



## Treasury Inspector General for Tax Administration Office of Audit

### **PENALTY ABATEMENT PROCEDURES SHOULD BE APPLIED CONSISTENTLY TO ALL TAXPAYERS AND SHOULD ENCOURAGE VOLUNTARY COMPLIANCE**

Issued on September 19, 2012

## Highlights

Highlights of Report Number: 2012-40-113 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed Division and the Wage and Investment Division.

### **IMPACT ON TAXPAYERS**

The Internal Revenue Code imposes a Failure to File (FTF) penalty for failing to file a tax return and a Failure to Pay (FTP) penalty for failing to pay the tax shown on any tax return by the date prescribed. The IRS can abate both penalties under certain circumstances. If the IRS does not administer these and other penalties fairly and accurately, taxpayers' confidence in the tax system will be jeopardized.

### **WHY TIGTA DID THE AUDIT**

This audit was initiated to determine whether abatements of the FTF and FTP penalties were applied consistently and accurately. This audit addresses the major management challenge of Providing Quality Taxpayer Service Operations.

### **WHAT TIGTA FOUND**

The IRS waives FTF and FTP penalties for some taxpayers who have demonstrated full compliance over the prior three years. The purpose for granting the waiver, called a First-Time Abate (FTA), is to reward past tax compliance and promote future tax compliance. However, most taxpayers with compliant tax histories are not offered and do not receive the FTA waiver.

TIGTA estimated that for Tax Year 2010, approximately 250,000 taxpayers with FTF penalties and 1.2 million taxpayers with FTP penalties did not receive penalty relief even though they qualified under FTA waiver criteria. TIGTA estimated the unabated penalties totaled more than \$181 million. Further, the FTA waiver is not used to its full potential as a compliance tool because it is granted to taxpayers before they demonstrate full compliance by paying their current tax liability.

Taxpayer requests for penalty abatements were not always processed accurately. The IRS took immediate

corrective action to address this issue.

In addition, taxpayers who qualify for penalty relief based on reasonable cause may receive FTA waivers instead, which can negatively affect some taxpayers.

### **WHAT TIGTA RECOMMENDED**

TIGTA recommended that the FTA waiver be better used as a compliance tool by ensuring taxpayers are aware of their potential to receive the waiver based on their past compliance history. Receipt of the waiver should be contingent upon taxpayers paying their current tax liability.

TIGTA also recommended that a process be developed to address the negative impact to taxpayers who qualify for abatement of the FTF and FTP penalties based on reasonable cause, but are given FTA waivers instead.

In their response to the report, IRS officials agreed with the recommendations and are taking appropriate corrective actions. The IRS plans to study how best to use the FTA waiver as a compliance tool. It also plans to review the current process for application of an FTA waiver prior to reasonable cause and its impact on taxpayers who qualify for reasonable cause, but instead are given an FTA waiver.

### **READ THE FULL REPORT**

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

<http://www.treas.gov/tigta/auditreports/2012reports/201240113fr.pdf>