



Treasury Inspector General for Tax Administration Office of Audit

FUTURE TAX REVENUES ARE AT RISK BECAUSE CERTAIN TAX-EXEMPT BONDS MAY EXCEED ANNUAL DOLLAR LIMITS WITHOUT DETECTION

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Highlights

Highlights of Report Number: 2009-10-097 to the Internal Revenue Service Commissioner for the Tax Exempt and Government Entities Division.

IMPACT ON TAXPAYERS

The Internal Revenue Code places a limit (volume cap) on the amount of tax-exempt private activity bonds that can be issued annually within each State. Any bonds issued above the maximum yearly dollar limit would be taxable. The Federal Government is at risk of losing future tax revenue because the Tax Exempt Bonds office has not developed or implemented the processes necessary to identify and address noncompliance with State volume cap limits for tax-exempt private activity bonds. Without these processes, tax-exempt private activity bonds could be issued in excess of the Federally mandated yearly State dollar limits without the Internal Revenue Service (IRS) detecting and addressing the noncompliance.

WHY TIGTA DID THE AUDIT

This audit was initiated as part of the TIGTA Office of Audit Fiscal Year 2009 Annual Audit Plan. The overall objective of this review was to determine whether the IRS has an effective program to identify and address noncompliance with State volume cap limits specified by Internal Revenue Code Section 146 for tax-exempt private activity bonds.

WHAT TIGTA FOUND

The Tax Exempt Bonds office has not developed needed processes for this compliance issue because its compliance program is based on determining whether individual bond issues are compliant with applicable regulations and not on determining whether aggregate bond issues exceeded yearly dollar limits. However, even though the Tax Exempt Bonds office did not have processes in place to identify States that had exceeded annual volume cap limits, TIGTA determined that no tax revenue was lost in Calendar Years 2006 and 2007 because the 50 States and the District of Columbia did

not issue excess tax-exempt private activity bonds above their respective volume cap limits.

To ensure tax revenues are not lost in the future, the Tax Exempt Bonds office should expand its compliance program to address volume cap compliance. However, the IRS is not regularly receiving all the information it will need to verify volume cap compliance and bond data are not always accurately entered into its computer systems. For example, 18 percent of the bond returns TIGTA reviewed did not include required State certifications, which are the official approval from the State that indicate the bond issue has been allocated volume cap dollars and complies with Internal Revenue Code Section 146. Also, TIGTA identified more than \$11 billion in transcription errors between amounts submitted on bond returns and bond carryforward returns and amounts entered into IRS computer systems. Without complete and accurate data, any processes the Tax Exempt Bonds office develops may not result in the accurate identification of bonds that are over the volume cap and therefore should be taxable.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Director, Tax Exempt Bonds, develop and implement processes to identify and address tax-exempt private activity bonds that exceed the volume cap limitations in Internal Revenue Code Section 146. To ensure that processes accurately detect when volume caps have been exceeded, TIGTA recommended the Director, Tax Exempt Bonds, work with the Wage and Investment Division to ensure that required State certifications and carryforward elections are received with filed bond returns (Forms 8038), and identify and implement a methodology to ensure that transcription errors for bond documentation are detected.

In their response to the report, IRS management agreed with the recommendations and provided planned actions to address them. These actions include identifying approaches available to identify and address Section 146 compliance, improving guidance for processing bond information returns, and identifying errors for previously processed bond information returns.

READ THE FULL REPORT

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

<http://www.treas.gov/tigta/auditreports/2009reports/200910097fr.pdf>