TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Improvements to the Nonfiler Program Could Help the Internal Revenue Service More Effectively Address Additional Nonfilers Owing Billions of Dollars in Taxes

September 23, 2016

Reference Number: 2016-30-085

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HIGHLIGHTS

IMPROVEMENTS TO THE NONFILER PROGRAM COULD HELP THE INTERNAL REVENUE SERVICE MORE EFFECTIVELY ADDRESS ADDITIONAL NONFILERS OWING BILLIONS OF DOLLARS IN TAXES

Highlights

Final Report issued on September 23, 2016

Highlights of Reference Number: 2016-30-085 to the Internal Revenue Service Commissioner for Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Individual taxpayers with income above a certain threshold are generally required to file a tax return with the IRS by April 15 of each calendar year. However, taxpayers may request an extension of time to file, which is typically six months. The IRS will attempt to identify and notify taxpayers who do not timely file a tax return by the extended due date. The IRS typically issues delinquency notices to more than 640,000 nonfilers with expired extensions annually.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether IRS controls effectively identify and address delinquent individual taxpayers with expired extensions of time to file.

WHAT TIGTA FOUND

The IRS has implemented a strategy under the Case Creation Nonfiler Identification Process to identify taxpayers who have not filed a tax return, including taxpayers with expired extensions, on an annual basis. Although it is mostly an automated process, the vast majority of nonfilers with expired extensions were not identified or addressed in Tax Year 2012 due to a programming error that was not fully investigated or timely corrected. Additionally, in Tax Year 2013, IRS management canceled this process for all taxpayers with expired extensions. As the nonfiler process is run on a stand-alone basis for each tax year, the majority of the nonfilers with expired extensions in Tax Years 2012 and 2013 will likely never be notified of their obligation and failure to file a tax return. The IRS identified high-income nonfilers as both a high compliance risk and one of the top eight high-priority areas in the annual work plan, but none of the high-income nonfilers with expired extensions were notified of their delinquency in Tax Years 2012 or 2013.

In February 2014, the IRS revised its nonfiler strategy and outlined goals to increase compliance. However, as of July 2016, the IRS has not implemented any of the proposed nonfiler initiatives. Furthermore, the nonfiler strategy did not outline any specific actions to improve the compliance rate, including how to reach more of the nonfilers the IRS identifies annually and determining the effectiveness of the return delinquency notice in an effort to increase the response rate.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS change various Collection function and information technology controls, tools, and procedures to improve the nonfiler program and ensure that additional nonfilers are addressed. In response to the report, IRS management agreed with our recommendations and plans to take corrective actions.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 23, 2016

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

Michael E McKenney

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Improvements to the Nonfiler Program Could Help the Internal Revenue Service More Effectively Address Additional Nonfilers Owing Billions of Dollars in Taxes (Audit # 201530037)

This report presents the results of our review to determine whether Internal Revenue Service (IRS) controls effectively identify and address delinquent individual taxpayers with expired extensions of time to file. This review is included in our Fiscal Year 2016 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 VI.

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

CCNIP	Case Creation Nonfiler Identification Process
CDW	Compliance Data Warehouse
FY	Fiscal Year
HINF	High-Income Nonfiler
IRS	Internal Revenue Service
IT	Information Technology
NIA	Nonfiler Inventory and Analysis
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year

Background

Although the Internal Revenue Service (IRS) collected more than $3.3 trillion in Fiscal Year (FY) 2015, there is a $458 billion estimated Tax Gap (*i.e.*, an IRS measurement of the extent to which taxpayers do not file their tax returns and pay the correct tax on time).[1] Approximately $26 billion (6 percent) of the $458 billion is due to individual taxpayers who do not file a tax return or timely pay the associated tax due on such delinquent returns (hereafter referred to as nonfilers).[2]

Third-party information reporting is used by the IRS to identify nonfilers with earned income. Specifically, the IRS identifies nonfilers who receive income from an employer or business as reflected on information returns such as Form W-2, *Wage and Tax Statement*, and Form 1099-Misc, *Miscellaneous Income*. The income reported on such forms indicates whether the taxpayer should have filed a tax return. For example, starting in Tax Year (TY) 2011, stock brokers and mutual fund companies are now required to report adjusted basis and whether any gain or loss on a sale is classified as short-term or long-term on Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*. The information reported on Form 1099-B is reported to both the taxpayer and the IRS, which assists the taxpayer with properly reporting gains and losses as well as alerts the IRS that the taxpayer may be required to report such gains and losses on a properly filed tax return.

In addition to third-party reporting, the IRS identifies nonfilers by analyzing taxpayers' prior year filing history with current year data. For instance, the IRS attempts to identify nonfilers who filed in a prior year but failed to file a tax return for the current tax year. Sections (§§) 6012 and 6072 of the Internal Revenue Code generally require individuals with income over a certain threshold amount to file an income tax return by April 15 of each calendar year. However, Internal Revenue Code § 6081 grants individuals the option to request an extension of time to file a tax return, not to exceed six months from the original filing due date.[3]

To identify potential nonfilers with and without extensions of time to file, the IRS established the Nonfiler Inventory and Analysis (NIA) group, which is part of the Collection function in the Small Business/Self-Employed Division. The NIA group analyzes available data twice a year to

[1] See Appendix V for a glossary of terms.
[2] The Tax Gap and the individual nonfiling gap are the most recent estimates prepared by the IRS, *Tax Gap Estimates for Tax Years 2008–2010* (Apr. 2016).
[3] To request an extension for most situations, a taxpayer must file Form 4868, *Application for Automatic Extension of Time to File U.S. Individual Income Tax Return*, by the original due date. Form 4868 extends the time to file an individual tax return, but it does not extend the time to pay the estimated net tax due; interest will start accruing after the original due date of the return if payment is not made prior to such time.

identify and address nonfilers.[4] The analysis performed by the NIA group is referred to as the Case Creation Nonfiler Identification Process (CCNIP).[5] The CCNIP examines each tax year on a stand-alone basis (*i.e.*, the process is performed two times a year for each tax year, but it only includes data from the applicable tax year being reviewed). Once the nonfilers are identified, the IRS categorizes the cases based on a number of characteristics, such as the amount of third-party reported income, withholding data, and estimated net tax due, and assigns each case a selection code that is used to prioritize the CCNIP inventory (*i.e.*, the population of cases that show a potential for securing a tax return).

The CCNIP typically identifies more than 7 million nonfilers annually; however, it is possible that a taxpayer will file a tax return after the nonfiler cases are initially identified, whereby the nonfiler case will be updated to reflect the subsequent filing and will be excluded from further processing.[6] The remaining nonfiler cases comprise the CCNIP inventory. The Collection function will determine the number of nonfiler cases from the CCNIP inventory that will be selected for delinquency notification depending on available resources. These cases will be issued the first delinquent return notice, Computer Paragraph 59, *First Notice – Return Delinquency* (hereafter referred to as "notice").[7] Cases that the IRS considers to be either more of a compliance risk or more likely to result in a secured tax return receive the highest priority. For example, if a taxpayer meets a certain income threshold and has not filed a tax return by the due date, the taxpayer will be deemed high priority as a high-income nonfiler (HINF). According to IRS procedures, HINF cases present a high compliance risk and should typically be selected for review and issued a notice.

While the CCNIP is designed to identify and address potential individual nonfilers, the IRS has an additional administrative process to identify nonfilers who are also current IRS employees. Specifically, the IRS's Employee Conduct and Compliance Office performs an analysis separate from the CCNIP to identify nonfilers (with and without extensions of time to file) who are IRS

[4] Although the NIA group uses available data to identify nonfilers, such as information obtained from third-party reporting and tax returns filed in prior years, there are various reasons why a taxpayer may not be required to file a tax return (for example, a taxpayer whose income is below the minimum filing requirement). It is important to note that while there may be an indication that a tax return is due, the nonfilers identified by the CCNIP are potential nonfilers, and all references made to nonfilers in this report should be interpreted as such.
[5] The IRS designed a separate process for individual nonfilers (*i.e.*, Individual Master File CCNIP) as well as business nonfilers (*i.e.*, Business Master File CCNIP). Our review focused only on the Individual Master File CCNIP, and all data contained herein pertains only to individual taxpayers.
[6] Other circumstances may result in a nonfiler case that was initially included in the inventory being excluded from further processing. In general, if a nonfiler has paid the tax balance due, that nonfiler will not be pursued via the CCNIP. If a taxpayer has filed a tax return but still owes taxes, the case would be considered a balance due delinquency, which is not part of the CCNIP.
[7] Although we obtained information regarding the criteria for prioritizing and selecting cases, we did not test the effectiveness of the criteria during our review. IRS officials informed us that the same criteria have been in effect for more than 20 years.

employees. The IRS employees identified are placed into the Automated Labor and Employee Relations Tracking System, the IRS's labor and employee relations tracking tool, for further review and possible disciplinary action.

This review was performed with information obtained from the IRS Small Business/ Self-Employed Division Headquarters and Information Technology organization facilities in New Carrollton, Maryland, and the IRS Human Capital Office's Workforce Relations Division Employee Conduct and Compliance Office in Washington, D.C., during the period July 2015 through June 2016. 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.

Results of Review

Although the IRS has developed procedures for identifying nonfilers, the IRS failed to identify and address approximately 1.9 million TYs 2012 and 2013 nonfilers with expired extensions due to system programming errors, managerial decisions, and resource constraints. In addition, improvements to the return delinquency notice and monitoring of call site activities may provide opportunities to address more nonfilers. We believe that the IRS can take additional steps to better ensure that nonfilers with and without expired extensions are addressed to help protect revenue for the Department of the Treasury as well as ensure that there is fair and consistent treatment among taxpayers.

Our review of the Employee Conduct and Compliance Office process found that all IRS employees whom we identified as nonfilers for TYs 2010 through 2013 were properly identified and accounted for in the IRS's tracking system. We did not evaluate the IRS's controls for disciplining IRS employees who fail to file their tax returns because those controls were reviewed during a FY 2015 Treasury Inspector General for Tax Administration (TIGTA) audit.[8]

Programming Errors, Managerial Decisions, and Resource Constraints Prevented Nonfilers With Expired Extensions From Being Addressed

The IRS failed to identify and address a total of approximately 1.9 million TY 2012 and TY 2013 (770,749 for TY 2012 and 1.1 million for TY 2013) potential nonfilers with expired extensions.[9] Specifically, programming errors and subsequent IRS management decisions, as well as resource constraints, resulted in millions of potential nonfilers with expired extensions not being notified of their obligation and failure to file a tax return and pay the associated tax balance, resulting in a significant decrease in taxes collected to date for TYs 2012 and 2013. As shown in Figure 1 below, collections related to the nonfiler program were $433 million and $240 million for TYs 2012 and 2013, respectively, compared to an average of $3.9 billion annually for TYs 2010 and 2011. Since the NIA group completes the CCNIP on a stand-alone basis for each tax year, these 1.9 million TYs 2012 and 2013 potential nonfilers with expired

[8] TIGTA, Ref. No. 2015-10-002, *Review of the Internal Revenue Service's Process to Address Violations of Tax Law by Its Own Employees* (Apr. 2015).

[9] The 1.1 million potential nonfilers not addressed in TY 2013 is the actual number of nonfiler cases with expired extensions identified by the CCNIP as meeting the parameters to be included in the CCNIP inventory but not issued a notice. The 770,749 nonfilers not identified or addressed in TY 2012 is an estimate that was calculated using the average number of nonfilers with extensions in the inventory for TYs 2010 and 2011 (770,818) less the actual number of TY 2012 nonfilers with extensions that were identified (69).

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extensions will not be included in any subsequent nonfiler analysis and will therefore not be notified of their obligation and failure to file a tax return via the CCNIP.

Figure 1: TYs 2010 Through 2013 Summary of Nonfiler Results (as of May 2016)

Tax Year	Potential Cases Identified	Cases in Nonfiler Inventory	Cases Issued a Notice	Tax Returns Filed After Notice Issued	Tax Dollars Collected From Nonfilers Issued a Notice	Variance in Tax Dollars (From TY 2010–2011 Average)
2010	7,427,550	3,524,816	2,214,922	1,054,666	$ 4,250,773,224	N/A
2011	7,504,808	3,296,337	2,000,316	838,993	$ 3,616,757,718	N/A
2012	5,954,485	2,498,769	1,574,316	447,163	$ 433,147,979	-89%
2013	7,668,368	4,349,548	1,156,956	288,669	$ 240,368,419	-94%
Average, 2010–2011	***7,466,179***	**3,410,577**	**2,107,619**	***946,830***	***$ 3,933,765,471***	**N/A**

Source: TIGTA analysis of nonfiler data and other filing information obtained from the IRS's Compliance Data Warehouse (CDW).

Nonfiler programming errors were not timely resolved, preventing a significant number of TY 2012 nonfilers with expired extensions from being addressed

Each year, prior to initiating the CCNIP, program users submit change requests to IRS Information Technology (IT) organization programmers to update the system programming for mandatory tax law changes, such as changes to tax tables, as well as other discretionary modifications such as changes to the selection codes used to prioritize the cases. Although the IRS has designed and implemented several layers of controls for testing the accuracy of system programming changes for the CCNIP, we found that those controls did not effectively or timely identify and address errors resulting from programming changes, which primarily affected those nonfilers with expired extensions. Specifically, in March 2013, the IRS made a programming change for the TY 2012 CCNIP as a result of a programming change to the Individual Master File involving the formatting of data to be used later by the CCNIP for nonfiler analysis. Although IRS documentation showed that the programming change was tested and appeared to be working as intended, this change caused the CCNIP to inappropriately exclude records.

We analyzed historical data that was available to the IRS (*i.e.*, IT programmers and the NIA group) during testing of the TY 2012 CCNIP inventory and found that the number of nonfilers identified decreased significantly, from approximately 7.5 million cases in TY 2011 to 6 million cases in TY 2012, as shown in Figure 1. As the total inventory decreased by approximately 1.5 million cases (or a 21 percent decrease) from the previous year, we believe that the IRS should have realized there was a potential problem with the CCNIP for TY 2012. It is important to note that while there were several select code categories that had significant drops in record counts, there was one common theme, which involved taxpayers who had expired extensions. Specifically, the number of nonfilers with expired extensions included in the CCNIP inventory decreased significantly, from an average of 770,818 cases in the two prior years to just 69 cases in TY 2012, as shown in Figure 2. IRS officials informed us that, prior to processing the nonfiler cases, they performed a similar comparison of TY 2012 CCNIP counts to historical counts as required in the CCNIP procedure manual. However, their comparison only looked at records without expired extensions (*i.e.*, they limited the analysis to only include nonfiler cases without an approved extension to file a tax return), so the significant decrease in the CCNIP case counts involving nonfilers with expired extensions was not detected in their analysis.

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Figure 2: TYs 2010 Through 2012 Collections for Nonfilers With and Without Expired Extensions (as of May 2016)

Tax Year	Cases in Nonfiler Inventory	Cases Issued a Notice	Tax Returns Filed by Nonfilers Issued a Notice (in total and as a percentage of cases issued a notice)		Tax Dollars Collected From Nonfilers Issued a Notice (in total and per tax return filed)[10]	
***With* Expired Extensions**						
2010	775,085	652,003	408,541	63%	$ 3.2 billion	$ 7,813
2011	766,551	632,024	355,134	56%	$ 2.9 billion	$ 8,230
2012	69	0	0	0%	$ 0	$ 0
Average, 2010–2011	***770,818***	***642,014***	***381,838***	***59%***	***$ 3.1 billion***	***$ 8,007***
***Without* Expired Extensions**						
2010	2,749,731	1,562,919	646,125	41%	$ 1.1 billion	$ 1,639
2011	2,529,786	1,368,292	483,859	35%	$ 694 million	$ 1,434
2012	2,498,700	1,574,316	447,163	28%	$ 433 million	$ 969
Average,[11] 2010–2011	***2,639,759***	***1,465,606***	***564,992***	***39%***	***$ 876 million***	***$ 1,551***

Source: TIGTA analysis of nonfiler data and other filing information obtained from the IRS's CDW.

Although the IRS was unable to determine the reason that the programming error primarily affected nonfilers with expired extensions (since the cases that were excluded are not saved in the historical records), TIGTA believes, and the IRS agreed, that it is because the nonfiler records with expired extensions have a longer string of characters in certain data fields and the programming change did not account for this.

[10] Tax dollars collected per tax return filed may not compute due to rounding.
[11] Average tax dollars collected from nonfilers issued a notice may not compute due to rounding.

Although the NIA group and the IRS IT programmers documented the tests performed for the TY 2012 CCNIP, as required by IRS procedures, we did not find evidence to support that the IRS identified the significant decrease to nonfilers with expired extensions during its testing. Specifically, the documentation provided by the IRS showed there were no discrepancies noted during testing. However, since the programmer did not specify what the CCNIP case counts were before or after the change was made, the scope of the problem was not likely known by the programmer at that time. In addition, documentation of the testing performed by the NIA group specifically excluded nonfiler cases with expired extensions, so the scope of the problem may not have been evident to the CCNIP users either. Despite the lack of detailed documentation, IRS officials said that the IT programmers identified the anomalies in the counts during their testing but did not have the time or resources needed to perform sufficient analysis to determine the source and scope of the issue. According to IRS officials, researching the suspected anomalies identified in the TY 2012 CCNIP would have been a time-intensive project, and resources were not available for such, especially because the testing occurred around the same time the vast majority of the Federal Government was shut down as a result of the FY 2013 furlough. While we understand the ongoing resource constraints, the anomalies identified for TY 2012 were significant, and we believe that further research was warranted.

It was not until January 2015, almost two years after the programming change was made to the system for the CCNIP, that the IRS addressed the reason for the anomalies. Specifically, according to the IRS, the programming changes implemented for TY 2012 were applicable for all tax years going forward; therefore, the changes also resulted in anomalies for the record counts in TY 2013. The difference between TY 2012 and TY 2013 nonfiler processing was that the IT programmers fully investigated the anomalies identified during the CCNIP for TY 2013 and realized that the TY 2012 programming changes were the cause of the anomalies. Because the issue was identified before the completion of the TY 2013 CCNIP, the IRS was able to revise the system programming prior to compiling the TY 2013 CCNIP inventory and thus was able to appropriately identify those nonfilers with expired extensions.

Neither the IRS nor TIGTA knows the exact number of TY 2012 nonfilers with extensions that were affected by this programming error; and the IRS did not perform any analyses to measure the impact that the programming error had on potential tax revenue. As shown in Figure 2, of those nonfiler cases included in the CCNIP inventory, the IRS notified an average of 642,014 nonfilers with expired extensions in TYs 2010 and 2011. Of the nonfilers notified, those with expired extensions had a higher filing rate and higher tax dollars collected per return than those nonfilers without extensions. Specifically, as shown in Figure 2 for TYs 2010 and 2011, an average of 59 percent of those cases with expired extensions filed a return after being notified compared to only 39 percent for those nonfilers without extensions. In addition to a higher filing rate, collections for nonfilers with expired extensions are also higher than those nonfilers without extensions. Figure 2 shows that, on average for TYs 2010 and 2011, the tax dollars collected per tax return filed after a notice was issued was $8,007 for a case with an expired extension compared to only $1,551 for a case without an extension.

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IRS officials agreed with our finding that, in addition to the significant number of nonfiler cases with expired extensions excluded from processing, those cases that were in the TY 2012 CCNIP inventory were not as productive as cases in prior years because many of the higher-priority cases (*e.g.*, HINF cases) were nonfilers with expired extensions. As a result, the IRS collected less tax dollars per case than for previous tax years. For example, the average amount collected per case from those nonfilers receiving a notice dropped 78 percent, from $4,311 in TY 2011 to $969 in TY 2012, as shown in Figure 3.

Figure 3: TYs 2010 Through 2012 Filing Rate Comparison of Nonfilers Notified Versus Nonfilers Not Notified (as of May 2016)

Tax Year	Nonfiler Inventory	Tax Returns Filed (in total and as a percentage of the total inventory)		Tax Dollars Collected for Filed Tax Returns[12]	Tax Dollars Collected Per Tax Return Filed[13]	Unfiled Tax Returns (in total and as a percentage of the total inventory)	
Notified							
2010	2,214,922	1,054,666	48%	$ 4.3 billion	$ 4,030	1,160,256	52%
2011	2,000,316	838,993	42%	$ 3.6 billion	$ 4,311	1,161,323	58%
2012	1,574,316	447,163	28%	$ 433 million	$ 969	1,127,153	72%
Average, 2010–2011	***2,107,619***	***946,830***	***45%***	***$ 3.9 billion***	***$ 4,155***	***1,160,790***	**55%**
Not Notified							
2010	1,309,894	377,819	29%	$ 384 million	$ 1,017	932,075	71%
2011	1,296,021	313,395	24%	$ 210 million	$ 671	982,626	76%
2012	924,453	167,042	18%	$ 70 million	$ 420	757,413	82%
Average, 2010–2011	***1,302,958***	***345,607***	***27%***	***$ 297 million***	***$ 860***	***957,351***	**73%**

Source: TIGTA analysis of nonfiler data and other filing information obtained from the IRS's CDW.

This significant decrease is likely because half of the HINF cases had expired extensions. For example, as shown in Figure 4 for TYs 2010 and 2011, there was an average of 314,066 HINFs in the CCNIP inventory and, of those, 144,125 (46 percent) nonfilers had expired extensions. Given that the CCNIP erroneously excluded the vast majority of TY 2012 nonfilers with expired extensions, approximately half of the HINFs were not identified or addressed. As a result of not addressing the estimated 142,111 TY 2012 HINFs with expired extensions that typically would

[12] Average 2010–2011 Tax dollars collected for filed tax returns may not compute due to rounding.
[13] Tax dollars collected per tax return filed may not compute due to rounding.

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have been issued a notice, approximately $2.1 billion in tax revenue may not be collected unless these HINFs subsequently filed a TY 2012 tax return on their own accord.[14]

Figure 4: TYs 2010 Through 2012 Number of Notices Issued to and Tax Dollars Collected From High-Income Nonfilers With Expired Extensions (as of May 2016)

Tax Year	HINF Cases	HINF Expired Extension Inventory	Percentage of HINF Cases With Extensions	HINFs With Expired Extensions Issued a Notice	Tax Returns Filed by HINFs with Extensions Issued a Notice	Filing Rate of HINF Extension Cases Issued a Notice	Tax Dollars Collected From HINFs With Expired Extensions Issued a Notice
2010	305,843	141,738	46%	139,353	103,919	75%	$ 2.1 billion
2011	322,289	146,512	45%	144,869	99,637	69%	$ 2.1 billion
2012	165,435	17	0%	0	0	0%	$ 0
Average, 2010–2011	**314,066**	**144,125**	**46%**	**142,111**	**101,778**	**72%**	**$ 2.1 billion**

Source: TIGTA analysis of nonfiler data and other filing information obtained from the IRS's CDW.

IRS officials explained that it would be extremely difficult and cumbersome to reprogram the CCNIP system for TY 2012 to identify the excluded HINF cases because the IRS would need to modify the system for the TY 2012 tax calculations and the IRS is already in the process of analyzing nonfilers for TY 2014, which involves different tax calculations. ******2*********
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**********************************2**
*******2********.[15]

While the IRS subsequently took appropriate actions to correct the programming errors, quality control procedures have not been formally updated to require the IRS to (1) conduct additional analysis, when needed, to determine the scope and source of any anomalies identified and (2) address any potential issues prior to finalizing the CCNIP for each respective tax year. We believe such controls are needed to ensure that future programming errors are caught in a timely manner. Also, if resource constraints prevent the IRS from fully addressing an identified error, it

[14] The estimated number of TY 2012 HINF cases with expired extensions that were not addressed, as well as the approximate amount of uncollected tax, was calculated based on TY 2010 and 2011 averages, as shown in Figure 4.
[15] The estimated number of expired extensions cases for TY 2012 was calculated based on the average number of nonfilers included in the CCNIP inventory in TYs 2010 and 2011 (770,818 cases, as shown in Figure 2) less the actual number of TY 2012 nonfilers with extensions that were identified (69 cases).

may be able to make a more informed decision regarding the impact the errors would likely have on potential tax revenue.

Nonfilers with expired extensions for Tax Year 2013 were not addressed due to managerial decisions and resource constraints

Although TY 2013 nonfilers were identified per the IRS's normal procedures, notices were not issued on a systematic basis to the nonfilers with expired extensions. The IRS performed the necessary procedures to identify the TY 2013 nonfilers with expired extensions; however, the IRS canceled the portion of the CCNIP that primarily addresses nonfilers with expired extensions due to resource constraints related to reduced staffing and the unavailability of overtime. Therefore, the IRS did not issue notices to approximately 1.1 million TY 2013 nonfilers with expired extensions that were included in the CCNIP inventory.

While we understand the resource constraints, a decision to not address any nonfilers with expired extensions is concerning, especially because IRS procedures require that notices be sent to certain nonfiler cases, regardless of the balance due, as such cases have historically been considered to be high compliance risk cases. Specifically, according to IRS procedures, HINFs, among other types of nonfilers, should be issued a notice. In addition, in FY 2015, the Collection function noted HINFs as one of the top eight high-priority areas in its annual work plan and the IRS's primary means of identifying and addressing HINF cases is through the CCNIP.[16]

During our review, IRS officials informed us that the Collection function deemed it a higher priority to address the increasing workload related to establishing installment agreements for taxpayers who had filed a return but failed to pay the entire amount of the taxes due rather than addressing the nonfilers.[17] Although the IRS process for notifying nonfilers is mostly automated, according to IRS officials, resource constraints related to answering taxpayer inquires often result in the IRS being unable to issue notices to all nonfilers. We believe that the IRS should have evaluated whether the shift of resources from working the TY 2013 nonfiler with expired extension inventory, including the HINF cases, was consistent with its stated priorities and was the best use of scarce resources in its overall goal to increase tax compliance. For instance, IRS management was unable to provide documentation supporting that they evaluated whether addressing HINFs with expired extensions has a history of generating more revenue than the installment agreement inventory that resources were reassigned to work. Analyzing such data can assist IRS officials when making decisions regarding resource allocations in the future.

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[16] FY 2015 covers the period October 2014 through September 2015—the period during which the TY 2013 CCNIP cases are worked.

[17] Balance due notices are issued to taxpayers who filed a tax return but failed to pay the entire balance due for the tax year. These taxpayers may request an installment agreement, which allows them to make monthly payments on their outstanding tax obligation if they owe less than $50,000 and have filed all required tax returns.

In addition to the HINF cases with expired extensions being historically more productive, it is important to note that the IRS had already identified and prioritized the 1.1 million TY 2013 nonfilers with expired extensions at the time of the cancelation of the TY 2013 CCNIP, so the inventory of cases was ready for the IRS to pursue. Although the IRS did not issue notices to any of these 1.1 million nonfilers, approximately 39 percent of them have subsequently filed a return and made tax payments totaling $6.2 billion. However, as of May 2016, there were still 670,000 nonfilers with expired extensions who had not filed a TY 2013 tax return, with an estimated tax obligation of $7.4 billion, as shown in Figure 5.

Figure 5: Estimated Tax Not Collected for TY 2013 Nonfilers (as of May 2016)[18]

TY 2013 Nonfiler Cases	All Nonfilers	Nonfilers With Expired Extensions (incl. HINF)	HINF Cases With Expired Extensions	Percentage of HINFs to Total Nonfilers
Cases in Inventory	4,350,000	1,105,000	244,000	6%
Tax Returns Subsequently Filed	1,232,000	435,000	117,000	9%
Tax Collected for Filed Tax Returns[19]	$ 7.1 billion	$ 6.2 billion	$ 5.0 billion	70%
Average Tax Collected per Tax Return[20]	$ 5,763	$ 14,253	$ 42,735	742%
Tax Returns Still Not Filed	3,117,000	670,000	127,000	4%
Estimated Tax Due for Unfiled Tax Returns[21]	$ 18.0 billion	$ 9.5 billion	$ 5.4 billion	30%
Payments Received for Unfiled Tax Returns[22]	$ 2.2 billion	$ 2.1 billion	$ 1.6 billion	73%
Estimated Tax Not Collected[23]	**$ 15.8 billion**	**$ 7.4 billion**	**$ 3.8 billion**	**24%**

Source: TIGTA analysis of nonfiler data and other filing information obtained from the IRS's CDW.

While the IRS may have not been capable of pursing all 1.1 million nonfiler cases with expired extensions, the NIA group had requested executive approval to work at least the 244,000 TY 2013 HINF cases, but the request was denied. Some of the taxpayers associated with the 244,000 HINFs with expired extensions filed their delinquent returns on their own accord; however, as of May 2016, there were still approximately 127,000 unfiled tax returns with estimated uncollected tax liabilities of approximately $3.8 billion, as shown in Figure 5.

[18] Numbers are rounded in thousands unless otherwise noted, and some numbers may not compute due to rounding.
[19] Includes estimated tax payments and credits made by nonfilers prior to a TY 2013 tax return being filed.
[20] Calculated using "Tax Collected for Filed Tax Returns" divided by "Tax Returns Subsequently Filed."
[21] Calculated using "Average Tax Collected per Tax Return" multiplied by "Tax Returns Still Not Filed."
[22] Includes estimated tax payments made by nonfilers who have not filed a tax return.
[23] Calculated using "Estimated Tax Due for Unfiled Tax Returns" less "Payments Received for Unfiled Tax Returns."

The IRS can process approximately 270,000 nonfiler notices each week and the average amount collected for a TY 2013 HINF with an expired extension was $42,735. We believe that, at a minimum, the IRS should have used its resources to work all 244,000 TY 2013 HINF cases because notices could have been issued to these nonfilers in a relatively short time period (approximately one to two weeks). Although approximately 1.2 million of the TY 2013 nonfilers with and without expired extensions identified by the CCNIP have subsequently filed a tax return, as of May 2016, there were still more than 3.1 million TY 2013 nonfilers who have not met their tax filing obligation, as shown in Figure 5. TIGTA estimated that these nonfilers owe approximately $15.8 billion in tax.

In addition to the significant loss of tax revenue, failing to pursue nonfiler cases with expired extensions results in inequitable treatment of taxpayers and potentially allows circumvention of the tax laws. Specifically, taxpayers are not being treated equitably if a taxpayer with an expired extension has less of a chance of entering the collection stream (*i.e.*, being issued a notice and possibly escalating to other collection channels) than a taxpayer who lacks a filing extension. The mission of the IRS is to provide top quality service by helping taxpayers understand and meet their tax responsibilities and to enforce the law with integrity and fairness to all. In an effort to balance many competing priorities, such as the collection of tax revenue, equitable treatment of nonfilers, and continued resource constraints, we believe that the IRS should pursue all HINFs with and without expired extensions each tax year. In fiscal years with considerable resource constraints, the IRS should ensure that the criteria used to select HINFs for delinquency notification is the same for cases with and without expired extensions and that resources are appropriately allocated to address both groups of nonfilers.

IRS management stated that no significant portion (including the portion related to identifying nonfilers with expired extensions) of the TY 2014 CCNIP, which was ongoing during our review, will be canceled despite the continued resource constraints and competing priorities. Instead, the IRS has plans to focus on the HINF taxpayers with and without expired extensions, among other high compliance risk cases, if resource constraints persist. However, it is important to note that the IRS has not formally documented this limited-scope CCNIP (*i.e.*, requiring that all high-risk cases with and without expired extensions be addressed prior to working on lower-risk cases when faced with considerable resource constraints) as a requirement in the IRS's standard operating procedures.[24]

[24] Currently, the CCNIP procedures outline several different scenarios for selecting the number of cases each year. However, it is not clear when a particular scenario should be implemented, except in one specific example related to the events of September 11, 2001, in which case no selections would be made.

Recommendations

The Small Business/Self-Employed Division's Director, Collection Inventory Delivery and Selection, should:

Recommendation 1: Work with the Director, Corporate Data in Information Technology Applications Development to develop and implement additional controls and procedures, such as defining expected record counts and documenting results, to ensure that programming revisions are adequately implemented and effective to properly identify delinquent taxpayers with and without extensions of time to file. In addition, ensure that identified anomalies are researched until resolved and that the details regarding the anomalies and the actions taken to resolve them are documented.

> ***Management's Response:*** The IRS agreed with this recommendation. A checklist will be developed detailing the expected record counts throughout the development cycle, for both the first and second inventory, to help detect any changes that are not compatible with existing code. The IRS will also ensure that proper research, coordination, and resolution documentation is done if any future anomalies are detected.

Recommendation 2: Implement additional controls over NIA group reviews of current year CCNIP counts compared to prior year counts, including managerial review of the results of the comparison and mandatory documentation of the review and approval for all variances over an established threshold.

> ***Management's Response:*** The IRS agreed with this recommendation. The existing process will be strengthened by formally documenting the fluctuations in inventory counts. If the count varies by more than the average variance over prior years, the NIA group will document the variance and initiate contact with IT for an explanation. The NIA program manager will formally document the review and elevate to management.

Recommendation 3: Determine and document which nonfiler cases are high-priority cases, including HINFs with and without expired extensions, that must be identified and addressed during the CCNIP in any given year. In fiscal years with considerable resource constraints, ensure that HINF cases with expired extensions are addressed in the same manner as HINF cases without expired extensions and that such cases are appropriately considered and allocated resources.

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS will determine and document which nonfiler cases are high priority, and the documentation will include selection criteria for high priority cases. The IRS will schedule selections of both HINFs with and without expired extensions, and distribute the fiscal year selection plan for appropriate leadership work plan consideration.

Recommendation 4: Analyze the population of TY 2013 HINFs with expired extensions identified as not having filed a tax return and notify those taxpayers of the requirement to file the TY2013 tax return. If resources do not allow for the notification of the entire population, document the analysis performed to determine the percentage or number of TY 2013 HINFs with expired extensions who should be notified.

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS will determine which TY 2013 HINF cases with expired extensions remain unaddressed by any Collection program. The IRS will also review the TY 2014 inventory to determine if any of the TY 2013 cases were addressed. Any remaining unaddressed cases will be investigated for possible methods of notification and the IRS will determine which cases merit contact, and the results of such analysis will be documented.
>
> IRS management did not agree with the original $3.8 billion outcome measure in our draft report. They asserted that there is no historical basis to establish that sending a notice will generate one hundred percent filing and payment compliance, and that the measure should include historical information on what proportion of taxpayers receiving notices actually file and pay their taxes with no further interaction with the IRS.
>
> ***Office of Audit Comment:*** The outcome measure was originally calculated at $3.8 billion. IRS officials reviewed and agreed with the methodology to determine this amount, however, they later suggested a reduction of the outcome was appropriate to account for the likelihood that not all of the unfiled returns would have resulted in tax collections. Although the IRS does not have historical data as to collection rates of unfiled returns given the age of these tax years (*i.e.*, four years for TY 2013), collection rates generally for HINFs are approximately 72 percent. Accordingly, we recalculated the outcome measure reducing the $3.8 billion to $2.7 billion.

Improvements to the Delinquency Notice and Monitoring of Call Site Activity May Provide Opportunities to Address More Nonfilers

Once the CCNIP identifies the population of nonfiler cases to pursue, the IRS uses additional system filters to analyze the characteristics of the nonfiler inventory and ranks the inventory from the most productive (*i.e.*, greater chance of securing a tax return) to least productive. The IRS ranks its nonfiler inventory so it can pursue the nonfiler cases that would most likely result in a secured tax return because the IRS has a limited amount of resources and is only able to work a portion of the inventory identified. Specifically, in prior years (without a CCNIP suspension or known programming issues) the IRS has issued notices to approximately 62 percent of the nonfilers included in the CCNIP inventory.[25] For those nonfilers who are

[25] As shown in Figure 1, the average number of notices issued for TYs 2010 and 2011 was 2.1 million, or 62 percent of the total 3.4 million nonfilers in the CCNIP inventory.

contacted by the IRS, the filing rate is favorable, averaging 45 percent for nonfilers who were issued a notice in TYs 2010 and 2011 compared to only 27 percent for nonfilers who filed a return without being issued a notice, as shown in Figure 3.

In an effort to improve taxpayer compliance, including promoting consistency in the nonfiler enforcement efforts and reviewing the treatment of repeat nonfilers, the IRS revised its nonfiler strategy in February 2014. Although the revised strategy outlined several goals, as of July 2016 none of the proposed nonfiler initiatives have been implemented due to continued resource constraints. In addition, we found that the strategy lacks specific action items on how the IRS intends to improve the nonfiler compliance rate, including determining how to reach more of the nonfilers the CCNIP identifies annually and the effectiveness of the notice in an effort to increase the response rate. IRS indicated that specific goals have not yet been set because the availability of resources is unknown at this time.

Since issuing notices to nonfilers is mostly an automated process, we believe that the program could be expanded to reach more of the nonfilers identified annually. Although the IRS agreed that issuing the notices was not labor intensive, IRS officials stated that the available resources could not handle the volume of calls expected as a result of issuing additional notices. However, the IRS has not performed, nor does it have plans to perform, any studies to measure the effectiveness of the notices, such as tracking trends at the call centers to identify whether nonfilers are calling about the notice received from the IRS and, if so, the reason for the nonfilers' inquiry. Without such studies, the IRS may be overlooking opportunities to reach additional nonfilers as well as improve the clarity of the notice, which in turn could improve the compliance rate and increase the tax revenue collected. We believe that the IRS should take steps to determine whether nonfilers are calling the IRS in response to receiving a notice and should track the reasons for the inquiries for use in improving the notice. Providing additional or clarifying information on either the notice itself or through an online resource may reduce the number of inquiries received by the IRS, thereby alleviating some of the workload for the call sites. This, in turn, would make it possible for the IRS to address more nonfilers by issuing more notices, which would likely result in an increase in the compliance rate of nonfilers.

Recommendations

The Small Business/Self-Employed Division's Director, Collection Inventory Delivery and Selection, should:

Recommendation 5: Develop a strategy for evaluating and improving the effectiveness of the delinquency notice, which may include tracking the reasons for taxpayer inquires at IRS call sites.

Management's Response: The IRS agreed with this recommendation. The IRS will develop a strategy using notice response data and notice effectiveness research results that addresses return delinquency notice effectiveness. A detailed evaluation of return delinquency notice metrics will be performed to define and determine notice effectiveness.

Recommendation 6: Revise the nonfiler strategy to include specific action items aimed at increasing the number of nonfilers who are contacted and the nonfiler response rate. Action items should focus on increasing automation and addressing areas of taxpayer confusion in an effort to limit any additional burden on current resources in the Compliance Services Collection Operations function.

Management's Response: The IRS agreed with this recommendation. The nonfiler strategy will be revised to include improving the effectiveness of nonfiler notices to reach more taxpayers who subsequently respond to such notices. IRS will use the results of the detailed evaluation of return delinquency notice metrics outlined in the response above to develop a strategy specific to return delinquency notice effectiveness, stratified by nonfiler priority. IRS will ensure that the strategy aligns with current initiatives and goals.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether IRS controls effectively identify and address delinquent individual taxpayers with expired extensions of time to file.[1] To meet this objective, we performed the following subobjectives and tests:

I. Determined the applicable policies, procedures, and controls related to identifying and addressing all nonfilers (including IRS employees) with expired extensions.

   A. Reviewed and documented applicable sections within the Internal Revenue Manual.

   B. Conducted a walk-through of the CCNIP.

   C. Interviewed IRS management and employees.

   D. Evaluated any ongoing efforts related to improving the nonfiler strategy and process.

II. Determined if controls were effective in ensuring that nonfilers with expired extensions are being identified by the CCNIP for potential selection and delinquency notification.

   A. Obtained and analyzed data from the CDW to verify the number of potential nonfilers with expired extensions identified by the IRS for TYs 2010 through 2013.

   B. Developed a data methodology plan to document our understanding and approach for analyzing the data and shared this plan with IRS officials to obtain their concurrence.

   C. Assessed the reliability of the nonfiler data obtained from the CDW.

      1. Validated a judgmental sample of applicable data elements extracted from the CDW to the Integrated Data Retrieval System. [2]

      2. Discussed the data with knowledgeable agency officials.

      3. Determined that the data were sufficiently reliable for purposes of this report.

III. Determined whether IRS controls effectively monitored programming changes to the CCNIP to ensure that those taxpayers who were identified as nonfilers were properly evaluated for subsequent processing.

   A. Interviewed IRS officials, including IT organization programmers, who have knowledge of the processes and procedures related to CCNIP programming changes.

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[1] See Appendix V for a glossary of terms.

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

B. Discussed the programming changes implemented for TY 2012 and the testing that was performed prior to the programming implementation.

C. Determined if the programming change had an effect on cases with expired extensions by analyzing the data obtained in Subobjective II in the TY 2012 CCNIP file to determine the number of nonfilers with expired extensions and comparing these data to historical data.

IV. Determined whether controls are in place to ensure that the IRS is effectively prioritizing its inventory of nonfilers and capturing those HINFs with extensions when faced with resource constraints.

A. Reviewed the changes implemented by the Collection function in FY 2015 that affected the normal CCNIP cycle.

B. Determined if it would be beneficial for the IRS to implement a limited-scope process to identify and pursue delinquent taxpayers with high income when resources are seriously constrained.

1. Used the nonfiler data extracted from the CDW in Subobjective II, along with subsequent filing data for those nonfilers identified, to determine the number of nonfilers who were issued a notice, those who subsequently filed a tax return, and the total tax dollars collected from each nonfiler case.

2. Assessed the reliability of the nonfiler data obtained from the CDW by validating a judgmental sample of nonfiler cases to data in the Integrated Data Retrieval System and found that the data were sufficiently reliable for purposes of this report.

V. Determined whether all delinquent IRS employees with expired extensions were appropriately identified and considered for disciplinary action.

A. Obtained and analyzed available data from TIGTA's Data Center Warehouse to identify the IRS employees with expired extensions for TYs 2010 through 2013 and comparing the results to the IRS Automated Labor and Employee Relations Tracking System data to determine if those delinquent IRS employees were identified.

B. Assessed the reliability of the data obtained from the Data Center Warehouse by validating a judgmental sample of applicable data elements to the Integrated Data Retrieval System.

VI. Determined the effectiveness of the first delinquent return notice (*i.e.*, Computer Paragraph 59, *First Notice–Return Delinquency)* in addressing nonfilers.

A. Researched applicable IRS policies and procedures related to the issuance of delinquency notices.

B. Used the nonfiler data extracted in Subobjective II, along with subsequent filing data obtained in Subobjective IV, to analyze the filing trends of nonfilers who were and were not issued a delinquency notice and determined the percentage of nonfilers who subsequently filed a tax return, stratified by those who were and were not issued a notice, as well as the total amount of tax collected.

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 identifying and addressing delinquent taxpayers with expired extensions of time to file. We evaluated these controls by interviewing management, reviewing source materials, and analyzing taxpayer data. While the scope of this review was focused on internal controls related to individual nonfilers with expired extensions, we reviewed the policies, procedures, and controls in effect for all individual nonfilers (including those nonfilers without extensions of time to file), but we did not evaluate the nonfiler program in its entirety.

Appendix II

Major Contributors to This Report

Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Glen Rhoades, Director
Michelle Philpott, Audit Manager
Tram Le, Acting Audit Manager
Julia Woods, Lead Auditor

Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Services and Enforcement
Chief Information Officer
Human Capital Officer
Associate Chief Information Officer, Applications Development
Director, Collection, Small Business/Self-Employed Division
Director, Campus Collection, Small Business/Self-Employed Division
Director, Corporate Data
Director, Headquarters Collection, Small Business/Self-Employed Division
Director, Collection Inventory Delivery and Selection, Small Business/Self-Employed Division
Director, Research, Applied Analytics and Statistics
Director, Workforce Relations Division
Director, Office of Audit Coordination

Appendix IV

Outcome Measure

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $2.7 billion in additional tax revenue by addressing the 127,000 TY 2013 HINFs with expired extensions who did not voluntarily file a tax return or submit full payment of the estimated tax liability (see page 4).

Methodology Used to Measure the Reported Benefit:

We analyzed nonfiler data obtained from the IRS's CDW and documented our analysis, which was reviewed and approved by IRS officials. We determined that the CCNIP identified approximately 7.7 million potential nonfilers in TY 2013.

We performed additional analysis to determine the number of notices issued to nonfilers, as well as the number of tax returns filed and tax dollars collected, by matching the Taxpayer Identification Numbers of nonfilers listed in the TY 2013 CCNIP file to notification and filing data extracted from the CDW and documented the results of our analysis, which was reviewed and approved by IRS officials. For TY 2013, we identified approximately 1.1 million nonfilers with expired extensions and determined that ***none of these cases were issued a notice***. Of the approximately 1.1 million nonfilers with expired extensions, we determined that approximately 244,000 of these nonfilers were HINFs with expired extensions.

Using the filing data extracted from the IRS's CDW, we determined that as of May 2016, approximately 117,000 HINFs with expired extensions subsequently filed a tax return and paid taxes of $5 billion (an average amount collected per return of $42,735 ($5 billion divided by 117,000)). We determined that there were still approximately 127,000 HINFs with expired extensions who were not issued a delinquency notice and still had not filed a TY 2013 tax return as of May 2016.

Using the previously determined average of $42,735 collected per return filed by HINFs with expired extensions, we estimate that the remaining 127,000 HINFs with expired extensions owe approximately $5.4 billion (127,000 HINFs multiplied by $42,735). As of May 2016, the IRS collected approximately $1.6 billion of this $5.4 billion, primarily due to estimated tax payments received, leaving approximately $3.8 billion ($5.4 billion less $1.6 billion) uncollected.

Although we estimated an uncollected tax balance of $3.8 billion for the 127,000 HINFs with expired extensions, it is unlikely that the IRS would be able to collect on the entire balance by issuing return delinquency notices, especially since two years have passed since the typical notification period. To account for this, we used the TYs 2010 and 2011 historical filing average of 72 percent for HINFs with expired extensions, as shown in Figure 4, to estimate the number of such nonfilers that we would expect to file a tax return after being issued a notice. If the IRS were to issue notices to all 127,000 TY 2013 HINFs with expired extensions, we estimate that approximately 91,440 may subsequently file a tax return (127,000 HINFs multiplied by 72 percent).

Using the previously calculated average of $42,735 collected per return filed by HINFs with expired extensions, this results in approximately $3.9 billion of potential tax revenue (91,440 HINFs with expired extensions multiplied by $42,735). However, this number does not take into account any prepayments made by the HINFs with expired extensions to the IRS. Using the total amount of $1.6 billion collected by the IRS through prepayments made by the 127,000 HINFs with expired extensions, we prorated this amount for the portion of such nonfilers that we would expect to file (91,440 of the 127,000), which results in approximately $1.2 billion in prepayments (72 percent multiplied by $1.6 billion).[1]

We then reduced the $3.9 billion estimate of potential tax revenue by the $1.2 billion of estimated tax prepayments associated with the population of 91,440 HINFs with expired extensions reasonably expected to file a tax return after being issued a notice. We estimated that this may generated $2.7 billion of additional tax revenue ($3.9 billion potential tax revenue less $1.2 billion prorated amount collected).

[1] The actual amount of prepayments calculated is $1.152 billion. However, this amount was rounded to $1.2 billion to produce a more conservative outcome measure in the next calculation.

Appendix V

Glossary of Terms

Term	Definition
Automated Labor and Employee Relations Tracking System	The IRS's labor and employee relations management information system. This system allows the IRS to track conduct issues and disciplinary actions identified for all IRS employees.
Case Creation Nonfiler Identification Process (CCNIP)	A program that identifies individual nonfilers by using Individual Master File and Information Returns Masterfile data to determine if certain criteria are met for a specific tax year. Once the nonfiler cases are identified, the program also categorizes the cases and assigns selection codes.
Computer Paragraph	Computer-generated notices and letters of inquiry that are mailed to taxpayers in connection with tax returns. Computer paragraph numbers are located in the upper right corner of the notices and letters.
Compliance Data Warehouse (CDW)	An IRS repository of compliance, filing, and related databases that are used to support projects, analyses, and studies related to tax administration.
Data Center Warehouse	A collection of IRS databases containing various types of taxpayer account information that is maintained by TIGTA for the purpose of analyzing data for ongoing audits.
Expired Extension	An extension of time to file an individual tax return has exceeded the extension due date to file the tax return.
Fiscal Year (FY)	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.
High-Income Nonfiler	A nonfiler with total income above a threshold established by the IRS.
Individual Master File	An IRS computer system that stores transactions or records of individual tax accounts.

Information Returns Master File	An IRS computer system that stores income and withholding data reported to the IRS from payers and employers.
Installment Agreement	Arrangement in which a taxpayer agrees to pay his or her tax liability over time in smaller, more manageable payments.
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	Federal statutes pertaining to taxes that are imposed by the Federal Government are compiled into Title 26 of the United States Code.
Internal Revenue Manual	The operations manual for employees of the IRS. It contains the policies, procedures, instructions, guidelines, and delegations of authority that direct the operation for all divisions and functions of the IRS. Topics include tax administration, personnel and office management, and others.
Nonfilers	Individual taxpayers who have been identified as liable to file a tax return but have not filed a tax return by the return due date or extended due date.
Nonfiler Inventory and Analysis	A team under the Headquarters Collection function that administers the CCNIP.
Return Delinquency	An IRS program designed to work responses to notices issued to taxpayers identified as liable to file a tax return but have not filed.
Selection Code	CCNIP cases are categorized and assigned a code based on potential noncompliance criteria that are used to determine which cases will be pursued.
Small Business/ Self-Employed Division	The IRS organization that services self-employed taxpayers and small businesses by educating and informing them of their tax obligations, developing educational products and services, and helping them understand and comply with applicable tax laws.
Tax Gap	The estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.
Tax Year	The 12-month period for which tax is calculated. For most individual taxpayers, the tax year is synonymous with the calendar year.

Appendix VI

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

SEP 13 2016

MEMORANDUM FOR MICHAEL E. McKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Karen Schiller
Commissioner Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Improvements to the Nonfiler Program Could Help the Internal Revenue Service More Effectively Address Additional Nonfilers Owing Billions of Dollars in Taxes (Audit #201530037)

Thank you for the opportunity to review the above subject draft report. We appreciate your in-depth review of our Nonfiler program, as well as your insightful findings and recommendations for opportunities for improvement. Indeed, this report is illustrative of the contributions of the Inspector General to tax administration.

We will use your findings and recommendations, coupled with data analytics research that we plan to undertake, to help refine our Nonfiler Program strategy, with a dual goal of prioritizing as much of this work as our resources will allow and also developing a process for selecting productive nonfiler cases. To find efficiencies, we will investigate the options for improving the effectiveness of the delinquency notice to increase the number of nonfilers who are contacted and the nonfiler response rate. As part of that process, we will collaborate with our Information Technology (IT) function to expand its review of the inventory volume and document fluctuations in inventory counts for each new tax year, ensuring that anomalies are addressed.

We note that the data analysis we perform each year in order to identify and address nonfilers is very complex. For tax year (TY) 2012, it was compressed as a result of the federal government shutdown in October 2013. This limited our time to investigate and react to a programming error that resulted in our systems failing to identify nonfilers with expired extensions of time to file. For the following tax year (2013) we made a difficult resource-based decision to prioritize other work in lieu of addressing nonfilers with expired extensions.

While IRS did not issue notices to TY 2013 nonfilers with expired extensions that were included in the nonfiler inventory, it should be noted that we still made efforts to secure these unfiled returns. Every year many unfiled returns are addressed through our other compliance efforts. For example, when a taxpayer files a refund return, IRS has a program which places a "hold" on the refund when a filing delinquency has been identified for a prior year return. Additionally, an individual's compliance with return filing requirements is addressed by our employees when there is active collection or examination activity on other tax years. Indeed, TIGTA has noted that almost 40% of the taxpayers who were the subject of this audit have already filed their returns. After we determine which TY 2013 high income nonfilers with expired extensions have not been addressed by other Collection programs or have not filed a return, we will then determine which remaining cases should be contacted and will investigate possible methods of notification.

We do not agree with the outcome measure stating that a potential $3.8 billion in additional tax revenue could have been collected by addressing the TY 2013 high income nonfilers with expired extensions who did not voluntarily file a tax return or submit full payment of the estimated tax liability. There is no historical basis to establish that sending a notice will generate one hundred percent filing and payment compliance; in other words, it would not necessarily result in all of the outstanding tax returns being filed, nor would it result in the balances due on each of those tax returns being paid in full. The measure should include historical information on what proportion of taxpayers receiving notices actually file and pay their taxes with no further interaction with the IRS.

We will continue to face difficult decisions as to how to allocate limited resources. Finding efficiencies we can implement that help us to achieve our organizational goals and priorities is very important. We appreciate your insight and guidance in that regard.

Attached is a detailed response outlining your recommendations, our corrective actions and supporting statements. If you have any questions, please contact me, or a member of your staff may contact, Scott Prentky, Director Collection at (954) 991-4326.

Attachment

Attachment

RECOMMENDATION 1: The Small Business/Self-Employed Division's Director, Collection Inventory Delivery and Selection (CIDS) should work with the Director, Corporate Data in Information Technology Applications Development to develop and implement additional controls and procedures, such as defining expected record counts and documenting results, to ensure that programming revisions are adequately implemented and effective to properly identify delinquent taxpayers with and without extensions of time to file. In addition, ensure that identified anomalies are researched until resolved and that the details regarding the anomalies and the actions taken to resolve them are documented.

CORRECTIVE ACTION: With SB/SE input, IT programmers will develop a checklist detailing the expected record counts throughout the development cycle, for both the first and second inventory, to help detect any changes that are not compatible with existing code. SB/SE will ensure proper research, coordination, and resolution documentation is done if any future anomalies are detected.

IMPLEMENTATION DATE:
February 15, 2017

RESPONSIBLE OFFICIAL(S):
Director, Collection Inventory Delivery & 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 Small Business/Self-Employed Division's Director, Collection Inventory Delivery and Selection should implement additional controls over Nonfiler & Inventory Analysis (NIA) group reviews of current year Case Creation Nonfiler Identification Process (CCNIP) counts compared to prior year counts, including managerial review of the results of the comparison and mandatory documentation of the review and approval for all variances over an established threshold.

CORRECTIVE ACTION: NIA will strengthen the existing process by formally documenting the fluctuations in inventory counts. If the count varies by more than the average variance over prior years, NIA will document the variance and initiate contact with IT for an explanation. The NIA program manager will formally document the review and elevate to the Director of CIDS.

IMPLEMENTATION DATE:
February 15, 2017

RESPONSIBLE OFFICIAL:
Director, Collection Inventory Delivery & 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 3: The Small Business/Self-Employed Division's Director, Collection Inventory Delivery and Selection should determine and document which nonfiler cases are high-priority cases, including high-income nonfilers with and without expired extensions that must be identified and addressed during the CCNIP in any given year. In fiscal years with considerable resource constraints, ensure that high-income nonfiler cases with expired extensions are addressed in the same manner as high-income nonfiler cases without expired extensions and that such cases are appropriately considered and allocated resources.

CORRECTIVE ACTION: We will determine and document which nonfiler cases are high priority. Additionally, the documentation will include selection criteria for high priority cases. We will schedule selections of both high income nonfilers with and without expired extensions, post to the NIA directory, and distribute the fiscal year selection plan for appropriate leadership workplan consideration.

IMPLEMENTATION DATE:
February 15, 2017

RESPONSIBLE OFFICIAL:
Director, Collection Inventory Delivery & 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 4: The Small Business/Self-Employed Division's Director, Collection Inventory Delivery and Selection should analyze the population of TY 2013 high-income nonfilers with expired extensions identified as not having filed a tax return and notify those taxpayers of the requirement to file the TY 2013 tax return. If resources do not allow for the notification of the entire population, document the analysis performed to determine the percentage or number of TY 2013 high-income nonfilers with expired extensions who should be notified.

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CORRECTIVE ACTION: We will determine which TY 2013 high income nonfiler cases with expired extensions remain unaddressed by any Collection program (e.g., full compliance checks, Refund Hold). We will also review the TY 2014 inventory to determine if any of these cases were addressed. For any remaining unaddressed cases, we will investigate possible methods of notification and determine which cases merit contact. We will document the analysis performed.

IMPLEMENTATION DATE:
October 15, 2017

RESPONSIBLE OFFICIAL:
Director, Collection Inventory Delivery & 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 5: The Small Business/Self-Employed Division's Director, Collection Inventory Delivery and Selection should develop a strategy for evaluating and improving the effectiveness of the delinquency notice, which may include tracking the reasons for taxpayer inquiries at IRS call sites.

CORRECTIVE ACTION:
To develop a strategy that addresses return delinquency notice effectiveness, IRS will perform a detailed evaluation of return delinquency notice metrics to define and determine notice effectiveness. IRS will utilize notice response data and notice effectiveness research results to develop the strategy.

IMPLEMENTATION DATE:
October 15, 2017

RESPONSIBLE OFFICIAL:
Director, Collection Inventory Delivery & 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.

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RECOMMENDATION 6: The Small Business/Self-Employed Division's Director, Collection Inventory Delivery and Selection should revise the nonfiler strategy to include specific action items aimed at increasing the number of nonfilers who are contacted and the nonfiler response rate. Action items should focus on increasing automation and addressing areas of taxpayer confusion in an effort to limit any additional burden on current resources in the Compliance Services Collection Operations function.

CORRECTIVE ACTION: We will revise our nonfiler strategy to include improving the effectiveness of Nonfiler notices to reach more taxpayers who subsequently respond to our notices. IRS will perform a detailed evaluation of return delinquency notice metrics to define and determine notice effectiveness. IRS will utilize notice response data and notice effectiveness research results to develop a strategy specific to return delinquency notice effectiveness. The analysis will include results stratified by nonfiler priority. We will also ensure the strategy aligns with Future State themes and will include key nonfiler metrics in appropriate Enterprise goals.

IMPLEMENTATION DATE:
October 15, 2017

RESPONSIBLE OFFICIAL:
Director, Collection Inventory Delivery & 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.