TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Plans Exist to Engage the Tax Preparer Community in Reducing the Tax Gap; However, Enhancements Are Needed

June 10, 2010

Reference Number: 2010-30-061

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HIGHLIGHTS

PLANS EXIST TO ENGAGE THE TAX PREPARER COMMUNITY IN REDUCING THE TAX GAP; HOWEVER, ENHANCEMENTS ARE NEEDED

Highlights

Final Report issued on June 10, 2010

Highlights of Reference Number: 2010-30-061 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement and the Chief Financial Officer.

IMPACT ON TAXPAYERS

Paid preparers prepare more than half of all individual tax returns filed and have a great deal of influence on taxpayer compliance levels. Because most taxpayers use preparers to file their tax returns, adherence to standards and the preparation of accurate tax returns have a significant effect on taxpayer compliance and the Internal Revenue Service's (IRS) efforts to reduce the tax gap.

WHY TIGTA DID THE AUDIT

The individual income tax is the largest single source of Federal receipts and comprises over 71 percent of the tax gap. TIGTA initiated this review to evaluate the IRS' efforts to engage the tax practitioner community in a productive partnership to reduce the tax gap.

WHAT TIGTA FOUND

The IRS has taken actions to engage the tax preparer community that could affect tax administration and reduce the tax gap. The IRS developed a Fiscal Years 2009–2013 Strategic Plan to improve oversight of tax administration. It includes two key objectives and several strategies that pertain to reducing the tax gap by engaging the tax preparer community. However, actions were not taken to ensure previously omitted key components were included in the existing IRS Strategic Plan. Without these components, it is unclear how the IRS will effectively monitor its performance and adherence to the requirements for strategic plans.

The IRS' Strategic Plan is supported by plans from 10 business divisions and functional offices, with numerous goals and activities to strengthen the partnership with tax practitioners. Additionally, in June 2009, the IRS Commissioner launched the Return Preparer Review, which supports the Strategic Plan to enhance compliance standards for tax preparers. The Review resulted in a report issued on January 4, 2010, that contained eight recommendations, including mandatory tax return preparer registration and competency examination requirements for tax preparers.

Our review found that the IRS' Strategic Plan does not contain sufficient measures that will be useful for monitoring its performance in achieving its goals and objectives to engage the paid preparer community. Also, the plans of the IRS business divisions and functional offices did not always include outcome measures, baselines, or targets that could be used to measure whether actions taken would achieve desired objectives in the Strategic Plan.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Chief Financial Officer 1) take steps to update the existing IRS Strategic Plan and ensure future strategic plans have all key components and 2) define and include in the Strategic Plan sufficient measures that will provide data that can be used to monitor the IRS' efforts to achieve objectives aimed at strengthening partnerships with tax practitioners and paid preparers to ensure effective tax administration.

IRS officials agreed with our recommendations; however, the planned corrective actions did not address updating the existing Strategic Plan with omitted key components and sufficient measures to monitor the IRS' efforts regarding the paid preparer community.

TIGTA continues to believe the existing Strategic Plan should be updated to ensure the IRS is compliant with the Government Performance and Results Act of 1993. In addition, without an effective process to monitor its performance, the IRS cannot ensure its programs are achieving their objectives and desired outcomes.

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

June 10, 2010

MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT
CHIEF FINANCIAL OFFICER

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Plans Exist to Engage the Tax Preparer Community in Reducing the Tax Gap; However, Enhancements Are Needed (Audit # 200930027)

This report presents the results of our review to evaluate the Internal Revenue Service's (IRS) efforts to engage the tax practitioner community in a productive partnership to reduce the tax gap.[1] The audit was conducted as part of our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

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 recommendations.

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] See Appendix V for a glossary of terms.

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Abbreviations

FY	Fiscal Year
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration

Background

The United States has one of the highest tax compliance rates in the world at 83.7 percent. However, each percentage point of noncompliance costs the Federal Government approximately $21 billion, which equates to more than $342 billion in annual lost revenue. On an annual basis, more than half of all taxpayers pay someone else to prepare their income tax returns. In Calendar Year 2009, the Internal Revenue Service (IRS) processed approximately 86 million individual Federal income tax returns prepared by paid preparers. This activity is down by less than 5 percent from the nearly 90.4 million tax returns prepared by paid preparers in Calendar Year 2008, but is still more than half of all individual taxpayers who filed a tax return. Taxpayers are ultimately responsible for the information reported on their tax returns. However, there are no existing national standards that a preparer is required to satisfy before selling tax preparation services to the public. Anyone, regardless of training, experience, skill, or knowledge, is allowed to prepare Federal income tax returns for others for a fee.

Paid preparers can be self-employed or may work for accounting firms, large tax preparation services, or law firms and include the following:

- *Licensed professionals, such as attorneys and Certified Public Accountants. These licensed professionals are regulated by the State licensing authority.*
- *Enrolled agents. These professionals pass an IRS examination or present evidence of qualifying experience as a former IRS employee and have been issued an enrollment card. Enrolled agents are the only taxpayer representatives who receive their right to practice from the Federal Government.*
- *Unenrolled or unlicensed preparers. These individuals range from those who might receive extensive training to those with little or no training. Currently, only three States—California, Maryland, and Oregon—have requirements for unenrolled paid preparers. In these States, unenrolled paid preparers must register with State agencies and meet continuing education requirements.*

The individual income tax is the largest single source of Federal receipts, and tax practitioners have a great deal of influence to ensure taxpayers comply with tax laws. The individual income tax comprises over 71 percent of the $345 billion gross tax gap.[1]

Since 2006, the Department of the Treasury and the IRS Oversight Board (hereafter referred to as the Board) have developed strategies to address noncompliance. The Department of the Treasury Office of Tax Policy issued *A Comprehensive Strategy for Reducing the Tax Gap* that referenced coordination with partners and stakeholders.

[1] See Appendix V for a glossary of terms.

It suggested that:

> *Closer coordination is needed between the IRS and State and Foreign Governments to share information and compliance strategies. Closer coordination also is needed with practitioner organizations, including bar and accounting associations, to maintain and improve mechanisms to ensure that advisors provide appropriate tax advice. Through contacts with practitioner organizations, the Department of the Treasury and IRS learn about recent developments in tax practice and hear directly from practitioners about taxpayer concerns and potentially abusive practices.*

In its Fiscal Year (FY) 2006 Annual Report, the Board recommended six interrelated strategies that it believed would reduce the tax gap. The strategies included simplifying the tax code, improving information reporting and enforcement tools to address underreporting of income, improving customer service, and creating a more productive partnership between the IRS and the tax preparer community.

In its FY 2008 Annual Report, the Board reported that the tax gap was a serious systemic weakness that must be addressed and is a real cost to taxpayers. The Annual Report stated that the tax gap, which is unacceptably high, deprives the nation and its people of $290 billion in tax revenue each year that should be collected. The report further stated that if the tax gap was zero, the Federal Government would have additional revenue each year that it could either spend on programs or refund to taxpayers.

The review was performed at the IRS National Headquarters in Washington, D.C., in the Office of Appeals, Criminal Investigation Division, Large and Mid-Size Business Division, Tax Exempt and Government Entities Division, Office of Professional Responsibility, and Taxpayer Advocate Service; the National Headquarters in New Carrollton, Maryland, for the Small Business/Self-Employed Division; and the National Headquarters in Atlanta, Georgia, for the Wage and Investment Division during the period May 2009 through January 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. Detailed information on our audit objective, scope, and methodology are presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

Actions Taken to Engage the Tax Preparer Community Could Affect Tax Administration and Reduce the Tax Gap

Because more than half of all tax returns filed are prepared by paid preparers, tax return preparers have a significant effect on taxpayer compliance. In January 2008, Senate Finance Committee Chairman Max Baucus, Democrat-Montana, expressed his concern with the tax gap at Douglas Shulman's nomination hearing to become the 47th IRS Commissioner. Mr. Shulman agreed that the tax gap was a significant problem and stated he was 100 percent committed to working toward increasing compliance and closing the tax gap.

The IRS developed a strategic plan to improve oversight of tax administration

During FY 2008, the IRS, the Department of the Treasury, the Board, and a consulting firm identified emerging trends affecting tax administration. A key trend identified included the expanding role of tax practitioners and other third parties in the tax system. The IRS Commissioner and his executives used these trends to develop a Strategic Plan outline, which was shared with IRS senior management in August 2008.

The Board, which is responsible for approving the Strategic Plan, worked with the IRS to update the Strategic Plan for FYs 2009–2013. The Board approved the IRS plan in April 2009. It includes two overall goals related to achieving the IRS' mission:

Goal 1 – Improve service to make voluntary compliance easier.

Goal 2 – Enforce the law to ensure everyone meets their obligation to pay taxes.

The IRS identified 10 key objectives for both goals—two pertain to reducing the tax gap by engaging the tax community and include the approach to accomplish the objectives. Specifically:

- Goal 1, Objective 4: Strengthen partnerships with tax practitioners, tax preparers, and other third parties in order to ensure effective tax administration.

  Strategy:

  1. *Enable partners to better serve their customers by providing faster issue resolution and tailored service.*
  2. *Treat partners as the "first line of compliance" by providing them with the tools and information to encourage taxpayer compliance and prevent mistakes.*

- Goal 2, Objective 6: Ensure that all tax practitioners, tax preparers, and other third parties in the tax system adhere to professional standards and follow the law.

  Strategy:

  1. *Develop and implement a coordinated preparer plan across the IRS and the preparer community.*
  2. *Administer a fair, diligent, and effective system of sanctions and penalties for those who fail to follow the law.*
  3. *Leverage research to identify fraudulent return preparers and other areas of abuse and noncompliance by return preparers.*

Actions were not taken to ensure previously omitted key components were included in the strategic plan

In FY 2007, the Treasury Inspector General for Tax Administration (TIGTA) reported[2] that the IRS' FYs 2005–2009 Strategic Plan did not have all of the information required to be included in its plan. The IRS agreed with our recommendations, and the office of the Chief Financial Officer[3] planned to take corrective actions by April 15, 2008, to ensure future strategic plans included the following:

- A timetable/schedule for future program evaluations.
- A list of major management challenges and high-risk areas.
- A description of consultations conducted with Congress to develop the Strategic Plan.
- Information on how or where to send comments or questions.

Review of the existing IRS Strategic Plan showed only 1 (25 percent) of the planned corrective actions was implemented. For the remaining three, one was not addressed, one was partially completed, and there was not sufficient documentation to support that the remaining action was implemented. IRS personnel stated that the lack of timely implementation on the corrective actions occurred for the following reasons: 1) the timetable/schedule was not included because they are expecting a revamping of the Performance Assessment Rating Tool;[4] 2) a request was made for Congress to provide input, but the IRS did not receive a response; and 3) they did not have a reason for not clearly providing instructions for taxpayers to provide comments. We

[2] *The Development of Specific Long-Term Measures and Targets Improved the Internal Revenue Service's Strategic Plan (2005–2009)* (Reference number 2007-10-140, dated August 23, 2007).
[3] The Chief Financial Officer's Corporate Planning and Internal Control staff leads the development of the IRS' Strategic Plan and the processes for determining, collecting, analyzing, reviewing, reporting, and communicating the measures of IRS-wide performance, as well as integrating performance and cost information.
[4] Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

followed up with the appropriate personnel in the Office of Management and Budget and they confirmed that the IRS is still required to measure and gather data while the Performance Assessment Rating Tool is being revamped. In addition, documentation was not available for us to review and confirm that Congress was asked to provide input on the Strategic Plan.

Without these components, it is unclear how the IRS will effectively monitor its performance and adherence to the requirements for strategic plans. The Government Accountability Office guidance regarding audit recommendations suggests that management is responsible for implementing recommendations made to Federal Government agencies.

Ten business divisions and functional offices created individual plans to support the strategic plan

Workshops with senior IRS management and executives were held to discuss and identify ways to align the Strategic Plan's goals and objectives with the business operating divisions and functional offices' processes. We discussed these efforts with IRS personnel and determined this task was accomplished by:

- Providing input and key priorities to their respective offices.
- Identifying external factors such as laws and economic changes that affect taxpayers and the IRS processes. Examples of economic changes that have an impact on IRS operations include unemployment rates and the housing market.
- Using internal performance report information, strategic performance measures evaluations, and research information on taxpayer segments.

Each business division and functional office developed annual multi-year plans and program letters (hereafter referred to as functional plans). A review of the functional plans showed the goals, programs, and activities were consistent and supported the IRS' objectives to strengthen the partnership with tax practitioners to ensure an effective tax administration and to ensure that all tax practitioners adhere to professional standards and follow the law. For example, the Taxpayer Advocate Service plan includes a goal to explore the role of preparers in bringing taxpayers into compliance by identifying the types and causes of preparer errors and the role of preparers in facilitating noncompliance. In addition, business units and functional offices took the following steps to engage the tax practitioners:

Each IRS business division and functional office developed plans that showed goals, programs, and activities to support the IRS' two key objectives aimed at the tax preparer community.

- Conducted workshops with tax professionals from Federal advisory committees such as the Information Reporting Program Advisory Committee, the IRS Advisory Committee, and the American Institute of Certified Public Accountants to develop scenarios and testing protocol to study preparer work processes.

- Completed a research study on the role of preparers in relation to taxpayer compliance with Internal Revenue Laws.
- Initiated a Preparer Penalty Program to address the following two primary preparer penalties:
  1) Internal Revenue Code Section 6694 – Understatement of taxpayer's liability by tax return preparer.
  2) Internal Revenue Code Section 6701 – Penalties for aiding and abetting understatement of tax liability.

See Appendix IV for examples of goals, programs, and activities from all 10 business divisions and functional offices.

Recommendation

Recommendation 1: The Chief Financial Officer should take steps to update the existing IRS Strategic Plan and ensure future strategic plans have all of the information in the plans as required by the Government Performance and Results Act of 1993[5] and Office of Management and Budget Circular A-11 (*Preparation, Submission, and Execution of the Budget*).

> ***Management's Response:*** IRS management agreed with this recommendation and will ensure future strategic plans incorporate the requirements in Department of the Treasury guidance, which includes both the Government Performance and Results Act of 1993 and Circular A-11.
>
> ***Office of Audit Comment*:** While IRS management agreed with our recommendation, the IRS did not address modifying its existing Strategic Plan to include omitted key components required by the Department of the Treasury. We previously reported these omissions during our 2007 review, and the IRS responded it would ensure consistency with Treasury guidance in developing its next strategic plan. However, the current management response is similar to the IRS' 2007 response, and we continue to believe the existing Strategic Plan should be updated to ensure the IRS is compliant with the Government Performance and Results Acts of 1993. We followed up with IRS management to provide them an opportunity to reconsider their response; however, we were advised that their position remained the same.

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[5] Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C. and 39 U.S.C.).

A Return Preparer Review Was Initiated to Enhance Compliance Standards for Tax Preparers

In June 2009, the IRS Commissioner launched a Return Preparer Review (hereafter also referred to as the Review). The goal of the Review is to help the IRS better leverage the tax return preparer community to increase taxpayer compliance and ensure uniform and high ethical standards of conduct for tax preparers. The Review team was led by the Deputy Commissioner for Operations Support and included senior IRS executives, a designated project manager, and a team of IRS employees.

From June to December 2009, the IRS conducted three public forums with various members of the preparer community and other stakeholders to obtain input on how to meet its objectives. Participants who attended the forums included the Government Accountability Office, TIGTA, selected States,[6] software developers, independent tax preparers, IRS employees, and taxpayers. The IRS received more than 1,050 comments from the public and its employees on specific questions regarding tax preparer activities. A review of the responses showed 53 percent of respondents were in favor of the IRS providing improved oversight and enforcement of tax practitioners and the tax preparer community, while only 42 percent were in favor of a proposed requirement to register all preparers. Some offered methodologies to improve the oversight and enforcement, and others questioned how the IRS would enforce control standards such as signing tax returns for tax professionals and paid preparers who use off-the-shelf tax software. All comments are available for review on the IRS' website (IRS.gov).

The expected outcome of the Return Preparer Review was to propose a comprehensive set of recommendations for the IRS Commissioner to provide to the Secretary of the Treasury and the President by December 2009. On January 4, 2010, the Commissioner issued the Return Preparer Review (Publication 4832), which included eight recommendations. Figure 1 reflects a brief description of the eight Review recommendations.

[6] The States of California, Maryland, New York, and Oregon were selected because they have, or are in the process of developing, a regulatory mechanism for all preparers of State tax returns.

Figure 1: Return Preparer Review Recommendations

Recommendations	Description of Recommendations
Mandatory Tax Return Preparer Registration	All individuals required to sign a Federal tax return as a paid tax return preparer will be required to register and obtain a preparer tax identification number. The registration will be effective for a 3-year period and requires tax return preparers to renew their registration every 3 years.
Competency Examination Requirements	All paid tax return preparers required to register with the IRS who are not attorneys, certified public accountants, or enrolled agents will be required to take a competency test.
Continuing Professional Education	All paid tax preparers who are required to register will be required to take 15 hours of annual continuing professional education, including 3 hours of Federal tax law updates, 2 hours of tax preparer ethics, and 10 hours of Federal tax law topics. Attorneys, certified public accountants, enrolled agents, or others enrolled to practice before the IRS will be excluded because these individuals generally must complete continuing education requirements to retain their professional credentials.
Ethical Standards	All signing and nonsigning tax return preparers will be placed under Department of the Treasury Circular 230.[7]
Tax Return Preparer Enforcement	The IRS plans to implement a comprehensive enforcement strategy that includes applying significant examination and collection resources to tax return preparer compliance.
Tax Return Preparation Software	The IRS plans to establish a task force that will seek the input of the tax preparation software industry, State Government representatives, and other relevant stakeholders to address identified risks associated with the dependence of tax administration on consumer and commercial tax preparation software and discuss the possibility of establishing industry standards.
Refund Settlement Products	The IRS plans to convene a working group to review the refund settlement product industry. Part of this review will include analyzing opportunities to improve refund delivery options.
Public Awareness and Service Enhancements	The IRS plans to develop a public awareness campaign to educate taxpayers, paid tax return preparers, and IRS employees about the new standards and requirements for tax return preparers. In addition, the IRS will develop a searchable database of tax return preparers who have registered and passed the competency examination.

Source: The IRS Return Preparer Review Report dated January 4, 2010.

[7] *Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, Enrolled Retirement Plan Agents, and Appraisers Before the Internal Revenue Service* (Treasury Department Circular No. 230, (revised 4-2008)).

The IRS did not provide any time periods for implementation; however, all but two of the recommendations will be implemented. The IRS will conduct a study to determine if standards are needed for the recommendations that address tax return preparation software and delivery options for refund settlement products for the unbanked taxpayer.

The IRS acknowledges that it does not know how many paid preparers exist and cannot determine the full extent of noncompliance and incompetence within the tax practitioner community. This lack of information hinders the IRS' efforts to expand its outreach and education initiatives and to identify potentially problematic preparers. Pursuing abusive preparers is part of the IRS' strategy to reduce the tax gap. While it is too soon to comment whether the suggested recommendations will meet the IRS' objectives, the recommendations are an effective step in engaging the tax preparer community. The overall estimated cost in conducting the Review is $1.3 million, which includes costs for 2 Federal contractors to provide research and project management activities. The IRS did not consider opportunity costs for the Return Preparer Review and funded the Review from its FY 2009 available and unallocated funds. Also, IRS management stated that existing IRS programs were not negatively impacted (from a resource and productivity perspective) by the undertaking of the Review. The TIGTA is currently conducting a review[8] to evaluate the IRS' efforts to implement the Review recommendations by the 2011 Filing Season.

Performance Measures Are Needed to Monitor Efforts to Engage the Tax Preparer Community

The IRS' FYs 2009–2013 Strategic Plan does not contain sufficient measures that will be useful for monitoring its performance in achieving IRS goals and objectives to engage the paid preparer community. For example, the existing measures will not provide IRS executives with data needed to evaluate if the IRS is fairly applying penalties or effectively leveraging research to identify fraudulent tax return preparers. We discussed the importance of having useful performance measures with IRS personnel and were advised that specific measures were not needed because the broad measures included in the plan would provide the information needed to assess performance. Figure 2 depicts the IRS' existing plans for measuring performance to achieve the goals outlined in its Strategic Plan.

Existing measures will not provide IRS executives with data needed to evaluate if the IRS is fairly applying penalties or effectively leveraging research to identify fraudulent tax return preparers.

[8] Review of the IRS' implementation of the Paid Preparer Strategy (Audit # 201040037).

Figure 2: The IRS' Long-Term Measures to Monitor Performance

Measures	Description of Measures
Voluntary Compliance Rate	Measure the amount of tax that is paid voluntarily and in a timely manner as a percentage of the corresponding estimate of true tax liability. The compliance rate reflects the impact of nonfiling, underreporting, and underpayment combined.
American Customer Satisfaction Index	Monitor the American Customer Satisfaction Index score related to the electronic and paper filing processes for individual income tax returns.
E-File Rate	Measure the percentage of all major tax returns filed electronically by individuals, businesses, and tax-exempt entities. "Major" tax returns are those on which filers account for income, expenses, and/or tax liabilities.
Taxpayer Satisfaction With IRS Services	Administer surveys across all types of service to assess whether the taxpayer's issue was resolved in a reasonable timeframe.
Enforcement Contacts	Track all enforcement contacts including audits, notices, and Automated Underreporter Program work to arrive at a more complete measure of coverage rate.
Non-Revenue Enforcement Activity	Track its enforcement activities that promote compliance but do not primarily focus on increasing tax revenue (e.g., tax-exempt compliance programs or Bank Secrecy Act activities).
Nonfilers	Analyze and estimate the number of individuals who do not file income tax returns but have an obligation to file an income tax return.

Source: The IRS' FYs 2009–2013 Strategic Plan.

Paid tax return preparers are a critical component and stakeholder in tax administration and represent an important intermediary between taxpayers and the IRS. They are also an important component in IRS efforts to close the tax gap. In addition, the tax return preparer community provides a unique opportunity to affect taxpayer behavior and compliance with the tax laws. Without specific measures and a process to obtain needed data, the IRS will not be able to monitor the effectiveness of its strategies to engage paid preparers and their role in reducing the tax gap.

Performance measures were excluded from the business divisions' and functional offices' plans and business performance reviews

The IRS business divisions' and functional offices' business performance reviews and plans did not always include outcomes, outcome measures, baselines, or targets that could be used to measure if actions taken would achieve objectives in the IRS Strategic Plan. We reviewed 10 business divisions' and functional offices' plans and business performance reviews for the two strategic plan objectives related to paid preparers and identified the following:

- Five of the 10 had all the measures needed for the Strategic Plan objective to strengthen partnerships with tax practitioners, tax preparers, and other third parties to ensure effective tax administration.
- Two of the 10 had all the measures needed for the Strategic Plan objective to ensure that all tax practitioners, tax preparers, and other third parties in the tax system adhere to professional standards and follow the law.

The Government Performance and Results Act of 1993 was enacted to bring to Federal Government agencies more accountability in how they spend their budgets and how well they fulfill their public service roles. It requires strategic plans to include a mission statement, general goals, objectives, and strategies and measures. In addition, the Government Accountability Office guidelines require top-level reviews of actual performance and the establishment and review of performance measures because it is critical that plans have a method to measure the progress and expected outcome of goals and actions. The availability of this data in the IRS Strategic Plan and in the business divisions' and functional offices' plans and business performance reviews will improve their usefulness and provide information needed to make better management decisions.

As the IRS moves forward with it plans to implement the Return Preparer Review recommendations, it is critical that it considers our results and takes the necessary steps to document methods to measure and monitor the progress and expected outcomes for the planned strategies. The initial care exercised will enable management to better evaluate the success of its goals and objectives. Furthermore, the concept of accountability for use of public resources and government authority is a key component to our nation's governing processes. Legislators, government officials, and the public need to know whether government programs are achieving their objectives and desired outcomes.

Recommendation

Recommendation 2: The Chief Financial Officer should define and include in the IRS Strategic Plan sufficient measures that will provide data that can be used to monitor the IRS' efforts to achieve objectives aimed at strengthening partnerships with tax practitioners and paid preparers to ensure effective tax administration. This effort includes coordinating with the business divisions and functional offices to ensure their plans and/or business performance reviews include acceptable measures to assess their progress in achieving the expected outcomes of goals and actions which support the IRS Strategic Plan.

> ***Management's Response:*** IRS management agreed with this recommendation and will include in the IRS Strategic Plan measures to assess progress in achieving the expected goals and objectives that support the IRS Strategic Plan.

***Office of Audit Comment*:** While IRS management agreed with the recommendation, the planned corrective actions did not address modifying the existing Strategic Plan to include sufficient measures that will provide data that can be used to monitor IRS efforts to achieve objectives aimed at strengthening partnerships with tax practitioners and paid preparers. For example, we reported that the IRS does not have a measure to evaluate if the IRS is fairly applying penalties or effectively leveraging research to identify fraudulent tax return preparers. Also, IRS management did not address how they plan to coordinate with the business divisions and functional offices to ensure their plans and business performance reviews include acceptable measures to assess their progress in achieving the actions/goals specifically for the tax preparer community. Finally, IRS management agreed to assess the progress in achieving the expected goals and objectives which support the Strategic Plan; however, they did not clarify if the assessment will include all or some of the goals and objectives in all business divisions and functional offices. Without an effective process to monitor its performance, the IRS cannot ensure its programs are achieving their objectives and desired outcomes. We followed up with IRS management to clarify and provided them the opportunity to reconsider their response; however, we were advised that their position remained the same.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate the IRS' efforts to engage the tax practitioner community in a productive partnership to reduce the tax gap.[1] To accomplish the overall objective, we:

I. Determined whether the IRS Strategic Plan for FYs 2009–2013 was sufficient for items such as goals, objectives, and quantifiable measures to engage the tax practitioner community to reduce the tax gap.

  A. Discussed with the IRS office of the Chief Financial Officer the development of the Strategic Plan.

  B. Reviewed the IRS Strategic Plan for FYs 2009–2013 to determine if it included the information that was missing from the FYs 2005–2009 Strategic Plan.

  C. Determined if the prior recommendations from the TIGTA FY 2007 audit report[2] were implemented.

  D. Obtained and reviewed documents from the office of the Chief Financial Officer to determine whether any stakeholders concerns pertaining to partnering with tax practitioners to reduce the tax gap were addressed in the IRS Strategic Plan for FYs 2009–2013.

  E. Determined whether the plan contained the critical components required by the Government Performance and Results Act of 1993.[3]

II. Determined if the 10 business divisions and functional offices[4] developed plans to support the IRS' direction to engage the tax practitioner community to reduce the tax gap,

[1] See Appendix V for a glossary of terms.
[2] *The Development of Specific Long-Term Measures and Targets Improved the Internal Revenue Service's Strategic Plan (2005–2009)* (Reference number 2007-10-140, dated August 23, 2007).
[3] Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C. and 39 U.S.C.).
[4] The 10 offices are: the Criminal Investigation Division; the Large and Mid-Size Business Division; the Office of Appeals; the Office of Professional Responsibility; the Taxpayer Advocate Service; the Wage and Investment Division; the Small Business/Self-Employed Division; and the Employee Plans, Exempt Organizations, and Tax Exempt Bonds functions of the Tax Exempt/Government Entities Division. Since the Tax Exempt/Government Entities Division completed separate annual plans for each office, we counted each office as a separate office.

which includes all tax preparers adherence to professional standards and following the law.

A. Determined if the 10 business divisions' and functional offices' plans addressed and included specifics to support the IRS' goals outlined in the IRS Strategic Plan for FYs 2009–2013.

B. Determined if the business divisions' and functional offices' plans included the elements required under the Performance Assessment Rating Tool.

C. Identified any other programs not included in the functional plans that engage the tax community to reduce the tax gap and help ensure adherence to professional standards and the law.

III. Determined if IRS management considered the opportunity cost of conducting the Return Preparer Review and determined the impact of diverted resources for the Review on existing IRS programs.

A. Identified and interviewed the Review team to discuss the planning and goals for the Review.

B. Obtained and reviewed documentation that addressed the goals/objectives, resource commitments, impact of the resource commitments on existing IRS programs, planned efforts/activities, expected outcomes, and milestones for the Review.

C. Identified the method the IRS used to monitor the actions/tasks for accomplishing the Review.

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: the establishment of a Strategic Plan and its goals and strategies for relevance to engaging the tax preparer community to reduce the tax gap and the performance measures needed to assist in assessing the accomplishment of the Plan goals. We evaluated these controls by interviewing management and reviewing the current Strategic Plan, functional plans that support it, and business performance reviews that reflect the IRS' performance to accomplish its goals and strategies.

Appendix II

Major Contributors to This Report

Margaret Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
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Appendix III

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- Commissioner, Large and Mid-Size Business Division SE:LM
- Director, Office of Professional Responsibility SE:OPR
- Commissioner, Small Business/Self-Employed Division SE:S
- Commissioner, Tax Exempt and Government Entities Division SE:T
- Commissioner, Wage and Investment Division SE:W
- National Taxpayer Advocate TA

Appendix IV

Examples of Goals, Programs, and Activities

(From 10 Business Divisions and Functional Offices That Support the Strategic Plan)

Business Divisions and Functional Offices	Goals, Programs, and Activities
Appeals	Increase taxpayer awareness of Alternative Dispute Resolution programs while exploring opportunities to expand early issue resolution.
Criminal Investigation Division	Reach out both alone and in partnership with other IRS operating divisions to all market segments, including the tax practitioner community, for the purpose of educating individuals, businesses, and return preparers about the various types of fraud committed in their industry and how to recognize, avoid, and report it.
Employee Plans	Coordinate with the Lead Development Center[1] in the Small Business/Self Employed Division and the Department of Justice to protect participants and their retirement funds by working to seek injunctions against promoters of abusive arrangements.
Exempt Organizations	Conduct reviews of the activities of exempt organizations using data on file and publically available information, without direct involvement with the taxpayer. These reviews may lead to compliance checks, examinations, or followup in a later year, thus ensuring that compliance is maintained on an ongoing basis.
Large and Mid-Size Business Division	Engage taxpayers and their preparers in the development of the facts and the issue resolution process, using appropriate tools to timely reach agreement.
Office of Professional Responsibility	Continue to disclose final case dispositions on its webpage for reference and guidance.
Small Business/ Self-Employed Division	Identify and act on emerging schemes through approval and development of promoter penalties, abusive preparer, and participant cases.
Tax Exempt Bonds	Continue to utilize the Internal Revenue Code Section 6700, Tax Promoter Penalty, to target the promoters of abusive transactions and the lack of diligence by market professionals.
Taxpayer Advocate Service	Explore the role of preparers in bringing taxpayers into compliance. Identify the types of and causes of preparer errors and the role of preparers in facilitating noncompliance.
Wage and Investment Division	Provide improved training tools through web-based training that links tax law and software into a single process-based training module.

Source: The annual and multi-year functional plans of 10 IRS business divisions and functional offices.

[1] See Appendix V for a glossary of terms.

Appendix V

Glossary of Terms

American Customer Satisfaction Index – A customer satisfaction index that relates expectations and evaluations of quality to customer satisfaction and is an internationally accepted measure of customer satisfaction used in over 20 countries.

Business Performance Review – A process which establishes a framework for measuring, reporting, and reviewing a business division's performance against its functional plans established within the Strategic Planning and Budget process. The Business Performance Review is one of several communication vehicles used to report quarterly performance measures to the IRS Commissioner's Office.

Gross Tax Gap – An estimated amount determined by the IRS of tax liabilities due in Tax Year 2001 before enforcement efforts and late payments were considered. The estimated amount is $345 billion. The amount of enforcement effort and late payments totaled $55 billion. The difference between the two—$290 billion—is the net tax gap.

Lead Development Center – Coordinates local and national projects initiated to identify specific areas/industries of noncompliance. It is the focal point for the fraud referral program, coordinating all referrals to and from the operating divisions and providing fraud awareness training to operating division employees.

Opportunity Costs – The benefits forgone by a particular use of resources. Also, it is the alternative with the greatest value to an agency that is the next best use of the resources.

Performance Assessment Rating Tool (PART) – A vehicle for achieving the goals of the Government Performance and Results Act of 1993.[1] It strengthens and reinforces performance measurement under that act by encouraging careful development of performance measures for programs according to the outcome-oriented standards of the law and by requiring that agency goals include actions with completion dates and designed to improve program results.

Tax Gap – The difference between the annual Federal tax obligation and the amount of tax the taxpayer pays voluntarily and timely. The tax gap consists of those who do not file their returns, do not make their payments on time, and file returns but underreport their income or over report their expenses.

Unbanked Taxpayer – A taxpayer who does not have a bank account.

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[1] Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C. and 39 U.S.C.).

Appendix VI

Management's Response to the Draft Report

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

CHIEF FINANCIAL OFFICER

RECEIVED
MAY 1 2 2010
BY: DAS

May 11, 2010

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Alison L. Doone
Chief Financial Officer

SUBJECT: Draft Audit Report – Plans Exist to Engage the Tax Preparer Community in Reducing the Tax Gap; However, Enhancements are Needed (Audit 200930027)

This is in response to your Draft Audit Report, "Plans Exist to Engage the Tax Preparer Community in Reducing the Tax Gap; However, Enhancements are Needed (Audit # 200930027).

I am pleased with your acknowledgement that the IRS Strategic Plan contains objectives critical to reducing the tax gap by engaging the tax preparer community and that the IRS business divisions and functional offices have plans in place that show goals, programs and activities to support the key objectives aimed at the tax preparer community.

The IRS is pleased with both the IRS Strategic Plan (2009-2013) and the process used to develop it. The plan includes measures that help the IRS monitor progress toward its long-term goals. The IRS tracks hundreds of metrics to ensure effective operations at all levels of the organization.

If you have any questions, please contact Peter Rose, Acting Associate CFO for Corporate Planning and Internal Control, at (202) 622-4508.

Attachment

Attachment

RECOMMENDATION 1

The Chief Financial Officer should take steps to update the existing IRS Strategic Plan and ensure future strategic plans have all of the information in the plans as required by the Government Performance and Results Act of 1993 (GPRA) and Office of Management and Budget Circular A-11 *(Preparation, Submission and Execution of the Budget).*

CORRECTIVE ACTION

Ensure future strategic plans incorporate the requirements in Department of Treasury guidance which includes both GPRA and Circular A-11.

PROPOSED IMPLEMENTATION DATE

December 31, 2013

RESPONSIBLE OFFICIAL

Associate Chief Financial Officer, Corporate Planning and Internal Control.

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 2

The Chief Financial Officer should define and include in the IRS Strategic Plan sufficient measures that will provide data that can be used to monitor the IRS' efforts to achieve objectives aimed at strengthening partnerships with tax practitioners and paid preparers to ensure effective tax administration. This effort includes coordinating with the business divisions and functional offices to ensure their plans and/or business performance reviews include acceptable measures to assess their progress in achieving the expected outcomes of goals and actions which support the IRS Strategic Plan.

CORRECTIVE ACTION

Include in the IRS Strategic Plan measures to assess progress in achieving the expected goals and objectives which support the IRS Strategic Plan.

2

IMPLEMENTATION DATE

December 31, 2013

RESPONSIBLE OFFICIAL

Associate Chief Financial Officer, Corporate Planning and Internal Control.

CORRECTIVE ACTION MONITORING PLAN

N/A