



*Fiscal Year 2015 Statutory Audit of
Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester
and Similar Designations*

August 25, 2015

Reference Number: 2015-30-067

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.

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HIGHLIGHTS

FISCAL YEAR 2015 STATUTORY AUDIT OF COMPLIANCE WITH LEGAL GUIDELINES PROHIBITING THE USE OF ILLEGAL TAX PROTESTER AND SIMILAR DESIGNATIONS

Highlights

Final Report issued on August 25, 2015

Highlights of Reference Number: 2015-30-067 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 out of approximately 4.8 million records and cases, there were four instances in which

employees referred to taxpayers as "Tax Protester," "Constitutionally Challenged," or other similar designations in case narratives in the Appeals Centralized Database System.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Chief, Appeals, emphasize to all Appeals employees the importance of compliance with RRA 98 Section 3707 and reinforce that taxpayers are not to be referred to as Illegal Tax Protesters or any other similar designations. This may include, but is not limited to, updating Appeals procedures, issuing a memorandum, and/or adding a module to an existing training course.

In response to the report, IRS management agreed with our recommendation and stated that they plan to take corrective action.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 25, 2015

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 2015 Statutory Audit of Compliance
With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations (Audit # 201530007)

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” (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 2015 Annual Audit Plan and addresses the major management challenge of Taxpayer Protection and Rights.

Management’s complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the IRS managers affected by the report recommendations.

If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

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

ACDS	Appeals Centralized Database System
CIMIS	Criminal Investigation Management Information System
IRS	Internal Revenue Service
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 seventeenth 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.***

To conduct this audit, TIGTA reviews the Individual Master File and related systems annually, as required by the RRA 98, and each year TIGTA additionally selects other IRS systems for review on a periodic basis. This year we focused on the Appeals Centralized Database System (ACDS) and the Criminal Investigation Management Information System (CIMIS).

¹ Pub. L. No. 105-206, 112 Stat. 685.

² See Appendix V for a glossary of terms.



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This review was performed with information obtained from the Small Business/Self-Employed Division in New Carrollton, Maryland; the Office of Appeals in Washington, D.C.; and the Wage and Investment Division in Atlanta, Georgia, during the period December 2014 through April 2015. 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 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 54,000 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.

In a Few Instances, Employees Used Illegal Tax Protester or Similar Designations in Case Narratives

We found four instances, out of approximately 3.4 million comment records created during the period of October 2013 through September 2014 in the ACDS, in which four employees had labeled taxpayers as "Tax Protester," "Constitutionally Challenged," or other similar designations in case narratives. In our 2012 review³ (the last time we considered the ACDS), we identified 13 cases in which 13 employees used Illegal Tax Protester or a similar designation when referring to specific taxpayers in ACDS case narratives. During this year's review, the Appeals function informed us that they do not have any formal guidance or training material that

³ 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).



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discusses the use of Illegal Tax Protester or similar designations. Given Appeals' vital mission to resolve cases impartially, it is important that its employees not label taxpayers in this manner.⁴

We believe the four instances identified in the system are prohibited by law. The statute states that "officers and employees of the Internal Revenue Service shall not designate taxpayers as Illegal Tax Protesters (or any similar designation)." It further specifies that existing designations in the Master File must be removed and any other designations made before the effective date of the statute, such as those on paper records that have been archived, must be disregarded. *Senate Committee on Finance Report 105-174* (dated April 22, 1998), related to the RRA 98 § 3707 provision, stated the Committee was concerned that taxpayers might be stigmatized by a designation as an "Illegal Tax Protester." The law prohibits officers and employees from designating taxpayers as such because a designation alone contains a negative connotation and appears to label the taxpayer.

We also reviewed the Allegation section of CIMIS for 15,317 cases that were initiated and/or closed from October 1, 2013, to September 30, 2014. Our review found no use of Illegal Tax Protester or other similar designations in any of allegation narratives.

Recommendation

Recommendation 1: The Chief, Appeals, should emphasize to all Appeals employees the importance of compliance with RRA 98 § 3707 and reinforce that taxpayers are not to be referred to as Illegal Tax Protesters or any other similar designations. This may include, but is not limited to, updating Appeals procedures, issuing a memorandum, and/or adding a module to an existing training course.

Management's Response: IRS management agreed with this recommendation and stated that they will issue a communication to all Appeals personnel to refrain from using terminology that refers to taxpayers as Illegal Tax Protesters or similar designations. IRS management also stated that they disagree with TIGTA's determination that comments in case histories constitutes an official designation that violates RRA 98 § 3707.

Office of Audit Comment: Based upon the language of the statute and the Senate Committee Report discussed earlier in this report, we believe that IRS officers and employees labeling taxpayers as Illegal Tax Protesters or similar designations in any record, including paper and electronic case files, is a violation of RRA 98 § 3707.

⁴ IRM 8.1.1.1 provides that "The Appeals Mission is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service." (Feb. 2, 2012).



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Other Internal Revenue Service Compliance Programs May Involve Taxpayer Designations

The IRS has substantially eliminated the use of the Illegal Tax Protester designation in compliance with the law. However, the IRS has a legitimate purpose in designating certain taxpayer behavior, and the IRS has compliance programs to address this behavior. 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.

Each of these programs is set up to address various issues IRS employees may encounter when dealing with taxpayers who may be intentionally not complying with the tax laws. 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, 2014, on the Business Master File and Individual Master File. We analyzed 1,226,897 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 103,594 open records with activity between October 1, 2013, and September 30, 2014.
- 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 IRS employees are using Illegal Tax Protester or similar designations within taxpayer case history narratives on the ACDS. We reviewed open ACDS cases as of October 1, 2014, with history action dates between October 1, 2013, and September 30, 2014.
- VII. Determined if Criminal Investigation function employees are using Illegal Tax Protester or similar designations within taxpayer case history narratives on the CIMIS. We reviewed all current cases on the CIMIS covering October 1, 2013, to September 30, 2014.

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, Taxpayer Information File, and ACDS 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 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

Matthew Weir, 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
Kenneth Henderson, 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
Chief, Appeals AP
National Taxpayer Advocate TA
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
Chief, Criminal Investigation: SE, CI
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 SE:W:S
Chief, GAO/TIGTA/IMRS SE:S:COSS:CSOHQ:GTI
Chief Counsel CC
Director, Office of Program Evaluation and Risk Analysis RAS:O
Director, Office of Audit Coordination OS:PPAC:AC
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

*Recent Audit Reports Related to This
Statutory Review*

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. 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. 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. 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. 2014-30-060, *Fiscal Year 2014 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (Aug. 2014).

¹ This list provides the most recent five of the 16 previous reports issued by TIGTA.



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Appendix V

Glossary of Terms

Activity Code	A code that identifies the type and condition of returns selected for audit.
Appeals Centralized Database System	ACDS functionality encompasses all application programming to enable Appeals employees to create, maintain, and close an Appeals case inventory item throughout its life cycle.
Business Master File	The 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.
Criminal Investigation Management Information System	A management and information system for tracking the status and progress of Criminal Investigation function investigations, time expended by Criminal Investigation employees, employee information, and IRS Criminal Investigation investigative equipment.
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	The 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.



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Master File	The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
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.



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Appendix VI

Management's Response to the Draft Report



CHIEF, APPEALS

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

July 29, 2015

MEMORANDUM FOR Michael E. McKenney
Deputy Inspector General for Audit

FROM: Kirsten B. Wielobob 
Chief, Appeals

SUBJECT: Draft Audit Report – Fiscal Year 2015 Statutory Audit of
Compliance with Legal Guidelines Prohibiting the Use of Illegal
Tax Protester and Similar Designations (Audit # 201530007)

Thank you for the opportunity to review your draft audit report on the use of Illegal Tax Protester and similar designations.

Since 2003, the IRS has disagreed with TIGTA's determination that including particular language in case histories constitutes an official "designation" that violates the IRS Restructuring and Reform Act of 1998 (RRA 98) § 3707. Comments in case histories do not transfer to any IRS database and should not be categorized as designations. While we understand the importance of using appropriate language, we do not believe the four cases you mentioned violate the RRA 98 legal requirements.

Nonetheless, Appeals does not condone employees' use of the term illegal tax protester (and similar terms) in any manner. Consistent with your recommendation, we will reinforce to our employees that they are not to refer to taxpayers using these terms.

Attached is a response outlining our planned action.

If you have any questions, please have a member of your staff contact John V. Cardone, Director, Appeals, Policy, Quality and Case Support, at 202-317-8830.

Attachment



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Attachment

Recommendation 1:

The Chief, Appeals, should emphasize to all Appeals employees the importance of compliance with RRA 98 §3707 and reinforce that taxpayers are not to be referred to as Illegal Tax Protesters or any other similar designations. This may include, but is not limited to, updating Appeals procedures, issuing a memorandum, and/or adding a module to an existing training course.

Proposed Action:

Appeals will issue a communication to all Appeals personnel to refrain from using terminology that refers to taxpayers as Illegal Tax Protesters or similar designations.

Implementation Date: September 15, 2015

Responsible Official: Director, Appeals Policy, Quality and Case Support