



*Fiscal Year 2006 Statutory Audit of  
Compliance With Notifying Taxpayers  
of Their Rights When Requested to  
Extend the Assessment Statute*

**September 21, 2006**

**Reference Number: 2006-40-163**

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

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*Phone Number* | 202-927-7037

*Email Address* | [Bonnie.Heald@tigta.treas.gov](mailto:Bonnie.Heald@tigta.treas.gov)

*Web Site* | <http://www.tigta.gov>



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

September 21, 2006

**MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND  
ENFORCEMENT**

**FROM:** *Michael R. Phillips*  
Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Fiscal Year 2006 Statutory Audit of Compliance  
With Notifying Taxpayers of Their Rights When Requested to Extend  
the Assessment Statute (Audit # 200540040)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) was complying with Internal Revenue Code Section (§) 6501(c)(4)(B) (2000 Suppl. 2), 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 is required to provide information annually regarding the IRS' compliance with Internal Revenue Code § 6501(c)(4)(B).<sup>1</sup> 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, Congress expressed concern that taxpayers were not being advised adequately of their rights.

*Impact on the Taxpayer*

We identified instances in which case files did not contain the necessary documentation to show the taxpayers were advised of their rights regarding assessment statute extensions. Without adequately documenting this process, the IRS can not demonstrate compliance with the statutory requirements and taxpayers could have entered into statute extension agreements without adequate knowledge of their rights.

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<sup>1</sup> Internal Revenue Code § 7803(d)(1)(C) (2000 Suppl. 2).



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## Synopsis

There was not always documentation in the related case files that taxpayers were advised of their rights regarding assessment statute extensions. During our period of review, the IRS used both prior versions of the consent forms and the newly distributed revised consent forms that provide an explanation of the taxpayers' rights to limit or refuse to extend the assessment statute of limitations.<sup>2</sup> In our sample of 201 tax returns, 35 (17.41 percent) of the related case files reviewed did not contain any documentation to support that the taxpayers had been advised of their rights regarding assessment statute extensions. In addition, 13 (12.75 percent) of the case files in our sample with authorizations for third-party representation did not document that the representatives were separately notified of the written communications advising taxpayers of their rights.<sup>3</sup> Taxpayer rights were potentially affected in 360 tax returns for which related case files were not documented to show that taxpayers' rights were protected with regard to assessment statute extensions. In addition, taxpayer rights were potentially affected in 134 tax returns for which related case files were not documented to show that the taxpayers' representatives were given copies of the written communications advising taxpayers of their rights regarding assessment statute extensions.

***Taxpayer rights were potentially affected when case files did not contain documentation that taxpayers were notified of their rights.***

## Recommendation

We made no recommendations in this report because we have made prior recommendations that continue to provide benefits.

## Response

IRS management conveyed their appreciation of our acknowledgement that the revisions the IRS has made to various consent forms in response to our previous recommendations continue to provide benefits and that no further recommendations are necessary. However, the IRS expressed disagreement pertaining to the legal interpretations of 26 Code of Federal Regulations § 601.506<sup>4</sup> and, as a result, our outcome measures. The IRS believes providing notice to the taxpayer's authorized representative constitutes compliance with statutory requirements. Management's complete response to the draft report is included as Appendix VI.

<sup>2</sup> 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.

<sup>3</sup> See Appendix V.

<sup>4</sup> 26 Code of Federal Regulations § 601.506 (2002).



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*Office of Audit Comment*

Contrary to the IRS' position, we believe the statute and the regulations are clear on the IRS' responsibility to send notification to the taxpayer. The IRS' own procedures require that "... the notification must be made to the taxpayer *and* the taxpayer's representative . . . ." While taxpayers may permit authorized representatives to receive IRS notifications in addition to the notice required to be provided to the taxpayers, taxpayers may not designate that their representatives receive notification *instead of* the taxpayers. As a result, we believe our outcome measures are valid.

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 E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 622-5916.



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*Abbreviations*

I.R.C.	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service



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## *Background*

The Internal Revenue Service (IRS) is required by Internal Revenue Code (I.R.C.) Section (§) 6501(c)(4)(B) (2000 Suppl. 2) 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, 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 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 to the taxpayer and to the taxpayer's representative.<sup>1</sup> 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, IRS Restructuring and Reform Act of 1998<sup>2</sup> § 3201 requires the IRS to send any notice relating to a jointly filed tax return separately to each individual filing the joint return.

If the IRS examines a tax return and determines there is an additional tax liability, it generally must assess the tax 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.<sup>3</sup>

***A consent extends  
the assessment  
statute of limitations  
to either a specific  
date or for an  
indefinite period.***

To extend the assessment statute, the IRS asks the taxpayer to sign a statute extension agreement form (i.e., a consent form).<sup>4</sup> A consent extends the assessment statute of limitations to either a specific date or for an unlimited, indefinite period. 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. There are two basic types of consents: the fixed date consent and the open-ended consent. The

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<sup>1</sup> 26 Code of Federal Regulations § 601.506 (2002).

<sup>2</sup> 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.).

<sup>3</sup> There are some exceptions to the 3-year statute of limitations. For example, I.R.C. § 6501(c)(1) (2000 Suppl. 2) extends the assessment statute indefinitely when false or fraudulent tax returns are filed.

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



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fixed date consent sets a specific expiration date on the statute, while the open-ended consent extends the statute for an infinite period of time.

Although the IRS has revised its internal procedures over the last few years to help enhance controls, our reviews have 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,<sup>5</sup> the IRS revised the various consent forms to include a statement informing taxpayers of their rights regarding assessment statute extensions as provided for in I.R.C. § 6501(c)(4)(B) and to 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 also have been advised of their rights.

Form 872 (Rev. Dec. 2004) Department of the Treasury-Internal Revenue Service Consent to Extend the Time to Assess Tax In reply refer to: Taxpayer Identification Number

Your Rights as a Taxpayer

You have the right to refuse to extend the period of limitations or limit this extension to a mutually agreed-upon issue(s) or mutually agreed-upon period of time. Publication 1035, Extending the Tax Assessment Period, provides a more detailed explanation of your rights and the consequences of the choices you may make. If you have not already received a Publication 1035, the publication can be obtained, free of charge, from the IRS official who requested that you sign this consent or from the IRS' web site at www.irs.gov or by calling toll free at 1-800-829-3676. Signing this consent will not deprive you of any appeal rights to which you would otherwise be entitled.

YOUR SIGNATURE HERE [arrow] I am aware that I have the right to refuse to sign this consent or to limit the extension to mutually agreed-upon issues and/or period of time as set forth in I.R.C. § 6501(c)(4)(B). (Date signed)

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

5 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).



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- 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 develop further any 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' compliance with I.R.C. § 6501(c)(4)(B).<sup>6</sup> This report presents the results of our seventh annual review of the IRS' compliance with the statute extension provisions of the law.

This review was performed at the Large and Mid-Size Business Division Headquarters, Office of Appeals Headquarters, Small Business/Self-Employed Division Headquarters, and Tax Exempt and Government Entities Division Headquarters in Washington, D.C., during the period October 2005 through June 2006. 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.

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<sup>6</sup> I.R.C. § 7803(d)(1)(C) (2000 Suppl. 2).



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## *Results of Review*

### **Case Files Did Not Always Contain Documentation That Taxpayers Were Advised of Their Rights Regarding Assessment Statute Extensions**

In 35 (17.41 percent) of the 201<sup>7</sup> tax returns sampled, case files did not contain sufficient documentation to indicate whether taxpayers had been advised of their rights before consenting to extend the time to assess tax. There were 20 tax returns filed by single individuals, businesses, or exempt organizations and 15 jointly filed individual tax returns.<sup>8</sup> We estimate from our population of 2,065 tax return files that 360 tax return files may not have contained adequate documentation to show taxpayers were advised of their rights when assessment statutes were extended during the first 6 months of Calendar Year 2005.<sup>9</sup> We considered that IRS employees advised taxpayers of their rights if any of the following documentation was found in the related case files:

- A revised Consent to Extend the Time to Assess Tax (Form 872) and Consent to Extend the Time to Assess Employment Taxes (Form SS-10),<sup>10</sup> signed by the taxpayer, that briefly outlines taxpayer rights regarding assessment statute extensions.
- A copy of Request to Extend Assessment Statute (Letter 907), Letter Transmitting Consent Extending Period of Limitation (Letter 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.

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<sup>7</sup> This number is a unique count of tax returns. It is made up of single individuals, businesses, exempt organizations, and taxpayers who filed a joint tax return.

<sup>8</sup> See Appendix V.

<sup>9</sup> Based on the estimated population of 2,065 tax return files, we are 95 percent confident that between 250 and 470 tax return files may not have contained adequate documentation that taxpayers were properly notified of their assessment statute of limitation rights. See Appendix IV for additional details.

<sup>10</sup> The IRS uses several different types of consents, depending on the type of tax involved. For example, Form 872 is used for income taxes and Form SS-10 is used for employment taxes. Form 872 is the most commonly used consent form.



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Tax Assessment  
Period**



Publication 1035 (Rev.05-2003)  
Catalog Number 46890Q

The 35 exceptions occurred because employees did not follow IRS internal guidelines. The Internal Revenue Manual (IRM)<sup>11</sup> and other internal procedures require IRS employees to provide the taxpayer with a Letter 907 or 967 (with a copy of Publication 1035 as an enclosure) and to document on an activity record whether the taxpayer was notified of his or her rights every time the IRS requested an assessment statute extension. The guidelines covering requests for taxpayers to extend the assessment statute require that notices relating to jointly filed tax returns be sent to each individual filing the joint return, wherever practicable. Specifically, the IRM requires that each individual filing a joint tax return be provided with a Letter 907 or 967. Without the required documentation, we could not determine if the IRS protected the rights of these taxpayers. Taxpayer rights can be affected if the IRS

does not follow the Federal Government regulations to 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.

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. 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.

***The revised Forms 872 should be an effective means for the IRS to document that taxpayers were notified of their rights***

During our audit period in January 2005, IRS employees began using the revised Form 872. In our sample of 201 cases, employees used the revised consent form in 83 cases.<sup>12</sup> In 8 of the 83 cases, the revised consent form was the only documentation on file that taxpayers had been notified of their rights. Without the new consent form that advised the taxpayers of their rights, these 8 cases would have been considered exceptions because other required documentation was not included in the files.

<sup>11</sup> The IRM contains policy, direction, and delegations of authority necessary to carry out IRS responsibilities to administer tax law and other legal provisions.

<sup>12</sup> Form 872 (Rev. 12-2004); Form SS-10 (Rev. 12-2004).



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The revised Form 872 includes a prominent statement informing taxpayers of their rights regarding assessment statute extensions, as provided for in I.R.C. § 6501(c)(4)(B), and information on how to obtain Publication 1035. By signing the revised version of the consent form, the taxpayer attests that “I am aware that I have the right to refuse to sign this consent or to limit the extension to mutually agreed-upon issues and/or period of time as set forth in I.R.C. § 6501(c)(4)(B).”

***The revised consent form includes a prominent statement informing taxpayers of their assessment statute rights.***

Once the IRS fully integrates use of the revised consent form with the statement advising taxpayers of their rights, the percentage of cases without required documentation should decrease. The only time the revised consent form would not be an effective vehicle to notify taxpayers of their rights is when the consent form is signed by the taxpayers’ representatives instead of the taxpayers, and there is no additional documentation in the case file that the taxpayers were notified of their rights.

The statutory requirement of I.R.C. § 6501(c)(4)(B) is for the IRS to notify taxpayers of their rights regarding assessment statute extensions. Federal Government regulations state that any notice given to a taxpayer must be given to the taxpayer and the taxpayer’s representative. The IRM also requires that “the notification must be made to the taxpayer and the taxpayer’s representative unless the taxpayer has placed restrictions on providing copies to the representative.” The IRS meets this obligation by demonstrating that the notice was mailed or presented to the taxpayer in person. This is usually accomplished by maintaining a copy of the Letter 907 or 967 in the case file and documenting this notification on an examination activity record.

In the IRS Restructuring and Reform Act of 1998 Committee Report, Congress further emphasized the need for taxpayers to be fully informed of their statute extension rights: “The Committee is concerned that in some cases taxpayers have not been fully aware of their rights to refuse to extend the statute of limitations and have felt they had no choice to extend the statute of limitations upon request of the IRS.”

Our sample cases were processed during the time the IRS was distributing (in December 2004 and March 2005) the revised version of the Form 872. If the revised version of the Form 872 had been available and used at the time employees requested the assessment statute extensions for the 201 returns sampled, there would have been only 16 case files without sufficient documentation instead of the 35 case files we reported. The revised Form 872 would have provided documentation that an additional 19 taxpayers had been notified of their rights. In the 16 case files, the Forms 872 were signed by the taxpayers’ representatives rather than the taxpayers; therefore, using the revised consent form would not have been an effective vehicle to notify the taxpayers of their rights.



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**Employees usually used the revised consent form once it became available**

Our sample indicated the IRS took effective actions to integrate the new consent forms into the assessment statute extension process. Employees used the revised consent forms for soliciting assessment extensions in 83 of the cases we sampled. Based on the dates the consents were requested, employees should have accessed and used the revised consent forms in 100 of the 201 tax returns we sampled. In the remaining 17 of 100 case files, employees used previous versions of the consent forms rather than the newly distributed revised consent forms.

The revised consent forms were initially distributed by memoranda on December 29, 2004, from the Director, Examination, Small Business/Self-Employed Division, to all affected business units/functions with instructions for:

- The immediate use of the revised consent forms for soliciting assessment statute agreements.
- The web site where the electronic versions of the revised consent forms could be obtained.
- The destruction of all hardcopy stock of prior versions of the consent forms.
- Management to remind employees to update the electronic version of the consent forms on their computers to ensure older versions were not being used.

***Employees had not always updated electronic versions of the consent forms on their computers.***

Employees did not use the revised consent forms for a variety of reasons. Managers we interviewed stated that some employees used previous versions of the consent forms that had been saved to their computer hard drives. We believe this may be resolved in time as employees update the electronic versions of the consent forms on their computers. Also, there was a 2-month delay in updating the software program for 1 IRS function, preventing employees ready access to the revised forms until mid-February 2005.

**Case Files Did Not Always Contain Documentation That the Internal Revenue Service Provided Taxpayers' Representatives With the Required Copies of Notices**

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's representative. In our sample of 201 tax returns, 102 of the related case files contained an authorization for a third party to represent the taxpayers in front of the IRS. In 89 of the related case files, employees documented that representatives were given a copy of the written communications advising taxpayers of their rights regarding assessment statute extensions.

However, there was no documentation that employees had provided the representatives with a copy of the written communications provided to taxpayers in the remaining 13 (12.75 percent)



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case files. We estimate from a population of 1,048 tax return files that 134 case files were not documented to show the taxpayers' representatives were given copies of the written communications advising taxpayers of their rights regarding assessment statute extensions.<sup>13</sup> Taxpayer entitlements could be affected if the IRS does not follow the Federal Government regulations to 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.

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

### ***Recommendation***

We made no recommendations in this report because we have made prior recommendations that continue to provide benefits.

**Management's Response:** IRS management conveyed their appreciation of our acknowledgement that the revisions the IRS has made to various consent forms in response to our previous recommendations continue to provide benefits and that no further recommendations are necessary. However, the IRS expressed disagreement pertaining to the legal interpretations of 26 Code of Federal Regulations § 601.506<sup>14</sup> and, as a result, our outcome measures. The IRS believes providing notice to the taxpayer's authorized representative constitutes compliance with statutory requirements.

**Office of Audit Comment:** Contrary to the IRS' position, we believe the statute and the regulations are clear on the IRS' responsibility to send notification to the taxpayer. The IRS' own procedures require that "... the notification must be made to the taxpayer *and* the taxpayer's representative . . ." While taxpayers may permit authorized representatives to receive IRS notifications in addition to the notice required to be provided to the taxpayers, taxpayers may not designate that their representatives receive notification *instead of* the taxpayers. As a result, we believe our outcome measures are valid.

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<sup>13</sup> Based on the estimated population of 1,048 tax return files, we are 95 percent confident that between 66 and 202 case files were not documented to show that taxpayers' representatives were given copies of notices advising taxpayers of their rights regarding assessment statute extensions. See Appendix IV for additional details.

<sup>14</sup> 26 Code of Federal Regulations § 601.506 (2002).



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## Appendix I

### *Detailed Objective, Scope, and Methodology*

The overall objective of this review was to determine whether the IRS was complying with I.R.C. § 6501(c)(4)(B) (2000 Suppl. 2), 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 this objective, we:

- I. Determined whether a sample of tax returns contained adequate documentation to show taxpayers and their representatives were being advised of their rights pertaining to assessment statute extension requests.
  - A. Reviewed the IRM,<sup>1</sup> IRS memoranda and regulations, and the Office of Appeals (Appeals) guidelines to determine the policies and procedures for processing requests to extend the assessment statute of limitations.
  - B. Identified a population of 6,720 Business Master File<sup>2</sup> and Individual Master File<sup>3</sup> tax returns with taxpayer consents to extend assessment statutes processed from January 1 through June 30, 2005. We validated the Business Master File and Individual Master File data by examining a random sample of 50 of the 6,720 records. The validation test results demonstrated the data were reliable and could be used to meet the objectives of this audit. We developed a statistical sampling plan using a 95 percent confidence level, an expected error rate of 16 percent, and a precision of  $\pm 5$  percent, which resulted in a sample size of 201 tax returns (closed cases). A statistical sample was taken because we wanted to estimate the number of tax returns in the population for which taxpayer rights were potentially affected.
  - C. Randomly selected for review 700 tax returns from the category of cases likely to have statute extensions by taxpayer consent from the Examination function and Appeals processes. We met our statistical sample size of 201 cases after reviewing 654 tax returns and related case files and eliminating 453 tax returns (1) that did not meet our criteria or (2) for which we did not receive all the requested tax returns and related case files. The sample of 201 tax returns was comprised of 116 single individual, business, and exempt organization tax returns and 85 jointly filed

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

<sup>2</sup> 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.

<sup>3</sup> The IRS database that maintains transactions or records of individual tax accounts.



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- individual tax returns. In addition, 102 of the 201 tax returns had declarations of representative made by the taxpayers.<sup>4</sup>
- D. Reviewed the 201 selected tax returns and related case files for the necessary documentation to verify whether taxpayers and their representatives were advised of their rights regarding assessment statute extensions. We also verified whether taxpayers were separately advised of their rights related to the assessment statute extension when they filed a joint return.
  - E. Discussed exceptions identified with the IRS business unit or function that requested the extension for concurrence or an explanation of why the IRS believed proper procedures were followed.
- II. Determined the status of the IRS corrective action related to a recommendation in a prior Treasury Inspector General for Tax Administration audit report<sup>5</sup> dealing with the revision of the consent forms. We determined how the IRS ensured the revised consent forms were made available to the tax examiners, how effectively the IRS implemented use of the revised consent forms, and whether the appropriate consent form was used for cases in our sample. For the exceptions in which the revised consent form should have been used, we obtained an explanation for why the wrong consent form was used.

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<sup>4</sup> See Appendix V for details.

<sup>5</sup> *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).



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**Appendix II**

*Major Contributors to This Report*

Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs)  
Mary V. Baker, Director  
James O'Hara, Audit Manager  
Tanya Boone, Acting Audit Manager  
William Simmons, Acting Audit Manager  
David Hartman, Lead Auditor  
Kristi Larson, Senior Auditor  
David Lowe, Auditor  
Lynn Ross, Auditor  
Sylvia Sloan-Copeland, Auditor



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**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 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, Communications, Liaison, and Disclosure, Small Business/Self-Employed Division  
SE:S:CLD  
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  
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    Chief, Appeals AP  
    Chief, Customer Liaison, Small Business/Self-Employed Division SE:S:COM



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## Appendix IV

### *Outcome Measures*

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

#### **Type and Value of Outcome Measure:**

- Taxpayer Rights and Entitlements – Potential; in 360<sup>1</sup> tax returns (208 single individual, business, or exempt organization and 152 jointly filed tax returns) for which related case files did not contain adequate documentation to show the taxpayers were advised of their rights when assessment statutes were extended during the first 6 months of Calendar Year 2005 (see page 4).

#### **Methodology Used to Measure the Reported Benefit:**

To determine the number of tax returns for which there was not adequate documentation to support that the taxpayers were advised of their rights when assessment statutes were extended, we electronically identified 6,720 tax returns from the universe of Business Master File<sup>2</sup> and Individual Master File<sup>3</sup> tax returns (posted during January through June 2005) on which the assessment statute was extended. Based on this population, we reviewed a statistically valid sample of 201 tax returns and identified 35 (17.41 percent) for which the required documentation was not found. Because we could not electronically identify just those tax returns for which the assessment statute was executed by consent, we requested 700 tax returns for which the assessment statute was extended and reviewed a total of 654 tax returns to identify the 201 tax returns for which the assessment statute was executed by consent needed for our sample. We then had to estimate the size of the population for which the assessment statute was executed by consent. This was accomplished by dividing the 201 tax returns in our sample by total tax returns reviewed ( $201/654 = 30.73$  percent) and then multiplying this percentage by the population to estimate the number of tax returns for which the assessment statute was executed by consent ( $6,720 * 30.73$  percent = 2,065 tax returns). Using the estimated population, we projected the reported error rate ( $2,065$  tax returns \* 17.41 percent = 360 [ $\pm 110$ ] tax returns).

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<sup>1</sup> Our sampling plan was based on a 95 percent confidence level, 16 percent expected error rate, and  $\pm 5$  percent desired precision.

<sup>2</sup> 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.

<sup>3</sup> The IRS database that maintains transactions or records of individual tax accounts.



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*Fiscal Year 2006 Statutory Audit of  
Compliance With Notifying Taxpayers of Their Rights  
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The projections were calculated using valid statistical formulas to determine the variable range of total error returns.

**Type and Value of Outcome Measure:**

- Taxpayer Rights and Entitlements – Potential; in 134<sup>4</sup> tax returns in which related case files were not documented to show the taxpayers’ representatives were given copies of the written communications advising taxpayers of their rights regarding assessment statute extensions (see page 7).

**Methodology Used to Measure the Reported Benefit:**

To determine the number of tax returns for which there was not adequate documentation to support that the taxpayers’ representatives were advised of the taxpayers’ rights, we used the same sample of 201 tax returns and identified 102 case files that contained an authorization for a third party to represent the taxpayers in front of the IRS. In 13 of the 102 case files (12.75 percent), there was no documentation that employees provided the representatives with a copy of the written communications provided to the taxpayers. As we did above, we had to estimate the size of the population of taxpayers that had authorized third-party representatives. This was accomplished by dividing the number of tax returns in our sample with declarations of representation by the total tax returns reviewed for which the assessment statute was executed by consent ( $102/654 = 15.60$  percent) and then multiplying this percentage by the population to estimate the number of tax returns for which the assessment statute was executed by consent and that had a declaration of representation ( $6,720 * 15.60$  percent = 1,048 tax returns). Using the estimated population, we projected the reported error rate ( $1,048$  tax returns \* 12.75 percent = 134 [ $\pm 68$ ] tax returns). The projection was calculated using valid statistical formulas to determine the variable range of total error returns.

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<sup>4</sup> Our sampling plan was based on a 95 percent confidence level, 16 percent expected error rate, and  $\pm 5$  percent desired precision.



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**Appendix V**

**Case Review Results by Division<sup>1</sup>**

	Appeals	LMSB	SB/SE	TE/GE <sup>2</sup>	Totals <sup>3</sup>
<b>Compliance With Requirement to Notify Taxpayers of Their Rights</b>					
Number of Tax Return Files That Did Not Contain Adequate Documentation That Single Individuals, Businesses, or Exempt Organizations Were Advised of Their Rights	1				20 <sup>4</sup>
Number of Tax Return Files Reviewed:	24	43	44	5	116
Number of Tax Return Files That Did Not Contain Adequate Documentation That Separate Notices Were Sent to Both Taxpayers Listed on a Joint Return	1				15 <sup>5</sup>
Number of Tax Return Files Reviewed:					85

<sup>1</sup> 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.

<sup>2</sup> Large and Mid-Size Business Division (LMSB), Small Business/Self-Employed Division (SB/SE), Tax Exempt and Government Entities Division (TE/GE).

<sup>3</sup> No cases from the Wage and Investment Division occurred in our sample.

<sup>4</sup> These 20 cases are comprised of 14 cases with no evidence that the taxpayers had ever been advised of their rights and 6 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.

<sup>5</sup> These 15 cases are comprised of 12 cases with no evidence that the taxpayers had ever been advised of their rights and 3 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.





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**Appendix VI**

*Management's Response to the Draft Report*



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

RECEIVED  
SEP 11 2006

September 11, 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report - Fiscal Year 2006 Statutory Audit of  
Compliance With Notifying Taxpayers of Their Rights When  
Requested to Extend the Assessment Statute  
(Audit # 200540040)

We have reviewed your draft report, "Fiscal Year 2006 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute." We appreciate your acknowledgement that the revisions we made to various consent forms in response to recommendations in prior reports continue to provide benefits and that no further recommendations are necessary at this time.

That said, we note one area of disagreement pertaining to the interpretation of 26 C.F.R. § 601.506. As our Office of Chief Counsel explains, the intent of that rule is to confirm that the IRS generally will not bypass an authorized representative and contact a taxpayer directly regarding his liability. Indeed, reading 26 C.F.R. to suggest that notice to a taxpayer's authorized representative is not effective notice to the taxpayer belies the intent of the provision.

As a result, we cannot concur with the calculation of the benefits to tax administration because, as stated above, we believe that providing notice to the taxpayer's authorized representative constitutes compliance with our statutory requirements. Therefore, 185 of the 201 related case files included documentation that taxpayers were advised of their relevant rights. Stated differently, only 16 or 7.96 percent of the related case files did not contain adequate documentation to confirm that taxpayers had been advised of their rights, and a projected 164 tax returns were potentially affected.

If you have any questions or need additional information, please contact me or Steve Burgess, Director, Examination, Small Business/Self-Employed Division at (202) 283-2170.