



*Fiscal Year 2014 Statutory Audit of
Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester
and Similar Designations*

August 27, 2014

Reference Number: 2014-30-060

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

Phone Number / 202-622-6500

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

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



HIGHLIGHTS

FISCAL YEAR 2014 STATUTORY AUDIT OF COMPLIANCE WITH LEGAL GUIDELINES PROHIBITING THE USE OF ILLEGAL TAX PROTESTER AND SIMILAR DESIGNATIONS

WHAT TIGTA RECOMMENDED

TIGTA made no recommendations in this report. IRS officials were provided an opportunity to review the draft report and did not provide any comments.

Highlights

Final Report issued on August 27, 2014

Highlights of Reference Number: 2014-30-060 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement and Deputy Commissioner for Operations Support.

IMPACT ON TAXPAYERS

Congress enacted the IRS Restructuring and Reform Act of 1998 (RRA 98) Section 3707 to prohibit the IRS from labeling taxpayers as Illegal Tax Protesters or any similar designations. Using Illegal Tax Protester or other similar designations may stigmatize taxpayers and may cause employee bias in future contacts with these taxpayers.

WHY TIGTA DID THE AUDIT

Congress enacted the prohibition against Illegal Tax Protester designations because it was concerned that some taxpayers were being permanently labeled as Illegal Tax Protesters even though they had subsequently become compliant with the tax laws. TIGTA is required to annually evaluate IRS compliance with the prohibition against using Illegal Tax Protester or similar designations.

The purpose of this audit was to determine whether the IRS complied with RRA 98 Section 3707 and its own internal guidelines that prohibit IRS officers and employees from referring to taxpayers as Illegal Tax Protesters or any similar designations.

WHAT TIGTA FOUND

The IRS has not reintroduced past Illegal Tax Protester codes or similar designations on taxpayer accounts. However, TIGTA found that in one instance the IRS used the phrase "Tax Defier" in the Internal Revenue Manual.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 27, 2014

MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND
ENFORCEMENT
DEPUTY COMMISSIONER FOR OPERATIONS SUPPORT

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Fiscal Year 2014 Statutory Audit of Compliance
With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations (Audit # 201430007)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) complied with the IRS Restructuring and Reform Act of 1998 (RRA 98)¹ Section 3707 and its own internal guidelines that prohibit IRS officers and employees from referring to taxpayers as Illegal Tax Protesters or any similar designations. The Treasury Inspector General for Tax Administration is required under Internal Revenue Code Section 7803(d)(1)(A)(v) to annually evaluate the IRS's compliance with the provisions of RRA 98 Section 3707. The review is included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Taxpayer Protection and Rights.

Although we made no recommendations in this report, we did provide IRS officials an opportunity to review the draft report. IRS management did not provide us with any report comments.

Copies of this report are also being sent to the IRS managers affected by the report. If you have any questions, please contact me or Bryce Kisler, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations).

¹ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).



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Abbreviations

IRM	Internal Revenue Manual
IRS	Internal Revenue Service
RCCMS	Reporting Compliance Case Management System
RRA 98	Restructuring and Reform Act of 1998
TIGTA	Treasury Inspector General for Tax Administration



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Background

Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98)¹ Section (§) 3707 prohibits the IRS from using Illegal Tax Protester or any similar designations. In addition, the law requires the removal of all existing Illegal Tax Protester codes from the Master File² and instructs IRS employees to disregard any such designation located on databases other than the Individual Master File.

Prior to enactment of the RRA 98, the IRS used the Illegal Tax Protester Program to identify individuals and businesses that were using methods that were not legally valid to protest the tax laws. IRS employees identified taxpayers for referral to the Program when their tax returns or correspondence contained specific indicators of noncompliance with the tax law, such as the use of arguments that had been repeatedly rejected by the courts. There were tax protester coordinators who were responsible for determining whether a taxpayer should be included in the Illegal Tax Protester Program. If a taxpayer was classified as an Illegal Tax Protester, the taxpayer's record was coded as such on the Master File. Once a taxpayer's account was coded, certain tax enforcement actions were accelerated. The designation was also intended to alert employees to be cautious so they would not be drawn into confrontations with taxpayers.

Congress was concerned that some taxpayers were being permanently labeled and stigmatized by the Illegal Tax Protester designation. The concern was that this label could bias IRS employees and result in unfair treatment of the taxpayer. Internal Revenue Code § 7803(d)(1)(A)(v) requires the Treasury Inspector General for Tax Administration (TIGTA) to annually evaluate IRS compliance with the prohibition against using the Illegal Tax Protester or any similar designations. This is our sixteenth review since Fiscal Year 1999. These reviews have identified areas for improvement to help the IRS comply with the Illegal Tax Protester designation prohibition.

***The Treasury Inspector General
for Tax Administration is
required to annually evaluate
IRS compliance with the
prohibition against using
Illegal Tax Protester or any
similar designations.***

Based on the general decline in the use of Illegal Tax Protester or similar designations by IRS employees in recent years, and in the interest of conserving resources, TIGTA revised its methodology for evaluating the use of these designations on the multiple computer systems used by IRS employees. TIGTA will continue to review the Individual Master File and related

¹ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

² See Appendix V for a glossary of terms.



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systems annually, as required by the RRA 98, and will review other IRS systems on a periodic basis. This year we focused on the Internal Revenue Manual (IRM) and the Reporting Compliance Case Management System (RCCMS).

This review was performed with information obtained from the Small Business/Self-Employed Division in New Carrollton, Maryland; the Tax Exempt and Government Entities Division in Washington, D.C.; and the Wage and Investment Division in Atlanta, Georgia, during the period January 2014 through June 2014. This performance audit was conducted 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

Illegal Tax Protester Codes Were Not Used on the Master File

Prior to enactment of the RRA 98, the IRS used Illegal Tax Protester indicators on the Master File to accelerate collection activity for taxpayers who were delinquent in filing tax returns or paying their taxes. These indicators were also intended to alert employees that they might encounter problems when dealing with nonfilers and delinquent taxpayers.

Congress was concerned about the use of the Illegal Tax Protester designation because:

- Taxpayers were labeled as Illegal Tax Protesters without regard to their filing obligations or compliance.
- Illegal Tax Protester indicators were not always reversed when taxpayers became compliant with their tax obligations.

RRA 98 § 3707 required the IRS to remove the existing Illegal Tax Protester designations from taxpayers' accounts on the Master File beginning January 1, 1999.

In prior reviews, TIGTA reported that the IRS had removed these designation codes from the Master File as required by the law. Based on our analysis of approximately 1.2 million taxpayer records that had been coded for accelerated collection activity, the IRS has not reintroduced Illegal Tax Protester codes on the Master File. The law also prohibits using any designation similar to Illegal Tax Protester. We matched approximately 57,000 taxpayer accounts formerly coded as Illegal Tax Protesters to the Master File and confirmed that the IRS had not input any other type of similar designation on these accounts.

Illegal Tax Protester or Similar Designations Were Not Found in Case Narratives

We selected a random sample of 56 cases from the Tax Exempt and Government Entities Division's RCCMS with activity between October 1, 2012, and September 30, 2013. The RCCMS provides Tax Exempt and Government Entities Division personnel with the capability to perform division-wide inventory control, compliance testing, tax computing, education and outreach, and team examination monitoring. Our review found no use of Illegal Tax Protester or other similar designations in any of the sampled case narratives.

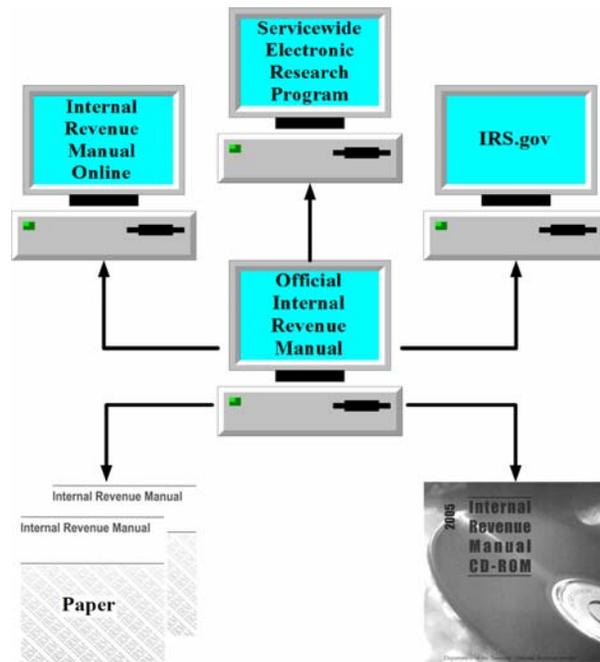


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The Internal Revenue Manual Contained One Use of a Similar Designation

In nine of our prior reviews, we identified Illegal Tax Protester references in various formats of the IRM. The official IRM is maintained on the Electronic Publishing website. However, it is also found electronically on the IRM Online, the Service-wide Electronic Research Program, IRS.gov, and on CD-ROM, as well as in paper format. The graphic to the right shows the relationship between the official IRM and the various formats available to IRS employees.

In our current review, we found one use of the term “Tax Defier” in the various formats of the IRM. This reference was brought to the attention of Small Business/Self-Employed Division management during our audit. We were told by Small Business/Self-Employed Division management that this reference will be removed from the next update of the IRM, planned for March 2016.



Removing all Illegal Tax Protester or similar references from the various formats of the IRM helps to avoid any inappropriate implication that the use of this label is permitted. Based on the actions taken by the IRS, we believe no further recommendations are warranted at this time.

Alternative Methods That Avoid the Need for Illegal Tax Protester Designations Are in Place to Address Tax Compliance Issues

IRS tax compliance operations have not been significantly affected by the prohibition against using Illegal Tax Protester or similar designations because alternative programs exist to address issues previously handled by the Illegal Tax Protester Program. These include:

- The Frivolous Return Program that handles taxpayers who file tax returns based on some type of frivolous argument that justifies payment of little or no income tax. This includes filing a tax return claiming no income using the rationale that paying taxes is voluntary or claiming to be a citizen of a State but not a citizen of the United States.
- The Nonfiler Program that handles taxpayers who fail to file their required tax returns.
- The Potentially Dangerous Taxpayer/Caution Upon Contact Program that handles taxpayers who have assaulted and/or threatened IRS employees.



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Each of these programs is set up to address various issues IRS employees may encounter when dealing with taxpayers protesting the legality of paying their income taxes. Unlike the former Illegal Tax Protester Program, each program addresses a specific taxpayer behavior. In addition, taxpayers are not assigned to these individual programs on a permanent basis, as was the case in the Illegal Tax Protester Program.

None of our prior reviews have identified instances in which the Illegal Tax Protester indicator was needed on a taxpayer's account to either accelerate tax enforcement actions and/or alert IRS employees to be cautious when dealing with the taxpayer. As such, prohibiting the use of the Illegal Tax Protester designation has not had a significant impact on IRS collection or examination activities.



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Appendix I

Detailed Objective, Scope, and Methodology

The objective of this review was to determine whether the IRS complied with RRA 98¹ § 3707 and its own internal guidelines that prohibit IRS officers and employees from referring to taxpayers as Illegal Tax Protesters or any similar designations. To accomplish the objective, we:

- I. Determined if the Illegal Tax Protester coding on the Master File² was removed by reviewing all tax accounts coded for accelerated collection activity as of September 30, 2013, on the Business Master File and Individual Master File. We analyzed 1,224,351 Master File records that had been coded for accelerated collection activity.³

We also matched our historic computer extract of approximately 57,000 taxpayers designated as Illegal Tax Protesters before the RRA 98 was enacted to the records that had been coded for accelerated collection activity to determine if any new common codes were being used to classify the taxpayers as Illegal Tax Protesters.

- II. Determined if employees were using Illegal Tax Protester or any similar designations within the Activity Code field on the Taxpayer Information File by securing a copy of the database and analyzing 109,128 open records with activity between October 1, 2012, and September 30, 2013.
- III. Determined if the IRS is using any Frivolous Return Program codes as replacements for Illegal Tax Protester designations by reviewing guidance provided for the Frivolous Return Program and interviewing its Program Coordinator.
- IV. Determined if there is any relationship between Illegal Tax Protester designations and Potentially Dangerous Taxpayer/Caution Upon Contact indicator use on the Master File by reviewing guidance provided for the Potentially Dangerous Taxpayer/Caution Upon Contact Program and interviewing its Program Coordinator.
- V. Determined if the IRS Nonfiler Program is in compliance with the provisions established by RRA 98 § 3707(b) by reviewing guidance provided for the Nonfiler Program and interviewing its program coordinators.

¹ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

² See Appendix V for a glossary of terms.

³ A Transaction Code 148 causes the accelerated issuance of a Taxpayer Delinquency Investigation or Taxpayer Delinquent Account.



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- VI. Determined if the IRM contained Illegal Tax Protester or any similar designations by performing key word searches of the IRS Electronic Publishing website, the IRM online, the Service-wide Electronic Research Program, and the IRS.gov website.
- VII. Determined if employees were using Illegal Tax Protester or any similar designations within case narratives of the Tax Exempt and Government Entities Division's RCCMS. Due to limited audit resources, we obtained and reviewed a randomly selected sample of 56 individual case files out of a total of 2,378 cases with activity on the RCCMS for the period October 1, 2012, through September 30, 2013.

Validity and reliability of data from computer-based systems

Unless otherwise noted, our limited tests of the reliability of data obtained from various IRS systems did not identify any errors. We tested the reliability of the data by scanning the data received for blank, incomplete, illogical, or improper data. In addition, we compared the information in a judgmental sample of 25 records each for the Business Master File, Individual Master File, RCCMS, and Taxpayer Information File to IRS source data on the Integrated Data Retrieval System to ensure data accuracy.

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: controls that ensure the reliability of the data used for our analysis. During our review, we tested the validity of the data used for our analyses against selected IRS data, but we did not perform any specific testing of data input controls. However, it should be noted that, except for the RCCMS, data from these same systems were used during prior audits of Illegal Tax Protester designations, and no significant data issues were identified.



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Appendix II

Major Contributors to This Report

Nancy Nakamura, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Bryce Kisler, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Glen Rhoades, Director
Robert Jenness, Audit Manager
Ali Vaezazizi, Lead Auditor
Donna Saranchak, Senior Auditor
James Allen, Information Technology Specialist



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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Wage and Investment Division SE:W
Commissioner, Tax Exempt and Government Entities Division SE:T
Chief, Appeals AP
Chief Technology Officer OS:CTO
Director, Office of Research, Analysis and Statistics RAS
Director, Communications and Liaison, National Taxpayer Advocate TA:CL
Director, Office of Servicewide Policy, Directives and Electronic Research RAS:SPDER
Director, Communications and Stakeholder Outreach SE:S:COSS:CSO
Director, Strategy and Finance, Wage and Investment Division SE:W:S
Director, Accounts Management, Wage and Investment Division SE:W:CAS:AM
Director, Strategy and Finance, Research and Analysis SE:W:S:R:PEI
Chief, GAO/TIGTA/IMRS SE:S:COSS:CSOHQ:GTI
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:
 Deputy Commissioner for Operations Support OS
 Deputy Commissioner for Services and Enforcement SE
 National Taxpayer Advocate TA
 Chief Technology Officer OS:CTO
 Senior Operations Advisor, Wage and Investment Division SE:W:BMO



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Appendix IV

Previous Audit Reports Related to This Statutory Review

TIGTA previously performed 15 mandatory audits in this subject area. These audits were:

TIGTA, Ref. No. 2013-30-085, *Fiscal Year 2013 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (Aug. 2013).

TIGTA, Ref. No. 2012-30-066, *Fiscal Year 2012 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (Jun. 2012).

TIGTA, Ref. No. 2011-30-040, *Fiscal Year 2011 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (Apr. 2011).

TIGTA, Ref. No. 2010-30-073, *Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (Jul. 2010).

TIGTA, Ref. No. 2009-40-078, *Fiscal Year 2009 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (May 2009).

TIGTA, Ref. No. 2008-40-124, *Fiscal Year 2008 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (May 2008).

TIGTA, Ref. No. 2007-40-112, *Fiscal Year 2007 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (Jun. 2007).

TIGTA, Ref. No. 2006-40-098, *Fiscal Year 2006 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (Jul. 2006).

TIGTA, Ref. No. 2005-40-104, *Fiscal Year 2005 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (Jul. 2005).

TIGTA, Ref. No. 2004-40-109, *Fiscal Year 2004 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (Jun. 2004).

TIGTA, Ref. No. 2003-40-098, *Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (Apr. 2003).

TIGTA, Ref. No. 2002-40-162, *Efforts Are Still Needed to Discourage the Use of Illegal Tax Protester and Similar Designations* (Sept. 2002).

TIGTA, Ref. No. 2001-10-141, *Improvements Have Been Made to Eliminate Illegal Tax Protester Designations* (Sept. 2001).



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TIGTA, Ref. No. 2000-10-119, *Additional Action Is Needed to Eliminate Illegal Tax Protester Designations* (Sept. 2000).

TIGTA, Ref. No. 1999-10-080, *The Internal Revenue Service Is Addressing the Use of the Illegal Tax Protester and Nonfiler Designations* (Sept. 1999).



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Appendix V

Glossary of Terms

Activity Code	A code that identifies the type and condition of returns selected for audit.
Business Master File	IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.
Campus	The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
Fiscal Year	A 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.
Individual Master File	IRS database that maintains transactions or records of individual tax accounts.
Integrated Data Retrieval System	A computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.
Internal Revenue Code	Federal tax law enacted by Congress in Title 26 of the United States Code.
Internal Revenue Manual	A manual containing the IRS's internal guidelines.
Master File	IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
Reporting Compliance Case Management System	Provides Tax Exempt and Government Entities Division personnel with the capability to perform division-wide inventory control, compliance testing, tax computing, education and outreach, and team examination monitoring.



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Service-wide Electronic Research Program	An electronic research tool containing many former paper research applications (<i>e.g.</i> , publications, the IRM, the Probe and Response Guide).
Taxpayer Delinquency Investigation	An unfiled tax return for a taxpayer. One Taxpayer Delinquency Investigation exists for all unfiled tax periods for a specific taxpayer.
Taxpayer Delinquent Account	A balance due account of a taxpayer. A separate Taxpayer Delinquent Account exists for each balance due tax period.
Taxpayer Information File	A file containing entity and tax data processed at a given campus for all Taxpayer Identification Numbers.
Transaction Code	A three-digit code used to identify transactions being taken on a taxpayer's account.