

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



The Large Case Examination Selection Method Consistently Results in High No-Change Rates

June 22, 2020

Reference Number: 2020-30-031

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HIGHLIGHTS: The Large Case Examination Selection Method Consistently Results in High No-Change Rates



Final Audit Report issued on June 22, 2020
Reference Number 2020-30-031

Why TIGTA Did This Audit

The IRS compiles Tax Gap data to periodically update appraisals of the nature and extent of tax payment noncompliance for use in formulating tax administration strategies. The IRS estimates the average annual gross Tax Gap for Tax Years 2011 through 2013 to be \$411 billion. The largest component, \$352 billion, is attributable to underreporting of taxes. Large corporation (assets of \$10 million or more) tax noncompliance contributes an estimated \$26 billion to the average annual underreporting Tax Gap.

This audit was initiated to evaluate the selection process, use of resources, and examination productivity for corporate returns examined as part of the Large Business and International (LB&I) Division's Discriminant Analysis System (DAS) workstream. Approximately 44 percent of Form 1120, *U.S. Corporation Income Tax Return*, examinations during Fiscal Years 2015 through 2018 were closed from the DAS workstream.

Impact on Taxpayers

The IRS's primary objective in selecting returns for examination is to promote the highest degree of voluntary compliance. The LB&I Division has a variety of examination programs and uses a multitude of methods to select returns. However, it consistently spent most of its examination resources on large business returns.

What TIGTA Found

TIGTA analyzed the 10,755 returns closed in the DAS workstream during Fiscal Years 2015 through 2018 and found that 47 percent were closed with no change to the tax return. TIGTA analyzed the potential cost for excessive time charged to no-change returns, *i.e.*, time in excess of 200 hours, and estimated that potentially \$22.7 million was spent examining no-change returns in excess of 200 hours.

Of the 10,755 returns, 7,831 returns (73 percent) were systemically selected, *i.e.*, were selected as the primary tax return to be examined. The overall no-change rate for these returns was about 55 percent (4,327 of the 7,831), and the no-change rate was generally high across all activity codes for businesses with assets of \$10 million or more (ranging from 44 percent to 61 percent).

The LB&I Division is updating the DAS model to improve the no-change rates. However, TIGTA found that the LB&I Division is not leveraging all available information to improve the model, such as the examination scope and which tax issues are the most productive to examine. LB&I also plans to test the new formulas only on returns that are nearly a decade old.

TIGTA reviewed the examination results for the 10,755 DAS returns and found that the LB&I Division is not adequately monitoring DAS examination results to assess whether the model is effectively ranking returns based on the likelihood of potential tax adjustment. When assessing the productivity of its models, the LB&I Division does not use the actual examination amount when an examination results in a refund. Instead, it treats examinations that result in a refund as no change in tax. By not using the actual examination amount for refunds, the LB&I Division's productivity is skewed to the positive and does not accurately reflect the true compliance impact.

What TIGTA Recommended

TIGTA recommended that the LB&I Division develop an action plan to reduce the examination no-change rates; avoid working pickup returns unless issues are established on primary tax returns that may affect prior or subsequent years; minimize hours expended on no-change closures; test newly developed formulas on current examined returns and consider breadth of scope and noncompliance issues found in past examinations; and analyze DAS return actual examination results on a regular basis.

The LB&I Division agreed with two recommendations and will formulate a plan to reduce the no-change rate and hours incurred. The LB&I Division also plans to analyze examination results on a regular basis. The LB&I Division disagreed with three recommendations pertaining to the DAS model and noted that it released a new DAS model in April 2020. The LB&I Division also disagreed with using actual examination dollar results for evaluating the effectiveness of the DAS model.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

June 22, 2020

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

A handwritten signature in blue ink that reads "Michael E. McKenney".

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Large Case Examination Selection Method
Consistently Results in High No-Change Rates (Audit # 201830021)

This report presents the results of our review to evaluate the selection process, use of resources, and examination productivity for corporate returns examined as part of the Large Business and International Division's Discriminant Analysis System workstream. This review is part of our Fiscal Year 2020 Annual Audit Plan and addresses the major management and performance challenge of *Improving Tax Reporting and Payment Compliance*.

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

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).



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Background

The Internal Revenue Service (IRS) compiles Tax Gap data to periodically update appraisals of the nature and extent of noncompliance for use in formulating tax administration strategies.¹ The IRS estimates the average annual gross Tax Gap for Tax Years (TY) 2011 through 2013 to be \$441 billion. The largest component, \$352 billion, is attributable to underreporting of taxes. Large corporation (those with assets of \$10 million or more) tax noncompliance contributes an estimated \$26 billion to the average annual underreporting Tax Gap.²

The IRS's primary objective in selecting returns for examination is to promote the highest degree of voluntary compliance.³ The IRS's Large Business and International (LB&I) Division serves corporations, Subchapter S corporations, and partnerships with assets of \$10 million or greater. These businesses typically employ large numbers of employees, deal with complicated issues involving tax law and accounting principles, and conduct business in an expanding global environment.

According to its performance reports, the LB&I Division closed examinations totaling 130,162 returns across all its work selection methods during Fiscal Years (FY) 2015 through 2018. These returns consisted of individual, large business, and small business returns (see Figure 1). The LB&I Division's accomplishments have steadily declined over this four-year period. The number of closures in FY 2018 were 37 percent less than in FY 2015.

Moreover, we noted that the LB&I Division consistently spent most of its examination resources (*e.g.*, 85 percent in FY 2018) on large business returns, which was not in proportion to the volume (*e.g.*, 29 percent in FY 2018) of closed cases for these returns given that the volume of returns closed were predominately from individual tax returns (*e.g.*, 66 percent in FY 2018). According to the LB&I Division, this resource allocation is significantly higher because large business returns are more complex and take more time to complete than the less complex individual tax returns. Considering the resource-intensive nature of large corporate examinations, it is critical for the LB&I Division to have an effective return selection method for large business returns.

LB&I Division spent most of its examination resources on large business returns, but returns closed were predominately from individual tax returns.

¹ See Appendix VI for a glossary of terms.

² The Large Business and International Division uses large corporations and large businesses interchangeably. Throughout this report, we used these terms based on how the IRS used them during discussions and in supporting documentation that we relied on.

³ Internal Revenue Manual 1.2.1 (Dec. 2019). Internal Revenue Manual 1.2.1.5.10(2) has been unchanged since June 1, 1974.



The Large Case Examination Selection Method Consistently Results in High No-Change Rates

**Figure 1: Number of LB&I Division Returns Closed and Examination Time Incurred
(by Type of Return for FYs 2016–2018 Compared to FY 2015)**

	Type of Returns Closed			Total *	Comparison to FY 2015: Increase (Decrease)
	Individual ⁴	Large Business ⁵	Small Business		
FY 2015					
Return Count	26,759	10,763	1,387	38,909	
Return Count Percentage	69%	28%	4%	100%	
Exam Time (Hours)	486,850	3,523,637	115,277	4,125,764	
Exam Time Percentage	12%	85%	3%	100%	
FY 2016					
Return Count	24,614	8,866	1,196	34,676	(11%)
Return Count Percentage	71%	26%	3%	100%	
Exam Time (Hours)	480,644	3,526,948	134,229	4,141,821	0.4%
Exam Time Percentage	12%	85%	3%	100%	
FY 2017					
Return Count	22,796	7,801	1,283	31,880	(18%)
Return Count Percentage	72%	24%	4%	100%	
Exam Time (Hours)	418,196	3,070,766	159,782	3,648,744	(12%)
Exam Time Percentage	11%	84%	4%	100%	
FY 2018					
Return Count	16,409	7,163	1,125	24,697	(37%)
Return Count Percentage	66%	29%	5%	100%	
Exam Time (Hours)	371,816	2,789,948	137,188	3,298,952	(20%)
Exam Time Percentage	11%	85%	4%	100%	
Total Return Count for FYs 2015–2018	90,578	34,593	4,991	130,162	
Total Exam Time (Hours) for FYs 2015–2018	1,757,506	12,911,299	546,476	15,215,281	

Source: LB&I Division FYs 2015–2018 Key Stats reports.

* May be off due to rounding.

Based on the LB&I Division's performance reports, the additional tax recommended from large corporate examinations increased from \$9 billion to \$13.3 billion from FY 2015 to FY 2018. Proposed assessments from examinations of corporate taxpayers with assets of \$1 billion or more in FY 2018 totaled \$12.3 billion, approximately 93 percent of the LB&I Division's total proposed corporate assessment for the year (see Figure 2).

⁴ Includes high-wealth individuals filing Form 1040, *U.S. Individual Income Tax Return*.

⁵ Includes mid- and high-corp returns in Activity Codes 219 through 231 (assets of \$10 million or more); flow-through returns from S Corporation returns in Activity Code 290 (assets of \$10 million or more) and partnership returns in Activity Codes 480 through 483; and foreign corporate returns in Activity Codes 262 through 265.



The Large Case Examination Selection Method Consistently Results in High No-Change Rates

**Figure 2: LB&I Division Recommended Additional Tax
for Corporate Examinations by Size of Taxpayers' Assets**

Activity Code and Total Assets Amount ⁶	Recommended Additional Tax (in Millions)			
	FY 2015	FY 2016	FY 2017	FY 2018
Mid-Corp Returns				
219 – \$10M to <\$50M	\$236.3	\$180.0	\$135.7	\$128.7
221 – \$50M to <\$100M	\$129.8	\$102.6	\$75.3	\$98.5
223 – \$100M to <\$250M	\$145.2	\$239.4	\$79.9	\$515.0
High-Corp Returns				
226 – \$250M to <\$500M	\$218.9	\$130.9	\$101.7	\$167.4
227 – \$500M to <\$1B	\$306.7	\$145.0	\$319.7	\$76.1
228 – \$1B to <\$5B	\$1,881.8	\$1,868.0	\$1,724.3	\$1,060.9
229 – \$5B to <\$20B	\$2,107.9	\$2,309.4	\$3,454.7	\$1,593.4
230 – \$20B or more	\$3,935.3	\$8,196.9	\$10,444.4	\$9,612.6
Total (Mid- and High-Corp)*	\$8,961.9	\$13,172.1	\$16,335.7	\$13,252.6
Total: Activity Codes 228–230*	\$7,925.0	\$12,374.2	\$15,623.4	\$12,266.9
Activity Codes 228–230 as a Percentage of the Total	88%	94%	96%	93%

Source: LB&I Division FYs 2015–2018 Key Stats reports.

* May be off due to rounding.

As we previously stated, the number of closures in FY 2018 was 37 percent less than in FY 2015. LB&I Division management cited staff resource constraints as a contributing factor to the declining return closure accomplishments. As shown in Figure 3, the number of full-time equivalent LB&I Division employees who worked examination cases and contributed to the LB&I Division's Examination Plan steadily declined during FYs 2015 through 2018, with the largest decline (542) from revenue agents. This negatively affected the LB&I Division because revenue agents conduct examinations and work the most complex returns.

Figure 3: FYs 2015–2018 Full-Time Equivalents Contributing to the Examination Plan

Position	FY 2015	FY 2016	FY 2017	FY 2018	Change From FYs 2015–2018
Revenue Agent	3,502	3,315	3,153	2,960	(542)
Tax Technician	71	59	48	44	(27)
Tax Examiner	74	81	71	70	(4)
Appraisers	63	57	54	53	(10)
Economist	134	127	119	111	(23)
Engineer	203	191	180	164	(39)

Source: LB&I Division management.

⁶ According to LB&I Division's FYs 2015–2018 Key Stats reports, there were no return closures in Activity Code 231 during that period. Consequently, all figures in this report do not include any Activity Code 231 data.



The Large Case Examination Selection Method Consistently Results in High No-Change Rates

The LB&I Division has a variety of examination programs (hereafter referred to as workstreams) and uses a multitude of methods to select returns. We previously identified that the LB&I Division consistently spent most of its examination resources (*e.g.*, 85 percent in FY 2018, as shown in Figure 1) on large business returns. In our analysis of large business returns closed during FYs 2015 through 2018, we found that the majority of those returns were Form 1120, *U.S. Corporation Income Tax Return*. Additionally, approximately 44 percent of Form 1120 returns closed were selected by the Discriminant Analysis System (DAS) (see Figure 4). The scope of this audit focused on Form 1120 returns examined as part the LB&I Division’s DAS workstream.

**Figure 4: Form 1120 and DAS Returns Closed
by the LB&I Division During FYs 2015–2018⁷**

	Large Business Returns ⁸	Total Number of Form 1120 Returns Closed	DAS Returns Closed ⁹	DAS As Percentage of Total Number of Form 1120
FY 2015	10,763	6,831	2,726	40%
FY 2016	8,866	5,973	2,663	45%
FY 2017	7,801	5,588	2,722	49%
FY 2018	7,163	5,855	2,644	45%
Totals	34,593	24,247	10,755	44%
Total Exam Time (Hours) for FYs 2015–2018	12,911,299	10,368,869	2,689,345	26%

Source: LB&I Division’s FYs 2015–2018 Key Stats report and Treasury Inspector General for Tax Administration (TIGTA) analysis of FYs 2015–2018 data provided by LB&I Division management.

The DAS is a computer model developed to systemically score the examination potential for Form 1120 returns with total assets of \$10 million or more. Generally, the higher the score, the greater the audit potential. During return processing, Form 1120 returns are first assigned to the appropriate activity code. Next, the returns are partitioned into the appropriate examination program by identifying case type (*e.g.*, coordinated industry case or other industry case). Finally, the appropriate DAS formula applies a DAS score to each Form 1120 return. The LB&I Division’s DAS model consists of five unique formulas specific to the type of filer (see Figure 5).

⁷ All Forms 1120 referenced in this table are those with assets of \$10 million or more.

⁸ Includes mid- and high-corp returns in Activity Codes 219–231 (assets \$10 million or more), flow-through returns (*e.g.*, Forms 1120-S with assets of \$10 million or more), partnership returns, and foreign corporate returns.

⁹ Includes only those returns assigned a quantile; *i.e.*, Quantiles 1 through 6.



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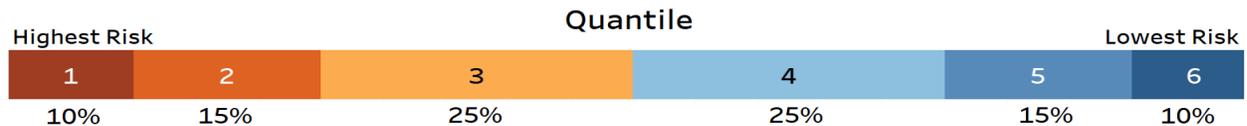
Figure 5: Formulas for the DAS Model

DAS Model	
Formula	Filer Description
Activity Code 219 Filers	Form 1120 filers with total assets of \$10M to <\$50M
Activity Code 221 Filers	Form 1120 filers with total assets of \$50M to <\$100M
Activity Code 223 Filers	Form 1120 filers with total assets of \$100M to <\$250M
Activity Codes 226–230 Filers	Form 1120 filers with total assets of \$250M or more
All Form 1120 Coordinated Industry Case Filers	Generally, the largest corporations in each industry.

Source: LB&I Division management.

After the DAS score is assigned, each Form 1120 return is assigned a quantile number. By activity code, the Form 1120 returns are placed in descending DAS score order for assignment to one of six quantile numbers. The quantile assignment considers both the DAS score and return volume. Returns placed into Quantile 1 are perceived to have the greatest examination potential, whereas returns placed into Quantile 6 are perceived to have the lowest risk. Figure 6 outlines the quantile assignment methodology for DAS-scored Form 1120 returns. For example, the top 10 percent of all DAS-scored Form 1120 returns are assigned to Quantile 1, the next 15 percent are assigned to Quantile 2, and so on. The quantile assignment process is completed before returns are selected for examination.

Figure 6: Assignment of DAS-Scored Form 1120 Returns to Quantiles



Source: LB&I Division management.

According to LB&I Division management, the DAS scoring and quantile methodology has been used since 1999. The LB&I Division attempts to update the DAS model on a five-year cycle or the year following the enactment of a major tax law change related to the Form 1120 filing population. The current operational DAS model was implemented in January 2016. The LB&I Division is currently in the process of updating the DAS model for several reasons, including to address changes due to the Tax Cuts and Jobs Act of 2017 and the increasing no-change rate trend and to ensure that the model remains current as it nears the end of the five-year cycle.¹⁰

As reflected in Figure 1, the LB&I Division incurred a total of 12,911,299 hours in examination resource expenditures for large business examinations during FYs 2015 through 2018. For the same period, DAS returns represent 44 percent of the corporate returns examined (Figure 4) and 26 percent of the total examination hours incurred for these corporate returns. As such, DAS

DAS returns are a significant workload for the LB&I Division

¹⁰ Pub. L. No. 115-97, 131 Stat. 2054 (2017). Officially known as "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for Fiscal Year 2018."



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returns continue to represent a significant compliance workload as well as the importance of the DAS model and formulas.

In recent years, the LB&I Division initiated a Campaign Strategy with the intention to use data analytics, combined with input from IRS compliance employees and feedback from the tax community, to select better work. However, as TIGTA found in a recent report, without tracking and monitoring the results of the work, the assessment of the Campaign Strategy's effectiveness may be greatly diminished.¹¹ TIGTA also previously reported on the need for the LB&I Division to incorporate information on its compliance results into its planning process. Specifically, in September 2016, TIGTA reported that the LB&I Division does not know at a corporate level the results of its own compliance efforts, so it cannot use compliance results to inform and improve its issue-focused strategy.¹² In a separate September 2016 report, TIGTA also reported that LB&I Division management does not specifically track or monitor transfer pricing examination results or outcomes.¹³ TIGTA believes that data analytics will continue to be at the forefront as the LB&I Division seeks to improve its workload selection.

Results of Review

LB&I Division management acknowledges the need to improve DAS return scoring and affirms their commitment to reduce the examination no-change rates. They are taking steps to improve the DAS model and are considering employees' input on causes for nonproductive closed examinations of DAS returns. However, in reviewing the LB&I Division's DAS model update effort, TIGTA identified several factors the LB&I Division did not consider that may affect the risk assessment and DAS scoring of its Form 1120 returns. Moreover, the LB&I Division needs to analyze examination results to monitor the effectiveness of DAS scoring.

Efforts Are Needed to Reduce the Discriminant Analysis System Examination No-Change Rates

DAS returns represent a significant portion of the LB&I Division's workload. As shown in Figure 4, approximately 44 percent of Form 1120 return examinations closed during FYs 2015 through 2018 were from the DAS workstream.

One of the IRS's strategic goals during FYs 2018 through 2022 is to advance data access, usability, and analytics to inform decisionmaking and improve operational outcome. Moreover, the LB&I Division cited the following as part of its FY 2019 strategic goals:

- Use data to drive compliance decisions.
- Improve selection of, and employee time allocation on, compliance work.

¹¹ TIGTA, Ref. No. 2019-30-066, *Initial Compliance Results Warrant a More Data-Driven Approach to Campaign Issue Selection* (Sept. 2019).

¹² TIGTA, Ref. No. 2016-30-089, *The Large Business and International Division's Strategic Shift to Issue-Focused Examinations Would Benefit From Reliable Information on Compliance Results* (Sept. 2016).

¹³ TIGTA, Ref. No. 2016-30-090, *Barriers Exist to Properly Evaluating Transfer Pricing Issues* (Sept. 2016).



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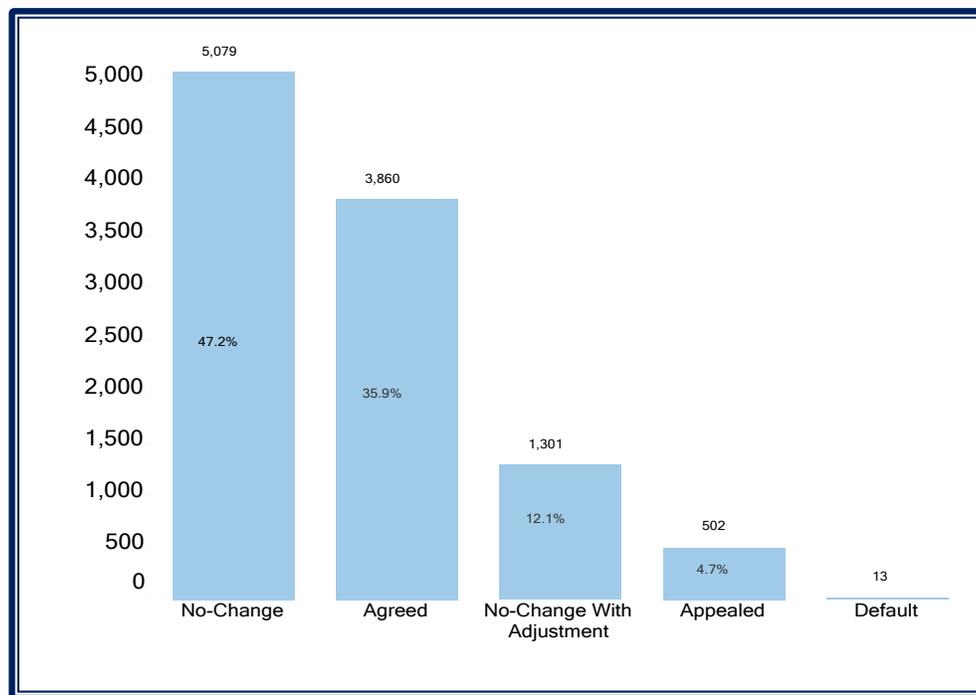
Given the above, as well as its reduced staff to conduct examinations, it is critical for the LB&I Division to harness examination resources effectively by selecting audits of returns that have the greatest compliance risk. However, based on the results of our data analyses, we found that the LB&I Division is not examining the most productive cases. If this condition is not corrected, the LB&I Division risks expending limited resources on unproductive returns and unnecessarily burdening compliant taxpayers.

The LB&I Division is not examining the most productive cases.

DAS examinations resulted in high no-change rates

Using examination data provided by the LB&I Division, we analyzed the 10,755 DAS Form 1120 examinations closed during FYs 2015 through 2018 that were assigned to Quantiles 1 through 6 (see Figure 4). We evaluated the examination results and, as shown in Figure 7, we found that the LB&I Division closed 47.2 percent of the returns with no change.¹⁴

Figure 7: FYs 2015–2018 DAS Return Examination Dispositions



Source: TIGTA analysis of the LB&I Division's FYs 2015–2018 DAS examination data.

Additionally, no-change examinations accounted for a significant percentage of the closures for each activity code across the six quantiles. Returns assigned to Quantile 1 are supposed to have the highest risk for potential examination issues and therefore should have the lowest no-change rate in comparison to other quantiles, whereas returns assigned to Quantile 6 are

¹⁴ The overall no-change rate is 59.3 percent when including returns closed as no-change with adjustment. No-change with adjustment closures may have significant adjustments made; however, they result in no additional tax due. For example, a no-change with adjustment disposition occurs when an examination adjustment is made to the tax base, such as an income or deduction item, but there is no tax liability or refundable credit impact to the tax year in which adjustment is made.



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supposed to have the lowest risk and therefore would likely have the highest no-change rate. In theory, the no-change rate should ascend moving from Quantiles 1 to 6.

Generally, TIGTA found the individual activity code's no-change rate did not consistently ascend moving from Quantiles 1 to 6. For example, the highest no-change rates are Quantile 1 for Activity Code 219, Quantile 4 for Activity Code 229, and Quantile 5 for Activity Codes 221, 226, 227, and 228 instead of Quantile 6. Specifically, we found that only one (Activity Code 223) of eight activity codes ascended sequentially across all six quantiles, from Quantile 1 at 47 percent to Quantile 6 at 60 percent as shown in Figure 8. However, 47 percent is still a high no-change rate, especially for tax returns that the LB&I Division regards as having the highest compliance risk. Overall, TIGTA found that 52 percent (1,179 of 2,249) of DAS returns examined from Activity Code 223 were closed with no change. Additionally, four activity codes with the most return closures accounted for 86 percent (9,216 of the 10,755) of the total closures and had the highest no-change rates.¹⁵ Our analysis demonstrates that the DAS formulas need refinement in order to better correlate scores with risk.

**Figure 8: FYs 2015–2018 DAS Return Examination
No-Change Rates by Activity Code by Quantile**

Activity Code and Total Asset Amount	Total Return Count	No-Change Rates *						
		Overall (Quantiles 1–6)	Quantile 1	Quantile 2	Quantile 3	Quantile 4	Quantile 5	Quantile 6
Mid-Corp Returns								
219 – \$10M to <\$50M	3,479	43%	47%	44%	40%	39%	40%	41%
221 – \$50M to <\$100M	2,382	54%	53%	56%	53%	51%	61%	52%
223 – \$100M to <\$250M	2,249	52%	47%	48%	54%	58%	58%	60%
High-Corp Returns								
226 – \$250M to <\$500M	1,106	49%	37%	47%	46%	49%	58%	55%
227 – \$500M to <\$1B	720	41%	30%	34%	45%	44%	56%	41%
228 – \$1B to <\$5B	664	35%	20%	38%	35%	43%	52%	40%
229 – \$5B to <\$20B	138	34%	28%	26%	35%	53%	36%	44%
230 – \$20B or more ¹⁶	17	35%	25%	50%	50%	N/A	100%	N/A
Combined	10,755	47%	44%	46%	47%	48%	54%	49%

Source: TIGTA analysis of LB&I Division's FYs 2015–2018 DAS examination data.

* The highest no-change rate is highlighted for each activity code.

The LB&I Division's work is complex, and examinations may take multiple years to complete. The examinations closed in FYs 2015 through 2018 consisted of returns selected by multiple DAS models (*i.e.*, various models were in effect depending on when the respective return was

¹⁵ Activity Codes 219, 221, 223, and 226.

¹⁶ Activity Code 230 had few no-change closures, and therefore, we did not highlight the highest no-change rate by quantile for this activity code. No-change returns by quantile follow: Quantile 1: three of 12 closed with no change; Quantiles 2 and 3: one of two closed with no change; Quantiles 4 and 6: no returns closed in these quantiles; and Quantile 5: the only return was closed with no change.



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filed).¹⁷ Consequently, for our population, 95.5 percent of the 10,755 DAS returns examined consist of TYs 2011 through 2016 returns that were scored based on the various models listed in Figure 9.

We analyzed the returns by DAS model and found that the no-change rate by DAS model almost mirrored the total return percentage breakdown by DAS model. Furthermore, the no-change rate within each DAS model was consistently high.

Figure 9: DAS Examinations Closed in FYs 2015–2018 by DAS Model

Selected by DAS Model:	Total Closed		Closed As No-Change		No-Change Rate Within Each DAS Model
	Count	Percentage	Count	Percentage	
Prior to June 2013	1,631	15.2%	516	10.2%	31.6%
June 2013 to Dec. 2015	6,971	64.8%	3,416	67.3%	49.0%
Jan. 2016 to Present	2,153	20.0%	1,147	22.6%	53.3%
Total*	10,755	100.0%	5,079	100.0%	47.2%

Source: TIGTA analysis of LB&I Division's FYs 2015–2018 DAS examination data.

** May be off due to rounding.*

The LB&I Division worked prior and subsequent year returns when the primary returns had no issues, and it subsequently closed the pickup returns as no-change also

To gain an understanding of the sources of the 10,755 returns shown in Figure 7, we analyzed the reasons why these returns were selected. We found that 7,831 returns (72.8 percent) were systemically selected (hereafter referred to as primary return) and another 2,748 returns (25.6 percent) were prior and subsequent year returns picked up by the examiner (hereafter, pickup returns will be used in lieu of prior and subsequent year returns).¹⁸ The remaining 176 returns (1.6 percent) consisted of situations in which returns could not be classified as either primary or pickup returns.

We analyzed the examination results by activity code for the 7,831 primary returns and the 2,748 pickup returns closed during FYs 2015 through 2018 regardless of association between these two groups. TIGTA recognizes that the primary and pickup returns for a case are not always closed at the same time. As such, examinations of primary returns that resulted in a pickup return could have closed prior to FY 2015 or still be open at the end of FY 2018.

As shown in Figure 10, we found that the overall no-change rate for primary returns was about 55 percent (4,327 of 7,831). Moreover, the no-change rates for primary returns were generally high across all activity codes, ranging from 44 percent to 61 percent.

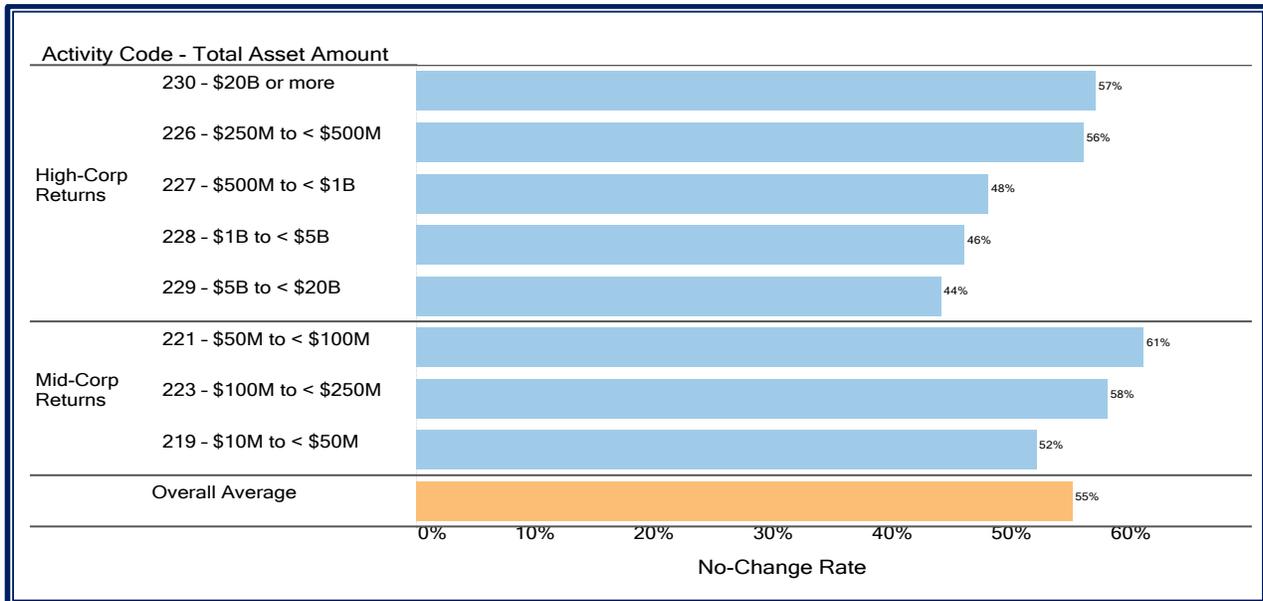
¹⁷ According to the LB&I Division, there is only one DAS model in the system at any one time. Hence, for example, a late-filed TY 2014 Form 1120 return received during Calendar Year 2017 would be scored using the DAS model formulas in operation at time of receipt. In this example, the return would be scored using the DAS model in operation since January 2016.

¹⁸ Examiner is a generic term referring to an IRS employee who conducts examinations (revenue agent, tax examiner, etc.).



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Figure 10: FYs 2015–2018 DAS Primary Return No-Change Rates by Activity Code



Source: TIGTA analysis of LB&I Division's FYs 2015–2018 DAS examination data.

In order to address the association between the primary and pickup returns, we further analyzed the 703 pickup returns that were closed as no-change to determine whether the LB&I Division found issues with the primary return before adding more tax years to the examination. As previously stated, TIGTA recognizes that the primary and pickup returns for a taxpayer are not always closed at the same time. While this was a constraint, our additional analysis was successful in matching 315 of the 703 pickup returns with their respective primary return. For the remaining 388 pickup returns, we could not match to or locate the associated primary return records in the FYs 2015 through 2018 data extract. Our analysis found that 234 of the 315 matched primary returns (74.3 percent) were also closed as no-change.

When TIGTA shared the results with the LB&I Division, management agreed that the no-change rates for the primary returns were too high. However, management stated that revenue agents work each case as a package of returns, so usually they work more than just the primary return.

Given its declining examination staff resources, it is important for the LB&I Division to work returns with the greatest compliance impact. Examiners should avoid adding pickup returns to a case unless they find problems with the primary return or an issue affects prior or subsequent years. Not only is it a potential inefficient and ineffective use of resources, but the examination of additional returns also burdens compliant taxpayers.

Examination hours expended on no-change returns generally took as much time as agreed examinations

While the high no-change rates are a concern, LB&I Division management expects no-change closures to incur fewer examiner hours, whereas examinations with tax adjustments should require more hours. While averages vary from year to year, the LB&I Division stated that the



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four activity codes with the most return closures (see Figure 8) average around 200 hours per examination. The LB&I Division provided the following descriptions:¹⁹

- A “fast” examination is less than 150 hours.
- An “average” examination is 150 to 200 hours.
- A “slow” examination is more than 250 hours.

The LB&I Division suggested that TIGTA analyze the number of no-change returns by categories of hours incurred. Using the examination data provided by the LB&I Division, TIGTA analyzed the examination hours incurred for the 5,079 no-change returns and determined the return count by activity code based on these ranges. See Appendix III for the complete breakdown of the 5,079 no-change returns.

Figure 11: Total No-Change Return Count by Activity Code by Range of Hours Incurred

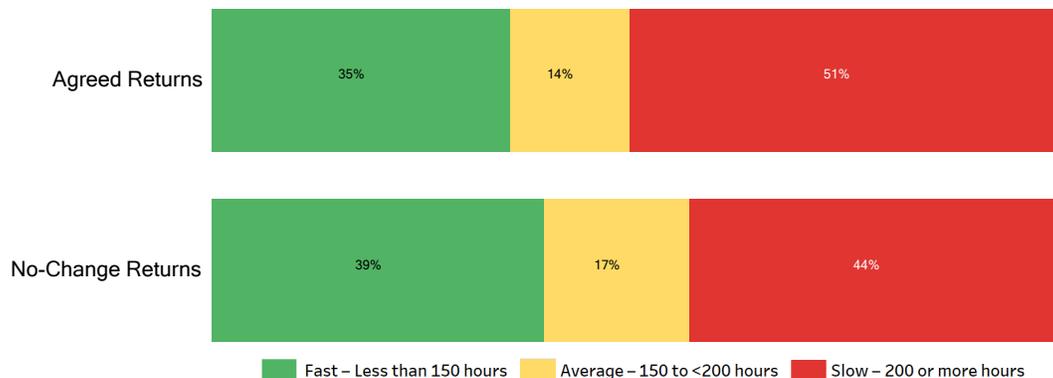
Range of Hours	Return Count by Activity Code									Percentage
	219	221	223	226	227	228	229	230	Total	
Less than 150 hours	750	508	408	154	82	58	15	1	1,976	39%
150 to <200 hours	283	237	194	87	40	34	0	1	876	17%
200 or more hours	453	546	577	299	175	141	32	4	2,227	44%
Total	1,486	1,291	1,179	540	297	233	47	6	5,079	100%

Source: TIGTA analysis of LB&I Division’s FYs 2015–2018 DAS examination data.

As previously shown in Figure 7, the LB&I Division closed 3,860 DAS returns as agreed during FYs 2015 through 2018. We analyzed the examination hours for these agreed cases to determine if they required more or less examination time compared to no-change cases.

Based on Figure 12, which includes the total no-change comparison for returns in Figure 11, it appears that no-change examinations generally took as much time as agreed examinations. See Appendix IV for detail breakdown of the 3,860 agreed returns.

Figure 12: Categories of Hours Incurred—Agreed Returns vs. No-Change Returns



Source: TIGTA analysis of LB&I Division’s FYs 2015–2018 DAS examination data.

¹⁹ The four activity codes are 219, 221, 223, and 226. They accounted for 86 percent of the total closures during FYs 2015 through 2018.



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When we shared this observation, the LB&I Division provided the possible causes shown below. However, without conducting case reviews for the no-change returns, TIGTA cannot comment on the validity of these assertions.

- Some no-change examinations may include complex technical issues and require involvement of several subject matter experts and IRS Chief Counsel. The IRS National Office and Counsel may initially support the development of a technical issue but at a later stage may recommend dropping the issue because the position of the IRS has changed.
- An examiner may spend many hours developing issues but later no-change the case because the tax law has changed.
- A decision from IRS Office of Appeals may persuade the examiner to forego the issue, resulting in a no-change.
- The examiner may appropriately detail and conclusively determine that the taxpayer is substantially compliant. A reasonable decision may be made, in consultation with the Practice Network Subject Matter Expert, to forego making an immaterial adjustment.
- Agents may charge time for an issue on the first year of the audit cycle, but the tax effect may occur in the subsequent year. The subsequent year may be placed under audit and the adjustment made quicker because it was already developed in the previous year.
- Flow-through cases or cases with multiple tiers may require additional time being spent on the case due to statutory and procedural requirements.

LB&I Division conducted an employee survey on the causes of high no-change rates

During this audit, TIGTA worked collaboratively with the LB&I Division by sharing our data analysis results and associated supporting data so this information could be considered during the DAS model update effort. LB&I Division management agreed that the no-change rates indicate a serious issue in the process, and the quality of the work assigned to the field needs improvement. To help management resolve this issue, the LB&I Division conducted a division-wide employee survey in September 2019 asking why the no-change rates are so high and how they can be reduced. According to LB&I Division management, the top three causes cited by employees were case assignment and quality, a flawed risk assessment process, and insufficient time to work cases properly.

LB&I Division management agrees that high no-change rates indicate a serious issue in the examination process.

LB&I Division management stated that they do not have a goal for the no-change rates because setting goals that could drive case decisions is problematic. Additionally, the IRS's office of General Legal Service advised that the IRS Restructuring and Reform Act of 1998 prohibits the IRS from setting goals in this area.²⁰ However, the Act does not prohibit the IRS from setting goals at a high level (*e.g.*, at the LB&I Division level). Moreover, the purpose here is not to set such a goal with the intention of evaluating employees, it is to improve the DAS formula so that the resulting scores better correlate with the actual risk of noncompliance.

²⁰ Pub. L. No. 105-206, 112 Stat. 685.



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TIGTA found that the LB&I Division does not have an established acceptable range of hours to spend on an examination of a tax return before an examiner should seek a manager's decision to either close the case as no-change or continue to pursue a potential issue. LB&I Division management stated that the amount of time that any given case takes depends on a variety of factors. The group managers oversee revenue agent work on cases and can assess whether further development should continue. The LB&I Division's stance does not affect its ability to run High Time reports to identify returns with examination time exceeding a predetermined number of hours. Running these reports would help management identify potential examinations for which a decision could be made to either continue or close with no change, thereby minimizing the time incurred on no-change returns. The Internal Revenue Manual states that this report is used to monitor excessive time applied to the returns and should be run monthly to address issues early in order to meet the Examination Plan. In fact, the Internal Revenue Manual even specifies default hours for the creation of the report for two of LB&I Division's activity codes: Activity Codes 219 and 221 at 90 hours and 150 hours, respectively.²¹

The LB&I Division has neither a no-change rate goal nor an established hour range within which to decide whether to continue to pursue an issue or closed it as a no-change.

While there will always be some amount of no-change work, TIGTA's data analysis and the results of the LB&I Division's employee survey demonstrates that there are opportunities for the LB&I Division to improve the use of its limited examination resources. It could be useful for the LB&I Division to review its examination procedures and processes and take steps to minimize the time incurred on no-change returns as well as provide further guidance on when it would be appropriate for examiners to add pickup returns to an examination.

To determine the impact of time incurred on FYs 2015 through 2018 DAS no-change returns, TIGTA analyzed the potential cost for time charged in excess of the 200-hour upper range description for an average examination for four activity codes.²² Absent of any hourly standards for Activity Codes 227 through 230, TIGTA applied the 200-hour average to all eight activity codes and found the following:

- Using the same no-change returns identified in Figures 7, 9, and 11, we identified that 2,211 of the 5,079 no-change returns incurred more than 200 hours.²³
- Those 2,211 no-change returns incurred a total of 335,949 hours above the 200 hours per return.
- Using LB&I Division's FY 2015 average cost per full-time equivalent hourly rate of \$67.64, the above hours represent about \$22.7 million total spent on these no-change returns during FYs 2015 through 2018. These are potential funds that the LB&I Division could have spent more efficiently.

Without taking corrective actions, the LB&I Division risks continuing to work unproductive returns and burdening compliant taxpayers.

²¹ Internal Revenue Manual 4.7.6.4.6 (Jan. 21, 2015).

²² The four activity codes are 219, 221, 223, and 226.

²³ Sixteen no-change returns incurred exactly 200 hours each. As such, the 2,211 return count reconciles with Figure 11's return count for the "200 or more hours" category (*i.e.*, $2,227 - 16 = 2,211$).



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Recommendation 1: The Commissioner, LB&I Division, should formulate an action plan to reduce the examination no-change rates, refine the examination process to avoid working pickup returns unless issues have been established on primary tax returns that may affect prior or subsequent years, minimize the hours expended on no-change closures by monitoring excessive time applied to returns, and encourage terminating an examination when issues do not materialize regardless of how many hours have been incurred.

Management's Response: The LB&I Division agreed with the spirit and intention of this recommendation and plans to monitor its corrective actions as part of its internal management control system. The LB&I Division implemented an action plan to address the high no-change rate and hours incurred. However, it will continue to rely on the current processes and procedures for opening pickup returns.

Office of Audit Comment: We believe the current process for opening pickup returns should be improved to avoid working pickup returns unless issues have been established on primary returns that may affect prior or subsequent years.

Discriminant Analysis System Model Development Needs Refining to Better Select Corporate Returns With Compliance Impact

All Form 1120 returns in Activity Codes 219 through 230 are scored using the appropriate DAS formula. The current DAS model has been in effect since January 1, 2016, with no modifications because the LB&I Division does not refine the model during the years between DAS model update cycles.

The LB&I Division is currently updating the DAS formulas with the primary focus on reducing the no-change rates and a secondary focus on examination productivity (tax dollars assessed).²⁴ For the DAS model currently in operation, the primary focus was on examination productivity, with a secondary focus on the no-change rates.

The DAS model development team (hereafter referred to as simply the Team) is using TYs 2006 and 2007 examination results for data analysis and TYs 2010 and 2011 to evaluate the new model. The Team is analyzing examination results for TYs 2006 and 2007 Form 1120 returns regardless of which workstream those returns were selected for and worked under. For the TYs 2006 and 2007 Forms 1120 examinations that resulted in an adjustment (assessment of additional tax or abatement such as tax refund), the Team will analyze the characteristics of those returns to develop new DAS formulas. The goal is to determine which return line items or combination of return line items best predict that examination result.

The Team will create two populations: (a) all returns that resulted in an examination tax adjustment and (b) all returns for which examiners found no problems (*i.e.*, no tax adjustment). The Team will profile the general characteristics of each population. Picturing each population as a circle, the Team is trying to end up with the two circles overlapping as little as possible so that the characteristics are distinct between the compliant and noncompliant populations. Once the Team arrives at a model, that hypothesis will be tested on the TYs 2010 and 2011 returns to determine how well it predicts the desired outcome.

²⁴ For DAS model development purposes, a no-change means that the Form 1120 examination resulted in zero change to the tax dollar amount, which includes returns for which examiners made an adjustment but there was no tax impact.



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The DAS model development team needs to test the new DAS formulas on more current tax years' returns

Today's business and economic conditions are significantly different from TYs 2010 and 2011, which will affect the returns' compliance risk profile. For example, increased globalization, virtual currency, tax reforms from the Tax Cuts and Jobs Act, *etc.*, all present new and different compliance issues. By testing the new DAS formulas on returns that are nearly a decade old, the evaluation results may not be accurate for determining if the new formula better identifies noncompliant returns than the current formulas.

TIGTA provided the above observation to the Team, which responded that, while the type of testing described by TIGTA is a generally accepted practice, it is not appropriate for the testing of any IRS noncompliance detection model or formula. The Team wants to use a complete set of tax year returns, and TYs 2010 and 2011 are the most current available. According to the LB&I Division, it typically waits from six to seven years before getting a representative year of Form 1120 examination data for the following reasons:

- TY 2011 returns are filed in Calendar Year 2012.
- Most TY 2011 return examinations begin in Calendar Year 2013.
- Most TY 2011 return examinations are closed by Calendar Year 2017.
- TY 2011 examination closure data is available for analysis in 2018.

We are not suggesting that the LB&I Division not use TYs 2010 and 2011 data, but rather that it enhances its evaluation plan by also testing the new formulas on more current returns that have examination results available. TIGTA acknowledges the LB&I Division's concern that no-change examinations may likely close the fastest and thus the availability of current year returns may be limited. However, no-change returns could still offer useful insight. For example, the LB&I Division can test score those no-change returns using the new formula. If those no-change returns score high, then it may indicate that the new formulas need to be modified. This would allow the Team to identify potential problems and timely refine the formulas as needed. Without this additional effort, the LB&I Division may miss an opportunity to better select noncompliant returns.

DAS model data analysis needs to factor in the breadth of past examinations

When analyzing examination results to profile compliant and noncompliant returns, the Team should also consider the breadth of examination scope. For example, the LB&I Division should weight DAS examination results that may cover multiple issues differently than limited-issue examinations. The LB&I Division has various workstreams under which returns are worked. Some workstreams are issue-specific, with limited examination scope (*e.g.*, Campaigns). In contrast, the DAS returns have no scope limitation, and the examination group performs its own risk assessments to identify issues for examination. Consequently, the same tax return can result in a different examination scope and outcome depending on which workstream examines the return (*i.e.*, the compliance assumption on the same return could be vastly different).

When TIGTA raised the above concern, the Team explained that, if the DAS model analysis used random sampling, then it would consider examination scope in creating the sample. However, the LB&I Division's methodology is to analyze all examined Form 1120 returns from TYs 2006 and 2007. The Team accepts the risk that an examination limited to one issue could potentially



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have missed, for example, 10 other issues. Regardless, the Team is going to treat every return the same and assume that the audit results represent the totality of compliance risk for that return. Furthermore, for DAS model development, the Team assumes all no-change closures to be compliant, including those closed as no-change with adjustments.

We believe the above assumptions and methodology may potentially affect the DAS scoring, resulting in an incorrect ranking of a return's noncompliance and thereby affecting return selection.

DAS model data analysis needs to leverage all available examination results data

When analyzing TYs 2006 and 2007 examination results to profile compliant and noncompliant returns, the LB&I Division should incorporate data on the examination results captured in its systems. Leveraging knowledge on which issues were productive versus those that resulted in a no-change could assist in identifying returns with the highest compliance risk for inclusion in return selection.

The Team concurred that it would be helpful if the issue component could be incorporated in the data analysis for DAS formula development. The DAS model currently in operation has a small issue component. The Team is concerned that the issues captured in the LB&I Division's systems are not exhaustive and may not provide sufficient details.

However, according to the LB&I Division, it can systemically identify the issues examined (*i.e.*, worked) based on hours charged because examiners are required to record their time by issue. Also, the LB&I Division can identify issues that were productive because examiners are required to record dollar results by issue. The issue information is captured in the following two fields:

- Standard Audit Index Number – this relates to how an issue is reported on a return.
- Uniform Issue List – this is based on the Internal Revenue Code and published by IRS Chief Counsel.

TIGTA previously recommended that the LB&I Division implement controls to improve the accuracy and completeness of data entered into the Issue Management System and emphasize the accuracy and completeness of data in the quality review process.²⁵ In another audit, TIGTA recommended that the LB&I Division develop and implement plans to streamline the Uniform Issue List codes available to examiners, provide additional guidance for the appropriate use of these codes, and include the Uniform Issue List code accuracy in quality reviews.²⁶ According to the LB&I Division, it implemented an update to the Issue Management System in December 2019. LB&I Division management further commented that, even when the new Issue Management System is rolled out, given the length of time to complete an LB&I examination, it will take a couple years before adequate data are available to analyze selected versus examined issues. Therefore, due to the IRS's rollout and data availability time constraints, we did not review the Issue Management System in this audit.

As explained previously, Form 1120 returns are scored by the DAS formula based on risk of noncompliance. The DAS score determines the respective assignment of each return to one of

²⁵ TIGTA, Ref. No. 2017-30-084, *Improvement Is Needed in Compliance Efforts to Identify Unsupported Claims for Foreign Tax Credits* (Sept. 2017).

²⁶ TIGTA, Ref. No. 2016-30-089, *The Large Business and International Division's Strategic Shift to Issue-Focused Examination Would Benefit From Reliable Information on Compliance Results* (Sept. 2016).

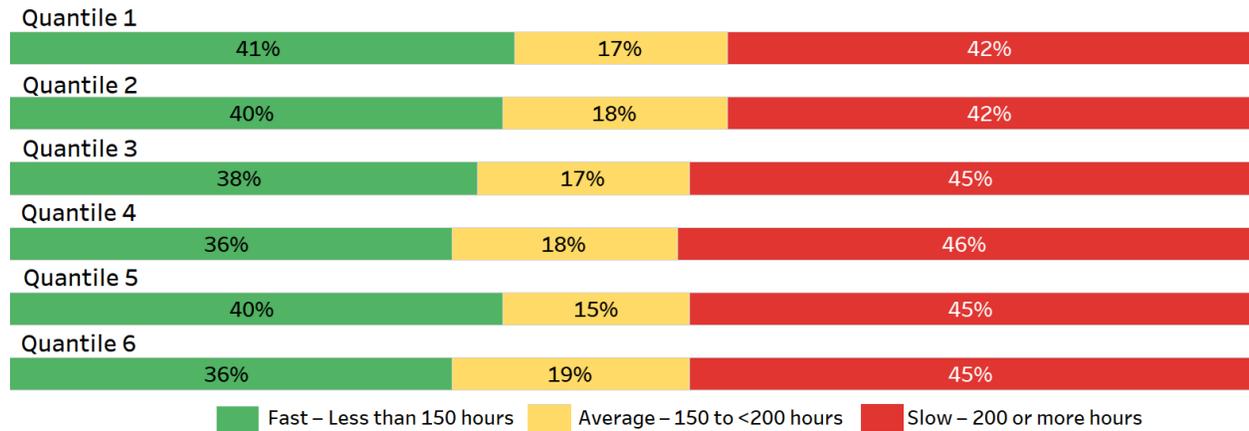


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the six quantiles. Returns placed into Quantile 1 are perceived to have the greatest examination potential, whereas returns in Quantile 6 are perceived to have the lowest risk. However, as shown in Figure 8, the no-change rates demonstrate that the LB&I Division did not consistently achieve this objective.

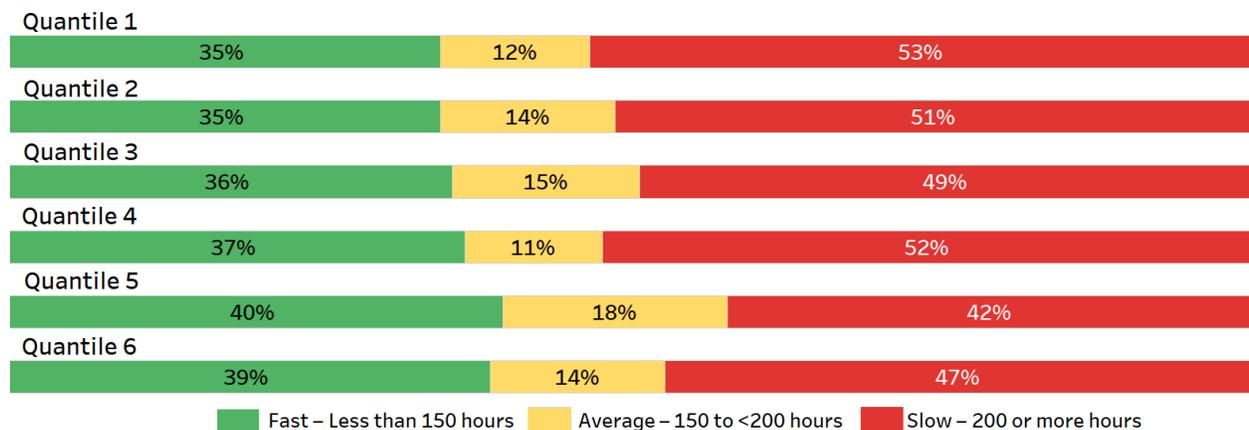
Quantiles with the highest risk would therefore be expected to expend more resources, with a descending trend in total examination hours incurred from Quantile 1 (highest risk, highest hours) to Quantile 6 (lowest risk, lowest hours). However, TIGTA's analysis of examination hours incurred for the 5,079 no-change returns and 3,860 agreed returns by quantile (Figures 13 and 14), found that examiners expended a similar number of hours on low-risk returns compared to high-risk returns. This is contrary to what we expected to find and suggests that there are opportunities to refine the DAS scoring formulas. See Appendices III and IV for the complete breakdown of the 5,079 no-change and 3,860 agreed returns, respectively.

**Figure 13: No-Change Return Percentage
by DAS Quantile and Range of Hours Incurred**



Source: TIGTA analysis of LB&I Division's FYs 2015–2018 DAS examination data.

**Figure 14: Agreed Return Percentage
by DAS Quantile and Range of Hours Incurred**



Source: TIGTA analysis of LB&I Division's FYs 2015–2018 DAS examination data.



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Capitalizing on available pertinent data would advance the LB&I Division's strategic goal of using data to drive compliance decisions. More importantly, it could assist the LB&I's Division to better assess and rank the compliance risk of returns.

The Commissioner, LB&I Division, should:

Recommendation 2: Test the newly developed formulas on available examined returns from more current tax years in addition to the testing on TYs 2010 and 2011 returns.

Management's Response: The LB&I Division agreed that it should use the most current data available. However, it disagreed with this recommendation because a subset of returns from more recent tax years will offer limited value in improving the model's usefulness.

Office of Audit Comment: We disagree with LB&I Division's position and believe testing new formulas on more current returns will enhance the DAS model development evaluation. The LB&I Division released a new DAS model in April 2020 after our fieldwork. Given the timing and resource constraints, TIGTA did not review the new DAS model.

Recommendation 3: Weight the examination results data when conducting data analysis in order to appropriately consider the breadth of scope of past examinations.

Management's Response: The LB&I Division disagreed with this recommendation because the DAS model's value lies in its ability to distinguish the general characteristics of noncompliant from compliant Form 1120 filers. The LB&I Division believes this recommendation may be better suited to other workload selection methods.

Office of Audit Comment: We maintain that this recommendation is valid to the DAS selection method. The same Form 1120 return can result in different outcomes depending on the workstream in which the return was examined. As such, it affects the basis of the DAS model's ability to distinguish the characteristics of noncompliant from compliant Form 1120 filers.

Recommendation 4: Consider the noncompliance issues found in past examinations and trend those returns' commonalities to identify returns with potential similar compliance risks for consideration during return selection.

Management's Response: The LB&I Division disagreed with this recommendation. While it acknowledges that the capability exists and that the Issue Management System has improved on informing compliance programs, the LB&I Division believes the Issue Management System data are incomplete at the present time.

Office of Audit Comment: The LB&I Division needs to leverage all available examination results data to assist in identifying characteristics of compliant and noncompliant Form 1120 filers. Capitalizing on pertinent data could assist in improving the identification of Form 1120 returns with potential compliance risk.



The Large Case Examination Selection Method Consistently Results in High No-Change Rates

Examination Results Analysis Is Needed to Monitor the Effectiveness of Discriminant Analysis System Scoring

A key factor for accountability in achieving an entity's mission is to implement an effective internal control system. One of the governmental control principles is for management to identify, analyze, and respond to risks related to achieving defined objectives.²⁷ For the DAS return selection program, we identified the risk that management does not monitor whether the DAS scoring and quantiles methodology is effective in ranking tax returns based on the likelihood of potential tax adjustments.

Examination results should be analyzed to determine if the DAS scoring and quantile methodology is meeting its objective

According to the LB&I Division, its executives review examination performance statistics, such as those reported in the Key Stats report, as part of its effort to monitor the effectiveness of the DAS scoring formulas and quantile assignment based on examination potential. When indicators show significant trending, further analysis is undertaken. However, no quality review or testing is performed on a regular basis to determine whether the DAS scoring formulas are meeting their objectives.

TIGTA's review of the Key Stats report for FYs 2015 through 2018 found that the performance measures are based on consolidated data from all the workstreams and returns worked by the LB&I Division. There is no visibility to the examination performance for DAS returns. According to the LB&I Division, its systems limit oversight capability because they can only track data by activity codes or geographic compliance practices areas. It is in the process of updating the systems to track performance by specific workstream.

Nevertheless, the above effort remains inadequate because the Discretionary workstream includes returns other than DAS returns. Our analysis of the returns closed in the Discretionary workstream during FYs 2015 through 2018 found that DAS returns represented approximately 60 percent of that workstream's workload. Consequently, even if the LB&I Division monitors its Discretionary workstream's performance as a whole, without segregating the DAS work, management is unable to adequately assess whether the DAS scoring is effective in ranking the returns based on the likelihood of potential tax adjustment.

Using LB&I Division examination data, TIGTA analyzed the examination yield (assessed dollars per hour and per return) for the 10,755 DAS Form 1120 returns closed during FYs 2015 through 2018 and assigned to Quantiles 1 through 6. As shown in Figures 15 and 16, we found that the examination productivity did not reflect the LB&I Division's risk assessment plan (*e.g.*, compliance risk in descending order from Quantiles 1 to 6) for both dollars per hour and dollars per return by activity code. In October 2019, TIGTA shared the supporting data analysis and results, and LB&I Division management responded that it had no comments on our results. Then in March 2020, LB&I Division management stated that they do not track the DAS-selected returns from the start of the examination. Furthermore, they stated that TIGTA may have derived the data in Figures 15 and 16 from IRS-provided data, but they could neither validate nor reproduce without significant effort. Notwithstanding the IRS's lack of comments on TIGTA's analysis, Figures 15 and 16 indicate an issue exists with examination results for several

²⁷ Government Accountability Office, GAO-14-704G, *Standards for Internal Control in the Federal Government* (Sept. 2014).



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activity codes that contradict expected compliance risk by quantile. For example, one of the lowest risk quantiles (Quantile 5) had the highest dollars per hour and dollars per return for certain activity codes.

Figure 15: FYs 2015–2018 DAS Returns Examination Results (Dollars Per Hour)

Activity Code and Total Asset Amount	Dollars Per Hour					
	Quantile 1	Quantile 2	Quantile 3	Quantile 4	Quantile 5	Quantile 6
Mid-Corp Returns						
219 – \$10M to <\$50M	\$591	\$540	\$526	\$330	\$598	\$140
221 – \$50M to <\$100M	\$477	\$293	\$288	\$654	\$46	\$78
223 – \$100M to <\$250M	\$324	\$3,223	\$277	\$390	\$292	\$178
High-Corp Returns						
226 – \$250M to <\$500M	\$4,368	\$324	\$1,060	\$617	\$355	\$(278)
227 – \$500M to <\$1B	\$286	\$785	\$1,171	\$1,469	\$1,894	\$96
228 – \$1B to <\$5B	\$1,950	\$1,389	\$3,294	\$231	\$4,447	\$2,056
229 – \$5B to <\$20B	\$2,990	\$538	\$932	\$43	\$0	\$(219)
230 – \$20B or more	\$14,280	\$977	\$(571)	N/A	\$0	N/A

Source: TIGTA analysis of LB&I Division's FYs 2015–2018 DAS examination data.

* The highest dollars per hour is highlighted for each activity code.

Figure 16: FYs 2015–2018 DAS Returns Examination Results (Dollars Per Return)

Activity Code and Total Asset Amount	Dollars Per Return					
	Quantile 1	Quantile 2	Quantile 3	Quantile 4	Quantile 5	Quantile 6
Mid-Corp Returns						
219 – \$10M to <\$50M	\$117,421	\$105,056	\$98,539	\$63,651	\$98,706	\$25,702
221 – \$50M to <\$100M	\$106,086	\$69,645	\$66,824	\$149,467	\$10,664	\$19,894
223 – \$100M to <\$250M	\$89,224	\$866,642	\$70,534	\$97,006	\$68,708	\$44,317
High-Corp Returns						
226 – \$250M to <\$500M	\$1,768,214	\$96,853	\$288,104	\$168,400	\$99,112	\$(71,726)
227 – \$500M to <\$1B	\$103,394	\$239,576	\$379,634	\$422,731	\$512,626	\$25,703
228 – \$1B to <\$5B	\$1,187,965	\$508,351	\$1,015,675	\$81,570	\$1,441,230	\$629,268
229 – \$5B to <\$20B	\$1,817,234	\$397,176	\$493,727	\$26,367	\$0	\$(80,203)
230 – \$20B or more	\$4,014,214	\$131,934	\$(24,114)	N/A	\$0	N/A

Source: TIGTA analysis of LB&I Division's FYs 2015–2018 DAS examination data.

* The highest dollars per return is highlighted for each activity code.

The LB&I Division should analyze examination results for DAS returns on a regular basis in order to take corrective actions for any unfavorable trends. Without this insight, the LB&I Division will not be able to timely refine the DAS scoring formulas and work the returns with the greatest compliance impact.



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The LB&I Division should analyze actual examination dollar results

The DAS model development team uses the actual examination dollar amount when analyzing TYs 2006 and 2007 examination results for data analysis to develop the new model. TIGTA agrees with the Team's approach and believes that actual examination results, including tax refunds, should be considered to evaluate a workload selection method. When computing the examination results in Figures 16 and 17, TIGTA included both tax assessments and refunds to show the true examination outcome.

However, the LB&I Division does not use actual examination results to monitor the effectiveness of the DAS model. When generating the Key Stats reports, the LB&I Division uses data from the IRS's Table 37, Examination Program Monitoring report, which replaces all refund examinations with a zero. As an example, the LB&I Division closed a total of 807 returns in Activity Code 219, Quantile 1, during FYs 2015 through 2018. Figure 17 details the actual results with an average dollars per hour of \$591 and dollars per return of \$117,421 and the IRS's Table 37 dollar amounts of \$654 and \$130,125, respectively.

**Figure 17: Tax Refund Modification's
Impact on Activity Code 219, Quantile 1**

Type of Examination Result	Actual Examination Result Amount	Table 37 Examination Result
Tax Refund	\$(10,251,921)	\$0
No Change in Tax ²⁸	\$0	\$0
Tax Assessment	\$105,011,027	\$105,011,027
Total Amount	\$94,759,106	\$105,011,027
Average Dollars Per Return	\$117,421	\$130,125
Average Dollars Per Hour	\$591	\$654

Source: TIGTA analysis of LB&I Division's FYs 2015–2018 DAS examination data.

By using Table 37 data, the LB&I Division's productivity is skewed to the positive and does not accurately reflect the true compliance impact. In order to achieve the IRS's strategic goal of informed decision-making and improved operational outcomes through advanced data access, usability, and analytics, the LB&I Division should use accurate and complete data. Furthermore, to more effectively monitor and evaluate the effectiveness of the DAS model, the LB&I Division should use the same methodology and uncensored data source used to develop the DAS model. Management needs quality information to make informed decisions and to evaluate its performance in achieving key objectives as well as to address risks such as the effectiveness of the DAS model in ranking returns based on the likelihood of potential tax adjustments.

²⁸ The LB&I Division closed 417 returns with no change in tax: 32 returns closed as no-change with adjustment, 381 returns closed as no-change, and four returns closed as appealed.



The Large Case Examination Selection Method Consistently Results in High No-Change Rates

The Commissioner, LB&I Division, should:

Recommendation 5: Analyze examination results for DAS returns on a regular basis in order to take timely corrective actions for unfavorable trends.

Management's Response: The LB&I Division agreed with this recommendation. It will incorporate additional monitoring fields to better analyze examination results for DAS returns.

Recommendation 6: Use accurate and complete examination data, including both tax assessments and refunds, to monitor and evaluate whether the DAS model is achieving the LB&I Division's objectives.

Management's Response: The LB&I Division disagreed with this recommendation. The LB&I Division uses actual examination results for DAS modeling. Both tax assessments and refunds are reflected as changes during the examination, and either type of change made affects the no-change rate. The LB&I Division uses Table 37 metrics for Key Stats reporting to be consistent with reporting from all other IRS business operating divisions.

Office of Audit Comment: Only by analyzing the actual examination dollar results (tax assessments and refunds) will the LB&I Division see the true picture on the effectiveness of the DAS model and the quantile methodology. This report demonstrated the impact of using actual examination results versus Table 37 amounts. This effort has no bearing on consistency with other IRS business operating divisions.



Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to review the selection process, use of resources, and examination productivity for corporate returns examined as part of the LB&I Division's DAS workstream. To accomplish our objective, we:

- Determined how the DAS workstream supports the IRS's Service-wide and LB&I Division's program goals and objectives. We obtained (a) statistics on LB&I Division's examination performance results and hours incurred for FYs 2015 through 2018 and (b) information on the LB&I Division's FY 2019 strategic goals and the IRS's strategic goals for FYs 2018 through 2022. Additionally, we discussed with LB&I Division management how direct audit staff resources have affected DAS case selection and assignment.
- Determined how the LB&I Division assesses whether the DAS model and formulas identify high-risk returns and meet its objectives. We obtained (a) an overview of the past and current DAS models and (b) information regarding the LB&I Division's effort in monitoring the effectiveness of the DAS scoring formula and quantile assignment. Also, we interviewed the DAS model development team for a walkthrough of the process used to develop and update the DAS model and formulas, including the current model update effort.
- Determined whether the DAS quantiles methodology is effective in ranking the returns based on the likelihood of potential tax adjustments.
 - Obtained data extracts, from the LB&I Division, containing the 10,755 DAS Form 1120 returns assigned to Quantiles 1 through 6 for examinations closed during FYs 2015 through 2018.
 - For the 10,755 DAS Form 1120 returns identified, we analyzed how the examinations were closed and the number of returns closed by each DAS model. Additionally, we analyzed the examination results (dollars per hour and dollars per return) by activity code and quantile.
 - Among the 10,755 DAS Form 1120 returns, we identified 5,079 no-change returns. We performed the following analyses on these no-change returns:
 - Return count and no-change rates by activity code and quantile.
 - Examination hours incurred by activity code and quantile.
 - Among the 10,755 DAS Form 1120 returns, we identified 3,860 agreed returns, and we further analyzed the examination hours incurred by activity code and quantile.
 - For each of the 10,755 DAS Form 1120 returns identified, we analyzed the reason for selection. Our analysis disclosed that the population consisted of 7,831 primary returns, 2,748 pickup returns (regardless of association with



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aforementioned primary returns), and 176 returns selected for other reasons. For the 7,831 primary and 2,748 pickup returns, we analyzed the no-change rates.

- Obtained and analyzed the LB&I Division's employee survey questions and results for causes of high no-change rates.
- Requested information regarding the LB&I Division's no-change rate goals. We also requested the policy on the acceptable range of hours to spend on an examination before an examiner should seek a manager's decision to either close the case as no-change or continue to pursue a potential issue.

Performance of This Review

This review was performed with information obtained from the LB&I Division during the period of October 2018 through March 2020. 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.

Major contributors to the report were Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations); Christina Dreyer, Director; Javier Fernandez, Audit Manager; and Julia Tai, Lead Auditor.

Validity and Reliability of Data From Computer-Based Systems

We verified the completeness of the record counts in the data extracts provided by the LB&I Division against the LB&I Division's Key Stats reports. Additionally, we verified the accuracy of 10 returns from each fiscal year against the IRS's Integrated Data Retrieval System and examination documents.

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 LB&I Division's policies, procedures, and practices related to updating the DAS model and monitoring the effectiveness of the formulas in ranking returns based on the likelihood of potential tax adjustments. We evaluated these controls by analyzing FYs 2015 through 2018 examination results of DAS Form 1120 returns assigned to Quantiles 1 through 6. Additionally, we interviewed representatives from the DAS model development team and LB&I Division management regarding the policies and procedures to monitor DAS formula effectiveness.



Appendix II

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:

- Inefficient Use of Resources – Potential; \$22.7 million in total resources used working no-change returns during FYs 2015 through 2018 (see Recommendation 1).

Methodology Used to Measure the Reported Benefit:

We analyzed the 10,755 DAS Form 1120 examinations closed during FYs 2015 through 2018 that were assigned to Quantiles 1 through 6.

We identified 2,211 returns closed as no-change in Activity Codes 219 through 230 that incurred more than 200 examination hours, the upper range of time for an average no-change examination.¹ We determined that these returns incurred a total of 335,949 hours in excess of the average 200 hours per return.

Applying LB&I Division's \$67.64 average cost per full-time equivalent hour for FY 2015, we estimate the staffing cost for the 335,949 hours to be \$22,723,590. This amount represents the total for the four-year period of FYs 2015 through 2018.

Management's Response: The LB&I Division disagreed with the estimated monetary benefit and believes that TIGTA's outcome measure is overstated by \$11,084,568 (48.78 percent x \$22,723,590) because TIGTA found 48.78 percent of the DAS workstream resulted in no change. Consequently, 48.78 percent of TIGTA's estimated monetary benefit will also result in staffing costs associated with no-change closures.

Office of Audit Comment: We believe that the methodology used to quantify the outcome was appropriate and provided a reasonable estimate of potential inefficient use of resources. TIGTA acknowledged that there will always be some no-change closures. The point is that by minimizing the hours expended on no-change closures, the LB&I Division will be able to increase the number of examinations and advance the IRS's examination objective to promote the highest degree of voluntary compliance.

Furthermore, the \$22.7 million is a conservative amount. During fieldwork, we shared with the LB&I Division that the potential inefficient use of resources would be even higher (\$25.7 million) under an alternate computation method covering Activity Codes 219 through 226 only (excluding Activity Codes 227 through 230) were we to use the Internal Revenue Manual's standards of 90 and

¹ The 200-hour average definition was provided by the LB&I Division for Activity Codes 219, 221, 223, and 226. Because the LB&I Division did not provide any hours measure for Activity Codes 227 through 230, we also applied the 200-hour average to estimate the potential inefficient use of resources for Activity Codes 227 through 230.



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150 hours for Activity Codes 219 and 221, respectively, and the 200 average hours for Activity Codes 223 and 226.



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Appendix III

Total No-Change Return Count by Range of Hours Incurred

During FYs 2015–2018, the LB&I Division closed 5,079 DAS Form 1120 returns as no-change. Figures 1 and 2 show the no-change return counts by activity code and DAS quantile.

Figure 1: Total No-Change Return Count by Activity Code

Range of Hours	Return Count by Activity Code									Percentage*
	219	221	223	226	227	228	229	230	Total	
Less than 4 hours	4	7	16	6	3	5	0	0	41	0.8%
4 to < 16 hours	20	11	15	5	5	5	1	0	62	1.2%
16 to < 40 hours	40	32	31	15	6	8	1	0	133	2.6%
40 to < 100 hours	295	194	149	59	33	16	7	1	754	14.8%
100 to < 150 hours	391	264	197	69	35	24	6	0	986	19.4%
150 to < 200 hours	283	237	194	87	40	34	0	1	876	17.2%
200 to < 250 hours	168	168	174	74	51	30	6	0	671	13.2%
250 to < 300 hours	111	152	114	62	32	25	8	2	506	10.0%
300 to < 350 hours	68	72	74	42	22	15	1	0	294	5.8%
350 to < 400 hours	36	49	62	31	20	14	5	0	217	4.3%
400 to < 500 hours	39	61	66	41	24	11	4	1	247	4.9%
500 to < 600 hours	16	26	49	22	7	15	2	0	137	2.7%
600 to < 700 hours	6	9	13	12	6	7	2	1	56	1.1%
700 to < 800 hours	3	5	7	10	1	6	3	0	35	0.7%
800 to < 900 hours	3	2	6	1	4	4	0	0	20	0.4%
900 to < 1,000 hours	0	0	3	1	4	6	0	0	14	0.3%
1,000 to < 1,200 hours	3	2	3	2	2	3	0	0	15	0.3%
1,200 to < 1,400 hours	0	0	3	1	0	2	0	0	6	0.1%
1,400 to < 1,600 hours	0	0	2	0	1	0	0	0	3	0.1%
1,600 or more hours	0	0	1	0	1	3	1	0	6	0.1%
Total	1,486	1,291	1,179	540	297	233	47	6	5,079	100.0%

Source: TIGTA analysis of LB&I Division's FYs 2015–2018 DAS examination data.

* May be off due to rounding.



The Large Case Examination Selection Method Consistently Results in High No-Change Rates

Figure 2: Total No-Change Return Count by Quantile

Range of Hours	Return Count by Quantile							Percentage*
	1	2	3	4	5	6	Total	
Less than 4 hours	5	9	13	7	5	2	41	0.8%
4 to < 16 hours	14	13	15	10	5	5	62	1.2%
16 to < 40 hours	21	38	35	23	10	6	133	2.6%
40 to < 100 hours	150	189	192	117	68	38	754	14.8%
100 to < 150 hours	159	262	267	179	91	28	986	19.4%
150 to < 200 hours	143	222	235	166	68	42	876	17.2%
200 to < 250 hours	102	167	181	129	64	28	671	13.2%
250 to < 300 hours	88	122	134	92	43	27	506	10.0%
300 to < 350 hours	39	71	82	65	26	11	294	5.8%
350 to < 400 hours	29	49	72	39	18	10	217	4.3%
400 to < 500 hours	39	56	62	54	24	12	247	4.9%
500 to < 600 hours	21	37	41	24	10	4	137	2.7%
600 to < 700 hours	9	12	17	11	4	3	56	1.1%
700 to < 800 hours	7	8	7	7	4	2	35	0.7%
800 to < 900 hours	6	4	5	2	3	0	20	0.4%
900 to < 1,000 hours	3	3	6	1	1	0	14	0.3%
1,000 to < 1,200 hours	4	2	3	2	2	2	15	0.3%
1,200 to < 1,400 hours	0	1	0	1	2	2	6	0.1%
1,400 to < 1,600 hours	1	1	1	0	0	0	3	0.1%
1,600 or more hours	3	1	0	2	0	0	6	0.1%
Total	843	1,267	1,368	931	448	222	5,079	100.0%

Source: TIGTA analysis of LB&I Division's FYs 2015–2018 DAS examination data.

* May be off due to rounding.



Appendix IV

Total Agreed Return Count by Range of Hours Incurred

During FYs 2015 through 2018, the LB&I Division closed 3,860 DAS Form 1120 returns as taxpayer agreed. Figures 1 and 2 show the agreed return count by activity code and DAS quantile.

Figure 1: Total Agreed Return Count by Activity Code

Range of Hours	Return Count by Activity Code									Percentage*
	219	221	223	226	227	228	229	230	Total	
Less than 4 hours	17	5	8	4	3	8	0	2	47	1.2%
4 to < 16 hours	50	21	17	14	3	4	1	1	111	2.9%
16 to < 40 hours	122	31	36	25	15	18	3	0	250	6.5%
40 to < 100 hours	287	84	82	39	32	40	7	1	572	14.8%
100 to < 150 hours	203	75	55	24	21	21	3	2	404	10.5%
150 to < 200 hours	272	91	73	33	27	27	1	0	524	13.6%
200 to < 250 hours	171	90	67	38	34	22	3	0	425	11.0%
250 to < 300 hours	112	61	67	27	22	22	1	0	312	8.1%
300 to < 350 hours	87	55	59	30	19	20	2	0	272	7.0%
350 to < 400 hours	70	36	43	26	25	18	3	1	222	5.8%
400 to < 500 hours	75	48	51	30	35	20	7	0	266	6.9%
500 to < 600 hours	40	26	36	20	14	14	2	0	152	3.9%
600 to < 700 hours	18	27	23	18	10	14	2	0	112	2.9%
700 to < 800 hours	11	6	9	4	7	8	1	0	46	1.2%
800 to < 900 hours	3	3	7	11	9	10	1	0	44	1.1%
900 to < 1,000 hours	2	2	6	3	3	8	4	0	28	0.7%
1,000 to < 1,200 hours	4	5	4	6	5	9	1	1	35	0.9%
1,200 to < 1,400 hours	4	2	0	1	2	3	1	0	13	0.3%
1,400 to < 1,600 hours	0	0	0	1	1	2	2	0	6	0.2%
1,600 or more hours	2	2	3	0	2	5	5	0	19	0.5%
Total	1,550	670	646	354	289	293	50	8	3,860	100.0%

Source: TIGTA analysis of LB&I Division's FYs 2015–2018 DAS examination data.

* May be off due to rounding.



The Large Case Examination Selection Method Consistently Results in High No-Change Rates

Figure 2: Total Agreed Return Count by Quantile

Range of Hours	Return Count by Quantile							Percentage*
	1	2	3	4	5	6	Total	
Less than 4 hours	11	12	14	8	1	1	47	1.2%
4 to < 16 hours	23	33	32	15	4	4	111	2.9%
16 to < 40 hours	55	77	74	31	8	5	250	6.5%
40 to < 100 hours	115	164	149	101	23	20	572	14.8%
100 to < 150 hours	89	127	108	56	17	7	404	10.5%
150 to < 200 hours	103	165	155	64	24	13	524	13.6%
200 to < 250 hours	82	133	123	64	13	10	425	11.0%
250 to < 300 hours	64	88	94	51	8	7	312	8.1%
300 to < 350 hours	63	68	78	45	7	11	272	7.0%
350 to < 400 hours	61	73	59	24	4	1	222	5.8%
400 to < 500 hours	55	83	62	53	7	6	266	6.9%
500 to < 600 hours	33	56	33	17	10	3	152	3.9%
600 to < 700 hours	23	42	30	9	5	3	112	2.9%
700 to < 800 hours	16	13	13	3	0	1	46	1.2%
800 to < 900 hours	14	12	9	8	1	0	44	1.1%
900 to < 1,000 hours	12	5	4	6	0	1	28	0.7%
1,000 to < 1,200 hours	13	9	4	6	2	1	35	0.9%
1,200 to < 1,400 hours	5	5	2	1	0	0	13	0.3%
1,400 to < 1,600 hours	3	1	2	0	0	0	6	0.2%
1,600 or more hours	7	4	7	1	0	0	19	0.5%
Total	847	1,170	1,052	563	134	94	3,860	100.0%

Source: TIGTA analysis of LB&I Division's FYs 2015–2018 DAS examination data.

* May be off due to rounding.



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Appendix V

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

May 28, 2020

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Douglas W. O'Donnell
Commissioner, Large Business and International Division

SUBJECT: Draft Audit Report - Large Case Examination Selection Method
Consistently Results in a High No-Change Rate
(Audit 201830021)

Douglas W. O'Donnell
Digitally signed by Douglas W. O'Donnell
Date: 2020.05.28 13:56:12
Digital Signature

Thank you for the opportunity to provide input on the draft report. We appreciate Treasury Inspector General for Tax Administration's (TIGTA) fieldwork and efforts in understanding how the Discriminate Analysis System (DAS) model works, including its capabilities, limitations and intended outcomes. With any mathematical modeling application, there is room for making adjustments that will improve the model's predictive power, and we are working on improving this model as well as our other workload selection methods. Indeed, a new DAS model was released in April 2020, which we believe addresses some of the report's recommendations.

With improvements to the DAS model underway, we continue to explore additional opportunities and data analytics to enhance our overall return selection process. We strive to focus our resources on the most productive work. For example, we recently implemented a plan to reduce the no-change rate on DAS work which included conducting an extensive survey of our employees, discussing and analyzing results with management, updating the DAS model, and improving reporting. The Large Business and International Division (LB&I) will continue to monitor our resources to minimize the hours expended on no-change cases.

While the DAS model can be improved, LB&I does not rely solely on the DAS model to select large case work. In fact, a majority of LB&I's work is generated through other compliance programs such as Large Corporate Compliance and Campaigns. We continue to shift compliance resources from DAS-source work to these other compliance programs. Also, currently, new DAS work can only be initiated with the approval of a senior director.



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The IRS does not concur with TIGTA's estimate of monetary benefit in the Outcome Measures. Both TIGTA's hourly estimate and the cost savings are overstated. By alternatively applying TIGTA's estimate of a 48.78% no-change rate in Figures 8 and 11, we estimate that this overstates staff hours by 163,876 hours thereby overstating the monetary benefit by \$11,084,568.

Attached is our response to your recommendations. If you have any questions, please contact John Cardone, Assistant Deputy Commissioner Compliance Integration (ADCCI) at 202-317-8830.

Attachment



The Large Case Examination Selection Method Consistently Results in High No-Change Rates

Attachment

RECOMMENDATION 1

The Commissioner, LB&I Division, should formulate an action plan to reduce the examination no-change rates, refine the examination process to avoid working pickup returns unless issues have been established on primary tax returns that may affect prior or subsequent years, minimize the hours expended on no-change closures by monitoring excessive time applied to returns, and encourage terminating an examination when issues do not materialize regardless of how many hours have been incurred.

CORRECTIVE ACTION

LB&I has implemented an action plan to address the no change rate, which included the employee field survey and the analysis and discussion of results with management. TIGTA's observations on the no-change cases and the hours expended are valid concerns and we are striving to reduce the hours while still preserving the agent's discretion to examine related years. There are processes in place that govern the procedures for opening related returns and applying time to issues. These processes for related cases appear to be effective, because in many instances the related-year pickup yielded more favorable results than the year selected by the model. The Large Examination Process includes requirements for managerial oversight. In addition, operational reviews give management another opportunity to monitor time spent, while maintaining examiner discretion to develop unique issues and to consider facets of each examination. We will reinforce adherence to the Large Examination Process with respect to time management.

IMPLEMENTATION DATE

July 15, 2021

RESPONSIBLE OFFICIAL

Assistant Deputy Commissioner Compliance Integration, LB&I

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 2

The Commissioner, LB&I Division, should test the newly developed formulas on available examined returns from more current tax years in addition to the testing on TYs 2010 and 2011 returns.



The Large Case Examination Selection Method Consistently Results in High No-Change Rates

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CORRECTIVE ACTION

While we agree that we should use the most current data available, such data need to be a complete data set to be effective. TIGTA's recommendation may, at best, yield more information, but it will have limited value in improving the model's usefulness if it is based on an unrepresentative subset of returns from a more recent tax year. Additional testing at this time will not improve the model's current capabilities and indeed, may impede our efforts to identify the Form 1120 returns most likely to be non-compliant.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 3

The Commissioner, LB&I Division, should weight the examination results data when conducting data analysis in order to appropriately consider the breadth of scope of past examinations.

CORRECTIVE ACTION

Applying weights to consider scope of examinations is not appropriate for DAS model purposes. The DAS model's value lies in its ability to distinguish the general characteristics of non-compliant Form 1120 filers from compliant ones. It is not designed to look at the scope or issues of the examination. TIGTA's suggestion may be better suited to other LB&I workload selection methods.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A



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RECOMMENDATION 4

The Commissioner, LB&I Division, should consider the noncompliance issues found in past examinations and trend those returns' commonalities to identify returns with potential similar compliance risks for consideration during return selection.

CORRECTIVE ACTION

As with Recommendation 3, we do not believe this is appropriate for DAS model improvements. LB&I has made recent strides in improving the Issue Management System for the purpose of informing our suite of compliance programs, including discretionary work of which DAS is a part. While we acknowledge that this capability exists, such data are incomplete and it would not be advisable to use at the present time for DAS model development.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 5

The Commissioner, LB&I Division, should analyze examination results for DAS returns on a regular basis in order to take timely corrective actions for unfavorable trends.

CORRECTIVE ACTION

We will take actions to incorporate additional monitoring fields to better analyze examination results for DAS returns.

IMPLEMENTATION DATE

July 15, 2021

RESPONSIBLE OFFICIAL

Assistant Deputy Commissioner Compliance Integration, LB&I

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.



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RECOMMENDATION 6

The Commissioner, LB&I Division, should use accurate and complete examination data, including both tax assessments and refunds, to monitor and evaluate whether the DAS model is achieving the LB&I Division's objectives.

CORRECTIVE ACTION

LB&I uses all assessments in measuring the effectiveness of the DAS model, including both deficiency and overassessment (refund) cases. While TIGTA is using the Key Stats report to make this recommendation, the Key Stats figures are not used for evaluating the effectiveness of the DAS model. Instead, all examination results are used in evaluating DAS. Both overassessments and underassessments are reflected as changes during the examination of a return, and neither type of change made would impact the number of Disposal Code 02 (no-change) cases closed by LB&I during any given time frame. The Key Stats Report is using IRS reporting metrics from Table 37, to be consistent with closed case reporting from all other Business Operating Divisions within the IRS. Therefore, no corrective action will be taken.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A



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Appendix VI

Glossary of Terms

Term	Definition
Coordinated Industry Case	Any case assigned to the LB&I Division for which the taxpayer and its effectively controlled entities warrant the application of team examination procedures. Case criteria can be found in Internal Revenue Manual 4.46.2.
Discriminant Analysis System	A computer model developed to score Form 1120 returns as to examination potential. Generally, the higher the score, the greater the audit potential.
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government’s fiscal year begins on October 1 and ends on September 30.
Full-Time Equivalent	A measure of labor hours in which one FTE is equal to eight hours multiplied by the number of compensable days in a particular FY. For example, for FYs 2015 and 2016, one FTE was equal to 2,088 and 2,096 staff hours, respectively.
Industry Case	Any case within the LB&I Division that has not been defined as a coordinated industry case. Industry cases typically have Activity Codes 219 to 227.
Integrated Data Retrieval System	IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer’s account records.
Internal Revenue Manual	The official compendium of internal guidelines for IRS personnel.
Issue Management System	LB&I Division’s computerized case management system. It captures information from audits, such as the type of examination issues pursued and the amounts and reasons for adjustments.
Revenue Agent	A revenue agent working in the LB&I Division, individually or as a team member, conducts independent examinations and related investigations of cases involving the most complex tax returns filed by large businesses, corporations, and organizations. These taxpayers include those with extensive subsidiaries, diversified activities, and national or international scope and operations. A revenue agent applies an expert knowledge of the Internal Revenue Code, rulings, court decisions, and agency policies, regulations, and practices to determine the correct tax liability.
Tax Gap	The estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.
Tax Examiner	A tax examiner working in the LB&I Division performs a wide variety of technical duties to conduct or support audit issues. The tax examiner is responsible for resolving issues and prepares audit work for resolution by higher-graded tax technicians. The tax examiner analyzes and resolves tax processing problems as well as adjusts taxpayer accounts, prepares and issues manual refunds, performs credit transfers, and computes tax, penalties, and interest.



The Large Case Examination Selection Method Consistently Results in High No-Change Rates

Tax Technician	A tax technician working in the LB&I Division conducts independent on-site or IRS office examinations of individual and business taxpayers to determine Federal tax liability. The tax technician also provides tax guidance and assistance through the development and implementation of promotional and communication program plans to educate and assist taxpayers, stakeholders, and partners.
Tax Year	A 12-month accounting period for keeping records on income and expenses used as the basis for calculating annual taxes due.



Appendix VII

Abbreviations

DAS	Discriminant Analysis System
FY	Fiscal Year
IRS	Internal Revenue Service
LB&I	Large Business and International
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year