



*The Informants' Rewards Program Needs
More Centralized Management Oversight*

June 2006

Reference Number: 2006-30-092

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

June 6, 2006

**MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND
ENFORCEMENT**

FROM: *Michael R. Phillips*
Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Informants’ Rewards Program Needs More
Centralized Management Oversight (Audit # 200530022)

This report presents the results of our review of the Internal Revenue Service’s (IRS) Informants’ Rewards Program. The overall objective of this review, initiated at the request of the Senate Finance Committee, was to determine whether the IRS uses its Informants’ Rewards Program as a viable tool to identify, investigate, and address potential tax law violations with equitable rewards for cooperating informants.

Synopsis

The IRS uses its Informants’ Rewards Program to administer the authority provided by Internal Revenue Code Section 7623 (2004) to make payments to private citizens for assistance in “(1) detecting underpayments of tax, and (2) detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws.” Rewards are paid as a percentage of the taxes, fines, and penalties collected based on the relationship of the informant’s information to the recovery. Rewards can also be paid on amounts collected prior to receipt of the information if the information leads to the denial of a claim for refund that otherwise would have been paid. This Program has been an effective method of identifying and collecting unpaid taxes. From Fiscal Years (FY) 2001 through 2005, over \$340 million in taxes, fines, penalties, and interest were recovered based on information obtained through the Informants’ Rewards Program, with rewards of over \$27 million paid to informants.

The Informants’ Rewards Program has significantly contributed to the IRS’ efforts to enforce tax laws, but additional management focus could enhance the effectiveness of the Program as an enforcement tool and make the process more accommodating to informants. Our analysis of IRS data indicated that examinations initiated based on informant information were often more



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effective and efficient than returns initiated using the IRS' primary method for selecting returns for examination.¹

However, we found that a lack of standardized procedures and limited managerial oversight resulted in control weaknesses over the Program. We reviewed a judgmental sample of 22 paid claims for reward and 69 rejected claims for reward processed at 3 of the 5 Informants' Claims Examiner (ICE) units² in operation during FY 2005. We noted that each ICE unit maintained its own records because a nationwide database of informant claims does not exist. For the paid informant claims in our sample, we found that 45 percent of the case files reviewed had problems with basic control issues (missing copies of key forms, no record of letters to informants, etc.), and we were unable to determine the justification for the reward percentage awarded to the informant in 32 percent of the cases. For the rejected informant claims in our sample, we were unable to determine the rationale for the reviewer's decision to reject the claim in 76 percent of the cases reviewed.

We also found that an average of over 7 ½ years passed between the filing of the initial claim by the informant and the payment of the reward. We observed lapses in the monitoring of taxpayers' accounts for payment activity, which may have contributed to delays. For the rejected claims in our sample, an average of over 6 ½ months elapsed between the date of the claim and the letter to the informant rejecting the claim. We observed instances of lengthy delays in the processing of rejected claims, such as unexplained delays between the receipt of the claim and the initial or subsequent review of the claim by ICE unit personnel.

The lack of centralized and active management oversight of the Program increases the risk of errors such as improper payment of rewards or incorrect rejection of valid claims. Additional management focus could also assist in reducing the processing time for paid claims, which would make the Program more attractive to future informants wishing to report violations of tax laws.

Recommendations

We recommended the Deputy Commissioner for Services and Enforcement centralize management of the Informants' Rewards Program to increase oversight of the Program and standardize the processing of informant claims. We also recommended the Deputy Commissioner for Services and Enforcement ensure a detailed nationwide database of informant

¹ The IRS uses the Discriminant Index Function, which is a mathematical technique used to classify income tax returns for examination potential by assigning weights to certain basic return characteristics.

² We visited the ICE units at the IRS Campuses in Brookhaven, New York; Ogden, Utah; and Philadelphia, Pennsylvania. The other ICE units were located at the IRS Campuses in Cincinnati, Ohio, and Memphis, Tennessee.



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claims is developed and implemented to provide increased visibility of the processing and disposition of informant claims.

Response

IRS management agreed with our recommendations. Management's response stated that the IRS had conducted its own review of the Informants' Rewards Program in 2005 and was taking a number of steps to improve the management and oversight of the Program. These steps include designating an Informants' Rewards Program coordinator for each operating division, establishing a National Oversight Committee for the Informants' Rewards Program, consolidating informant claims processing at the Ogden Campus, and implementing a nationwide web-based system to track, monitor, and control informant claims. Management's complete response to the draft report is included as Appendix VII.

Copies of this report are also being sent to IRS officials affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Curtis W. Hagan, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.



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Background

Section (§) 7623 of the Internal Revenue Code¹ authorizes payment of rewards for “(1) detecting underpayments of tax, and (2) detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws.” The Internal Revenue Service (IRS) administers this authority through its Informants' Rewards Program. This Program is unrelated to the rewards² paid to private citizens who bring suit for violations of the Federal False Claims Act³ because the violations of the Internal Revenue Code were specifically excluded from the scope of the False Claims Act.⁴

The IRS receives information about potential tax violations in the mail, over the telephone, or from visits to IRS walk-in offices. Generally, an IRS employee receiving an allegation of a potential tax violation will record the information on an Information Report Referral (Form 3949). IRS procedures instruct employees not to solicit or encourage an informant to provide information in exchange for a reward. However, if the informant indicates that he or she wants a reward, the IRS employee will provide *Rewards for Information Given to the Internal Revenue Service* (Publication 733) and an Application for Reward for Original Information (Form 211)⁵ to the informant.

The Informants' Rewards Program provides rewards for concerned citizens who supply information to the IRS that leads to the detection and punishment of tax law violations.

Instructions on the back of Form 211 direct informants to submit the completed Form to the IRS campus⁶ servicing their State.⁷ Upon reaching the campus, the form is routed to the Informants' Claims Examiner (ICE) staff at the campus, which performs an initial evaluation of the reward claim. If the Form 211 does not contain information that warrants further action, the reward claim should be rejected and the ICE staff will issue a rejection letter⁸ to the informant. If the

¹ Internal Revenue Code § 7623 (2004).

² Under 31 United States Code (U.S.C.) § 3730 (1994), a private plaintiff may be entitled to between 15 percent and 30 percent of the proceeds of a successful action or settlement for a violation of the False Claims Act.

³ 31 U.S.C. § 3729 (2002).

⁴ 31 U.S.C. § 3729(e) (2002).

⁵ See Appendix IV for a copy of this Form.

⁶ IRS campuses perform submission processing, accounts management, and compliance services for designated customer segments.

⁷ At the time of our review, the IRS had Informants' Claims Examiner (ICE) staffs at the IRS Campuses in Brookhaven, New York; Cincinnati, Ohio; Memphis, Tennessee; Ogden, Utah; and Philadelphia, Pennsylvania.

⁸ Internal Revenue Manual Exhibit 25.2.2-7 shows Letter 1010 (SC) can be used for this purpose. See Appendix V for the text of this Letter.



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reward claim is not immediately rejected, the claim will be acknowledged,⁹ a case file established, and a control number assigned to the reward claim. The ICE staff also performs research on the alleged tax violator's account to determine whether there is open examination or collection activity. If an open case exists, the examiner should send a copy of the reward claim and any information to the office conducting the ongoing activity. If the informant alleges unreported income of \$50,000 or more per year, the information should be routed to the Criminal Investigation function Area Office for the area where the alleged tax violator resides.

For those informant reward claims with open examination or collection activity, the examination or collection employee assigned to the case will complete a Confidential Evaluation Report on Claim for Reward (Form 11369) to assess the significance of the information provided by the informant and whether the informant is entitled to a reward. If the field employee determines that a reward should be allowed, the reward percentage is determined by whether the information directly led to the recovery (15 percent); indirectly led to the recovery (10 percent); or caused the investigation but had no direct relationship to the determination of tax liability (1 percent). The dollar amount of the reward is computed by multiplying the reward percentage by the amount of taxes, fines, and penalties (but not interest) collected. Different reward percentages can be used if the case involves multiple taxpayers and/or tax years. The reward amount must total at least \$100 to be paid and cannot exceed \$2 million in total. The limits on the reward percentage and dollar amount can be waived by the use of a special agreement between the informant and the IRS, which must be approved by the IRS Commissioner or his or her delegate.

During hearings for the IRS Restructuring and Reform Act of 1998,¹⁰ some members of Congress called for a provision to eliminate the Informants' Rewards Program, believing it resulted in unwarranted examinations of honest taxpayers. Although this provision was not included in the final legislation, the IRS does not openly promote the Program. The public web site (IRS.gov) does not contain a webpage explaining the Program, nor does the webpage for reporting tax fraud mention the availability of rewards. However, information such as Form 211 and Publication 733 can be located by a search of the web site.

This review was performed at the Small Business/Self-Employed (SB/SE) Division National Headquarters in New Carrollton, Maryland, in the Campus Compliance Services organization and at the ICE staffs in the Brookhaven, Ogden, and Philadelphia Campuses, during the period September 2005 through March 2006. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁹ Internal Revenue Manual Exhibit 25.2.2-4 shows Letter 1891 (SC) can be used for this purpose. See Appendix VI for the text of this Letter.

¹⁰ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).



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Results of Review

The Informants' Rewards Program Has Aided in the Recovery of a Substantial Amount of Revenue at a Minimal Cost

The Commissioner of the IRS annually provides information to Congress on the amounts collected based on informant information and the rewards paid to informants. Figure 1 shows the results reported to Congress for the past 5 years.

Figure 1: Rewards Paid to Informants and Taxes, Fines, Penalties, and Interest Recovered From Informants' Information - Fiscal Years (FY) 2001 Through 2005

	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	TOTALS
Rewards Paid to Informants	\$3,337,035	\$7,707,402	\$4,057,476	\$4,585,143	\$7,602,685	\$27,289,741
Taxes, Fines, & Penalties Recovered	\$30,774,539	\$56,583,517	\$48,379,562	\$45,644,890	\$68,126,671	\$249,509,179
Interest Recovered on Amount Above	\$13,249,794	\$10,357,002	\$13,176,613	\$28,485,904	\$25,550,935	\$90,820,248

Source: IRS annual reports to Congress.

From FYs 2001 through 2005, a total of \$27,289,741 in rewards was paid to informants for the recovery of \$249,509,179 in taxes, fines, and penalties, for an average reward of 10.9 percent. Interest of \$90,820,248 was also recovered on the taxes, fines, and penalties recovered, although rewards are not paid on interest recovered. Therefore, a total of \$340,329,427 was recovered due to informant information for FYs 2001 through 2005. Because IRS procedures generally require that rewards be paid only in cases in which the informant's information led to the examination of an issue,¹¹ it is reasonable to assume that the amounts recovered due to informants' information would not have been otherwise recovered by the IRS.

¹¹ Treasury Regulation § 301.7623-1 (1998) also allows rewards to be paid for information that leads to a denial of a claim for refund that otherwise would have been paid



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IRS Restructuring and Reform Act of 1998 § 3804 required the Secretary of the Treasury to produce a report on the use of Internal Revenue Code § 7623 and the results of its use.¹² The report, prepared by the IRS, was delivered in September 1999¹³ and determined that the cost/benefit ratio of the Program compared favorably with other IRS enforcement programs. The report estimated the IRS incurred slightly over 4 cents in cost (including personnel and administrative costs) for each dollar collected from the Informants' Rewards Program (including interest), compared to a cost of over 10 cents per dollar collected for all enforcement programs.

The IRS report also found that examinations initiated based on informant information had a higher dollar yield per hour¹⁴ and a lower no-change¹⁵ rate, when compared to returns selected using the IRS' primary method of selecting returns, the Discriminant Index Function (DIF).¹⁶ The results from the final 3 years of the review are summarized in Figure 2.

Figure 2: Comparison of Recommended Adjustment Dollars and No-Change Rates for Informant Examinations and DIF Returns - FYs 1996 Through 1998

FYs 1996 - 1998 Returns	ADJUSTMENT DOLLARS/HOUR			NO-CHANGE RETURNS		
	Total Recommended Adjustments	Total Hours	Dollars per Hour	Total Returns	No-Change Returns	No-Change %
Informants' Program	\$160,091,580	169,259	\$946	5,292	648	12%
DIF-selected	\$7,358,908,430	13,418,772	\$548	997,550	169,148	17%

Source: IRS study dated September 1999.

Examinations initiated based on informant information continue to be more productive than those initiated based on DIF scores. The examination results from the 3 most recent years for the SB/SE Division, which conducts the vast majority of examinations based on informant information, are shown in Figure 3.

¹² Pub. L. 105-206, title III, Sec. 3804, July 22, 1998, 112 Stat. 783.

¹³ *The Informants' Project: A Study of the Present Law Reward Program*, Internal Revenue Service, dated September 1999.

¹⁴ Dollar yield per hour refers to the total recommended adjustments to tax liability divided by the number of examiner hours charged to examinations.

¹⁵ For the purpose of this analysis, an examination of a return results in a "no-change" when the examination is closed in the Audit Information Management System using Disposal Code 02 (no adjustments or changes to tax liability).

¹⁶ The DIF is a mathematical technique used to classify income tax returns for examination potential by assigning weights to certain basic return characteristics.



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Figure 3: SB/SE Division – Comparison of Recommended Adjustment Dollars and No-Change Rates for Informant Examinations and DIF Returns - FYs 2003 Through 2005

FYs 2003 - 2005	ADJUSTMENT DOLLARS/HOUR			NO-CHANGE RETURNS		
	Total Recommended Adjustments	Total Hours	Dollars per Hour	Total Returns	No-Change Returns	No-Change %
Informants' Program (SB/SE Division examinations)	\$26,233,554	38,139	\$688	727	152	21%
DIF (SB/SE Division Revenue Agent Individual & Corporate)	422,356,790	1,105,890	\$382	15,832	4,435	28%

Source: Treasury Inspector General for Tax Administration analysis of IRS data.

Because examinations based on informants' information involve taxpayers or issues that may not have been otherwise selected by the IRS and are often more productive than examinations initiated using the IRS' usual methods, the Informants' Rewards Program continues to contribute to enforcement of the tax laws.

The Effectiveness of the Informants' Rewards Program Is Limited by a Lack of Detailed Policies and Procedures and Centralized Management Oversight

The primary guidance for the Informants' Rewards Program is found in Internal Revenue Manual Section 25.2. This document contains general guidance for the administration of the Program and the computation of rewards but does not include any provision for centralized management oversight or review of the activities of the ICE units. As a result, each ICE unit has traditionally operated as a semi-autonomous entity, attached to various other teams in the Compliance Services organization at each campus. We visited three of the five ICE units in operation in FY 2005 (Brookhaven, Ogden, and Philadelphia) and found that two of the units were attached to classification teams, while the other was attached to a Tax Equity Fiscal Responsibility Act team. Each ICE unit had different procedures for the processing of claims, but only one unit had written documentation of these procedures.



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No nationwide database currently exists to allow management to track and monitor claims on a nationwide basis, although SB/SE Division officials informed us that a system will be implemented in the near future. Yearly reporting of consolidated results to Congress is done by a coordinator at SB/SE Division Headquarters based on written input from each ICE unit. Each of the three ICE units we visited tracked its claim inventory differently: one unit primarily used a manual system and updated an online database periodically; the other two ICE units used different online databases, supplemented by standalone computer spreadsheets.

The overall management of the Informants' Rewards Program currently resides within the Campus Compliance Services function within the SB/SE Division. A coordinator at the SB/SE Division Headquarters is responsible for collecting and reporting certain information annually to Congress but does not exert any managerial control over the operation of the ICE units. No other personnel within this function devote significant time to the management of the Informants' Rewards Program. In our discussions with ICE unit and SB/SE Division Headquarters personnel, we were informed that there was no ongoing program to monitor the performance of ICE units, such as operational reviews or management assistance visits.

The lack of standardized procedures and the limited managerial oversight were evident in the results of our reviews of paid and rejected claims at the three ICE units included in our review. We reviewed a judgmental sample of 22 paid claims for reward and 69 rejected claims for reward processed at the 3 ICE units during FY 2005. For the informant claims paid in FY 2005, we found that almost one-half (45 percent) of the case files reviewed had a problem with basic control issues (missing copies of key forms, no record of letters to informants, etc.). For the informant claims rejected in FY 2005, approximately 14 percent of the case files had similar issues, including 4 files that an ICE unit could not locate, despite the fact that the claims were listed on its database.

In addition to reviewing the basic recordkeeping at the ICE units, we reviewed the files of the rejected cases to determine if the informants' information received appropriate initial and subsequent reviews. We evaluated whether basic evaluation steps were taken after the claims were received, such as a review of the alleged tax violator's account on the Integrated Data Retrieval System¹⁷ to determine if there was open examination or collection activity against the taxpayer(s) named in the informant's allegation, and found no evidence of these steps in the files for 59 percent of the rejected claims reviewed. We also reviewed the rejected claims to determine if subsequent steps were taken, for example referring the information to the appropriate entities, such as the Criminal Investigation function for evaluation and/or a field examination function for determination of tax potential. We did not find evidence of such referrals in 80 percent of the case files reviewed.

¹⁷ The Integrated Data Retrieval System is an automated data base composed of information from several sources that provides IRS employees instantaneous access to certain taxpayer accounts for research, data entry, and other purposes.



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Finally, we reviewed both the paid and rejected claims to determine if the reviewer's decision on the ultimate action taken on the claim was justified, based on information in the case file. For a paid claim, the most important decision is on the reward percentage granted to the informant; in 32 percent of the paid claims, we were unable to determine the justification for the percentage granted. In most of these cases, the reviewers simply entered the percentage on the Form 11369 and did not provide any explanation for the decision.

For a rejected claim, the reason for rejection is of major significance. In 76 percent of the rejected informant claims included in our review, we were unable to determine the rationale for the reviewer's decision to reject the claim, based on information in the case file. In most of these cases, the reviewers simply noted their decisions in the case files and provided little or no description of the rationale for the decisions.

As part of our review of rejected informant claims, we selected 30 rejected claims that alleged tax law violations by taxpayers serviced by the Large and Mid-Size Business (LMSB) Division, to determine if these claims received greater scrutiny due to the higher profile of the taxpayers and presumably larger dollar amounts involved. We reviewed these informant claims for the same attributes as the other rejected claims, which were primarily directed at individual and small business taxpayers. We found the results were largely comparable for all attributes other than the control of claims, as shown in Figure 4.



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Figure 4: Comparison of Results for Review of Rejected Claims Pertaining to LMSB Division Taxpayers to Results for Review of All Other Rejected Claims

Review Item:	Rejected Claims to Which Review Item Applies		Number of Claims Not Meeting Standard		Percentage of Claims Not Meeting Standard	
	LMSB	All Others	LMSB	All Others	LMSB	All Others
<i>Was claim properly controlled?</i>	30	39	1	9	3%	23%
<i>Did claim receive proper initial evaluation after receipt?</i>	30	34 ¹⁸	19	19	63%	56%
<i>Was claim properly screened for tax potential?</i>	29 ¹⁹	21 ²⁰	22	18	76%	86%
<i>Was the decision to reject the claim justified?</i>	29 ²¹	21 ²²	21	17	72%	81%

Source: Treasury Inspector General for Tax Administration reviews of FY 2005 rejected informant claims at the Brookhaven, Ogden, and Philadelphia Campus ICE units.

Rewards are offered both to encourage informants to provide information and, in some cases, to compensate informants for risking their personal and business relationships by providing the information. If the claims are not timely processed, the rewards may lose some of their motivating value. Our review of the sample of 22 paid claims found that an average of over 7 ½ years passed between the filing of the initial claim by the informant and the payment of the reward. Much of this delay was attributable to the fact that the law requires that rewards be paid

¹⁸ Five rejected claims were not evaluated for this attribute because the ICE unit could not locate the files.

¹⁹ One rejected claim was not evaluated for this attribute because the informant did not adequately document his or her claim.

²⁰ Thirteen rejected claims were not evaluated for this attribute because the informant did not adequately document his or her claim.

²¹ One rejected claim was not evaluated for this attribute because the informant did not adequately document his or her claim.

²² Thirteen rejected claims were not evaluated for this attribute because the informant did not adequately document his or her claim.



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only once the additional taxes, fines, and penalties have been collected from taxpayers.²³ However, we also observed lapses in the monitoring of the taxpayer's account for payment activity for periods in excess of a year. The length of time required to receive payment for claims may cause informants to be less willing to come forward, especially those that risk losing their jobs by informing on their employers.

We also observed that the processing of rejected claims took a significant length of time, with an average of over 6 ½ months between the date of the claim and the letter to the informant rejecting the claim. We also observed instances of lengthy delays in the processing of rejected claims, such as unexplained delays between the receipt of the claim and the initial or subsequent review of the claim by ICE unit personnel.

In summary, although the Informants' Rewards Program has significantly contributed to the detection and punishment of tax law violations, additional management focus could enhance the effectiveness of the Program. Additional management focus could assist in reducing the processing time for claims, which would make the Program more attractive to future informants. While our review of a sample of paid and rejected informant claims did not disclose any obvious errors of a significant magnitude (i.e., improper payment of rewards or incorrect rejection of valid claims), the lack of centralized and active management oversight of the Program increases the risk of these errors and decreases the effectiveness of the Program as a useful enforcement tool.

Recommendations

Recommendation 1: The Deputy Commissioner for Services and Enforcement should centralize management of the Informants' Rewards Program to increase oversight of the Program and standardize the processing of informant claims.

Management's Response: IRS management agreed with this recommendation and stated that the Informants' Rewards Program is being consolidated at the Ogden Campus. All Forms 211 received at any campus after April 26, 2006, are to be routed to the Ogden Campus for control and processing.

Recommendation 2: The Deputy Commissioner for Services and Enforcement should ensure a detailed nationwide database of informant claims is developed and implemented to provide increased visibility of the processing and disposition of informant claims.

²³ An informant can receive an early payment of a reward on the amounts collected by the IRS by agreeing to waive his or her right to a reward on the amounts collected after the payment of the early reward.



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Management's Response: IRS management agreed with this recommendation and stated they are developing a web-based Informants' Claims application that will be accessible from the Ogden Campus and IRS Headquarters. This will facilitate response to informant claims. The application is to be operational by December 31, 2006.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Internal Revenue Service (IRS) uses its Informants' Rewards Program as a viable tool to identify, investigate, and address potential tax law violations with equitable rewards for cooperating informants. To accomplish our objective, we:

- I. Interviewed managers and responsible officials at Small Business/Self-Employed Division Headquarters to obtain an overview of the Informants' Rewards Program; Program statistics; and the coordination that takes place among the Informants' Rewards Program, IRS Lead Development Center, and Criminal Investigation Division Confidential Informant Program.
- II. Reviewed Internal Revenue Code Section (§) 7623,¹ the Internal Revenue Manual, and other documents to obtain an understanding of the parameters and procedures for the Informants' Rewards Program.
- III. Analyzed statistical data from the IRS Informants' Rewards Program for the past 5 fiscal years to determine information such as the numbers and amounts of rewards paid.
- IV. Obtained statistical performance data and other information about informant programs at the Department of Defense and the Department of Health and Human Services and discussed these programs with knowledgeable officials at the agencies.
- V. Discussed the IRS Informants' Rewards Program with knowledgeable parties outside the IRS, such as informants and attorneys familiar with the Program, to determine whether there are opportunities to increase reporting of tax violations and whether the amount of the awards provides enough incentive for well-compensated professionals to become informants.
- VI. Selected a judgmental sample² of 22 informant rewards paid in Fiscal Year (FY) 2005 at the 3 Informants' Claims Examiner (ICE) units visited. We reviewed the case files to determine whether proper procedures were followed in processing the claims, whether

¹ Internal Revenue Code § 7623 (2004).

² A judgmental sample was used for this step due to the lack of a nationwide informant claims database, which prevented us from obtaining an accurate and complete sampling universe. The IRS reported that 169 claims were paid in full during Fiscal Year 2005, with an unknown number of additional partial payments. At each of the 3 Informants' Claims Examiner (ICE) units visited, we selected the 2 cases with the largest payments for each reward level (15 percent, 10 percent, and 1 percent), plus any special agreement cases with payments larger than those made under the normal reward levels.



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- the criteria used to decide upon the reward percentage were reasonable, and the amount of time from the filing of the claims to issuance of the rewards.
- VII. Reviewed examination data for the cases selected in Step VI. to determine whether the reward percentage given to the informant complied with the criteria outlined in Part 25 of the Internal Revenue Manual and applicable sections of the Internal Revenue Code and Regulations.
- VIII. Visited ICE units at three IRS Campuses (located in Brookhaven, New York; Ogden, Utah; and Philadelphia, Pennsylvania) to determine whether informants' reward claims were properly processed and evaluated.
- A. Interviewed the manager of each ICE unit to determine the actual procedures used to process informants' claims for rewards.
- B. Selected a judgmental sample³ of 69 informant claims rejected in FY 2005 at the 3 ICE units. We determined the information provided by the informant; the reason for rejection; the amount of time for the decision; the extent of communication, if any, with the informant; and whether the case was referred to the Criminal Investigation Division. We also evaluated whether the rejection was made in accordance with IRS procedures.
- IX. Validated the Revenue Agent examination data used in the review to the Table 37 for the appropriate IRS business unit. We did not establish the reliability of these data because extensive data validation tests were outside the scope of this audit and would have required a significant amount of time.

³ A judgmental sample was used due to the lack of a nationwide informant claims database, which prevented us from obtaining an accurate and complete sampling universe. The IRS reported a total of 3,193 claims rejected during FY 2005. At each ICE unit visited, we randomly selected a sample of 10 rejected claims from a judgmental pool of claims rejected in FY 2005. Additional sampling of rejected claims was required at one ICE unit. We also randomly selected a sample of 30 rejected claims from a judgmental pool of claims rejected in FY 2005 relating to taxpayers serviced by the Large and Mid-Size Business Division.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Assistant Deputy Commissioner for Services and Enforcement SE
Commissioner, Large and Mid-Size Business Division SE:LM
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Wage and Investment Division SE:W
Deputy Commissioner, Large and Mid-Size Business Division SE:LM
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Wage and Investment Division SE:W
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Director, Communications and Liaison, Small Business/Self-Employed Division SE:S:C&L
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Appendix IV

Application for Reward for Original Information

The following Form is used by informants to apply for a reward.

Form 211 <small>(Rev. March 2005)</small>	<small>Department of the Treasury - Internal Revenue Service</small> Application for Reward for Original Information	<small>OMB Clearance No. 1545-0409 Expires 7/31/2007 Claim No.</small>				
<small>This application is voluntary and the information requested enables us to determine and pay rewards. We use the information to record a claimant's reward as taxable income and to identify any tax outstanding (including taxes on a joint return filed with a spouse) against which the reward would first be applied. We need taxpayer identification numbers, i.e., social security number (SSN) or employer identification number (EIN), as applicable, in order to process it. Failure to provide the information requested may result in suspension of processing this application. Our authority for asking for the information on this form is 26 USC 6001, 6011, 6109, 7602, 7623, 7802, and 5 USC 301.</small>						
<small>Name of claimant. If an individual, provide date of birth</small>		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%;"><small>Date of Birth</small></td> <td style="width: 25%;"><small>Claimant's Taxpayer Identification Number (SSN or EIN)</small></td> </tr> <tr> <td><small>(Month) (Day) (Year)</small></td> <td></td> </tr> </table>	<small>Date of Birth</small>	<small>Claimant's Taxpayer Identification Number (SSN or EIN)</small>	<small>(Month) (Day) (Year)</small>	
<small>Date of Birth</small>	<small>Claimant's Taxpayer Identification Number (SSN or EIN)</small>					
<small>(Month) (Day) (Year)</small>						
<small>Name of spouse (if applicable)</small>		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%;"><small>Date of Birth</small></td> <td style="width: 25%;"><small>Social Security Number</small></td> </tr> <tr> <td><small>(Month) (Day) (Year)</small></td> <td></td> </tr> </table>	<small>Date of Birth</small>	<small>Social Security Number</small>	<small>(Month) (Day) (Year)</small>	
<small>Date of Birth</small>	<small>Social Security Number</small>					
<small>(Month) (Day) (Year)</small>						
<small>Address of claimant, including zip code, and telephone number (telephone number is optional)</small>						
<small>I am applying for a reward, in accordance with the law and regulations, for original information furnished, which led to the detection of a violation of the internal revenue laws of the United States and the collection of taxes, penalties, and fines. I was not an employee of the Department of the Treasury at the time I came into possession of the information nor at the time I divulged it.</small>						
<small>Name of IRS employee to whom violation was reported</small>	<small>Title of IRS employee</small>	<small>Date violation reported (mm/dd/yyyy)</small>				
<small>Method of reporting the information (check applicable box) <input type="checkbox"/> Telephone <input type="checkbox"/> Mail <input type="checkbox"/> In person</small>						
<small>Name of taxpayer who committed the violation and, if known, the taxpayer's SSN or EIN</small>						
<small>Address of taxpayer, including zip code, if known</small>						
<small>Relative to information I furnished on the above taxpayer, the Internal Revenue Service made the following payments to me or on my behalf</small>						
<small>Date of Payment</small>	<small>Amount</small>	<small>Name of Person/Entity to Whom Payment was made</small>				
<small>Under penalties of perjury, I declare that I have examined this application and my accompanying statements, if any, and to the best of my knowledge and belief, they are true, correct, and complete. I understand the amount of any reward will represent what the Area Director/Compliance Services Field Director considers appropriate in this particular case. I agree to repay the reward, or an appropriate percentage thereof, if the collection on which it is based is subsequently reduced.</small>						
<small>Signature of Claimant</small>		<small>Date</small>				
The following is to be completed by the Internal Revenue Service						
Authorization of Reward						
<small>Area Director/Compliance Services Field Director</small>	<small>Sum Recovered</small> \$	<small>Amount of Reward</small> \$				
<small>In consideration of the original information that was furnished by the claimant named above, which concerns a violation of the internal revenue laws and which led to the collection of taxes, penalties, and fines in the sum shown above, I approve payment of a reward in the amount stated.</small>						
<small>Signature of the Compliance Services Field Director</small>		<small>Date</small>				
<small>MAIL COMPLETED FORM TO THE APPROPRIATE ADDRESS SHOWN ON THE BACK</small>						
<small>Catalog Number 16571S</small>	<small>www.irs.gov</small>	<small>Form 211 (Rev. 3-2005)</small>				



The Informants' Rewards Program Needs More Centralized Management Oversight

Send the completed Form 211 to the Internal Revenue Service Campus for your area shown below.

Name of Campus	Address	
Brookhaven Campus	Internal Revenue Service Attention: ICE P.O. Box 630 Holtsville, NY 11742-0630	If you live in: Connecticut, Maine, Massachusetts, New Hampshire, New York, Rhode Island, Vermont
Cincinnati Campus	Internal Revenue Service Attention: ICE P.O. Box 12267, Stop 828G Covington, KY 41012	If you live in: Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, West Virginia, Wisconsin
Memphis Campus	Internal Revenue Service Attention: ICE P.O. Box 129 Memphis, TN 38101-0129	If you live in: Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, Oklahoma, Tennessee, Texas
Philadelphia Campus	Internal Revenue Service BMF Classification - Drop Point 605 11511 Roosevelt Blvd. Philadelphia, PA 19255-0002	If you live in: Delaware, Maryland, New Jersey, North Carolina, Pennsylvania, South Carolina, Virginia, Washington DC, Puerto Rico
Ogden Campus	Internal Revenue Service 1973 N. Rulon White Blvd. MS/4110 — ICE Ogden, UT 84404	If you live in: Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming

PAPERWORK REDUCTION ACT NOTICE: We ask for the information on this form to carry out the internal revenue laws of the United States. We need it to insure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax.

You are required to give us the information if you are applying for a reward.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and return information are confidential, as required by Code section 6103.

The time needed to complete this form will vary depending on individual circumstances. The estimated average time is 15 minutes. If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can email us at taxforms@irs.gov (please type "Forms Comment" on the subject line) or write to the Internal Revenue Service, Tax Forms Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave. NW, IR-6406, Washington, DC 20224.

Do NOT send the completed Form 211 to the Tax Forms Coordinating Committee. Instead, send it to the IRS Campus for your area shown above.



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Appendix V

Form Letter to Notify Informant of Rejection of Claim

The text of the following form letter (Letter 1010 (SC)) is generally used to notify an informant of the rejection of his or her claim.

(name of service center)

(service center address)

Person to Contact:

Contact Telephone Number:

Claim Number:

(informant's name)

(informant's address)

Dear:

We have considered your Form 211, Application for Reward for Original Information. We are sorry, but the information you furnished did not meet our criteria for a reward. We assure you that your information was carefully reviewed and evaluated before we made our decision.

Federal disclosure and privacy laws prohibit us from telling you the specific reason for rejecting your claim. However, we can tell you that the most common reasons for not allowing a reward are:

1. Your information did not cause an investigation or result in the recovery of taxes, penalties, or fines.
2. The Internal Revenue Service (IRS) already had the information you provided.
3. The taxes recovered were too small to warrant a reward. (Our policy states that we do not pay rewards less than \$100.)

Your claim will be reconsidered only if you have new information, not previously reviewed by the IRS, that has enough investigative potential to warrant further action. If you have information that meets this description, please send it to this office, to the attention of the above contact person, and ask us to reconsider your claim.

There are no other administrative appeals available to you. If we deny your request for reconsideration, you must bring suit in the U.S. Court of Federal Claims if you wish to pursue the matter further.

Although your information did not qualify for a reward, we thank you for participating in the Informants' Claims for Reward program.

Sincerely,

Director, Service Center



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Appendix VI

Form Letter to Notify Informant of Receipt of Claim

The text of the following form letter (Letter 1891 (SC)) is generally used to notify an informant of the receipt of his or her claim for reward.

(name of service center)

(service center address)

Person to Contact:

Contact Telephone Number:

Claim Number:

(Informant's name)

(Informant's address)

Dear:

We received your claim (Form 211) in connection with the information you furnished about a tax matter and have assigned the above claim number. We will evaluate the information you provided as soon as possible to determine if an investigation is warranted and a reward is appropriate. Please retain this notice for future reference.

It is important to understand that if we initiate an investigation as a result of your information, it could take several years until final resolution of all tax matters. This is especially true if the taxpayer exercises all administrative and judicial appeal rights. In addition, before the Internal Revenue Service (IRS) can pay a reward, we must collect any additional taxes, penalties, or fines recovered by reason of your information. Collection action could also take several years.

At the conclusion of our review and evaluation, we will only be able to tell you whether or not the information you provided met the criteria for a reward. Federal disclosure and privacy laws prohibit us from informing you of specific actions we take or do not take with respect to your information. We hope you understand this restriction placed on the IRS, by law, and ask for your patience in this matter.

We will notify you as soon as we complete all actions relating to your claim and determine whether your information qualifies you for a reward. If you change your address, please send us a completed Form 8822, Change of Address. You can get this form by calling 1-800-TAX-FORM. If you request a status of your claim, please include the claim number with your request. Send it to this office, to the attention of the above contact person. Please keep in mind that we may only tell you whether or not your claim is still active.

Thank you for participating in the Informants' Claims for Reward program.

Sincerely,

Director, Service Center



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Appendix VII

Management's Response to the Draft Report




DEPUTY COMMISSIONER

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

RECEIVED
MAY 25 2006

May 23, 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: 
Mark E. Matthews
Deputy Commissioner for Services and Enforcement

SUBJECT: Draft Audit Report – The Informants' Rewards Program Needs
More Centralized Management Oversight (Audit 200530022)

We have reviewed the attached subject draft report and agree with your recommendations. In 2005, the Internal Revenue Service (IRS) conducted its own review of the Informants' Claims for Reward Program (ICRP). We are pleased that your audit findings were consistent with our review, as well as the corrective actions that are already underway.

Your report notes that examinations involving informant information often result in a higher yield than examinations initiated using Discriminant Index Function (DIF). The IRS receives numerous leads from many sources, such as informants, hotline calls, etc. Before diverting our audit resources from DIF and other identified work that has a proven yield and low no change rate, we carefully screen the leads to ensure that the information is credible and specific with respect to a violation of the tax laws. Our experience is that the largest percent of these leads are not productive. While the IRS does want to pursue quality leads, it is not effective or efficient for the IRS to initiate audits based on general statements of noncompliance from business competitors, disgruntled employees or acquaintances. The fact that examinations involving informant information results in a higher yield than DIF reflects the quality of our screening process.

As the report noted, an informant does wait on average 7 ½ years from the filing of a claim to receive a payment when IRS utilizes the information in an audit. By law, the IRS cannot pay a reward until the taxes, fines and penalties have been collected from taxpayers. One area that we continually focus on is taking all actions within our control to shorten the time to complete an audit, however, the taxpayer actions also contribute to the time to complete the audit. The taxpayer also has complete control over whether to exercise their appeal and litigation rights, as well as when the taxes are paid.

Before commenting on the specific recommendations in the report, I want to share the following steps that we have already taken to improve the administration of the ICRP



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program. After conducting our own review of the IRS ICRP, we have taken the following steps to improve the management and oversight of this program.

- Each Operating Division has designated a coordinator that is responsible for oversight and management of the ICRP in their Division
- A National Oversight Committee comprised of the division coordinators and the senior adviser to the Deputy Commissioner has been established to centralize management and oversight
- Informant claims are being consolidated at the Ogden Campus to standardize claims control and tracking; expedite claims processing; and foster a more expert staff
- A new nationwide web-based system to track, monitor, and control claims will be operational on December 31, 2006, which will streamline claims research, inventory control, and reporting

Our comments on your recommendations are as follows:

RECOMMENDATION 1

The Deputy Commissioner for Services and Enforcement should centralize management of the Informants' Claims for Rewards Program to increase oversight of the program and standardize the processing of informant claims.

CORRECTIVE ACTION:

We are consolidating the ICRP program at the Ogden Campus. This includes routing all claims on Forms 211, Application for Reward for Original Information, received at any campus after April 26, 2006, to the Ogden Campus for control and processing.

IMPLEMENTATION DATE:

We will complete consolidation of ICRP inventory by August 31, 2006.

RESPONSIBLE OFFICIAL:

Director, Campus Compliance Services, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN:

The Director, Campus Compliance Services, SB/SE Division, will advise the SB/SE Commissioner of any delays in implementing this corrective action.



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RECOMMENDATION 2:

The Deputy Commissioner for Services and Enforcement should ensure that a detailed nationwide database of informant claims is developed and implemented to provide increased visibility of the processing and disposition of informant claims.

CORRECTIVE ACTION:

We will complete development of a web-based Informants' Claims (ICE) application that will provide a repository for all informant claims that is accessible at the Ogden Campus and from the IRS Headquarters. This will facilitate IRS response to informant claim letters.

IMPLEMENTATION DATE:

We have scheduled the web-based control system to be operational by December 31, 2006.

RESPONSIBLE OFFICIAL:

Director, Campus Compliance Services, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN:

The Director, Campus Compliance Services, SB/SE Division, will advise the SB/SE Commissioner of any delays in implementing this corrective action.

If you have any questions, please call me at (202) 622-4255 or Brenda Dial, Acting Director Campus Compliance Services, SB/SE Division at (202) 283-2518.