

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 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.

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ABUSIVE TAX AVOIDANCE TRANSACTIONS

IRS Needs Better Data to Inform Decisions about Transactions

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 on 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.