



*Taxpayer Referrals of Suspected
Tax Fraud Result in Tax Assessments,
but Processing of the Referrals
Could Be Improved*

February 20, 2013

Reference Number: 2013-40-022

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

Redaction Legend:

2(f) = Risk Circumvention of Agency Regulation or Statute

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HIGHLIGHTS

TAXPAYER REFERRALS OF SUSPECTED TAX FRAUD RESULT IN TAX ASSESSMENTS, BUT PROCESSING OF THE REFERRALS COULD BE IMPROVED

Highlights

Final Report issued on February 20, 2013

Highlights of Reference Number: 2013-40-022 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division and Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

When individuals want to report possible instances of Federal tax fraud by a taxpayer, the IRS instructs them to complete and mail Form 3949-A, *Information Referral*, or to provide this information via a letter. During Fiscal Years 2010 through 2012, the Small Business/Self-Employed (SB/SE) and Wage Investment (W&I) Divisions received and screened 274,976 Forms 3949-A. During that same time period, examinations initiated from Form 3949-A referrals resulted in more than \$66.5 million in tax assessments. However, TIGTA previously reported that the IRS misrouted referrals it sent to other functions. While corrective actions will reduce the number of referrals received by the SB/SE and W&I Divisions, both divisions can more efficiently and effectively process Forms 3949-A.

WHY TIGTA DID THE AUDIT

This audit was initiated in coordination with a previous TIGTA audit based on a TIGTA Office of Investigations referral that reported thousands of identity theft cases reported on Form 3949-A were not being processed.

WHAT TIGTA FOUND

TIGTA determined that both the SB/SE and W&I Division screeners improperly screened Forms 3949-A. While improvements to the processes and better communication with the Accounts Management function will reduce the

number of referrals the divisions receive, other issues affect the screeners' ability to research and identify referrals worthy of examination. Neither division has a routine review process to evaluate screened referrals not selected for examination. Routine checks of screened work would identify potential areas for improvement. In addition, the SB/SE Division does not have specific guidelines for screeners. More detailed guidelines would allow SB/SE Division screeners to be more consistent when evaluating referrals.

The SB/SE and W&I Divisions spent approximately \$211,041 to screen the 102,465 Forms 3949-A received for Fiscal Year 2012 and assessed more than \$29 million. The divisions should reevaluate the Form 3949-A program's effectiveness once corrective actions are complete and determine how much of their limited resources they should devote to the program. Increased efficiency may make it more cost efficient for the divisions to place a higher priority on these referrals.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) ensure that it periodically communicates its referral needs to the Accounts Management function; 2) conduct routine reviews of screened referrals; 3) develop detailed SB/SE Division standard screening guidelines; 4) implement procedures to include information about each misrouted referral sent to another function or returned to the Accounts Management function; and 5) assess the value of the Form 3949-A program once the IRS implements the corrective actions resulting from the previous TIGTA report.

IRS management agreed with all of our recommendations and, as appropriate, plans to implement corrective actions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 20, 2013

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION
COMMISSIONER, WAGE AND INVESTMENT DIVISION

A handwritten signature in black ink, appearing to read "Michael E. McKenney".

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Taxpayer Referrals of Suspected Tax Fraud
Result in Tax Assessments, but Processing of the Referrals Could Be
Improved (Audit # 201240037)

This report presents the results of our review to determine the effectiveness of the actions the Internal Revenue Service takes on taxpayer reports of fraud using Form 3949-A, *Information Referral*. This audit was added to our Fiscal Year¹ 2012 Annual Audit Plan and addresses the major management challenges of Fraudulent Claims and Improper Payments, and Providing Quality Taxpayer Service Operations.

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

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 Augusta R. Cook, Acting Assistant Inspector General for Audit (Returns Processing and Account Services).

¹ A 12-consecutive-month period ending on the last day of any month, except December. The Federal Government's fiscal year begins on October 1 and ends on September 30.



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Abbreviations

IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
TIGTA	Treasury Inspector General for Tax Administration
W&I	Wage and Investment



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Background

When individuals want to report possible instances of Federal tax fraud by a taxpayer, the Internal Revenue Service (IRS) instructs them to complete and mail Form 3949-A, *Information Referral*, or to provide this information via a letter. Figure 1 is an excerpt from the IRS public Internet website, IRS.gov, which provides guidelines for reporting suspected fraud.

Figure 1: Guidelines for Reporting Suspected Tax Fraud Activity

How Do You Report Suspected Tax Fraud Activity?

If you suspect or know of an individual or company that is not complying with the tax laws, you may report this activity by completing Form 3949-A. You may fill out Form 3949-A online, print it, and mail it to:

Internal Revenue Service
Fresno, CA 93888

If you do not wish to use Form 3949-A, you may send a letter to the address above. Please include the following information, if available:

- Name and address of the person you are reporting.
- The Taxpayer Identification Number (Social Security Number for an individual or Employer Identification Number for a business).
- A brief description of the alleged violation, including how you became aware of or obtained the information.
- The years involved.
- The estimated dollar amount of any unreported income.
- Your name, address, and daytime telephone number.

Although you are not required to identify yourself, it is helpful to do so. Your identity can be kept confidential.

Frequently Asked Questions – 1.13 IRS Procedures: Reporting Fraud [link to web page entitled IRS Procedures]

How to Report:

- **Abusive Tax Promotions and/or Promoters**
Complete the referral form [link to Form 14242, *Report Suspected Abusive Tax Promotions or Preparers*] which documents the information necessary to report an abusive tax avoidance scheme. The form can be mailed or faxed to the IRS address and fax number on the form.
- **Fraudulent IRS e-Mails and Websites**
Visit this page if you receive an e-mail claiming to be from the IRS. [The IRS does not initiate contact with taxpayers by e-mail or any social media tools to request personal or financial information. Link to web page on how to Report Phishing.]

Source: IRS.gov web page “How Do You Report Suspected Tax Fraud Activity?”



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In Fiscal Year 2011,¹ the IRS website for reporting fraud was visited 501,218 times, and 116,307 Forms 3949-A were received by the Accounts Management function² clerical unit in Fresno, California. Figure 2 shows the volume of Forms 3949-A the IRS received in Fiscal Years 2010 through 2012.

**Figure 2: Forms 3949-A Inventory
for Fiscal Years 2010 Through 2012³**

	Fiscal Year 2010	Fiscal Year 2011	Fiscal Year 2012
Total Receipts	89,944	116,307	122,586
Receipts Routed for Further Review	73,168	114,943	110,541
Receipts Destroyed	14,628	12,401	12,045
Ending Inventory	5,614	4,250	0

Source: IRS management information reports.

The Accounts Management function does not classify the tax returns or investigate the taxpayers referred on Forms 3949-A. The function is merely a conduit for the referrals. Its clerks review the referrals and use routing sheets to help them identify where to send the referrals. The Accounts Management function retains the referrals not forwarded to a business unit or office for 90 days and then destroys them.

On a daily basis during Fiscal Year 2012, the Accounts Management function forwarded referrals to 11 different offices. The Small Business/Self-Employed (SB/SE) and the Wage and Investment (W&I) Divisions received the most referrals.

Figure 3 shows the functions and offices that received most of the Form 3949-A referrals in Fiscal Year 2012.

¹ A 12-consecutive-month period ending on the last day of any month, except December. The Federal Government's fiscal year begins on October 1 and ends on September 30.

² The Accounts Management function in the Wage and Investment Division provides assistance to individual taxpayers with tax and account-related inquiries via telephone, correspondence, and e-mail.

³ The IRS-reported categories of inventory do not equal total receipts, and the IRS stated that the information for Fiscal Year 2010 is incomplete.



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**Figure 3: Top Five Functional Destinations for
Receipt of Fiscal Year 2012 Form 3949-A Referrals**

Destination	Total Forms 3949-A	Percent of Total Closures*
SB/SE Division (Brookhaven, New York)	57,857	47.20%
W&I Division (Andover, Massachusetts)	44,608	36.39%
Retained for Future Destruction	12,045	9.83%
Employment Taxes	2,742	2.24%
Return Preparer Program	2,266	1.85%
Total	119,518	97.50%

Source: Fiscal Year 2012 Informant Referral Destination Report. *Individual percentages may not add up to total due to rounding.

Prior Treasury Inspector General for Tax Administration audit report

In September 2012, the Treasury Inspector General for Tax Administration (TIGTA) concluded an audit opened as a result of a TIGTA Office of Investigations referral that reported thousands of identity theft cases reported on Form 3949-A were not being processed. TIGTA reported that the guidelines taxpayers use to report taxpayer fraud referrals are confusing and inconsistent.⁴ Instructions on Form 3949-A do not explain what types of fraud and tax law violations to report using this form. As a result, individuals often use Form 3949-A for purposes other than reporting suspected tax fraud or tax law violations. Additionally, because Form 3949-A lacks specificity, taxpayers do not always provide the IRS with sufficient information for the IRS to take action. As a result, many referrals do not meet any criteria under which the IRS would be able to take action.

Ineffective routing procedures and oversight also allowed Forms 3949-A to be misrouted to the wrong functions. Others are mistakenly considered unworkable and retained for 90 days and then destroyed.

TIGTA recommended and the IRS agreed to clarify guidance and instructions and implement controls for routing documents. The IRS also plans to conduct a feasibility study for developing an online Form 3949-A that ensures sufficient information is collected and evaluate the clerical unit routing process to determine if it would be more efficient for technical employees to assume those responsibilities.

⁴ TIGTA, Ref. No. 2012-40-106, *The Process for Individuals to Report Suspected Tax Law Violations Is Not Efficient or Effective* p. 3 (Sept. 2012).



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This review was performed at the SB/SE Division Examination Operations function in Brookhaven, New York, the W&I Division Customer Account Services Accounts Management function clerical unit in Fresno, California, and the W&I Division Examination Operations function in Andover, Massachusetts, during the period May through September 2012. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

The Processing of Taxpayer Referrals of Suspected Tax Fraud Could Be Improved

During Fiscal Years 2010 through 2012, the SB/SE and W&I Divisions received and screened 274,976 Form 3949-A referrals. During that same time period, examinations initiated from Form 3949-A referrals resulted in more than \$66.5 million in tax assessments—an average of approximately \$12,672 per referral selected and examined.⁵

Of the 274,976 Forms 3949-A received by the SB/SE and W&I Divisions during Fiscal Years 2010 through 2012:

- 3,542 (1.3 percent) Forms 3949-A had tax returns waiting to be examined by the Divisions.
- 5,254 (1.9 percent) Forms 3949-A resulted in 8,153 tax returns being examined.
- 266,180 (96.8 percent) Forms 3949-A were not selected for examination because, in most cases, the IRS rejected the referrals during the screening or classification processes. The IRS rejected the referrals because, for example: 1) Forms 3949-A were misrouted to the divisions or offices, or the referrals did not have sufficient information to identify the subject of the referral, 2) the issues were not significant or did not meet examination criteria, or 3) the statute of limitations had expired or was near expiration.

Figures 4 and 5 show the number of Forms 3949-A received by each division as well as the number of tax returns examined and the dollars assessed as a result of the Form 3949-A referrals for Fiscal Years 2010 through 2012.

⁵ This average was obtained by dividing the total number of assessment dollars in Figures 4 and 5 (\$41,139,993 and 25,439,595, respectively) by the total number of referrals selected and examined (1,266 and 3,988, respectively).



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**Figure 4: Forms 3949-A Received, Selected, and Examined
by the SB/SE Division for Fiscal Years 2010 Through 2012**

Fiscal Year	Total Referrals Received	Referrals Selected and Examined		Related Tax Returns Examined	Totals
2010	53,462	Examinations	235	270	505
		Dollars	\$1,855,784	\$2,095,057	\$3,950,841
2011	41,611	Examinations	266	475	741
		Dollars	\$3,026,854	\$7,278,500	\$10,305,354
2012	57,857	Examinations	765	1,300	2,065
		Dollars	\$8,495,580	\$18,388,218	\$26,883,798
Totals	152,930	Examinations	1,266	2,045	3,311
		Dollars	\$13,378,218	\$27,761,775	\$41,139,993

Source: The IRS's Audit Information Management System.

**Figure 5: Forms 3949-A Received, Selected, and Examined
by the W&I Division for Fiscal Years 2010 Through 2012**

Fiscal Year	Total Referrals Received	Referrals Selected and Examined	Tax Returns Selected and Examined*	
2010	40,250	1,238	Examinations	1,890
			Dollars	\$6,812,690
2011	37,188	2,370	Examinations	3,633
			Dollars	\$16,039,807
2012	44,608	380	Examinations	585
			Dollars	\$2,587,098
Totals	122,046	3,988	Examinations	6,108
			Dollars	\$25,439,595

Source: The IRS's Audit Information Management System. * The additional tax returns examined as a result of the initial referral could not be separated due to the way the W&I Division records examinations on the System.

The SB/SE Division averaged approximately 69.9 staff hours per referral to examine related tax returns for the referrals selected and assessed more than \$41 million. For the 1,266 referrals with



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examinations closed during Fiscal Years 2010 through 2012, the average yield was \$465 per examiner staff hour.⁶

The W&I Division averaged approximately 2.54 staff hours per referral to examine related tax returns for the referrals selected and assessed more than \$25.4 million. For the 3,988 referrals with examinations closed during Fiscal Years 2010 through 2012, the average yield was \$2,507 per examiner staff hour.⁷

The divisions receive misrouted, incomplete, or unrelated referrals

In September 2012, TIGTA reported that the Accounts Management function misrouted referrals it sent to other functions.⁸ From our samples of SB/SE and W&I Division referrals:⁹

- The SB/SE Division should generally receive referrals dealing with business taxpayers, such as self-employed income issues on tax returns. From our sample of 120 referrals sent to the SB/SE Division, the Accounts Management function should not have sent 41 (34 percent) referrals.¹⁰
 - 20 (17 percent) of 120 referrals dealt with employment tax issues, return preparer issues, or nontax-related issues.¹¹ The Accounts Management function should have sent these referrals to other IRS offices, including the Employment Tax Office (13 referrals) and the Return Preparer Office (three referrals), or should have retained these referrals for destruction (four referrals).

⁶ We calculated the average yield of \$465 per examiner staff hour by multiplying 69.9 average staff hours per examination by 1,266 SB/SE Division referrals selected and examined and dividing that subtotal into the \$41,139,993 assessed.

⁷ We calculated the average yield of \$2,507 per examiner staff hour by multiplying 2.54 average staff hours per examination by 3,988 W&I Division referrals selected and examined and dividing that subtotal into the \$25,439,595 assessed. The average staff hours per examination is rounded to two decimals for consistency in reporting but the average yield was calculated using the non-rounded value for average staff hours per examination. Therefore, the \$2,507 average yield is slightly different than it would be if it were calculated using the rounded value in the report.

⁸ TIGTA, Ref. No. 2012-40-106, *The Process for Individuals to Report Suspected Tax Law Violations Is Not Efficient or Effective* (Sept. 2012).

⁹ During one day in the Fresno Accounts Management function, auditors selected two random samples of 120 Forms 3949-A referred to the SB/SE Division and 118 Forms 3949-A referred to the W&I Division. We have no reason to believe there was any bias related to our sampling methodology or that this day was not representative of typical Form 3949-A processing.

¹⁰ For 120 sampled referrals, at a 95 percent confidence level, the precision for projecting a 34 percent error rate is 8.52 percent.

¹¹ For 120 sampled referrals, at a 95 percent confidence level, the precision for projecting a 17 percent error rate is 6.70 percent.



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- 21 (18 percent) of the 120 referrals did not contain sufficient information to identify the taxpayer or the subject of the referral.¹²
- The W&I Division should generally receive referrals dealing with individual taxpayers, such as dependent discrepancies and Earned Income Credit Tax issues. From our sample of 118 referrals to the W&I Division, the Accounts Management function misrouted 46 (39 percent). For example, the division received referrals for business and identity theft issues that should have been sent to other IRS offices.¹³

The SB/SE Division is making a proactive effort to reduce the number of misroutes by communicating its needs to the Accounts Management function. However, when the W&I Division's receiving offices send misroutes back to the Accounts Management function, they only include limited information and do not provide the Accounts Management function with detailed information, such as the reason the referral should not have been sent to them.

The divisions should provide detailed feedback to the Accounts Management function when they return misrouted referrals. Without better communication, the Accounts Management function cannot take corrective actions. However, the corrective actions to the recommendations from TIGTA's September 2012 report should significantly decrease the number of misrouted Forms 3949-A and the amount of time it takes screeners to identify referrals for additional review or examination.

The divisions' screening processes need improved guidance and oversight

Both samples contained referrals with sufficient information that were suitable to be retained for further consideration. However, screeners in both divisions did not identify referrals that warranted classification or further action. Additionally, the W&I Division screeners retained referrals for classification that should not have been retained. Figure 6 shows the results of our analysis.

¹² For 120 sampled referrals, at a 95 percent confidence level, the precision for projecting an 18 percent error rate is 6.83 percent.

¹³ For 118 sampled referrals, at a 95 percent confidence level, the precision for projecting a 39 percent error rate is 8.84 percent.



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Figure 6: Results of the Analysis of the Referrals Sampled

	SB/SE Division	W&I Division
Properly Screened or Identified as a Misrouted Referral	104 (87%)	96 (81%)
Erroneously Selected for Classification	0 (0%)	8 (7%)*
Erroneously Not Selected for Classification	16 (13%)*	14 (12%)*
Sample Size	120	118

*Source: TIGTA's analysis of Forms 3949-A. *For the sample sizes in the table, at a 95 percent confidence level, the precisions for projecting a 7 percent error rate, 13 percent error rate, and 12 percent error rate are 4.56 percent, 6.11 percent, and 5.86 percent, respectively.*

The following concerns were identified:

- Neither division has a routine review process to evaluate screened referrals not selected for examination. In Calendar Year 2010, the SB/SE Division initiated a review to identify ways to make its processes more efficient, including reducing the number of misroutes and improving its screening process. Management stated they plan to identify training needs in Calendar Year 2013 as part of the ongoing program reviews. However, including routine reviews of screened work as part of the screening process would identify potential areas for improvement, keep management apprised of current training needs, and ensure that screeners are not missing referrals with examination potential.
- The SB/SE Division does not have specific guidelines or instructions for screeners to use when screening referrals. It is strictly a subjective process. Without the necessary guidelines to support their decision, screeners use their personal judgment to not forward for classification referrals they believe would ultimately not result in an examination, including 16 sampled referrals we determined should have been forwarded for classification. More detailed guidelines would allow SB/SE Division screeners to be more consistent when evaluating referrals.

The W&I Division did not properly screen all referrals

Screeners improperly handled 22 (19 percent) of 118 referrals.¹⁴

- For 14 (12 percent) referrals, screeners improperly determined the Accounts Management function misrouted the referrals or improperly determined the referrals should have been sent to the Federal Records Center without classification. However, these cases had been correctly routed to the W&I Division and should have been forwarded for classification.

¹⁴ For 118 sampled referrals, at a 95 percent confidence level, the precision for projecting a 19 percent error rate is 7.06 percent.



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- For eight (7 percent) referrals, screeners improperly retained them for classification even though they had been misrouted by the Accounts Management function or did not warrant further classification.

Of the remaining 96 (81 percent) referrals, screeners properly retained 57 (48 percent) referrals for classification and determined that 39 (33 percent) were either misrouted to them or did not warrant classification.

The W&I Division cannot account for referrals not retained for classification

Of the 118 referrals we selected at the Accounts Management function that were referred to the W&I Division, auditors were only able to physically locate 65 (55 percent) referrals. For the remaining 53 (45 percent) referrals, it appears screeners determined the referrals were misrouted or did not warrant classification for examination.¹⁵

When the W&I Division receives misrouted referrals, it returns them to the Accounts Management function. When screeners determine referrals do not warrant classification and examination, they send them to the Federal Records Center to be retained for a specified period and then ultimately destroyed. However, they do not maintain a log of these referrals, record them on a routing slip, or track them. Therefore, W&I Division management does not have the ability to determine the status or outcome of these individual referrals once the screeners determine they should not be retained for classification. Neither can they ensure that they received and processed specific referrals if any follow-up or further action is needed.

The SB/SE Division records the last four digits of taxpayers' Social Security Numbers and name controls on Form 3210, *Document Transmittal*, when it sends misrouted referrals to other functions, but it does not do this for referrals returned to the Accounts Management function or sent to the Federal Records Center. It also maintains a spreadsheet of all referrals it considers for examination. As a result, of the 120 referrals selected at the Accounts Management function and referred to the SB/SE Division, auditors were able to physically locate all but eight (7 percent) referrals at the receiving SB/SE Division office.¹⁶

Both W&I and SB/SE Division management stated limited resources prevent them from tracking referrals sent to the Federal Records Center, especially when they receive unexpected or significant increases in referrals.

¹⁵ For 118 sampled referrals, at a 95 percent confidence level, the precision for projecting a 45 percent error rate is 9.01 percent.

¹⁶ For 120 sampled referrals, at a 95 percent confidence level, the precision for projecting a 7 percent error rate is 4.48 percent.



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The divisions should reevaluate the Form 3949-A program's effectiveness once corrective actions are complete

The Form 3949-A program is one of many compliance programs within the divisions to promote taxpayer compliance with the tax laws and identify tax returns for audit. The SB/SE and W&I Divisions spent approximately \$211,041 to screen the 102,465 Forms 3949-A received from the Accounts Management function for Fiscal Year 2012. However, the two divisions assessed more than \$29.4 million. For every \$1 spent to screen referrals, examinations assessed approximately \$140.

- The SB/SE Division spent 6,044 staff hours to screen the 57,857 referrals received in Fiscal Year 2012. With costs of \$26.91 per staff hour to screen Form 3949-A referrals, the division spent approximately \$162,700¹⁷ and assessed almost \$27 million (765 taxpayers).
- The W&I Division spent approximately 1,850 staff hours to screen the 44,608 referrals it received during Fiscal Year 2012. At a cost of \$26.13 per staff hour to screen Form 3949-A referrals, the division spent approximately \$48,341¹⁸ and assessed more than \$2.6 million (380 taxpayers).

The SB/SE Division does not place a restriction on the number of referrals examined in a fiscal year. However, it must look at overall resource availability when considering the overall audit potential of the Form 3949-A referrals. Once the referrals are screened, classified, and selected for examination, they are available for assignment along with other discretionary returns. The availability of SB/SE Division resources does not always allow it to examine all referrals before the statute of limitations expires. When the statute of limitations expires on tax returns related to referrals, the SB/SE Division closes the referrals/cases as non-examined.

*****2(f)*****
*****2(f)*****
*****2(f)*****. Although the W&I Division continues to screen and classify Forms 3949-A throughout the year, *****2(f)***** resulting from Form 3949-A referrals until the next fiscal year. *****2(f)*****
*****2(f)*****. However, increases in these audits could result in reductions to other types of audits, some of which may be prerefund audits.

Once the Accounts Management function has the opportunity to implement corrective actions and reduce the overall number of Form 3949-A referrals the divisions receive, the divisions should reevaluate the effectiveness of the Form 3949-A program and determine where to focus

¹⁷ To compute total costs for screening Forms 3949-A, the SB/SE Division used labor costs to screen cases and the costs of shipping Forms 3949-A to other functions.

¹⁸ To compute total costs for screening Forms 3949-A, the W&I Division used labor costs.



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their limited resources. By reducing the number of Forms 3949-A screeners must review, the program's value may increase and make it more cost efficient for the divisions to place a higher priority on referrals.

Recommendations

Recommendation 1: The Commissioner, W&I Division, should ensure that the W&I Division periodically communicates more detailed information on misroutes and its needs to the Accounts Management function. This will ensure that referrals are more likely to be referrals the division can pursue and work.

Management's Response: The IRS agreed with this recommendation. The W&I Division Compliance function partnered with the Accounts Management function and the SB/SE Division Campus Examination function and developed a revised routing system to alleviate misroutes. The SB/SE Division met and will continue to meet with the Accounts Management function on a bi-annual basis to communicate misroute information and provide feedback as it relates to referrals.

Recommendation 2: The Commissioners, SB/SE and W&I Divisions, should ensure that the program is routinely and periodically reviewed to ensure the quality of screeners' work, evaluate and identify additional training needs, identify procedures that need improvements, and help ensure that screeners are not mishandling referrals to expedite the screening process. In addition, when it would be beneficial to the Accounts Management function, the results of these reviews should be shared with the Accounts Management function to assist it in improving its screening process.

Management's Response: The IRS agreed with this recommendation. The SB/SE Division Campus Compliance Service function will continue periodic program reviews, and the W&I Division Reporting Compliance function will establish a product review and provide feedback to the Accounts Management function as appropriate.

Recommendation 3: The Commissioner, SB/SE Division, should enhance existing screening guidelines and provide more specificity to assist screeners in identifying and retaining quality referrals for case building and to provide more consistency to the screening process.

Management's Response: The IRS agreed with this recommendation. The SB/SE Division Campus Compliance Services function will work with the SB/SE Division Examination function to better define case-building criteria.

Recommendation 4: The Commissioners, SB/SE and W&I Divisions, should implement or enhance procedures to include information about each misrouted referral returned to the Accounts Management function or sent to any other office on Form 3210. In addition, once the IRS implements the corrective actions resulting from the previous TIGTA report, W&I and SB/SE Division management should reassess the feasibility of tracking all referrals sent to the



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Federal Records Center. This would allow managers to ensure that the divisions received and processed specific referrals and help them determine how screeners handled them.

Management's Response: The IRS agreed with this recommendation. However, the IRS responded that while it agreed individual feedback on each rejected referral would help prevent future inappropriate referrals, doing so on such a large volume of cases, prior to implementation of corrective actions agreed to in the prior TIGTA audit report, would be premature. The IRS stated that once it implements corrective actions from the prior TIGTA audit report, it will reconsider this recommendation.

Recommendation 5: The Commissioner, W&I Division, should assess the value of the Form 3949-A program once the IRS implements the corrective actions resulting from the prior TIGTA report, reassess the emphasis placed on the program, and prioritize it as needed.

Management's Response: The IRS will assess the value of the Form 3949-A Program once the Accounts Management function implements the corrective actions resulting from the prior TIGTA audit report.

Office of Audit Comment: In IRS management's response memorandum, they expressed concerns about the presentation of statistical data for our sampled cases. In response, we added the confidence levels and precision rates for the 10 error rates presented in this report.

Management also expressed concerns that our statement, "For every \$1 spent to screen referrals, examinations assessed approximately \$140" did not reflect the total cost of the actual examinations. This statement, taken in context, is not meant to reflect the total cost to make assessments and states that we are only referring to screening costs. The statement shows the screening of Form 3949-A referrals is a small cost when compared to the amount of assessments the IRS makes when examining these referrals.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine the effectiveness of the actions the IRS takes on taxpayer reports of fraud using Form 3949-A, *Information Referral*. To accomplish our objective, we:

- I. Determined if the SB/SE and W&I Divisions adequately control and track taxpayer fraud referrals received from the Accounts Management function.
 - A. Evaluated the process used to receive and screen Forms 3949-A within the divisions.
 - B. Determined how the divisions track the referrals during the workflow.
 - C. Determined if the divisions are able to identify and process time-sensitive referrals.
- II. Evaluated referrals from the Accounts Management function and determined if the information provided was adequate to process the forms.
 - A. Determined what types of Form 3949-A referrals the SB/SE and W&I Divisions are able to select and work.
 - B. Determined what information the divisions need to accurately screen Form 3949-A.
- III. Evaluated the SB/SE and W&I Divisions' screening and classification processes to determine if the processes are effectively identifying and selecting the best cases to work.
 - A. During a visit to the Accounts Management function, used IRS criteria to screen and classify a random sample of 118 referrals from a total population of 425 referrals scheduled to be sent to the W&I Division and a random sample of 120 referrals from a total of 390 referrals scheduled to be sent to the SB/SE Division. We used a 95 percent confidence level, a 10 percent expected error rate, and a ± 5 percent precision rate to identify the desired sample sizes. We used random samples to ensure there was no bias in our selection process. TIGTA's contract statistician agreed with the sampling plan and methodology.
 - B. Interviewed IRS management to determine how they evaluate the Form 3949-A program and determine its success.
 - C. Used the Audit Information Management System to identify the results of Form 3949-A referral cases worked by the SB/SE and W&I Divisions.



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- D. We assessed the reliability of the Audit Information Management System data by performing electronic testing of required data elements. This included comparing assessment data to IRS records. We determined the data were sufficiently reliable for the purposes of this report.

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 the following internal controls were relevant to our audit objective: the IRS's internal guidelines used by the divisions to process Forms 3949-A. We evaluated these controls by interviewing management and reviewing policies and procedures. We also reviewed two statistical samples of 120 Forms 3949-A sent to the SB/SE Division and 118 Forms 3949-A sent to the W&I Division.



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Appendix II

Major Contributors to This Report

Augusta R. Cook, Acting Assistant Inspector General for Audit (Returns Processing and Account Services)
Paula W. Johnson, Acting Director
Wilma Figueroa, Audit Manager
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Lynn Faulkner, Senior Auditor
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Jerome Antoine, Auditor



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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Operations Support OS
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Services and Operations, Wage and Investment Division SE:W
Director, Customer Account Services, Wage and Investment Division SE:W:CAS
Director, Strategy and Finance, Wage and Investment Division SE:W:S
Director, Accounts Management, Wage and Investment Division SE:W:CAS:AM
Chief, Program Evaluation and Improvement, Wage and Investment Division SE:W:S:PEI
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons: Commissioner, Small Business/Self-Employed Division SE:S
Chief, Program Evaluation and Improvement, Wage and Investment Division
SE:W:S:PEI



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Appendix IV

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

JAN 29 2013

MEMORANDUM FOR MICHAEL E. MCKENNEY, ACTING DEPUTY
INSPECTOR GENERAL FOR AUDIT

FROM: Faris R. Fink  For
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report –Taxpayers' Referrals of Suspected
Tax Fraud Result in Tax Assessments, but Processing of
the Referrals Could Be Improved (Audit # 201240037)

Thank you for the opportunity to review your draft report titled: "Taxpayers' Referrals of Suspected Tax Fraud Result in Tax Assessments, but Processing of the Referrals Could Be Improved." We appreciate your acknowledgement of the efforts we have previously taken to improve this program.

As you note in your report, classification of this work is subjective and our screeners successfully use their personal knowledge base and professional judgment during the screening process in the absence of formal screening guidelines. We agree formal screening guidelines, more structured reviews, and a refined feedback process would further improve this program.

However, we have some concerns with the statistical data presentation, specifically, with the lack of inclusion of confidence intervals when reporting error rates for the sampled cases. In addition we believe the statement in the report "For every \$1 spent to screen referrals, examinations assessed approximately \$140" may be misleading as this does not take into account the cost of performing the examinations resulting in the referenced monetary outcome.

Attached is a detailed response outlining our corrective actions to address your recommendations.

If you have any questions, please contact me, or a member of your staff may contact Denice Vaughan, Director, Campus Compliance Services at (404) 338-9116.

Attachment



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Attachment

RECOMMENDATION 1:

The Commissioner, W&I Division, should ensure the W&I Division periodically communicates more detailed misroute information and its needs to the Accounts Management function. This will ensure referrals are more likely to be referrals the Division can pursue and work.

CORRECTIVE ACTION:

W&I Compliance partnered with Accounts Management and SB/SE Campus Exam and developed a revised routing system to alleviate misroutes. We have met and will continue to meet with Accounts Management on a bi-annual basis to communicate misroute information and provide feedback as it relates to the referrals.

IMPLEMENTATION DATE:

Implemented and on going

RESPONSIBLE OFFICIAL(S):

Director, Compliance, Wage & Investment Division (W&I)

CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 2:

Commissioners, SB/SE and W&I Divisions, should ensure the program is routinely and periodically reviewed to ensure the quality of screeners' work, evaluate and identify additional training needs, identify procedures that need improvements, and help ensure screeners are not mishandling referrals to expedite the screening process. In addition, when it would be beneficial to the Accounts Management function, the results of these reviews should be shared with the Accounts Management function to assist it in improving its screening process.

CORRECTIVE ACTION:

SB/SE, Campus Compliance Service will continue periodic program reviews, and W&I Reporting Compliance will establish a product review and provide feedback to Accounts Management as appropriate.

IMPLEMENTATION DATE:

- SB/SE Implemented and ongoing
- W&I September 15, 2013



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RESPONSIBLE OFFICIAL(S):

Director, Campus Compliance Services, Small Business/Self-Employed Division (SB/SE)
Director, Compliance, Wage & Investment Division (W&I)

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 3:

The Commissioner, SB/SE Division, should enhance existing screening guidelines and provide more specificity to assist screeners in identifying and retaining quality referrals for case building and to provide more consistency to the screening process.

CORRECTIVE ACTION:

SB/SE Campus Compliance Services will work with SB/SE Examination to better define case building criteria.

IMPLEMENTATION DATE:

September 15, 2013

RESPONSIBLE OFFICIAL(S):

Director, Campus Compliance Services, Small Business/Self-Employed Division (SB/SE)

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 4:

The Commissioners, SB/SE and W&I Divisions, should implement or enhance procedures to include information about each misrouted referral returned to the Accounts Management function or sent to any other office on Form 3210. In addition, once the IRS implements the corrective actions resulting from the previous TIGTA report, W&I and SB/SE Division management should reassess the feasibility of tracking all referrals sent to the Federal Records Center. This would allow managers to ensure the divisions received and processed specific referrals and help them determine how screeners handled them.



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CORRECTIVE ACTION:

While we agree that individual feedback on each rejected referral would help to prevent future inappropriate referrals, doing so on such a large volume of cases, prior to implementation of corrective actions agreed to in the prior audit, would be premature. Once corrective actions from the previous TIGTA audit are implemented, we will reconsider this recommendation.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL(S):

N/A

CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 5:

The Commissioner, W&I Division, should assess the value of the Form 3949-A Program once the IRS implements the corrective actions resulting from the previous TIGTA report, reassess the emphasis placed on the Program and prioritize it, as needed.

CORRECTIVE ACTION:

We will assess the value of the Form 3949-A Program once Accounts Management implements the corrective actions resulting from the previous TIGTA report.

IMPLEMENTATION DATE:

January 15, 2015

RESPONSIBLE OFFICIAL(S):

Director, Compliance, Wage & Investment Division (W&I)

CORRECTIVE ACTION MONITORING PLAN:

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