



*Fiscal Year 2016 Statutory Audit of
Compliance With Legal Guidelines
Prohibiting the Use of Illegal Tax Protester
and Similar Designations*

September 14, 2016

Reference Number: 2016-30-087

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 2016 STATUTORY AUDIT OF COMPLIANCE WITH LEGAL GUIDELINES PROHIBITING THE USE OF ILLEGAL TAX PROTESTER AND SIMILAR DESIGNATIONS

Highlights

**Final Report issued on
September 14, 2016**

Highlights of Reference Number: 2016-30-087 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 16.6 million records, there

were seven instances in which employees referred to taxpayers as "Tax Protester/Protector" or "Defier" in case narratives in the Correspondence Examination Automation Support system.

WHAT TIGTA RECOMMENDED

TIGTA recommended that IRS management emphasize to all examination 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 examination procedures, issuing a memorandum, or adding a module to an existing training course.

In their response, IRS management agreed with TIGTA's recommendation and plans to implement corrective actions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 14, 2016

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 2016 Statutory Audit of Compliance
With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations (Audit # 201630005)

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 2016 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.

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.).



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

Table of Contents

<u>Background</u>	Page 1
<u>Results of Review</u>	Page 3
<u>Illegal Tax Protester Codes Were Not Used on the Master File</u>	Page 3
<u>In a Few Instances, Employees Used Illegal Tax Protester or Similar Designations in Case Narratives</u>	Page 3
<u>Recommendation 1:</u>	Page 4
<u>Other Internal Revenue Service Compliance Programs May Involve Taxpayer Designations</u>	Page 4
Appendices	
<u>Appendix I – Detailed Objective, Scope, and Methodology</u>	Page 6
<u>Appendix II – Major Contributors to This Report</u>	Page 8
<u>Appendix III – Report Distribution List</u>	Page 9
<u>Appendix IV – Recent Audit Reports Related to This Statutory Review</u>	Page 10
<u>Appendix V – Glossary of Terms</u>	Page 11
<u>Appendix VI – Management’s Response to the Draft Report</u>	Page 13



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

Abbreviations

AOIC	Automated Offer in Compromise
CEAS	Correspondence Examination Automation Support
IRS	Internal Revenue Service
RRA 98	Restructuring and Reform Act of 1998
TIGTA	Treasury Inspector General for Tax Administration



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

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 required the removal of all existing Illegal Tax Protester codes from the Individual Master File² and instructed IRS employees to disregard any such designation located on any other databases. In prior reviews, the Treasury Inspector General for Tax Administration (TIGTA) reported that the IRS removed the Illegal Tax Protester codes from the Individual Master File as required by the law.

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.

TIGTA is required to annually evaluate IRS compliance with the prohibition against using Illegal Tax Protester or any similar designations.

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 TIGTA to annually evaluate IRS compliance with the prohibition against using the Illegal Tax Protester or any similar designations. This is our eighteenth review since Fiscal Year 1999. These reviews have identified areas for improvement to help the IRS comply with the Illegal Tax Protester designation prohibition.

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 Automated Offer in Compromise (AOIC) system and the Correspondence Examination Automation Support (CEAS) system.

¹ Pub. L. No. 105-206, 112 Stat. 685.

² See Appendix V for a glossary of terms.



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

This review was performed with information obtained from the IRS Information Technology function in Dallas, Texas; the Small Business/Self-Employed Division in New Carrollton, Maryland; and the Wage and Investment Division in Atlanta, Georgia, during the period December 2015 through June 2016. 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.



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

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 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.

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

We found seven instances, out of 63,197 records for examination cases closed during the period of October 2014 through September 2015 in the CEAS system, in which seven employees had labeled taxpayers as "Tax Protester," "Tax Protestor," or "Defier" in case documents or narratives.

We believe the seven 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.



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

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 Remarks section of the AOIC system for approximately 16.5 million records created for 542,893 taxpayers between October 1, 2014, and September 30, 2015. Our review found no use of Illegal Tax Protester or other similar designations in any of the text narratives.

Recommendation

Recommendation 1: The Commissioner, Small Business/Self-Employed Division, should emphasize to all examination 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 examination procedures, issuing a memorandum, or adding a module to an existing training course.

Management’s Response: The IRS agreed with this recommendation. The Small Business/Self-Employed Division stated that it will include language in Internal Revenue Manual section 4.10.1, *Examination of Returns – Overview and Basic Examiner Responsibilities*, to emphasize the importance of compliance with RRA 98 and reinforce that employees should refrain from the use of “illegal tax protester” or similar terms when referring to taxpayers.

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 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.



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

Each of these programs is set up to address various issues IRS employees may encounter when dealing with taxpayers. 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 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.



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

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, 2015, on the Business Master File and Individual Master File. We analyzed 1,228,632 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 77,806 open records with activity between October 1, 2014, and September 30, 2015.
- 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.



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

- VI. Determined if IRS employees are using Illegal Tax Protester or similar designations within the Remarks section of the AOIC system. We reviewed AOIC system cases as of October 1, 2014, with history action dates between October 1, 2014, and September 30, 2015.
- VII. Determined if IRS employees are using Illegal Tax Protester, any similar designation, or reference within Examination tax return case history narratives and related examination case documents. We reviewed examination cases closed between October 1, 2014, and September 30, 2015, in the CEAS system.

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, AOIC system, and CEAS system 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.



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

Appendix II

Major Contributors to This Report

Matthew Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Glen Rhoades, Director
Robert Jenness, Audit Manager
Ali Vaezazizi, Lead Auditor
Debra Mason, Senior Auditor



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Commissioner, Small Business/Self-Employed Division
Commissioner, Wage and Investment Division
Chief, Appeals
National Taxpayer Advocate
Chief Technology Officer
Director, Accounts Management, Wage and Investment Division
Director, Communications and Stakeholder Outreach
Director, Office of Program Evaluation and Risk Analysis
Director, Office of Research, Applied Analytics, and Statistics
Director, Office of Servicewide Policy, Directives, and Electronic Research
Director, Office of Audit Coordination



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

Appendix IV

*Recent Audit Reports Related to This
Statutory Review¹*

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* (July 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* (June 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).

TIGTA, Ref. No. 2015-30-067, *Fiscal Year 2015 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (Aug. 2015).

¹ This list provides the most recent six of the 17 previous reports issued by TIGTA.



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

Appendix V

Glossary of Terms

Activity Code	A code that identifies the type and condition of returns selected for audit.
Automated Offer in Compromise System	A computer system that tracks and controls taxpayer offers in compromise to settle tax liabilities. The AOIC system allows the user to process, view, and track the status of each offer.
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.
Correspondence Examination Automation Support System	A suite of web-based applications developed to enhance the campus examination process. CEAS system applications satisfy Report Generation Software Client and Batch requests to store/retrieve exam cases to/from the CEAS system centralized database.
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.



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

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.



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

Appendix VI

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

SEP 07 2016

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report - Fiscal Year 2016 Statutory Audit of
Compliance With Legal Guidelines Prohibiting the Use of Illegal
Tax Protester and Similar Designations (Audit # 201630005)

Thank you for the opportunity to review and comment on the subject draft audit report. We agree with your recommendation and appreciate that Treasury Inspector General for Tax Administration (TIGTA) acknowledged the IRS previously removed the Illegal Tax Protestor codes from the Individual Master File as required by the law and has not reintroduced them. We also appreciate TIGTA acknowledging that the IRS has a legitimate purpose in designating certain taxpayer behavior and has compliance programs to address this behavior (e.g., Frivolous Return, Nonfiler, and Potentially Dangerous Taxpayer/Caution Upon Contact compliance programs).

All our efforts in the past have had a significant impact since TIGTA's review of approximately 16.6 million records only found seven instances where "tax protester" or a similar phrase was mentioned. The IRS still disagrees with your statement that an employee's use of the term Illegal Tax Protestor or other similar terms in case narratives is a violation of law. However, the IRS continues its conservative approach on this issue by taking actions to further minimize the number of instances these references occur.

Attached is a detailed response outlining our corrective actions to address your recommendation. If you have any questions, please contact me, or a member of your staff may contact Shenita Hicks, Director, Examination, Small Business/Self-Employed Division, at 240-613-2849.

Attachment



*Fiscal Year 2016 Statutory Audit of Compliance With
Legal Guidelines Prohibiting the Use of Illegal Tax Protester and
Similar Designations*

Attachment

RECOMMENDATION 1:

The Commissioner, Small Business/Self-Employed Division, should emphasize to all examination 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 examination procedures, issuing a memorandum, and/or adding a module to an existing training course.

CORRECTIVE ACTION:

We agree and will include language in Internal Revenue Manual (IRM) 4.10.1, *Examination of Returns - Overview and Basic Examiner Responsibilities*, to emphasize the importance of compliance with IRS Restructuring and Reform Act of 1998 (RRA 98) § 3707, and reinforce that employees should refrain from the use of "illegal tax protester" or similar terms when referring to taxpayers. The IRM will be revised and sent to Media & Publications prior to the implementation date.

IMPLEMENTATION DATE:

November 15, 2017

RESPONSIBLE OFFICIAL(S):

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

CORRECTIVE ACTION MONITORING PLAN:

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