as of March 5, 2001. Using discovery sampling technique (95 percent confidence level with occurrence rate of 1 percent or less), we selected a statistical random sample of 299 active ACS cases. We reviewed the sample for ITP designations or references by manually researching the cases directly on the ACS.
  - B. Obtained a computer extract of 52,320 active TAMIS records as of March 12, 2001. Using discovery sampling technique (95 percent confidence level with occurrence rate of 1 percent or less), we selected a statistical random sample of 298 active TAMIS cases. We reviewed the sample for ITP designations or references by manually researching the cases directly on the TAMIS.
  - C. Obtained a computer extract of 66,752 active Appeals Consolidated Data System (ACDS) records as of April 20, 2001. Using discovery sampling technique (95 percent confidence level with occurrence rate of 1 percent or less), we selected a statistical random sample of 298 active ACDS cases. We reviewed the sample for ITP designations or references by manually researching the cases directly on the ACDS.
  - D. Obtained a computer extract of 1,086,494 active ERCS records as of March 31, 2001. We selected a judgmental sample of 427 active ERCS cases located at the Cincinnati, Grand Rapids, Ogden, Portland, Sacramento, and Sarasota IRS office sites. A judgmental sample was used for this audit step because it was necessary to review the

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sample for ITP designations or references by manually researching the physical case files located at the six IRS office sites. These sites were selected because they had the greatest number of active cases for taxpayers that had formerly been categorized as ITPs.

- E. Obtained a computer extract of 6,601 active Criminal Investigation Management Information System (CIMIS) records as of February 28, 2001, for cases that were not in Grand Jury status. From this extract, we selected a judgmental sample of 57 active CIMIS cases located at the Grand Rapids, Portland, Sacramento, and Sarasota IRS office sites. A judgmental sample was used for this audit step because it was necessary to review the sample for ITP designations or references by manually researching the physical case files located at the six IRS office sites. See step V. D. for site selection criteria.

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**Appendix II**

**Major Contributors to This Report**

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**Appendix III**

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