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*TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION*



*Improvements Are Needed to Ensure  
That Employee Tax Compliance Cases  
Are Adjudicated Consistently*

**April 15, 2019**

**Reference Number: 2019-10-021**

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.

**Redaction Legend:**

1 = Tax Return/Return Information

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Phone Number / 202-622-6500

E-mail Address / [TIGTACommunications@tigta.treas.gov](mailto:TIGTACommunications@tigta.treas.gov)

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## HIGHLIGHTS

### IMPROVEMENTS ARE NEEDED TO ENSURE THAT EMPLOYEE TAX COMPLIANCE CASES ARE ADJUDICATED CONSISTENTLY

## Highlights

**Final Report issued on April 15, 2019**

Highlights of Reference Number: 2019-10-021 to the Commissioner of Internal Revenue.

### IMPACT ON TAXPAYERS

Section (§) 1203 of the IRS Restructuring and Reform Act of 1998 states that the IRS shall terminate the employment of any IRS employee if there is a final determination that the employee committed certain acts of misconduct and omissions, including willful violations of tax law. In Fiscal Year (FY) 2017, IRS management closed 1,250 cases involving employees who either underreported income or did not file their income taxes timely. IRS management determined 90 of the 1,250 cases involved willful noncompliance. As the agency responsible for administering Federal tax law, IRS employees have a higher expectation and responsibility for full tax compliance.

### WHY TIGTA DID THE AUDIT

The overall objective of this review was to evaluate the process for determining whether cases of employee tax noncompliance rise to the level of willful noncompliance and determine what actions the IRS takes to address employees with repeated tax noncompliance issues.

### WHAT TIGTA FOUND

Although the IRS has established procedures for reviewing and adjudicating § 1203 cases, TIGTA found that IRS management is not always following these procedures. As a result, IRS management does not always accurately determine willful noncompliance or consistently adjudicate § 1203 cases.

TIGTA's review of a statistical sample of 50 of the 1,250 closed cases found that, in 21 cases, IRS management did not make a proper

determination of willfulness as required. Based on these results, TIGTA estimates that IRS management did not properly determine willfulness in 530 (42 percent) of the 1,250 cases closed in FY 2017.

TIGTA also found that, in seven cases, IRS management did not include required documentation to support the determination of willfulness. Overall, TIGTA estimates that IRS management did not include required documentation in 177 (14 percent) of the 1,250 cases closed in FY 2017.

In addition, a review of 22 judgmentally selected case files found that IRS management's determinations were not supported by the facts of the case. For example, cases were determined to be nonwillful when the employees had a history of misconduct, such as previous tax noncompliance, or the employee was in a tax-related position, e.g., employees who perform examinations or answer tax questions and thus should be aware of filing requirements.

Finally, labor relations specialists did not ensure that cases were properly classified in the Automated Labor and Employee Relations Tracking System. As a result, an estimated 123 cases closed in FY 2017 are potentially misclassified.

### WHAT TIGTA RECOMMENDED

TIGTA made five recommendations to the IRS, which include ensuring that all prior substantiated tax issues are documented and considered in the case file, requiring that management document and comment on both willfulness and reasonable cause factors, and ensuring that cases are properly classified.

IRS management agreed with all five recommendations and plans to take appropriate corrective actions.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

April 15, 2019

**MEMORANDUM FOR** COMMISSIONER OF INTERNAL REVENUE

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

**SUBJECT:** Final Audit Report – Improvements Are Needed to Ensure That  
Employee Tax Compliance Cases Are Adjudicated Consistently  
(Audit # 201810009)

This report presents the results of our review to evaluate the process for determining whether cases of employee tax noncompliance rise to the level of willful noncompliance and determine what actions the Internal Revenue Service (IRS) takes to address employees with repeated tax noncompliance issues. This audit is included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of Improving Tax Reporting and Payment Compliance.

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

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have any questions, please contact me or Deann Baiza, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations).



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*Improvements Are Needed to Ensure That Employee Tax  
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Compliance Cases Are Adjudicated Consistently*

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*Abbreviations*

ALERTS	Automated Labor and Employee Relations Tracking System
ETC	Employee Tax Compliance
FY	Fiscal Year
IRS	Internal Revenue Service
RRA 98	Restructuring and Reform Act of 1998



## *Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

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### *Background*

#### **Employee tax compliance guidance**

The *Standards for Ethical Conduct*<sup>1</sup> states that all Federal Government employees are expected to satisfy their obligations as citizens of the United States, “including all just financial obligations, especially those such as Federal, State, or local taxes that are imposed by law.” As the agency of the Federal Government primarily responsible for administering the Federal tax law, Internal Revenue Service (IRS) employees have a higher expectation and responsibility for full tax compliance. Specifically, Section (§) 1203, *Termination of Employment for Misconduct*, of the IRS Restructuring and Reform Act of 1998 (RRA 98)<sup>2</sup> describes 10 specific acts or omissions for which IRS employees are required to be removed. Two of these apply to IRS employee tax compliance. Specifically,

- § 1203(b)(8) – willfully failing to timely file a Federal tax return unless such failure is due to reasonable cause and not willful neglect.
- § 1203(b)(9) – willfully understating their Federal tax liability unless such failure is due to reasonable cause and not willful neglect.

According to the provisions of the RRA 98, the IRS shall terminate the employment of any IRS employee if there is a final determination that the employee committed certain acts of misconduct and omissions, including willful violations of tax law. Section 1203 also states that the determination to terminate may be mitigated only at the discretion of the IRS Commissioner and that the decision on mitigation may not be appealed.

In order for IRS management to determine if a violation is willful, it must be established that the employee knew (or should have known) his or her obligation under the tax law and that the employee knew he or she was violating that duty. This is referred to as “known legal duty.” Labor Relations provides management with case processing procedures to address any potential § 1203(b)(8) or (b)(9) issues.

To sustain a § 1203(b)(8) or (b)(9) charge, the deciding official must find that the employee’s conduct was willful. The IRS defines a willful act as the voluntary intentional violation of a known legal duty (*i.e.*, timely filing of a tax return or accurate reporting of a tax obligation) for which there is no reasonable cause.<sup>3</sup> Reasonable cause may be established and excuse willful misconduct if the employee exercised ordinary business care and prudence but, due to

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<sup>1</sup> Code of Federal Regulations Title 5, Volume 3, Section 2635.809 (revised as of January 1, 2011).

<sup>2</sup> Pub. L. No. 105-206, 112 Stat. 685 (July 22, 1998).

<sup>3</sup> IRS, *RRA 98 § 1203 All Employee Guide*, Document 11043 (Rev. Sept. 2007) Catalog Number 27823R.



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circumstances beyond the employee's control, he or she was unable to comply with his or her obligations.<sup>4</sup>

IRS employees are responsible for being aware of § 1203 conduct provisions, abiding by them, seeking necessary information regarding their interpretation, and reporting possible § 1203 conduct violations promptly. In addition, employees are reminded annually of their tax obligations. IRS employees are also reminded to review their tax returns for accuracy before filing them and to file on time, no later than the filing deadline.<sup>5</sup>

### **Roles in the adjudication process of employee tax compliance cases**

Within the IRS, multiple groups are involved in identifying and resolving potential employee tax noncompliance.

***Employee Tax Compliance (ETC) Branch*** – An organization within the Employee Conduct and Compliance Office that identifies IRS employees with potential tax noncompliance. Once a potential tax compliance issue is identified, the ETC Branch sends a letter of inquiry to the employee requesting an explanation of the circumstances that led to the tax noncompliance issue. The ETC Branch reviews the employee's response and may close the issue without further managerial review. However, if the tax matter cannot be closed, the ETC Branch will refer the potential tax noncompliance to management through Labor Relations for further review.

***Labor Relations*** – Provides administrative oversight for case management and advises IRS management through the process of determining willfulness of potential tax compliance issues for employees that are Grade 14 or equivalent and below.<sup>6</sup> Labor relations specialists maintain and track cases in the Automated Labor and Employee Relations Tracking System (ALERTS).<sup>7</sup>

***IRS Management*** – Has the ultimate responsibility of determining whether a potential § 1203(b)(8) or (b)(9) was willful or not willful. IRS management works in coordination with an assigned labor relations specialist and is responsible for conducting fact-finding interviews and documenting the final determination as well as the associated penalty.

***The § 1203 Review Board*** – Reviews the willful § 1203 cases to determine whether to sustain the employee's removal or recommend penalty mitigation to the IRS Commissioner.

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<sup>4</sup> IRS, *Guidance on Willfulness and Reasonable Cause in Section 1203(b)(8) and (b)(9) cases*.

<sup>5</sup> The filing deadline is on April 15, unless the due date falls on Saturday, Sunday, or a legal holiday, in which case the due date is delayed until the next business day.

<sup>6</sup> The Executive Misconduct Unit provides administrative oversight for case management and assists and advises IRS management in determining willfulness of potential tax compliance issues for Grade 15 (or equivalent) employees and above.

<sup>7</sup> The ALERTS is a database that tracks allegations of misconduct and related disciplinary actions.





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**IRS Commissioner** – The ultimate deciding authority for any penalty mitigation for § 1203 cases. The IRS Commissioner can sustain a removal or lessen the penalty of an employee who has willfully violated § 1203.

### **Resolving potential employee tax noncompliance**

If the ETC Branch is unable to resolve a tax noncompliance issue with the employee, the case is referred through Labor Relations to the employee's local management. Labor Relations will prepare a case file for management, which includes: prior disciplinary data, tax transcripts,<sup>8</sup> a 1203 Case Analysis Form,<sup>9</sup> sample interview questions to guide managers during fact-finding interviews, and the 1203 Willfulness and Reasonable Cause Determinations Guide. Labor Relations sends the case and associated documentation to the employee's immediate manager. The manager completes fact-finding, which includes reviewing the attachments in the tax case and interviewing the employee to make an initial determination of willfulness.<sup>10</sup> Once contact has been made with the employee, the manager consults with the proposing official<sup>11</sup> to make a determination of willfulness. The proposing official will document the determination of willfulness and propose a penalty.

The potential § 1203 tax case, along with the appropriate documentation, determination of willfulness, and proposed penalty, is forwarded to one of three Labor Relations branch consultants.<sup>12</sup> The Labor Relations branch consultant reviews management's determination to assess whether or not he or she agrees with management or if additional facts are needed to support management's determination. If the Labor Relations branch consultant disagrees with management's determination, he or she may seek an opinion from the IRS General Legal Services<sup>13</sup> to provide additional information to the proposing official.

Although Labor Relations is involved in this process, the determination of willfulness and penalty is ultimately management's decision. Figure 1 depicts the process for determining the willfulness of a tax violation in an ETC case.

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<sup>8</sup> Tax transcripts provide the tax year, employee Social Security Number, taxes assessed, penalties and interest, payments received, pay dates, and balance due.

<sup>9</sup> See Appendix V.

<sup>10</sup> A determination of willfulness is based on management's assessment of facts and the employee's explanation in order to make a decision on whether the violation was willful or not willful.

<sup>11</sup> The proposing official is typically two levels above the employee in the management chain.

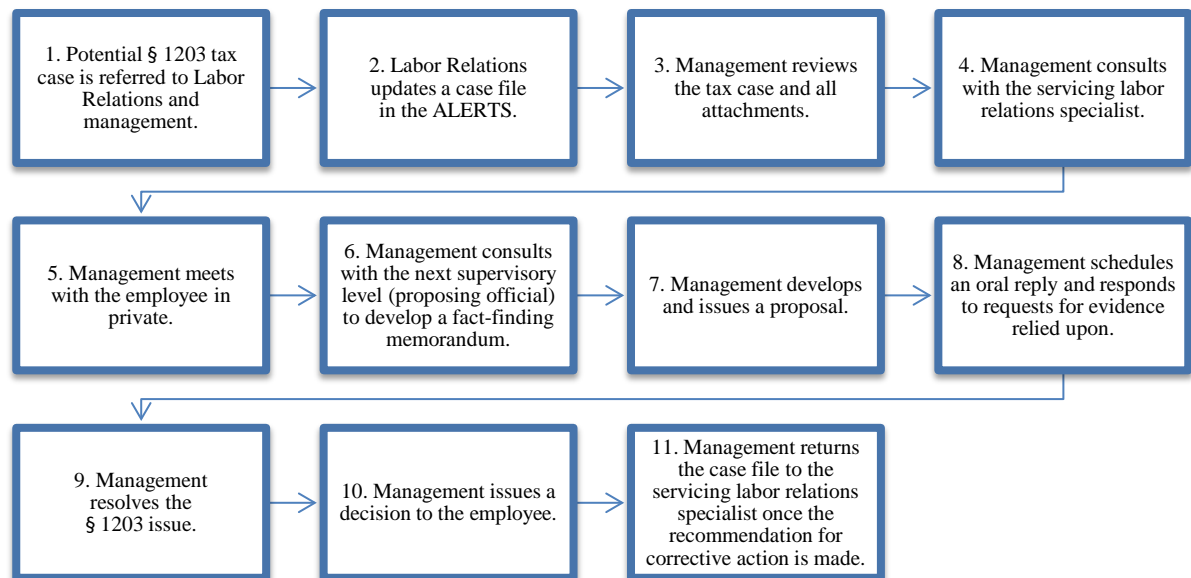
<sup>12</sup> The branch consultant is a senior labor relations specialist who reviews § 1203(b)(8) and (b)(9) cases with both willful and nonwillful determinations.

<sup>13</sup> General Legal Services provides legal advice and litigation representation with regard to nontax administrative law issues, including labor and employee relations, personnel matters, ethics, procurement, and other laws.



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**Figure 1: IRS Process to Determine Willfulness**



*Source: IRS § 1203(b)(8) and (b)(9) manager guidelines.*

In Fiscal Year (FY)<sup>14</sup> 2017, IRS management closed 1,250 cases of potentially willful violations of tax law and found 90 to be willful. Of the 1,250 cases closed in FY 2017:

- 326 were potential § 1203(b)(8) – willful failure to timely file a Federal tax return.
- 884 were potential § 1203(b)(9) – willful understatement of Federal tax liability.
- 40 were both potential failure to timely file and understatement of liability (§ 1203(b)(8) and § 1203(b)(9)).

We determined that 802 employees associated with the 1,250 cases were employed in tax-related positions. Examples of employees in tax-related positions include individuals who perform examinations, answer tax questions, or investigate possible tax noncompliance. Figure 2 provides a breakdown on the number of overall cases involving employees in tax-related versus other positions. Figure 3 provides examples of the types of tax-related positions held by employees with potential § 1203 tax violations.

<sup>14</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.



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**Figure 2: Total Potential § 1203 Tax Cases Closed in FY 2017**  
(based on the attribute of whether the employees' positions are tax related)

	Tax-Related Positions	Other Positions	Total Cases
<b>Nonwillful Determination</b>	736	424	1,160
<b>Willful Determination</b>	66	24	90
<b>Total</b>	802	448	1,250

Source: Treasury Inspector General for Tax Administration analysis of § 1203(b)(8) and (b)(9) cases closed in FY 2017 and IRS designation of employees in tax-related positions.

**Figure 3: Types of Tax-Related Positions Held by Employees With Potential § 1203 Tax Cases Closed in FY 2017**

Tax-Related Position	Position Description	Not Willful	Willful	Total Cases
<b>Contact Representative</b>	Performs work involving the customer service toll-free telephone system used by the public to resolve issues about tax administration.	247	28	275
<b>Tax Examining Technician</b>	Resolves tax account issues, such as tax delinquency, adjusts taxpayer accounts, and provides information on all types of individual and business accounts.	174	16	190
<b>Internal Revenue Agent</b>	Investigates the most complex tax returns filed by individuals or business entities.	70	4	74
<b>Revenue Officer</b>	Collects delinquent accounts, secures delinquent tax returns, and conducts tax investigations.	*1*	*1*	51
<b>Criminal Investigator</b>	Plans and conducts investigations concerning alleged criminal tax fraud and has other investigative responsibilities.	*1*	*1*	22
<b>Other<sup>15</sup></b>		174	*1*	190
<b>Total:</b>		<b>736</b>	<b>66</b>	<b>802</b>

Source: Treasury Inspector General for Tax Administration analysis of § 1203(b)(8) and (b)(9) cases closed in FY 2017 and IRS designation of employees in tax-related positions.

Based on our review of ALERTS data, we identified 334 employees who had substantiated tax noncompliance in prior years. Prior substantiated tax noncompliance includes issues such as:

- Prior substantiated § 1203 willful tax noncompliance.

<sup>15</sup> Other positions include data transcribers, bankruptcy specialists, and tax specialists.



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- Late paid or unpaid Federal taxes.
- Late or nonfiled Federal tax returns.

We identified 15 employees who had a prior substantiated § 1203 willful tax noncompliance case. These repeat offenders were not previously terminated under the provisions of RRA 98 and subsequently had another potential § 1203 tax violation in FY 2017. Through its adjudication process, the IRS determined that eight of the 15 employees did not willfully violate § 1203 in FY 2017. \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*

This review was performed at the Human Capital Office at the IRS National Headquarters in Washington, D.C., and at Labor Relations offices in Fresno and Walnut Creek, California; Washington, D.C.; Atlanta, Georgia; Kansas City and St. Louis, Missouri; and Dallas, Texas, during the period November 2017 through October 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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### *Results of Review*

#### **Adjudication of Section 1203 Cases Is Not Consistent**

Although the IRS has established procedures for reviewing and adjudicating § 1203 cases, we found that IRS management does not always follow these procedures. As a result, the adjudication of § 1203 cases is inconsistent. Our review of a statistically valid sample<sup>16</sup> of 50 § 1203 cases closed in FY 2017 identified 21 cases in which IRS management did not make a proper determination of willfulness as required.<sup>17</sup> We also identified seven cases that did not contain required documentation. Based on these results, we estimate that IRS management neglected to make a proper determination on 530 (42 percent)<sup>18</sup> of the 1,250 § 1203 cases closed in FY 2017 and that 177 (14 percent)<sup>19</sup> cases lack required documentation. \*\*\*\*\*1\*\*\*\*\*

\*\*\*\*\*1\*\*\*\*\*

As the agency responsible for administering the Federal tax law, IRS employees have a higher expectation and responsibility for full tax compliance. Employees who willfully do not comply with their Federal tax responsibilities are in direct violation of the Standards of Ethical Conduct. As such, it is essential that the IRS take appropriate steps to ensure that employees who willfully do not comply with the Federal tax laws are appropriately and consistently penalized.

#### **A determination of willfulness was not always made before determining reasonable cause**

While guidance provides an avenue for a willful violation of tax law to be excused with reasonable cause, Labor Relations guidance clearly states management needs to establish whether the noncompliance is willful *before* considering reasonable cause:

*The **first** action required is to review the evidence and determine whether the employee's noncompliance is a willful violation of the 1203 statute. To determine whether the employee violated 1203(b)(8) or (b)(9), you must also determine whether the employee's*

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<sup>16</sup> See Appendix I for our sampling methodology.

<sup>17</sup> Of the 50 cases selected, 18 cases (36 percent) included a potential § 1203(b)(8) violation for a failure to timely file and 32 cases (64 percent) included a potential § 1203(b)(9) violation for understating a Federal tax liability.

<sup>18</sup> Our sample was selected using a 90 percent confidence interval, a 42.37 percent error rate, and  $\pm 11.11$  percent precision factor. When projecting the results of our statistical sample, we are 90 percent confident that the actual total amount is between 391 and 668 cases.

<sup>19</sup> Our sample was selected using a 90 percent confidence interval, a 14.12 percent error rate, and  $\pm 8.01$  percent precision factor. When projecting the results of our statistical sample, we are 90 percent confident that the actual total amount is between 76 and 277 cases.



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## *Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

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*actions were due to reasonable cause and consult with the servicing labor relations specialist for guidance.*<sup>20</sup>

Additionally, according to guidance provided to management by Labor Relations:

*Reasonable cause allows IRS management to consider whether the facts and circumstances at the time of a violation might have impacted the employee's ability to meet his/her tax responsibilities. If reasonable cause exists, then the willful conduct is excused.*<sup>21</sup>

In the 21 cases we identified in which IRS management did not make a proper determination of willfulness as required, we found that IRS management did not determine willfulness before establishing reasonable cause in 19 (38 percent) cases.<sup>22</sup> In these 19 cases, management only determined if reasonable cause existed. The reasonable cause claims that IRS management relied upon in the 19 cases included: missing signatures, tax software issues, \*\*\*\*\*1\*\*\*\*\*, reliance on tax preparers, and forgetfulness. For example, several employees stated that they forgot to claim Form 1099 income<sup>23</sup> for areas such as \*\*\*\*\*1\*\*\*\*\* \*1\*, and retirement distributions. Additionally, four employees cited an inability to properly use e-file software, such as TurboTax,<sup>®</sup> which therefore caused their returns to be filed late.

To properly determine whether a claim for reasonable cause is appropriate to excuse a willful violation, management must clearly establish willfulness by citing factors such as the fact that the employee is in a tax-related position, has been with the IRS for numerous years, or has had prior tax noncompliance. Then management can properly evaluate if a claim of reasonable cause is appropriate for the facts and circumstances of the case. By relying upon only reasonable cause factors, management cannot properly consider all relevant facts and circumstances and cannot make a proper determination on a case.

Part 1 of the 1203 Case Analysis Form lists certain factors for management to consider in establishing an employee's known legal duty such as:

- The employee's position.
- The employee's length of service.
- Whether the employee has prior tax issues.<sup>24</sup>
- Facts surrounding the potential § 1203 misconduct.

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<sup>20</sup> IRS, *Memorandum for Proposing and Deciding Officials* (Rev. Aug. 8, 2016).

<sup>21</sup> IRS, *1203 Willfulness and Reasonable Cause Determinations* (Rev. Dec. 10, 2010).

<sup>22</sup> \*\*\*\*\*1\*\*\*\*\*

<sup>23</sup> Forms 1099, the miscellaneous income series of tax forms, report income from self-employment earnings, interest and dividends, Government payments, and more.

<sup>24</sup> Prior tax issues include prior filing history, repeat errors after receiving caution from the ETC Branch for the same error on a previous tax return, and prior discipline for the same tax issue.



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Part 2 of the 1203 Case Analysis Form documents management's determination of willfulness along with Labor Relations' concurrence or disagreement. However, the 1203 Case Analysis Form does not require management to separately consider and comment on willfulness before considering reasonable cause factors.

### **Sufficient documentation was not always included in the § 1203 case file**

IRS guidance instructs management to consider prior tax issues and include any additional facts for supporting a willful determination, *e.g.*, prior filing history, repeat tax errors, or a prior notice of discipline for the same tax issue. While it is the ultimate responsibility of IRS management to make a determination on willfulness, Labor Relations plays a critical role in equipping management with the applicable factors for management to consider. Labor relations specialists are responsible for filling out Part 1 of the 1203 Case Analysis Form, which documents key factors, before forwarding the case to management for review and determination. As noted previously, Part 1 lists certain factors that management is to consider in establishing an employee's known legal duty. In addition, Labor Relations reviews each case after IRS management has made a final determination and provides guidance as needed.

However, our review of the statistical sample of 50 cases identified seven cases in which applicable factors were not included in the case file for management's consideration \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*. In five cases, Labor Relations did not include documentation in the case file such as prior instances of \*\*\*\*\*1\*\*\*\*\* late payment or nonpayment of taxes, and \*\*\*\*\*1\*\*\*\*\*

\*\*\*\*\*1\*\*\*\*\*

Based on these results, we estimate that 177 (14 percent) of 1,250 cases closed in FY 2017 concerning potential § 1203(b)(8) and (b)(9) tax noncompliance did not consider prior noncompliance or were not properly documented.<sup>25</sup>

The IRS cannot ensure that management has all the necessary information needed to properly make a determination on willfulness if Labor Relations does not include sufficient detail of an employee's prior substantiated issues in the case file. In addition, errors in the oversight of case adjudication by Labor Relations can result in cases being processed incorrectly. \*\*\*\*\*1\*\*\*\*\*

\*\*\*\*\*1\*\*\*\*\*

\*\*\*\*\*1\*\*\*\*\*

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<sup>25</sup> Our sample was selected using a 90 percent confidence interval, a 14.12 percent error rate, and  $\pm 8.01$  percent precision factor. When projecting the results of our statistical sample, we are 90 percent confident that the actual total amount is between 76 and 277 cases.





## *Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

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### **IRS management's determination was not always supported by the facts and circumstances of cases**

Our review of a judgmental sample<sup>26</sup> of 22 potential § 1203 tax noncompliance cases, closed in FY 2017, found that the facts of the case did not support IRS management's determination regarding willfulness in 13 (59 percent) of the cases. We based our judgmental selection on factors such as employees with prior tax-related discipline (including § 1203 discipline); cases in which Labor Relations and IRS management disagreed; cases involving employees with past nontax misconduct; and cases involving employees in tax-related positions. Of these 22 potential § 1203 tax noncompliance cases:

- 5 were determined by management to be willful § 1203 tax violations.
- 17 were determined by management to be nonwillful § 1203 tax violations.

To establish whether an employee had a known legal duty, managers can consider factors such as the employee's filing history, prior discipline for the same tax issue, and repeated "errors." We reviewed the case files to determine if managers took into account prior misconduct, especially tax-related misconduct, when making a determination of willfulness.

Based on our review, we found that management appropriately considered and documented the factors to support the determinations in nine of the 22 cases. Of these nine cases, five were determined by IRS management to be willful violations of tax law. We found that, when a case is determined to be a willful violation of tax law, management clearly establishes and documents the known legal duty of the employee to support the determination by referencing factors such as the employee's position, length of service with the IRS, and prior filing history. The following is an example of a case in which the facts and circumstances align with the manager's position and Labor Relations concurrence for a willful violation of § 1203.

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<sup>26</sup> A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.



[illegible]

However, IRS management did not appropriately consider and document the factors of the case to support the determination in 13 cases we reviewed. In each of these 13 cases, IRS management determined that the employee's violation was not willful, but the case facts and circumstances did not support the determination. Specifically, IRS management did not document or comment on all of the factors in Part 1 of the 1203 Case Analysis Form. We found that, when a case was determined to be a nonwillful violation of tax law, management did not clearly establish and document the known legal duty of the employee and did not demonstrate that the employee's position, length of service, and prior filing history were all factored into the determination of willfulness. In 10 of the 13 cases, we identified employees who had at least one prior case that contained a substantiated tax violation.<sup>27</sup> We found that, in some of these cases, not all prior tax-related discipline was documented and considered by management.

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## Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently

Examples 2 through 4 illustrate cases in which IRS management did not consider all applicable factors when determining willfulness.

For the case in Example 2, our review of ALERTS data indicated that, \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
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### **Example 2: Example of an Employee Tax Compliance Case in Which IRS Management Did Not Consider a Prior § 1203 Case**

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Source: Individual IRS ETC case file.

Example 3 shows a case in which \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*

[illegible]

Example 4 shows three employees in tax-related positions who had each been with the IRS more than 20 years and who were previously disciplined for tax noncompliance. Examples of employees in tax-related positions include revenue agents, contact representatives, and correspondence examination technicians. Each of these employees' tax noncompliance was determined to be not willful.

Three employees in tax-related positions, each with more than 20 years in service with the IRS, failed to timely file their Federal tax returns when due. Each employee had a balance due of approximately \$1,000. Each employee provided management with personal reasons for not filing timely. \*\*\*\*\*I\*\*\*\*\*

*Source: Individual IRS ETC case files.*



In four of the five cases, an additional opinion was obtained from a Labor Relations branch consultant. While management determined that these employees did not willfully violate tax law, Labor Relations disagreed, citing that these employees should have known of their tax obligations. Example 5 shows cases in which IRS management and Labor Relations did not agree on the determination of willfulness.

[illegible]

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## *Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

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The IRS plays a critical role in ensuring that taxpayers understand and meet their tax obligations. Allowing its own employees to be tax noncompliant without significant consequences can adversely affect the public's confidence that the IRS is meeting its obligation to administer the Nation's tax system fairly. The examples illustrate the need for IRS management to adequately consider and document factors such as an employee's position, length of service, filing history, and prior violations when determining if a tax violation rises to the level of a willful violation.

### ***Recommendations***

The IRS Human Capital Officer should:

**Recommendation 1:** Ensure that Labor Relations includes all prior substantiated factors in the case file for a potentially willful tax violation determination.

**Management's Response:** The IRS agreed with this recommendation and will update current procedures to emphasize the requirement to include all prior substantiated factors in the case file for a potentially willful tax violation determination.

**Recommendation 2:** Update the 1203 Case Analysis Form to require that management comment separately on willfulness and reasonable cause.

**Management's Response:** The IRS agreed with this recommendation. The 1203 Case Analysis Form was replaced with the 1203 Review Board Executive Summary and will be updated to require management to comment separately, first on willfulness and then on whether there is reasonable cause.

**Recommendation 3:** Ensure that management makes a determination on the willfulness of a tax violation on the 1203 Case Analysis Form by first considering willful factors and then determining if reasonable cause exists to excuse the violation.

**Management's Response:** The IRS agreed with this recommendation. The 1203 Case Analysis Form was replaced with the 1203 Review Board Executive Summary. The Executive Summary will be updated to require management to first document its consideration of willful factors and then document its determination of whether reasonable cause exists to excuse the violation. The IRS will emphasize these requirements during 1203 refresher training and provide written communication to managers regarding the change in procedure.



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## *Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

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**Recommendation 4:** Provide annual training to labor relations specialists and management to ensure that both willfulness and reasonable cause factors are documented and commented on when making a determination on a potentially willful tax violation.

**Management's Response:** The IRS agreed with this recommendation. Annual 1203 training will be provided to labor relations specialists beginning in the third quarter of FY 2019. Manager training will be developed by the third quarter of FY 2019. By the fourth quarter of FY 2019, a special offer for managers to attend 1203 training will be made through the Labor Relations on Demand tool.

### **Case Data Recorded in the Automated Labor and Employee Relations System Are Not Always Accurate**

Our review of a statistical sample of 50 § 1203 cases closed in FY 2017 identified five (10 percent) cases that were erroneously classified in the ALERTS.<sup>28</sup> These cases were misclassified as a potential § 1203 tax case when there was no potential tax violation or were coded as a willful violation although the § 1203 issue was not addressed.<sup>29</sup> IRS guidance requires that labor relations specialists input the appropriate issue codes in the ALERTS and ensure that erroneous issue codes are deleted.<sup>30</sup> We contacted the assigned labor relations specialists for each of the five cases and confirmed that these cases were miscoded in the ALERTS and should not have been marked as a potential § 1203 tax case. Based on these results, we estimate that 123 cases closed in FY 2017 concerning potential § 1203(b)(8) and (b)(9) tax noncompliance were erroneously classified in the ALERTS.<sup>31</sup>

Inaccurate ALERTS data may result in the improper processing of conduct cases. Inaccurate reporting of employee tax issues or misclassified case files could potentially overstate § 1203 cases in semiannual reports to the public.

According to IRS management, these inaccuracies occurred because of oversights by the assigned labor relations specialists. IRS management provided documentation of the current staffing challenges that are negatively affecting Labor Relations' ability to manage its case workload. Specifically, the IRS indicated that between Calendar Years 2015 and 2018, it lost 50 labor relations specialists.

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<sup>28</sup> In addition, we found another case that was erroneously classified in the ALERTS as part of our judgmental sample review.

<sup>29</sup> \*\*\*\*\*1\*\*\*\*\*

<sup>30</sup> IRS, *1203 Case Processing Procedures* (revised Aug. 18, 2016).

<sup>31</sup> Our sample was selected using a 90 percent confidence interval, a 9.87 percent error rate, and  $\pm 6.92$  percent precision factor. When projecting the results of our statistical sample, we are 90 percent confident that the actual total amount is between 37 and 210 cases. See Appendix IV.



*Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

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***Recommendation***

**Recommendation 5:** The IRS Human Capital Officer should establish processes to ensure that the issue codes and determinations of willfulness are accurately recorded in the ALERTS.

**Management's Response:** The IRS agreed with this recommendation and will create a checklist for labor relations specialists to complete before closing conduct cases.



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*Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

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## **Appendix I**

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

Our overall objective was to evaluate the process for determining whether cases of employee tax noncompliance rise to the level of willful noncompliance and determine what actions the IRS takes to address employees with repeated tax noncompliance issues. To accomplish our objective, we:

- I. Identified the controls and criteria in place for determining the willfulness of an employee's tax violation and determined if the controls are designed to consider all relevant facts when determining the willfulness of an employee's tax violation.
  - A. Identified and reviewed Federal regulations and the Department of the Treasury directives for guidance pertaining to Federal employee tax compliance.
  - B. Identified and reviewed any IRS issued guidance pertaining to the adjudication and determination of tax noncompliance cases, including the factors used by the IRS when determining willfulness.
  - C. Interviewed IRS personnel to understand the adjudication and determination process for employees with tax noncompliance cases, including the factors used by the IRS when determining willfulness.
  - D. Determined whether existing controls direct managers to consider all relevant factors when determining the willfulness of an employee's tax noncompliance, including prior tax misconduct and other disciplined misconduct.
- II. Determined whether controls for ensuring consistent and appropriate determinations of willfulness for tax noncompliance cases were implemented as designed.
  - A. Obtained and summarized employee tax noncompliance data and other relevant data. We assessed the reliability of ALERTS<sup>1</sup> 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) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for the purposes of this report.
  - B. Selected and tested a statistically valid random sample of tax noncompliance cases closed in FY<sup>2</sup> 2017 (determined to be both willful and nonwillful) to determine

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<sup>1</sup> The ALERTS is a database that tracks allegations of misconduct and related disciplinary actions.

<sup>2</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.





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## *Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

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whether the IRS properly made a determination on willfulness. We selected 50 cases from a population of 1,250 potential §1203 tax noncompliance cases.<sup>3</sup> The sample was stratified into two stratum: willful cases and nonwillful cases.

- C. Judgmentally<sup>4</sup> selected and reviewed 22 tax noncompliance cases closed in FY 2017 to determine if prior misconduct, especially tax-related misconduct, were taken into account when determining whether current misconduct was willful. We based our judgmental selection on factors such as employees with prior tax-related discipline (including § 1203 discipline), cases in which Labor Relations and IRS management disagreed, cases involving employees with past misconduct, and cases involving employees in tax-related positions.

### **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: Public Law;<sup>5</sup> Department of the Treasury directives;<sup>6</sup> Federal Regulations;<sup>7</sup> and IRS policies, procedures, and guidelines for administering the ETC program. We evaluated these controls by interviewing IRS personnel regarding the ETC program, reviewing applicable documentation, and analyzing selected case files.

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<sup>3</sup> Our sample size was determined using a confidence level of 90 percent, an expected error rate of 5 percent for willful cases and 10 percent for nonwillful cases, and a precision of  $\pm 6.94$  percent. A statistical sample was used in order to support a statistically valid projection to the population of total cases if exceptions were found during the review. A contract statistician assisted with developing the sampling plans and projections.

<sup>4</sup> A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

<sup>5</sup> IRS RRA 98, Pub. L. No. 105-206, 112 Stat. 685 (July 22, 1998).

<sup>6</sup> U.S. Department of the Treasury Reasonable Cause and Good Faith Exception to Section 6662 Penalties §1.6664-4 (February 9, 1996).

<sup>7</sup> Code of Federal Regulations Just Financial Obligations (January 1, 2011).



*Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

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## **Appendix II**

### *Major Contributors to This Report*

Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations)

Deann L. Baiza, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations)

Troy D. Paterson, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations)

Jonathan T. Meyer, Director

Kasey J. Koontz, Acting Audit Manager

Zachary P. Orrico, Lead Auditor

Nina A. Hill, Senior Auditor

Gene A. Luevano, Senior Auditor



*Improvements Are Needed to Ensure That Employee Tax  
Compliance Cases Are Adjudicated Consistently*

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**Appendix III**

*Report Distribution List*

Deputy Commissioner for Operations Support  
Internal Revenue Service Human Capital Officer  
Deputy Human Capital Officer  
Director, Workforce Relations Division  
Director, Office of Audit Coordination



## Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently

### Appendix IV

#### Outcome Measure

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

#### Type and Value of Outcome Measure:

- Reliability of Information – Potential; 123 § 1203 ALERTS<sup>1</sup> cases closed in FY<sup>2</sup> 2017 that were misclassified (see page 16).

#### Methodology Used to Measure the Reported Benefit:

We reviewed a statistically valid random sample of 50 potential § 1203 tax cases that were closed in FY 2017 as either willful or nonwillful and found that five (10 percent) cases were misclassified in the ALERTS. Of the five misclassified cases, \*\*\*\*\*1\*\*\*\*\*. \*\*\*\*\*1\*\*\*\*\*. Using the five misclassified cases and a contract statistician, we projected an error rate to the overall population. Based on a 90 percent confidence level, we estimate that 123<sup>3</sup> of the 1,250 cases closed in FY 2017 were misclassified.

**Figure 1: Calculation of Estimated Number of Misclassified Potential § 1203 Tax Cases Closed in FY 2017**

Strata	Sample Size	Total Population of Cases	Misclassified Cases		
			Total Number in Sample	Percentage in Sample	Estimated Number in Total Population
Nonwillful Determination	46	1,160	*1*	8.70%	101
Willful Determination	4	90	*1*	*1*	23
<b>Totals</b>	<b>50</b>	<b>1,250</b>	<b>5</b>		<b>124*</b>

Source: Statistician projections provided based on audit results. \*Difference is due to rounding.

<sup>1</sup> The ALERTS is a database that tracks allegations of misconduct and related disciplinary actions.

<sup>2</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>3</sup> Our sample was selected using a 90 percent confidence interval, a 9.87 percent error rate, and  $\pm 6.92$  percent precision factor. When projecting the results of our statistical sample, we are 90 percent confident that the actual total amount is between 37 and 210 cases.



*Improvements Are Needed to Ensure That Employee Tax  
Compliance Cases Are Adjudicated Consistently*

**Appendix V**

*1203 Case Analysis Form*

Attachment 02

**1203 Case Analysis Form**

**Part 1 (To be completed as the preliminary case analysis.)**

**Personal Data**

Name:

ALERTS #:

Current Title/Series/Grade:

Prior Title/Series/Grade [If different at time of misconduct]:

Work Schedule:

EOD:

SCD:

Probationary: ☐ No ☐ Yes

**1203 Misconduct:**

**Description of 1203 Misconduct (Facts):**

**Non-1203 Misconduct:**

**Description of Non-1203 Misconduct (Facts):**

**Rules Violated (If applicable):**

**Summary of Employee's Response to ETC (If provided):**

**Prior Tax Issues:**

**Additional Factors to Consider:**

**Research contained in File (list):**

**Labor Relations contact (Name and Number):**



*Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

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**Part 2 (To be completed as documentation of fact finding inquiry and management's position.)**

**Summary of Employee's Response during fact-finding interview:**

**Management's Position/Why:**

**LR's position/Why:**



*Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

**Appendix VI**

*Management's Response to the Draft Report*



HUMAN CAPITAL OFFICE

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

MAR 21 2019

MEMORANDUM FOR MICHAEL E. MCKENNEY

Deputy Assistant Inspector General for Audit

FROM:

Robin D. Bailey, Jr.

IRS Human Capital Officer

SUBJECT:

Draft Audit Report – Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently (Audit #201810009)

Thank you for the opportunity to review TIGTA Draft Report #201810009 – *Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*, dated February 4, 2019. The IRS takes seriously our responsibility to ensure that the adjudication of employee tax noncompliance cases is consistent, and we are committed to adhering to all federal laws, regulations, and IRS policies, and procedures and guidelines that are applicable to our Employee Tax Compliance Program.

We agree with all five recommendations in the report and have attached a detailed response outlining the corrective actions that the Human Capital Officer will take to address your recommendations.

As we have shared with TIGTA, the staffing challenges of the Labor Relations' division, including the loss of tenured staff and the inability to backfill positions, are significant contributing factors to these findings.

If you have any questions, please contact me at 202-317-7600, or a member of your staff may contact Julia Caldwell, acting Director, Workforce Relations Division, at 202-317-6289.

Attachment



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*Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

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2

Attachment

**RECOMMENDATION 1:**

Ensure that Labor Relations includes all prior substantiated factors in the case file for a potentially willful tax violation determination.

**CORRECTIVE ACTIONS:**

We agree with this recommendation. We will update our current procedures to emphasize the requirement to include all prior substantiated factors in the case file for potentially willful tax violation determination\*.

\*Note: For expired discipline, prior substantiated factors may be in the form of ALERTS printouts used by management to determine clarity of notice.

**IMPLEMENTATION DATE:** June 15, 2019

**RESPONSIBLE OFFICIAL(S):**

Acting Director, Workforce Relations Division

**CORRECTIVE ACTION(S) MONITORING PLAN:**

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

**RECOMMENDATION 2:**

Update the 1203 Case Analysis Form to require that management comment separately on willfulness and reasonable cause.

**CORRECTIVE ACTIONS:**

We agree with this recommendation. The 1203 Case Analysis form was replaced with the 1203 Review Board Executive Summary and will be updated to require management to comment separately, first on willfulness and then on whether there is reasonable cause.

**IMPLEMENTATION DATE:** June 15, 2019

**RESPONSIBLE OFFICIAL(S):**

Acting Director, Workforce Relations Division

**CORRECTIVE ACTION(S) MONITORING PLAN:**

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





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## *Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

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### **RECOMMENDATION 3:**

Ensure management makes a determination on the willfulness of a tax violation on the 1203 Case Analysis Form by first considering willful factors and then determining if reasonable cause exists to excuse the violation.

### **CORRECTIVE ACTIONS:**

We agree with this recommendation. The 1203 Case Analysis form was replaced with the 1203 Review Board Executive Summary. The Executive Summary will be updated to require management to first document its consideration of willful factors and then document its determination of whether reasonable cause exists to excuse the violation. We will emphasize these requirements during 1203 Refresher Training and provide written communication to managers regarding the change in procedure.

**IMPLEMENTATION DATE:** June 15, 2019

**RESPONSIBLE OFFICIAL(S):** Acting Director, Workforce Relations Division

### **CORRECTIVE ACTION(S) MONITORING PLAN:**

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

### **RECOMMENDATION 4:**

Provide annual training to Labor Relations Specialists and management to ensure that both willfulness and reasonable cause factors are documented and commented on when making a determination on a potentially willful tax violation.

### **CORRECTIVE ACTIONS:**

We agree with this recommendation. Annual 1203 Training will be provided to Labor Relations Specialists beginning the third quarter Fiscal Year (FY) 2019. Managers training will be developed by the third quarter of FY 2019. By the fourth quarter of FY 2019, a special offer for managers to attend 1203 Training will be made through the Labor Relations on Demand (LROD) tool.

**IMPLEMENTATION DATE:** July 15, 2019

**RESPONSIBLE OFFICIAL(S):** Acting Director, Workforce Relations Division

### **CORRECTIVE ACTION(S) MONITORING PLAN:**

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

### **RECOMMENDATION 5:**

Ensure that the ALERTS data associated with cases of potentially willful tax violations is accurate by having Labor Relations Specialists conduct case reviews before closing cases.



*Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently*

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**CORRECTIVE ACTIONS:**

We agree with this recommendation. We will create a checklist for Labor Relations Specialists to complete before closing conduct cases.

**IMPLEMENTATION DATE:** June 15, 2019

**RESPONSIBLE OFFICIAL(S):** Acting Director, Workforce Relations Division

**CORRECTIVE ACTION(S) MONITORING PLAN:**

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