



Treasury Inspector General for Tax Administration Office of Audit

COMBAT ZONE INDICATORS ON TAXPAYER ACCOUNTS ARE FREQUENTLY INACCURATE

Issued on September 23, 2009

Highlights

Highlights of Report Number: 2009-40-138 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

In recognition of the dangers that members of the military face and the sacrifices they make on behalf of the United States, special Federal income tax benefits are extended to members of the military. These benefits include the exclusion of combat pay from taxation and extension of time to file tax returns and pay taxes. While civilian employees supporting the military in combat zones are not entitled to the Combat Zone military pay exclusion, they are entitled to other benefits, such as extensions of time to file and pay. To identify these taxpayers, the Internal Revenue Service (IRS) places Combat Zone indicators on their tax accounts. However, Combat Zone indicators are often inaccurate which can result in taxpayers not receiving the benefits to which they are entitled or continuing to receive special tax benefits to which they are no longer entitled.

WHY TIGTA DID THE AUDIT

This audit was part of our audit coverage in the TIGTA Fiscal Year 2009 Annual Audit Plan. The overall objective of this audit was to assess the IRS actions to ensure the accuracy of Combat Zone indicators.

WHAT TIGTA FOUND

TIGTA found that Combat Zone indicators are frequently inaccurate because the IRS is incorrectly updating Combat Zone indicators to active status when a military member self-identifies on their tax return that they served in a combat zone. In addition, Combat Zone indicators used by the IRS do not distinguish between military and civilian taxpayers. As a result, civilians can receive Combat Zone tax relief benefits to which they are not entitled. The IRS also cannot identify for married individuals filing a joint tax return which individual(s) is/are in the military.

Further, unpostable conditions are not accurately resolved when there is a problem posting the entry/exit dates provided by the Department of Defense. As a result, Combat Zone indicators are not being placed on

individuals' accounts when they enter a combat zone and/or are not being reversed when they exit a combat zone. Finally, the IRS requires no documentary evidence to support an individual's self-identification that they are serving in a combat zone.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division, develop processes to distinguish military taxpayers from civilian taxpayers, properly identify individuals who are in the military that file a joint tax return, and ensure indicators are properly reversed. The IRS should also discontinue providing the option to self-identify by annotating a tax return. Further, the IRS should review the accounts of nonfilers with inaccurate indicators to determine if notification or compliance actions are needed, identify and resolve unpostable records from the Department of Defense, validate Combat Zone service at the time an individual self-identifies, and develop a secure fillable form with the required data fields to improve electronic self-identification.

In their response to the report, IRS officials agreed with or agreed to take action on 9 of our 10 recommendations. The IRS disagreed with our recommendation to develop a process to distinguish military taxpayers from civilian taxpayers. IRS management indicated that they have the ability to distinguish between military and civilian taxpayers. TIGTA acknowledges that the IRS can identify military individuals via the information received monthly from the Department of Defense. However, as our report states, the IRS uses the same indicator for both military and civilian taxpayers. Once this indicator is set on the accounts of civilian taxpayers, it could allow civilian taxpayers to inappropriately exclude income without action by the IRS because the IRS will not review accounts with unreported income if a Combat Zone indicator is present.

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/200940138fr.pdf>.

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