



*Review of the Internal Revenue Service's
Process to Address Violations of
Tax Law by Its Own Employees*

April 14, 2015

Reference Number: 2015-10-002

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax Return/Return Information

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HIGHLIGHTS

REVIEW OF THE INTERNAL REVENUE SERVICE'S PROCESS TO ADDRESS VIOLATIONS OF TAX LAW BY ITS OWN EMPLOYEES

Highlights

**Final Report issued on
April 14, 2015**

Highlights of Reference Number: 2015-10-002 to the Internal Revenue Service Commissioner.

IMPACT ON TAXPAYERS

According to Section 1203 of the IRS Restructuring and Reform Act of 1998 (RRA 98), the IRS shall terminate employment of any IRS employee if there is a final determination that the employee committed certain acts of misconduct, including willful violations of tax law, unless such penalty is mitigated by the IRS Commissioner. As the agency primarily responsible for administering Federal tax law, the IRS must ensure that its employees comply with the tax law in order to maintain the public's confidence.

WHY TIGTA DID THE AUDIT

The overall objective of this review was to determine whether the IRS had an effective process in place to address willful violations of tax law by employees.

WHAT TIGTA FOUND

Twice a year, the IRS's Employee Tax Compliance Branch uses a screening process to identify potential employee tax noncompliance. TIGTA found that potential employee tax noncompliance cases the IRS identified were forwarded for further examination by managers and Labor Relations Office personnel. More than 1,000 cases of potential employee tax noncompliance are referred each year.

TIGTA reviewed records for cases closed in Fiscal Years 2004 through 2013 (prior to the term of the current Commissioner). For this period, IRS records show that 1,580 employees were found to be willfully tax noncompliant. While the RRA 98 states the IRS shall terminate employees who willfully violate tax law, it also

gives the IRS Commissioner the sole authority to mitigate cases to a lesser penalty. Over this 10-year period, 620 employees (39 percent) with willful tax noncompliance were terminated, resigned, or retired. For the other 960 employees (61 percent) with willful tax noncompliance, the proposed terminations were mitigated to lesser penalties such as suspensions, reprimands, or counseling.

TIGTA's review of a judgmental sample of 34 cases of willful tax violations found that employees with similar violations received different discipline. In cases that were mitigated, files included mitigating factors as well as evidence that violations of tax law were willful; however, the basis for the Commissioner's decision to mitigate was not clearly identified in the case files. Some employees had significant and sometimes repeated tax noncompliance issues, and a history of other conduct issues. Moreover, management had concluded that the employees were not credible. Nonetheless, the proposed terminations were mitigated by the IRS Commissioner. These cases included willful overstatement of expenses, claiming the First-Time Homebuyer Tax Credit without buying a home, and repeated failure to timely file required Federal tax returns.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS Commissioner amend existing policy on how Section 1203 cases are handled to include a requirement to document the analysis of evidence and the basis for the decision on whether or not to mitigate penalties to something less than termination.

In its response, the IRS agreed with TIGTA's recommendation, noting that it plans to review existing procedures to document the analysis of evidence and basis for decision, and consult with its General Legal Services on potential improvements to the transparency of the mitigation process while not interfering with the IRS Commissioner's authority. In addition, the IRS has subsequently advised TIGTA that it has begun to document the analysis of evidence and the basis for the decision on whether or not to mitigate penalties for 1203 cases to something less than termination.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

April 14, 2015

MEMORANDUM FOR INTERNAL REVENUE SERVICE COMMISSIONER

FROM:

Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Review of the Internal Revenue Service’s Process
to Address Violations of Tax Law by Its Own Employees
(Audit # 201410005)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) had an effective process in place to address willful violations of tax law by employees. This audit is included in our Fiscal Year 2015 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 IV.

Copies of this report are also being sent to the IRS managers affected by the report recommendation. If you have any questions, please contact me or Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations).



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Abbreviations

ALERTS	Automated Labor and Employee Relations Tracking System
ETC	Employee Tax Compliance
FY	Fiscal Year
IRS	Internal Revenue Service
RRA 98	Restructuring and Reform Act of 1998
TY	Tax Year
VSIP	Voluntary Separation Incentive Payment



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Background

The Standards for Ethical Conduct¹ states that all Federal Government employees are expected to satisfy their obligations as citizens of the United States, “including all just financial obligations, especially those such as Federal, State, or local taxes that are imposed by law.” As the Federal Government agency primarily responsible for administering the Federal tax law, the Internal Revenue Service (IRS) must ensure that its employees comply with the same tax law to which all taxpayers are subject. In addition, failure to comply with the tax law by an IRS employee is a conduct issue and may result in discipline up to and including removal. Specifically, Section 1203, Termination of Employment for Misconduct, of the IRS Restructuring and Reform Act of 1998 (RRA 98)² states that the IRS shall terminate the employment of any IRS employee if there is a final determination that the employee committed certain acts of misconduct, including willful violations of tax law. Section 1203 also states that this penalty may only be mitigated at the discretion of the IRS Commissioner, and his decision on mitigation may not be appealed. Section 1203(b) describes 10 specific acts or omissions for which IRS employees are required to be removed; two of the 10 acts apply to IRS employee tax compliance. Specifically,

- Section 1203(b)(8) – willfully failing to timely file a Federal tax return unless such failure is due to reasonable cause and not willful neglect.
- Section 1203(b)(9) – willfully understating their Federal tax liability unless such failure is due to reasonable cause and not willful neglect.

Within the IRS, multiple groups are involved in identifying and responding to potential employee tax noncompliance. The Employee Conduct and Compliance Office, a division of the IRS Human Capital Office, is responsible for administering the Employee Tax Compliance (ETC) Program. The mission of the ETC Program is to help IRS employees comply with their tax obligations. This goal is accomplished by making employees aware of their tax filing, reporting, and payment responsibilities.³

The ETC Branch of the Employee Conduct and Compliance Office administers the ETC Program that identifies IRS employees’ potential tax noncompliance issues; researches and resolves issues within given thresholds; and refers technical/complex issues to management for further adjudication. Twice a year, the ETC Branch identifies IRS employees with potential

¹ Title 5, Code of Federal Regulations § 2635.809 (2014).

² 26 U.S.C. § 7804 note.

³ The IRS does not provide mandatory ethics training covering Section 1203 violations of employee tax compliance to all employees; however, there is an annual reminder and an ongoing communication strategy regarding employee tax compliance.



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tax noncompliance issues by matching employee database files against tax administration files.⁴ This database match identifies instances in which an employee potentially did not file a Federal tax return, did not file timely, did not pay the tax owed when due, or understated his or her tax liability. The ETC Branch then researches all the resulting potential employee noncompliance by reviewing employee tax records and requesting clarification from the employee.

If the ETC Branch determines that there is no tax compliance issue, it notifies the employee that it is closing the inquiry. If the ETC Branch cannot resolve an issue through its research or it determines there is a potential tax noncompliance issue, the ETC Branch refers the issue through the Labor Relations Office to the employee's local management. At this time, the ETC Branch enters the details of the employee's potential noncompliance into the Automated Labor and Employee Relations Tracking System (ALERTS), the IRS's labor and employee relations tracking tool. The ALERTS tracks conduct issues and disciplinary actions identified for all IRS employees.⁵

At that point, IRS management must determine if the employee's noncompliance was willful or not. The IRS, consistent with RRA 98, defines a willful act as the voluntary intentional violation of a known legal duty (timely filing of a tax return or accurate reporting of a tax obligation) for which there is no reasonable cause.⁶ If management finds the employee's noncompliance was not willful, management will determine, after fact-finding interviews and review of relevant documents, the appropriate disciplinary action for the employee's tax noncompliance misconduct. However, if management finds the employee's noncompliance was a willful failure to timely file or to accurately report his or her tax liabilities, this is a violation of Federal law, and RRA 98 states the IRS shall terminate the employee, subject to mitigation by the IRS Commissioner.⁷

Administrative disciplinary actions for nonwillful tax noncompliance range from oral counseling to suspension and even removal, depending on the severity of the noncompliance and whether there have been repeated or multiple misconduct issues. If disciplinary action is warranted, the appropriate discipline is determined by many factors, including the suggested penalty range and guidelines set forth in the IRS Penalty Determination Guide. Managers are advised to seek advice from the IRS Labor Relations Office, which is responsible for ensuring consistency in penalty actions by using similar cases as a guideline, in addition to the Penalty Determination

⁴ Employee tax issues can also originate through IRS examinations of tax returns, Treasury Inspector General for Tax Administration investigations of IRS employees, special projects, or self-disclosure by an IRS employee. Issues surfaced through these sources may include other types of noncompliance than that identified by the ETC Branch computer application.

⁵ The ALERTS contains information on all IRS employees except IRS Office of Chief Counsel employees; the Office of Chief Counsel has its own internal Labor Relations function and tracking system.

⁶ RRA 98 Section 1203 All Employee Guide, Document 11043 (Rev. 9-2007) Catalog Number 27823R.

⁷ Mitigating factors considered include the employee's job, disciplinary record, work record, and credibility concerns.



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Handbook.⁸ The proposed disciplinary action must be approved by the employee's second-level manager as well as an executive who is responsible for making the final determination on the appropriate action unless it is a Section 1203 violation.

The RRA 98 states the IRS shall terminate employees who willfully violate tax law; however, the law also left the final determination about the Section 1203 penalty to the IRS Commissioner by giving him sole authority to mitigate. According to the IRS, the IRS Commissioner's mitigation decisions are made based on consideration of a variety of factors including the employee's job, disciplinary record, work record, and credibility concerns. The RRA 98 states that the Section 1203 penalty, regardless of whether mitigated, cannot be appealed. However, management's determination that the employee's actions were willful is appealable. After the IRS Commissioner makes a decision regarding mitigation, if non-Section 1203 charges are present, IRS management then decides if other disciplinary action is required.

To facilitate the mitigation decision making process, the IRS Commissioner established the 1203 Review Board to identify Section 1203 cases that may warrant mitigation. The 1203 Review Board examines all cases for which management determines there is a willful Section 1203 violation.⁹ Cases that are recommended for mitigation go to the IRS Commissioner for a decision. Cases for which the 1203 Review Board does not recommend mitigation are returned to management to issue a decision to remove the employee. Figure 1 lists the current members of the 1203 Review Board.

Figure 1: The 1203 Review Board

Title	Type of Member
Deputy Commissioner for Operations Support (Chair)	Primary voting member
Chief, Appeals	Primary voting member
Executive Director, Equity, Diversity and Inclusion	Primary voting member
Commissioner, Wage and Investment Division	Primary voting member
Commissioner, Small Business/Self-Employed Division	Primary voting member

Source: IRS Human Capital Office.

In tax-related Section 1203 cases, the 1203 Review Board considers of a variety of factors including the employee's job, disciplinary record, work record, and credibility concerns when it decides whether to recommend mitigation for a Section 1203 case. In addition, in

⁸ According to IRS policy, as with any action taken against an employee, the IRS has the burden of proof to establish substantial evidence that the employee engaged in misconduct prior to imposing a disciplinary action. As a result, not all cases result in a substantiated tax noncompliance issue. Additionally, some cases have multiple substantiated issues within a single case.

⁹ The 1203 Review Board reviews all substantiated cases associated with RRA 98 Section 1203 violations; however, for this report, we focused on Section 1203 cases associated with willful tax violations.



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Section 1203(b)(8) willful failure to timely file cases, the Board considers whether the return involved a refund.

This review was performed at the IRS Human Capital Office, Workforce Relations Division Employee Conduct and Compliance function in Washington, D.C., and the ETC Branch in Cincinnati, Ohio, during the period December 2013 through March 2015. 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 is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

Potential Employee Tax Noncompliance Issues Were Forwarded for Management Response; However, Most Employees With Willful Tax Noncompliance Issues Were Not Terminated

Cases of potential employee tax noncompliance the IRS identified as part of the ETC Program process were appropriately forwarded to management for further action. Between Fiscal Years (FY) 2004 and 2013, more than 13,000 cases were sent to IRS management for review. Although Federal law requires IRS employees who willfully violate the tax law under RRA 98 to be terminated, unless such penalty is mitigated by the IRS Commissioner, our audit found that the discipline for the majority of employees was mitigated to something less than termination by the IRS Commissioner.¹⁰ Our review of a judgmental sample¹¹ of 34 cases found that some employees, who management had concluded were not credible, with significant and sometimes repeated tax noncompliance issues, or a history of other conduct issues, were not terminated. In these cases, documentation in the files included mitigating factors as well as evidence to support willful violations of tax law; however, the basis for the Commissioner's decision to mitigate the case was not clearly identified in the file. After having their termination mitigated, some employees received promotions and awards within one year after their willful tax noncompliance cases were closed.¹²

The ETC Branch forwarded potential employee tax noncompliance cases to IRS management for disciplinary consideration

The ETC Branch appropriately forwarded all potential employee tax noncompliance cases it identified to management for consideration, and all cases were recorded in the ALERTS. The ETC Branch is the function within the IRS that identifies potential IRS employee Federal tax compliance violations twice a year through matching employee database files against tax administration files to identify employees who appear to have tax compliance issues. From FYs 2004 through 2013, the ETC Branch identified 128,855¹³ cases of potential employee tax noncompliance. Through the ETC Branch's review and fact-finding process, it narrowed down

¹⁰ Willful tax noncompliance cases reviewed were closed between October 1, 2004, and September 30, 2013. The cases in our review were mitigated prior to the term of the current IRS Commissioner.

¹¹ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

¹² A typical IRS employee's appraisal period spans the length of one year; however, due to delays between when an award is earned, when it becomes effective, and when a payment is made, some of the employee tax compliance cases may have closed after the employee's appraisal period.

¹³ Count of cases with a last action date within the 10-year period.

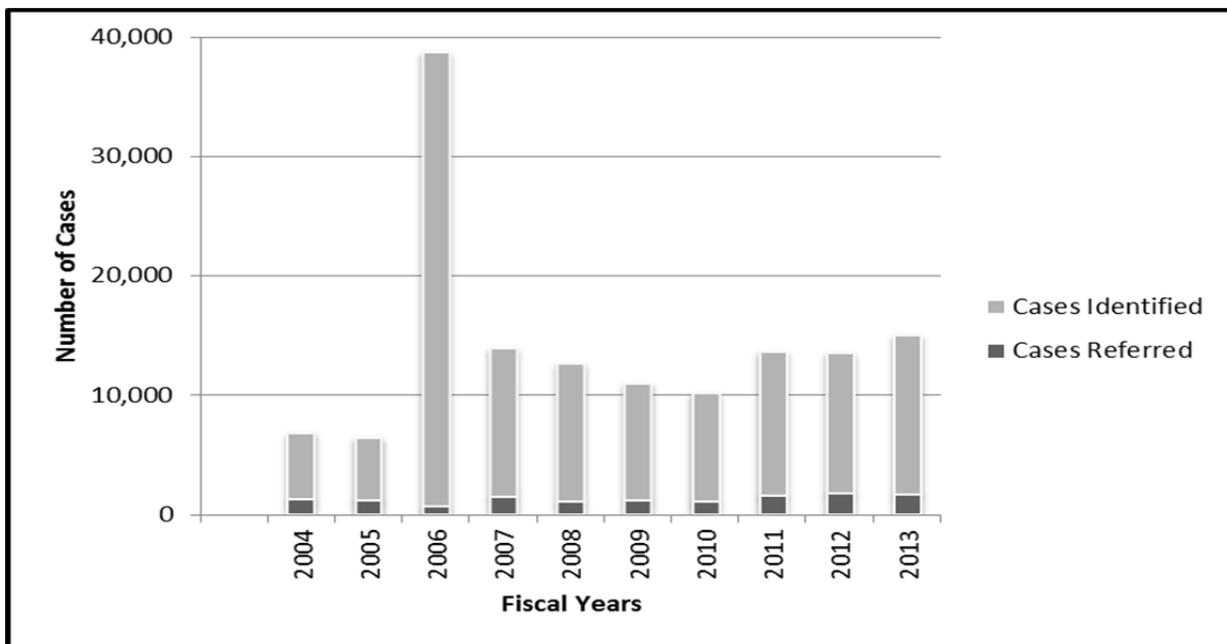


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the number of cases that were potential instances of employee tax noncompliance to approximately 13,000 cases. We found that generally all cases that required management review were properly entered into the ALERTS after the last action date in the ETC Branch database.

The ETC Branch determined that the remaining cases were not employee tax noncompliance issues and were closed without action, issued a clearance letter, or issued an advisory letter rather than referred for potential discipline. The ETC Branch's effective referral process provides assurance that IRS management personnel follow up on potential tax noncompliance issues. Figure 2 shows the number of potential tax noncompliance cases that the ETC Branch identified annually in comparison to how many cases were referred to IRS management and the Labor Relations Office from FYs 2004 through 2013. On average, more than 1,000 cases were referred by the ETC Branch to the Labor Relations Office during that time period.

Figure 2: Potential Employee Tax Noncompliance Cases Identified and Referred to IRS Management



Source: Download of ETC Branch database provided on November 26, 2013.¹⁴

From FYs 2004 through 2013, the ETC Branch's automated process identified employees with between one and nine potential tax noncompliance issues. The majority of the IRS employees involved with the almost 129,000 potential tax noncompliance issues identified by the

¹⁴ In FY 2006, the surge in cases identified as potential employee tax noncompliance cases was due to the ETC Schedule C Project, an initiative the IRS used to identify IRS employees filing fraudulent Schedule C, *Profit or Loss From Business (Sole Proprietorship)*, forms with their Federal tax returns. The majority of potential cases identified through this initiative did not result in referrals to management as potential tax violations.



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ETC Branch had only one potential case; however, more than 2,000 employees had multiple potential tax noncompliance issues over the 10-year period.

Most employees with willful tax noncompliance issues were not terminated from employment with the IRS

According to IRS data from FYs 2004 through 2013, IRS management reviewed more than 1,500 cases of willful employee tax noncompliance and almost 18,300 cases of nonwillful employee tax noncompliance.¹⁵ More than 25 percent, or 400, of the willful employee tax noncompliance cases resulted in termination of the employee, while an additional almost 14 percent of employees, or 220, resigned or retired from the IRS prior to a final disposition of the case. More than 60 percent of employees, or 960, with willful tax noncompliance cases had their discipline mitigated to a penalty lower than termination.

While the RRA 98 prescribes that employees who willfully violate tax law should be terminated, it does allow for the IRS Commissioner to mitigate the penalty and retain the employee. According to the IRS, the 1203 Review Board was established to make mitigation recommendations to the IRS Commissioner. The Board relies on the RRA 98 and other guidelines related to discipline, as well as a policy letter which describes mitigating factors the Board should consider when making a recommendation to the IRS Commissioner on whether to mitigate an employee's termination. However, the IRS does not have a policy that specifically addresses how the Board or the IRS Commissioner should document the analysis of evidence and the basis for the Commissioner's decision whether or not to mitigate the penalty of termination.

The Board considers mitigating information such as the employee's job, disciplinary record, work record, and credibility concerns, and then makes a recommendation to the IRS Commissioner. The IRS Commissioner considers the facts and the Review Board's recommendation and decides whether to mitigate the penalty to a discipline that is less than termination. It is this review process that resulted in the majority of employees with willful tax noncompliance remaining at the IRS with a lesser discipline than termination.

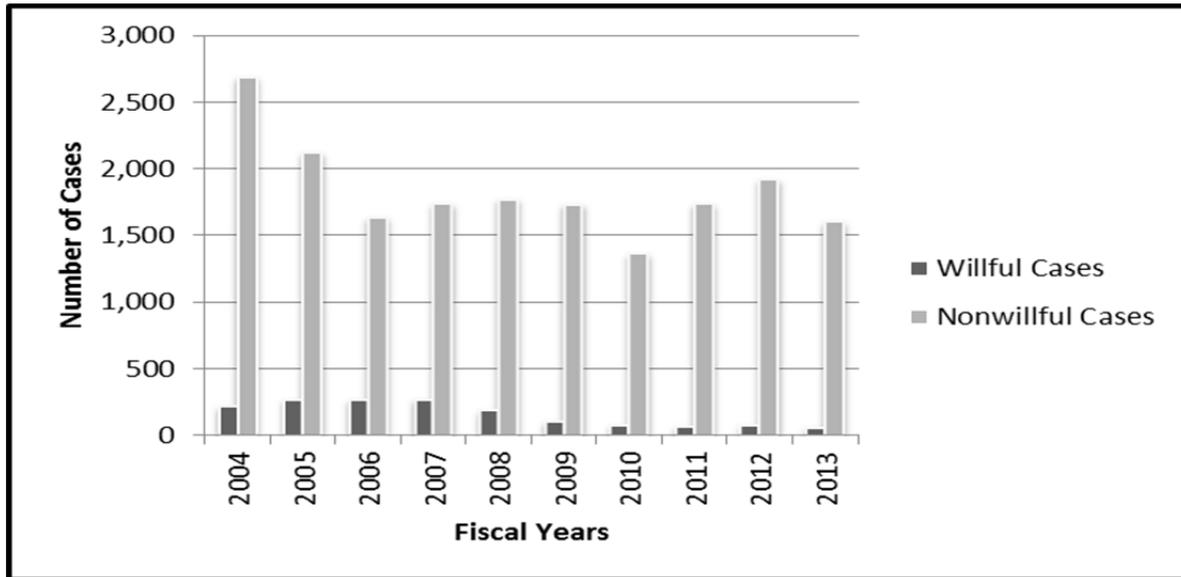
Figure 3 shows the number of willful and nonwillful employee tax noncompliance cases that were closed each fiscal year.

¹⁵ Employee tax issues can originate from sources other than the ETC Branch screening process, such as IRS examinations of tax returns, Treasury Inspector General for Tax Administration investigations of IRS employees, special projects, or self-disclosure by the employee. Information from all of these sources is input to the ALERTS.



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**Figure 3: Substantiated Willful and Nonwillful
Employee Tax Noncompliance Cases Closed per Fiscal Year**



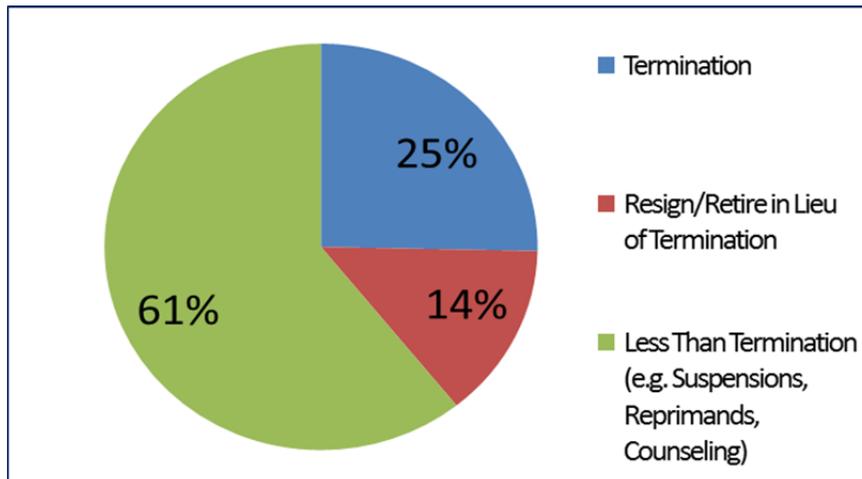
Source: Download of the ALERTS extracted on April 5, 2014.

IRS records showed that administrative disciplinary responses for employee tax noncompliance, both willful and nonwillful, ranged from oral counseling to termination. If multiple substantiated tax compliance issues are identified for one employee during the same time period, the issues are generally considered together and result in one disciplinary action. Of the 1,580 willful employee tax noncompliance cases, 1,472 employees received a discipline of admonishment or higher; the remaining 108 cases were closed without action or adjudication, the cases were withdrawn or suspended, or the employee received counseling. There were 400 employees terminated out of the 1,472 employees who were disciplined for willful tax noncompliance, which represents more than 25 percent of the 1,580 willful tax noncompliance cases. Figure 4 shows the discipline that employees received for their willful tax noncompliance.



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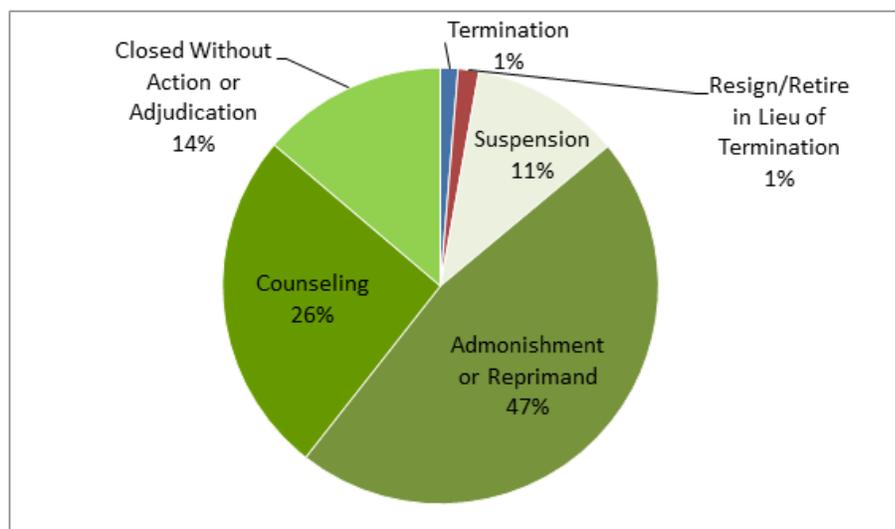
**Figure 4: Final Disciplines for Willful
Employee Tax Noncompliance Cases**



Source: Download of the ALERTS extracted on April 5, 2014.

Of the more than 18,000 employee cases that were found to be instances of nonwillful tax noncompliance, 11,087 employees received a discipline of admonishment or higher, which included 238 terminations. The 238 terminations are approximately 1 percent of the nonwillful employee tax noncompliance cases. Figure 5 shows the disciplinary actions taken against employees for nonwillful tax noncompliance.

**Figure 5: Final Disciplines for Nonwillful
Employee Tax Noncompliance Cases**



Source: Download of the ALERTS extracted on April 5, 2014.



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Case reviews show that disciplinary actions varied from case to case, and significant and repeated tax noncompliance did not necessarily result in termination

Our review of a judgmental sample of 34 willful tax noncompliance cases that closed in FYs 2009 to 2013 found that the discipline administered varied from case to case, and that employees with significant willful tax violations and repeated tax noncompliance cases were not necessarily terminated.¹⁶ The RRA 98 states that the IRS shall terminate the employment of any IRS employee if there is a final determination that the employee committed certain acts of misconduct, including willful violations of tax law. This penalty may only be mitigated at the discretion of the IRS Commissioner.¹⁷ The 1203 Review Board and the IRS Commissioner determine whether mitigation is appropriate based on a variety of factors including the employee's job, disciplinary record, work record, and credibility concerns. For example, during our review of cases of employees with willful tax violations, we found employees in tax compliance job positions who the IRS determined had willfully understated tax liabilities by failing to report income and employees who improperly claimed the First-Time Homebuyer Tax Credit. Disciplinary actions for violations ranged from suspensions to terminations. Figure 6 details some of the findings from our judgmentally sampled cases of employees in tax compliance job positions and non-tax compliance job positions with willful tax violations.

¹⁶ Details concerning cases were obtained from IRS case files and IRS data.

¹⁷ Mitigating factors considered include the employee's job, disciplinary record, work record, and credibility concerns.



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Figure 6: Case Studies of Employees With Willful Tax Violations

Tax Compliance Job Positions	Non-Tax Compliance Job Positions
<ul style="list-style-type: none"> • Twenty-one of the 34 employees reviewed were in tax compliance job positions including ****1****, tax examining technicians, and ****1****. • Eight employees with a willful tax noncompliance case were terminated, resigned, or retired. • Thirteen employees were not terminated and received discipline ranging from a ****1***** ****1*****. • Fifteen employees had multiple tax offenses (nine of these employees were not terminated and did not resign or retire). • Eleven employees had other non-tax-related conduct issues. • Case examples included IRS employees who: <ul style="list-style-type: none"> • Understated their tax liability by improperly claiming the First-Time Homebuyer Tax Credit for more than \$7,500 although they did not purchase a home as required. • ****1*****. • ****1*****. • Discipline for these cases included suspensions and terminations. 	<ul style="list-style-type: none"> • Thirteen of the 34 employees reviewed were in non-tax compliance job positions including ****1****, tax examining clerks, and mail clerks. • Seven employees with a willful tax noncompliance case were terminated, resigned, or retired. • Six employees were not terminated and received discipline ranging from a three-day to a ****1** **1**. • Eight employees had multiple tax offenses, including four who were not terminated and did not resign or retire. • Six employees had other non-tax-related conduct issues. • Case examples included IRS employees who: <ul style="list-style-type: none"> • Understated their income by improperly claiming dependents, ****1***** ****1***** ****1***** ****1****, or claiming Head of Household for exemptions to which they were not entitled. • Failed to report thousands of dollars in ***1***income, ****1***** ****1***** ****1*****. • ****1***** ****1***** ****1*****. • Discipline for these cases included suspensions and terminations or resignations.

Source: IRS case files. Note: Some employees had multiple issues. For example, an employee may have had both multiple tax offenses and conduct issues. That employee would be counted in both categories.



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In some instances, the IRS case files we reviewed raised concerns because employees the IRS determined had significant willful tax violations, repeated tax noncompliance, and other prior substantiated conduct issues were not terminated. According to the Review Board, it considers mitigating factors raised by the employee and management statements concerning the facts of the case and then makes a recommendation to the IRS Commissioner. Notwithstanding this description by the Board, case files lacked documentation to show the Board's analysis of the evidence used to support the IRS Commissioner's decision to mitigate the punishment to something less than termination. For example, employees claimed mitigating factors such as financial problems, cited paid preparers were used, and that they had medical or other family problems. However, management had recommended termination, concluding (as documented in the case file) that these employees' actions were willful, and that the employees were not credible. For these cases there was no clear explanation of why the case was mitigated. In addition, and as shown for the cases below and in Figure 6, many cases that were mitigated involved employees with a history of tax noncompliance, including three employees with Federal tax liens. Details of some of these cases are listed below.

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¹⁸ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.



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Employees who were not terminated for willful tax violations received awards and promotions within one year after being disciplined

In addition to not being terminated for willful tax violations, some IRS employees also received promotions, performance awards, and permanent pay increases within one year after their willful tax noncompliance case was closed. Specifically, 108 of 364 employees with willful tax noncompliance cases closed between October 1, 2008, and September 30, 2013, received one or more awards, promotions, quality step increases,19 or Voluntary Separation Incentive Payments (VSIP)20 within one year after being disciplined for the tax noncompliance. The IRS has an awards and recognition program in place to reward and retain competent and talented employees, but, as previously reported,21 with few exceptions the IRS did not consider tax compliance or other misconduct when issuing performance awards or most other types of awards for these cases. Additionally, Governmentwide policies do not provide guidance on providing awards to employees with conduct issues. As a result of the lack of consideration of conduct issues, these employees were provided the following awards and other payments after being disciplined for willful tax noncompliance:

- Almost \$145,000 in performance and special act awards.
• Almost 900 hours in time-off awards.
• More than 30 temporary and permanent promotions.

19 A quality step increase is an additional "within-grade" pay increase used to recognize and reward General Schedule employees at any grade level who display outstanding performance.
20 A VSIP is a direct buyout incentive used to encourage voluntary separation by employees who occupy positions affected by organizational change. The incentive is paid in a lump sum after separation and is equivalent to the employee's severance pay entitlement up to a maximum of \$25,000.
21 Treasury Inspector General for Tax Administration, Ref. No. 2014-10-007, The Awards Program Complied With Federal Regulations, but Some Employees With Tax and Conduct Issues Received Awards (Mar. 2014).



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- Four permanent pay increases in the form of a quality step increase.²²
- *****1*****
*****1*****²³

Recommendation

Recommendation 1: The IRS Commissioner should amend existing policy on how Section 1203 cases are to be handled to include a requirement to document the analysis of evidence and basis for the decision on whether or not to mitigate penalties to something less than termination.

Management's Response: The IRS agreed with the recommendation and stated that it will amend existing policy on how Section 1203 cases are handled. Specifically, the IRS stated it would make changes to ensure a more proactive, consistent, and timely approach to Section 1203 cases with respect to the process that occurs before cases arrive at the Review Board. The IRS also stated it would review existing procedures to document the analysis of evidence and basis for mitigation decisions by the 1203 Review Board and IRS Commissioner, in consultation with its General Counsel's General Legal Services office.

Office of Audit Comment: In its response, the IRS noted that it plans to review existing procedures to document the analysis of evidence and basis for decision, and consult with its General Legal Services on potential improvements to the transparency of the mitigation process while not interfering with the IRS Commissioner's authority. In addition, the IRS has subsequently advised TIGTA that it has begun to document the analysis of evidence and the basis for the decision on whether or not to mitigate penalties for 1203 cases to something less than termination.

²² Some employees received these payments and promotions as soon as three days after being disciplined.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the IRS had an effective process in place to address willful violations of tax law by employees. To accomplish our objective, we:

- I. Determined the controls the IRS had in place to respond to substantiated cases of employee tax noncompliance.
 - A. Identified and reviewed the Federal law and regulations and IRS policies and guidance that apply to employee tax compliance.
 - B. Interviewed IRS staff and officials who respond to substantiated cases of employee tax noncompliance.
- II. Evaluated the IRS's process for responding to substantiated cases of employee tax noncompliance.
 - A. Determined the volume and types of cases the IRS ETC Branch identified with potential tax compliance issues for FYs 2004 to 2013 by obtaining a copy of the ETC Branch database maintained by that office.
 - B. Determined whether the IRS responded to each case identified in Step II.A. by comparing records contained in the ETC Oracle database to the ALERTS.
 - C. Determined the IRS's response to employee tax compliance cases closed in FYs 2009 to 2013.
 - D. Developed case examples from the Section 1203 cases describing the IRS's response to employee tax noncompliance.
 - E. Requested case files for a judgmental sample¹ of 34 of 364 employees with Section 1203 ETC cases closed in FYs 2009 to 2013 based on the severity of the case and the type of noncompliance that the case represented in order to determine how case dispositions were administered. We selected a judgmental sample due to the large number of Section 1203 employee tax compliance cases and the volume of documentation contained in the case files. We assessed the reliability of the ALERTS computer-processed data by examining employee data such as Social Security Number, job position, grade, case number, case closed date, issue, and employment status. We determined that the data were sufficiently reliable to use for our audit tests.

¹ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.



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- F. Obtained position descriptions, promotions, awards, quality step increase, and other payment information for the 364 employees with closed Section 1203 cases in FYs 2009 to 2013.

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 that the following internal controls were relevant to our audit objective: IRS policies, procedures, and practices for administering the ETC Program and the 1203 Review Board. We evaluated these controls by interviewing management and analysts responsible for executing the program, reviewing applicable documentation, testing the effectiveness of the program, and analyzing selected employee tax noncompliance case details.



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Appendix II

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Appendix III

Report Distribution List

Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Operations Support OS
Internal Revenue Service Human Capital Officer OS:HC
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Internal Revenue Service Human Capital Officer OS:HC



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Appendix IV

Management's Response to the Draft Report



HUMAN CAPITAL OFFICE

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

February 17, 2015

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Daniel T. Riordan 
IRS Human Capital Officer

SUBJECT: Draft Audit Report – Review of the Internal Revenue Service's
Process to Address Violations of Tax Law by Its Own Employees
(Audit Number 201410005)

I am responding on behalf of Commissioner Koskinen to your revised draft report entitled *Review of the Internal Revenue Service's Process to Address Violations of Tax Law by Its Own Employees* (Audit Number 201410005), dated December 22, 2014. Thank you for the opportunity to review your revisions. Employee tax compliance is a key foundation of the public's trust in the IRS, and we are committed to maintaining an effective process to address those employees who fail to meet their tax compliance responsibilities. The IRS ranks at the top of all federal agencies for tax compliance, as reported by the Federal Employee/Retiree Delinquency Initiative in September 2013.

Section 1203 of the Restructuring and Reform Act of 1998 (RRA '98) states that, for certain offenses, including the willful failure to file a tax return and the willful understatement of a Federal tax liability, IRS employees shall be terminated unless the IRS Commissioner makes a decision to mitigate the penalty of termination. As you noted in your draft report, RRA '98 Section 1203(c)(1) grants the Commissioner the "sole discretion" to mitigate a penalty of termination for Section 1203 offenses. Accordingly, the statute does not permit additional requirements or limitations on the exercise of that authority.

The authority under Section 1203(c)(2) also grants the Commissioner sole discretion to establish a procedure used to determine which cases would be referred to the Commissioner for a mitigation determination. The Commissioner exercised this authority when he established the Section 1203 Review Board to assist in the mitigation process.

In June 2014, the Section 1203 Review Board modified the guidelines regarding referrals to the Commissioner. The Board remains committed to ensuring that each employee warrants and receives consideration of his or her specific, individual mitigating factors. The Board clarified the significance of an employee's mitigating factors during its review and excluded from the Board's consideration process information pertaining to prior recommendations for like or similar cases.



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The RRA '98 Section 1203(c) statute gave the Commissioner sole discretion to make this decision and made the Commissioner's decision not subject to appeal. The only appealable action in a Section 1203 decision is whether the agency correctly interpreted the employee's actions as willful and, as part of the appeal process, the third-party reviews the management's "analysis of evidence."

While our current procedures include the documentation of how management determined whether the employee's actions were willful violations of a Section 1203(b) provision, the Commissioner does not revisit that issue in the course of deciding whether to mitigate.

Although we currently document the mitigating factors specific to the employee and the decision whether to mitigate a termination to a lesser penalty, we agree that we can improve this process.

We, therefore, agree with your recommendation and will amend our existing policy on how Section 1203(b) cases are handled. Our changes will include a more proactive approach to ensure timeliness and consistency, where appropriate, and provide more transparency in the mitigation process while ensuring we do not interfere with the Commissioner's authority or damage the integrity of the 1203 adjudication process.

Attached is a detailed response outlining the corrective action that we will take to address your recommendation. If you have any questions, please contact me at (202) 317-7600, or a member of your staff may contact Lia Colbert, Director, Workforce Relations Division, at (202) 317-4390.

Attachment



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Attachment

RECOMMENDATION 1:

The IRS Human Capital Office amend existing policy on how Section 1203(b) cases are to be handled to include a requirement to document the analysis of evidence and basis for the decision on whether or not to mitigate the penalties to something less than termination.

CORRECTIVE ACTIONS:

We agree with this recommendation. We will amend our existing policy on how Section 1203(b) cases are to be handled. In reviewing our current policy and procedures, we determined that a more proactive approach is necessary to ensure more timely actions and more consistency with determinations about employees' intentions and whether Section 1203 tax provisions were violated. As such, we are taking the following corrective actions:

- Reinstated the consultation process between the Labor Relations Specialist (LRS) and the 1203 Subject Matter Experts in the Workforce Relations Division. This will ensure more consistent and timely processing.
- Ensure each case file provides management with the complete guidance and information about the meaning of willful and intentional, including the factors to consider in that determination.
- Require the LRS to work more closely with management during the assessment and determination about the employee's intentions and whether a Section 1203(b) provision was violated.
- Ensure that both management and the LRS are aware that, if there is a difference of opinion concerning a willful determination, they may request an opinion from IRS General Council's General Legal Services (GLS).
- Review the existing procedures to document the analysis of evidence and basis for decision, and consult with GLS on potential improvements to increase the transparency of the mitigation process while ensuring we do not interfere with the statutory authority or damage the integrity of the 1203 adjudication process.

IMPLEMENTATION DATE: October 31, 2015

RESPONSIBLE OFFICIAL(S):

Chief Human Capital Officer and Director, Workforce Relations Division



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CORRECTIVE ACTION(S) MONITORING PLAN:

We will enter accepted Corrective Actions into the Joint Audit Management Enterprise System (JAMES), monitor progress towards completion on a monthly basis, and upload supporting documentation into JAMES with Forms 13872 *Planned Corrective Action (PCA) Status Update for TIGTA/GAO/MW/SD/TAS/REM*.