



*Fiscal Year 2018 Statutory Audit of  
Compliance With Notifying Taxpayers  
of Their Rights When Requested to  
Extend the Assessment Statute*

**August 23, 2018**

**Reference Number: 2018-30-059**

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 2018 STATUTORY AUDIT OF COMPLIANCE WITH NOTIFYING TAXPAYERS OF THEIR RIGHTS WHEN REQUESTED TO EXTEND THE ASSESSMENT STATUTE

## Highlights

Final Report issued on August 23, 2018

Highlights of Reference Number: 2018-30-059 to the Commissioner of Internal Revenue.

### IMPACT ON TAXPAYERS

The IRS is required by law to notify taxpayers of their rights when requesting an extension of the statute of limitations for assessing additional taxes and penalties. Taxpayers might be adversely affected if the IRS does not follow the requirements to notify both the taxpayers and their representatives of the taxpayers' rights related to assessment statute extensions.

### WHY TIGTA DID THE AUDIT

TIGTA is required by law to annually determine whether the IRS complied with Internal Revenue Code Section 6501(c)(4)(B), which requires that the IRS provide notice to taxpayers of their rights to decline to extend the assessment statute of limitations or to request that any extension be limited to a specific period of time or specific issues.

### WHAT TIGTA FOUND

TIGTA's review of a statistical sample of 60 closed taxpayer audit files with assessment statute extensions found that the IRS was compliant with Internal Revenue Code Section 6501(c)(4)(B). However, 10 of the taxpayer audit files lacked documentation to support that employees followed the IRS's internal procedures for further explaining the taxpayers' rights to the taxpayers.

In addition, TIGTA's review found instances in which the audit files lacked documentation to support that the IRS complied with procedures requiring the notification of a taxpayer's representative when an authorization for third-party representation exists. Specifically,

TIGTA reviewed 43 taxpayer audit files that had authorizations for third-party representation and found that five of the taxpayer audit files did not contain documentation to support that the taxpayers' representatives were provided with the required notifications.

### WHAT TIGTA RECOMMENDED

TIGTA recommended that the Deputy Commissioner for Services and Enforcement work with the Office of Appeals and the Large Business and International, Small Business/Self-Employed, and Tax Exempt and Government Entities Divisions to ensure that management or other authorized officials verify that notification was provided to all taxpayers and authorized representatives, for both joint and other returns, and that notice has been properly documented in the case activity records in accordance with Internal Revenue Manual 25.6.22.3.

The IRS agreed with the recommendation and will update Internal Revenue Manual 25.6.22 to clarify IRS management's responsibilities to ensure that notification was provided to all taxpayers and authorized representatives, for both joint and other returns, and to ensure that the notification was properly documented in the case activity record or on other appropriate forms.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

August 23, 2018

**MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE**

**FROM:** Michael E. McKenney  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Fiscal Year 2018 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute (Audit # 201830006)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) complied with Internal Revenue Code Section 6501(c)(4)(B), which requires that the IRS provide notice to taxpayers of their rights to decline to extend the assessment statute of limitations or to request that any extension be limited to a specific period of time or specific issues. The Treasury Inspector General for Tax Administration is statutorily required to provide information annually regarding the IRS's compliance with this provision. This audit is included in our Fiscal Year 2018 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 VIII.

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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## *Abbreviations*

BMF	Business Master File
FY	Fiscal Year
IMF	Individual Master File
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
RRA 98	Restructuring and Reform Act of 1998
TIGTA	Treasury Inspector General for Tax Administration



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## *Background*

The Internal Revenue Service (IRS) is required by the IRS Restructuring and Reform Act of 1998 (RRA 98) and the Internal Revenue Code (I.R.C.) to notify taxpayers of their rights when requesting an extension of the statute of limitations for the assessment of additional taxes and penalties.<sup>1</sup> When the IRS audits a tax return and determines that there is an additional tax liability, the additional tax assessment must generally be processed within three years from the date the return was due or from the date on which the return was actually filed, whichever is later. This three-year assessment statute of limitations normally cannot be extended without the taxpayer's written consent.

***The IRS is required to notify taxpayers of their rights when requesting an extension of the statute of limitations for the assessment of additional taxes and penalties.***

To extend the statute, the IRS generally requests that the taxpayer provide a signed consent form, such as Form 872, *Consent to Extend the Time to Assess Tax*; Form 872-B, *Consent to Extend the Time to Assess Miscellaneous Excise Taxes*; Form 872-P, *Consent to Extend the Time to Assess Tax Attributable to Partnership Items*; or Form SS-10, *Consent to Extend the Time to Assess Employment Taxes*.<sup>2</sup> IRS employees who often request assessment statute extensions include examiners in the various Examination functions of the business divisions and appeals officers in the Office of Appeals. These consents extend the assessment statute of limitations to either a specific period of time or an unlimited, indefinite period on each occasion when the taxpayer is requested to provide such consent. The statute is usually extended for a period of time that both the IRS and the taxpayer agree is reasonable to complete the examination. The consent can also be negotiated to apply only to certain audit issues.

In passing the RRA 98, Congress wanted to ensure that taxpayers are fully aware of their rights to refuse or limit the statute extension. Otherwise, taxpayers might believe that they are required to agree to an extension upon the request of the IRS.

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<sup>1</sup> RRA 98 § 3461(b)(2)(B), 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.). I.R.C. § 6501(c)(4)(B).

<sup>2</sup> For partnerships, Form 872-P is used for fixed-date Tax Equity and Fiscal Responsibility Act partnership-level consent. This form should be signed by the Tax Matters Partner or authorized officials. For employment taxes, Form SS-10 is used.



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A taxpayer might agree to extend the assessment statute of limitations for the following reasons:

- The taxpayer might want to pursue additional audit issues that are in the taxpayer's favor in offsetting a proposed tax assessment or that might allow for a tax refund.
- If the remaining time before the statute expires is too short, the IRS might have to prematurely stop the audit process and issue a notice of deficiency that limits the time for the normal appeals process before the taxpayer must file a petition with the U.S. Tax Court.

A taxpayer might decide to limit or refuse to extend the assessment statute of limitations because the taxpayer might not want to:

- Provide the IRS more time to consider additional audit issues.
- Allow the IRS the opportunity to further develop audit issues already under consideration after the normal statute period has expired.

RRA 98 Section (§) 3461(b)(2)(B) requires the IRS to "...notify the taxpayer of the taxpayer's right to refuse to extend the period of limitations, or to limit such extension to particular issues or to a particular period of time, on each occasion when the taxpayer is requested to provide such consent." To implement this statutory requirement, the IRS revised its procedures to direct IRS employees to provide the taxpayer with Letter 907, *Request to Extend Assessment Statute*, or Letter 967, *Letter Transmitting Consent Extending Period of Limitation*. Included with these letters should be the actual consent forms to be signed as well as Publication 1035, *Extending the Tax Assessment Period*, which includes a more detailed explanation of the taxpayer's rights and consequences of the taxpayer's choices.

The consent forms include a prominent statement informing taxpayers of their rights regarding assessment statute extensions and provide information about Publication 1035. Figure 1 shows that the consent forms also include a statement for the taxpayer's representative to sign, confirming that they were notified of their rights regarding assessment statute extensions and that the taxpayers were made aware of the same rights. In addition, the consent form includes a place for an IRS official's signature. Prior to signing the consent form, the manager should review the case file and consent form in compliance with IRM 25.6.22.5.13, *Manager's Responsibilities When Signing Consents*.<sup>3</sup>

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<sup>3</sup> August 26, 2011.



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**Figure 1: Excerpt of Form 872**

Form <b>872</b> (Rev. July 2014)	Department of the Treasury-Internal Revenue Service <b>Consent to Extend the Time to Assess Tax</b>	In reply refer to:  TIN
-------------------------------------	--	-------------------------------

**Your Rights as a Taxpayer**

You have the right to refuse to extend the period of limitations or limit this extension to a mutually agreed-upon issue(s) or mutually agreed-upon period of time. **Publication 1035, Extending the Tax Assessment Period**, provides a more detailed explanation of your rights and the consequences of the choices you may make. If you have not already received a Publication 1035, the publication can be obtained, free of charge, from the IRS official who requested that you sign this consent or from the IRS' web site at [www.irs.gov](http://www.irs.gov) or by calling toll free at 1-800-TAX-FORM (1-800-829-3676). Signing this consent will not deprive you of any appeal rights to which you would otherwise be entitled.

**YOUR SIGNATURE HERE** → \_\_\_\_\_ (Date signed)  
 \_\_\_\_\_ (Type or Print Name)

I am aware that I have the right to refuse to sign this consent or to limit the extension to mutually agreed-upon issues and/or period of time as set forth in I.R.C. § 6501(c)(4)(B).

**TAXPAYER'S REPRESENTATIVE SIGN HERE** → \_\_\_\_\_ (Date signed)  
*(Only needed if signing on behalf of the taxpayer.)* \_\_\_\_\_ (Type or Print Name)

I am aware that I have the right to refuse to sign this consent or to limit the extension to mutually agreed-upon issues and/or period of time as set forth in I.R.C. § 6501(c)(4)(B). In addition, the taxpayer(s) has been made aware of these rights.

If this document is signed by a taxpayer's representative, the Form 2848, Power of Attorney and Declaration of Representative, or other power of attorney document must state that the acts authorized by the power of attorney include representation for the purposes of Subchapter C of Chapter 63 of the Internal Revenue Code in order to cover items in paragraph (4).

**INTERNAL REVENUE SERVICE SIGNATURE AND TITLE**

(IRS Official's Name - see instructions)	(IRS Official's Title - see instructions)
(IRS Official's Signature - see instructions)	(Date signed)

Source: IRS Form 872. Note: The wording on Form SS-10 is consistent with that shown on Form 872.



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IRS procedures require that any notice or other written communication required to be given to a taxpayer also be given to the taxpayer's representative (unless restricted by the taxpayer), along with a cover letter, Letter 937, *Transmittal Letter for Power of Attorney*.<sup>4</sup> IRS employees are instructed to document in their audit file activity log whether the taxpayer was notified of his or her rights each time the IRS requested an assessment statute extension. In addition, IRS internal procedures require employees to provide copies of any correspondence with a taxpayer's representative to the taxpayer.

In response to the exception errors identified in the Fiscal Year (FY)<sup>5</sup> 2017 review,<sup>6</sup> the IRS has taken the following actions:

- Published an article in its newsletter.
- Conducted training at the management and staff levels on guidance for soliciting extensions.

In FY 2018, the IRS completed its revised job aid for examiners on using Form 10949, *Statute Extension Checklist*.<sup>7</sup> Figure 2 shows that Form 10949, specifically Part 1, questions 11 through 15, should remind the employee of the requirements to properly notify taxpayers of their rights when requesting an extension of the statute of limitations.

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<sup>4</sup> Conference and Practice Requirements, Statement of Procedural Rules, 26 C.F.R. § 601.506 (2002).

<sup>5</sup> 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.

<sup>6</sup> Treasury Inspector General for Tax Administration, Ref. No. 2017-30-081, *Fiscal Year 2017 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (July 2017).

<sup>7</sup> Form 10949 is a job aid audit tool for preparing, issuing, and receiving consents to extend the statute of limitations, with links to applicable procedures within the Internal Revenue Manual.



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**Figure 2: Excerpt of Form 10949**

<b>Statute Extension Check Sheet</b>		
Taxpayer		
Tax Period	Examiner	
This form is a job aid and is not a substitute for, nor does it take precedence over, the provisions of applicable IRMs		
Part 1 - Prepare and Issue Consent	Action Taken	N/A
1. Obtain managerial approval to solicit a consent – IRM <a href="#">25.6.22.2.1(2)</a>		
2. Prepare most current appropriate consent form in duplicate(s) – IRM <a href="#">25.6.22.5.2(4)</a> . Refer to IRM <a href="#">25.6.22.4</a> Consent Forms, Letters, and Publications to determine which forms to use. Consent form must contain Notification of Taxpayer’s rights – IRM <a href="#">25.6.22.3</a> . See footnote (a)		
3. Include examiner’s identification (i.e., office symbols, name, identifying info, etc.) in the “in reply refer to” box		
4. Verify correct taxpayer identification number - IRM <a href="#">25.6.22.5.9</a>		
5. Determine correct taxpayer name for consent – IRM <a href="#">25.6.22.6.1</a> . Generally, the name should match the name on the return or electronic filing transcript. However, if there was a name change, show both current & former names IRM <a href="#">25.6.22.5.3</a>		
6. If a corporate return, follow procedures for taxpayer name in accordance with IRM <a href="#">25.6.22.6.2</a> thru <a href="#">25.6.22.6.2.5</a> . If there is a name change, verify whether there were any business reorganizations which would impact who is authorized to sign the consent and bind the entity. It is a best practice to obtain updated authorizations to confirm who is empowered to sign the Form 872		
7. Verify current address – IRM <a href="#">25.6.22.5.5</a>		
8. Verify “kind of tax” is correct – IRM <a href="#">25.6.22.5.4</a>		
9. Verify the tax period(s) to be extended – IRM <a href="#">25.6.22.5.6</a> . State tax period in full –e.g., December 31, 2006. If you have more than one tax period to be extended please refer to IRM <a href="#">25.6.22.5.6.1</a>		
10. Verify the expiration date is correct – IRM <a href="#">25.6.22.5.7</a> . State date in full –e.g., December 31, 2010. If you have an open-ended consent, follow IRM <a href="#">25.6.22.7</a>		
11. Generate most current version of <a href="#">Letter 907</a> or <a href="#">Letter 907-L</a> and <a href="#">Publication 1035</a> . Letter 907-L is used by LB&I only in case of Corporation, S-Corporation and Partnership tax returns		
12. Mail or present consent, <a href="#">Letter 907</a> or <a href="#">Letter 907-L</a> and <a href="#">Publication 1035</a> <b>each time</b> when a request is made to the taxpayer soliciting a consent to extend the period of time for assessment - IRM 25.6.22.3. The notification should be made to the taxpayer (see IRM 25.6.22.3.1, Separate Notification of Each Spouse, for joint return situations) <b>and</b> the taxpayer’s properly authorized representative IRM 25.6.22.3 (2)b		
13. If a POA, issue <a href="#">Letter 937</a> with copies of <a href="#">Letter 907</a> or <a href="#">Letter 907-L</a> , consent and <a href="#">Publication 1035</a> – IRM <a href="#">25.6.22.3(2)b</a>		
14. If a joint return, send separate notices where required – IRM <a href="#">25.6.22.3.1</a>		
15. Retain copy of letter(s) in case file, update activity record as to actions taken – IRM <a href="#">25.6.22.3(3)</a>		
16. If the consent is not timely returned by the taxpayer, issue <a href="#">Letter 928</a> , follow-up letter when consents have been previously requested but not received – IRM <a href="#">25.6.22.4.2</a>		
Part 2 - Examiner Actions Upon Receipt of Signed Consent	Action Taken	N/A
1. Ensure consent is properly date stamped by receiving office – IRM <a href="#">25.6.22.5.12(1)a</a>		
2. Ensure consent is properly executed by the taxpayer or representative, with original signature(s) - IRM <a href="#">25.6.22.5.12(1)b</a> and IRM <a href="#">25.6.22.5.2</a> . Consent forms signed by the taxpayer(s) or duly authorized representative and submitted via fax are acceptable only if <b>all of the conditions listed below are met</b> - IRM <a href="#">25.6.22.5.1</a> , Fax Signatures: <ul style="list-style-type: none"> <li>• Contact with the taxpayer(s) is made by phone or in-person,</li> <li>• The taxpayer(s) history/activity record documents the date and method of contact, and</li> <li>• The taxpayer(s) history/activity record notes that the taxpayer wishes to send the consent by fax, and the case history is documented as described</li> </ul> <p><b>Note:</b> This guidance does not extend to the use of faxed, or other electronically generated, signatures by Service personnel. Raise concerns of any obvious discrepancies with signatures to manager</p>		
3. Ensure taxpayer and/or representative does not make any alterations, deletions or impose any restrictions on the consent – IRM <a href="#">25.6.22.5.12(1)b</a> . A consent which was signed by a taxpayer must not be unilaterally altered by a Service employee – See Note in IRM <a href="#">25.6.22.5.12</a>		

Source: IRS Intranet website.



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The Treasury Inspector General for Tax Administration (TIGTA) is required by the RRA 98 to provide information annually regarding the IRS's compliance with I.R.C. § 6501(c)(4)(B). This report presents the results of our nineteenth annual review of the IRS's compliance with the statute extension provisions of the law.<sup>8</sup>

This review was performed with information obtained from the Office of Appeals, the Large Business and International Division, and the Tax Exempt and Government Entities Division Headquarters in Washington, D.C.; the Small Business/Self-Employed Division Headquarters in New Carrollton, Maryland; and the Wage and Investment Division Headquarters in Atlanta, Georgia, during the period December 2017 through May 2018. 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. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>8</sup> See Appendix V for a list of our most recent prior reports issued from FY 2008 through 2017.



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*Results of Review*

The IRS was compliant with legal requirements to notify taxpayers of their rights when requesting an extension of the statute of limitations for assessing additional taxes and penalties. However, employees did not always follow internal IRS requirements to document that detailed letters further explaining the taxpayers' rights to both the taxpayer and taxpayers' representatives were sent.

*The Internal Revenue Service Was Compliant With Legal Requirements  
Related to Requests to Extend the Assessment Statute*

The IRS is required to notify taxpayers of their rights when requesting an extension of the statute of limitations for assessing additional taxes and penalties. Based on the results of this review, we believe that the IRS was compliant with legal requirements.<sup>9</sup> We reviewed a sample of 60 closed taxpayer audit files for cases in which the taxpayers granted an extension of the statute expiration date. We did not identify any instances in which the IRS failed to provide notice to the taxpayers of their rights to decline to extend the assessment statute of limitations or to request that any extension be limited to a specific period of time or specific issues. In all 60 taxpayer audit files, the legal requirements were satisfied when the taxpayers or the taxpayers' representatives signed Forms 872, 872-B, or SS-10, because the taxpayers' rights are clearly specified on the front of the forms.

*Internal Revenue Service Internal Requirements for Notifying Taxpayers  
and Their Representatives of Taxpayers' Rights Were Not Always Followed*

IRS procedures and publications are clear that both the taxpayer and the taxpayer's representative are to be provided with notices, including notification of the taxpayer's rights. The IRS's internal procedures require that notification be made to the taxpayer by sending Letter 907 or Letter 967 along with a properly completed consent form, which contains the notice of taxpayers' rights and Publication 1035, each time a request is made.<sup>10</sup> IRS employees must also document in the case file on Form 9984, *Examining Officer's Activity Record*, that the required notification was made. We found that taxpayer audit files did not always contain documentation to support that the IRS complied with these procedures.

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<sup>9</sup> I.R.C. § 6501(c)(4)(B).

<sup>10</sup> IRS internal procedures do not require the taxpayer's representative notification package to include Publication 1035.



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- We reviewed a statistically valid sample of 60 taxpayer audit files and identified 10 (16.7 percent) audit files that did not contain documentation to indicate whether taxpayers were properly notified of their rights as required by the IRS's internal procedures, *i.e.*, Letters 907 or Letter 967 was not in the case file and/or the activity log was not appropriately documented that the notification was made.<sup>11</sup> Based on our sample results, from a universe of 10,738 taxpayer audit files with statute extensions, we projected there were approximately 1,395 taxpayer audit files that did not contain documentation to show that the taxpayers were properly notified of their rights when the assessment statutes were extended.<sup>12</sup>
- The 60 taxpayer audit files included 43 (71.6 percent) taxpayer audit files that had authorizations for third-party representation before the IRS. Of these 43 files, five (11.6 percent) audit files did not contain documentation to support that the taxpayers' representatives were provided with the required notifications, *i.e.*, Letter 937 was not in the case file and/or the activity log was not appropriately documented that the notification was made.<sup>13</sup> Based on our sample results, from a universe of 10,738 taxpayer audit files with statute extensions, we projected that there were approximately 697 taxpayer audit files that did not contain documentation to support that the taxpayers' representatives were provided with the required notifications.<sup>14</sup>

We considered the notification sufficient if any of the required documentation appeared to have been given to the taxpayers or a log entry to that effect was found in the related taxpayer audit files. The fact that we could not identify the required documentation in the audit file does not mean the taxpayers and/or their representatives were not properly notified of their rights. However, based upon the information available to us, we could not determine if the taxpayers or their representatives were properly notified of their rights in accordance with IRS internal procedures. Taxpayers may be adversely affected if the IRS does not follow requirements to notify both the taxpayers and their representatives of the taxpayers' rights related to statute extensions.

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<sup>11</sup> The statistically valid sample had an error rate of 16.7 percent and a 90 percent confidence interval between 9.4 percent (lower limit) and 26.6 percent (upper limit). The rate used for projecting to the population is 13 percent, which is further explained in Appendix IV.

<sup>12</sup> The point estimate projection is based on a two-sided 90 percent confidence interval. We are 90 percent confident that the point estimate is between 777 and 2,255 taxpayer audit files that did not contain proper documentation. See Appendix IV for additional details.

<sup>13</sup> The statistically valid sample had an error rate of 11.6 percent and a 90 percent confidence interval between 4.7 percent (lower limit) and 22.9 percent (upper limit). The rate used for projecting to the population is 6.5 percent, which is further explained in Appendix IV.

<sup>14</sup> The point estimate projection is based on a two-sided 90 percent confidence interval. We are 90 percent confident that the point estimate is between 280 and 1,411 taxpayer audit files that did not contain proper documentation. See Appendix IV for additional details.



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As noted previously, the IRS has taken steps over the last few years to help ensure that employees are properly notifying taxpayers of their rights when requesting an extension of the statute of limitations. However, the additional training, newsletter article, and updated Form 10949 do not appear to be affecting the number of exceptions we are identifying. We believe managerial review for documentation of taxpayer notifications, at the time of Form 872 approval, would make employees more aware of the notification and documentation requirements.

### ***Recommendation***

**Recommendation 1:** The Deputy Commissioner for Services and Enforcement should work with the Office of Appeals and the Large Business and International, Small Business/Self-Employed, and Tax Exempt and Government Entities Divisions to ensure that management or other authorized officials verify that notification was provided to all taxpayers and authorized representatives, for both joint and other returns, and that notice has been properly documented in the case activity record in accordance with Internal Revenue Manual 25.6.22.3.

**Management's Response:** The IRS agreed with this recommendation and will update Internal Revenue Manual 25.6.22 to clarify IRS management's responsibilities to ensure that notification was provided to all taxpayers and authorized representatives, for both joint and other returns, and to also ensure that the notification was properly documented in the case activity record or on other appropriate forms.



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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

Our overall audit objective was to determine whether the IRS complied with I.R.C. § 6501(c)(4)(B), which requires that the IRS provide notice to taxpayers of their rights to decline to extend the assessment statute of limitations or to request that any extension be limited to a specific period of time or specific issues. To accomplish this objective, we:

- I. Determined whether taxpayers and their designated representatives are being notified of their rights when the IRS requests an extension of the assessment statute.
  - A. Reviewed the Internal Revenue Manual and consulted with IRS officials to determine if there were any changes to existing policies and procedures for processing requests to extend the assessment statute of limitations since our last audit.<sup>1</sup>
  - B. Identified a universe of 10,738 taxpayer audit files from the combined Individual Master File (IMF) and Business Master File (BMF) with closed examinations for which the assessment statute was extended and the examination subsequently closed.<sup>2</sup> The period covered IMF and BMF taxpayer audit files for which the assessment statute was extended between October 1, 2016, and September 30, 2017.
    1. Analyzed the universe of 10,738 taxpayer audit files and determined that all four business operating divisions were represented in our population. Additionally, we determined the types and volume of tax return forms represented in the total population of 10,738 taxpayer audit files that met our sampling criteria.
    2. Validated the IMF and the BMF data by examining a judgmental sample<sup>1</sup> of 30 (15 from each extract) taxpayer audit files. This judgmental sample was used for data validation and not for projecting or reporting results. The validation test results demonstrated that the data extracts were reliable and could be used to meet the objective of this audit.
    3. Developed a statistical sampling plan using a 90 percent confidence level, an 11.7 percent expected error rate, and a  $\pm 7.6$  percent precision to identify a statistically designed sample size of 60 taxpayer audit files. It was necessary to screen 77 audit files to meet the designed sample size of 60. A statistical sample

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<sup>1</sup> Internal Revenue Manual 25.6.22 (Aug. 26, 2011).

<sup>2</sup> The IMF is the IRS database that maintains transactions or records of individual tax accounts. The BMF is the IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on business, and excise taxes.

<sup>1</sup> A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.



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was taken in order to estimate the number of taxpayers in the universe for which taxpayer rights were potentially affected.

4. Used RAT-STATS to select a sample of 60 taxpayer audit files from the universe identified in Step I.B.<sup>3</sup> We selected more than our sample of 60 taxpayer audit files in the event that some of the files received were incomplete, *e.g.*, did not include all related tax years, audit file history notes, *etc.*, which would prevent us from performing our review of such files. We screened 77 of the taxpayer audit files received. Of those 77 taxpayer audit files, we identified 60 complete taxpayer audit files that had statute extensions with the taxpayer's written consent.
- C. Reviewed the sample of 60 taxpayer audit files and related audit files for the necessary documentation to determine whether taxpayers and their representatives were properly notified of their rights regarding assessment statute extensions. We then discussed exceptions with the appropriate business unit coordinator to obtain agreement to the facts.
1. Projected our sample results to the universe of 10,738 taxpayer audit files from which we selected our sample to identify the number of taxpayer audit files that potentially did not contain documentation to support that the taxpayers or taxpayers' representatives were properly notified of the taxpayers' rights when assessment statutes were extended.<sup>4</sup> TIGTA's contracted statistician reviewed our methodology and projections.

### **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 policies, procedures, and practices used by the Office of Appeals, the Large Business and International Division, the Small Business/Self-Employed Division, the Tax Exempt and Government Entities Division, and the Wage and Investment Division as they relate to notifying taxpayers and their designated third-party representatives of their rights to decline to extend the assessment statute of limitations or request that any extension be limited to a specific period of time or specific issues. We evaluated these controls by reviewing applicable Internal Revenue Manual sections and documentation, interviewing management from these divisions, and reviewing a statistical sample of 60 taxpayer audit files.

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<sup>3</sup> The Office of Inspector General for the Department of Health and Human Services, Regional Advanced Techniques Staff (RATS) in San Francisco, California, initially developed the RAT-STATS statistical software package.

<sup>4</sup> See Appendix IV for an explanation.



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**Appendix II**

*Major Contributors to This Report*

Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)  
Glen Rhoades, Director  
Michele Jahn, Audit Manager  
Ken Henderson, Lead Auditor  
Tina Fitzsimmons, Senior Auditor  
David Guerra, Senior Auditor  
Antony Shang, Senior Auditor



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**Appendix III**

*Report Distribution List*

Deputy Commissioner for Services and Enforcement  
Commissioner, Large Business and International Division  
Commissioner, Small Business/Self-Employed Division  
Commissioner, Tax Exempt and Government Entities Division  
Commissioner, Wage and Investment Division  
Chief, Appeals  
Chief Counsel  
Assistant Deputy Commissioner (Government Entities/Shared Services)  
Director, Communications and Liaison, Wage and Investment Division  
Director, Employee Plans, Tax Exempt and Government Entities Division  
Director, Examination, Small Business/Self-Employed Division  
Director, Exempt Organizations, Tax Exempt and Government Entities Division  
Director, Return Integrity and Compliance Services, Wage and Investment Division  
Director, Specialty Exam, Small Business/Self-Employed Division  
Director, Exam Policy, Small Business/Self-Employed Division  
Director, Exam Quality and Technical Support, Small Business/Self-Employed Division  
Director, Office of Audit Coordination



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## **Appendix IV**

### *Sampling and Case Review Methodology*

#### **Methodology used to identify the universe and sample cases**

To determine the number of taxpayer audit files for which there was no documentation to support that the taxpayers were notified of their rights, we identified 10,738 taxpayer audit files from the combined universe of IMF and BMF<sup>1</sup> closed taxpayer audit files in which the assessment statute was extended and the examination subsequently closed. The period covered IMF and BMF taxpayer audit files for which the assessment statute was extended between October 1, 2016, and September 30, 2017. Figure 1 shows that the majority of these consents were obtained for Forms 1040, *U.S. Individual Income Tax Return*, followed by Forms 1120, *U.S. Corporation Income Tax Return*; Forms 941, *Employer's QUARTERLY Federal Tax Return*; Forms 1065, *U.S. Return of Partnership Return*; and all other forms.<sup>2</sup>

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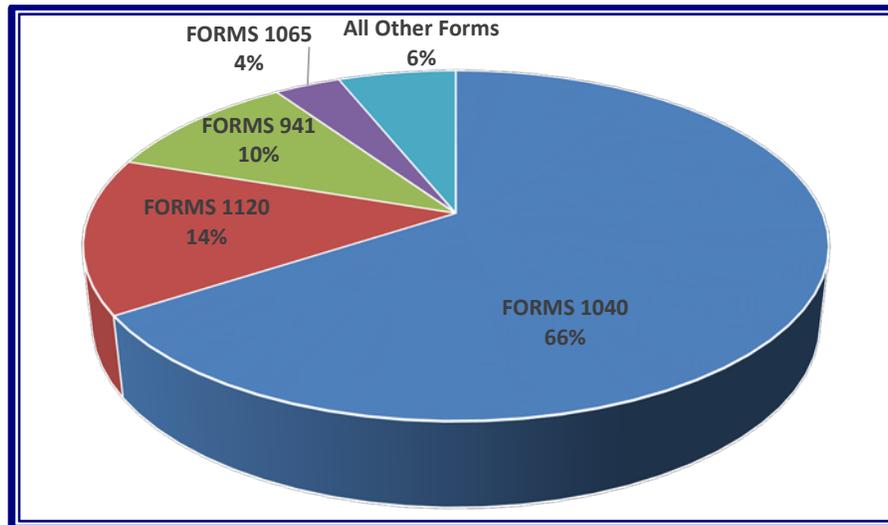
<sup>1</sup> The IMF is the IRS database that maintains transactions or records of individual tax accounts. The BMF is the IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on business, and excise taxes.

<sup>2</sup> The remaining forms in "All Other Forms" include forms such as Form 8868, *Application for Automatic Extension of Time To File an Exempt Organization Return*; Form 5578, *Annual Certification of Racial Nondiscrimination for a Private School Exempt From Federal Tax*; Form 5330, *Return of Excise Taxes Related to Employee Benefit Plans*; Form 4720, *Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code*; Form 1041, *U.S. Income Tax Return for (Estates and Trusts)*; Form 945, *Annual Return Of Withheld Federal Income Tax*; Form 944, *Employee's ANNUAL Federal Employment Tax Return*; Form 944-PR, *Employer's ANNUAL Federal Employment Tax Return – Puerto Rico*; Form 943, *Employer's Annual Federal Tax Return for Agricultural Employees*; and Form 11C, *Occupational Tax and Registration Return for Wagering*.



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**Figure 1: Percentage of Extensions by Form**



Source: Analysis of IMF and BMF records for FY 2018.

**Methodology used to identify the number of taxpayers that were not properly notified**

To determine the number of taxpayer audit files for which there was no documentation to support that the taxpayers were properly informed of their rights, we identified 10,738 taxpayer audit files from the universe of IMF and BMF closed taxpayer audit files for which the assessment statute was extended and the examination subsequently closed. The period covered IMF and BMF taxpayer audit files for which the assessment statute was extended between October 1, 2016, and September 30, 2017. We used a 90 percent confidence level, an 11.7 percent expected error rate, and a  $\pm 7.6$  percent precision to determine our sample size of 60 taxpayer audit files. After screening through 77 taxpayer audit files, we met our sample size of 60 taxpayer audit files. The remaining 17 taxpayer audit files that were not included in our sample did not meet our criteria.<sup>3</sup>

We reviewed the sample of 60 taxpayer audit files and identified 10 taxpayer audit files that did not contain documentation to show that the taxpayers were properly informed of their rights. Because we determined, as noted previously, that a percentage of our population included taxpayer audit files that were screened and not complete, we decided to make the conservative assumption that all of the 17 incomplete audit files were compliant. Therefore, our error rate was based on the 60 taxpayer audit files we reviewed as well as the 17 taxpayer audit files that we screened which did not meet our criteria ( $60 + 17 = 77$  taxpayer audit files). We then calculated our projected error rate (13 percent) by dividing 10 by 77 and multiplied that percentage by the

<sup>3</sup> There were 11 audited files with statute extensions due to procedural issues that do not require the taxpayer's consent to extend the statute. In addition, there were six audited files that were incomplete.



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population size of 10,738 to obtain the projected number of taxpayers who were not notified (1,395 taxpayer audit files).

The range of lower and upper limits was calculated using this error rate and a 90 percent confidence interval between 9.4 percent (lower limit) and 26.6 percent (upper limit). We are 90 percent confident that the range of procedural errors is between 777 and 2,255 taxpayer audit files.

**Methodology used to identify the number of taxpayer representatives that were not properly notified**

We reviewed the same sample of 60 taxpayer audit files and identified 43 taxpayer audit files that contained an authorization for a third party to represent the taxpayer before the IRS. In the subpopulation of all taxpayer representatives, five (11.6 percent) of the 43 taxpayer audit files showed no documentation to support that the employees provided the representatives with a copy of the written communications provided to the taxpayers. Although we were able to determine that there were 43 taxpayer representatives in our sample of 60 taxpayer audit files, we were unable to determine the true number of taxpayer representatives in our sampled population of 10,738 taxpayer audit files with statute extensions.

In our sample, we found 43 audit files with taxpayer representatives, of which five audit files were noncompliant. Based on the 60 taxpayer audit files we reviewed as well as the 17 taxpayer audit files that we screened which did not meet our criteria ( $60 + 17 = 77$  taxpayer audit files) and assuming the 17 audit files not meeting our criteria were all compliant; the projected error rate is 6.5 percent (five divide 77 audit files). The 90 percent confidence interval for this projection is 4.7 percent to 22.9 percent. Based on this, projected to the general population of all 10,738 audit files, we estimate that 697 audit files for which the taxpayer was represented by an authorized representative were noncompliant. The 90 percent confidence interval for this projection is 280 to 1,411 audit files.



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**Appendix V**

*Prior Reports on Compliance With  
Requests to Extend the Assessment Statute*

1. TIGTA, Ref. No. 2017-30-081, *Fiscal Year 2017 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (July 2017).
2. TIGTA, Ref. No. 2016-30-081, *Fiscal Year 2016 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (Aug. 2016).
3. TIGTA, Ref. No. 2015-30-071, *Fiscal Year 2015 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (Aug. 2015).
4. TIGTA, Ref. No. 2014-30-066, *Fiscal Year 2014 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (Aug. 2014).
5. TIGTA, Ref. No. 2013-30-071, *Fiscal Year 2013 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (July 2013).
6. TIGTA, Ref. No. 2012-30-102, *Fiscal Year 2012 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (Sept. 2012).
7. TIGTA, Ref. No. 2011-30-055, *Fiscal Year 2011 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (June 2011).
8. TIGTA, Ref. No. 2010-30-103, *Fiscal Year 2010 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (Aug. 2010).
9. TIGTA, Ref. No. 2009-30-113, *Fiscal Year 2009 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (Aug. 2009).
10. TIGTA, Ref. No. 2008-40-127, *Fiscal Year 2008 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute* (June 2008).



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**Appendix VI**

*Audit Review Results by Division*

<b>Noncompliance With IRS Internal Procedural Requirements to Notify Taxpayers and Their Representatives of Taxpayer Rights</b>	<b>Division<sup>1</sup></b>					<b>Total</b>
	<b>Appeals</b>	<b>LB&amp;I</b>	<b>SB/SE</b>	<b>TE/GE</b>	<b>W&amp;I</b>	
Noncompliance With Requirement to Notify Taxpayers	4	1	5	0	0	10
Noncompliance With Requirements to Notify Taxpayer Representatives	3	0	2	0	0	5
Number of Taxpayer Audit Files Reviewed	13	8	36	3	0	60 <sup>2</sup>

<sup>1</sup> Office of Appeals, Large Business and International (LB&I) Division, Small Business/Self-Employed (SB/SE) Division, Tax Exempt and Government Entities (TE/GE) Division, and Wage and Investment (W&I) Division.

<sup>2</sup> Of the 60 taxpayer audited files reviewed, 43 taxpayer audited files contained an authorization for a third party to represent the taxpayer before the IRS.



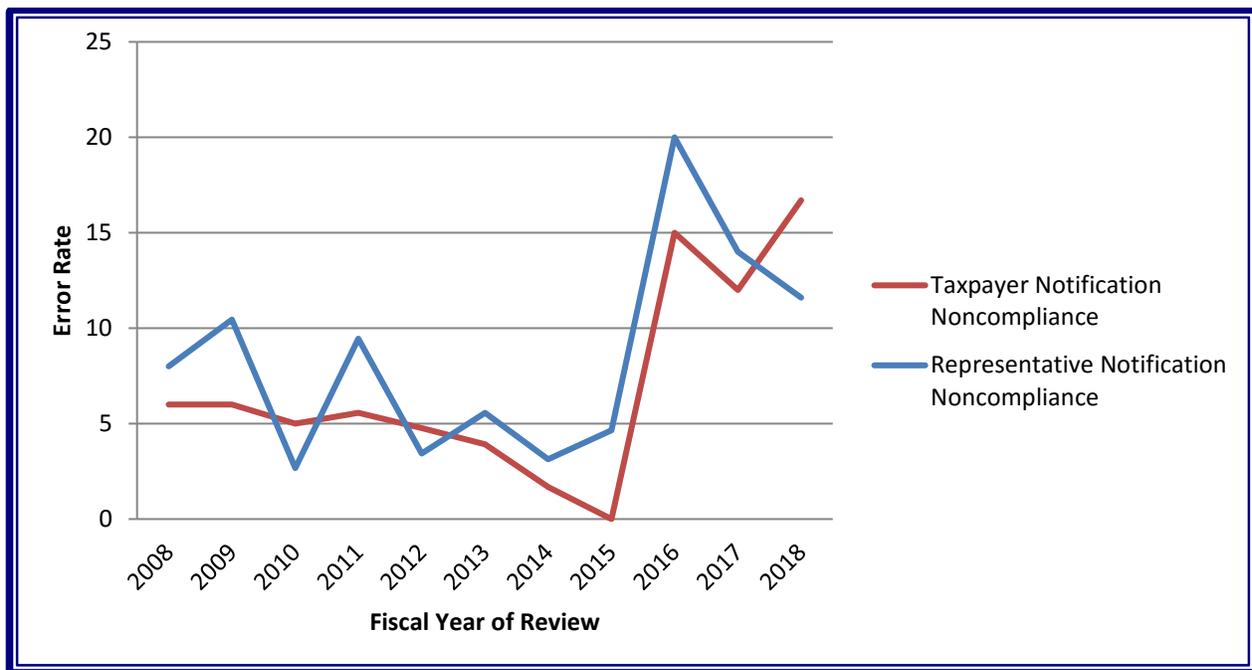
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**Appendix VII**

*Error Rates for Noncompliance With Internal  
Revenue Service Procedures for Notifying  
Taxpayers and Their Representatives*

As noted in the report, the IRS is in compliance with statutory requirements and is providing taxpayers and taxpayers’ representatives with notice of the taxpayers’ rights when applicable. In addition, the IRS’s noncompliance with internal procedures has increased with respect to notifying taxpayers. Specifically, for our FY 2018 review, we reviewed 60 audit case files and found evidence that 16.7 percent of taxpayers (10 taxpayers) were not properly notified, which is up from 12 percent in our FY 2017 review, as shown in Figure 1. As for the IRS’s compliance with notifying the taxpayers’ representatives, we reviewed the 60 audit case files and found that 43 cases involved a representative. Of those 43 audit case files, 11.6 percent of taxpayer representatives (five representatives) were not properly notified, which decreased from 14 percent in our FY 2017 review, as shown in Figure 1.

**Figure 1: Trend Analysis of Error Rates From Prior TIGTA Reviews**



Source: Prior TIGTA audit reports (see Appendix VI).



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**Appendix VIII**

*Management's Response to the Draft Report*



COMMISSIONER  
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

August 9, 2018

MEMORANDUM FOR MICHAEL E. MCKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Mary Beth Murphy *for Lisa J. Buda-Pumain*  
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Fiscal Year 2018 Statutory Audit of  
Compliance With Notifying Taxpayers of Their Rights When  
Requested to Extend the Assessment Statute (Audit #  
201830006)

Thank you for the opportunity to review the subject draft report. We make every effort to examine returns as soon as possible after filing and to compute any changes to the return within the normal assessment statute of limitations. However, situations arise where we need to request that taxpayers extend the assessment statute. The assessment statute of limitations restricts the amount of time within which we can make additional tax assessments on a tax return. It is generally limited to three years from the date the return was due or actually filed, whichever is later.

Taxpayers have rights when we request an extension and we are required by law to notify them of those rights. We work diligently to ensure that taxpayer rights are protected and our actions to protect those rights are properly documented in our case files. Our Internal Revenue Manual (IRM) outlines the procedures to be followed and provides guidance to our employees when soliciting statute extensions. Over the last several years, we have taken many steps to reinforce the information contained in our IRM. Some of those steps included training our management and staff on soliciting statute extensions, publishing a newsletter article to remind employees of their responsibilities when requesting an extension of the assessment statute, and revising our statute extension checklist that is available for use by employees to aid them in the statute extension request process.

We appreciate your acknowledgement that in 100% of the cases sampled, we properly notified taxpayers of their rights when requesting an extension of the assessment statute. We understand that your review noted some limited circumstances where our case files did not contain complete documentation to show that certain IRS procedures were adhered to when requesting an extension. We intend to update our IRM to require that management or authorized officials verify that applicable procedures were followed.



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Attached is a detailed response outlining our corrective action to address your recommendation. If you have any questions, please contact me or Brenda Dial, Director Examination Operations.

Attachment



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Attachment

**RECOMMENDATION 1:**

The Deputy Commissioner for Services and Enforcement should work with the Office of Appeals and the Large Business and International, Small Business/Self-Employed, and Tax Exempt and Government Entities Divisions to ensure that management or other authorized officials verify that notification was provided to all taxpayers and authorized representatives, for both joint and other returns, and that notice has been properly documented in the case activity record in accordance with Internal Revenue Manual 25.6.22.3.

**CORRECTIVE ACTION:**

IRS agrees with TIGTA's recommendation. We will update IRM 25.6.22 to clarify management's responsibilities to ensure notification was provided to all taxpayers and authorized representatives, for both joint and other returns, and to ensure the notification has been properly documented in the case activity record or on other appropriate forms.

**IMPLEMENTATION DATE:**

March 15, 2019

**RESPONSIBLE OFFICIAL:**

Director, Examination Field and Campus Policy, Small Business/Self-Employed Division (SB/SE)

**CORRECTIVE ACTION MONITORING PLAN:**

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