



*Fiscal Year 2010 Statutory Audit of
Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester
and Similar Designations*

July 23, 2010

Reference Number: 2010-30-073

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 redaction from this document.

Redaction Legend:

1 – Tax Return/Return Information



HIGHLIGHTS

FISCAL YEAR 2010 STATUTORY AUDIT OF COMPLIANCE WITH LEGAL GUIDELINES PROHIBITING THE USE OF ILLEGAL TAX PROTESTER AND SIMILAR DESIGNATIONS

Highlights

Final Report issued on July 23, 2010

Highlights of Reference Number: 2010-30-073 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement and Deputy Commissioner for Operations Support.

IMPACT ON TAXPAYERS

Congress enacted Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98) Section 3707 to prohibit the IRS from labeling taxpayers as Illegal Tax Protesters or any similar designations. However, IRS employees continue to refer to taxpayers by these designations in case narratives. Using Illegal Tax Protester or other similar designations may stigmatize taxpayers and may cause employee bias in future contacts with these taxpayers.

WHY TIGTA DID THE AUDIT

This audit was initiated because TIGTA is required to annually evaluate compliance with the prohibition against using Illegal Tax Protester or similar designations. Prior to enactment of the RRA 98, the IRS used the Illegal Tax Protester Program to identify individuals and businesses using methods that were not legally valid to protest the tax laws. IRS employees referred taxpayers to the Illegal Tax Protester Program when their 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.

Congress enacted the prohibition against Illegal Tax Protester designations because it was concerned that some taxpayers were being permanently labeled as Illegal Tax Protesters even though they had subsequently become

compliant with the tax laws. The label could bias IRS employees and result in unfair treatment.

The purpose of our audit was to determine whether the IRS complied with RRA 98 Section 3707 and internal guidelines that prohibit officers and employees from referring to taxpayers as Illegal Tax Protester and similar designations.

WHAT TIGTA FOUND

The IRS has not reintroduced past Illegal Tax Protester codes or similar designations on taxpayer accounts. In addition, IRS publications and the Internal Revenue Manual no longer contain any Illegal Tax Protester references. However, TIGTA found that out of approximately 80.6 million records and cases, there were 196 instances in which 163 employees had referred to taxpayers as "Tax Protester," "Constitutionally Challenged," or other similar designations in case narratives on the computer systems analyzed.

The IRS did take the positive step of modifying the Integrated Collection System so that prohibited protester designations could not be entered into case histories. This is significant because this system has historically accounted for a large number of the exceptions TIGTA identified in prior reviews. The IRS should be commended for taking this action to protect taxpayer rights.

WHAT TIGTA RECOMMENDED

TIGTA made no recommendations in this report.

In their response to a draft of this report, IRS management disagreed that the references listed in the report are potential violations. However, management continues to discourage employees from using such designations in their casework.

TIGTA continues to believe the use of Illegal Tax Protester or similar designations may stigmatize taxpayers because electronic case narratives are available to other IRS employees for future reference and may affect the opinions and actions of employees working cases.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 23, 2010

MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND
ENFORCEMENT
DEPUTY COMMISSIONER FOR OPERATIONS SUPPORT

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Fiscal Year 2010 Statutory Audit of Compliance
With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations (Audit # 200930042)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) complied with the IRS Restructuring and Reform Act of 1998¹ Section 3707 and its own internal guidelines that prohibit IRS officers and employees from referring to taxpayers as Illegal Tax Protesters or any similar designations. The Treasury Inspector General for Tax Administration is required under Internal Revenue Code Section 7803(d)(1)(A)(v) to annually evaluate the IRS' compliance with the provisions of RRA 98 Section 3707.

Although we made no recommendations in this report, we did provide IRS officials an opportunity to review the draft report. Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the IRS managers affected by the report. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.

¹ 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.).



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

Table of Contents

BackgroundPage 1

Results of ReviewPage 3

 Illegal Tax Protester Codes Were Not Used on the Master File.....Page 3

 Internal Revenue Service Publications Do Not Contain Illegal Tax Protester ReferencesPage 3

 Illegal Tax Protester References Have Been Removed From the Internal Revenue Manual.....Page 4

 In Some Instances, Employees Used Illegal Tax Protester or Similar Designations in Case NarrativesPage 4

 Changes to the Integrated Collection System Should Reduce Improper Designations.....Page 7

 Alternative Methods That Avoid the Need for Illegal Tax Protester Designations Have Been Established to Address Tax Compliance Issues.....Page 8

Appendices

 Appendix I – Detailed Objective, Scope, and MethodologyPage 10

 Appendix II – Major Contributors to This Report.....Page 13

 Appendix III – Report Distribution ListPage 14

 Appendix IV – Outcome MeasurePage 15

 Appendix V – Glossary of TermsPage 17

 Appendix VI – Management’s Response to the Draft ReportPage 19



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

Abbreviations

IRS

Internal Revenue Service

RRA 98

Restructuring and Reform Act of 1998



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

Background

Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98)² Section (§) 3707 prohibits the IRS from using Illegal Tax Protester or any similar designations. In addition, the law requires the removal of all existing Illegal Tax Protester codes from the Master File³ and instructs IRS employees to disregard any such designation not located on the Individual Master File.

Prior to enactment of the RRA 98, the IRS used the Illegal Tax Protester Program to identify individuals and businesses that were using methods that were not legally valid to protest the tax laws. Employees identified taxpayers for referral to the 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. There were tax protester coordinators who were responsible for determining whether a taxpayer should be included in the Illegal Tax Protester Program. If a taxpayer was classified as an Illegal Tax Protester, the taxpayer's record was coded as such on the Master File. Once a taxpayer's account was coded, certain tax enforcement actions were accelerated. The designation was also intended to alert employees to be cautious so they would not be drawn into confrontations with taxpayers.

Congress was concerned that some taxpayers were being permanently labeled and stigmatized by the Illegal Tax Protester designation. The concern was that this label could bias IRS employees and result in unfair treatment of the taxpayer.

Internal Revenue Code § 7803(d)(1)(A)(v) requires the Treasury Inspector General for Tax Administration to annually evaluate IRS compliance with the prohibition against using the Illegal Tax Protester or any similar designations. This is our twelfth review since Fiscal Year 1999. These reviews have identified areas for improvement to help the IRS comply with the Illegal Tax Protester designation prohibition.

The Treasury Inspector General for Tax Administration is required to annually evaluate IRS compliance with the prohibition against using Illegal Tax Protester or any similar designations.

This review was performed in the Criminal Investigation Division, the Office of the National Taxpayer Advocate and the Office of Appeals in Washington, D.C.; the Small Business/Self-Employed Division in New Carrollton, Maryland; and the Wage and Investment

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

³ See Appendix V for a glossary of terms.



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

Division in Atlanta, Georgia, during the period July 2009 through March 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. However, due to concerns with providing us access to sensitive grand jury information, the IRS provided us with an extract of manually edited Criminal Investigation Division cases from the Criminal Investigation Management Information System. While our audit results seem reasonable based on prior experience with this database, we were not able to validate any of the information due to IRS editing of the data. We are required by generally accepted government auditing standards to disclose this limitation in the scope of our work. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

Results of Review

Illegal Tax Protester Codes Were Not Used on the Master File

Prior to enactment of the RRA 98, the IRS used Illegal Tax Protester indicators on the Master File to accelerate collection activity for taxpayers who were delinquent in filing tax returns or paying their taxes. These indicators were also intended to alert employees that they might encounter problems when dealing with nonfilers and delinquent taxpayers.

Congress was concerned about the use of the Illegal Tax Protester designation because:

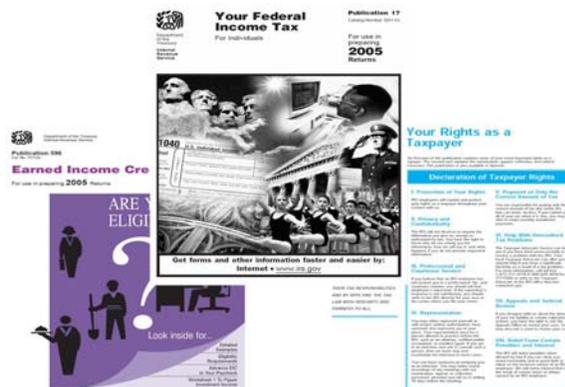
- Taxpayers were labeled as Illegal Tax Protesters without regard to their filing obligations or compliance.
- Illegal Tax Protester indicators were not always reversed when taxpayers became compliant with their tax obligations.

RRA 98 § 3707 required the IRS to remove the existing Illegal Tax Protester designations from taxpayers' accounts on the Master File beginning January 1, 1999.

In prior reviews, we reported the IRS had removed these designation codes from the Master File as required by the law. Based on our analysis of approximately 1.2 million taxpayer records that had been coded for accelerated collection activity, the IRS has not reintroduced Illegal Tax Protester codes on the Master File. The law also prohibits using any designation similar to Illegal Tax Protester. We matched approximately 57,000 taxpayer accounts formerly coded as Illegal Tax Protesters to the Master File and confirmed that the IRS had not input any other type of similar designation on these accounts.

Internal Revenue Service Publications Do Not Contain Illegal Tax Protester References

To help promote compliance with RRA 98 § 3707, IRS management issued directives for employees to update various publications to eliminate references to Illegal Tax Protester terminology and programs. Our reviews prior to Fiscal Year 2002 identified several publications that contained Illegal Tax Protester references. When notified of the



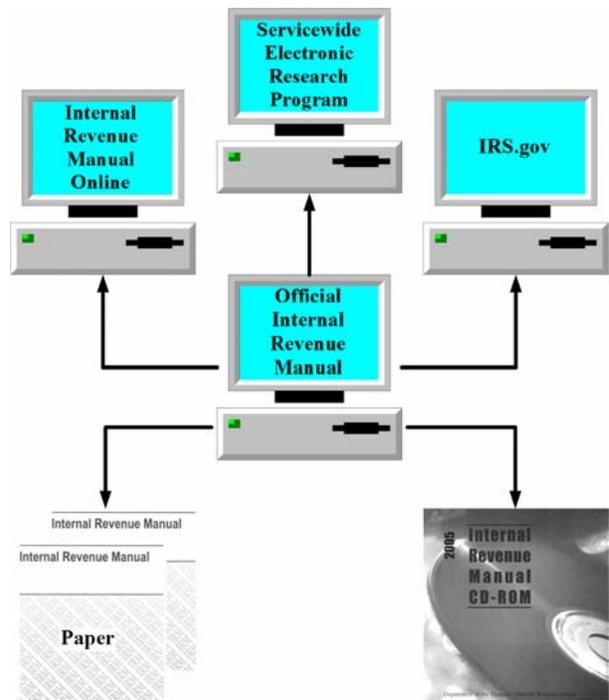


Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

problem, the IRS had either revised the publications or labeled them as being obsolete. Our review of available publications on the Servicewide Electronic Research Program, IRS public Internet web site (IRS.gov), Electronic Publishing web site, and 2009 Federal Tax Products DVD did not identify any current Illegal Tax Protester references. By eliminating these references from its forms, documents, letters, and training materials, the IRS avoids the implication that the use of this terminology is permissible.

Illegal Tax Protester References Have Been Removed From the Internal Revenue Manual

In 9 of our 11 prior reviews, we identified Illegal Tax Protester references in various formats of the Internal Revenue Manual. The Official Internal Revenue Manual is maintained on the Electronic Publishing web site. However, it is also found electronically on the Internal Revenue Manual online, the Servicewide Electronic Research Program, IRS.gov, and CD-ROM, as well as in paper format. The graphic to the right shows the relationship between the Official Internal Revenue Manual and the various formats available to IRS employees.



During our Fiscal Year 2010 review, we again verified that no Illegal Tax Protester references existed in the Internal Revenue Manual. By removing all Illegal Tax Protester references from the Internal Revenue Manual, the IRS avoids any inappropriate implication to taxpayers for whom these designations are being used.

In Some Instances, Employees Used Illegal Tax Protester or Similar Designations in Case Narratives

We found that, out of approximately 80.6 million records and cases, there were 196 instances in which employees had labeled taxpayers as “Tax Protester,” “Constitutionally Challenged,” or other similar designations in case narratives on the following computer systems during the period of October 2008 through September 2009:



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

- Appeals Centralized Database System: A review of approximately 2.7 million opened/closed Appeals function narrative comment records identified 21 cases in which 19 employees used Illegal Tax Protester or a similar designation when referring to specific taxpayers in the case narratives.
- Automated Collection System: A review of approximately 2.3 million open cases identified *****1*****
*****1*****.
- Criminal Investigation Management Information System: A review of approximately 16,000 opened/closed cases identified 3 cases in which 3 employees used a similar designation when referring to specific taxpayers in the case narratives.
- Account Management Services: A review of approximately 74.9 million records identified 99 cases in which 79 employees used Illegal Tax Protester or a similar designation when referring to specific taxpayers in the case narratives.
- Integrated Collection System: A review of approximately 495,000 open cases identified 63 cases in which 52 employees used Illegal Tax Protester or a similar designation when referring to specific taxpayers in the case narratives. Note that this number has decreased substantially from the prior year (refer to Figure 1). This is due to a programming change made to the system to prevent input of these terms (see page 7).
- Taxpayer Advocate Management Information System: A review of approximately 55,000 open cases identified 8 cases in which 8 employees used Illegal Tax Protester or a similar designation when referring to specific taxpayers in the case narratives.
- Taxpayer Information File: A review of approximately 130,000 open records identified *****1*****
*****1*****.

In addition to the systems above, we also reviewed hardcopy case files from the Exempt Organization function.⁴ We reviewed all 54 case files closed as denied during Fiscal Year 2009 and identified no case history narratives containing Illegal Tax Protester or other similar designations. This is the first time we have reviewed these types of cases, and because we did not identify any designations we did not include the results in Figure 1.

We believe the 196 instances we did identify in the various systems previously listed are prohibited by law. Figure 1 contains the number of Illegal Tax Protester or similar designations identified in IRS computer system case narratives during our Fiscal Years 2009 and 2010 reviews.

⁴ The Exempt Organization function ensures religious, charitable, social, educational, political, and other not-for-profit organizations meet and maintain compliance with the complex requirements for tax-exempt status.



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

Figure 1: Illegal Tax Protester and Similar Designations in Case Narratives

Computer System	Fiscal Year 2009 Review			Fiscal Year 2010 Review		
	Employees Involved	Protester Designation Used	Similar Designation Used	Employees Involved	Protester Designation Used	Similar Designation Used
Appeals Centralized Database System	41	15	33	19	10	11
Automated Collection System	3	3	0	**1***	****1***	0
Criminal Investigation Management Information System	4	0	4	3	0	3
Account Management Services ⁵	77	75	19	79	85	14
Integrated Collection System	131	49	119	52	18	45
Taxpayer Advocate Management Information System	3	0	3	8	***1***	**** **1**
Taxpayer Information File	4	**1***	*** **1*****	*****1*****	*****1*****	*****0

Source: Case narratives found on various IRS computer systems and the Treasury Inspector General for Tax Administration report entitled *Fiscal Year 2009 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (Reference Number 2009-40-078, dated May 28, 2009).

We also identified 58 case narratives in which employees made references about the taxpayers’ actions (e.g., taxpayer sent letters containing “typical protester language,” the taxpayer responded with “protester jargon”). We agree with the IRS that merely making references to a taxpayer’s actions does not constitute a designation prohibited by statute. However, we are concerned these references could become, or be considered, permanent labels that could subsequently stigmatize taxpayers in future contacts with the IRS. We did not include any instances in which employees were only documenting statements made by a taxpayer and/or his or her representative because quoting a taxpayer’s self-designation as an Illegal Tax Protester is not prohibited by the law.

⁵ In prior reviews, we reviewed and reported on Desktop Integration. In February 2009, Desktop Integration was integrated into Account Management Services.



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

The statute states that officers and employees of the IRS shall not designate taxpayers as Illegal Tax Protesters or any similar designations. It further specifies that existing designations in the Master File must be removed and any other designations made before the effective date of the statute, such as those on paper records that have been archived, must be disregarded. *Senate Committee on Finance Report 105-174* (dated April 22, 1998), related to the RRA 98 § 3707 provision, stated the Committee was concerned that taxpayers might be stigmatized by a designation as an “Illegal Tax Protester.” Based upon the language of the statute and the Senate Committee Report, we believe IRS officers and employees should not label taxpayers as Illegal Tax Protesters or similar designations in any records, which include paper and electronic case files. Officers and employees should not designate taxpayers as such because a designation alone contains a negative connotation and appears to label the taxpayer.

IRS management disagrees that employee use of Illegal Tax Protester or similar designations in a case narrative is a potential violation of the law. We continue to believe that the use of these designations in case narratives may stigmatize taxpayers and cause employee bias in future contacts with these taxpayers. Electronic case narratives are available to other IRS employees for future reference and may affect the opinions and actions of employees working the taxpayers’ cases.

Even though IRS management continues to disagree with our interpretation of the law, they have taken a conservative approach by implementing a policy that prohibits employees from using Illegal Tax Protester or any similar designation. In August 2007, IRS management issued a memorandum to all employees reminding them of this policy. In Fiscal Year 2008, guidance in the form of Alerts and memorandums were issued to employees and portions of the Internal Revenue Manual were updated to reflect the prohibition on using Illegal Tax Protester or any similar designation. Through IRS management’s continued efforts, the total number of improper designations by IRS employees has decreased.

Changes to the Integrated Collection System Should Reduce Improper Designations

During our review, we identified that the IRS had made a very positive change to the Integrated Collection System that should reduce the usage of Illegal Tax Protester or similar designations on that system. During Fiscal Year 2009, the Integrated Collection System was converted from a Unix-based to a Windows-based platform. As part of the conversion, a systemic control was put in place that prevents employees from using specific protester-type designations in case histories. If an employee uses a prohibited designation in their case history, the system will recognize it and prevent the employee from saving the information until the term is changed or removed. New terms or wording can be added to the systemic control to ensure that new words or terms are not being substituted for Illegal Tax Protester or similar designations. The conversion process was completed in July 2009. This change is very significant because the Integrated Collection System has historically had a large number of the exception cases identified during



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

our reviews. When asked if this process could be incorporated into other systems, we were told that it would work only on Windows-based systems, and the majority of the other applicable systems are Unix-based. However, the IRS should still be commended for making this change that will protect taxpayer rights.

Alternative Methods That Avoid the Need for Illegal Tax Protester Designations Have Been Established to Address Tax Compliance Issues

IRS tax compliance operations have not been significantly affected by the prohibition against using Illegal Tax Protester or similar designations because alternative programs exist to address issues previously handled by the Illegal Tax Protester Program. These include:

- The Frivolous Return Program that handles taxpayers who file tax returns based on some type of frivolous argument that justifies payment of little or no income tax. This includes filing a tax return claiming no income because paying taxes is voluntary or claiming to be a citizen of a State but not a citizen of the United States.
- The Nonfiler Program that handles taxpayers who fail to file their required tax returns.
- The Potentially Dangerous Taxpayer/Caution Upon Contact Program that handles taxpayers who have assaulted and/or threatened IRS employees.

Each of these programs is set up to address various issues IRS employees may encounter when dealing with taxpayers protesting the legality of paying their income taxes. Unlike the former Illegal Tax Protester Program, each program addresses a specific taxpayer behavior. In addition, taxpayers are not assigned to these individual programs on a permanent basis, as was the case in the Illegal Tax Protester Program.

None of our prior reviews have identified instances in which the Illegal Tax Protester indicator was needed on a taxpayer's account to either accelerate tax enforcement actions and/or alert IRS employees to be cautious when dealing with the taxpayer. As a result, we believe that prohibiting the use of the Illegal Tax Protester designation has had no negative impact on collection or examination activities.

Management's Response: Although we made no recommendations in this report, in their response to a draft of this report, IRS management stated there are no indications that the use of Illegal Tax Protester or similar designations has affected the way in which the IRS deals with taxpayers who disapprove of the tax system. Because these taxpayers are treated in the same manner and given the same rights as any other taxpayer, the IRS does not believe that the rights of the taxpayers related to the 196 instances we identified were affected. However, the IRS continues its conservative approach on this issue by taking actions to further minimize the number of instances in which these references occur. The



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

IRS plans to issue a Servicewide Electronic Research Program Alert to remind employees not to use Illegal Tax Protester or similar designations when referring to taxpayers.

Office of Audit Comment: We continue to believe our outcome measure is valid because the use of Illegal Tax Protester, or similar designations, may stigmatize taxpayers and cause employee bias in future contacts with these taxpayers. Electronic case narratives are available to other IRS employees for future reference and may affect the opinions and actions of employees working the taxpayers' cases.



Fiscal Year 2010 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 whether the IRS complied with RRA 98¹ § 3707 and its own internal guidelines that prohibit IRS officers and employees from referring to taxpayers as Illegal Tax Protesters or any similar designations. The Treasury Inspector General for Tax Administration is required to annually evaluate compliance with the prohibition against using Illegal Tax Protester or any similar designations.² Unless otherwise noted, our limited tests of the reliability of data obtained from various IRS systems did not identify any errors. We tested the reliability of the data by scanning the data received for blank, incomplete, illogical, or improper data. In addition, we traced a judgmental sample for each data set to the source IRS files to ensure accuracy. To accomplish the objective, we:

- I. Determined if the Illegal Tax Protester coding on the Master File³ was removed by reviewing all tax accounts coded for accelerated collection activity as of September 2009 on the Business Master File and Individual Master File. We analyzed 1,218,567 Master File records that had been coded for accelerated collection activity.

We also matched our historic computer extract of approximately 57,000 taxpayers designated as Illegal Tax Protesters before the RRA 98 was enacted to our records that had been coded for accelerated collection activity to determine if any new common codes were being used to classify the taxpayers as Illegal Tax Protesters.
- II. Determined if the Internal Revenue Manual contained Illegal Tax Protester or any similar designations by performing key word searches on electronic versions found on the IRS Electronic Publishing web site, the Internal Revenue Manual Online and on CD-ROM, the Servicewide Electronic Research Program, IRS.gov web site, and the IRS Chief Counsel Directives Manual. We performed our review tests from August 10 to 27, 2009.
- III. Determined if IRS publications contained Illegal Tax Protester or any similar designations by performing key word searches of the Servicewide Electronic Research Program, IRS.gov, and the IRS Electronic Publishing web site in August 2009, and the IRS 2009 Federal Tax Products DVD in January 2010.
- IV. Determined if employees were using Illegal Tax Protester or any similar designations within taxpayer case narratives on the Integrated Collection System by securing a copy of

¹ 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.).

² Internal Revenue Code § 7803(d)(1)(A)(v).

³ See Appendix V for a glossary of terms.



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

the database and analyzing 495,015 cases on the open Integrated Collection System file as of September 30, 2009, with history action dates from October 1, 2008, through September 30, 2009.

- V. Determined if employees were using Illegal Tax Protester or any similar designations within taxpayer case narratives on the Automated Collection System by securing a copy of the database and analyzing 2,292,222 cases open as of September 30, 2009, with history action dates between October 1, 2008, and September 30, 2009.
- VI. Determined if employees were using Illegal Tax Protester or any similar designations within taxpayer case narratives on the Taxpayer Advocate Management Information System by securing a copy of the database as of September 2009 and analyzing 55,261 open cases with activity from October 1, 2008, through September 30, 2009.
- VII. Determined if employees were using Illegal Tax Protester or any similar designations within the taxpayer case narratives on Account Management Services by securing a copy of the database as of September 2009 and analyzing 74,855,413 records with activity between October 2008 and September 2009.
- VIII. Determined if employees were using the Illegal Tax Protester or any similar designations within taxpayer case narratives on the Appeals Centralized Database System by securing a copy of the database as of September 2009 and analyzing 2,716,451 open/closed Appeals function narrative comment records with activity between October 2008 and September 2009.
- IX. Determined if employees were using Illegal Tax Protester or any similar designations within the taxpayer case narratives on the Criminal Investigation Management Information System by analyzing 15,940 Criminal Investigation cases with current year updates between October 1, 2008, and September 30, 2009.

Due to concerns with providing us access to sensitive grand jury information, the IRS provided a manually edited extract of Criminal Investigation Division cases from the Criminal Investigation Management Information System. While our audit results seem reasonable based on prior experience with this database, we were unable to validate any of the information due to IRS editing of the data. We are required by generally accepted government auditing standards to disclose this limitation in the scope of our work.

- X. Determined if the IRS is using any Frivolous Return Program⁴ codes as replacements for Illegal Tax Protester designations by reviewing guidance provided for the Frivolous Return Program and interviewing its Program Coordinator.

⁴ The Frivolous Return Program handles taxpayers who file tax returns based on some type of frivolous argument that justifies payment of little or no income tax. This would include filing a tax return claiming no income because paying taxes is voluntary or claiming to be a citizen of a State but not a citizen of the United States.



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

- XI. Determined if the IRS Nonfiler Program⁵ is in compliance with the provisions established by RRA 98 § 3707(b) by reviewing guidance provided for the Nonfiler Program and interviewing its Program Coordinator.
- XII. Determined if there is any relationship between Illegal Tax Protester designations and Potentially Dangerous Taxpayer/Caution Upon Contact indicator use on the Master File by reviewing guidance provided for the Potentially Dangerous Taxpayer/Caution Upon Contact Program⁶ and interviewing its Program Coordinator.
- XIII. Determined if employees were using Illegal Tax Protester or any similar designations within the Activity Code field on the Taxpayer Information File by securing a copy of the database and analyzing 130,085 open records with activity between October 2008 and September 2009.
- XIV. Determined if employees were using Illegal Tax Protester or any similar designations within taxpayer case narratives in the Exempt Organization function.⁷ We obtained and reviewed all of the 54 closed cases that were denied out of the total 77,309 Exempt Organization cases closed for the period September 27, 2008, through September 25, 2009.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: controls that ensure the reliability of the data used for our analyses, including input validation. During our review we tested the validity of the data used for our analyses against the source; however, we did not perform any specific testing of data input controls. It should be noted that data from these same systems were used during prior audits of Illegal Tax Protester designations and no significant data issues were identified.

⁵ The Nonfiler Program handles taxpayers who fail to file their required tax returns.

⁶ The Potentially Dangerous Taxpayer/Caution Upon Contact Program handles taxpayers who have assaulted and/or threatened IRS employees.

⁷ The Exempt Organization function ensures religious, charitable, social, educational, political, and other not-for-profit organizations meet and maintain compliance with the complex requirements for tax-exempt status.



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

Appendix II

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Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Tax Exempt and Government Entities Division SE:T
Commissioner, Wage and Investment Division SE:W
Chief, Appeals AP
Chief, Criminal Investigation SE:CI
National Taxpayer Advocate TA
Chief Technology Officer OS:CTO
Director, Office of Research, Analysis, and Statistics RAS
Director, Communications and Liaison, National Taxpayer Advocate TA:CL
Director, Office of Servicewide Policy, Directives, and Electronic Research RAS:SPDER
Director, Collection, Small Business/Self-Employed Division SE:S:C
Director, Communications, Liaison, and Disclosure, Small Business/Self-Employed Division SE:S:CLD
Director, Compliance, Wage and Investment Division SE:W:CP
Director, Exempt Organizations, Tax Exempt and Government Entities Division SE:T:EO
Director, Strategy and Finance, Wage and Investment Division SE:W:S
Chief, Performance Improvement, Wage and Investment Division SE:W:S:PRA:PEI
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GAO/TIGTA Liaison, Deputy Commissioner for Operations Support OS
GAO/TIGTA Liaison, Deputy Commissioner for Services and Enforcement SE
GAO/TIGTA Liaison, National Taxpayer Advocate TA
GAO/TIGTA Liaison, Chief Technology Officer OS:CTO:SM:PO
Chief, GAO/TIGTA/Legislative Implementation Branch SE:S:CLD:PSP:GTL
GAO/TIGTA Liaison, Tax Exempt and Government Entities SE:T:CL
Senior Operations Advisor, Wage and Investment Division SE:W:S



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

Appendix IV

Outcome Measure

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

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; 192 taxpayers potentially affected¹ (see page 4).

Methodology Used to Measure the Reported Benefit:

We reviewed:

- From the Appeals Centralized Database System, approximately 2.7 million open/closed Appeals function narrative comment records with history action dates between October 2008 and September 2009 and identified 21 taxpayer cases with narratives that contained Illegal Tax Protester or a similar designation.
- From the Automated Collection System, approximately 2.3 million open cases with history action dates between October 2008 and September 2009 and identified ****1****
*****1*****.
- From the Criminal Investigation Management Information System, approximately 16,000 cases opened and/or closed between October 2008 and September 2009 and identified 3 taxpayer cases with narratives that contained a similar designation.
- From Account Management Services, approximately 74.9 million records with history action dates between October 2008 and September 2009 and identified 99 taxpayer cases with narratives that contained Illegal Tax Protester or a similar designation.
- From the Integrated Collection System, approximately 495,000 open cases with history action dates between October 2008 and September 2009 and identified 63 taxpayer cases with narratives that contained Illegal Tax Protester or a similar designation.

¹ We identified 196 instances in which employees had labeled taxpayers as an Illegal Tax Protester or a similar designation in a case narrative on an IRS computer system. Four of these taxpayers were labeled as an Illegal Tax Protester or similar designation in a case narrative on more than one IRS computer system.



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

- From the Taxpayer Advocate Management Information System, approximately 55,000 open cases with history action dates between October 2008 and September 2009 and identified 8 taxpayer cases with narratives that contained Illegal Tax Protester or a similar designation.
- From the Taxpayer Information File, approximately 130,000 open records with history action dates between October 2008 and September 2009 and identified ****1*****
*****1*****.



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

Appendix V

Glossary of Terms

Account Management Services	Provides employees access to multiple IRS systems through their computers and allows for inventory management, case delivery, history narratives, print-to-fax capabilities for sending information to taxpayers, and electronic referral generation.
Appeals Centralized Database System	The Appeals system for case receipt, control, and processing used by Appeals Technical Managers and employees to record their case activities and time charges.
Automated Collection System	A telephone contact system through which telephone assistants collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.
Business Master File	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.
Criminal Investigation Management Information System	A computerized system used to track the status and progress of criminal investigations.
Individual Master File	The IRS database that maintains transactions or records of individual tax accounts.
Integrated Collection System	A system used by Collection function employees to report taxpayer case time and activity.
Internal Revenue Manual	A manual containing the IRS' internal guidelines.
Master File	The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
Servicewide Electronic Research Program	An electronic researching tool containing many former paper research applications (e.g., publications, the Internal Revenue Manual, the Probe and Response Guide).



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

Taxpayer Advocate Management Information System

An electronic database and inventory control system used by Taxpayer Advocate Service employees.

Taxpayer Identification Number

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

Taxpayer Information File

A file containing entity and tax data processed at a given service center for all Taxpayer Identification Numbers.



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

Appendix VI

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

RECEIVED
JUN 17 2010

BY:DAS.....

June 16, 2010

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Christopher Wagner
Commissioner, Small Business/Self Employed Division

SUBJECT: Draft Audit Report - Fiscal Year 2010 Statutory Audit of Compliance with Legal Guidelines Prohibiting the Use of Illegal Tax Protestor and Similar Designations (Audit No. 200930042)

I have reviewed your report and appreciate your acknowledgement of our efforts to comply with Section 3707 of the Internal Revenue Restructuring and Reform Act of 1998 (RRA '98).

We have taken significant actions to comply with this section to ensure we protect the rights of all taxpayers, including those with constitutional or philosophical objections to our tax system. As noted in the report, we have removed Illegal Tax Protestor (ITP) codes and references from the Master File, current publications, and the Internal Revenue Manual. The report also noted the significant decrease in the number of instances of references to Illegal Tax Protestor or similar designations on the Integrated Collection System. This is the result of the implementation of the systemic process to prevent saving history entries when protestor words or phrases are used. Out of approximately 80.6 million records and cases reviewed, there were only 196 instances in which taxpayers were referred to as "Tax Protestor," "Constitutionally Challenged," or similar designations in case narratives.

The IRS still disagrees with your statement that an employee's use of the term Illegal Tax Protestor or other similar terms in case narratives is a violation of law. However, the IRS continues its conservative approach on this issue by taking actions to further minimize the number of instances these references occur. A Servicewide Electronic Research Program (SERP) Alert will be issued to remind employees not to use Illegal Tax Protestor or similar designations when referring to taxpayers.



Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations

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While no recommendations were made in this report, we continue to discourage using such designations in our casework. Although the use of "ITP" or similar designations is contrary to our policy, there are no indications that these references have affected the way the IRS deals with taxpayers who disapprove of the tax system. Because these taxpayers are treated in the same manner and given the same rights as any other taxpayer, we cannot concur with your described benefits.

If you have any questions, please contact me, or a member of your staff may contact Frederick W. Schindler at (202) 283-7650.