



*The Internal Revenue Service Still
Does Not Make Effective Use of
Currency Transaction Reports*

September 21, 2018

Reference Number: 2018-30-076

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..

Phone Number / 202-622-6500

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

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



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HIGHLIGHTS

THE INTERNAL REVENUE SERVICE STILL DOES NOT MAKE EFFECTIVE USE OF CURRENCY TRANSACTION REPORTS

Highlights

Final Report issued on
September 21, 2018

Highlights of Reference Number: 2018-30-076
to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

The Currency and Foreign Transactions Reporting Act of 1970, referred to as the Bank Secrecy Act, requires U.S. financial institutions to assist U.S. Government agencies by filing reports concerning currency transactions. One such report is known as the Currency Transaction Report (CTR), which financial institutions are required to file with the Financial Crimes Enforcement Network for currency transactions that exceed \$10,000 or multiple currency transactions that aggregate more than \$10,000 in a single day.

WHY TIGTA DID THE AUDIT

Congress believed that the reports required by the Bank Secrecy Act, including the CTRs, would be useful for numerous purposes, including tax compliance purposes. TIGTA previously recommended that the IRS make greater use of CTR data to pursue potential nonfilers and underreporters, and the IRS agreed to the recommendation. This audit was initiated to determine how effectively the IRS uses CTR information to select and examine taxpayers.

WHAT TIGTA FOUND

The IRS still makes no systemic use of CTR data in examinations. Although IRS management agreed with TIGTA's recommendation in a September 2010 report and cited steps taken to develop examination referrals from the CTRs, the IRS is still not systemically using the CTRs to identify and pursue potentially noncompliant individuals. It is

also not effectively tracking information referrals from Bank Secrecy Act examiners to the Examination function. Finally, some examiners are not documenting that they are considering available CTR information in their audits.

During the fieldwork for this review, TIGTA also found that CTR data stored in the Integrated Data Retrieval System incorrectly aggregated CTR amounts for multiple individuals and showed the same CTRs total dollar amount for these individuals. We have initiated a follow-up audit to determine the extent and potential causes of this issue.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS 1) establish formalized procedures for processing Bank Secrecy Act Program referrals and begin tracking the time required to send referrals to the Field Exam Support Team, and 2) clarify formal Internal Revenue Manual procedures to assist examiners in their consideration of CTR data in examinations.

IRS management agreed with the recommendations and plans to take corrective actions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 21, 2018

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Internal Revenue Service Still Does Not
Make Effective Use of Currency Transaction Reports
(Audit # 201730018)

This report presents the results of our review to determine how effectively the Internal Revenue Service uses Currency Transaction Report information to select and examine taxpayers. This audit is included in our Fiscal Year 2018 Annual Audit Plan and addresses the major management challenge of Improving Tax Compliance.

Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).



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Abbreviations

BSA	Bank Secrecy Act
CTR	Currency Transaction Report
ECS	Exam Case Selection
FinCEN	Financial Crimes Enforcement Network
FY	Fiscal Year
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year
U.S.C.	United States Code



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Background

The difference between what taxpayers owe in taxes and what they pay is referred to as the Tax Gap. In Tax Years (TY) 2008 through 2010, the Internal Revenue Service (IRS) estimated the gross Tax Gap, *i.e.*, the difference between true tax liability for a given tax year and the amount that is paid on time, to be \$458 billion. Reducing the Tax Gap is a significant challenge for the IRS. In the IRS's estimate of the gross Tax Gap, underreporting of income is the most significant portion at \$387 billion. One proven approach for tax compliance is third-party information return reporting to the IRS about taxpayers' income, expenses, and certain other financial activities. The IRS estimates that there is higher taxpayer compliance for amounts subject to information reporting (93 percent compliance). Compliance is even higher when payments are also subject to tax withholding (99 percent compliance). However, when there is no information reporting, the compliance rate is only 37 percent.

Underreporting of income is the most significant portion of the gross Tax Gap. Third-party information return reporting is a proven approach to increase taxpayer compliance.

Information return reporting is commonly required in the reporting of income and expenses to the IRS for items such as for wages (Form W-2, *Wage and Tax Statement*), proceeds from brokers (Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*), mortgage interest (Form 1098, *Mortgage Interest Statement*), and payment card transactions (Form 1099-K, *Payment Card and Third Party Network Transactions*). In addition to the IRS using this information for automated compliance programs, *e.g.*, Automated Underreporter and Automated Substitute for Return, the information may also be considered during the selection and examination of tax returns for noncompliance.¹ In Calendar Year 2007, the IRS National Taxpayer Advocate estimated that income earned in the "cash economy," *i.e.*, taxable income from legal activities not reported to the IRS by third parties, was more than \$100 billion annually.² Transactions in the cash economy are difficult to detect because they are generally not subject to third-party income reporting. However, as we subsequently describe, the IRS has insight into a segment of the cash economy through Currency Transaction Reports (CTR). The Currency and Foreign Transactions Reporting Act of 1970, referred to as the Bank Secrecy Act (BSA), requires U.S. financial institutions to assist U.S. Government agencies by filing reports

¹ See Appendix IV for a glossary of terms.

² National Taxpayer Advocate, *2007 Annual Report to Congress* (2007). At the time of the National Taxpayer Advocate's report, the underreporting component of the Tax Gap was \$285 billion for TY 2001, whereas the most current estimate of the underreporting component of the Tax Gap is \$387 billion for TYs 2008 through 2010.



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concerning currency transactions that are used for various purposes by the Government.³ The purpose of these reports is stated by the BSA as follows:

*It is the purpose of this subchapter (except § 5315) to require certain reports or records where they have a high degree of usefulness in criminal, **tax**, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism.*⁴ [emphasis added]

Financial institutions are generally required to file the CTRs with the Financial Crimes Enforcement Network (FinCEN) within 15 calendar days of currency transactions that exceed \$10,000 or multiple currency transactions that aggregate more than \$10,000 in a single day. Additional details for the terms used in the CTR regulations are:

- “Financial institutions” include various business types such as banks, money service businesses, insurance companies, and casinos.
- “Currency” includes U.S. or foreign legal tender, U.S. silver certificates, U.S. notes, Federal Reserve notes, and foreign bank notes, but does not include negotiable instruments, such as checks.
- “Transaction” must include a physical transfer of currency from one person to another and can be combined with other non-currency, such as negotiable instruments, as long as the total either in or out, *e.g.*, deposit or withdraw, exceeds \$10,000.
- “Structuring” is when multiple transactions are treated as a single transaction if the financial institution has knowledge that the transactions are by or on behalf of one person and result in more than \$10,000 during any one business day.

In July 2012, the electronic filing of the CTRs was made mandatory, and the former paper FINCEN Form 104, *Currency Transaction Report*, was no longer accepted.

The BSA also requires U.S. financial institutions to file reports, known as Suspicious Activity Reports, of suspicious activity by persons that might signify money laundering, tax evasion, or other criminal activities. Suspicious activity includes persons who try to avoid the filing of a CTR by keeping currency deposits or withdrawals under \$10,000. It is a crime to try to avoid filing a CTR by intentionally structuring currency deposits or withdrawals in such a way that the \$10,000 filing threshold is not crossed.⁵ The Treasury Inspector General for Tax Administration

³ 31 U.S.C. § 5311 *et seq.*

⁴ 31 U.S.C. § 5311.

⁵ 5324(a) states that “no person shall, for the purpose of evading the reporting requirements ...

(1) cause or attempt to cause a domestic financial institution to fail to file a report required [CTRs]; (2) cause or attempt to cause a domestic financial institution to file a report ... that contains a material omission or misstatement of fact; or (3) structure or assist in structuring, or attempt to structure or assist in structuring, any transaction with one or more domestic financial institutions.”



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(TIGTA) recently reported that although the purpose of the reports is to assist the Government in seizure of funds related to structuring, the IRS's Criminal Investigation was enforcing the BSA against legally-sourced funds and compromised the rights of some businesses and individuals in the forfeiture of those funds.⁶

One organization representing financial institutions estimated that approximately \$1 billion is spent annually on BSA compliance.⁷ TIGTA has previously recommended that the IRS make greater use of CTR data to pursue potential nonfilers and underreporters. The IRS agreed to this recommendation.⁸ In light of Congress's intent that the Government use the forms in part for tax compliance purposes, coupled with the burdens associated with CTR compliance, as well as the IRS's agreement in Fiscal Year (FY) 2010 that it should make greater use of the CTRs to identify tax noncompliance, this review was undertaken to determine whether the IRS uses the CTRs for tax compliance purposes.

Our overall audit objective was to determine how effectively the IRS uses CTR information to select and examine taxpayers. This was to include analyzing how the IRS uses the CTRs to identify nonfilers and underreporters. However, we encountered a significant problem that precluded us from fully addressing our audit objective. Although we validated the CTR data we received from the IRS to the Integrated Data Retrieval System before beginning our analysis, late in the audit, we found instances in which the CTR cash-in dollar amounts attributed to individual taxpayers were misstated in both the CTR data and in the Integrated Data Retrieval System. Because of this, we were unable to determine the correct dollar amount of CTR cash-in transactions for the individuals in our nonfiler sample population. We plan to initiate a follow-up review in the near future to address the accuracy of CTR data as well as the use of CTRs to identify nonfilers and underreporters.

This review was performed with information obtained from the Small Business/Self-Employed (SB/SE) Division Headquarters located in Lanham, Maryland, and field offices in Holtsville, New York, and New York, New York, during the period October 2017 through June 2018. With the exception of the data-related scope limitation previously described, 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. Notwithstanding the scope limitation, 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.

⁶ TIGTA, Ref. No. 2017-30-025, *Criminal Investigation Enforced Structuring Laws Primarily Against Legal Source Funds and Compromised the Rights of Some Individuals and Businesses* (Mar. 2017).

⁷ Stipano, Daniel, *Time to bring BSA into this century*, American Banker BankThink, Feb. 21, 2017, available at <https://www.americanbanker.com/opinion/time-to-bring-bsa-into-this-century>.

⁸ TIGTA, Ref. No. 2010-30-104, *Currency Report Data Can Be a Good Source for Audit Leads* (Sept. 2010).



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Results of Review

The IRS still makes no systemic use of CTR data for most tax compliance purposes. Although IRS management agreed with TIGTA's recommendation in a September 2010 report and cited steps taken to develop examination referrals from CTR data, the IRS is still not systemically using the CTRs to identify and pursue potentially noncompliant individuals. It is also not effectively tracking referrals from BSA Program examiners to the Examination function. Finally, some examiners are not documenting that they are considering available CTR information in their audits.

The Internal Revenue Service Does Not Systemically Use Currency Transaction Report Data to Identify Potential Nonfilers and Underreporters

TIGTA issued an audit report in September 2010 recommending that the Director, Examination, SB/SE Division, explore the feasibility of making greater use of the CTRs to pursue additional nonfilers and underreporters.⁹ IRS management agreed with the recommendation and stated that it would evaluate opportunities during its work planning process to expand audit coverage of nonfilers using CTR data. The report also stated that the IRS recognized the potential benefits of incorporating the CTRs into its criminal and civil enforcement efforts.

According to the June 2012 Planned Corrective Action document used to formally close the recommendation in August 2012, the IRS stated that the Field Examination function had partnered with the BSA Program to receive referrals from CTR information, which were to be sent by the BSA Program to the Brookhaven Campus for classification with other Information Report Referrals by field examiners.¹⁰ The IRS also stated that when reviewing closure data from cases arising from BSA Program referrals for the period of August 2009 through March 2012, 34 percent (878 out of 2,568) of the referrals received from the BSA Program were for taxpayers who were nonfilers of income tax returns.

As the IRS stated in its response to our FY 2010 report, the CTRs can provide substantive leads to ensure that individuals who attempt to use cash as a mechanism to avoid Federal tax obligations will be brought into compliance. However, according to IRS officials, the IRS is not systemically using the CTRs to identify and pursue individuals who are not meeting their filing

⁹ TIGTA, Ref. No. 2010-30-104, *Currency Report Data Can Be a Good Source for Audit Leads* (Sept. 2010).

¹⁰ The BSA Program is part of the SB/SE Division's Specialty Examination function and conducts examinations for compliance with the BSA's reporting requirements.



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obligations. Based on this, the IRS could potentially be missing an opportunity to bring thousands of individuals into compliance.

During this review, we attempted to analyze CTR data to determine the potential number of noncompliant individuals with significant dollar amounts of CTR transactions. Due to the data limitation described earlier, we were unable to determine the correct dollar amount of CTR transactions. We plan to initiate a follow-up review in the near future to address the accuracy of CTR data, as well as the use of the CTRs to identify nonfilers and underreporters.

The Internal Revenue Service Does Not Effectively Track Referrals From Bank Secrecy Act Program Examiners

The FinCEN delegates authority to the IRS to conduct certain BSA Program examinations to ensure compliance with established anti-money laundering programs and for filing required information return reports, including the CTRs. Because these examinations are conducted under Title 31 of the United States Code (U.S.C.), not the Internal Revenue Code (Title 26), courts have held that examiners cannot conduct tax examinations under the guise of a BSA Program examination.¹¹ However, when unusual cash activity regarding a particular individual or business is identified during a BSA Program examination, IRS procedures instruct the BSA Program examiner to make a referral to the Title 26 examination program.¹² Referrals should be forwarded to the BSA Program's Exam Case Selection (ECS) function using Form 5346, *Examination Information Report*.¹³ The BSA Program ECS function then researches and screens the referrals before sending them to the SB/SE Division Examination function for additional review and forwarding to Field Examination function groups.¹⁴

Since FY 2015, approximately 2,973 referrals have been submitted by BSA Program examiners to the BSA Program ECS function and examined. However, the BSA Program ECS function did not have detailed written procedures for processing these referrals until September 2017. Due to research conducted by the BSA Program ECS function that was later duplicated at the Brookhaven Campus, some referrals were not forwarded from the BSA Program ECS function to the Brookhaven Campus for a year or more. Although both the BSA Program ECS function and the Brookhaven Campus maintained informal computer worksheets, no formalized system was in place to track the referrals. The two organizations neither reconciled their records nor analyzed the length of time required for the referrals to be processed by the BSA Program and sent to the Brookhaven Campus.

Because of inconsistencies between the worksheets maintained by the two organizations, we were unable to determine the exact processing time for all referrals. However, using the dates

¹¹ See *U.S. v. Deak Perera & Co.*, 566 F. Supp. 1398 (D.D.C. 1983).

¹² Internal Revenue Manual (IRM) 4.26.15.5.2 (Jan. 9, 2013).

¹³ IRM 4.26.3.4 (Sept. 19, 2016).

¹⁴ IRM 4.1.1.6.11.4 (Oct. 25, 2017).



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contained in the BSA Program ECS function computer worksheets, we found at least 12 referrals with at least 1,000 calendar days between the time the referral was received by the BSA Program ECS function and the time it was forwarded to the Brookhaven Campus. Additionally, for approximately 595 more referrals, the time between receipt by the BSA Program ECS function and forwarding to the Brookhaven Campus was between 464 and 941 calendar days.¹⁵

We asked SB/SE Division management for any metrics used to track the number of BSA Program referrals that were forwarded to the Examination function. Although the division's quarterly Business Performance Review tracked the number of referrals from BSA Program examiners to the FinCEN through FY 2017, there is no similar tracking for BSA Program referrals to the Examination function. We were also informed that SB/SE Division management had no other formal method of tracking BSA Program referrals to the Examination function. Both IRS guidance and the Government Accountability Office's *Standards for Internal Control in the Federal Government* specify that establishing control activities, such as reviews by management at the activity level, helps management achieve objectives and respond to risks.¹⁶

Recommendation

Recommendation 1: The Director, Examination, SB/SE Division, should establish formalized procedures for processing BSA Program referrals and begin formally tracking the time required to send referrals to the Field Exam Support Team.

Management's Response: IRS management agreed with this recommendation. The IRS plans to update the IRM to formalize the procedures for processing BSA Program referrals and to track the days for the BSA Program to process referrals.

Internal Revenue Service Examiners Did Not Always Document Consideration of Currency Transaction Report Data in Examinations

Our FY 2010 report also noted that IRS examination statistics for FYs 2007 through 2009 included 493 audits that generated \$13.6 million (an average of \$27,700 for each return audited) based on referrals from compliance checks of the CTRs. In addition, another 2,042 audits generated \$68 million from a project that involved auditing individuals with large aggregate CTR amounts.

For the past several years, the IRS has used a project code to track examinations initiated from BSA Program examiner referrals. These referrals are based on questionable transactions in

¹⁵ In response to TIGTA's analysis, IRS management noted that referrals are often based on current year information and the IRS is unable to take action until the individual has filed a return or is delinquent. Individuals (with filing extensions) can file more than nine months after the end of the calendar year before being considered delinquent.

¹⁶ Government Accountability Office, *Standards for Internal Control in the Federal Government*, GAO-14-704G, (Sept. 2014). See pages 45-46.



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currency and/or monetary instruments identified during the course of a BSA Program compliance examination that indicated possible tax violations.¹⁷ For FYs 2015 through 2018 (as of January 2018), the IRS closed 2,970 field audits with the project code indicating that the return was selected based on a BSA Program referral. These audits generated total assessments of approximately \$189.1 million, an average of approximately \$63,689 per return audited.

As stated in TIGTA's FY 2010 report, the IRS considers currency transactions a high compliance risk area and recommends a number of techniques that examiners can use to address these risks in planning and executing audits. Internal Revenue Manual (IRM) 4.10.4 states that the database that holds the CTRs (the Currency and Banking Retrieval System) can be used to identify financial institution accounts; secreted cash; leads to assets; and foreign financial accounts, nominees, and other useful information for compliance and other law enforcement personnel.

IRM 4.10.4 also requires IRS examiners to consider gross income during all income tax examinations and should always complete certain analytical tests known as minimum income probes. If the examiner's minimum income probe provides a reasonable indication of unreported income, a more in-depth examination of income is required. This could include using third-party information, such as a large number or amount of CTR cash-in transactions, which may indicate that the taxpayer is not properly reporting income.

Finally, IRM 4.10.5 provides that Currency and Banking Retrieval System information is useful to identify cash activity that may not be reported accurately on the income tax return. In addition, it may lead the examiner to discover sources of unreported income, often derived from criminal activity.

We reviewed a judgmental sample of 50 examinations of returns with more than \$100,000 in cash-in CTRs (as reported in IRS databases) that were closed with no additional tax assessment (no-change).¹⁸ The sample consisted of 24 examinations conducted by field examiners and 26 examinations conducted by campus examiners. Generally, campus examinations are limited to a small number of pre-identified issues, and examiners are not expected to conduct additional research. For nine (37.5 percent) of the 24 field examinations, we found no documentation in the electronic or paper workpaper files that the examiners considered the large amount of the CTRs when selecting issues to audit or when conducting the mandatory check for unreported income. Figure 1 summarizes the results of our review of the field examinations.

¹⁷ IRM 4.26.15.5.2 (Jan. 9, 2013).

¹⁸ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population. As noted previously in this report, we were unable to verify the correct dollar amount of CTR cash-in transactions using IRS databases.



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**Figure 1: Results of Review of Selected Field Examination
Workpapers With Reported CTR Data in TY 2015**

Documentation of CTR Review?	Number of Examinations	Percentage
<i>Yes</i>	15	62.5%
<i>No</i>	9	37.5%
Total	24	100.0%

Source: TIGTA's analysis of IRS field examination files.

The IRS disagreed with four of the nine exceptions cases by stating that the examiner indirectly addressed the cash-in CTRs in other procedures or abbreviated notation indicated they considered the issue. However, our public record searches on the cases that the IRS disagreed with found work affiliations or ownership of a business for three of the four individuals that could indicate unreported income.

Although the presence of large cash deposits is not proof that the taxpayer did not accurately report income, it can be an indication of unreported income, as noted in the previously mentioned IRM sections. Given the inaccuracy of CTR information in the IRS databases previously discussed in the scope limitation, examiners should thoroughly investigate any reported large sums of the CTRs to determine whether the taxpayers owe additional taxes, interest, and/or penalties.

Recommendation

Recommendation 2: The Director, Examination, SB/SE Division, should clarify formal IRM procedures to assist examiners in their consideration of CTR data in examinations.

Management's Response: IRS management agreed with this recommendation and plans to update the IRM to clarify actions field examiners should take to analyze CTR data during an audit. However, IRS management disagreed that there is an opportunity to use the CTRs in a systemic manner because a tax assessment cannot be made solely using CTR information.

Office of Audit Comment: We did not suggest that the IRS should make assessments based solely on CTR information. As presented in this report, CTR information can be used as a tool to identify individuals for additional scrutiny with examination or collection actions. CTR information can also be used during examinations as a potential source for identifying unreported income. However, the inaccuracy of CTR information in IRS databases discussed in this report prevents examiners from readily using this information. We have initiated a follow-up review to address the accuracy of CTR data, as well as the use of the CTRs to identify nonfilers and underreporters.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine how effectively the IRS uses CTR information to select and examine taxpayers. To accomplish our objective, we:

- I. Identified and documented the applicable policies, procedures, and controls to select and examine nonfilers and potential underreporters using CTR data.
 - A. Met with IRS personnel to review and document procedures for using CTR data to select and examine taxpayers for potential unreported income.
 - B. Reviewed IRS procedures, the IRM,¹ local desk procedures, and training materials to document processes and controls for using CTR data in income tax examinations.
 - C. Obtained data on BSA² Program examiner referrals and evaluated the number of referrals sent to the BSA Program ECS function.
 - D. Evaluated the metrics for BSA Program referrals related to overall CTR data for FYs 2015 through 2018 (through January 2018).
- II. Determined whether the IRS has effectively implemented the corrective actions proposed in response to recommendations made in our prior audit report.³
- III. Attempted to analyze CTR data, information returns, and individuals' tax records on IRS systems to determine whether there was a potential for unreported income.
- IV. Assessed the effectiveness of the examinations of taxpayers with CTR cash-in transactions of more than \$100,000 (as reported in IRS databases).
 - A. Evaluated closed Audit Information Management System examination data for audits with CTR project codes.
 - B. Identified total population of examined taxpayers with combined CTR cash-in transactions of more than \$100,000 (as reported in IRS databases).
 - C. Randomly selected a judgmental sample of 50 cases from a sample population of 241 cases created in Step IV.B.⁴

¹ See Appendix IV for a glossary of terms.

² 31 U.S.C. § 5311 *et seq.*

³ TIGTA, Ref. No. 2010-30-104, *Currency Report Data Can Be a Good Source for Audit Leads* (Sept. 2010).

⁴ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.



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- D. Requested and reviewed examination case files for no-change taxpayers to determine if CTR data were properly evaluated in decisions to no-change the returns.

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 processes and procedures for using CTR information to identify potentially underreported income on tax returns. We evaluated the controls by reviewing written procedures and training materials, and holding discussions with IRS officials.



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Appendix II

Major Contributors to This Report

Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Glen Rhoades, Director
Robert Jenness, Audit Manager
John Park, Lead Auditor
Sean Morgan, Senior Auditor



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Appendix III

Report Distribution List

Deputy Commissioner for Services and Enforcement
Commissioner, Small Business/Self-Employed Division
Director, Examination, Small Business/Self-Employed Division
Director, Office of Audit Coordination



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Appendix IV

Glossary of Terms

Term	Definition for the Purpose of This Review
Audit Information Management System	A computer system used by the SB/SE Division Examination Operations function and others to control returns, input assessments/adjustments to the Master File, and provide management reports.
Automated Substitute for Return System	A system designed to assess taxes on wage earners who fail to file tax returns. It analyzes information submitted to the IRS and historical tax return information.
Automated Underreporter System	The case processing and inventory control system of the Automated Underreporter Program.
Bank Secrecy Act ¹ Program	The IRS BSA Program educates, examines, and enforces compliance with BSA reporting requirements for individuals required to file a FinCEN Form 114, <i>Report of Foreign Bank and Financial Accounts</i> , and non-bank financial institutions required to file the CTRs, as well as trades and businesses which are required under both the BSA and the Internal Revenue Code to file a FinCEN Form 8300, <i>Report of Cash Payments Over \$10,000 Received in a Trade or Business</i> , when receiving cash of more than \$10,000.
Business Performance Review	A quarterly high-level organizational performance document that provides an opportunity for IRS division executives to share significant accomplishments as well as evolving concerns with the IRS Commissioner and the IRS Oversight Board.
Campus	The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

¹ 31 U.S.C. § 5311 *et seq.*



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Term	Definition for the Purpose of This Review
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Integrated Data Retrieval System	IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.
Internal Revenue Code	Title 26 of the U.S.C. enacted by Congress containing all relevant legislation pertaining to Federal tax law.
Internal Revenue Manual	The IRS's primary official source of instructions to staff related to the administration and operations of the IRS.
Tax Year	The 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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Appendix V

Management's Response to the Draft Report




COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

September 5, 2018

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Mary Beth Murphy 
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – The Internal Revenue Service Still Does Not
Make Effective Use of Currency Transaction Reports (TIGTA
Audit # 201730018)

Thank you for the opportunity to review the above subject draft audit report. Currency Transaction Reports (CTRs) were designed to assist with identification of financial crimes including money laundering. CTRs are filed by financial institutions when currency deposits or withdrawals exceed \$10,000 in a single transaction or a series of transactions in a single business day. CTR information can be useful in our pursuit to identify and correct tax noncompliance.

We do not agree with your assertion the IRS does not make effective use of CTRs. When unusual cash activity is identified during a Bank Secrecy Act (BSA) examination, our procedures instruct the BSA examiner to make a referral to the appropriate function. As your report notes, from October 2015 through January 2018, Field Examination closed nearly 3,000 returns and assessed approximately \$189.1 million from BSA referrals. We continue to utilize CTRs during the case building and examination phases for both filed and non-filed returns. Our Internal Revenue Manual (IRM) alerts examiners that CTRs may provide additional avenues to identify unreported income (for example, financial institutions where other deposits may be held). The Financial Crimes and Enforcement Network (FinCEN) maintains a database which allows access to query and analyze CTR reports by taxpayer identification number and year. Access to the database is limited to certain employees designated as super users. Upon request, these super users can provide our examiners with a listing of all cash transactions for a taxpayer in a specified timeframe.

Your report notes the CTR data limitations including the aggregation and posting of transactions involving multiple taxpayers and the challenges of filing dates versus transaction dates. It also discusses information return reporting that we use in our automated compliance programs. However, unlike with some other information return documents, we cannot make a tax assessment based solely on CTR information. The



*The Internal Revenue Service Still Does Not
Make Effective Use of Currency Transaction Reports*

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CTR should be used to supplement other data and assist the examiner during the income probe. Thus, we disagree there is an opportunity to use CTRs in a systemic manner. However, we do have plans to incorporate CTR information during the selection of non-filer cases.

We also plan to formalize our procedures for making referrals from the BSA Program to other functions and will track the number of days to process a referral, consistent with your recommendations. However, there is an inherent time lapse when referrals are made from the BSA Program to other functions because the BSA Program is examining the current year while other functions are examining previous tax years. Other functions in the IRS generally do not examine a referral until the taxpayer has filed a tax return or is delinquent for the tax year on which the referral is based. For example, if a BSA Program referral is originated in April 2018 based upon April 2018 data, then this taxpayer may not file a tax return that would include this information until October 2019, which is over 500 days from when the referral was made.

Attached is a detailed response outlining our corrective actions to address your recommendations. If you have any questions, please contact me or Brenda Dial, Director, Examination Operations.

Attachment



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Attachment

RECOMMENDATION 1:

The Director, Examination, SB/SE Division, should establish formalized procedures for processing BSA Program referrals and begin formally tracking the time required to send referrals to the Field Exam Support Team.

CORRECTIVE ACTION:

We agree with your recommendation. We will update the IRM to formalize the procedures for processing BSA Program referrals and to track the days for the BSA Program to process the BSA Program referrals.

IMPLEMENTATION DATE:

December 15, 2019

RESPONSIBLE OFFICIAL:

Director, Examination Case Selection, Small Business/Self Employed Division

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:

The Director, Examination, SB/SE Division, should clarify formal IRM procedures to assist examiners in their consideration of CTR data in examinations.

CORRECTIVE ACTION:

We agree with your recommendation. We will update the IRM to clarify actions field examiners should take to analyze CTR data during an audit.

IMPLEMENTATION DATE:

October 15, 2019

RESPONSIBLE OFFICIAL:

Director, Examination Field and Campus Policy, Small Business/Self Employed Division

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.