



COMMISSIONER

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

July 29, 2019

The Honorable Charles E. Grassley
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

Dear Chairman Grassley:

Thank you for your letter dated May 2, 2019, concerning the Treasury Inspector General for Tax Administration's (TIGTA's) April 2019 report titled, "Improvements Are Needed to Ensure That Employee Tax Compliance Cases Are Adjudicated Consistently" (Report). The IRS is committed to ensuring that the adjudication of employee tax noncompliance cases is consistent. We adhere to all federal laws, rules, and regulations, as well as IRS policies, procedures, and guidelines concerning employee tax compliance. We are focused on ensuring all IRS employees are tax compliant.

The IRS established procedures for identifying, reviewing, and adjudicating employee tax noncompliance cases as part of our Employee Tax Compliance (ETC) Program. IRS labor relations (LR) specialists work closely with management during the process of determining employee willfulness in potential tax compliance cases. As shared with TIGTA, our staffing challenges, including the loss of experienced staff and the inability to backfill positions due to budget constraints, are significant contributing factors to TIGTA's findings. These resource and budget constraints limited our ability to conduct consistent compliance reviews of case work across the IRS, but we are taking steps to correct this deficiency.

The IRS conducted a thorough analysis of the statements and findings made in TIGTA's Report. As part of this analysis, we reviewed 77 cases that TIGTA identified as violations of Section 1203 of the IRS Restructuring and Reform Act of 1998 (RRA '98), specifically Section 1203(b)(8) (willful failure to timely file) and 1203(b)(9) (willful understatement of a federal tax liability).¹ In consultation with TIGTA, the number of identified Section 1203(b)(8) and (9) cases was reduced from 77 to 72. In Fiscal Year 2017, IRS management closed 1,250 cases involving employees who either understated income or did not file their income taxes timely. TIGTA's audit included a statistically valid² sampling of 50 of the 1,250 closed cases and a

¹ Section 1203(b)(8) and (9) include exceptions if the failure to timely file or the understatement of federal tax liability is due to reasonable cause and not to willful neglect.

² TIGTA's sample size was determined using a confidence level of 90 percent, an expected error rate of 5 percent for willful cases and 10 percent for non-willful cases, and a precision of ± 6.94 percent.

judgmental³ sampling of 22 cases, for a total of 72 closed cases. TIGTA found that in 21 of the 50 cases in the statistically valid sample, IRS management did not make a proper determination regarding willfulness as required. In addition, TIGTA's review of the 22 judgmentally selected cases found that in 13 cases, the facts of the case did not support IRS management's determination regarding willfulness.

IRS's analysis found management made a proper determination regarding willfulness, including reasonable cause considerations, for 53⁴ out of the 72 cases. For the remaining 19 cases, the IRS determined improved documentation was needed to further support management's determinations. Note that determinations regarding willfulness are based on established factors for management to consider and management's own personal assessment of the facts in the case. This is not a science, and it is possible for reasonable people to consider the same set of facts and yet disagree on whether the employee's actions were willful and whether the statutory exception (reasonable cause and lack of willful neglect) applies.

In the responses below, we share our analysis, which in some instances does not validate TIGTA's findings.

Our responses to your questions follow:

1. Were you aware that there were individuals in noncompliance with the tax laws within the IRS? If not, was the previous Commissioner aware?

Response: Yes. The IRS screens employee taxes through our ETC Program, which identifies employees who may be noncompliant. As noted above, the IRS has procedures for these cases and for making a willfulness determination.

2. Did you, or the previous IRS Commissioner, exercise discretion to disregard the Section 1203 requirement to dismiss employees who are not in compliance with the tax laws? If so, why?

Response: As noted above, Section 1203(b)(8) and (9) require that the employee's untimely filing and/or understatement be willful and include exceptions when the error is due to reasonable cause and not to willful neglect. Furthermore, in cases where a determination of willfulness has been made, Section 1203(c)(1) and (2) give the IRS Commissioner the sole discretion to take a personnel action other than termination for willful violations of Section 1203(b). Section 1203(c)(2) also gives the Commissioner the sole discretion to establish a procedure to determine which cases warrant his

³ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

⁴ The data TIGTA provided to the IRS did not identify the 21 cases from the statistically valid sample, or the 13 cases from the judgmental sample of 22, where TIGTA disagreed with the determinations of IRS management. The IRS analyzed all 72 cases. See Response 8 for additional information about the judgmental sample.

consideration for a lesser penalty. The IRS's Section 1203 adjudication procedures include two decision points:

1. Management's determination about the employee's willfulness and whether a Section 1203(b) provision were violated; and
2. The Commissioner's determination of whether the employee warrants a lesser penalty than termination, based on certain factors.

The 1203 Review Board considers each Section 1203 case management found willful and therefore under the statute recommended removal, and in some cases the board recommends mitigating the penalty from removal to some lesser punishment, such as a 30-day suspension without pay. Enclosed is the current 1203 Review Board Executive Summary template that management and LR must complete for every Section 1203 case. I have approved mitigating the penalty when I agreed with the board's mitigation recommendation.

3. What is the tax delinquency status of the Criminal Investigator, the Revenue Officer, and the four Internal Revenue Agents described as willful violators of the tax law?

Response: We performed an internal search that found six employees who fell within these categories. Of the six employees we identified, four are no longer with the IRS. Three of the employees were removed after a final determination of noncompliance. One employee resigned after the issuance of a proposed removal letter. The cases involving the remaining two, a revenue officer and a revenue agent, were mitigated to suspensions by the Commissioner, and these two employees are currently tax compliant.

4. TIGTA estimates that the IRS failed to properly determine willfulness in 530 cases. Has the IRS re-examined all of the 1,250 cases of noncompliance to make corrected determinations where necessary? If not, why?

Response: We re-examined the 72 cases TIGTA reviewed, but we did not re-examine all 1,250 noncompliance cases due to resource constraints. Previously, we conducted monthly reviews of Section 1203 cases only where there was a determination that a willful violation occurred. While the IRS reviewed closed cases during monthly quality reviews, resource constraints and knowledge gaps may have contributed to procedural issues found by TIGTA.

We are now reviewing all Section 1203 cases as they are processed to ensure compliance with standard operating procedures, including properly documented willfulness determinations.

To reinforce procedures and increase knowledge, we provided LR specialists with refresher training in April 2019 on the processing of Section 1203 cases, and we are

developing training for managers on their roles and responsibilities when making determinations for Section 1203 cases. This management training will be offered by September 2019. We will provide these training courses annually to proactively address concerns contained in the TIGTA Report. The IRS Human Capital Office is also in the process of hiring additional LR specialists to better manage the case workload.

5. What is prohibiting the IRS from adhering to the statutory requirement that requires the IRS to terminate the employment of any employees who are currently noncompliant with their taxes?

Response: Please see our response to Question 2.

6. What actions have been taken to address those within the IRS who are noncompliant with their taxes?

Response: RRA '98 imposes additional tax compliance standards and consequences for IRS employees – not in place of but in addition to the penalties and interest applicable to our employees as taxpayers. In addition to the usual non-compliance screening imposed on our employees as taxpayers, the IRS screens all IRS employees through our ETC Program throughout the year to identify those who may be noncompliant. Whenever noncompliance is determined, management is required to adjudicate the misconduct. Management uses the IRS Guide to Penalty Determinations and RRA '98 when determining the appropriate discipline. This discipline could range from admonishment to removal depending on the facts of each case.

7. TIGTA identified five cases in which labor relations specialists did not agree with IRS management's willfulness determination. Why did these labor relations specialists disagree with IRS management in these five cases? Please provide documentation on the decision-making process from IRS management.

Response: When the ETC Program identifies that an IRS employee may be noncompliant, the employee's management conducts an analysis (1) to determine whether intentional tax noncompliance occurred and (2) to render a final decision. LR specialists serve in an advisory capacity to management during this analysis phase. Enclosed is the IRS guidance for management on willfulness and reasonable cause in Section 1203(b)(8) and (9) cases.

We reviewed the five cases in which TIGTA stated that the labor relations specialists disagreed with IRS management, and we outline the circumstances of those particular cases below.

In the first case, management did not find that the employee willfully violated Section 1203(b)(9). The employee stated to management during the fact-finding interview that she filed her tax return in early February using Turbo Tax for the first time and forgot to include a TSP withdrawal. She also stated that she did not report income from a part-

time job and state unemployment benefits because each was less than \$1,000, and she believed each needed to exceed that amount to be reportable. The Branch 1203 Consultant did not agree with management's not willful determination because the issue occurred in two consecutive tax years, employees receive regular reminders of their tax obligations, the employee did not call for tax assistance, and the 1099s she received state that they are taxable amounts. Management did not believe that the employee willfully understated her tax liability because of her lack of understanding of the tax law. LR ultimately concurred with the final determination based on management's explanation of the lack of understanding of tax law.

In the second case, management did not find that the employee willfully violated 1203(b)(9). The employee stated to management during the fact-finding interview that she relied on her spouse to file their tax returns. Her spouse claimed numerous deductions that were disallowed in an audit because they were found to be personal rather than business expenses. Management did not find that the employee willfully understated her tax liability but rather was careless in trusting her husband, who is an attorney and a Harvard graduate, to prepare their returns. He told her that he had receipts for each item on the return, and she did not question him further. The labor relations specialist processing the case cited this employee's position as a revenue agent who is expected to understand tax law and did not agree with management's decision during initial review, but a subsequent review by the Branch 1203 Consultant resulted in concurrence with management.

For the third case, management did not find that the employee willfully violated 1203(b)(9). The employee stated: that she was not aware she had another W-2 to include in her return when she submitted it; that she received that W-2 two weeks after filing her return; that it did not occur to her to amend her taxes; and that at the same time her son and the mother of her two grandsons passed away, causing her mental, physical, and financial hardship. Upon initial review of the case, the Branch 1203 Consultant did not agree with management's determination, citing that the employee's excuse for not reporting income due to a death in the family was not a mitigating factor because the death occurred after the due date for the tax year. It was also cited that there was no indication that the employee intended to file an amended return. Management was insistent upon its position and explained that they believed the employee and believed that she intended to file an amended return. Moreover, management considered that the employee had a death in the family when she realized the amended return had not been filed and had no balance due during case adjudication, this was her first offense and she was a good employee.⁵ LR ultimately concurred with management's determination based on the factors listed above.

⁵ TIGTA's report correctly states that neither management nor LR mentioned the prior admonishment letter this employee received in FY 2013 (in December 2012) for a substantiated tax violation. For progressive discipline purposes, letters of admonishment remain in an employee's file for two years. See IRM 6.751.1.16.3(2)(c). This TIGTA audit reviewed employee tax compliance cases from FY 2017, and by the time of this employee's tax compliance case in FY 2017, the FY 2013 admonishment was too stale to support escalating discipline. Nevertheless, even though the prior discipline was too aged to require progressive discipline and enhance the

For the fourth case, management did not find that the employee willfully violated 1203(b)(9). The employee stated he felt he could claim the Earned Income Tax Credit (EITC) because he had a child living with him 60% of the time. He also claimed his certified public accountant (CPA) stated he could claim the child. The Branch 1203 Consultant did not agree with management's determination because the terms of the divorce decree provided that the EITC was to be used by his ex-wife and because the children were only with him 50% of the time. Management did not believe it was willful because, at the time of filing, he was a new employee, and management also believed he was relying upon the advice of his CPA. The labor relations specialist assigned to the case (a different person from the Branch 1203 Consultant) ultimately agreed with management's non-willful determination.

Lastly, in the fifth case, management ultimately did not find the employee liable for a willful 1203(b)(9) violation. The employee explained that her husband passed away in July of the tax year, and she simply forgot to include her Form 1099-R for a Thrift Savings Plan distribution. She also explained she lost her home that year, and she could no longer claim six of her dependents. The employee also did not report the unemployment funds she collected during a government shutdown. She ultimately returned those unemployment funds, but the W2s had already been issued. The assigned labor relations specialist concurred with management's initial willful determination, and management proposed the employee's removal. The Branch 1203 Consultant, however, did not agree that the employee should be disciplined for a willful 1203(b)(9) violation, because the employee provided reasonable cause for the underreported income. At this point, the case was transferred to a new labor relations specialist. The deciding official, upon hearing the employee's response during the oral reply, decided to suspend the employee for 7 calendar days, rather than discipline her for a willful 1203(b)(9) violation. The newly assigned labor relations specialist agreed with the deciding official's decision.

8. Has the IRS taken steps to address unsubstantiated non-determinations of willfulness in the 13 cases identified in this report? Are those employees still noncompliant with the tax laws? What is the status of those employees who are repeat offenders?

Response: Yes, the IRS has taken steps to address unsubstantiated non-determinations of willfulness. TIGTA reviewed 22 potential Section 1203 tax noncompliance cases in its judgmental sample and concluded that in 13 of the 22 cases, in TIGTA's opinion, the facts of the case did not support IRS management's determination regarding willfulness. As stated above, willfulness determinations are subjective, and reasonable people evaluating the same facts can reach different conclusions on willfulness. The data TIGTA provided the IRS did not identify those 13 cases. Therefore, the IRS conducted an analysis of all 22 cases. Eight of the 22 are in

penalty for the current offense (and for that purpose, this was her "first offense"), LR should have noted the prior admonishment to management as evidence that the employee had been put on notice and was aware of her obligation to file her taxes properly.

various stages of adjudication. Two of those eight are currently under review to confirm the misconduct. The other six cases include: (1) Two proposed removals that are awaiting final agency adjudication; (2) one proposed suspension; (3) one in which management is issuing a proposed removal; (4) one in which LR is preparing a letter of reprimand; and (5) a proposed 30-day suspension at the oral reply stage. The remaining fourteen cases were adjudicated as follows: six of the individuals are no longer employed by the IRS, and eight remain with the IRS and all eight are tax compliant.

9. How has the IRS addressed the potential misclassifications within the Automated Labor and Employee Relations Tracking System?

Response: To address potential misclassifications, the IRS created a checklist to complete before closing cases in the IRS's Automated Labor and Employee Relations Tracking System. The checklist requires all staff to ensure correct issue codes are entered. In addition to regular case processing reviews, an additional quality review is required for all Section 1203 cases.

10. Are the recommendations made by TIGTA sufficient to address these issues? If not, what else can the IRS do to better ensure that tax-noncompliance within the IRS does not occur?

Response: The IRS agreed with all five recommendations in the report, and we believe they are sufficient to address the findings. In response to TIGTA's recommendations, the IRS provided specific, ongoing actions to improve the Section 1203 process. These actions are described in TIGTA's final report.

I hope this information is helpful. If you have any questions, please feel to contact me, or a member of your staff may contact Leonard Oursler, director, Legislative Affairs, at 202-317-6985.

Sincerely,

A handwritten signature in blue ink, appearing to read "Charles P. Rettig", with a long horizontal flourish extending to the right.

Charles P. Rettig

Enclosures (2)