



Treasury Inspector General for Tax Administration Office of Audit

DESPITE SOME FAVORABLE PARTNERSHIP AUDIT TRENDS, THE NUMBER OF NO-CHANGE AUDITS IS A CONCERN

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Highlights

Highlights of Report Number: 2012-30-060 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

In deciding which returns to audit, the IRS strives to select those returns for which its examiners are likely to find areas of noncompliance and recommend changes to one or more items reported on the return. However, the number of audits closed with no recommended adjustments (no-change) is high among the returns selected by the Discriminant Index Function system, which uses mathematical formulas to calculate and assign a score to returns based on their audit potential. According to the IRS, a high no-change rate means compliant taxpayers are unnecessarily burdened by audits.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether Small Business/Self-Employed (SB/SE) Division examiners are conducting audits of partnership tax returns in accordance with IRS policy and procedures. The review was part of our Fiscal Year 2011 audit coverage and addresses the major management challenge of Tax Compliance Initiatives.

WHAT TIGTA FOUND

The IRS closed nearly 25 percent more partnership audits in Fiscal Year 2011 than in Fiscal Year 2007. While the number of partnership audits has increased, the time examiners spend on partnership audits has decreased. The average number of calendar days for audits decreased almost 11 percent, and the number of examiner hours decreased more than 15 percent.

However, Fiscal Year 2011 statistics from the SB/SE Division showed that about 50 percent of the partnership returns audited after selection by or related to the Discriminant Index Function were closed as a no-change. Except for a few instances, TIGTA did not find any significant quality problems during our review that would suggest how the items selected and audited on partnership returns could substantially improve the

no-change rates. Examiners generally followed procedures in selecting and verifying the accuracy of items they audited on partnership returns.

SB/SE Division researchers should consider exploring partnership data files to determine whether the most productive returns are selected for audit. With skills in such specialized areas as statistics, operations research, economics, and computers, SB/SE Division researchers are uniquely qualified to suggest alternative audit selection methods and explore details such as evaluating whether examiners should audit more partnership returns with international features or assessing the revenue impact from partnership audits.

WHAT TIGTA RECOMMENDED

TIGTA recommended that, as resources become available, the Director, Research, SB/SE Division, analyze partnership data files to help identify additional productive returns for audit, including returns with international features.

In their response to the report, IRS officials agreed with the recommendation and stated that the Director, Research, SB/SE Division, plans to work in collaboration with the SB/SE Division's Examination function to analyze partnership data files in order to better identify productive partnership returns for audit, including those returns with international features. As part of the return analysis, the SB/SE Division's Research function plans to consult with other IRS research units.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2012reports/201230060fr.pdf>

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