

**Fiscal Year 2003 Statutory Audit of
Compliance With Legal Guidelines Prohibiting
the Use of Illegal Tax Protester and Similar
Designations**

April 2003

Reference Number: 2003-40-098

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



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

April 14, 2003

MEMORANDUM FOR ACTING COMMISSIONER WENZEL

Gordon C. Milbourn III

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

SUBJECT: Final Audit Report – Fiscal Year 2003 Statutory Audit of
Compliance With Legal Guidelines Prohibiting the Use of Illegal
Tax Protester and Similar Designations (Audit # 200240069)

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)¹ Section (§) 3707 and internal IRS guidelines that prohibit IRS officers and employees referring to taxpayers as Illegal Tax Protesters (ITP) or any similar designations. In its response to the draft report, the IRS disagreed with our determination that in order to comply with this provision, IRS employees should not designate taxpayers as ITPs or similar designations in case histories. We intend to elevate this disagreement to the Assistant Secretary for Management and Chief Financial Officer of the Treasury.

Prior to enactment of 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 that 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.

RRA 98 § 3707 prohibits the IRS from referring to taxpayers as ITPs or any similar designations. The Treasury Inspector General for Tax Administration (TIGTA) is

¹ IRS Restructuring and Reform Act of 1998, 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.).

required to annually evaluate the IRS' compliance with the prohibition on the use of ITP or any similar designations.²

In summary, the IRS has not reintroduced past ITP codes on the Master File,³ and formerly coded ITP taxpayer accounts have not been reassigned to a similar ITP designation. In addition, the IRS does not have any current publications with ITP references. In response to our Fiscal Year (FY) 2002 recommendations,⁴ the IRS has taken steps to remove the ITP references from its Internal Revenue Manual (IRM). However, IRS employees continue to make references to taxpayers as ITPs and other similar designations in case narratives. Since the IRS has taken interim action on these issues, we believe that no further recommendations are needed at this time.

Our review showed the rights of 321 taxpayers were potentially affected due to improper designations. In addition, 110 subsections from various sources of the IRM contained ITP references. The recommendations from our FY 2002 report will continue to provide benefits on tax administration by protecting taxpayers' rights and improving the reliability of information. Appendix IV of this report provides a detailed description of these benefits, which will be included in our Semiannual Report to the Congress.

Management's Response: The Acting Commissioner, Small Business/Self-Employed Division, stated that the IRS has taken all of the necessary actions to comply with the Congressional intent of RRA 98 § 3707 by eliminating the ITP designation from its systems, the IRM, and publications. The IRS has stated, based on an opinion by IRS Chief Counsel, that notations in case histories to taxpayers as "tax protestors" and other similar designations are not "designations" within the meaning of the law. According to the IRS, to be a prohibited "designation," there must be an intent to set apart that person for a purpose, such as denying the taxpayer an administrative opportunity that is available to other taxpayers. Merely making references to taxpayers or their actions does not constitute a "designation" because those taxpayers continue to receive the same administrative remedies as all other taxpayers.

Management's complete response to the draft report is included as Appendix IX.

Office of Audit Comment: RRA 98 § 3707 provides that officers and employees of the IRS shall not designate taxpayers as ITPs or any similar designation. While there is little interpretive information provided concerning this provision, the Senate Committee Report (S. Rep. No. 105-174) states that the Committee is concerned that taxpayers might be stigmatized by a designation as an "illegal tax protester." Further, the Committee Report's explanation of the provision states that existing designations in the

² Internal Revenue Code § 7803(d)(1)(A)(v)(Supp. IV 1998), *as amended* by the Trade Act of 2002, Pub. L. No. 107-210, 116 Stat. 933, the Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, 116 Stat. 21, the Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427 (2002), and the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763.

³ The Master File is the IRS' database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

⁴ *Efforts Are Still Needed to Discourage the Use of Illegal Tax Protester and Similar Designations* (Reference Number 2002-40-162, dated September 2002).

Master File must be removed and any other designations, such as on paper records that have been archived, must be disregarded.

We believe that it is reasonable to conclude, based upon the language of the statute, that IRS officers and employees should not label taxpayers as ITPs or similar designations in any IRS record, which includes paper and electronic case files. We agree with the IRS that merely making references to taxpayers' actions (e.g., indicating the type of document the taxpayer files, or that the taxpayer files letters containing typical protestor language) does not constitute a designation prohibited by this statutory provision. IRS officers and employees should not, however, designate taxpayers as ITPs or similar designations, because such a designation alone contains a negative connotation and appears to label the taxpayer.

We have not reported that those taxpayers designated by IRS employees as ITPs or similar designations have been harmed by the designations. Only a thorough review of each taxpayer's case and the treatment accorded that taxpayer would determine if these taxpayers have been harmed. Accordingly, in our FY 2002 report, we recommended that the IRS review each case where the reference to ITP or similar designation had been identified and make such determinations.

In addition, in its response, the IRS stated that all ITP designations have been removed from the IRM as of March 3, 2003. This corrective action occurred after the end of our fieldwork. We will confirm that all ITP designations have been removed from the IRM during next year's mandatory review.

Because the TIGTA is required to annually evaluate the IRS' compliance with this provision of the law, we intend to elevate the disagreement about whether employees are labeling taxpayers as ITPs to the Department of the Treasury. In accordance with the Office of Management and Budget Circular A-50 and Treasury Directive 40-3, you should submit a written reply to the Assistant Secretary for Management and Chief Financial Officer of the Treasury within 30 calendar days from the date of this report. Your reply should explain the IRS' reasons for the lack of agreement with the findings contained in our report. You should also provide us with a copy of your reply.

Please contact me at (202) 622-6510 if you have questions, or your staff may contact Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

**Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**

Table of Contents

Background	Page 1
Illegal Tax Protester Codes Are Not Used on the Master File	Page 2
Internal Revenue Service Publications Do Not Contain Illegal Tax Protester References.....	Page 2
Steps Have Been Taken to Remove Illegal Tax Protester References From the Internal Revenue Manual	Page 2
Employees Continue to Use Illegal Tax Protester or Similar Designations in Case Narratives	Page 3
Appendix I – Detailed Objective, Scope, and Methodology	Page 7
Appendix II – Major Contributors to This Report.....	Page 10
Appendix III – Report Distribution List	Page 11
Appendix IV – Outcome Measures	Page 12
Appendix V – Use of Illegal Tax Protester and Similar Designations by Internal Revenue Service Employees During Fiscal Years 2002 and 2003	Page 14
Appendix VI – Examples of Illegal Tax Protester and Similar Designations Found in Case Narratives	Page 15
Appendix VII – Listing of Prior Audit Reports on Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations.....	Page 17
Appendix VIII – Internal Revenue Service Computer Systems.....	Page 18
Appendix IX – Management’s Response to the Draft Report	Page 19

Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

Background

The Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98)¹ Section (§) 3707 prohibits the IRS from referring to taxpayers as Illegal Tax Protesters (ITP) or any similar designations. In addition, the RRA 98 requires the removal of all existing ITP codes from the IRS' Master File² and instructs IRS employees to disregard any such designation not located on the Individual Master File.

Prior to enactment of 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 that 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.

The Congress had concerns that some taxpayers were being 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.

Internal Revenue Code (I.R.C.) § 7803(d)(1)(A)(v)(Supp. IV 1998)³ requires the Treasury Inspector General for Tax Administration (TIGTA) to annually evaluate the IRS' compliance with the prohibition against using ITP or any similar designations. This is our fifth review since Fiscal Year (FY) 1999. These reviews have identified areas for improvement to help the IRS comply with the ITP

¹ IRS Restructuring and Reform Act of 1998, 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.).

² The Master File is the IRS' database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

³ I.R.C., *as amended by* the Trade Act of 2002, Pub. L. No. 107-210, 116 Stat. 933, the Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, 116 Stat. 21, the Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427 (2002), and the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763.

Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

designation prohibition. See Appendix VII for a list of all prior audit reports issued on the IRS' compliance with the RRA 98 § 3707.

This audit was conducted in the IRS National Headquarters between August 2002 and January 2003. 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. A description of IRS computer systems can be found in Appendix VIII.

Illegal Tax Protester Codes Are Not Used on the Master File

In prior reviews (see Appendix VII), we reported that the IRS had removed the ITP codes from the Master File as required by the RRA 98 § 3707. The ITP designation has not been reintroduced on the Master File.

The RRA 98 § 3707 also prohibits using any designation similar to the ITP. A review of the approximately 57,000 taxpayer accounts formerly coded as ITPs on the Master File identified no reassignments of these taxpayer accounts to any other Master File designations.

Internal Revenue Service Publications Do Not Contain Illegal Tax Protester References

To help promote compliance with the RRA 98 § 3707, IRS management issued directives for employees to update various publications to eliminate references to ITP terminology and programs. A review of IRS publications identified no ITP references. The IRS has labeled those publications with ITP references identified in our previous reviews as obsolete.

Steps Have Been Taken to Remove Illegal Tax Protester References From the Internal Revenue Manual

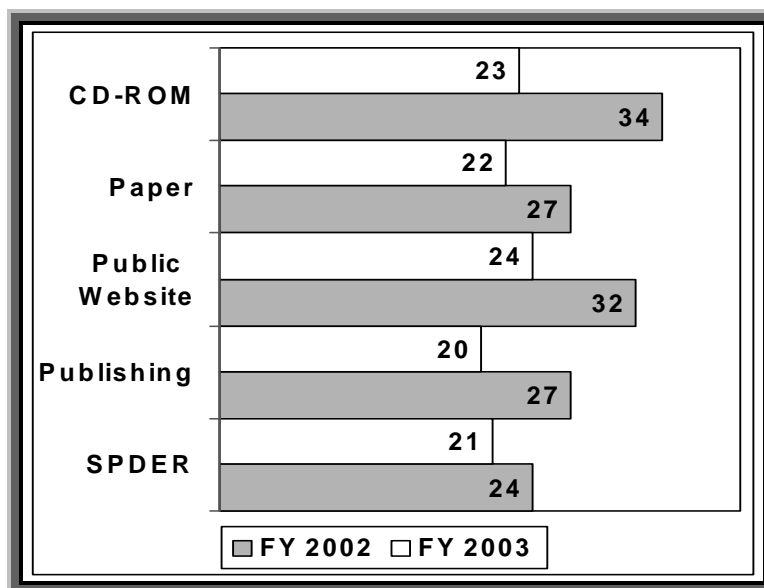
During each of the four prior reviews, we identified multiple subsections of the Internal Revenue Manual (IRM) that contained ITP designations or similar references. In August 2002, the IRS responded to our FY 2002 report stating that each operating division responsible for manual updates would delete these references from the IRM. If evidence of ITP references are found during periodic reviews, the Office of Servicewide Policy, Directives, and Electronic Research is to inform the appropriate operating division of the existence of the prohibited term and monitor the removal of the term based on a timetable provided by

Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

the operating division. The implementation of this corrective action was scheduled for March 2003.

The IRS has taken interim steps to remove ITP or similar designations from the various forms of the IRM. As of January 8, 2003, only 110 of these references still existed. According to the IRS, the remaining references will be removed this calendar year. The following chart compares the number of IRM subsections with ITP or similar references identified by location during our FYs 2002 and 2003 reviews.

**Comparison of Designations Identified During the TIGTA's
Fiscal Years 2002 and 2003 Reviews⁴**



Source: TIGTA audit report titled, "Efforts Are Still Needed to Discourage the Use of Illegal Tax Protester and Similar Designations" (Reference Number 2002-40-162, dated September 2002), and current versions of the IRM.

Employees Continue to Use Illegal Tax Protester or Similar Designations in Case Narratives

Our FY 2003 review of a sample of computer systems and paper files used by IRS employees to document case activity identified 321 instances where 296 employees designated taxpayers as "tax protesters," "ITPs," "constitutionally challenged," or other similar designations. These actions

⁴ During our FYs 2002 and 2003 reviews, no ITP or similar references were identified on the Service Electronic Research Program (SERP).

**Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**

are prohibited by the RRA 98 § 3707. Employees are allowed to document any statements made by a taxpayer or their representatives. Quoting a taxpayer's self-designation as an ITP is not prohibited by the RRA 98 § 3707. Examples of inappropriate employee comments can be found in Appendix VI, and a breakdown of where comments were made can be found in Appendix V.

In our FY 2002 report, we reported that IRS employees were still using ITP or similar designations in their case narratives, and recommended that IRS management consult with its Office of Chief Counsel to determine the effect on taxpayer rights. In August 2002, the IRS responded that it requested guidance from its Office of Chief Counsel regarding similar designations. Once this issue was defined, the IRS would issue a memorandum to all employees reinforcing the importance of not referring to taxpayers as ITPs.

In the interim, the IRS issued a SERP⁵ alert on October 11, 2002, reminding employees of the prohibition regarding the use of ITP or any similar designations. In addition, business and functional units independently took additional steps to address this issue.

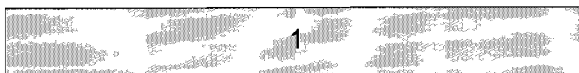
In January 2003, the IRS' Office of Chief Counsel issued an opinion that disagreed with our view that employee use of ITP or similar designations in case narratives were potential violations of the RRA 98 § 3707. However, the opinion also stated, "...the Service [IRS] should consider using acceptable alternatives to the terms and phrases that TIGTA finds objectionable." A memorandum to all employees has yet to be issued.

Employees referred to taxpayers using ITP designations in case narratives on the following IRS computer inventory management systems and paper case files:

- Appeals Consolidated Data System (ACDS): A review of approximately 30,000 current ACDS records identified [redacted] in which 2 employees [redacted]

⁵ Only those employees that use the SERP would have access to this alert.

**Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**



In December 2002, Appeals management issued an e-mail alert reminding their employees of the requirements of the RRA 98 § 3707, emphasizing that they are not to use ITP or similar designations. In addition, the Appeals internal website was updated, instructing employees to not use ITP designations in written documentation.

- Automated Collection System (ACS): A review of approximately 2.2 million open ACS records identified 83 cases in which 77 employees used ITP or similar designations when referring to specific taxpayers in their case narratives.

On August 6, 2002, Wage and Investment (W&I) Division management issued a memorandum directing all W&I Division Compliance function employees to stop using ITP or any similar designations. After the issuance of the memorandum, the occurrence of ITP or similar designations in the W&I Division's ACS cases declined. Of the 59 W&I Division ACS cases identified with improper designations, only 7 case narratives had ITP or similar designations occurring after the August 2002 memorandum.

In addition, in January 2003, the Small Business/Self-Employed (SB/SE) Division's Compliance function issued a memorandum to its employees,⁶ directing them to not use ITP or similar designations.

- Examination Paper Case Files:⁷ A review of a judgmental sample of 269 closed taxpayer examinations identified 4 cases in which 4 employees used ITP or similar designations when

⁶ This memorandum covered SB/SE Division's Compliance function employees responsible for narratives in the ACS, Examination paper case files, and the Integrated Collection System (ICS).

⁷ The judgmental sample included examination cases from only the SB/SE and W&I Divisions.

Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

referring to specific taxpayers in their paper case files.

- ICS: A review of approximately 1.7 million open and recently closed ICS records identified 228 cases in which 209 employees used ITP or similar designations when referring to specific taxpayers in their case narratives. This is an increase since our last report.
- Taxpayer Advocate Management Information System (TAMIS): A review of approximately 45,000 open TAMIS records identified 4 cases in which 4 employees used ITP or similar designations when referring to specific taxpayers in their case narratives.

As a result of our FY 2002 review, the Taxpayer Advocate Service (TAS) forwarded each exception to the appropriate TAS director, and each local office involved either included the ITP usage as a group meeting topic, addressed it directly with the employee, or sent out written clarification. In addition, the TAS included the verification of ITP usage as part of its annual management controls certification process and incorporated the ITP and similar designations prohibitions into a training course developed to improve history documentation.

In addition to the ITP and similar designations found in the various case narratives, we identified another 160 cases where IRS employees made comments or references to protester activities or used an obsolete ITP letter/form, but did not specifically designate taxpayers as “protesters.” While these actions are not prohibited by the RRA 98 § 3707, we are concerned that these references could become, or be considered, permanent labels that could subsequently stigmatize taxpayers in future contacts with the IRS.

In general, the IRS has taken steps in directing its employees to prevent ITP and similar designations from appearing in case narratives and the IRM. Since the IRS has taken interim action to address these issues, we believe that no further recommendations are needed at this time.

**Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**

Appendix I

Detailed Objective, Scope, and Methodology

The objective of this review was to determine if the Internal Revenue Service (IRS) complied with the IRS Restructuring and Reform Act of 1998 (RRA 98)¹ Section (§) 3707 and internal IRS guidelines that prohibit referring to taxpayers as Illegal Tax Protesters (ITP) or any similar designations. A description of IRS computer systems can be found in Appendix VIII. The Treasury Inspector General for Tax Administration (TIGTA) is required to annually evaluate the IRS' compliance with the prohibition against using ITP or any similar designation.² To complete this objective, we:

- I. Determined if the ITP coding on the IRS' Master File³ was removed by reviewing all Accelerated Issuance Codes (Transaction Code 148) as of October 2002 for Individual Master File (IMF) records and November 2002 for Business Master File (BMF) records. We reviewed 57,410 BMF records and 148,592 IMF records. We generally relied on the TIGTA's Office of Information Technology for validation of the data provided to us. However, we did a limited validation of the data by researching a judgmental sample of 30 Taxpayer Identification Numbers⁴ (TIN) on the Integrated Data Retrieval System⁵ (IDRS).

We also 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 118 taxpayers. We reviewed these taxpayers' accounts on the IDRS to determine if any new common codes were being used to classify them as ITPs.

¹ IRS Restructuring and Reform Act of 1998, 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.).

² Internal Revenue Code § 7803(d)(1)(A)(v)(Supp. IV 1998), *as amended by* the Trade Act of 2002, Pub. L. No. 107-210, 116 Stat. 933, the Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, 116 Stat. 21, the Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427 (2002), and the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763.

³ The Master File is the IRS' database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

⁴ A nine-digit number assigned to taxpayers for identification purposes. Depending on the nature of the taxpayer, the TIN is either an Employer Identification Number, a Social Security Number, or an Individual TIN.

⁵ IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

- II. Determined if the IRS' Internal Revenue Manual (IRM) still contained ITP or any similar designations by performing key word searches in January 2003 of the Servicewide Policy, Directive, and Electronic Research system; the Servicewide Electronic Research Program (SERP); the IRS' electronic publishing Intranet website; the IRS' public Internet website; the CD-ROM; and paper IRMs. We specifically searched for corrections to the exceptions identified in our Fiscal Year 2002 report⁶ and determined if there were any new references.
- III. Determined if IRS publications still contained ITP or any similar designations by performing key word searches of the SERP, the IRS' public Internet website, and the IRS' electronic publishing Intranet website in September 2002.
- IV. Determined if employees were using ITP or any similar designations within taxpayer case narratives on the IRS' Integrated Collection System (ICS) by securing and analyzing 1,706,806 open and recently closed ICS records from a database with history action dates between October 2001 and September 2002. We did not perform a detailed validation of the ICS data because this information was provided directly from the IRS through the TIGTA Data Center Warehouse.⁷ However, we did a limited validation of the data accuracy by matching a judgmental sample of 10 TINs to the IDRS to determine if the accounts were in current collection status.
- V. Determined if employees were using ITP or any similar designations within taxpayer case narratives on the IRS' Automated Collection System (ACS) by securing and analyzing all 2,152,457 records from the current open database as of September 2002 and subsequently analyzing additional records as of October 2002. We did not perform a detailed validation of the ACS data because this information was provided directly from the IRS through the TIGTA Data Center Warehouse. However, we did a limited validation of the data accuracy by matching a judgmental sample of 24 TINs to the IDRS to ensure the accounts were in current collection status.
- VI. Determined if employees were using ITP or any similar designations within taxpayer case narratives on the IRS' Taxpayer Advocate Management Information System (TAMIS) by analyzing the key word query results of 45,054 open TAMIS cases with activity between October 2001 and October 2002. The Taxpayer Advocate Service provided the data and validation information to us. The TIGTA Data Center Warehouse staff also conducted validation on the TAMIS data received, and we validated the data by scanning the data and comparing the volume with TAMIS reports provided by the IRS.

⁶ *Efforts Are Still Needed to Discourage the Use of Illegal Tax Protester and Similar Designations* (Reference Number 2002-40-162, dated September 2002).

⁷ The Data Center Warehouse consists of data used by the TIGTA in audits, investigations, integrity projects, and administrative requirements.

**Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**

- VII. Determined if employees were using ITP or any similar designations within taxpayer case narratives on the IRS' Appeals Consolidated Data System (ACDS) by analyzing 29,869 case records identified as received in the Appeals function from January through August 2002. We did not perform a data validation of the ACDS data because this information was provided directly from the IRS through the TIGTA Data Center Warehouse.
- VIII. Determined if Examination function employees were using ITP or any similar designations within paper case files by reviewing a judgmental sample of 269 closed taxpayer examinations. The sample was selected from 2,575 tax return examinations of taxpayers previously identified as ITPs that were closed between October 2001 and June 2002. We validated record counts for this time period against Examination reports provided by the IRS.
- IX. Determined if Criminal Investigation Division (CID) employees were using ITP or any similar designations within paper case files by reviewing a judgmental sample of 60 closed Subject Criminal Investigation (SCI) cases for taxpayers previously identified as ITPs. We selected our sample from 350 cases identified by matching a computer file containing 93,114 taxpayers with a CID freeze code (as of March 2002) with a file containing a list of taxpayers with ITP designations prior to the RRA 98. We researched IRS computer files for 155 of these cases to ensure that the data were valid and current.
- Our scope was limited based on the following: (1) Some CID cases were not available for our review because they were in Grand Jury status. Per Federal Rules of Criminal Procedure,⁸ case information that is in Grand Jury status cannot be disclosed. CID representatives provided information showing that 189 of the 350 cases in our match above were in Grand Jury status. (2) At the request of CID management, we limited our sample to closed SCI cases and to judgmentally selected sites to reduce the impact on their resources.
- X. Consulted with the TIGTA's Office of Chief Counsel on the correct application of the law.

⁸ 18 U.S.C. § 3322 (2000).

**Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**

Appendix II

Major Contributors to This Report

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

Augusta R. Cook, Director

Bryce Kisler, Audit Manager

Alan Lund, Senior Auditor

Sharla Robinson, Senior Auditor

Craig Pelletier, Auditor

**Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**

Appendix III

Report Distribution List

Assistant Deputy Commissioner N:ADC
Commissioner, Small Business/Self-Employed Division S
Commissioner, Wage and Investment Division W
Deputy Commissioner for Modernization & Chief Information Officer M
Director, Strategy and Finance W:S
Chief, Appeals AP
Chief, Criminal Investigation CI
Chief, Customer Liaison S:COM
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:AR:M
Audit Liaisons:
 Assistant Deputy Commissioner N:ADC
 Chief, Customer Liaison S:COM
 Program/Process Assistant Coordinator, Wage and Investment Division W:HR
 Deputy Commissioner for Modernization & Chief Information Officer M
 Chief, Appeals AP
 Chief Counsel CC
 Chief, Criminal Investigation CI
 National Taxpayer Advocate TA

**Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**

Appendix IV

Outcome Measures

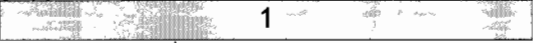

This appendix presents detailed information on the measurable impact on tax administration that the recommendations from the Treasury Inspector General for Tax Administration's Fiscal Year 2002 audit report¹ will continue to provide. These benefits will be incorporated into our Semiannual Report to the Congress. A description of Internal Revenue Service (IRS) computer systems can be found in Appendix VIII.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 321 taxpayers affected (see page 3).

Methodology Used to Measure the Reported Benefit:

We reviewed the following:

- From the Appeals Consolidated Data System, approximately 30,000 records received from January through August 2002, and identified  1 
- From the Automated Collection System, approximately 2.2 million records open as of October 2002, and identified 83 case narratives that contained ITP or a similar designation.
- From Examination function paper case files, a total of 269 judgmentally selected examinations nationwide that closed between October 2001 and June 2002, and identified 4 case files that contained ITP or a similar designation.
- From the Integrated Collection System, approximately 1.7 million records open and recently closed records with history action dates between October 2001 and September 2002, and identified 228 case narratives that contained ITP or a similar designation.
- From the Taxpayer Advocate Management Information System, approximately 45,000 open cases with activity between October 2001 and October 2002, and identified 4 case narratives that contained ITP or a similar designation.

Type and Value of Outcome Measure:

- Reliability of Information – Actual; 110 Internal Revenue Manual (IRM) subsections from various sources affected (see page 2).

¹ *Efforts Are Still Needed to Discourage the Use of Illegal Tax Protester and Similar Designations* (Reference Number 2002-40-162, dated September 2002).

**Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**

Methodology Used to Measure the Reported Benefit:

In January 2003, we searched various versions of the IRM available to IRS employees for ITP references. These were found on the Servicewide Policy, Directive, and Electronic Research; the IRS' publishing website; the IRS' public Internet website; the CD-ROM; and on paper.

**Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**

Appendix V

**Use of Illegal Tax Protester and Similar Designations by Internal Revenue
Service Employees During Fiscal Years 2002 and 2003¹**

Exception Location	Fiscal Year 2002 Review			Fiscal Year 2003 Review		
	Employees	Protester Use	Similar Designation Use	Employees	Protester Use	Similar Designation Use
Appeals Consolidated Data System		1			1	
Automated Collection System	81	59	32	77	66	17
Criminal Investigation Cases	0	0	0	0	0	0
Examination Cases		1		4	1	
Integrated Collection System	166	83	120	209	93	135
Taxpayer Advocate Management Information System	4	0	5	4	0	4
TOTALS	255	144	159	296	162	159

Source: Treasury Inspector General for Tax Administration report titled, "Efforts Are Still Needed to Discourage the Use of Illegal Tax Protester and Similar Designations" (Reference Number 2002-40-162, dated September 2002), and various IRS case narratives.

¹ Due to scope and methodology differences between our Fiscal Years 2002 and 2003 reviews, the numbers in this table should be viewed independently and not compared.

**Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**

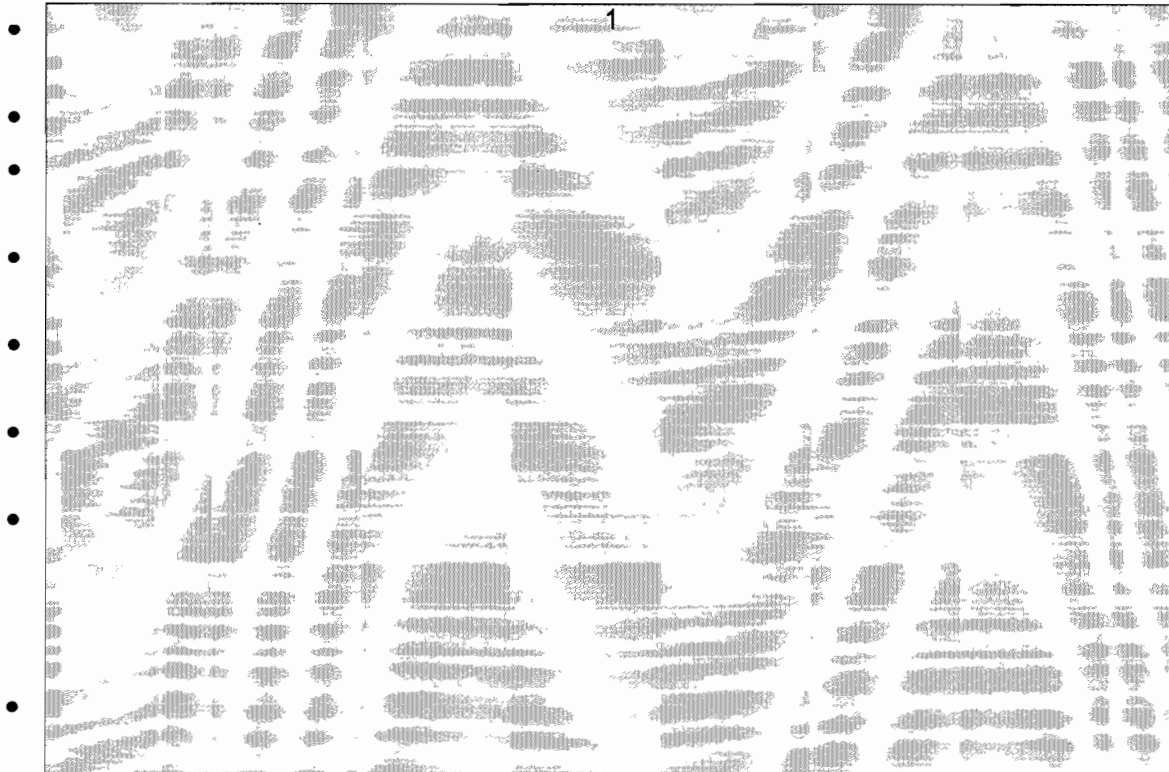
Appendix VI

**Examples of Illegal Tax Protester and Similar Designations
Found in Case Narratives**

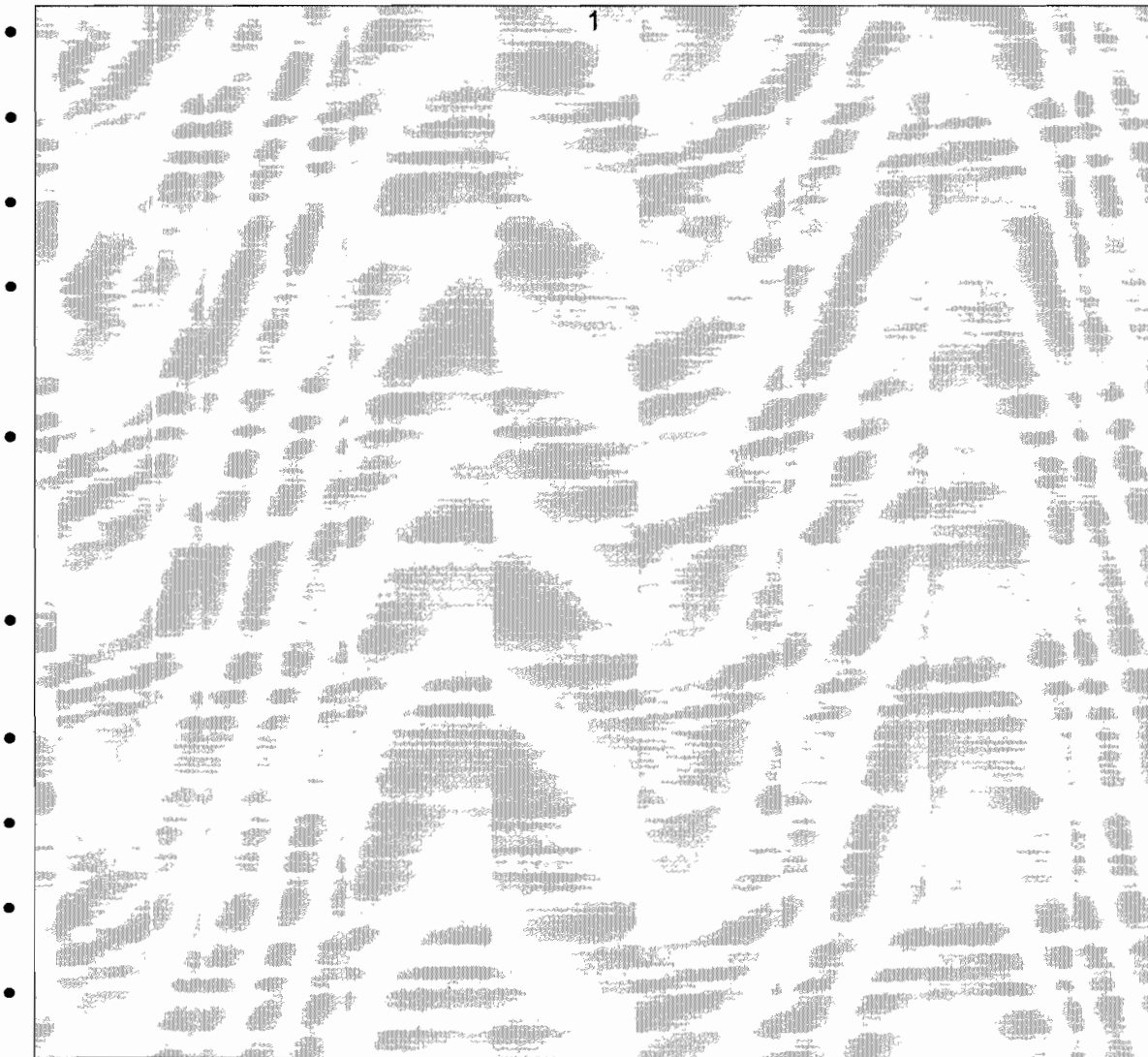
During our Fiscal Year 2003 review, we searched for the following words and abbreviations in order to identify Illegal Tax Protester (ITP) and other similar designations being used by Internal Revenue Service (IRS) employees in their case narratives. We did not take exception to employee comments quoting a taxpayer's self-designation as an ITP.

- CHALLENGE • CHLLNG • CNSTTTNL • CNSTTTNLY
- ITP • OBJECTOR • PROTESTER • PROTESTOR
- PROTESTR • PROTSTR • PRTSTR • TXPRTSTR

The following comments made by employees are some examples of ITP and similar designations found in IRS employees' case narratives.



**Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**



**Listing of Prior Audit Reports on Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**

1. *The Internal Revenue Service Is Addressing the Use of the Illegal Tax Protester and Nonfiler Designations* (Reference Number 1999-10-080, dated September 1999).
2. *Additional Action Is Needed to Eliminate Illegal Tax Protester Designations* (Reference Number 2000-10-119, dated September 2000).
3. *Improvements Have Been Made to Eliminate Illegal Tax Protester Designations* (Reference Number 2001-10-141, dated September 2001).
4. *Efforts Are Still Needed to Discourage the Use of Illegal Tax Protester and Similar Designations* (Reference Number 2002-40-162, dated September 2002).

Internal Revenue Service Computer Systems

Appeals Consolidated Data System: A computerized case control system used to control and track cases coming into and leaving Appeals.

Automated Collection System: A computerized system that maintains balance due accounts and return delinquency investigations.

Integrated Collection System: A system used by Collection function employees to report taxpayer case time and activity.

Integrated Data Retrieval System: A computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

Master File: A database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

Taxpayer Advocate Management Information System: An electronic database and case inventory control system used by Taxpayer Advocate Service employees.

**Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester and Similar Designations**

Appendix IX

Management's Response to the Draft Report



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



APR 2 2003

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *JK* Joseph G. Kehoe *Joe G. Kehoe*
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Fiscal Year 2003 Statutory Audit of
Compliance with Legal Guidelines Prohibiting the Use of Illegal
Tax Protestor (ITP) and Similar Designations
(Audit # 200240069)

I have reviewed your draft report and appreciate your acknowledgement of the actions we have taken to comply with Section 3707 of the Internal Revenue Restructuring and Reform Act of 1998 (RRA 98). As you indicated in the report, we have not:

- Reintroduced past ITP codes on the Master File;
- Reassigned cases formerly coded as ITP to a similar ITP designation; or,
- Published materials with ITP references.

We have taken all necessary actions to comply with the Congressional intent of this provision by eliminating the ITP designation from all of our systems, the Internal Revenue Manual (IRM), and our publications. We disagree that we must eliminate references to "tax protestors" or similar designations from all case histories in order to comply with this provision.

Although there are no recommendations in this audit, we have comments on two topics discussed in the report:

- Employees Continue to Use Illegal Tax Protestor or Similar Designations in Case Narratives
- IRS Has Taken Steps to Remove Illegal Tax Protester References from the Internal Revenue Manual

Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

2

Employees Continue to Use Illegal Tax Protestor or Similar Designations in Case Narratives

Out of over 3.9 million cases you reviewed for this audit, you identified 321 instances where IRS employees referred to taxpayers as "tax protestors" or other similar designations. In the FY 2002 report, you also reported that IRS employees were still using ITP or similar designations in their case histories and recommended that we consult with the Office of Chief Counsel to determine the effect on taxpayer rights.

Our Office of Chief Counsel stated that notations in case histories that our employees used to describe taxpayer behavior are not designations within the meaning of the law. To be a designation, there must be an intent to set apart that person for a purpose, such as denying the taxpayer an administrative opportunity that is available to other taxpayers. Merely making references to taxpayers or their actions does not constitute a designation because those taxpayers continue to receive the same administrative remedies as all other taxpayers. There was no indication that these taxpayers were subject to any different type of treatment than any other taxpayer.

Because you are unwilling to share your Counsel's opinion with us, we cannot comment on the rationale behind your decision to cite these types of references as violations. Consistent with our Counsel's guidance, we believe it is inappropriate to consider these types of references as violations. However, as you acknowledge in your report, we issued various forms of guidance to employees in an attempt to eliminate these types of references from case histories. Based on the statistically small number of references found (.008%), we believe we have been extremely successful in this attempt. Although we have not completely eliminated this type of language from the case files, we believe that we have fully complied with the Congressional intent of this provision.

IRS Has Taken Steps to Remove Illegal Tax Protester References from the Internal Revenue Manual

As of March 3, 2003, we removed the last ITP reference from the IRM with the publishing of IRM 4.10.3. We no longer use this terminology in the latest version of the official IRM. In your report, please acknowledge the actions taken by the Office of Servicewide Policy, Directives, and Electronic Research (SPDER) that resulted in the removal of all ITP references from the IRM.

It is also important to understand the distinction between the official IRM and other sources. As we have previously discussed with you, the official IRM is contained in the Multimedia core repository. All other versions of electronic IRMs originate from the Multimedia files. Multimedia updates the core repository as new IRMs are published. However, other electronic versions have varying production schedules such as quarterly or semi-annually. For this reason, these sources such as the *Digital Daily* website and

Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

3

the Multimedia CD ROM (CD ROM IRM) will be out of date until their next regularly scheduled update.

Additionally, we would like to clarify that Chief Counsel, not the IRS, is responsible for updating and removing ITP references from the Chief Counsel's Directives Manual (CCDM). Although the CCDM is published with the IRM, it is not a part of the IRM, and we do not control what happens with it. The CCDM still contains ITP references, and Chief Counsel is working to update it. SPDER asks that you deal directly with the points of contact previously provided to obtain status information on Chief Counsel's progress to remove ITP references. We understand that your auditors have already contacted the Chief Counsel organization responsible for the CCDM update and have been assured that the appropriate changes will be made.

If you have any questions, please call me at (202) 622-0600, or Joseph R. Brimacombe, Deputy Director, Compliance Policy, Small Business/Self-Employed Division at (202) 283-2200.