



Treasury Inspector General for Tax Administration Office of Audit

THE CORRESPONDENCE AUDIT SELECTION PROCESS COULD BE STRENGTHENED

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Highlights

Highlights of Report Number: 2013-30-077 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

The IRS relies heavily on the correspondence audit process to address individuals suspected of underreporting their income tax liabilities. Correspondence audits result in significant additional tax assessments and are more economical than other types of audits. IRS statistics show that in Fiscal Year 2012, the IRS conducted 1.1 million correspondence audits and recommended approximately \$9.2 billion in additional taxes.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine the effectiveness of filing checks made during the correspondence audit process in the Small Business/Self-Employed Division.

Filing checks are used, in part, to determine whether the same pattern of noncompliance identified on an audited tax return is present on the prior and/or subsequent year tax returns, and if those tax returns warrant an audit. When properly completed, filing checks leverage IRS audit resources by increasing the overall compliance coverage of every audit.

WHAT TIGTA FOUND

TIGTA evaluated a statistical sample of 102 of 7,470 single-year correspondence audits in which the taxpayers involved agreed that they understated their tax liabilities by at least \$4,000. Similar tax issues also existed on the prior and/or subsequent year tax returns for 43 of the 102 taxpayers. TIGTA found that 32 of the 43 individuals did not have those tax returns audited and, as a consequence, may have avoided additional assessments ranging from \$2,343 to \$18,874.

A factor that contributed to the limited number of prior and/or subsequent year tax audits in our sample is the emphasis the IRS places on keeping its audit inventories free of older tax years so there is sufficient time to complete audits and assess any resulting taxes within the three-year assessment statute of limitations. Control

issues also exist over how current year audit results are used in deciding whether to audit the prior and/or subsequent year returns.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS develop and implement procedures that instruct how current year correspondence audit results are to be used in deciding whether the prior and/or subsequent year tax returns warrant an audit. To ensure that the instructions are followed, the procedures should include instructions for monitoring how well current year correspondence audit results are used in deciding to audit prior and/or subsequent year returns.

The IRS agreed with TIGTA's recommendation and plans to develop an Internal Revenue Manual section to address the case selection and delivery process and the duties and roles of analysts and examiners.

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/201330077fr.pdf>