

MSP
#9**FIELD EXAMINATION: The IRS's Field Examination Program Burdens Taxpayers and Yields High No Change Rates, Which Waste IRS Resources and May Discourage Voluntary Compliance****RESPONSIBLE OFFICIALS**

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TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

Internal Revenue Code (IRC) § 7602(a) provides the IRS with the authority to conduct examinations to determine whether a tax return is correct, to create a return where the taxpayer has not filed, and to determine a taxpayer's tax liability. In fiscal year (FY) 2017, the IRS conducted only 29 percent of all audits and 23 percent of individual income tax return audits in the field or in an office, with the remaining conducted by correspondence.² Both IRS operating divisions conducting field audits, Small Business/Self-Employed (SB/SE) and Large Business and International (LB&I), have conducted fewer field exams in recent years, with approximately 272,000 field exams in FY 2010 and only about 156,000 field exams in FY 2018.³

The primary objective in identifying tax returns for examination is to promote the highest degree of voluntary compliance.⁴ However, the IRS may not be driving voluntary compliance and further, may have no way of knowing whether it is doing so as a result of its field exams. Between FY 2010 and FY 2018, an average of about 23 percent of SB/SE field audits and about 32 percent of LB&I field audits

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 IRS Data Book, 2017, Publication 55B, 22-23 (Mar. 2018).

3 IRS, Compliance Data Warehouse (CDW), Automated Information Management System (AIMS) fiscal year (FY) 2010 and 2018 (Dec. 2018). Due to the lapse in appropriations, the Large Business and International Division (LB&I) did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

4 Internal Revenue Manual (IRM) 1.2.13.1.10, *Policy Statement 4-21* (June 1, 1974).

resulted in no change.⁵ Research shows that no change audits result in greater future noncompliance.⁶ When measuring results, the IRS appears to look primarily at the bottom line from specific audits per resources expended—measuring closures, cycle time, employee satisfaction, and quality scores—and not the indirect effects. Moreover, neither SB/SE nor LB&I have a measure to track whether future filing or payment compliance increases after an audit. Although both divisions track the number of requests for audit reconsideration, they do not track how many of these audit reconsiderations are eventually appealed by the taxpayer.⁷

From a taxpayer's perspective, field audits provide an opportunity to interact with IRS employees face-to-face and work directly with a single employee or team. However, some taxpayers may not have access to all IRS employees making decisions about their issues, such as technical specialists. Others experience difficulty in understanding the scope of the audit due to a lack of transparency or overly broad document requests. The IRS has no formal centralized system to track taxpayer complaints and requests to speak to a manager in field exams. As a result, the IRS reduces the opportunities for two-way communication to learn why a particular issue should not be examined and what taxpayers are doing wrong, intentionally or unintentionally.

The National Taxpayer Advocate is concerned that:

- The IRS may be wasting resources and failing to drive future voluntary compliance due to the high no change rates for its field audits;
- The primary purpose of audits is to improve voluntary compliance, yet the IRS does not measure how field audits affect taxpayers' future filing behavior and attitudes towards tax administration;
- With declining numbers of field audits, the IRS must ensure that it selects the best cases to drive future compliance;
- A lack of transparency during field exams, including SB/SE's declining to share an individual exam plan with the taxpayer, infringes on the taxpayer's *right to be informed*; and
- The IRS does not provide a clear path for taxpayers to elevate issues nor does it track taxpayer complaints about field exams.

These shortcomings in the field examination process impair taxpayers' rights *to be informed, to quality service, to pay no more than the correct amount of tax, to challenge the IRS's position and be heard, and to a fair and just tax system.*

5 IRS, CDW, AIMS FY 2010 to FY 2018 (Dec. 2018). IRM 4.4.12.5.49.1, *No Change Disposal Codes* (June 1, 2002) defines a no change as a case closed by the examiner with no additional tax due (disposal code 1 and 2). In the Small Business/Self-Employed Division (SB/SE) response to TAS fact check (Dec. 20, 2018), SB/SE notes disposal code 1 as an agreed closure. TAS does not agree with the SB/SE definition because these cases do not require agreement from the taxpayer since there is no additional tax liability (see, e.g., IRM 4.10.8.2.2, *No Change with Adjustments Report Not Impacting Other Tax Year(s)* (Sept. 12, 2014)) and the taxpayer's agreement, or disagreement, with the adjustment(s) as it pertains to another's year's liability is not known. Treasury Inspector General for Tax Administration (TIGTA) Report 2018-30-069 concurs with TAS's definition. Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

6 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2 67-100 (Sebastian Beer, Matthias Kasper, Erich Kirchlner, Brian Erard, *Audit Impact Study*).

7 IRS responses to TAS information request (Nov. 1, 2018); Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

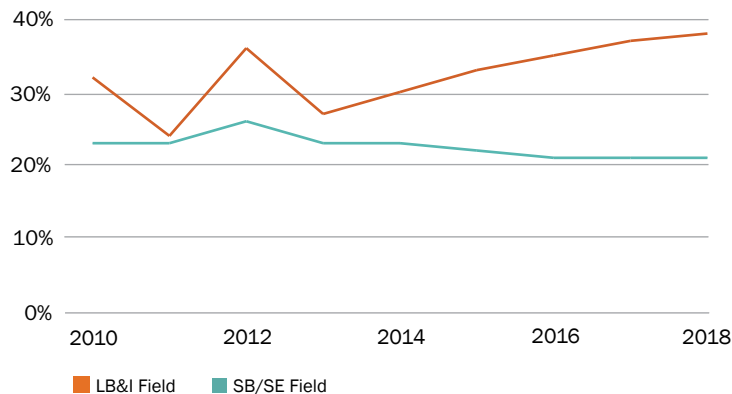
ANALYSIS OF PROBLEM

The IRS May Be Wasting Resources and Failing to Drive Voluntary Compliance Due to the High No Change Rates For Its Field Audits

There are direct and indirect effects from audits that propose no additional tax to be assessed (“no change” audits). First, a no change audit means the IRS has expended time and resources without assessing any additional dollars that can be collected from the taxpayer. Second, the IRS may have prompted the taxpayer to choose to report less tax in the future. A 2015 study conducted for TAS found that self-employed taxpayers filing Schedule C who received a no change audit reduced their reported income by 37 percent three years after the audit.⁸ This is in contrast to taxpayers with audits recommending an additional tax assessment, who instead increased the amount of tax they reported after the audit by an average of 250 percent.⁹ A recent study also found that taxpayers with audits recommending additional tax report a higher perceived risk of future audits, which may explain why they increased the amount of tax they reported in subsequent years.¹⁰ Despite the direct and indirect effects of audits, the IRS maintains a high no change rate for its field exams, as shown in Figure 1.9.1.

FIGURE 1.9.1¹¹

No Change Rate for Field Exams Closed During FY 2010-2018



8 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2 88 (Research Study: *Audit Impact Study*).

9 *Id.*

10 See Brian Erard, Matthias Kasper, Erich Kirchler, and Jerome Olsen, Research Study: *What Influence do IRS Audits Have on Taxpayer Attitudes and Perceptions? Evidence from a National Survey*, *infra*.

11 IRS, CDW, AIMS FY 2010 to FY 2018 (Dec. 2018). IRM 4.4.12.5.49.1, *No Change Disposal Codes* (June 1, 2002) defines a no change as a case closed by the examiner with no additional tax due (disposal code 1 and 2). In the SB/SE response to TAS fact check (Dec. 20, 2018), SB/SE notes disposal code 1 as an agreed closure. TAS does not agree with the SB/SE definition because these cases do not require agreement from the taxpayer since there is no additional tax liability (see, e.g., IRM 4.10.8.2.2, *No Change with Adjustments Report Not Impacting Other Tax Year(s)* (Sept. 12, 2014)) and the taxpayer’s agreement, or disagreement, with the adjustment(s) as it pertains to another liability is not known. TIGTA Report 2018-30-069 concurs with TAS’s definition. Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

The no change rate for SB/SE field exams has remained steady over recent years at close to a quarter of exams, meaning almost a quarter of the SB/SE field audits may actually be encouraging taxpayers to become less compliant.¹² LB&I, on the other hand, had higher no change rates in its field audits, about 32 percent on average from FY 2010 to FY 2018, demonstrating that LB&I may not be achieving its stated goal of targeting noncompliance.¹³ For corporate taxpayers, over 100 of whom are under continuous audit, this no change rate is particularly concerning.¹⁴

The Primary Purpose of Audits Is to Improve Voluntary Compliance, yet the IRS Does Not Measure How Field Audits Affect Taxpayers' Future Filing Behavior and Attitudes Towards Tax Administration

Although audits do have a direct effect in terms of recommending additional tax dollars to be assessed, the overarching goal should be improving voluntary compliance. In fact, the IRS gains about twice as much from the long-term effects of an audit than it does from the actual audit itself when one compares additional reported taxable income in years following the audit with the additional dollars assessed as a direct result of the audit.¹⁵ IRS Policy Statement 4-21 identifies promoting voluntary compliance as the primary driver of selecting returns for audits.¹⁶ One scholar explains what it means for the U.S. tax system to be based on voluntary compliance:

It means that the tax authority does not have adequate resources, and never did, to assess taxes against each taxpayer directly or audit every return. Since the IRS cannot execute either of these practices, it instead relies on individual taxpayers to accurately assess their own tax liability on annual returns and timely pay the correct amount due.¹⁷

Key to increasing voluntary compliance is building trust in taxpayers. To encourage this trust the IRS must focus on perceived fairness, which includes distributive justice, procedural justice, and retributive justice.¹⁸ In terms of procedural justice, “taxpayers consider the treatment by the tax authorities, information provided, costs regarding compliance and administration, and the dynamics of allocation of revenues.”¹⁹ Transparency also plays a role as “increased information related to tax law and explanations

12 When excluding SB/SE field exams conducted as part of the National Research Program (NRP), the no change rate is similar—an average of approximately 22 percent for SB/SE non-NRP exams for FY 2010-2018. IRS, CDW, AIMS FY 2010 through FY 2018 (Dec. 2018). “NRP audits are selected through stratified random sampling and therefore the no change rate would be expected to be higher than returns that are being selected for examination due to indications of a high risk of noncompliance.” IRS response to TAS fact check (Dec. 21, 2018).

13 Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

14 IRS, CDW, AIMS FY 2010 through FY 2017 (Dec. 2018). LB&I is transitioning its former continuous audit program for large corporations, the Coordinated Industry Case program, to the new Large Corporate Compliance program, which aims to develop better risk profiles for large corporations. Nonetheless, the group of high risk taxpayers under continuous audit is currently over 100 taxpayers, down only slightly from 2016. LB&I Business Performance Review, FY 2018 4th Quarter (Nov. 16, 2018).

15 Jason DeBacker, Bradley T. Heim, Anh Tran, and Alexander Yuskavage, *Once Bitten, Twice Shy? The Lasting Impact of IRS Audits on Individual Tax Reporting* (Aug. 25, 2015) (working paper, Indiana University), <https://pdfs.semanticscholar.org/3833/61d62ea27f93deb89bf2c4b926bc5e96e14b.pdf>.

16 IRM 1.2.13.1.10, *Policy Statement 4-21* (June 1, 1974).

17 J.T. Manhire, *What Does Voluntary Tax Compliance Mean?: A Government Perspective*, 164 U. Pa. L. Rev. Online 11 (2015), <http://www.pennlawreview.com/online/164-U-Pa-L-Rev-Online-11.pdf>.

18 Erich Kirchler, Erik Hoelzl, and Ingrid Wahl, *Enforced versus Voluntary Tax Compliance: The “Slippery Slope” Framework*, 29 J. Econ. Psychol. 218-219 (2008).

19 Distributive justice concerns the exchange of resources, both benefits and cost, and retributive justice applies when the sanctions for breaking rules are perceived as appropriate. *Id.*

for changes can increase fairness perceptions.”²⁰ Also important are a culture of interaction, perceived neutrality regarding the treatment of different groups, and equal and respectful treatment of taxpayers.²¹ Finally, metrics used to evaluate examinations should look at three types of indirect effects: (1) induced effects, which are behavior changes due to a change in the enforcement level or audit rate; (2) subsequent period effects, which are changes in an individual taxpayer’s behavior post-audit; and (3) group effects, which are changes in compliance by members of the taxpayer’s social network.²²

In measuring the effectiveness of the field audit program, the IRS appears to look primarily at the bottom line from specific audits per resources expended, without measuring the indirect effects, including social network effects. SB/SE’s Business Performance Review (BPR) reflects that the IRS measures closures, cycle time, employee satisfaction, and quality scores.²³ LB&I’s BPR includes similar performance measures.²⁴ In 2014, the National Taxpayer Advocate recommended that the IRS “[a]dopt ‘increasing voluntary compliance’ as the primary measure for evaluating both enforcement and taxpayer service initiatives.”²⁵ However, neither SB/SE nor LB&I have added a measure to track whether future filing or payment compliance increases after an audit.²⁶ Further, neither operating division has a system in place to track if audited taxpayers are compliant in future years.

The current measures may not be useful if the IRS does not choose the correct cases for an audit. Cycle time may be quick if the IRS is auditing taxpayers who are relatively compliant. Closing cases may not be a positive outcome if the taxpayer does not feel the issues are resolved. Although both SB/SE and LB&I track audit reconsiderations, neither tracks how many of these reconsiderations go to the IRS Office of Appeals, meaning the IRS does not know when it gets the answer wrong or when there are hazards of litigation, both of which should inform audit selection.²⁷

In addition to subsequent compliance, the IRS should also track taxpayers’ attitudes towards the IRS, tax administration, and paying their taxes after an audit. A study commissioned by TAS found that in terms of taxpayers’ attitudes towards the IRS and paying taxes, no change audits resulted in the most positive taxpayer attitudes, greater than taxpayers receiving a refund.²⁸ Taxpayers with additional taxes proposed had the most negative attitudes after an audit.²⁹ Likewise, taxpayers with additional taxes proposed reported a weaker sense of procedural and distributive justice, lower levels of trust in the IRS, a greater sense of coercion, and more feelings of anger.³⁰ Although reducing the number of taxpayers with additional tax proposed is not desirable, the IRS could still use metrics such as these to drive changes to

20 Erich Kirchler, Erik Hoelzl, and Ingrid Wahl, *Enforced versus Voluntary Tax Compliance: The “Slippery Slope” Framework*, 29 J. ECON. PSYCHOL. 219 (2008).

21 *Id.*

22 Kim Bloomquist, *Incorporating Indirect Effects in Audit Case Selection: An Agent-Based Approach*, IRS Research Bulletin 103 (2012), <https://www.irs.gov/pub/irs-soi/12resconincorporating.pdf>.

23 SB/SE FY 2018 1st Quarter Business Performance Review (BPR). BPRs review the operating divisions’ progress on meeting their performance goals and report on new or emerging issues that may affect programs and performance. IRM 1.5.1.15, *Proposing, Reviewing, and Updating Performance Budget Measures* (Sept. 24, 2014).

24 IRS response to TAS information request (May 4, 2018). Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

25 National Taxpayer Advocate 2014 Annual Report to Congress 122.

26 IRS response to TAS information request (Nov. 1, 2018). Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

27 *Id.*

28 See Brian Erard, Matthias Kasper, Erich Kirchler, and Jerome Olsen, *Research Study: What Influence do IRS Audits Have on Taxpayer Attitudes and Perceptions? Evidence from a National Survey*, *infra*.

29 *Id.*

30 *Id.*

the way the IRS conducts audits. For example, the IRS could test whether a greater focus on educating the taxpayer during the audit might reduce feelings of coercion because a taxpayer would understand the mistake made. Greater transparency at the beginning of the exam (discussed below) could reduce feelings of mistrust.

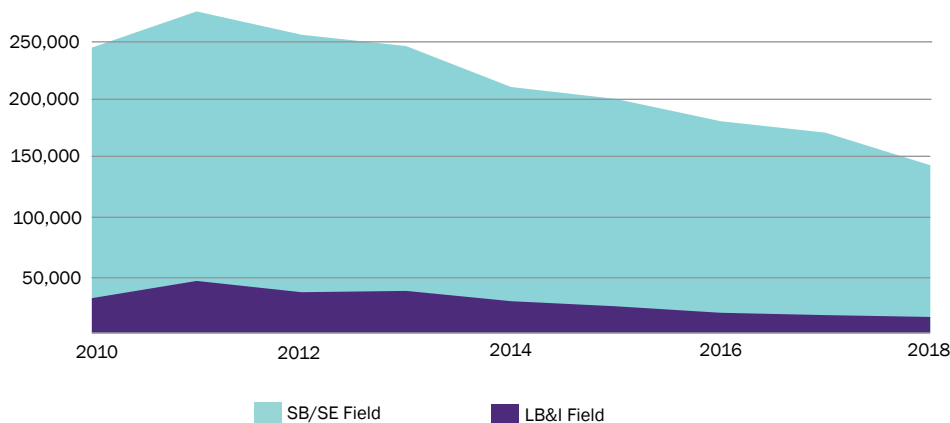
The field exam customer satisfaction surveys do not capture this information because they are more focused on how the taxpayer feels about a specific encounter and not how the taxpayer might alter their behavior in the future. LB&I reports that it has been collaborating with Research, Applied Analytics and Statistics (RAAS) to conduct behavioral research related to the LB&I campaigns to determine their impact on taxpayer behavior.³¹ The National Taxpayer Advocate encourages the IRS to continue with this research and conduct behavioral research regarding all audit treatments to better understand how they may affect voluntary compliance.

With Declining Numbers of Field Exams and Revenue Agents, the IRS Must Ensure That It Selects the Best Cases to Drive Future Compliance

As shown in Figure 1.9.2, both SB/SE and LB&I field audits have been declining in recent years, reflecting that both operating divisions may need to be more discriminating as managers must choose to survey more cases and audit less.

FIGURE 1.9.2³²

Volume of Field Audit Closures by Operating Division FY 2010-2018



Both LB&I and SB/SE focus largely on the current compliance risk—choosing returns based primarily on anticipated noncompliance found on that specific return. SB/SE selects over 22 percent of audits

31 IRS response to TAS information request (May 4, 2018). Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

32 IRS, CDW, AIMS FY 2010 to FY 2018 (Nov. 2018) for LB&I. IRS response to TAS fact check (Dec. 20, 2018). Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

based on the computer program Discriminant Function (DIF),³³ and over half of its audits based on a related-year audit, meaning instead of auditing a new taxpayer, it opens an audit on another tax year for a taxpayer already under audit.³⁴ As a result, there is only a limited number of audits to be selected from other criteria such as information matching and compliance projects. Although the Treasury Inspector General for Tax Administration (TIGTA) recently criticized SB/SE for not auditing enough related-year returns,³⁵ this criticism considered only the bottom line in terms of direct revenue from the examination. When one considers the indirect effects of an examination, including how the audited taxpayer and the taxpayer's peers in the community or industry might change their behavior, it is clear that audit selection must go beyond just the dollars assessed on a return.

LB&I uses the computerized scoring system, known as the Discriminant Analysis System (DAS), to score returns for corporations with assets over \$10 million to be delivered to the field.³⁶ Recent Government Accountability Office (GAO) audits of both SB/SE and LB&I show weaknesses for both operating divisions in how they document and justify managers' final decisions about whether to audit or survey a case that is included in the queue of potential cases.³⁷ Thus, even if computer systems such as the DIF or the DAS are effective in weeding out and not selecting taxpayers who are likely compliant, the IRS may not be making the best decisions in the end regarding which taxpayers in the queue to audit.

To be more nimble in identifying emerging trends and creating an enforcement presence, LB&I initiated the "campaign" program, in which it will conduct issue-based examinations and apply one or multiple treatment streams based on compliance risk.³⁸ There are currently 45 campaigns, and examples include: Foreign Earned Income Exclusion, Swiss Bank Program, IRC 48C Energy Credit, and Deferral of Cancellation of Indebtedness Income.³⁹ Although the long-term plan is for the campaigns to constitute a significant part of the LB&I compliance program, currently they only comprise a small minority—only about six percent—of LB&I's audit work.⁴⁰ LB&I is reportedly working to create metrics for the campaigns, but it is unclear how the IRS currently determines a campaign is not working and should

33 "The Discriminant Function (DIF) is a risk-based method of scoring tax returns for examination potential. The models are based on the mathematical technique called discriminant analysis and are developed using data from the National Research Program or the prior Taxpayer Compliance Measurement Program (TCMP) data." IRS response to TAS fact check (Dec. 21, 2018). Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

34 These prior or subsequent year returns were mostly related to methods for trying to shelter income and DIF-identified returns. Government Accountability Office (GAO), *IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened*, GAO 16-103 (Dec. 2015).

35 TIGTA, *Improvements Are Needed to Ensure Adequate Consideration of the Pickup of Prior and/or Subsequent Returns During Field Examinations*, 2018-30-073 (Sept. 17, 2018).

36 IRS response to TAS information request (May 4, 2018). IRS, *2016 Internal Revenue Service Advisory Council (IRSAC) Large Business and International Report* (Sept. 30, 2017), <https://www.irs.gov/tax-professionals/2016-irsac-lbi-report>. Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

37 GAO, *IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened*, GAO 16-103 (Dec. 2015); GAO, *IRS Return Selection: Improved Planning, Internal Controls, and Data Would Enhance Large Business Division Efforts to Implement New Compliance Approach*, GAO 17-324 (Mar. 2017).

38 IRS, *IRS Announces Initial Rollout of Campaigns* (June 28, 2018), <https://www.irs.gov/businesses/large-business-and-international-launches-compliance-campaigns>.

39 IRS response to TAS information request (Nov. 1, 2018). IRS, *Full List of LB Large Business and International Campaigns* (Oct. 30, 2018), <https://www.irs.gov/businesses/full-list-of-lb-large-business-and-international-campaigns>. Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

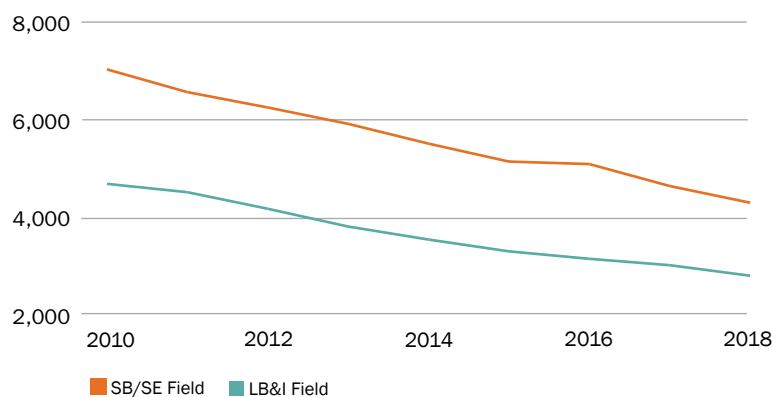
40 LB&I FY 2018 3rd Quarter BPR. Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

be abandoned, or perhaps should be broadened and expanded. The IRS recently ended some of its campaigns, but has not developed a strategy to communicate the terminations publicly.⁴¹ Without a system in place to provide updates on the exams conducted as part of the campaigns in real time—for example, when an issue is closed or an exam is agreed to—the IRS will not be able to adjust its exam strategy at the earliest point in time.

Not surprisingly, a reduction in Revenue Agents corresponds with the reduction in field exams over recent years. Both IRS operating divisions conducting field exams in FY 2018 employed only about 60 percent of the Revenue Agents they had in FY 2010.

FIGURE 1.9.3⁴²

Nonsupervisory Revenue Agents Last Pay Period of FY 2010 to FY 2018



This reduction makes it more critical for the IRS to ensure it has exam employees in the right locations. LB&I states that organizational components generally have discretion to decide at which locations to hire based on workload.⁴³ However, looking at past or current workload may not allow the IRS to have staffing in place in the right locations as it identifies emerging trends. Similarly, SB/SE may be taking a myopic view in selecting locations to hire examiners. For non-specialty examiners, SB/SE uses workload studies to distribute workload based on the geographic locations with the highest DIF scores.⁴⁴ However, only about a fifth of SB/SE field audits are based on DIF scores.⁴⁵ SB/SE was planning a new partnership audit selection process known as Flow-through Initiatives, partnering Field Case Selection with RAAS to improve workload selection for flow-through returns with emphasis on using data to

41 Amanda Athanasiou, *IRS Weighing Termination of LB&I Campaigns*, TAX NOTES TODAY (Nov. 8, 2018).

42 IRS Human Resources Reporting Center, *Workforce Information by Organization Report* for the ending pay period FY 2010 to FY 2018 for non-supervisory Revenue Agent jobs series 512. SB/SE counts do not include SB/SE campuses. Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

43 IRS response to TAS information request (Nov. 1, 2018). Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

44 IRS response to TAS information request (Nov. 1, 2018).

45 GAO, *IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened*, GAO 16-103 (Dec. 2015).

Both IRS operating divisions conducting field exams in Fiscal Year (FY) 2018 employed only about 60 percent of the Revenue Agents they had in FY 2010.

create business rules, statistical models, and select returns using an enterprise case approach. However, the IRS abruptly ended this initiative due to “resources.”⁴⁶

A Lack of Transparency During Field Exams, Including SB/SE’s Declining to Share an Individual Exam Plan With the Taxpayer, Infringes on the Taxpayer’s Right to Be Informed

The IRS misses opportunities by not learning from taxpayers during exams what the taxpayers are doing wrong, either intentionally or unintentionally. Although the focus of examinations can change as the audit unfolds, providing greater transparency at the beginning of an exam would allow the taxpayer to raise concerns that might show why an issue should not be examined or where taxpayers could use additional guidance. This transparency might also allow taxpayers to change their filing behavior for later years or correct errors via amended returns. Instead, taxpayers may not understand the focus of the examination until midway through.

When LB&I initiates an audit, it shares with the taxpayer an examination plan for that particular audit that includes the issues to be examined, timeframes, personnel required, processes to be followed, and respective responsibilities.⁴⁷ Both members of the exam team and the taxpayer sign the plan, committing to achieving the timeline set out.⁴⁸ When asked why SB/SE does not share a similar audit plan with the taxpayer, it stated: “SB/SE audits are more focused, with smaller scope, less complex and faster cycle time which does not warrant a full in-depth audit plan like LB&I’s process,” and “[g]enerally SB/SE examiners share/discuss the issues that will be audited and provide the taxpayers with an Information Document Request (IDR) prior to the initial appointment.”⁴⁹ However, the IDR may not provide the same level of detail as the LB&I exam plan nor is it a substitute for it.⁵⁰

Before the LB&I exam plan is final, it must be shared and discussed with the taxpayer in an interactive way that “contributes to their understanding of the examination plan and also affords them the opportunity to propose changes before the plan is final.”⁵¹ SB/SE’s IDR does not perform the same function as an exam plan. The IDR is a “request” for documents that, if the IRS determines is not responded to fully, can be the precursor to a summons—that is, an adversarial act in which there is no room for discussion. Moreover, the IRM allows SB/SE to use *pro-forma* type IDRs with a list of commonly requested items in exams; however, it warns examiners not to use a “shot-gun” approach by requesting everything on the list.⁵² However, practitioners at a 2016 Congressional hearing on small

46 IRS response to TAS information request (Nov. 1, 2018).

47 IRS, Publication 4837, *Achieving Quality Examinations through Effective Planning, Execution and Resolution* (Oct. 2010).

48 *Id.*

49 IRS responses to TAS information requests (May 4, 2018, Nov. 1, 2018).

50 IRM 4.46.3.8, *Examination Plan* (Mar. 14, 2016). Among other items, the LB&I Exam Plan must include: detailed steps for each issue; case and issue timeline(s) with milestone dates; issue team members, including each team member’s estimated days; established dates and decision points that are used to periodically risk-assess issues being examined; and agreements made during the opening meeting. IRM 4.6.3.8.1, *Elements of an Examination Plan* (Mar. 14, 2016).

51 IRM 4.46.3.8.2, *Taxpayer Review of the Examination Plan* (Mar. 14, 2016).

52 IRM 4.10.2.10.2, *Requesting Information or Documents from the Taxpayer* (Jan. 17, 2017).

business burdens stated “we are finding requests for things outside the scope of the audit”⁵³ and “while these requests [IDRs] are often customized, they also contain boilerplate items that agents are required to seek regardless of the issues that the agent has identified and regardless of the type of business that the taxpayer is operating.”⁵⁴

This lack of transparency impairs the taxpayer’s *right to be informed*. It not only creates burden for the taxpayer, who does not know what is being audited, but it also prevents the IRS from weeding out issues that do not need to be part of the audit or using information from the taxpayer to better understand why the taxpayer made a mistake and how the IRS can adjust its public guidance in real time to prevent further problems. Sharing the audit plan could allow for earlier resolution of issues. Taxpayers could also adjust prior or later year returns to avoid related audits. Further, with this increased communication with the taxpayer, the IRS may discover that the audit of the particular type of taxpayer or issue is not the best use of its resources and adjust its audit strategy.

The IRS Does Not Provide a Clear Path For Taxpayers to Elevate Issues Nor Does It Track Taxpayer Complaints About Field Exams

Another item that prevents the IRS from identifying, in real time, problems with its audit selection tools and examination procedures is the lack of a clear path for taxpayers to elevate issues and make complaints. Although the use of a “team” exam approach is necessary for large or complex cases, taxpayers may be cut off from the decision-makers in their cases. One practitioner explained to Congress:

While this [specialist] assistance is necessary, the process is often mysterious and the taxpayer is left in the dark regarding who is making decisions. Our experience includes situations where a revenue agent who lacks expertise may rely on a technical specialist to make the decision in an examination, and due to staffing levels, the specialist may not have adequate time to fully assist, so revenue agents have only consultations with them. In some cases, the taxpayer is not aware that this has occurred or has not had an opportunity to discuss the specialist’s technical conclusions.⁵⁵

Furthermore, when taxpayers have complaints, they may not have a reasonable path to raise them. The Tax Executive Institute notes the IRS’s public statement that there will be no single member of the exam team with a majority vote, and the first point of contact empowered to make the decision about whether to consider an issue resolved or abandoned is the Deputy Commissioner of LB&I.⁵⁶ With the number of members of an exam team and their breadth across the IRS, taxpayers at an impasse may have few options other than elevating to the Deputy Commissioner of LB&I.

Neither LB&I nor SB/SE Examination has a formal, centralized system to track taxpayer complaints and requests to speak to a manager.⁵⁷ As such, there is no mechanism for the IRS to catalog what it has

53 *IRS Puts Small Businesses Through Audit Wringer: Hearing before the H. Comm. on Small Business*, 114th Cong. (2016) (statement of Warren Hudak, President, Hudak & Company, testifying on behalf of the National Association of Enrolled Agents).

54 *Id.* (statement of Jennifer E. Breen, Partner, Morgan, Lewis & Bockius LLP, testifying on behalf of the American Bar Association Section of Taxation).

55 *Id.* (statement of Kathy Petronchak, Director of IRS Practice and Procedure, Alliantgroup).

56 Tax Executive Institute, *The New LB&I: Recent IRS reorganization raises panoply of significant issues* (Feb. 23, 2016), <http://taxexecutive.org/the-new-lbi/>.

57 IRS response to TAS information request (May 4, 2018). Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

learned in terms of what is or is not working from the taxpayer's perspective and use this to adjust its compliance strategy and ensure its case selection is optimal.

CONCLUSION

The IRS has many opportunities for improving its field examination program. The unacceptably high no change rates across the field exam programs reveal that the IRS is wasting resources by examining taxpayers for whom it will not recommend additional tax assessments. Further, these no change exams may be worse than no exams at all because taxpayers may choose to report less tax in subsequent years as a result of the exam. In order to meet its goal of promoting voluntary compliance, the IRS must reduce the no change rates and create measures that capture how a taxpayer changes his or her filing behavior and attitudes as a result of an audit. Creating better measures may also help the IRS identify areas where it needs to change how it conducts its exams—namely providing greater transparency and a clearer path for taxpayers to raise complaints.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Periodically survey taxpayers after field exams to determine the impact of the exam on the taxpayers' understanding of the audit process and audit adjustments, and attitudes towards the IRS and filing and paying taxes.
2. Periodically study taxpayers' filing behavior following field exams to determine whether the exams had an impact on whether the taxpayer filed, how much income the taxpayer reported, and whether the taxpayer repeated a mistake made on a previous return.
3. Require SB/SE to provide an examination plan similar to what LB&I requires for all audited taxpayers for all field examinations.
4. Notify taxpayers during an audit of any consultations with specialists and provide an opportunity for taxpayers to discuss with the specialist any technical conclusions that result from these consultations.
5. Track and report on the number of field examinations (including audit reconsiderations) that go to Appeals and the resulting adjustments.