



Treasury Inspector General for Tax Administration Office of Audit

ACTIONS CAN BE TAKEN TO REINFORCE THE IMPORTANCE OF RECOGNIZING AND INVESTIGATING FRAUD INDICATORS DURING OFFICE AUDITS

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Highlights

Highlights of Report Number: 2013-30-020 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Penalties, such as for civil fraud, are designed to promote voluntary compliance by imposing an economic cost on taxpayers who choose not to comply with the tax law. Because indicators of fraud are not always recognized and properly investigated, the IRS may be missing opportunities to further promote voluntary compliance and enhance revenue for the Department of the Treasury.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether fraud is recognized and pursued during office audits of individual tax returns in accordance with IRS procedures and guidelines. The review is part of our Fiscal Year 2013 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

WHAT TIGTA FOUND

TIGTA reviewed a statistical sample of 100 office audits, closed between October 2009 and September 2010, that involved high-income and sole proprietor taxpayers agreeing they owed additional taxes of at least \$10,000. The review identified 26 audits with fraud indicators that were not recognized and investigated in accordance with some key IRS procedures and guidelines. When the sample results are projected to the population of 3,674 closed office audits meeting the above characteristics, TIGTA estimates that fraud indicators were not recognized and investigated in approximately 939 office audits during Fiscal Year 2010. TIGTA estimates that additional assessments totaling approximately \$5.8 million in civil fraud penalties may have been avoided by taxpayers.

TIGTA's evaluation indicates that a combination of factors caused the quality problems and that actions can be taken at the examiner and first-line manager levels to

better ensure that fraud indicators are recognized and properly investigated.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Director, Exam Policy, Small Business/Self-Employed Division: 1) standardize the process for office audit examiners' documentation of fraud consideration by developing and implementing a specific job aid that requires examiners to acknowledge which indicators, if any, were considered during the audit and 2) develop additional criteria and guidance for when a discussion should be held between the examiner and first-line manager about the potential fraudulent activity of the taxpayer to cover instances other than omissions of income.

IRS management partially agreed with both recommendations. For the first recommendation, the IRS plans to review existing guidelines and make revisions to standardize the process for documenting the consideration of fraud. TIGTA believes this planned corrective action is responsive to the recommendation.

For the second recommendation, the IRS plans to provide a guidance memorandum to emphasize when a discussion should be held between the examiner and first-line manager about potential fraudulent activity. However, it did not agree to provide additional criteria related to overstated deductions. As such, it is unlikely that the corrective action will be effective. Overstated deductions can be just as egregious as omissions of income and result in the same tax loss to the Government. Moreover, the IRS agreed that the recommendations have the potential to increase revenue by \$29 million over five years. Therefore, TIGTA continues to believe the IRS should expand the requirement for examiners and first-line managers to discuss potential fraudulent behavior beyond unreported income.

READ THE FULL REPORT

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

<http://www.treas.gov/tigta/auditreports/2013reports/201330020fr.pdf>

E-mail Address: TIGTACommunications@tigta.treas.gov

Phone Number: 202-622-6500

Website: <http://www.treasury.gov/tigta>