ABUSIVE TAX AVOIDANCE TRANSACTIONS

IRS Needs Better Data to Inform Decisions about Transactions
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Why GAO Did This Study

Abusive tax avoidance transactions (ATAT) range from frivolous tax schemes to highly technical and abusive tax shelters marketed to taxpayers by promoters selling tax advice. ATATs threaten the U.S. tax system’s integrity if honest taxpayers believe that others do not pay their fair share of taxes.

GAO was asked to (1) describe what is known about trends in ATAT usage; (2) describe results of IRS’s ATAT enforcement efforts; and (3) evaluate IRS’s implementation of the ATAT provisions in the American Jobs Creation Act of 2004. Using criteria from the act, GAO analyzed statistics and other documents on trends and results and interviewed IRS and other tax experts.

What GAO Found

While trend data on taxpayers’ use of ATATs are limited, IRS and other experts GAO contacted agreed that a problem exists and is continually changing. One theme that emerged from GAO’s discussions with these experts is that ATATs marketed by promoters to corporations and wealthy individuals have declined in recent years, although the experts had different views on the extent of the decline. They also said that ATATs have become more international in nature. Even though estimating the extent of the ATAT problem is inexact because ATATs are often hidden, the experts believed that the changing nature of ATATs warrants continuous IRS vigilance.

IRS has many ATAT-related enforcement efforts—investigations, examinations, and settlement initiatives—across different divisions but has incomplete data on the results of those efforts. For example, IRS’s small business division’s promoter investigations help stop promotions, but IRS had incomplete information on why investigations often closed without penalties or injunctions, information that could be used to help decide the types of investigations to start. In addition, IRS recommended billions of dollars in additional taxes from examining tax returns with suspected ATATs, but IRS did not identify the part of the additional amount that was collected or that related to the ATAT issue as opposed to other issues. In addition, some ATAT results were reported inconsistently across IRS divisions. Without comprehensive or consistent information, IRS does not have the best information to decide which promoters to investigate and the number of examinations that should be done as well as to evaluate their impacts.

Even though the 2004 act increased the requirements for taxpayers and promoters to disclose their use of transactions and enhanced the penalties for improper disclosure, problems existed. IRS received many disclosures of transaction use from taxpayers, but it had no assurance that its Office of Tax Shelter Analysis received all the disclosures it should have. In addition, IRS did not verify that all the disclosures it received were complete, and a new process for reviewing the completeness of disclosures and following up with taxpayers was not yet finalized. Not receiving disclosures or receiving incomplete disclosures of transactions would keep IRS from having information needed to identify the transactions that merit an examination of their appropriateness and to assess related penalties as needed. Finally, certain promoters who are required by law under threat of penalty to give their list of investors within 20 business days after IRS requested it did so. However, other promoters who are not covered by this requirement often took longer than 20 days to provide the lists without the threat of a similar penalty. IRS did not comprehensively track how quickly the lists were received. Not receiving lists on a timely basis prevents IRS from quickly working to stop promoter activity.

What GAO Recommends

GAO suggests that Congress consider instituting a penalty aimed at certain promoters not giving investor lists to IRS within a specified time. GAO also recommends IRS act or establish processes to (1) improve data on the results of ATAT-related investigations and examinations, (2) ensure that required disclosures are filed by taxpayers, (3) review disclosures for completeness; (4) track the time for IRS to receive investor lists; and (5) induce more promoters to provide investor lists by a specified time.

In commenting on a draft of this report, IRS agreed with most recommendations but cited resource and capability constraints in tracking ATAT data and investor lists, which GAO believes can be addressed.

View GAO-11-493 or key components.

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<table>
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<tr>
<th>Abbreviation</th>
<th>Description</th>
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</thead>
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<tr>
<td>A-CIS</td>
<td>Audit Information Management-Computer Information System</td>
</tr>
<tr>
<td>AJCA</td>
<td>American Jobs Creation Act of 2004</td>
</tr>
<tr>
<td>ATAT</td>
<td>abusive tax avoidance transaction</td>
</tr>
<tr>
<td>ERIS</td>
<td>Enforcement Revenue Information System</td>
</tr>
<tr>
<td>IRC</td>
<td>Internal Revenue Code</td>
</tr>
<tr>
<td>IRS</td>
<td>Internal Revenue Service</td>
</tr>
<tr>
<td>LB&amp;I</td>
<td>Large Business and International division</td>
</tr>
<tr>
<td>LDC</td>
<td>Lead Development Center</td>
</tr>
<tr>
<td>LILO</td>
<td>Lease-In/Lease-Out</td>
</tr>
<tr>
<td>LMSB</td>
<td>Large and Mid-Size Business division</td>
</tr>
<tr>
<td>OPR</td>
<td>Office of Professional Responsibility</td>
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<tr>
<td>OTSA</td>
<td>Office of Tax Shelter Analysis</td>
</tr>
<tr>
<td>SB/SE</td>
<td>Small Business/Self-Employed division</td>
</tr>
<tr>
<td>SILO</td>
<td>Sale-In/Lease-Out</td>
</tr>
<tr>
<td>SOI</td>
<td>Statistics of Income</td>
</tr>
<tr>
<td>TOI</td>
<td>transaction of interest</td>
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May 12, 2011

The Honorable Max Baucus
Chairman
The Honorable Orrin G. Hatch
Ranking Member
Committee on Finance
United States Senate

The Honorable Charles Grassley
Ranking Member
Committee on the Judiciary
United States Senate

Abusive tax avoidance transactions (ATAT) range from tax schemes based on clearly frivolous arguments to highly technical and abusive tax shelters engineered and marketed by firms. As characterized by the Internal Revenue Service (IRS), ATATs take a tax position that is not supported by tax law or manipulate the law in a way that is not consistent with the law’s intent. Promoters (including material advisors) may encourage the use of these abusive transactions by their customers.\(^1\) In 2003, we reported that IRS officials estimated that several hundred thousand participants were likely engaged in abusive tax avoidance schemes.\(^2\) In addition, we reported that IRS data sources, all with limitations, suggested that abusive tax shelters totaled tens of billions of dollars of potential tax losses over about a decade.\(^3\) ATATs threaten our tax system’s integrity and fairness if honest taxpayers believe that significant numbers of individuals and businesses are not paying their fair share of taxes.

\(^1\) Based on IRS officials’ definition, the term promoter includes a person who (1) organizes an investment plan or arrangement affecting taxes or participates in selling it and (2) makes a statement about its tax benefits. Material advisors include promoters who earn or expect to earn at least a specified amount from any reportable transactions, such as $50,000 in gross income when a reportable transaction provides substantially all the tax benefits to individuals. To be a material advisor to a transaction, a party must provide material aid, assistance, or advice with respect to the organizing, managing, promoting, selling, implementing, insuring, or carrying out of any reportable transaction.


Since our 2003 work, the American Jobs Creation Act of 2004 (AJCA) addressed ATATs through disclosure and penalty provisions.\(^4\) Interested in the act’s effectiveness, you asked us to report on IRS’s efforts to address it. The objectives of this report are to:

- describe what IRS and other experts know about trends in the use of ATATs;
- describe the results that IRS’s promoter investigations, investor examinations, and settlement initiatives have achieved;\(^5\) and
- evaluate the results of IRS’s implementation of the ATAT disclosure and sanction provisions enacted in the AJCA.

To address these objectives, we did the following (see app. I for details about our scope and methodology):

- reviewed IRS’s documentation on ATAT trends, including its most recent report on the size of the ATAT problem,\(^6\) and interviewed IRS officials and outside tax experts—former high-level IRS officials and their suggested contacts—about these ATAT trends and whether the nature of ATAT problems changed in sophistication or scope in recent years;
- analyzed IRS investigation, examination, and settlement initiative statistics, focusing on two IRS divisions that pursue abusive promoters and that our 2003 work highlighted—the Large Business and International (LB&I) division\(^7\) and the Small Business/Self-Employed (SB/SE) division, and interviewed IRS officials about why IRS did certain investigations and examinations and not others; and
- using criteria inherent in the AJCA, evaluated (1) ATAT disclosures to IRS and their level of completeness, (2) IRS’s requests for the lists of investors in ATATs from tax advisors, and (3) ATAT penalties and other sanctions used since 2004, and interviewed IRS officials on why


\(^5\)IRS has investigated promoters to stop ATATs, examined the tax returns of investors in ATATs, and initiated settlements with taxpayers using ATATs.


\(^7\)On October 1, 2010, IRS created LB&I from the former Large and Mid-Size Business (LMSB) division. For ease of presentation, this report uses the term LB&I to include actions taken by LB&I or LMSB. LB&I serves the following taxpayers: corporations, subchapter S corporations, and partnerships with assets greater than $10 million, and certain high-wealth individuals.
some disclosures were required to be sent to two places in IRS and how well that requirement worked.

We conducted this performance audit from July 2009 through May 2011 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

If ATATs are highly technical and organized or marketed, they are often referred to as abusive tax shelters. According to IRS, abusive tax shelters result in unlawful tax evasion. Our report on business network-based tax evasion illustrates how one type of evasive transaction—the installment sale bogus optional basis—operated. ATATs also include abusive transactions that are considered scams or schemes based on the erroneous application of tax law or clearly frivolous arguments.

Tax shelters can be legitimate to the extent that they take advantage of various provisions in the tax code to lawfully avoid tax. For instance, retirement plans (e.g., 401(k)) shelter income by not subjecting certain wages to federal income taxes until the wages are distributed from the plan. Tax shelters can feature such techniques as taxpayers trying to avoid gains altogether or to convert ordinary income into capital gains to take advantage of lower tax rates on capital gains.

A difficulty arises when tax shelters are designed to confer a tax benefit that the Congress did not intend. An example of this type of shelter is the lease-in, lease-out (LILO) shelter that involved complex purported leasing arrangements in which corporations supposedly leased large assets, such as sewer systems, from owners without a tax liability and immediately leased them back to their original owners in an attempt to delay income recognition for tax purposes for many years.

ATATs have been a long-standing problem that the Congress, Treasury, and IRS have used different methods to address. For example, the Tax

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Reform Act of 1986 addressed tax shelters from the 1970s and 1980s by preventing individual taxpayers from using "passive activity" losses from tax shelter investments to reduce taxes by offsetting taxable income.\(^9\)

Interest in abusive tax shelters picked up again in the 1990s. In 1999, a Department of the Treasury report described a large and growing problem with abusive corporate tax shelters. In 2002, citing many ongoing efforts, Treasury published a plan to further combat ATATs, featuring both legislative proposals and administrative actions. In 2004, the AJCA provided updated disclosure and list-maintenance rules and updated penalty provisions. The list-maintenance rules require that material advisors keep lists of their investors and make the lists available to the Secretary of the Treasury within 20 business days of a request.\(^10\) For a summary of selected provisions of the AJCA related to ATATs, see appendix II.

Over time, Treasury’s strategy for addressing tax shelters centered on rules that were intended to reinforce each other. The rules attempted to do this by requiring taxpayers entering into certain transactions and tax advisors recommending the transactions to disclose to IRS information about the same transactions. The idea was that using these rules, IRS could follow a transaction from a taxpayer to the taxpayer’s advisor and from the advisor to any of the advisor’s clients.

The rules require specified taxpayers to disclose “reportable transactions.”\(^11\) These transactions include “listed transactions” that are the same or substantially similar to one of the types of transactions that IRS has determined to be a tax avoidance transaction and identified by notice, regulation or other published guidance. Reportable transactions also include “non-listed” transactions, which are not designated as tax avoidance transactions but prompt tax avoidance or evasion concerns nonetheless. Non-listed reportable transactions include certain transactions (1) offered to a taxpayer under conditions of confidentiality and for which the taxpayer paid an advisor a minimum fee and (2) certain loss transactions. Non-reportable abusive transactions are abusive

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\(^10\)26 U.S.C. §§ 6112, 6708. For this report, references to the responsibilities and authority of the Secretary of the Treasury are treated as being delegated to IRS unless otherwise noted.

transactions not described in one of the reportable categories. For a comparison of requirements for reportable and non-reportable transactions and a description of how taxpayers, material advisors and other promoters, and IRS interact with each other, see figure 1.
Figure 1: Comparison of Reportable and Non-reportable Abusive Transactions

**Reportable transactions**

Taxpayer participates in a reportable transaction.

- Required to file Reportable Transaction Disclosure Statement (Form 8886).
  - Required to file Material Advisor Disclosure Statement (Form 8918).
  - Required to file form with tax return each year taxpayer participates in the transaction.
  - If either form is not submitted, or is incomplete or delinquent, a penalty may be imposed.
  - Submission of either form may lead to a taxpayer examination.
  - The material advisor is required to maintain an investor list. If the list is not provided within 20 business days, a penalty may be imposed.

**Non-reportable abusive transactions**

Taxpayer participates in an abusive transaction that is not reportable.

- Not required to file Form 8918.
  - When the taxpayer is identified by IRS, an examination may follow.
  - The promoter is not required to maintain an investor list. Therefore, if the list is not provided within 20 business days, there is no penalty.

Promoter participates in an abusive transaction that is not reportable by the promoter, including cases in which the promoter does not meet the definition of a material advisor.

- Not required to file Form 8886.
  - When the promoter is identified by IRS, an investigation may follow. As part of the investigation, IRS may request an investor list from the promoter.

Source: GAO analysis of IRS information.
IRS has had various forms for filers reporting ATAT information. For example, taxpayers are to file Form 8886, Reportable Transaction Disclosure Statement, to disclose their reportable transactions. Form 8918, Material Advisor Disclosure Statement, is to be filed by material advisors. This form was created in 2007 to replace Form 8264, Application for Registration of a Tax Shelter, which was to be filed by tax shelter organizers in order to describe a transaction and its tax benefits when the transaction had certain potentially abusive characteristics.

To enforce compliance, IRS has three interlocking efforts: promoter investigations, investor examinations, and settlements. Figure 2 focuses on two IRS operating divisions—LB&I and SB/SE—that develop and evaluate promoter leads for investigation and shows how each division coordinates with others, including the Servicewide Abusive Transaction Executive Steering Committee.12

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12This committee is a major ATAT mechanism designed to provide leadership, coordination, and policy for addressing ATATs. It meets about monthly, sharing information across IRS and monitoring cross-cutting issues. Agenda items have included material advisors; emerging ATAT issues; and issue management teams, which are to gather information and develop a strategy for specific ATATs.
To make a case against abusive promoters, LB&I or SB/SE may examine the tax returns of taxpayers investing in the promotions. If they make such a case, the promoters will be unable to sell their ATATs to taxpayers, and IRS will thus have fewer taxpayers to examine to see if their investments in those promotions cause tax concerns. IRS may also settle with groups of taxpayers without necessarily having to first locate and examine each taxpayer who used a promotion. IRS induces these taxpayers to come forward in disputed matters by, in some cases, reducing their penalties in exchange for conceding tax benefits that they claimed.

Note: The Tax Exempt and Government Entities division, which is also involved with ATATs, is not shown with the same prominence as LB&I and SB/SE because we did not focus on it in our work.

Source: GAO analysis of IRS information.
IRS has limited trend data on the size of the ATAT problem in terms of the number of abusive promoters and taxpayers investing in the promotions. Estimating the extent of ATATs is at best an inexact process because ATATs are often hidden. Data do not exist to measure any ATATs unknown to IRS with much precision. Given these difficulties, IRS used various qualitative and quantitative methods in an attempt to develop some estimates in a 2006 study. IRS estimated that about 1 million tax returns and between about 11,000 and 15,000 promoters were involved in ATATs in 2004. Of the 1 million returns, IRS estimated that more than half related to “business and deduction” schemes and almost a third involved “frivolous filer/anti-tax” schemes. IRS put the rest of the returns into six other categories, such as corporate tax shelters. IRS had no plans to update these estimates.

In the absence of data on trends in the use of ATATs, we interviewed a number of tax experts in IRS or who were former top officials of IRS or others well-known in the tax community. The experts we interviewed told us that abusive tax avoidance is still a major issue but the nature of ATATs has changed. A theme we heard from the experts is that the mass marketing of ATATs has declined in recent years, although the experts had different views on the extent of the decline. Mass marketing refers to the sale of advice by promoters such as larger accounting and tax law firms about how to structure ATATs. This advice was sold to clients such as wealthy individuals and corporations. One expert said that mass marketing of ATATs has significantly declined in recent years. Others made statements like the battle has been “more won than not.”

Although mass marketing of ATATs has declined, these experts said that ATATs have become more sophisticated and international in scope. In addition to international transactions, ATATs are changing as false credits and deductions, customized shelters, and return preparer fraud entities have come more to the fore. IRS’s “dirty dozen” list, its annual listing of “notorious tax scams,” ranks certain abuses that are relevant to ATATs—

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13 Internal Revenue Service, *Forecasting Potential Abusive Tax Avoidance Transaction Promoters and Participants* (June 2006). IRS used many methods for its various estimates. For example, it used a quantitative CHAID/logistic process for tax year 2001 to determine the probability that taxpayers were involved in ATATs based on how closely they resembled known ATAT participants. For tax year 2004, it used the qualitative Nominal Group Technique. It also developed a model using IRS audit data to predict the change in the size of the promoter and participant population over time. Finally, it developed ideas using quantitative and qualitative approaches for tracking systems to assess the impact of enforcement on the population of potential promoters and participants over time.
such as return preparer fraud and trying to hide income offshore—at the top.

The experts we interviewed gave us details about how ATATs involving international features or tax return preparers changed. For instance, one expert believed abuse took the form of improperly keeping income offshore and not reporting it on a tax return. IRS officials said that abusive transactions moved from being domestic transactions mass marketed by large accounting and law firms to offshore transactions promoted by smaller entities and more customized to the buyers. IRS officials also said that ATATs seemed more international than before, with promoters changing the countries and mechanics of their promotions. In terms of tax return preparers, IRS officials told us of promotions systematically using false or inflated deductions or credits in tax returns. These schemes achieved broad coverage by taking small scale abusive positions with individual clients. For instance, preparers solicited clients in an attempt to improperly claim the First-Time Homebuyer Credit, which first came into existence in 2008.14

Experts also told us that the nature of the ATAT problem is cyclical and ever-changing and warrants continuous IRS vigilance. According to IRS officials, IRS tries to proactively identify and thwart emerging ATATs, especially early in their life cycles, pointing to early IRS identification of taxpayers’ attempts to improperly claim the First-Time Homebuyer Credit.

Three data sources other than the above IRS estimates also give some indication of changes in ATAT activity. First, taxpayers are disclosing fewer listed reportable transactions (which are designated as tax avoidance transactions) to IRS on Forms 8886. Taxpayers disclosed about 6,100 of these transactions in 2007 and about 1,300 each in 2008 and 2009. However, IRS cannot know how many listed transactions should have been disclosed but were not.

Second, the cumulative number of transaction types that IRS has “listed” since 2000 has leveled off at 36. As figure 3 shows, IRS did not designate any new listed transactions in years 2008 through 2010. IRS officials said they detected fewer widely promoted avoidance transactions suitable for listing in recent years. However, the number of transaction types that are

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listed is not an indication of how many promoters or taxpayers are using them.

Third, IRS identified two transactions of interest (TOI) in both 2007 and 2008 but none in 2009 or 2010. IRS designates a new promotion that has the potential for tax avoidance or evasion as a TOI when IRS lacks information to decide whether to list it as a tax avoidance transaction. Doing so triggers a requirement for the taxpayers involved to disclose information about the transaction to IRS on Form 8886.

IRS Shows Vigilance over ATATs in Its Enforcement Efforts, but Quantifying the Impact of the Efforts Is Difficult

IRS has investigated promoters in an effort to stop ATATs, examined the tax returns of taxpayers participating in ATATs, and initiated settlements with groups of taxpayers without necessarily having to first locate and examine each taxpayer using the ATAT. IRS efforts in these three areas are consistent with what we heard about how the ever-changing problems with ATATs merit continued vigilance.

However, IRS has difficulty quantifying the IRS-wide impact of these efforts on the ATAT problem. As context for discussing such IRS-wide impacts, several examination and settlement initiative projects considered by the Servicewide Abusive Transaction Executive Steering Committee...
showed the challenges of working across IRS units. An internal IRS report noted that decisions by different divisions on how and when to report results on their work for one IRS-wide settlement initiative initially resulted in inconsistent briefings to the Enforcement Committee, to which the Steering Committee reports. Another IRS team working on an ATAT issue informed the Steering Committee about obstacles to coordinating among IRS units and about needed mitigations. As our business networks report indicated, competing examination efforts or plans across divisions made prioritization difficult.  

For fiscal years 2006 through 2010, about 100 SB/SE promoter investigations annually resulted in injunctions for promoters to stop what they were doing and/or penalties for what they did, as table 1 shows. The 561 investigations over the 5 years resulting in injunctions or penalties were 38 percent of all investigations closed. For the same years, SB/SE closed (e.g., discontinued for various reasons) 905 investigations (62 percent) without penalties or injunctions.  

Investigations of Promoters Stopped Some Abuse, but IRS Has Incomplete Information on Why Many Investigations Were Closed without Penalties or Injunctions

15See GAO-10-968. We recommended and IRS agreed to develop a strategy that coordinated the various network tax evasion efforts. Without this strategy, IRS risked making redundant investments or failing to concentrate investments on the programs and tools with the greatest potential.

16Table 1 excludes LB&I because it started fewer promoter investigations after 2006. An OTSA official said that the earlier investigations had dealt with major promoter firms. For example, at the end of 2006, LB&I had over 200 ongoing investigations. For 2007 through 2009, LB&I approved 20 new investigations.
Table 1: SB/SE Closed Promoter Investigation Results, Fiscal Years 2006 through 2010

<table>
<thead>
<tr>
<th>Result</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Total</th>
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<tr>
<td>Penalties only</td>
<td>49</td>
<td>67</td>
<td>58</td>
<td>51</td>
<td>46</td>
<td>271</td>
</tr>
<tr>
<td>Injunctions only</td>
<td>11</td>
<td>15</td>
<td>17</td>
<td>20</td>
<td>10</td>
<td>73</td>
</tr>
<tr>
<td>Injunctions and penalties</td>
<td>35</td>
<td>37</td>
<td>52</td>
<td>57</td>
<td>36</td>
<td>217</td>
</tr>
<tr>
<td><strong>Subtotal for penalties and injunctions</strong></td>
<td><strong>95</strong></td>
<td><strong>119</strong></td>
<td><strong>127</strong></td>
<td><strong>128</strong></td>
<td><strong>92</strong></td>
<td><strong>561</strong></td>
</tr>
<tr>
<td>Discontinued/surveyed/other*</td>
<td>213</td>
<td>232</td>
<td>157</td>
<td>131</td>
<td>172</td>
<td>905</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>308</strong></td>
<td><strong>351</strong></td>
<td><strong>284</strong></td>
<td><strong>259</strong></td>
<td><strong>264</strong></td>
<td><strong>1,466</strong></td>
</tr>
<tr>
<td>Discontinued/surveyed/other rate</td>
<td>69%</td>
<td>66%</td>
<td>55%</td>
<td>51%</td>
<td>65%</td>
<td>62%</td>
</tr>
</tbody>
</table>

Source: GAO analysis of IRS information.

*“Discontinued” are closed after promoter contact, “surveyed” are closed without promoter contact, and “other” cases include those in which the promoter died (a rare occurrence).

This annual level of SB/SE investigations shows IRS’s vigilance in attempting to identify and pursue leads to address ATATs. According to Lead Development Center (LDC) officials and documents, LDC develops leads received from such sources as IRS revenue agents and officers and practicing accountants who suggest an individual may be involved in an abusive promotion. IRS field offices decide whether to pursue an investigation. If an investigation cannot sustain a penalty or injunction, it can be surveyed (closed without promoter contact) or discontinued (closed after promoter contact). LDC officials said that the reasons for surveyed or discontinued investigations include the difficulty in proving abuse, the need to balance limited resources and many priorities in addressing the most egregious promoters, and the lack of harm to the government.

IRS had incomplete data on why investigations were discontinued or surveyed. In fiscal year 2009, SB/SE discontinued 84 investigations, surveyed 46, and closed 1 because the promoter died. Of the 130 cases surveyed or discontinued, we could not analyze 30 because LDC officials said they did not receive the documentation and 3 because the documentation was incomplete. In over 65 percent of the other 97 cases we could analyze, the investigations closed because the parties were not 17 IRS revenue agents examine taxpayer tax returns to determine the correct tax liability, and revenue officers collect delinquent taxes.

18 Fiscal years 2006 through 2008 also had significantly more closed through discontinuances than surveys.
actively promoting abusive transactions or because IRS could not obtain enough evidence to support a penalty or injunction.

In February 2011, LDC started using codes to capture the reasons for surveying or discontinuing promoter investigations to have more complete data on these reasons. SB/SE officials told us they plan to promote consistency in the use of the reason codes by asking field offices to describe why they selected the codes for each case and by continually analyzing the different codes used. Because this process had just started, we had no assurance how these plans would work or how the reason-code data would be used to make decisions on the types of investigations to start.

IRS had no criteria to indicate whether the SB/SE investigation results in table 1 were at desired levels. While the effectiveness of injunctions is apparent when they stop promotions, tax experts questioned the effectiveness of penalties if they do not deter those who will risk a penalty to engage in an abusive promotion. Without criteria, IRS could not say whether having 62 percent of investigations closed without penalties or injunctions was too many, too few, or about right, which would be important information in deciding which types of cases to select for investigation.

Regardless, IRS officials said that closing 62 percent of investigations without penalty or injunction did not indicate any flaws. They said that decisions about doing an investigation usually cannot be made without some field work; decisions about continuing an investigation with additional field work must be balanced with the available field resources. These officials said they continually look for ways to develop and refine leads before turning them over to investigators because successful investigations of promoters drive unscrupulous individuals out of business.
IRS Examined Thousands of Tax Returns Involving Suspected ATATs and Recommended Billions of Dollars in Additional Taxes, but the Impact Is Unclear

The impact of examinations on the ATAT problem is uncertain. Examinations of the returns from taxpayers involved in suspected ATATs recommended billions of dollars in additional tax assessments from fiscal years 2006 through 2010. IRS did not track how much of these recommended amounts came from the ATATs versus other tax issues. Further, the recommended amounts may not produce actual tax assessments or collections when taxpayers dispute the recommended amounts in the appellate or litigation processes. For examinations closed in fiscal years 2006 through 2010:

- LB&I examinations of 9,400 tax returns with suspected ATATs recommended additional assessments for all tax issues of $42.4 billion, of which taxpayers disagreed with about 84 percent.

- SB/SE examinations of 125,700 returns with suspected ATATs recommended additional assessments for all issues of $6 billion, of which taxpayers contested at least 54 percent in IRS’s Appeals office.

Neither LB&I nor SB/SE readily tracked how much of the additional taxes were ultimately assessed and collected after examinations for either ATAT or all tax issues. IRS officials told us that they started tracking amounts collected from examinations that included ATAT issues on a monthly basis during fiscal year 2011, but the tracking does not isolate the amounts coming from the ATAT (as opposed to other) issues.

For examinations that included taxpayer disclosures of reportable transactions filed with OTSA, OTSA did not have a comprehensive view of the results of examinations done by LB&I and SB/SE. After OTSA sends

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19Examinations of complex tax returns can involve more than one tax issue—such as ATATs—and the examination data systems do not split out ATATs’ portion of the recommended additional tax amount.

20SB/SE’s database originally recorded 56 percent. IRS later removed some non-abusive cases for 2007 that its records had improperly included. We conservatively assumed all of the reduction also reduced the amount contested by taxpayers, which reduced the 56 percent to 54 percent. According to an IRS official, the same issue existed for 2006. However, because the amount of change for 2006 was not readily available, we assumed the amount was immaterial to the 5-year totals, just as it was for 2007.

21In March 2011, an IRS official told us about a research project showing 2007 and 2008 collections from taxpayers who were involved with ATATs. These collections resulted from examinations that could have been closed before 2007 and 2008 for tax returns filed in earlier tax years. The project did not break out how much of the collected amounts came from ATAT versus non-ATAT issues.
the disclosures to LB&I and SB/SE for possible examination, OTSA relies on the two IRS divisions to report back on the results. However, each division reported results differently.

For LB&I examinations, the examiners were the source on the examination results. OTSA officials said the examiners did not report back on all results in a consistent manner because they were not required to do so. For SB/SE examinations of the disclosures, SB/SE officials said they collected the results for OTSA from data systems and not from examiners. In general, SB/SE and LB&I officials said that divisions track information differently because of different needs. For example, SB/SE relies more on electronically capturing examination results because it does more examinations of shorter duration compared to LB&I.

According to SB/SE officials, SB/SE was unable to provide OTSA with data in time for the May 2010 annual report to the Joint Committee on Taxation due to its larger number of examinations. These SB/SE officials also said that they did not review the accuracy of the SB/SE data used in the annual reports. Without comprehensive or consistent results on examinations of ATAT disclosures for the report to the Joint Committee, IRS cannot be certain it is providing reliable information to the Congress. Nor will IRS executives have the best information available for making decisions about the number of examinations to do and for evaluating their impacts.

In various ATAT settlement initiatives, IRS provided inducements for taxpayers to come forward to IRS to resolve disputed matters. The inducements sometimes took the form of reducing taxpayers’ penalties in exchange for taxpayers conceding tax benefits that they claimed. IRS reported to the Joint Committee on Taxation that it had collected billions of dollars from taxes, penalties, and interest from the beginning of its 17 ATAT settlement initiatives through early 2010.

These dollar figures should not be considered the final word in describing the 17 initiatives’ results through early 2010. On one hand, they did not include the results of field work and litigation still occurring at the time of that report. On the other hand, initiative results included some collections from taxpayers who did not participate in the settlement but whose tax returns had been examined because they were related to the relevant
transaction.\textsuperscript{22} Also, according to IRS officials, initiative results sometimes included issues not targeted by the initiative. As noted earlier, IRS’s enforcement tracking systems only track ATAT results by case and not by separate tax issues within a case.

Furthermore, the dollar amounts collected for the 17 ATAT initiatives were not reported consistently to the Joint Committee on Taxation. For instance, the dollar amount for the Global Settlement Initiative, which aimed to resolve 21 unrelated abusive transaction issues under one framework, was the amount of additional tax recommended, not the amount collected. Also, the total for all of the ATAT initiatives as reported to the Joint Committee did not include any dollars collected from the very large-dollar LILO and similar Sale-In/Lease-Out (SILO) ATAT initiatives. The responsible IRS group did not provide data on the LILO initiative and provided data on adjustments to taxable income, rather than the amount collected, on the SILO initiative. Lacking data on how much additional tax ultimately was collected limits information on the impact of the settlement initiative.

Better tracking of dollar collections could be considered for future initiatives.\textsuperscript{23} However, IRS has not seen the need to start new ATAT initiatives, which could be consistent with experts’ view that the extent of the ATAT problem has eased. Further, isolating the impact on ATATs of settlement initiatives from the impacts of examinations and promoter investigations is difficult to do, especially when IRS does not have an IRS-wide system for tracking and comparing the results from its enforcement efforts.

\textsuperscript{22}For instance, taxpayers initially chose to participate but eventually did not pursue settlement.

\textsuperscript{23}For the 17 ATAT initiatives, 13 were completed or almost completed as of early 2010 when IRS collected information for the Joint Committee.
The AJCA provided new tools to address ATATs. For material advisors, it revised the requirements to disclose reportable transactions and provide lists of their investors to IRS upon request or face penalties. For taxpayers, the AJCA established requirements to disclose reportable transactions or be subject to enhanced penalties.

OTSA received thousands of Forms 8886 from taxpayers to disclose reportable transactions for 2007 through 2009, as table 2 shows. Almost all of these disclosures were associated with loss transactions—most of the losses had not been deemed by IRS to be tax avoidance. OTSA officials said that the number of disclosures dropped in 2008 because IRS combined multiple disclosures from one taxpayer into one disclosure, and increased in 2009 because economic conditions generated more losses that were disclosed as reportable transactions.

<table>
<thead>
<tr>
<th>Reportable transaction category</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listed</td>
<td>6,139</td>
<td>1,348</td>
<td>1,293</td>
</tr>
<tr>
<td>Non-listed, loss</td>
<td>88,371</td>
<td>50,782</td>
<td>88,582</td>
</tr>
<tr>
<td>Non-listed, other than loss</td>
<td>6,283</td>
<td>712</td>
<td>292</td>
</tr>
<tr>
<td>Total</td>
<td>100,793</td>
<td>52,842</td>
<td>90,167</td>
</tr>
</tbody>
</table>

Source: GAO analysis of IRS information.

If taxpayers do not file all required Forms 8886 or file incomplete or inaccurate forms, IRS would lack the information that it needs to make decisions on whether to examine the appropriateness of the transactions being disclosed by taxpayers. Without this transparency, abusive transactions are more likely to stay hidden from IRS.

According to OTSA officials, OTSA did not confirm that it always received its copy of the required Form 8886 from taxpayers disclosing a reportable transaction. Taxpayers must file one copy of the form with their tax return and send a second copy directly to OTSA for their initial year of participation. Absent a system to confirm that OTSA always received its
copy, IRS cannot know how prevalent this problem might be. However, IRS knows that a problem exists because, according to IRS officials, IRS examiners of tax returns have identified some taxpayers who filed their Form 8886 with their tax return but failed to send it to OTSA. If OTSA does not receive disclosures, it cannot identify transactions that merit examination for appropriateness as well as possible penalties.

For individual tax returns filed on paper, IRS had no return processing indicator that would specify when a Form 8886 was received with all types of returns. IRS had an indicator for corporate, partnership, estate and trust, and tax-exempt returns but did not update that indicator to cover all types of returns when it created the Form 8886; extensive computer programming would have been required. For electronically-filed tax returns with Form 8886 disclosures, OTSA officials said that they did not use existing IRS data to verify if they received copies of the forms. In 2008, OTSA investigated the viability of doing a match to verify if it received its copies. OTSA had data problems and had not made the match a high priority. OTSA officials said it will not do any match until it also covers paper-filed returns to adhere to IRS’s policy on treating paper- and electronically-filed returns equally for purposes of verification.

Recognizing this policy, OTSA officials said that IRS was establishing a new indicator for paper and electronic tax returns to identify each Form 8886 filed. OTSA officials said that the new indicator, if it works as intended, would allow them to identify paper and electronic Form 8886 disclosures that OTSA has not received. OTSA officials said that the new indicator would not be operational until September 2012 for use with 2011 tax returns filed in 2012.

Given that checking compliance in filing required Forms 8886 would be facilitated by electronically-filed tax returns, OTSA does annual studies on whether it should pursue authority from the Congress for mandatory electronic filing for all taxpayers who file Form 8886.24 Studies done in 2008, 2009, and 2010 indicated that mandatory electronic filing would make processing the Form 8886 less time- and labor-intensive and more accurate. However, all three studies concluded that mandating electronic filing was not currently viable or realistic, mainly because, according to

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the study reports, the great majority of taxpayers filing the Form 8886 did not already file their tax returns electronically and would have to change their filing format. For example, for all Form 8886 filers in processing year 2009, 14 percent filed their tax return electronically, including 43 percent of corporate filers, 32 percent of partnership filers, 11 percent of individual filers, and 3 percent of estate and trust filers.

However, these OTSA studies did not examine whether the returns were already being prepared on computers. If they were, taxpayers could more readily comply with an electronic filing mandate. IRS data compiled from codes collected on tax returns show that about two thirds of all paper returns in 2008 (and about 92 percent when a paid preparer was used) were prepared on a computer, printed, and mailed to IRS. As another indication of the feasibility of requiring electronic filing, the median adjusted gross income for individual Form 8886 filers in 2006 was about $1.4 million—an income level that would likely be able to afford a computer or a paid preparer in filing tax returns.

Instead of pursuing mandatory electronic filing, IRS planned to begin using barcode technology in early 2011. IRS’s plan assumes that taxpayers can use computers to download and complete the Form 8886 from the irs.gov Web site. A barcode on the Form 8886 will be updated automatically from specific fields on the form and then printed on the paper return. IRS can then scan the barcode without verifying the information. Even in this case, taxpayers would still need to send a paper copy of their Form 8886 directly to OTSA.

Material advisors may not have filed all of their Forms 8918 or 8264 with OTSA, as required. By analyzing IRS Statistics of Income (SOI) samples of 2007 partnership and S corporation tax returns, we found 668 entities that reported that they filed or were required to file a material advisor form on a reportable transaction. When we matched the Employer Identification Numbers of these entities against the identifying numbers that appeared on the Forms 8918 and 8264 in OTSA’s material advisor

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25 IRS created Form 8918 to replace Form 8264 in 2007, during which IRS received many of each type of form. See appendix II for the number of disclosures received from 2003 through 2009.

26 The forms on which individual sole proprietors and C corporations filed their tax returns with IRS did not have questions about material advisors.
database, only about 5 percent of the 668 entities appeared in the database.

For 2007, OTSA believed many partnership and S corporation filers likely confused the citation specified for material advisors (Internal Revenue Code (IRC) section 6111) with section 6011, which deals with the investor disclosure on Form 8886. As the section numbers are similar and the partnership and S corporation forms did not specifically ask if the taxpayer filed a Form 8918 or was a material advisor, OTSA believed that the filers would incorrectly answer the section 6111 question on the return, thinking that they were affirming they had a section 6011 obligation. In 2008 and 2010, IRS revised the relevant question on the partnership and S corporation forms, respectively, specifically mentioning the Form 8918 and material advisor disclosure. OTSA believes this change will correct the mismatches we found. It intends to match the material advisor database against SOI data for 2008 partnership forms to determine if the disparity persists in a year after the question revision. However, matching S corporation data would have to await the availability of SOI information for 2010.

IRS received more than 325,000 Forms 8886 for 2006 through 2009. IRS reviewed about 10 percent for completeness, which meant that IRS could understand the transaction and its tax benefits and identify the parties involved. After the review, IRS sent 177 letters to taxpayers on apparently incomplete disclosures, asking for the missing information to be submitted. IRS later determined that 111 (63 percent) of the taxpayers responding did not have either a disclosure requirement or a completeness issue. For various reasons, IRS did not resolve whether all of the other 66 taxpayers had disclosure requirements or complete disclosures.

In January 2011, OTSA officials said they were contemplating a new process for reviewing all disclosures for completeness based on a 10-question checklist. The completed checklist is to be used to determine whether the disclosure is incomplete and what action to take. OTSA officials said that final decisions on the details of the process have not been made and that the process would not be established until the 2012 filing season at the earliest. Afterward, its success would not be analyzed until after two years of reviews had occurred according to these officials.

IRS Did Not Verify That All Disclosures Were Complete

IRS officials said they were contemplating a new process for reviewing all disclosures for completeness based on a 10-question checklist. The completed checklist is to be used to determine whether the disclosure is incomplete and what action to take. OTSA officials said that final decisions on the details of the process have not been made and that the process would not be established until the 2012 filing season at the earliest. Afterward, its success would not be analyzed until after two years of reviews had occurred according to these officials.

27These reviewed Forms 8886 were characterized by OTSA as high risk. All high-risk forms were to be reviewed to verify the completeness of every item.
As a result, IRS will not know for at least two years whether the new process will overcome the previous problems in deciding if disclosures were really incomplete and in following up with the taxpayers. Without an adequate review process in place, IRS risks accepting filed disclosure forms from taxpayers that do not completely describe the potentially abusive transaction.

Even if the promoter is not a material advisor, IRS still can request lists of investors. Promoters of abusive schemes who do not provide lists to IRS when requested could continue their schemes. Receiving investor lists from these promoters sooner enables IRS to more quickly determine any harm to the government and obtain injunctions working with the Department of Justice to stop abusive promoter activity.

OTSA officials said they were unaware of IRS comprehensively tracking how often lists requested from material advisors were not received on time. IRS had data on how often material advisors were penalized for not keeping the lists or providing them on time. For 2008 and 2009, OTSA received 11 investor lists within the required 20 business days after the request under section 6112 and did not need to assess timeliness-related penalties under IRC section 6708. Outside of OTSA, IRS assessed five penalties against material advisors for requested investor lists during 2008 and 2009.

Unlike for material advisors, non-material advisors are not subject to the 20-business-day standard for timeliness under section 6112, or to the section 6708 penalty for not meeting that timeliness standard. Based on our interviews with 27 SB/SE revenue agents who do promoter investigations, they generally agreed that many of the non-material advisors do not quickly provide the lists. We sought such information from SB/SE revenue agents who investigated promoters because most of their investigations involve non-material advisors and because SB/SE did not track how often and how quickly the requested investor lists are received. Fourteen agents provided data on how quickly they received the lists for 54 ongoing investigations of non-material advisors. These non-generalizable data show that IRS received 13 of the 54 requested lists (24 percent) within 20 business days of the request date. IRS received another

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Promoters do not meet the material advisor criteria if the transactions are not reportable transactions or if they fall below the material advisor income thresholds.
22 lists (41 percent) after the 20 days (7 months to receive on average). IRS had not received 19 lists, (35 percent) of which 18 had exceeded 20 business days.

To induce non-material advisors to provide investor lists, the agents provided options and differing opinions on their possible impacts.

- Many agents said that they issued summonses for investor lists. Some said that bringing a summons to their first meeting with a promoter expedited receiving the lists while one agent said that some local IRS offices do not encourage bringing a summons to the first meeting.

- Agents said that extending the statute of limitations could help but raises difficulties. Taxpayers could be burdened by having to keep records longer. IRS officials also had concerns in certain circumstances, about relying on the extended statute of limitations provided by the AJCA for undisclosed listed transactions.

- Some revenue agents said that establishing a penalty on non-material advisor promoters who do not provide investor lists within 20 business days could help. Promoters who view their products as legitimate might quickly provide a list to avoid this penalty. This penalty might not prompt promoters who hide their transactions because they would not pay any penalty or they believe they can escape detection. The new penalty could be limited to those meeting the definition of a promoter for IRC sections 6700 and 6701.

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29 The purposes for which IRS may issue a summons include determining a tax liability or a tax return's correctness. These purposes include inquiring into offenses connected with the administration or enforcement of the internal revenue laws. 26 U.S.C. § 7602.

30 Statutes of limitations generally limit the time IRS has to make tax assessments to within 3 years after a return is due or filed, whichever is later. The statute of limitations can be extended to 6 years when taxpayers substantially omit items, such as additional gross income from their returns. In cases of false or fraudulent returns, willful attempts to evade taxes, or no returns being filed, no statute of limitations exists. 26 U.S.C. § 6501.

31 The concerns involved potential legal challenges in extending the statute if IRS already possessed the information on a transaction. As for the extension, if a taxpayer fails to disclose a listed transaction, the statute of limitations on any assessment will not end until at least one year from the earlier of when the listed transaction is disclosed by the taxpayer or the material advisor provides a list of investors to IRS including that taxpayer. 26 U.S.C. § 6501(c)(10). For more information, see appendix II.
Another option for getting investor lists from promoters who are not material advisors would be to lower the thresholds for material advisors, which IRS had once considered.\textsuperscript{32} If these material advisor thresholds were lowered, more promoters of reportable transactions could be required to maintain lists and be penalized for not providing them. However, burdens would increase for promoters with legitimate products, and those who were not legitimate may still not be material advisors and may therefore avoid the requirement.

The AJCA revised or added penalties to address abusive transactions. For the revised penalties, their annual number and aggregate dollar amount of penalty assessments increased at least part of the time since AJCA passage in 2004.\textsuperscript{33} For example, starting in 2004, the AJCA changed a penalty imposed by section 6700 on promoters of abusive tax shelters from a maximum of $1,000 to 50 percent of the gross income from a promotion. As a result, IRS assessed penalties over $1 million against some promoters. Compared to 2004, the annual aggregate number and amount of penalty assessments was higher through 2009, as figure 4 shows.

\begin{table}[h]
\centering
\begin{tabular}{|l|l|}
\hline
Abusive Transaction Penalty Assessments & Increased after AJCA Implementation \\
\hline
\end{tabular}
\end{table}

\textsuperscript{32}Material advisors are required to provide investor lists to IRS if their gross income from promoting a non-listed reportable transaction exceeds $250,000 or $50,000 if substantially all tax benefits are provided to individuals; the thresholds for listed transactions are generally lowered to $25,000 and $10,000, respectively. 26 U.S.C. § 6111(b); 26 C.F.R. § 301.6111-3(b)(3).

\textsuperscript{33}See app. II for AJCA provisions on abusive transactions and related statistics on the penalties. Our work did not assess whether the number or amount of AJCA penalty assessments was appropriate.
AJCA provisions revised two penalties for IRS’s use against abusive transactions (see app. II for details). For example, one provision—creating IRC section 6662A—augmented the existing accuracy-related penalty with an accuracy-related penalty for reportable transaction understatements. From fiscal year 2005 through 2009, the number of penalties and aggregate dollar amount generally rose each year.

The AJCA added or amended three reportable-transaction disclosure penalties, applying to taxpayers in the first case and material advisors in the others (see app. II for details).

- A new penalty imposed by IRC section 6707A is for taxpayers who fail to adequately disclose reportable transactions. Most of the penalty assessments were for $100,000 or $200,000.

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Figure 4: IRC Section 6700 Penalty Assessments on Promoters of Tax Shelters, Fiscal Years 2004 through 2009

Source: GAO analysis of IRS information.

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34The other provision amended a penalty for failing to report an interest in foreign financial accounts. 31 U.S.C. § 5321.

35The previously existing penalty provision is IRC section 6662.
A new penalty imposed by section 6707 is for material advisors who fail to adequately disclose reportable transactions. Compared to the 6707A penalty on taxpayers, fewer material advisors were penalized, but most of their penalty amounts exceeded $1 million, resulting in higher aggregate penalty amounts.

A penalty imposed by section 6708 is for material advisors who fail to maintain investor lists or provide them to IRS within 20 business days after the request. Most penalty assessments ranged from $740,000 to $1.1 million.

Figure 5 shows the number and dollar amount of assessments for the first two penalties for not adequately disclosing reportable transactions—section 6707A against taxpayers and section 6707 against material advisors.

Figure 5: Number and Dollar Amount of Penalty Assessments for Not Adequately Disclosing Reportable Transactions against Taxpayers under Section 6707A and Material Advisors under Section 6707, Fiscal Years 2005 through 2009

Source: GAO analysis of IRS information.

Note: Net assessments are initial assessments less abatements (reductions in assessments); taxpayer assessments do not reflect adjustments that IRS made after the Small Business Jobs Act of 2010 passed.
After IRS’s increased use of the enhanced penalty sanctions under the AJCA, the Congress amended section 6707A, decreasing the penalty amounts for some cases. Many small businesses had received penalty assessments that exceeded the benefits gained through the transactions. The Small Business Jobs Act of 2010\(^\text{36}\) lowered the penalty amounts (see app. II for changes). Because the 2010 law change was retroactively effective for penalties assessed after December 31, 2006, adjustments on many assessments were needed. IRS officials said that they adjusted 898 closed cases as well as about 100 cases with penalty assessments that were still open as of February 2011.

Because ATATs have been a long-standing, ever-changing, and often a hidden problem for IRS, much activity in this area is left to IRS’s judgment. For the same reasons, no set of actions taken by IRS would completely eliminate the problem. IRS has shown vigilance in pursuing ATATs with a number of programs and offices trying to attack the problem from different perspectives.

While measuring the impact of IRS’s efforts is challenging, having more information on the results of its enforcement efforts such as why investigations were closed without penalties or injunctions would better inform IRS management when making judgments about program effectiveness and resource allocation. In addition, if IRS improved the consistency and accuracy of its tracking and reporting of both its ATAT and non-ATAT examination results, the information could be more meaningful to managers as well as to the Joint Committee on Taxation.

Further, more could be done to ensure compliance with disclosure requirements by material advisors and taxpayers. If OTSA could verify that it received all required disclosures and that the disclosures were complete, IRS would have more information to determine whether the transactions disclosed were appropriate. However, paper filing continues to be a barrier in processing disclosures, and actions to have more disclosures filed electronically would be beneficial.

In addition, IRS has generally been successful in obtaining required disclosures and investor lists from material advisors. Promoters who do not meet the statutory definition to be a material advisor face no

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requirements to provide IRS with their list of investors within 20 business
days after IRS requested a list or no penalties for failing to do so. If IRS
started to monitor the timeliness of its receipt of requested investor lists,
IRS would be able to determine when actions are needed to obtain the lists
sooner. IRS also could consider taking steps to get the lists sooner.
Various administrative steps, such as not always having a summons in
hand when meeting a suspected promoter, slow IRS. Addressing such
concerns could help ensure that promoters and taxpayers are complying
with congressional intent in requiring provision of the investor lists and
better position IRS to ensure that taxes legally due to Treasury are paid.

The Congress should consider instituting a penalty on non-material
advisor promoters for failing to provide investor lists to IRS within a
specified time period when requested, comparable to the 20-business-day
requirement for material advisors.

We recommend that the Commissioner of Internal Revenue take the
following ten actions:

1. To focus resources on promoter investigations most likely to stop
abuse, establish a process to ensure that field office staff consistently
apply the recently created reason codes for closing investigations
without penalties or injunctions, and document how the results are
analyzed and used in decisions on investigations to start.

2. To improve reporting on the results of examinations on ATAT issues,
   a. require all divisions to supply similar, consistent results from
      existing data systems;
   b. separately track the tax amounts recommended, assessed, and
      collected between ATAT issues and non-ATAT issues; and
   c. establish a process to review the accuracy of examination data
      prior to its inclusion in future reports to the Joint Committee on
      Taxation.

3. To ensure that Forms 8886 filed with tax returns are also filed with
   OTSA, after establishing a new indicator for paper and electronic tax
   returns, establish a process to periodically check whether the filers
   met their filing obligations with OTSA.

Matter for
Congressional
Consideration

Recommendations for
Executive Action
4. To improve IRS's next study of whether Form 8886 should be filed electronically, identify how often filers already use computers to prepare these forms.

5. To ensure material advisor disclosure forms are filed, investigate why partnerships and S corporations often did not file a form with OTSA even though they reported on their tax returns that they filed the form with IRS or had a requirement to file.

6. To correct problems with its review of the completeness of disclosure forms, ensure that OTSA establishes a new process to review completeness and monitor its success.

7. To monitor the timeliness of investor list receipts, comprehensively track the elapsed days it takes for material advisors and non-material advisors to provide the lists to IRS.

8. To induce non-material advisors to provide investor lists to IRS within a specified time, take steps such as requiring IRS staff to bring a summons for an investor list to the first interview with a suspected non-material advisor, and reevaluating the idea of lowering material advisor dollar thresholds.

Agency Comments and Our Evaluation

We sent a draft of this report to the Commissioner of Internal Revenue for comment. We received written comments on the draft from IRS's Deputy Commissioner for Services and Enforcement on April 29, 2011 (for the full text of the comments, see app. III). IRS agreed that better data may lead to better resource allocation decisions and improved ATAT enforcement efforts. Of our ten recommendations, it fully agreed with seven, disagreed with one (number 7), and partially agreed with two (numbers 8 and 2b).

In describing actions on the recommendations with which IRS had agreements, the Deputy Commissioner stated that IRS would do the following:

- update the Internal Revenue Manual's handling of reason codes for surveying or discontinuing investigations and evaluate whether any of the reason data collected warrant changing how investigations are selected;
- ensure that IRS uses the same databases and methodologies (such as across IRS divisions) for public reporting on the examination results of ATAT issues;
• develop criteria for consistently using IRS examination result data and a consistent methodology for validating the data before they are released (such as to the Joint Committee on Taxation);
• establish a new indicator and a process to regularly review whether filers met their disclosure obligations with OTSA;
• improve its next study of whether Form 8886 should be filed electronically by identifying how many Form 8886 filers use computers to prepare the form;
• test mismatches of partnership and S corporation information with OTSA information to identify potentially unfiled forms; and
• formalize procedures to identify, evaluate, and follow up on incomplete disclosures.

IRS disagreed with our recommendation on comprehensively tracking the elapsed time for any advisors to provide investor lists when IRS requests. IRS commented that the information currently contained in individual case files reflects when information has been requested and received, but that resource and capability constraints may outweigh the benefits of capturing this additional information on a systematic basis. We agree that costs and benefits must be carefully weighed. In that regard, IRS’s data collection would not have to be elaborate. For instance, SB/SE officials already send data on the investor lists received to a central list keeper. These officials also could send the dates when each list was requested and received to that same office. In that way, SB/SE could see if the slowness in receiving some lists that we found is prevalent across the division, and other divisions could do the same thing. If the slowness is prevalent, IRS officials would then have the information needed to make decisions on whether IRS is doing all it can to quickly determine and address any harm to the government. Finally, the data collection is possible in that we were able to collect such data from some revenue agents on the timeliness of investor lists received.

IRS partially agreed with our recommendation on two options for inducing non-material advisors to provide investor lists within a specified time. It did not fully agree with the first option. In lieu of requiring summonses to be prepared for the first meeting with non-material advisors, IRS stated that its Internal Revenue Manual would recommend that IRS agents consider preparing summonses to use at initial meetings with possibly problematic non-material advisors. We encourage IRS to track how often IRS agents provide summonses at these meetings in the future and whether their doing so expedites obtaining non-material advisor investor lists. If IRS still finds obtaining the lists difficult after changing the Internal Revenue Manual, we encourage it to take additional steps to
receive the lists more quickly. IRS agreed with the second option on reevaluating whether lowering material advisor thresholds would be useful. It said it would gather input to make that determination.

IRS also partially agreed with our recommendation that it separately track the tax amounts recommended, assessed, and collected between ATAT issues and non-ATAT issues. Although IRS agreed that tracking these amounts by issue (rather than by case as is currently done) might provide valuable information for management, it cited resource and capability constraints in doing the tracking. Recognizing the value of tracking this management information, IRS should explore approaches to leverage its resources in order to provide more accurate and consistent data on the results of its examinations. This can help better inform IRS and the Congress about whether the ATAT examinations are an efficient use of resources in producing desired impacts.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to the Secretary of the Treasury, the Commissioner of Internal Revenue, and other interested parties. The report will also be available at no charge on GAO’s Web site at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-9110 or at whitej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix IV.

James R. White

Director, Tax Issues
Strategic Issues Team
Appendix I: Additional Details about Scope and Methodology

The statistics we analyzed came from many sources. We obtained data related to promoter investigations from the Lead Development Center’s (LDC) database within IRS’s Small Business/Self-Employed division. Information about examinations came from IRS’s Audit Information Management System-Computer Information System (A-CIS). IRS collected information on settlement initiatives from initiative participants throughout the organization.

To obtain information on why promoter investigations were either discontinued or surveyed by IRS, we obtained documentation on these investigations from LDC for fiscal year 2009. LDC received this documentation, which provided the reasons the promoter investigations were discontinued or surveyed, from examiners who performed the investigations. Of 130 investigations that were either discontinued or surveyed, we analyzed documentation on 97 investigations. We could not analyze the remaining 33 investigations because either LDC did not receive the documentation or the documentation was incomplete. From our analysis of the 97 investigations, we identified the reasons these investigations were either discontinued or surveyed.

To evaluate the results of IRS’s implementation of the AJCA, we selected those sections of the act for which IRS had data on the disclosures and penalties. We used data from different sources. We obtained ATAT disclosure information from the reportable transaction and material advisor databases kept by the Office of Tax Shelter Analysis (OTSA) and penalty information from IRS’s Enforcement Revenue Information System (ERIS). Criteria we used to evaluate the AJCA’s results included whether (1) OTSA received all the reportable transaction and material advisor forms it should have, (2) submitted reportable transaction disclosure forms met OTSA’s standard for completeness, (3) IRS received investor lists from material advisors within 20 business days of the time requested, and (4) the AJCA’s introduction of new penalties and penalty amounts increased the annual number and aggregate dollar amount of ATAT penalties assessed.

To determine if IRS’s requirement for material advisor disclosures to be filed with OTSA was met, we tested the extent for partnership and S corporation tax returns. The returns we tested were in the IRS Statistics of Income (SOI) division’s samples of partnership and S corporation tax returns.
returns for 2007, the last year for which we had information during our SOI work. These returns had a line item asking taxpayers if they had disclosed, or needed to disclose, information about material advisors. For those answering “yes,” we confirmed whether OTSA’s material advisor database showed them filing a material advisor form from the time the AJCA was enacted through much of 2010. After discovering that the database often showed no material advisor forms filed, we followed up with OTSA.

To determine how much time elapsed from when IRS requested lists of investors with non-material advisor promoters until when it received them, we used an IRS spreadsheet provided in August 2010 of open investigations for which IRS had received lists. This spreadsheet showed investigations being conducted by 90 investigators. We used this spreadsheet to pinpoint IRS investigators from whom we could collect information, rather than to project to a universe of investigators or investigations. From the spreadsheet, we selected the 11 investigators with the most open investigations. We selected another 20 investigators randomly. We also asked to meet with all of the selected investigators in groups to ask general questions about their impressions of how easy or hard it was to obtain the lists. We met with or received written answers from 27 investigators.

At our instruction, IRS sent each of the selected investigators a template asking for the dates on which investor lists were requested and received for each investigation. Fourteen investigators provided dates on when investor lists were requested and received from promoters who were not identified as tax return preparers. We excluded preparers because they are required to submit copies of tax returns or the names of taxpayers for whom they prepared tax returns to IRS when requested.

37S corporations provide limited liability to their owners and pass through gains and losses to the owners’ tax returns without generally paying taxes at the corporate level.
We found the IRS databases we used to be reliable for the purposes of this report. We had tested the reliability of A-CIS, ERIS, and SOI data for previous reports, and we supplemented our knowledge through interviews with IRS officials and through documentation review. For LDC and OTSA databases, we reviewed documentation and interviewed IRS officials. When we matched OTSA and SOI data, where appropriate, we ran electronic checks and compared output to other information for reasonableness purposes.

We conducted this performance audit from July 2009 through May 2011 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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Appendix II: Selected American Jobs Creation Act of 2004 Provisions Related to Tax Shelters

The American Jobs Creation Act of 2004 (AJCA) provided new or revised tools related to what it called tax shelters. For example, it established requirements for material advisors to disclose reportable transactions and provide lists of their investors to IRS. It also added or revised penalties and other sanctions, such as censures and injunctions. Information follows on the AJCA-created or AJCA-changed sections of the Internal Revenue Code (IRC) that we reviewed. Following that is similar information related to amendments to title 31 of the United States Code, dealing with money and finance.

IRC Section 6111—Disclosure of Reportable Transactions by Material Advisors

The AJCA provision amending section 6111 repealed the law on registering tax shelters as defined therein and began requiring each material advisor to describe any reportable transaction and its potential tax benefits on an information return filed with IRS on a timely basis. The main information return submitted by material advisors is the Material Advisor Disclosure Statement (Form 8918), which superseded the Application for Registration of a Tax Shelter (Form 8264). Table 3 shows the numbers of these forms received from 2003 through 2009.

<table>
<thead>
<tr>
<th>Calendar year</th>
<th>Number of disclosures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>1,083</td>
</tr>
<tr>
<td>2004</td>
<td>686</td>
</tr>
<tr>
<td>2005</td>
<td>1,053</td>
</tr>
<tr>
<td>2006</td>
<td>449</td>
</tr>
<tr>
<td>2007</td>
<td>357</td>
</tr>
<tr>
<td>2008</td>
<td>1,012</td>
</tr>
<tr>
<td>2009</td>
<td>206</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4,846</strong></td>
</tr>
</tbody>
</table>

Source: IRS.

IRC Section 6112—Investor Lists

The AJCA provision amending section 6112 required that a material advisor must keep a list identifying each person for whom the advisor acted as a material advisor for a reportable transaction, and provide the list to the Secretary when requested in writing. Table 4 shows the number

---

of lists that IRS’s Office of Tax Shelter Analysis (OTSA) requested from 2006 through 2009.

Table 4: Number of Investor Lists Requested from Review of Material Advisor Disclosures, Calendar Years 2006 through 2009

<table>
<thead>
<tr>
<th>Calendar year</th>
<th>Number of investor lists requested</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>8</td>
</tr>
<tr>
<td>2007</td>
<td>4</td>
</tr>
<tr>
<td>2008</td>
<td>3</td>
</tr>
<tr>
<td>2009</td>
<td>8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>23</strong></td>
</tr>
</tbody>
</table>

Source: IRS.

Note: OTSA officials said they did not know how many lists OTSA requested from 2003 through 2005, but to the best of their knowledge none was requested.

The AJCA amended section 6501 to extend the statute of limitations for IRS to assess taxes related to undisclosed listed transactions. Generally, the statute of limitations runs for 3 years after a tax return is filed or due, whichever is later. As amended by the AJCA, the statute of limitations with regard to listed transactions can extend beyond 3 years up to 1 year after the earlier of the date that (1) the taxpayer discloses pursuant to section 6011, or (2) a material advisor satisfied the Secretary’s request for an investor list under section 6112, including the name of the taxpayer in question. According to IRS, it did not have systemic data on whether assessments were made pursuant to section 6501(c)(10) because each case is different and systemic information would be unreliable.

The AJCA provision creating section 6662A augmented the existing 20 percent accuracy-related penalty of section 6662 with a new accuracy-related penalty for understated income from reportable transactions. If a taxpayer disclosed a reportable transaction, the penalty would equal 20 percent of the understatement amount. If the taxpayer did not disclose the transaction, the penalty would equal 30 percent of the understatement amount. Table 5 shows an increase in the number of these penalties for
fiscal years 2005 through 2009 as well as in the number of abatements, or reductions, of those penalties.40

<table>
<thead>
<tr>
<th>FY</th>
<th>Number of penalty assessments</th>
<th>Penalty assessment amounts</th>
<th>Number of penalty abatements</th>
<th>Penalty abatement amounts</th>
<th>Net penalty assessment amounts</th>
<th>Penalty collection amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>7</td>
<td>$56,853</td>
<td>0</td>
<td>$0</td>
<td>$56,853</td>
<td>$36,683</td>
</tr>
<tr>
<td>2006</td>
<td>37</td>
<td>608,188</td>
<td>4</td>
<td>15,472</td>
<td>592,716</td>
<td>264,252</td>
</tr>
<tr>
<td>2007</td>
<td>40</td>
<td>668,957</td>
<td>4</td>
<td>13,358</td>
<td>655,599</td>
<td>110,842</td>
</tr>
<tr>
<td>2008</td>
<td>123</td>
<td>1,367,724</td>
<td>21</td>
<td>101,718</td>
<td>1,266,006</td>
<td>176,860</td>
</tr>
<tr>
<td>2009</td>
<td>133</td>
<td>1,056,061</td>
<td>23</td>
<td>130,832</td>
<td>925,229</td>
<td>248,034</td>
</tr>
<tr>
<td>Total</td>
<td>340</td>
<td>$3,757,783</td>
<td>52</td>
<td>$261,380</td>
<td>$3,496,403</td>
<td>$836,671</td>
</tr>
</tbody>
</table>

Source: IRS.

The AJCA amended section 6700 to change the penalty amounts. Section 6700 imposes a penalty on persons who (1) organize or assist in the organization of any entity, plan, or arrangement or (2) participate, directly or indirectly, in the sale of any interest in an entity, plan, or arrangement. For the section 6700 penalty to apply, the person must also make, furnish, or cause another person to make or furnish (1) a gross valuation overstatement (as defined therein) as to any material matter or (2) a statement with respect to any tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement. Further, the person to whom the penalty applies must know or have reason to know that the statement is false or fraudulent in any material matter. Prior to the enactment of the AJCA, the maximum penalty under section 6700 was $1,000 for each activity (entity or arrangement). The AJCA changed the penalty imposed on someone who knowingly makes a false statement (but not to making a gross valuation overstatement) to 50 percent of the person’s gross income from activity involving that statement. Table 6 shows penalties assessed under section 6700 from fiscal years 2004 through 2009.

40The understatement penalty generally is abated in cases in which the taxpayer can demonstrate reasonable cause for the underpayment and good faith action. IRS officials also said penalties can be abated for other reasons such as penalty assessment posting errors or changes in the outcome of cases that are appealed or adjudicated in tax court.
Table 6: Penalty Assessments on Promoters, Fiscal Years 2004 through 2009

<table>
<thead>
<tr>
<th>FY</th>
<th>Number of penalty assessments</th>
<th>Penalty assessment amounts</th>
<th>Penalty abatement amounts</th>
<th>Penalty collection amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>15</td>
<td>$5,904,952</td>
<td>$0</td>
<td>$360,457</td>
</tr>
<tr>
<td>2005</td>
<td>65</td>
<td>45,531,570</td>
<td>3,442,696</td>
<td>866,745</td>
</tr>
<tr>
<td>2006</td>
<td>78</td>
<td>33,582,766</td>
<td>221,049</td>
<td>3,886,515</td>
</tr>
<tr>
<td>2007</td>
<td>94</td>
<td>43,081,451</td>
<td>24,852,419</td>
<td>501,513</td>
</tr>
<tr>
<td>2008</td>
<td>164</td>
<td>54,703,259</td>
<td>8,130,233</td>
<td>642,067</td>
</tr>
<tr>
<td>2009</td>
<td>140</td>
<td>54,684,280</td>
<td>8,616,000</td>
<td>328,289</td>
</tr>
<tr>
<td>Total</td>
<td>556</td>
<td><strong>$237,488,278</strong></td>
<td><strong>$45,262,397</strong></td>
<td><strong>$6,585,586</strong></td>
</tr>
</tbody>
</table>

Source: GAO analysis of IRS data.

Table 7: Penalty Assessments on Material Advisors for Failure to Disclose Reportable Transactions, Fiscal Years 2005 through 2009

<table>
<thead>
<tr>
<th>FY</th>
<th>Number of penalty assessments</th>
<th>Penalty assessment amounts</th>
<th>Penalty abatement amounts</th>
<th>Penalty collection amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>1</td>
<td>$3,000</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>2006</td>
<td>11</td>
<td>151,699,805</td>
<td>107,558,179</td>
<td>8,199,802</td>
</tr>
<tr>
<td>2007</td>
<td>3</td>
<td>13,316,575</td>
<td>3,657,008</td>
<td>9,659,567</td>
</tr>
<tr>
<td>2008</td>
<td>2</td>
<td>1,934,405</td>
<td>0</td>
<td>1,296,219</td>
</tr>
<tr>
<td>2009</td>
<td>9</td>
<td>23,751,151</td>
<td>0</td>
<td>23,749,901</td>
</tr>
<tr>
<td>Total</td>
<td>26</td>
<td><strong>$190,704,936</strong></td>
<td><strong>$111,215,187</strong></td>
<td><strong>$42,905,489</strong></td>
</tr>
</tbody>
</table>

Source: GAO analysis of IRS data.

IRC Section 6707—Penalty for Failing to Furnish Information Regarding Reportable Transactions

The AJCA provision amending section 6707 repealed the penalty for failure to register tax shelters and established a new penalty. The new penalty imposes on material advisors who fail to disclose reportable transactions or who file false or incomplete information a $50,000 penalty, unless the failure is related to a listed transaction; if the failure is related to a listed transaction, the amount is increased to the greater of $200,000 or 50 percent (75 percent for an intentional failure or act) of the gross income from the transaction. Table 7 shows assessments of this penalty from fiscal years 2005 through 2009.
Appendix II: Selected American Jobs Creation Act of 2004 Provisions Related to Tax Shelters

IRC Section 6707A—Penalty for Failure to Disclose Reportable Transactions

The AJCA provision creating 6707A established a penalty on any person who fails to include with any return or statement any required information on a reportable transaction. Generally, as amended by the Small Business Jobs Act of 2010, the penalty is 75 percent of the decrease in tax shown on the return resulting from the transaction, or which would have resulted if the transaction complied with federal tax laws. The maximum penalty amount is the same as the penalty amount prior to the change which is $50,000 ($10,000 for an individual), except for listed transactions for which the penalty is $200,000 ($100,000 for an individual). The minimum penalty amount is $10,000 ($5,000 for an individual). Table 8 shows the assessments for this penalty from fiscal years 2005 through 2009. However, IRS was adjusting these amounts in light of the 2010 amendment.

<table>
<thead>
<tr>
<th>FY</th>
<th>Number of penalty assessments</th>
<th>Penalty assessment amounts</th>
<th>Penalty abatement amounts</th>
<th>Penalty collection amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>2006</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2007</td>
<td>1</td>
<td>200,000</td>
<td>0</td>
<td>200,000</td>
</tr>
<tr>
<td>2008</td>
<td>115</td>
<td>18,350,000</td>
<td>2,977,000</td>
<td>5,510,250</td>
</tr>
<tr>
<td>2009</td>
<td>314</td>
<td>47,081,100</td>
<td>2,990,000</td>
<td>7,957,479</td>
</tr>
<tr>
<td>Total</td>
<td>430</td>
<td>$65,631,100</td>
<td>$5,967,000</td>
<td>$13,667,729</td>
</tr>
</tbody>
</table>

Source: GAO analysis of IRS data.

Note: Table amounts do not reflect adjustments that IRS made after the Small Business Jobs Act of 2010 passed.

IRC Section 6708—Failure to Maintain Investor Lists

The AJCA provision amending section 6708 modified the penalty for failing to maintain the required lists by making it a time-sensitive penalty instead of a per investor penalty. Thus, a material advisor required to maintain an investor list who fails to make the list available upon written request to the Secretary within 20 business days after the request will be subject to a $10,000 per day penalty. Table 9 shows assessments for this penalty from fiscal years 2005 through 2009.
Table 9: Penalty Assessments on Material Advisors for Failure to Maintain Investor Lists, Fiscal Years 2005 through 2009

<table>
<thead>
<tr>
<th>FY</th>
<th>Number of penalty assessments</th>
<th>Penalty assessment amounts</th>
<th>Penalty abatement amounts</th>
<th>Penalty collection amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>2006</td>
<td>4</td>
<td>2,600</td>
<td>0</td>
<td>2,600</td>
</tr>
<tr>
<td>2007</td>
<td>3</td>
<td>1,661,300</td>
<td>1,281,000</td>
<td>11,300</td>
</tr>
<tr>
<td>2008</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2009</td>
<td>5</td>
<td>4,840,000</td>
<td>0</td>
<td>11,256</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
<td>$6,503,900</td>
<td>$1,281,000</td>
<td>$25,156</td>
</tr>
</tbody>
</table>

Source: GAO analysis of IRS data.

The IRC authorizes civil actions to enjoin anyone from promoting abusive tax shelters or aiding or abetting tax liability understatements. The AJCA expanded this rule so that an injunction could be sought to enjoin a material advisor from engaging in specific conduct subject to penalty under (1) section 6707, failure to file an information return for a reportable transaction, or (2) section 6708, failure to maintain or to furnish within 20 business days of the Secretary’s written request a list of investors for a reportable transaction. According to the Lead Development Center (LDC), it does not track injunctions specifically under section 7408. Table 10 shows the number of injunctions that LDC obtained regardless of IRC section from fiscal years 2003 through 2009.41

IRC Section 7408—Enjoin Specified Conduct

According to OTSA officials, the Large Business and International division rarely issues injunctions because it deals with material advisors who are involved with transactions that, while they may be abusive, are not illegal.

41According to OTSA officials, the Large Business and International division rarely issues injunctions because it deals with material advisors who are involved with transactions that, while they may be abusive, are not illegal.
Title 31, Section 330—Practice before the Department of the Treasury

Before the AJCA, the Secretary was already authorized to suspend or disbar from practice before the department someone’s representative who was incompetent, was disreputable, violated rules regulating practice before the department, or with intent to defraud, willfully and knowingly misled or threatened the person being represented or who might be represented. The AJCA provision related to this section expanded the sanctions the Secretary could impose for these matters in two ways. First, it expressly permitted censure as a sanction. Second, it allowed imposing a monetary penalty as a sanction as long as the penalty did not exceed the gross income from the relevant conduct. The penalty could be in addition to or instead of any suspension, disbarment, or censure of the representative. According to Treasury’s Office of Professional Responsibility (OPR), OPR was already censuring before the AJCA was enacted. The act clarified OPR’s authority. Table 11 shows the number of OPR censures in fiscal years 2003 through 2009. OPR officials said OPR had not assessed any monetary penalties.

<table>
<thead>
<tr>
<th>FY</th>
<th>Number of injunctions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>30</td>
</tr>
<tr>
<td>2004</td>
<td>47</td>
</tr>
<tr>
<td>2005</td>
<td>51</td>
</tr>
<tr>
<td>2006</td>
<td>67</td>
</tr>
<tr>
<td>2007</td>
<td>73</td>
</tr>
<tr>
<td>2008</td>
<td>87</td>
</tr>
<tr>
<td>2009</td>
<td>75</td>
</tr>
<tr>
<td>Total</td>
<td>430</td>
</tr>
</tbody>
</table>

Source: IRS.
Table 11: Number of Censures, Fiscal Years 2003 through 2009

<table>
<thead>
<tr>
<th>FY</th>
<th>Number of censures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>9</td>
</tr>
<tr>
<td>2004</td>
<td>16</td>
</tr>
<tr>
<td>2005</td>
<td>11</td>
</tr>
<tr>
<td>2006</td>
<td>9</td>
</tr>
<tr>
<td>2007</td>
<td>18</td>
</tr>
<tr>
<td>2008</td>
<td>14</td>
</tr>
<tr>
<td>2009</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>79</td>
</tr>
</tbody>
</table>

Source: IRS.

Before the AJCA, citizens, residents, or persons doing business in the United States could be penalized if they willfully did not keep records and file reports when they made a transaction or maintained an account with a foreign financial entity. The AJCA added a civil penalty of up to $10,000 that could be imposed on anyone violating the reporting requirement, whether willfully or not. The AJCA also increased the prior-law penalty for willful behavior to the greater of $100,000 or 50 percent of the amount of the transaction or account. Table 12 shows the penalties imposed under section 5321 from 2003 through 2009.

Table 12: Penalty Assessments for Failure to Report Interest in Foreign Financial Accounts, Calendar Years 2003 through 2009

<table>
<thead>
<tr>
<th>Calendar year</th>
<th>Willful penalties assessed</th>
<th>Non-willful penalties assessed</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Amount</td>
</tr>
<tr>
<td>2003</td>
<td>7</td>
<td>$52,725</td>
</tr>
<tr>
<td>2004</td>
<td>113</td>
<td>2,272,180</td>
</tr>
<tr>
<td>2005</td>
<td>181</td>
<td>6,054,054</td>
</tr>
<tr>
<td>2006</td>
<td>118</td>
<td>4,127,352</td>
</tr>
<tr>
<td>2007</td>
<td>59</td>
<td>2,496,793</td>
</tr>
<tr>
<td>2008</td>
<td>16</td>
<td>388,119</td>
</tr>
<tr>
<td>2009</td>
<td>33</td>
<td>999,187</td>
</tr>
<tr>
<td>Total</td>
<td>527</td>
<td>$16,390,410</td>
</tr>
</tbody>
</table>

Source: IRS.
Appendix III: Comments from the Internal Revenue Service

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

April 29, 2011

Mr. James R. White
Director, Tax Issues
Strategic Issues Team
United States Government Accountability Office
Washington, DC  20548

Dear Mr. White:


We are pleased your report acknowledges the immense challenge of pursuing Abusive Tax Avoidance Transactions and our continued vigilance to identify and address them. The IRS agrees that better data may lead to better decisions about focusing resource allocations and improve our enforcement efforts for Abusive Tax Avoidance Transactions.

The enclosed response addresses each of the recommendations separately.

If you have any questions, please contact me, or a member of your staff may contact Monica Baker, Director, Examination, Small Business/Self-Employed Division at 202-283-2659.

Sincerely,

[Signature]

Steven T. Miller
Deputy Commissioner for Services and Enforcement

Enclosure
Appendix III: Comments from the Internal Revenue Service

Enclosure

GAO Recommendations and IRS Responses to GAO Draft Report
Abusive Tax Avoidance Transactions: IRS Needs Better Data to Inform Decisions about Transactions
GAO-11-493

Recommendation 1:
To focus resources on promoter investigations most likely to stop abuse, establish a process to ensure that field office staff consistently apply the recently-created reason codes for closing investigations without penalties or injunctions, and document how the results are analyzed and used in decisions on investigations to start.

Comment:
We concur with this recommendation. We will update the Internal Revenue Manual section 4.32.2, The Abusive Tax Avoidance Transaction (ATAT) Process, to require the use of reason codes on surveyed and discontinued investigations. We will regularly review the documentation prepared by the field to ensure the reason codes for surveying or discontinuing an investigation are properly applied and to evaluate whether any of the reasons warrant changes in the selection of investigations that are sent to the field.

Recommendation 2:
To improve reporting on the results of examinations results on ATAT issues, require all divisions to supply similar, consistent results from existing data systems; separately track the tax amounts recommended, assessed, and collected between ATAT issues and non-ATAT issues; and establish a process to review the accuracy of examination data prior to its inclusion in future reports to the Joint Committee on Taxation.

Comment:
We concur with this recommendation in part. Generally, the IRS uses our Enforcement Revenue Information System (ERIS) to consistently report on assessments where the ERIS database can provide the requested information. We agree that the IRS should ensure that it uses the same databases and methodologies to prepare public information. We also agree that tracking tax amounts proposed, assessed, and collected by issue (rather than by case as is currently done) might provide valuable information for management, however, there are resource and capability constraints that must be overcome to capture information in this way.
Appendix III: Comments from the Internal Revenue Service

The IRS will develop criteria for the consistent use of ERIS and Examination Return Control System (ERCS) data and for a consistent methodology in validating data before it is publicly released.

**Recommendation 3:**
To ensure that Forms 8886 filed with tax returns are also filed with Office of Tax Shelter Analysis (OTSA), after establishing a new indicator for paper and electronic tax returns, establish a process to periodically check whether the filers met their filing obligations with OTSA.

**Comment:**
We concur with this recommendation and continue to work towards establishing a new indicator and matching process to regularly review whether filers meet their filing obligations with OTSA.

**Recommendation 4:**
To improve IRS’s next study of whether Form 8886 should be filed electronically, identify how often filers already use computers to prepare these forms.

**Comment:**
We concur with this recommendation. We will improve the next Modified Electronic Filing (MeF) study. It may be beneficial to identify how often Form 8886, *Reportable Transaction Disclosure Statement*, filers already use computers to prepare these forms. The Large Business and International (LB&I) Division will include this data in our next study following the 2011 filing year.

**Recommendation 5:**
To ensure material advisor disclosure forms are filed, investigate why partnerships and S corporations often did not file a form with OTSA even though they reported on their tax returns that they filed the form with IRS or had a requirement to file.

**Comment:**
We concur with this recommendation and will test mismatches from partnership and S-Corp filers based on revisions to the Form 1065, *U.S. Return of Partnership Income*, in 2008 and Form 1120S, *U.S. Income Tax Return for an S Corporation*, in 2010. These form changes should provide more clarity for taxpayers and/or representatives and may result in a significant decrease in mismatches.

**Recommendation 6:**
To correct problems with its review of the completeness of disclosure forms, ensure that OTSA establishes a new process to review completeness and monitor its success.
3

Comment:
We concur that the IRS should formalize procedures for evaluating the completeness of disclosures and for following up with respect to incomplete disclosures, as appropriate, balancing resource demands and the potential for abuse identified in particular deficient disclosures.

SB/SE and LB&I will jointly develop and formalize procedures for Office of Tax Shelter Analysis (OTSA) and the Abusive Transactions Support Unit (ATSU) to identify, evaluate, and follow up on incomplete disclosures, as appropriate. Internal Revenue Manual Section 4.32.2, Abusive Tax Avoidance Transactions, will be updated as required.

Recommendation 7:
To monitor the timeliness of investor lists receipts, comprehensively track the elapsed days it takes for material advisors and non-material advisors to provide the lists to IRS.

Comment:
The information currently contained in individual case files reflects when information has been requested and received. There are resource and capability constraints to capturing this information on a systematic basis that may outweigh the benefits of this additional information.

Recommendation 8:
To induce non-material advisors to provide investor lists to IRS within a specified time, take steps such as:

- requiring IRS staff to bring a summons for an investor list to the first interview with a suspected non-material advisor; and
- reevaluating the idea of lowering material advisor dollar thresholds.

Comment:
We partially concur with this recommendation. The IRS attempts to obtain the required information with the least burden to both the promoter and the IRS. If a records request is not successful, the agent and manager should consider whether the expenditure of resources to prepare and enforce the summons is appropriate. Internal Revenue Manual Section 4.32.2 is being updated and includes a recommendation that an agent should consider whether a summons should be prepared for use at an initial meeting. We believe these case-specific decisions should remain with the agent and manager.
We concur that we should reevaluate whether it would be useful to lower the material advisor dollar thresholds. As noted by GAO, however, even with a lower threshold, many promoters still would not be “material advisors.” Moreover, lowering the material advisor threshold (or imposing penalties for non-material advisors) may not lead to receipt of investor lists more quickly. Those promoters who resist the IRS’s attempts to obtain information would likely continue to resist by asserting that they are not promoters, that they do not meet the dollar criteria, or that they are otherwise not subject to the relevant law.

The Director, Abusive Transactions and Technical Issues will gather input from SB/SE Examination field personnel to determine whether it would be useful to lower the material advisor thresholds and will make a recommendation to the Director, Examination, SB/SE and Director, Pre-Filing and Technical Guidance, LB&I.
Appendix IV: GAO Contact and Staff

Acknowledgments

GAO Contact

James R. White, (202) 512-9110, whitej@gao.gov

Staff

In addition to the contact named above, Ralph Block and Thomas Short, Assistant Directors; Virginia A. Chanley; Laurie C. King; Lawrence M. Korb; Karen V. O’Conor; Ellen M. Rominger; Lou V. B. Smith; Andrew J. Stephens; and James J. Ungvarsky made key contributions to this report.
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