

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



The IRS Has Yet to Develop a Successful Strategy for Examining Large Partnership Returns

March 18, 2026

Report Number: 2026-308-011

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.

HIGHLIGHTS: The IRS Has Yet to Develop a Successful Strategy for Examining Large Partnership Returns

Final Audit Report issued on March 18, 2026

Report Number 2026-308-011

Why TIGTA Did This Audit

IRS provided data show that the number of returns filed by partnerships with at least \$10 million in total assets increased from 140,577 returns for Tax Year (TY) 2011 to 334,686 returns for TY 2023. However, the IRS also stated that the examination rate for these partnerships decreased from 2.7 percent to less than 0.1 percent during the same period. The IRS believed it could increase the examination rate with additional Inflation Reduction Act resources that became available in 2022. We assessed whether the IRS is using available information to identify partnership noncompliance. To do so, we evaluated the IRS's soft letter campaign for balance sheet discrepancies, and its selection of certain large partnership returns for examination.

Impact on Tax Administration

A partnership does not pay tax on its income but passes through any profits or losses to its partners to report on their tax returns. The IRS has traditionally experienced high no-change rates on closed partnership examinations, meaning that the examination produced no adjustments to the partnership's return. The no-change rate for all partnership returns increased from 44 percent for TY 2014 to 47 percent for TY 2021. High no-change rates may be a measure of inefficiency, because the IRS expends time and resources on the examination but makes no adjustments to the taxes owed.

What TIGTA Found

In October 2023, the IRS issued Letter 6585, *Soft Letter Pass-Through Entity Campaign*, to 483 partnerships whose balance sheets contained a discrepancy. The IRS uses voluntary compliance letters, otherwise known as "soft letters," to alert taxpayers to potential issues with their tax returns. A soft letter is not an examination activity but can be a way to alert taxpayers of potential noncompliance. Although a response to a soft letter is not required, failure to provide a response, or providing an inadequate response, could result in an examination. Of the 483 soft letters sent to large partnerships, the IRS did not receive responses for 163 letters, rejected 182 responses for insufficient evidence or inadequate documentation, and accepted 138 responses.

In April 2024, IRS officials decided that they would not conduct examinations related to the soft letter responses because of resource limitations and insufficient time remaining on the assessment statute of limitations (the IRS generally has three years from the date a return is filed to examine the returns). While effective at identifying potentially problematic partnership returns, the soft letter campaign involved duplicative steps that consumed valuable time needed to conduct examinations.

In a separate large partnership initiative, the IRS is examining 82 of the largest U.S. partnerships, and most exams were ongoing as of December 2025. However, we observed that not all large partnership returns were analyzed for selection because of a lack of available resources.

Since January 2025, the IRS has taken steps to reduce the size of its workforce to comply with the President's executive orders and Office of Personnel Management guidance. The Pass-Through Entities Program had 1,079 employees in January 2025 and lost more than 20 percent of their staff by the end of December 2025. According to the IRS, they will need to reassess their exam coverage goals for large partnerships following the reduced staffing.

What TIGTA Recommended

We recommended that the IRS ensure that future projects involving complex tax returns eliminate duplicative steps and consider the statute of limitations to allow enough time for compliance actions to occur. We also recommended the IRS develop procedures to ensure that all large partnership returns filed throughout the year are considered for risk assessment.

The IRS agreed with both of our recommendations and plans to implement corrective actions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20024

March 18, 2026

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

A handwritten signature in black ink that reads "Diana M. Tengesdal".

FROM: Diana M. Tengesdal
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The IRS Has Yet to Develop a Successful Strategy
for Examining Large Partnership Returns (Audit No.: 2024308014)

This report presents the results of our review to determine if the Internal Revenue Service is using available information to identify partnership noncompliance. This review was part of our Fiscal Year 2025 Annual Audit Plan and addresses the major management and performance challenge of *Ensuring Tax Compliance*.

Management's complete response to the draft report is included as Appendix III. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

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Background

When starting a business, taxpayers must decide what form of business entity to establish. The form of business determines which income tax return form the business must file. A partnership is a relationship between two or more people to do trade or business. Each person contributes money, property, labor or skill, and shares in the profits and losses of the business.

A partnership reports income, gains, losses, deductions, credits, and other items on Form 1065, *U.S. Return of Partnership Income*. A partnership does not pay tax on its income but passes through any profits or losses to its partners. Partnerships provide a Schedule K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc.*, to partners for reporting their share of partnership profits or losses on their tax returns.

Before 2015, when the Internal Revenue Service (IRS) examined, or audited, partnerships, the law required that the IRS carry any partnership examination adjustments down to the individual partners' tax returns, essentially requiring an exam of each partner. This situation made examining partnerships more complex and time-consuming than other taxpayers, such as a single corporation or an individual taxpayer. The Bipartisan Budget Act of 2015 repealed the existing partnership procedures and replaced them with a new centralized partnership examination structure that allows the IRS to examine most partnerships at the entity level without having to examine each partner as part of the process.¹ However, while any tax assessed during a partnership exam is now imputed to the partnership under the Bipartisan Budget Act of 2015, partnerships can still elect to push out underlying adjustments to the partners.

Latest estimates of the annual gross Tax Gap, *i.e.*, the difference between what taxpayers owe each year and what they timely pay, total \$696 billion for Tax Year 2022. The largest part of the Tax Gap is the underreporting component at \$539 billion. Of that amount, unreported income attributed to entities such as partnerships, S-corporations, estates, and trusts is estimated to be \$42 billion. The IRS notes that Tax Gap estimates may be understated with respect to partnership income because of the difficulty in detecting sophisticated forms of noncompliance by examinations. In addition, the \$42 billion does not include amounts reported on Schedules K-1 such as interest, dividends, capital gains and royalties, which are included in other parts of the Tax Gap calculations.

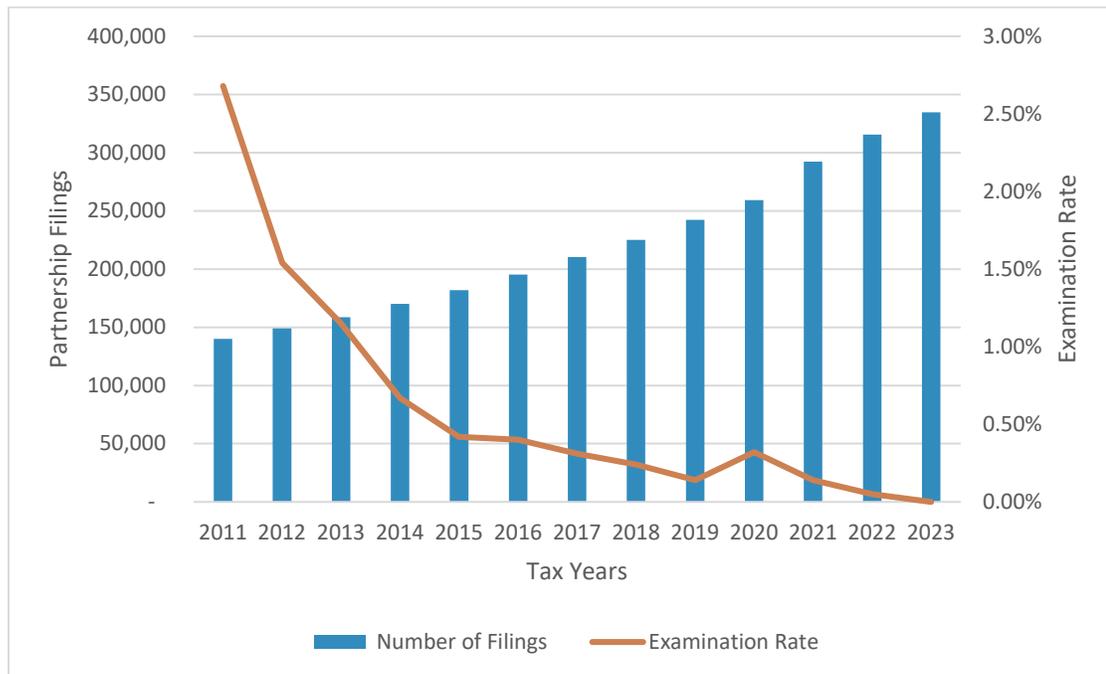
In April 2023, the IRS's Inflation Reduction Act (IRA) Strategic Operating Plan (SOP), stated that it lacked resources to sufficiently address the significant growth of partnerships.² Figure 1 shows that filings for partnerships with assets of \$10 million or more increased between Tax Year (TY) 2011 and TY 2023, while examination rates simultaneously fell.³

¹ Pub. L. No. 114-74, 129 Stat. 625 (2015). These changes were effective with tax years starting January 2018.

² IRS Publication 3744, *IRS IRA SOP Fiscal Years 2023 - 2031*, p. 70 (Rev. April 2023).

³ See Appendix IV for a glossary of terms.

Figure 1: Large Partnership Returns Filed Increased While Examination Rates Declined From TY 2011 to TY 2023



Source: IRS provided data for partnerships with assets of \$10 million or more.

In September 2023, the IRS announced plans to establish a special area to focus on large or complex pass-through entities. The new work unit, called the Pass-Through Organization, is housed in the Large Business and International Division (LB&I). According to the IRS,

The larger compliance effort...will center on adding more attention on high-income and high-wealth individuals, partnerships and large corporations that have seen sharp drops in audit rates during the past decade. The changes will be driven with the help of improved technology as well as Artificial Intelligence that will help IRS compliance teams better detect tax cheating, identify emerging compliance threats and improve case selection tools to avoid burdening taxpayers with needless "no-change" audits.

The IRS will need to revisit goals to increase examinations of partnerships due to reductions in supplemental funding and staffing

The IRS initially received \$79.4 billion in supplemental funding when the IRA was signed into law in August 2022.⁴ A portion of these funds were intended to increase enforcement activities for large partnerships, as noted in the IRA SOP. As of February 2026, Congress subsequently reduced IRA funding to approximately \$26 billion, cutting \$41.8 billion from the enforcement funding activity.⁵

In addition, since January 2025, the IRS has taken steps to reduce the size of its workforce to comply with the President's executive orders and Office of Personnel Management guidance.

⁴ Inflation Reduction Act of 2022, Pub. L. No. 117-169, 136 Stat. 1818.

⁵ The Fiscal Responsibility Act of 2023 (Pub. L. No. 118-5, 137 Stat. 10) rescinded \$1.4 billion; the Further Consolidated Appropriations Act, 2024 (Pub. L. No. 118-47, 138 Stat. 460) rescinded \$20.2 billion; the Full-Year Continuing Appropriations and Extensions Act, 2025 (Pub. L. No. 119-4) rescinded another \$20.2 billion, and the Consolidated Appropriations Act, 2026, rescinded another \$11.7 billion (Pub. L. No. 119-75).

The IRS Has Yet to Determine a Successful Strategy for Examining Large Partnership Returns

The Pass-Through Entities (PTE) program had 1,079 employees in January 2025 and lost more than 20 percent of its staff by the end of December 2025 due to the Deferred Resignation Program, retirements, and terminations.

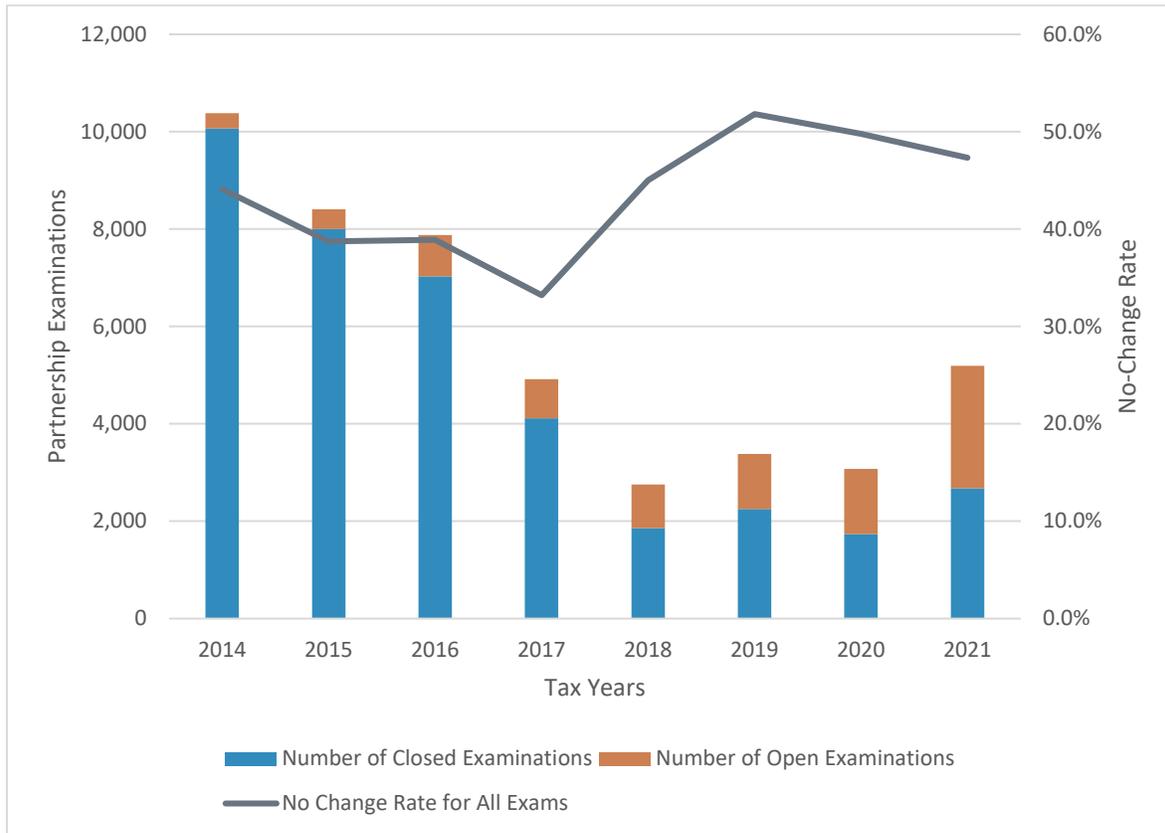
The IRS believed that with original levels of IRA funding, the partnership examination rate would increase ten-fold, from 0.1 percent in TY 2019 to 1.0 percent in TY 2026, even as projected filings increase to 469,800. The IRS has not estimated the impacts of the rescission and workforce reductions on its ability to conduct partnership examinations. According to LB&I management, they will need to reassess their exam coverage goals for large partnerships following the reduced staffing.

Examinations of large partnerships often result in no-change to tax returns

Large partnerships can be complex, with many tiers and sometimes hundreds of thousands of partners. Each partner can be a legally recognized entity such as an individual, corporation, foreign entity, or another partnership. Complex partnerships often require specialized capabilities and significant resources to examine. These large, complex partnership return examinations can take multiple years to complete.

The IRS uses different methods, such as modeling, to evaluate compliance risk for partnership returns and consider them for examination. Despite these processes, partnerships often have high no-change rates. A no-change determination occurs when the examination does not result in any adjustments to the partnership's income, loss, deductions, or credits on the return or the Schedules K-1 issued to the partners. Figure 2 shows the overall number of partnership returns selected for examination from TY 2014 through TY 2021 and the no-change rate for those examinations.

**Figure 2: Partnership Examinations Have Decreased While
No-Change Rates Increased From TY 2014 to TY 2021**



Source: Analysis of IRS Data Books for Fiscal Year 2024 Table 17. The no-change rate is subject to fluctuation as open cases are closed.

High no-change rates may be a measure of inefficiency, because the IRS expends time and resources on the examination but makes no adjustments to the taxes owed. They also unnecessarily burden compliant taxpayers. We addressed the problem of high no-change rates for partnership exams in a prior report.⁶ We stated that the IRS should develop a plan to monitor no-change examinations, including conducting a study to identify and address contributing factors to the no-change rates.

Although partnership examinations have high no-change rates, average adjustments are significant when noncompliance is identified in complex partnerships. One study, in which the IRS participated, reported that average adjustments in complex partnerships examinations are eight times higher than the average adjustments in large corporate exams and for every dollar spent on examining complex partnerships, the IRS gets back \$20 in revenue.⁷

The LB&I Division identified flaws in its case selection methodology

Before selecting a large partnership tax return for examination, the LB&I Division completes a risk assessment called a classification, which identifies issues for an examiner to consider during an examination. Classifiers for partnership returns use tools and job aids to identify issues when

⁶ TIGTA, Report No.: 2022-30-020, *Centralized Partnership Audit Regime Rules Have Been Implemented; However, Initial No-Change Rates Are High and Measurable Goals Have Not Been Established* (March 2022).

⁷ Ryan Hess et al., *The Spiderweb of Partnership Tax Structures*, p. 6 (September 2024).

reviewing the partnership's Form 1065 and its supporting schedules. Once potential issues are identified, the classifier will determine if the issues affect other entities that could warrant a potential examination of those other entities.

In 2018, as part of its efforts to improve partnership examination selection, the LB&I Division introduced the Partnership Model Project to select returns for examinations. Classifiers determine compliance risk by using tools and job aids to identify complex transactions that may involve other entities and partners, and that may cover multiple years. Subject Matter Experts (SME) provide input to determine the relative weight of potential risk factors. The results are combined and used to identify the risk of each return within a population as high, medium, or low. High-risk returns are sent to examiners.

The LB&I Division developed the Large Partnership Compliance (LPC) Program in Calendar Year 2021 to focus on the largest partnership cases. The IRS used the Partnership Model Project to test and refine the new classification process the LPC Program uses. This process uses artificial intelligence (AI) to produce a more comprehensive risk assessment and assist classifiers in selecting returns for examination. The LB&I Division collaborated with experts in data science and tax enforcement to develop a machine-learning process to improve data evaluation.⁸ To program the AI model, SMEs identify high-risk domestic and international business transactions that affect income, gains, expenses, or losses in the largest partnerships. The IRS used the LPC Program to select 78 of the largest partnership returns for examination. Additional returns were subsequently selected after identifying partnerships involved in related transactions with the key cases, bringing the total number of partnership returns selected to 82.

Another aspect of the LPC Program involved changing the timing of SME involvement in the examination process. SMEs knowledgeable in specialized tax areas and industries are available to assist during exams. The LB&I Division found that some examiners had consulted with SMEs late in the examination process or not at all. As a result, the LB&I Division engaged SMEs to identify and provide feedback on high-risk areas and guidance before the returns are assigned to examiners. LB&I Division officials believe this provides examiners with the best starting point for reviewing issues.

The IRS uses soft letters to address partnership balance sheet discrepancies

The IRS sometimes uses voluntary compliance letters or "soft letters" to alert taxpayers to potential issues with their tax returns. Soft letters allow taxpayers the opportunity to address issues without the need for further contact, including an examination. Soft letters are also used to educate, inform, and encourage voluntary compliance. Although a response is not required, failure to provide a response, or providing an inadequate response, could result in an examination. In October 2023, the IRS sent Letter 6585, *PTE Campaign*, to 483 partnerships whose balance sheets contained a discrepancy.⁹

A partnership's balance sheet summarizes a company's transactions affecting assets, liabilities, and partner's capital accounts. Total assets should equal the sum of total liabilities and partner's capital accounts. If a balance sheet's accounts do not balance, it is likely that the statement was prepared incorrectly. The balance sheet totals on the last day of the tax year should match the

⁸ Machine-learning means a set of techniques that can be used to train AI algorithms to improve performance at a task based on data.

⁹ See Appendix II.

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totals on the first day of the following tax year. If they do not, a statement is required to be attached to explain the difference. Figure 3 shows the Form 1065, Schedule L, which reports balance sheet accounts as part of the return filed by partnerships.

Figure 3: Form 1065 (2021), Schedule L

Analysis of Net Income (Loss)							
1	Net income (loss). Combine Schedule K, lines 1 through 11. From the result, subtract the sum of Schedule K, lines 12 through 13d, and 21					1	
2	Analysis by partner type:	(i) Corporate	(ii) Individual (active)	(iii) Individual (passive)	(iv) Partnership	(v) Exempt Organization	(vi) Nominee/Other
a	General partners						
b	Limited partners						
Schedule L Balance Sheets per Books		Beginning of tax year		End of tax year			
Assets		(a)	(b)	(c)	(d)		
1	Cash						
2a	Trade notes and accounts receivable						
b	Less allowance for bad debts						
3	Inventories						
4	U.S. government obligations						
5	Tax-exempt securities						
6	Other current assets (attach statement)						
7a	Loans to partners (or persons related to partners)						
b	Mortgage and real estate loans						
8	Other investments (attach statement)						
9a	Buildings and other depreciable assets						
b	Less accumulated depreciation						
10a	Depletable assets						
b	Less accumulated depletion						
11	Land (net of any amortization)						
12a	Intangible assets (amortizable only)						
b	Less accumulated amortization						
13	Other assets (attach statement)						
14	Total assets						
Liabilities and Capital							
15	Accounts payable						
16	Mortgages, notes, bonds payable in less than 1 year						
17	Other current liabilities (attach statement)						
18	All nonrecourse loans						
19a	Loans from partners (or persons related to partners)						
b	Mortgages, notes, bonds payable in 1 year or more						
20	Other liabilities (attach statement)						
21	Partners' capital accounts						
22	Total liabilities and capital						

Source: Form 1065, U.S. Return of Partnership Income (2021).

An incorrectly recorded revenue or expense transaction could misstate assets, liabilities, or owners' equity, causing a discrepancy in the balance sheet. From a tax perspective, misstatements of income and expenses can cause an underreporting of tax.

Results of Review

Limited Time and Resources Prevented Questionable Returns Identified in the Soft Letter Campaign From Being Considered for Examination

The IRS sent Letter 6585 to 483 partnerships with balance sheet discrepancies and requested that they provide a response within 30 days with one of three options:

- 1) Provide the required reconciliation statement.
- 2) Correct the balance sheet.
- 3) Request an additional 15 days to respond.

The LB&I Division considers a tax return with balance sheet discrepancies and no explanation to be incomplete since the required reconciliation was not included with the return. This allows the IRS to initiate limited contact with the taxpayer to correct their return. Under Revenue Procedure 2005-32, which deals with the examination of returns, limited communication with the taxpayer to correct their return is not considered notice of an examination.¹⁰ The IRS can either accept or reject a response to Letter 6585. If no response is received, or the response is determined to be inadequate, the return may then be selected for examination. As shown in Figure 4, the IRS rejected more than half of the responses to Letter 6585.

Figure 4: The IRS Rejected Almost 57 Percent of Taxpayer Responses to Letter 6585

Responses to Soft Letters Issued to Partnerships	Number	Percentage
Response received	320	66%
No response	163	34%
Total	483	100%
Of those that responded:		
Response was rejected	182	57%
Response was accepted	138	43%

Source: LB&I Division Management.

The IRS rejected responses for a variety of reasons, such as insufficient evidence and inadequate documentation.

LB&I Division officials believed that issuing letters allowed the partnerships the opportunity to include the required statement to support the discrepancies, which would help determine if examining the tax return was necessary. PTE program management planned to have two revenue agents concurrently review taxpayers' responses to determine if the reconciliation

¹⁰ Rev. Proc. 2005-32 section 4.03, 2005-23 I.R.B. 1206, 2005-1 C.B. 1206.

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statements addressed the balance sheet discrepancy. If the reviewers rejected the taxpayer's response as inadequate or incomplete, they would identify issues that could be examined.

The second review was intended to provide an independent assessment and the opportunity for the second reviewer to agree or disagree with the lead reviewer's decision to accept or reject the taxpayers' responses. LB&I Division officials indicated that due to limited resources, the second review was performed after the initial review was completed rather than concurrently. In the reviews, revenue agents with expertise in various tax disciplines attempted to identify the source behind the balance sheet discrepancies and look for issues that could be examined. However, the duplicative levels of review being performed consecutively significantly extended the review process.

In April 2024, the LB&I Division decided not to conduct examinations on any of the partnership returns that received Letter 6585 because it needed to direct these resources to higher priority work, such as managing the LPC Program, which did not allow time to address the returns. According to the PTE program, the LB&I Division usually follows Internal Revenue Manual procedures not to initiate an examination with less than 12 months remaining on the assessment statute of limitations. For example, the TY 2021 returns identified for this soft letter initiative were filed during 2022, so the three-year statute of limitations expired in 2025.

The compliance review procedures for the partnership soft letter campaign were unnecessarily duplicative and did not account for the complexity of the type of tax return and the amount of time remaining to examine the tax returns. While the soft letter campaign was effective at identifying partnership returns the IRS believed should be examined, the process also allowed valuable time for examining the returns to lapse. In addition, due to limited resources and the statute of limitations, the IRS did not consider whether the 163 nonrespondents, or 182 rejected responses, required an examination. We believe the decision not to conduct examinations on partnerships that did not respond or whose responses were rejected presents a fairness issue and a burden for partnerships who potentially spent time and money responding to the letter.

The LB&I Division planned to provide a report to its executives summarizing the soft letter campaign and anticipated using information from this report to determine subsequent steps for this project. However, as of December 2025, PTE program management stated that while they intend to identify lessons learned from the soft letter campaign, it is not a priority to complete this exercise.

Recommendation 1: The Commissioner, LB&I Division, should ensure that future initiatives involving complex tax returns do not duplicate steps in the compliance risk analysis process and consider the statute of limitations to allow examiners sufficient time to review and take appropriate compliance actions.

Management's Response: IRS management agreed with this recommendation. The LB&I Division will adhere to compliance review procedures for future voluntary compliance letter initiatives by soliciting feedback to eliminate duplicate steps, where appropriate, to allow enough time to review and take appropriate compliance actions.

The Large Partnership Compliance Program Excluded Certain Returns for Examination Consideration

The AI model used to assist with the risk assessment of returns under the LPC Program analyzed 282,884 TY 2021 partnership returns with assets over \$10 million and identified 1,617 of the largest partnership returns for consideration.¹¹ The LB&I Division selected 150 of those returns spread across a distribution of industry categories within the large partnership population. As previously noted, they selected 78 returns for examination but increased the amount to 82 due to related transactions that involved additional partnerships. However, according to the IRS, 2,204 qualifying returns (0.8 percent) filed after February 2023 were automatically excluded from consideration for exam by this program because the selection process was only run once [REDACTED]. The LB&I Division said that returns not selected by the LPC Program could be selected for examination if the returns met criteria for an existing campaign or were related to a return already under examination.

Of the 82 returns selected for the LPC Program, almost all had a December 31, 2021, tax year-end. A partnership with a December 31 tax year-end can timely file a return by September 15 of the subsequent year with a filed extension. Partnerships with other fiscal year-end dates are not required to be filed before the respective extended due date, such as March 15 for a June 30 year-end. [REDACTED]

The LB&I Division stated it only ran the model once to ensure that employees could complete classification and SME risk assessments within 90 days and assign the returns to examiners with sufficient time remaining on the assessment statute of limitations. As mentioned earlier, the IRS has a policy of not initiating an examination with less than 12 months remaining on the assessment statute of limitations. The LB&I Division also attributed running the model only once due to limited resources, including classifiers and examiners.

The LB&I Division stated that it typically runs case selection models multiple times to ensure comprehensive coverage of tax return populations for a tax year, such as for its Large Corporate Compliance Program.¹² However, it does not have similar guidance to ensure that the LPC Program analyzes all partnership returns. The LB&I Division indicated that as the LPC Program matures, it anticipates increasing the frequency of the LPC modeling.

The LB&I Division is attempting to enhance the partnership compliance process by using AI and experienced tax experts to add more sophisticated risk assessment and identification of examination issues. Although this effort is in its initial stages, the risk of not including all partnership returns in the LPC Program, regardless of the taxpayer's fiscal year-end, provides an opportunity for large partnerships to evade a layer of review and reduces their examination potential. Running the model more than once to account for fiscal year filers ensures comprehensive coverage for large partnership returns.

¹¹ According to LB&I Division management, TY 2021 was used in the model because this was the most complete year of filed tax returns. Since a partnership return filed with a December year end is not due until two and a half months after the year end and allowed a six-month extension, TY 2022 returns were still being received.

¹² A program that assists with selecting the largest corporations for examination.

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Recommendation 2: The Commissioner, LB&I Division, should develop procedures to ensure that all large partnership returns filed throughout the year are considered for risk assessment by the LPC Program.

Management's Response: IRS management agreed with this recommendation. The LB&I Division will develop procedures that describe how it will run the selection process multiple times throughout the year to ensure that returns with fiscal year-ends are considered for risk assessment by the LPC Program.

Preliminary results of the LPC Program

The IRS continues its examinations of returns selected for the LPC Program. As of December 31, 2025:

- 43 of the returns are still under examination.
- 36 examinations were closed.
- 3 have not yet been assigned to an examiner.

Of the examinations that have been closed, 92 percent were no-change determinations. Although preliminary, these results indicate that the IRS may need to continue to further refine its selection models to ensure that it is selecting returns with the highest compliance risk.

Figure 5: Most LPC Program Examinations Remain Open as of December 31, 2025

Examination Status	Number of Returns
In progress	43
Closed with no changes	33
Selected but not assigned	3
Closed without examination	■
Closed with an adjustment	■
Total	82

Source: LB&I Division Management.

As previously mentioned, various workforce reduction initiatives have affected the IRS, causing the LB&I Division to assess its examination workload. The PTE program lost more than 200 employees during 2025, nearly half of which were revenue agents. As of December 2025, the LB&I Division indicated that it is focusing on balanced coverage across the division, including the LPC Program, that reflects the updated staffing levels.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to determine if the IRS is using available information to identify partnership noncompliance. To accomplish our objective, we:

- Reviewed the selection processes the IRS used for compliance actions related to partnership returns. We discussed the modeling process with the IRS to identify returns for examination as well as using campaigns and soft letters as compliance tools. We obtained information on modeling processes the LB&I Division used to identify returns for examination.
- Reviewed the process the IRS used to select the 78 large partnership returns for examination during the First Quarter of Fiscal Year 2024. We discussed the AI modeling that is used as a tool for analyzing large complex returns. We obtained a list of factors used to calculate a risk number for returns which was used to isolate returns for classifiers to determine the 78 returns selected for examination. We also learned that the LB&I Division planned to examine 78 returns, but transactions were found between related entities that increased the total number of returns examined to 82. We obtained the tools classifiers used to determine risk of the 82 returns. We learned through discussions with the LB&I Division that the model is run only once per tax year and that returns that are filed after a cut-off period are not considered in the model and may be considered for examination either through a campaign or selected as a related return. We reviewed the examination status of the 82 returns using the list the IRS provided as of June 30, 2024, with updates as of June 30, 2025, and December 31, 2025.
- Reviewed the process the IRS used to select 483 large partnership returns for soft letters during the First Quarter of Fiscal Year 2024. We discussed the development of the balance sheet discrepancy campaign with the LB&I Division and how the 483 partnerships were selected to receive letters to address the discrepancies. We obtained information concerning the roles of those within the IRS involved in the process from issuing the letters to receiving and reviewing responses. We obtained the tracking worksheets used that included reasons why the IRS accepted or rejected the response. We learned how many responses were received and how many no responses there were through May 2024. We obtained information for reasons why the IRS changed its procedure to not continue with identifying returns for potential examination, which was contrary to what it reported publicly.

Performance of This Review

This review was performed with information obtained from the IRS's LB&I Division, headquartered in Washington, D.C, during the period December 2023 through February 2025. 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.

Data Validation Methodology

We reviewed and analyzed computerized information obtained from the IRS using Audit Information Management System extracts from our Data Center Warehouse. We evaluated the data by (1) performing electronic testing of required data elements, (2) reviewing existing information about the data and the system that produced them, and (3) obtaining clarification of our analysis from agency officials knowledgeable about the data. We determined that 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 that the following internal controls were relevant to our audit objective: the procedures used to identify factors to program into the AI model, the classification to select the returns, and the post classification by SMEs who reviewed the returns before issuing to examiners were important in addressing the LPC Program controls. The concurrent review by SMEs for soft letter responses was important in assessing the balance sheet discrepancy soft letter campaign. We evaluated these controls by reviewing and analyzing relevant data and interviewing IRS employees.

Letter 6585, Soft Letter PTE Campaign



Department of the Treasury
Internal Revenue Service
Large Business & International Division
3651 S. IH 35
MS 4301 AUSC
Austin, TX 78741

[Recipient name]
[Address line 1]
[Address line 2]
[Address line 3]

Date:
Partnership name:
Partnership ID number (last 4 digits):
Form:
Tax years:
VMS Hotline telephone number:
Fax number:
Response due date:

Dear [Name]:

Why we're writing to you

You have one or both of the following discrepancies on your Form 1065, Schedule L, Balance Sheet per Books:

- The amounts in the beginning of year columns on your 2021 Schedule L doesn't match the amounts in the end of year columns on your 2020 Schedule L.
- Your 2020 and/or the 2021 Schedule L doesn't balance in that the Total Assets doesn't equal Total Liabilities and Capital.

What you need to do

Complete the attached Response to Letter 6585 and return it with the required statement and any attachments by the response due date at the top of this letter using one of the following methods:

- Mail the response to the address at the top of this letter.
- Fax the response to the number at the top of this letter using either a fax machine or online fax service. Protect yourself when sending digital data by understanding the fax service's privacy and security policies.

What may happen if we don't hear from you by the due date or if we receive an inadequate response

We may refer your return for examination. We may also charge interest and penalties on any underpayments of tax.

What to do if you want someone to represent you

Send a completed Form 2848, Power of Attorney and Declaration of Representative, with your response.

Where you can find more information

- Visit [IRS.gov/BBAPartnerships](https://www.irs.gov/BBAPartnerships) for information about partnership reporting.
- Visit [IRS.gov/DesignatePR](https://www.irs.gov/DesignatePR) for information about how to designate a partnership representative.
- Find tax forms or publications by visiting [IRS.gov/forms](https://www.irs.gov/forms) or calling 800-TAX-FORM (800-829-3676).

If you have questions, call us at the telephone number on the first page of this letter. We'll respond to your message within five business days.

Keep a copy of this letter and any document you send to us for your records.

**The IRS Has Yet to Determine a Successful
Strategy for Examining Large Partnership Returns**

Thank you for your cooperation.

Sincerely,

Director, Pass-Through Entities Practice Area

Letter 6585 (9-2023)
Catalog Number 94243X

**The IRS Has Yet to Determine a Successful
Strategy for Examining Large Partnership Returns**

Response to Letter 6585

[Insert RECIPIENT Identifier and/or address]

Complete and mail to:

Internal Revenue Service
LB&I Division
3651 S. IH 35
MS 4301 AUSC
Austin, TX 78741

Or fax to:

[]

Choose one of the following options, check the applicable box, and follow the guidance provided. Return this document, any required statements and attachments, and the completed and signed penalties of perjury statement by the response due date on the letter.

Option 1 - Send us the required statement of explanation

Send us the missing statement, which was required as an attachment to the filed return, explaining the balance sheet discrepancies with a copy of this letter. Your statement must include a detailed description of the transactions that caused the differences on the balance sheets.

Option 2 - Send us a statement of explanation WITH a copy of an amended return or Administrative Adjustment Request (AAR)

If you determine, in addition to providing the statement of explanation, that you need to correct the balance sheet amounts reported for 2020 and/or 2021, you can file an Administrative Adjustment Request (AAR) (if partnership subject to IRC sections 6221 through 6241) or an amended return (if not subject to IRC sections 6221 through 6241).

- If you're filing on paper, write "Response to Letter 6585" at the top of the first page.
- If you're filing electronically, include "Response to Letter 6585" in the section when explaining the reason for the filing.
- Include a copy of your filed AAR or amended return with your statement of explanation.

For information on how to file an AAR or amended return, please refer to following online guidance:

- For Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR), visit [IRS.gov/Form8082](https://www.irs.gov/Form8082).
- For Form 1065-X, Amended Return or Administrative Adjustment Request (AAR), visit [IRS.gov/Form1065X](https://www.irs.gov/Form1065X).
- For general filing information, visit [IRS.gov/filing](https://www.irs.gov/filing).

Option 3 - Request an additional 15 days to respond

If you need more time, send us a written or faxed request. We must receive your request before the response due date on the first page of the letter.

Letter 6585 (9-2023)
Catalog Number 94243X

**The IRS Has Yet to Determine a Successful
Strategy for Examining Large Partnership Returns**

Penalties of perjury statement

I, _____, declare under penalties of perjury that I have examined this entire document, including all attachments, and accompanying statements, and that the enclosed is true, correct, and complete. I also understand with respect to any submission that, the IRS reserves the right to contact me and my representatives to clarify any written explanation or other documents. Statements and documents sent under this option will be checked against other sources for accuracy.

Signature

Title

Date

Additional information

This inquiry letter does not constitute an examination under Internal Revenue Code Section 7605(b) or a contact regarding an examination under Treasury Regulation 1.6664-2(c)(3)(i)(A) for purposes of defining a qualified amended return. If you're under audit or have other matters before the IRS, consult your examiner or point of contact.

Letter 6585 (9-2023)
Catalog Number 94243X

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

February 20, 2026

MEMORANDUM FOR DIANA M. TENGESDAL
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Mabeline T. Baldwin Digitally signed by Mabeline T. Baldwin
Date: 2026.02.20 13:23:33 -05'00'
Acting Commissioner, Large Business and International Division

SUBJECT: Draft Audit Report – The IRS Has Yet to Develop a Successful
Strategy for Examining Large Partnerships Returns
(Audit # 2024308014)

Thank you for the opportunity to review and comment on the subject draft audit report titled, *The IRS Has Yet to Develop a Successful Strategy for Examining Large Partnerships Returns*. We appreciate TIGTA's recognition of the IRS's ongoing efforts to address the increasing complexity of large partnership filings.

The consolidated Pass-Through Entities Practice Area was created partly in response to the findings of various TIGTA and Government Accountability Office audits, which noted that the IRS has not historically examined a proportionate number of pass-through filings as compared to individuals and corporations. The IRS centralized different partnership groups under one umbrella organization, providing a more consistent approach and taxpayer experience to support more than 14 million U.S. filers¹— including partnerships, S-corporations and trusts.

Tiered partnership structures present challenges in identifying noncompliance because the noncompliance may occur in lower tiers that the IRS cannot readily identify when it first reviews the transaction. As a result, examinations may result in a “no change” to the partnership return and instead propose adjustments to related returns. Therefore, measuring the impact of a partnership examination solely through the lens of the change to the partnership return does not capture the true compliance impact of the examination.

¹ Internal Revenue Service, Fiscal Year Return Projections for the United States, Fall 2025, Publication 6292, September 2025, <https://www.irs.gov/statistics/soi-tax-stats-fiscal-year-projections-publication-6292>

**The IRS Has Yet to Determine a Successful
Strategy for Examining Large Partnership Returns**

2

As with any new initiative, the IRS recognizes the importance of learning and improving over time by incorporating feedback from both internal and external stakeholders. The IRS remains focused on fairness, improved compliance, and reducing the tax gap.

We agree with TIGTA's recommendations. Attached is our detailed response to the recommendation. If you have any questions, please contact Joseph Banks, Acting Director, Pass-Through Entities Practice Area, Large Business and International Division.

Attachment

**The IRS Has Yet to Determine a Successful
Strategy for Examining Large Partnership Returns**

Attachment

RECOMMENDATION 1:

The Commissioner, LB&I Division, should ensure that future initiatives involving complex tax returns do not duplicate steps in the compliance risk analysis process and consider the statute of limitations to allow examiners sufficient time to review and take appropriate compliance actions.

CORRECTIVE ACTION:

The IRS agrees with this recommendation. The LB&I Division will adhere to compliance review procedures for future voluntary compliance letter initiatives by soliciting feedback to eliminate duplicate steps, where appropriate, to allow enough time to review and take appropriate compliance actions.

RESPONSIBLE OFFICIAL:

Director, Pass Through Entities Practice Area.

IMPLEMENTATION DATE:

September 30, 2027

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 2:

The Commissioner, LB&I Division, should develop procedures to ensure that all large partnership returns filed throughout the year are considered for risk assessment by the LPC Program.

CORRECTIVE ACTION:

The IRS agrees with this recommendation. The LB&I Division will develop procedures that describe how we will run the selection process multiple times throughout the year to ensure returns with fiscal year-ends are considered for risk assessment by the LPC Program.

RESPONSIBLE OFFICIAL:

Director, Pass Through Entities Practice Area.

IMPLEMENTATION DATE:

September 30, 2027

CORRECTIVE ACTION MONITORING PLAN:

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

Glossary of Terms

Term	Definition
Artificial Intelligence	A machine-based system that can, for a given set of human-defined objectives, make predictions, recommendations, or decisions influencing real or virtual environments. AI systems use machine and human-based inputs to perceive real and virtual environments; abstract such perceptions into models through analysis in an automated manner; and use model inference to formulate options for information or action.
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The federal government's fiscal year begins on October 1 and ends on September 30.
Internal Revenue Code	The body of law that codifies all federal tax laws. These laws constitute Title 26 of the United States Code, which is a consolidation and codification by subject matter of the general and permanent laws of the United States.
Internal Revenue Manual	The primary source of instructions to employees relating to the administration and operation of the IRS. The Manual contains the directions employees need to carry out their operational responsibilities.
Statute of Limitations	A specified period of time for correction of taxes by the IRS, usually three years from the due date or received date of the return, whichever is later.
Tax Year	A 12-month accounting period for keeping records of income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

Abbreviations

AI	Artificial Intelligence
IRA	Inflation Reduction Act of 2022
IRS	Internal Revenue Service
LB&I	Large Business and International Division
LPC	Large Partnership Compliance
PTE	Pass-Through Entity
SME	Subject Matter Expert
SOP	Strategic Operating Plan
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year



**To report fraud, waste, or abuse,
contact our hotline on the web at
<https://www.tigta.gov/reportcrime-misconduct>.**

**To make suggestions to improve IRS policies, processes, or systems
affecting taxpayers, contact us at
TIGTACommunications@tigta.treas.gov.**

Information you provide is confidential, and you may remain anonymous.