



*Fiscal Year 2007 Statutory Audit of  
Compliance With Notifying Taxpayers  
of Their Rights When Requested to  
Extend the Assessment Statute*

**August 31, 2007**

**Reference Number: 2007-40-167**

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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TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

August 31, 2007

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

*Michael R. Phillips*

**FROM:**

Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Fiscal Year 2007 Statutory Audit of Compliance  
With Notifying Taxpayers of Their Rights When Requested to Extend  
the Assessment Statute (Audit # 200740011)

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), 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 specific issues or a specific period of time. The Treasury Inspector General for Tax Administration is required to provide information annually regarding the IRS' compliance with this provision.<sup>1</sup>

*Impact on the Taxpayer*

The IRS is required to notify taxpayers of their rights when requesting an extension of the statute of limitations for assessing additional taxes and penalties. In passing this law, Congress expressed concern that taxpayers were not being advised adequately of their rights to refuse to extend the statute of limitations or to request that a statute extension be limited to specific issues or a specific period of time. Based on the results of our sample, we believe the IRS is generally complying with the intent of the statute. However, there were still some instances in which IRS employees did not document whether taxpayers and their representatives were advised of these rights.

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<sup>1</sup> Internal Revenue Code Section 7803(d)(1)(C).



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### Synopsis

There was not always documentation in the related case files to show that taxpayers were advised of their rights regarding assessment statute extensions. In our sample of 203 tax returns, 23 (11.3 percent) of the related case files reviewed did not contain adequate documentation to support that the taxpayers had been advised of their rights regarding assessment statute extensions. In addition, from this same sample, we reviewed 126 case files with authorizations for third-party representation and found 14 (11.1 percent) did not contain documentation that representatives were separately notified of the written communications advising taxpayers of their rights.

### Recommendation

We recommended the Deputy Commissioner for Services and Enforcement ensure a memorandum is issued reminding IRS employees of their responsibility to document the assessment statute extension notification of rights in every taxpayer case file when dealing with taxpayer representatives.

### Response

IRS management agreed with our recommendation. They will issue a memorandum to remind examiners that they should provide to both the taxpayer and the authorized representative copies of all notices and other written communications, unless the taxpayer specifies otherwise, and the case file is to be documented accordingly.

The IRS continues to disagree that it has a responsibility to notify the taxpayer in addition to the taxpayer's authorized representative when informing the parties of the taxpayer's rights regarding the assessment statute extension. Therefore, the IRS disagrees with that portion of our outcome measure. The IRS believes (1) the law governing principals and agents provides that the authorized representative acts for the principal based on the authority vested in the agent by the principal should apply and (2) it has fulfilled its responsibility to the taxpayer by notifying the taxpayer's representative. Management's complete response to the draft report is included as Appendix VII.

### Office of Audit Comment

We continue to believe the IRS should send notification to the taxpayer even if the taxpayer has an authorized representative. The IRS' own internal procedures and *Practice Before the IRS and Power of Attorney* (Publication 947) require that notification be made to both the taxpayer and the taxpayer's representative. While a taxpayer may permit an authorized representative to



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receive IRS notifications *in addition to* the notice required to be provided to the taxpayer, the taxpayer may not designate that the representative receive notifications *instead of* the taxpayer. Consequently, we believe our outcome measure is valid.

Copies of this report are also being sent to the IRS managers affected by the report recommendation. 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
IRS	Internal Revenue Service
RRA 98	IRS Restructuring and Reform Act of 1998



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## *Background*

The Internal Revenue Service (IRS) is required by IRS Restructuring and Reform Act of 1998 (RRA 98)<sup>1</sup> Section (§) 3461(b)(2)(B) and Internal Revenue Code (I.R.C.) § 6501(c)(4)(B) to advise taxpayers of their rights when requesting an extension of the statute of limitations on the assessment of additional tax and penalties. If the IRS examines a tax return and determines there is additional tax due, the assessment must generally be processed 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 consent.<sup>2</sup> In the event of multiple extension requests, the IRS must notify the taxpayer of his or her rights on each occasion when the taxpayer is requested to consent to an extension. In addition, RRA 98 § 3201(d) requires the IRS, wherever practicable, to send any notice relating to a jointly filed tax return separately to each individual filing the joint return. Congress passed these statutory requirements over 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 specific issues or a specific period of time.

To extend the assessment statute, the IRS asks the taxpayer to sign a statute extension agreement form (i.e., a consent).<sup>3</sup> There are two basic types of consents: fixed-date and open-ended. Once signed, the 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. The statute is normally extended for a period that both the IRS and the taxpayer agree is reasonable to complete the examination. A consent that applies only to certain examination issues can also be negotiated.

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

A taxpayer may agree to grant the IRS an extension of the statute of limitations because it is determined to be in the taxpayer's best interest. For example:

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<sup>1</sup> Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

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

<sup>3</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. The IRS uses different types of consents depending on the type of tax involved. 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. Form 872 (Rev. 12-2004) is the most commonly used consent form.

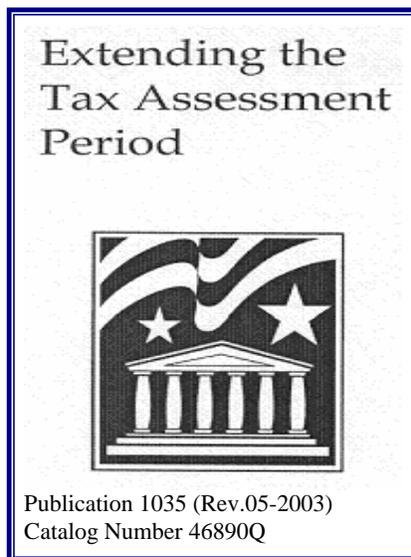


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- To pursue additional examination issues that could offset a proposed tax or that might allow for a tax refund.
- Because, if the time remaining before the statute expires is too short, the IRS may have to prematurely stop the examination process and issue a notice of deficiency. This would limit the time the taxpayer has available to follow the normal appeal process before a petition must be filed with the United States Tax Court.

There may also be certain circumstances in which a taxpayer decides to limit or refuse to extend the assessment statute of limitations. For example, this may happen if the taxpayer does not want to provide the IRS more time to consider additional examination issues or the taxpayer does not want to allow the IRS the opportunity to further develop examination issues already under consideration after the normal statute period has expired.

RRA 98 § 3461(b)(2)(B) required the IRS to “. . . notify the taxpayer of the taxpayer’s right to refuse to extend the period of limitations, or to limit such extension to particular issues or to a particular period of time, on each occasion when the taxpayer is requested to provide such consent.” To implement this statutory requirement, the Internal Revenue Manual<sup>4</sup> and other internal procedures direct IRS employees to provide the taxpayer with a Request to Extend



Assessment Statute (Letter 907) or Letter Transmitting Consent Extending Period of Limitation (Letter 967) (along with a copy of *Extending the Tax Assessment Period* [Publication 1035] and Consent to Extend the Time to Assess Tax [Form 872] or Consent to Extend the Time to Assess Employment Taxes [Form SS-10]<sup>5</sup> as enclosures) and to document on the case activity record as to whether the taxpayer was notified of his or her rights each and every time the IRS requested an assessment statute extension.

RRA 98 § 3201(d) specifically required that the IRS “. . . shall, wherever practicable, send any notice relating to a joint return . . . separately to each individual filing the joint return.” As such, the Internal Revenue Manual requires that each individual filing the joint tax return be provided a separate package including Letter 907 or 967 and the attachments. Even though the IRS had formalized internal

procedures to document compliance with the statutory requirements, our reviews have continued to identify instances where documentation was not adequate to support that taxpayers were advised of their rights.

<sup>4</sup> The Internal Revenue Manual contains policy, direction, and delegations of authority necessary to carry out IRS responsibilities to administer tax law and other legal provisions.

<sup>5</sup> Form 872 is used for income taxes; Form SS-10 is used for employment taxes.



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In 2005, the IRS deployed revised versions of Forms 872 and SS-10 to include a statement informing taxpayers of their rights regarding assessment statute extensions, as required under RRA 98 § 3461(b)(2)(B) and I.R.C. § 6501(c)(4)(B), and to provide information on Publication 1035. In addition, the revised consent form included a statement for the taxpayers' representatives to sign, confirming they were notified of the taxpayers' rights regarding assessment statute extensions and that the taxpayers were also advised of their rights.

**Figure 1: Excerpt From Form 872**

Form <b>872</b> (Rev. Dec. 2004)	Department of the Treasury-Internal Revenue Service <b>Consent to Extend the Time to Assess Tax</b>	In reply refer to: Taxpayer Identification Number
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**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](http://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 →

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)

**TAXPAYER'S REPRESENTATIVE**

SIGN HERE →

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)  
In addition, the taxpayer(s) has been made aware of these rights.

Note: The wording in the Form SS-10 is consistent with that shown in Form 872.

Source: *The IRS*.

We considered the revised consent forms adequate evidence that taxpayers were notified of their rights when the taxpayers signed the forms. In our Fiscal Year 2006 report, we noted the use of the revised forms made a difference in documenting that taxpayers were advised of their rights when the consent forms were signed by the taxpayers. However, we still noted taxpayers on joint tax returns were not always being provided separate notification packages informing them of their rights under the statute; moreover, when representatives signed the consents, documentation was not adequate, as described above, to show the taxpayers were directly notified of their rights.

In September 2005, the Director, Examination, Small Business/Self-Employed Division, advised IRS Examination function executives that the requirement to provide or mail a Letter 907 or 967, Publication 1035, and consent form separately to each spouse filing a joint tax return was no longer required when it is determined that both spouses are residing at the same address. When this is the case, the examiner will send one complete packet of information, addressed to both spouses at the common address, and document such in the case activity record. If the taxpayers filing a joint tax return do not appear to be residing at the same address, separate notifications



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must be provided. The IRS justified this change based on application of the new consent form, which contains the notice of rights to the taxpayer. Because the signatures of both spouses must be obtained to have a valid consent, the IRS believed the signatures on the new consent form provided reasonable assurance that both spouses received the notice of rights; hence, meeting the “wherever practicable” exception allowed under RRA 98 § 3201(d).

In prior audits, we took exception to cases in which taxpayers filing a joint tax return were not separately notified of their rights regarding the assessment statute extension.<sup>6</sup> However, we believe the IRS’ policy revision is a reasonable interpretation that meets the intent of the statute. Because Congress’ intent for requiring separate notification was merely to increase the likelihood that separated or divorced spouses received notice of their rights, it would be reasonable for the IRS to send only one notice to taxpayers who reside together but separate notices to taxpayers who reside apart.

Also, in response to our Fiscal Year 2006 report, the IRS disagreed that, when a representative is notified of the taxpayer’s rights regarding statute extensions, the taxpayer(s) must also be separately notified. The IRS believed providing notice to the taxpayer’s authorized representative constitutes compliance with its statutory requirement. However, in reading RRA 98, the associated regulations, and required IRS procedures, we concluded the taxpayer still must be individually notified and the contact documented in the case file.

The Treasury Inspector General for Tax Administration is required by RRA 98<sup>7</sup> to provide information annually regarding the IRS’ compliance with I.R.C. § 6501(c)(4)(B). This report presents the results of our eighth annual review of the IRS’ compliance with the statute extension provisions of the law.<sup>8</sup>

This review was performed at the Office of Appeals Headquarters, Large and Mid-Size Business Division Headquarters, Small Business/Self-Employed Division Headquarters, and Tax Exempt and Government Entities Division Headquarters in Washington, D.C., during the period September 2006 through May 2007. 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> In our *Fiscal Year 2006 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (Reference Number 2006-40-163, dated September 21, 2006), we reported 15 cases in which taxpayers filed joint returns and there was not sufficient evidence to show both taxpayers were separately notified of their rights.

<sup>7</sup> I.R.C. § 7803(d)(1)(C).

<sup>8</sup> See Appendix V for a complete list of prior audits on this subject.



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## *Results of Review*

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

In 23 (11.3 percent) of the 203<sup>9</sup> tax returns sampled, case files did not contain sufficient documentation to indicate whether taxpayers were advised of their rights before consenting to extend the time to assess tax.<sup>10</sup> There were 14 tax returns filed by single individuals, businesses, or exempt organizations and 9 jointly filed individual tax returns.<sup>11</sup> From our population of 3,265 tax return case files having statutes extended during the first 6 months of Calendar Year 2006, we estimate 370 may not have contained adequate documentation to show taxpayers were advised of their rights.<sup>12</sup> We considered that IRS employees advised taxpayers of their rights if any of the required documentation was found in the related case files.

The 23 exceptions occurred because employees did not follow required IRS documentation procedures.

- In 19 cases, only the representative signed the revised Form 872 or SS-10 containing the taxpayer's notification of rights.
- In 2 cases, the representatives signed outdated versions of the Form 872 or SS-10 without the notification of rights statement.
- In 2 cases, the taxpayers signed outdated consent forms that did not include the notification of rights statement.

In all 23 cases, there was no other evidence in the case files to document that the taxpayers were advised of their rights when asked to extend the assessment statute.

The IRS has taken the position that notifying a taxpayer's representative satisfies the requirement to notify the taxpayer. In response to our Fiscal Year 2006 report, IRS management stated:

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<sup>9</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>10</sup> The Fiscal Year 2006 audit reported an error rate of 17.4 percent (35 of 201 tax returns) in this category.

Compared to this year's error rate of 11.3 percent, there was a 35 percent improvement over last year's results.

<sup>11</sup> See Appendix VI.

<sup>12</sup> Based on the estimated population of 3,265 tax return files, we are 95 percent confident that between 229 and 511 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.



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*. . . that the IRS generally will not bypass an authorized representative and contact a taxpayer directly regarding his liability. Indeed, reading 26 [Code of Federal Regulations] 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. . . . we believe that providing notice to the taxpayer's authorized representative constitutes compliance with our statutory requirements.*

We believe the language of the statute, as well as the RRA 98 Congressional Committee report, indicate the taxpayer must be notified directly. In the Committee Report, Congress emphasized the need for taxpayers to be fully informed of their statute extension rights: "The Committee is concerned that in some cases taxpayer[s] have not been fully aware of their rights to refuse to extend the statute of limitations, and have felt that they had no choice but to agree to extend the statute of limitations upon the request of the IRS."

As a result, RRA 98 § 3461(b)(2)(B) emphasized that the IRS ". . . shall notify the taxpayer . . ." of their rights regarding assessment statute extensions. This wording was carried over in I.R.C. § 6501(c)(4)(B), which stated the ". . . Secretary shall notify the taxpayer of the taxpayer's right . . ." to refuse or limit extensions, and in Internal Revenue Manual section 25.6.22.3, which stated ". . . 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 notification process is also explained in *Practice Before the IRS and Power of Attorney* (Publication 947), in which the IRS informs the taxpayer:

*If you have a recognized representative, you and the representative will receive notices and other correspondence from the IRS . . . . the IRS will send your representative(s) a duplicate of all computer-generated correspondence that is sent to you. The IRS employee handling the case is responsible for ensuring that the original and any requested copies of each manually-generated correspondence are sent to you and your representative(s) in accordance with your authorization.*

From the statute, regulations, and IRS procedures and publications, it is clear that the expectation is for both the taxpayer and the taxpayer's representative to receive notices, including notification of the taxpayer's rights when considering whether to extend the assessment statute. Although a taxpayer may permit an authorized representative to receive notification from the IRS in addition to the notification provided to the taxpayer, we found no statutory or regulatory provisions allowing the taxpayer to designate that certain individuals receive notification instead of the taxpayer.

Taxpayer rights could be negatively affected if the IRS does not comply with RRA 98 and follow the regulations and IRS procedures requiring that taxpayers be directly notified of their 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



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did not always document that taxpayers were so informed in all of the 23 reported cases. Without the IRS meeting the documentation requirements when a statute extension is requested, we could not determine whether the IRS protected the rights of these taxpayers. Because the IRS maintains the same position expressed in the Fiscal Year 2006 report, we will not be making a recommendation.

**Employees did not always use the revised version of Form 872 or Form SS-10**

Our Fiscal Year 2006 review found the IRS took effective actions to integrate the revised consent forms into the assessment statute extension process. However, IRS employees are still not consistently using the revised forms. In 23<sup>13</sup> (11.3 percent) of the 203 tax returns in our sample, employees improperly used an outdated version of the consent form. The 203 cases in our sample consisted of 186 tax returns with assessment statutes extended by Form 872 and 17 tax returns with assessment statutes extended by Form SS-10. Of the 23 exceptions, 16 consents were made on an outdated Form 872 and 7 consents were made on an outdated Form SS-10.

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

In 18 of the 23 cases, we were able to find other documentation to show taxpayers were properly notified of their rights. However, in five cases, the consent form was the only documentation in the case file regarding the assessment statute extension request. There was no other evidence that demonstrated the taxpayers were notified of their rights. Taxpayers signed the outdated consent forms in three of the five cases. The other consents were signed by the representatives. For the three cases, if the revised consent form had been used, we would have considered that the taxpayers were notified of their assessment statute extension rights. As a result, from our population of 3,265 tax return case files having statutes extended during the first 6 months of Calendar Year 2006, we estimate 370 cases for which employees did not use the revised consent form when assessment statutes were extended.

The revised Forms 872 and SS-10 include a prominent statement informing taxpayers of their rights regarding assessment statute extensions, as provided for in I.R.C. § 6501(c)(4)(B). By signing the revised version of the consent form, the taxpayer attests “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 only time the revised consent form would not be an effective vehicle to document that taxpayers were notified of their rights is when the consent form is signed by the taxpayers’ representatives instead of the taxpayers.

By January 2006, the new consent forms should have been completely integrated into the assessment extension consent process. However, we still found instances in which employees used the outdated version of the form but this was not identified by the employees’ managers

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<sup>13</sup> This number includes two tax returns for different tax periods covered by the same SS-10.



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during their review process.<sup>14</sup> Managers we interviewed stated that some employees used previous versions of the consent forms that had been saved to their computer hard drives.

We made no recommendation because we have made prior recommendations to address these issues.

**Management's Response:** The IRS continues to disagree that it has a responsibility to notify the taxpayer in addition to the taxpayer's authorized representative when informing the parties of the taxpayer's rights regarding the assessment statute extension. Therefore, the IRS disagrees with that portion of our outcome measures. The IRS believes (1) the law governing principals and agents provides that the authorized representative acts for the principal based on the authority vested in the agent by the principal should apply and (2) it has fulfilled its responsibility to the taxpayer by notifying the taxpayer's representative.

**Office of Audit Comment:** We continue to believe the IRS should send notification to the taxpayer even when the taxpayer has an authorized representative. The IRS' own internal procedures require that notification must be made to the taxpayer and the taxpayer's representative. In Publication 947, the IRS informs the taxpayer "If you have a recognized representative, you and the representative will receive notices and other correspondence from the IRS . . . . the IRS will send your representative(s) a duplicate of all computer-generated correspondence that is sent to you." In addition, it states "The IRS employee handling the case is responsible for ensuring that the original and any requested copies of each manually-generated correspondence are sent to you and your representative(s) in accordance with your authorization." While a taxpayer may permit an authorized representative to receive an IRS notification *in addition to* the notice required to be provided to the taxpayer, the taxpayer may not designate that the representative receive notification *instead of* the taxpayer. Consequently, we believe our outcome measure is valid.

### ***Some Case Files Did Not Have Documentation That Taxpayers' Representatives Were Provided the Required Copies of Notices***

This year's review continued to confirm IRS employees did not always document that the taxpayers' representatives were properly advised of the taxpayers' rights regarding assessment statute extensions. In our sample of 203 tax returns, 126 of the related case files contained authorizations for third parties to represent the taxpayers before the IRS.

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<sup>14</sup> The Large and Mid-Size Business Division, Small Business/Self-Employed Division, and Tax Exempt and Government Entities Division extension requests are subject to a second review when signed by a group manager. In the Office of Appeals, extension requests are prepared and signed by the appeals officer and are not subject to a second review.



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- In 112 case files, employees documented that the taxpayers' representatives were given a copy of the written communications advising taxpayers of their rights regarding assessment statute extensions.
- In the remaining 14 cases (11.1 percent), there was no documentation to support that the taxpayers' representatives were provided with the required notifications. We estimate from a population of 2,027 tax return files with authorized representatives that 225 case files were not adequately documented to show the taxpayers' representatives were given copies of the written communications advising taxpayers of their rights regarding assessment statute extensions.<sup>15</sup> These exceptions occurred because employees did not follow required IRS documentation procedures.

Once a power of attorney is filed and recognized, IRS procedures require that any computer-generated or manually generated 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. Without the required documentation, we could not determine if the IRS properly notified the taxpayer representatives in these 14 cases. Taxpayers may be adversely affected if the IRS does not follow the requirements 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.

### ***Recommendation***

**Recommendation 1:** The Deputy Commissioner for Services and Enforcement should ensure a memorandum is issued reminding IRS employees of their responsibility to document the assessment statute extension notification of rights in every taxpayer case file when dealing with taxpayer representatives.

**Management's Response:** IRS management agreed with this recommendation. They will issue a memorandum to remind examiners that they should provide both the taxpayer and the authorized representative copies of all notices and other written communications, unless the taxpayer specifies otherwise, and the case file is to be documented accordingly.

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<sup>15</sup> Based on the estimated population of 2,027 tax return files, we are 95 percent confident that between 138 and 312 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.



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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. Section 6501(c)(4)(B), 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 specific issues or a specific period of time. To accomplish this objective, we:

- I. Determined whether taxpayers and their representatives were being advised of their rights when the IRS requested an extension of the assessment statute.
  - A. Reviewed the Internal Revenue Manual, IRS memoranda, IRS Office of Chief Counsel Opinions, and Office of Appeals guidelines to determine whether there were any changes to existing policies and procedures for processing requests to extend the assessment statute of limitations since our last audit.
  - B. Identified a population of 10,132 Business Master File<sup>1</sup> and Individual Master File<sup>2</sup> closed examination cases with taxpayer consents to extend the assessment statute of limitations processed from January 1 through June 30, 2006. We validated the Business Master File and Individual Master File data by examining a random sample of 50 of the 10,132 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 203 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 800 tax returns from the category of closed cases that were likely to have statute extensions by taxpayer consent from the Examination function and Appeals function processes. We met our statistical sample size of 203 cases after reviewing 630 tax returns and related case files and eliminating 427 tax returns that either did not meet our criteria or for which we did not receive all the requested tax returns and related case files. The sample of 203 tax returns was comprised of 104 single individual, business, and exempt organization tax returns and

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<sup>1</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>2</sup> The IRS database that maintains transactions or records of individual tax accounts.



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- 99 jointly filed individual tax returns. In addition, 126 of the 203 tax returns had declarations of representative made by the taxpayers.<sup>3</sup>
- D. Reviewed the 203 selected tax returns and related case files for the necessary documentation to verify whether taxpayers and their representatives, if applicable, were properly advised of their rights regarding assessment statute extensions and whether the revised consent form was used in the process.
  - 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.

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<sup>3</sup> See Appendix IV for details.



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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  
Marybeth H. Schumann, Director  
Bryce Kisler, Acting Director  
James D. O'Hara, Audit Manager  
Lynn Ross, Lead Auditor  
Julia Tai, Senior Auditor  
Andrea McDuffie, Auditor  
Sylvia Sloan-Copeland, Auditor  
Dorothy Richter, Information Technology Specialist



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**Appendix III**

*Report Distribution List*

Acting Commissioner C  
Office of the Commissioner – Attn: Acting 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  
Chief Counsel CC  
National Taxpayer Advocate TA  
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, Liaison, and Disclosure, Small Business/Self-Employed Division  
SE:S:CLD  
Director, Communications and Liaison, Tax Exempt and Government Entities Division  
SE:T:CL  
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  
Director, Communication and Liaison, Large and Mid-Size Business Division SE:LM:M:CL  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
    Commissioner, Large and Mid-Size Business Division SE:LM:CL  
    Commissioner, Small Business/Self-Employed Division SE:COM  
    Commissioner, Tax Exempt and Government Entities Division SE:T:CL  
    Chief, Appeals AP:TP:SS



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## **Appendix IV**

### *Outcome Measures*

This appendix presents detailed information on the measurable impact that our recommended corrective action will have on tax administration. In addition, 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; 370 tax returns (225 single individual, business, or exempt organizations and 145 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 (see page 5).

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

To determine the number of tax returns for which documentation was not adequate to support that the taxpayers were advised of their rights when assessment statutes were extended, we electronically identified 10,132 tax returns from the universe of Business Master File<sup>1</sup> and Individual Master File<sup>2</sup> tax returns (processed from January 1 through June 30, 2006) for which the assessment statute was extended. Because we could not electronically identify just those tax returns for which the assessment statute was executed by consent, we requested 800 tax returns for which the assessment statute was extended. We reviewed 630 of those tax returns to identify the 203 tax returns used for our sample. Based on this population, we reviewed a statistically valid sample of 203 tax returns and identified 23 (11.33 percent) for which the required documentation was not found. 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 203 tax returns in our sample by total tax returns reviewed ( $203/630 = 32.22$  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 ( $10,132 * 32.22$  percent = 3,265 tax returns). Using the estimated population, we projected the reported error rate (3,265 tax returns \* 11.33 percent

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<sup>1</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>2</sup> The IRS database that maintains transactions or records of individual tax accounts.



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= 370 [ $\pm 141$ ]<sup>3</sup> tax returns). 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; 225 tax returns for 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 8).

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

To determine the number of tax returns for which documentation was not adequate to support that the taxpayers’ representatives were advised of the taxpayers’ rights, we used the same sample of 203 tax returns and identified 126 case files that contained an authorization for a third party to represent the taxpayer(s) before the IRS. In 14 (11.11 percent) of the 126 case files, there was no documentation that employees provided the representatives with a copy of the written communications provided to the taxpayers. 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 ( $126/630 = 20$  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 had a declaration of representation ( $10,132 * 20$  percent = 2,027 tax returns). Using the estimated population, we projected the reported error rate ( $2,027$  tax returns \* 11.11 percent =  $225 [\pm 87]$ <sup>4</sup> tax returns). The projection was calculated using valid statistical formulas to determine the variable range of total error returns.

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<sup>3</sup> Calculated as follows:  $3,265$  tax returns \*  $\pm 4.32$  percent (actual precision) =  $\pm 141$ . The lower limit of the range is  $370 - 141 = 229$  tax returns. The upper limit of the range is  $370 + 141 = 511$  tax returns.

<sup>4</sup> Calculated as follows:  $2,027$  tax returns \*  $\pm 4.28$  percent (actual precision) =  $\pm 87$ . The lower limit of the range is  $225 - 87 = 138$  tax returns. The upper limit of the range is  $225 + 87 = 312$  tax returns.



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## **Appendix V**

### *Prior Audit Reports*

The Treasury Inspector General for Tax Administration has previously performed seven mandatory audits in this subject area. These audits were:

*Fiscal Year 2006 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (Reference Number 2006-40-163, dated September 21, 2006).

*Fiscal Year 2005 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (Reference Number 2005-40-112, dated July 2005).

*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).

*Fiscal Year 2003 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (Reference Number 2003-40-193, dated September 2003).

*Improved Documentation Is Needed to Ensure Taxpayers Are Informed of Their Rights When Requested to Extend the Assessment Statute* (Reference Number 2002-40-175, dated September 2002).

*Most Taxpayers Are Advised of Their Rights Before Signing an Agreement to Extend the Assessment Statute of Limitations* (Reference Number 2001-10-157, dated September 2001).

*Information Provided to Taxpayers When Requesting Extensions of the Assessment Statute of Limitations Can Be Improved* (Reference Number 2000-10-142, dated September 2000).



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Appendix VI

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

Compliance With Requirement to Notify Taxpayers of Their Rights	Division <sup>2</sup>				Totals <sup>3</sup>
	Appeals	LMSB	SB/SE	TE/GE	
Number of Tax Return Files That Did Not Contain Adequate Documentation That Single Individuals, Businesses, or Exempt Organizations Were Advised of Their Rights	1	[REDACTED]	[REDACTED]	[REDACTED]	14 <sup>4</sup>
Number of Tax Return Files Reviewed:	10	26	64	4	104
Number of Tax Return Files That Did Not Contain Adequate Documentation That Jointly Filing Taxpayers Were Advised of Their Rights	2	0	7	0	9 <sup>5</sup>
Number of Tax Return Files Reviewed:	1	[REDACTED]	[REDACTED]	[REDACTED]	99

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

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

<sup>4</sup> In the 14 cases, there were 9 in which there was not enough evidence that the taxpayers were advised of their rights and 5 in which the taxpayers were advised of their rights during the examination but not for the last extension requested.

<sup>5</sup> In the nine cases, there were six in which there was not enough evidence that the taxpayers were advised of their rights and three in which the taxpayers were advised of their rights during the examination but not for the last extension requested.



**Fiscal Year 2007 Statutory Audit of Compliance With  
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Compliance With Internal Guidelines or Regulations	Division				Totals
	Appeals	LMSB	SB/SE	TE/GE	
Number of Tax Return Files for Which the Prior Version of the Consent Form Was Used When the Revised Version Was Available	1				23 <sup>6</sup>
Number of Tax Return Files Reviewed:	30	38	130	5	203
Number of Tax Return Files That Did Not Contain Adequate Documentation That Taxpayers' Representatives Were Advised of the Taxpayers' Rights	0	6	8	0	14 <sup>7</sup>
Number of Tax Return Files Reviewed:	1				126

<sup>6</sup> This number includes four cases that were included in the previous section for which there was not enough documentation to determine whether the IRS properly advised taxpayers of their assessment statute extension rights.

<sup>7</sup> This number includes 1 in the previous section for which there was not enough documentation to determine whether the IRS properly advised taxpayers of their assessment statute extension rights.



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**Appendix VII**

*Management's Response to the Draft Report*



DEPUTY COMMISSIONER

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

**RECEIVED**

AUG 16 2007

August 15, 2007

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kevin M. Brown *Kevin M. Brown*  
Deputy Commissioner for Services and Enforcement

SUBJECT: Draft Audit Report – Fiscal Year 2007 Statutory Audit of  
Compliance with Notifying Taxpayers of Their Rights When  
Requested to Extend the Assessment Statute (Audit #  
200740011)

We have reviewed the above-referenced draft report and appreciate your acknowledgement of our improved documentation of the notification to taxpayers of their rights when we request an extension of the assessment statute. We concur with your recommendation to remind employees of their responsibilities to document the notification because this documentation provides the necessary assurance that the IRS is fulfilling its statutory obligation.

We agree that it is important to notify taxpayers of their rights when we request an extension of the statute date. The law governing principals and agents provides that the authorized representative acts for the principal based on the authority vested in the agent by the principal. Therefore, we believe the IRS complies with its statutory obligation if we provide notice to either the taxpayer or the taxpayer's authorized representative. As a result, we believe that your calculation of the benefits to tax administration is incorrect since it does not account for notices that were provided to the taxpayer's authorized representative. We believe 199 of the 203 case files sampled included documentation that taxpayers were advised of the relevant rights. Accordingly, four (or 1.9 percent) of the sampled case files did not contain adequate documentation to support that taxpayers had been advised of their rights, and a projected 64 tax returns out of a projected population of 3,265 returns were potentially affected.

Attached is a detailed response outlining our corrective actions.

If you have any questions or need additional information, please contact me or Monica L. Baker, Director, Examination, Small Business/Self-Employed Division, at (202) 283-2659.

Attachment



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**Attachment**

**RECOMMENDATION 1:** The Deputy Commissioner for Services and Enforcement should ensure that a memorandum is issued reminding IRS employees of their responsibility to document the assessment statute extension notification of rights in every taxpayer case file when dealing with taxpayer representatives.

**CORRECTIVE ACTION:** The IRS will issue a memorandum to remind examiners that they should provide to both the taxpayer and the authorized representative copies of all notices and other written communications, unless the taxpayer specifies otherwise, and the case file is to be documented accordingly.

**IMPLEMENTATION DATE:** November 15, 2007

**RESPONSIBLE OFFICIAL:** Director, Examination, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN:** The Director, Examination, Small Business/Self-Employed Division will advise the SB/SE Commissioner of any delays in implementing the corrective action.