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In a 1975 newspaper article, allegations were made that the Internal Revenue Service (IRS) had harassed 28 Mississippi civil rights activists through extensive audits of their income tax returns. To investigate these allegations, GAO examined tax returns, audit case files, intelligence records, and other pertinent data and interviewed appropriate officials and taxpayers. Findings/Conclusions: No evidence was found to support the allegations. The 28 taxpayers were audited a total of 45 times for tax years 1970 through 1975. With possibly one exception, IRS followed normal procedures in selecting the returns for audit. It followed normal procedures in: initiating, conducting, and closing audits; allowing taxpayers time and flexibility in providing information and allowing them to exercise appeal rights; and obtaining limited information through its intelligence-gathering apparatus and in using that information. Allegations that random selections would not have resulted in audits of this group were without merit since selections are not random but based on such factors as whether returns involve business, income levels, and characteristics of the returns. The news article noted that none of the audits suggested serious taxpayer misconduct. This is not contrary to the purpose of audits which is to verify tax liability. The average tax change in these audits approximated that national average. In any tax audit, the taxpayer may experience a feeling of harassment because of the adversary situation, but the situations in these cases were not unusual. (HTW)

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REPORT OF THE COMPTROLLER GENERAL OF THE UNITED STATES

Allegations That IRS Harassed Mississippi Civil Rights Activists Unsupported

Pursuant to a request from the Chairman of the Oversight Subcommittee of the House Ways and Means Committee, GAO investigated allegations that IRS harassed 28 Mississippi civil rights activists through extensive audits of their income tax returns. GAO found no evidence to support those allegations.

- The 28 taxpayers were audited a total of 45 times for tax years 1970 through 1975.
- IRS followed normal procedures in selecting the 45 returns for audit and in auditing them.
- The audits of the 28 taxpayers produced an average tax change approximating the national average.
- IRS followed normal procedures in gathering intelligence on several of the taxpayers and in using that intelligence.



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-137762

The Honorable Sam Gibbons
Chairman, Subcommittee on
Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

In response to your Subcommittee's request, we are reporting on the results of our investigation into allegations that the Internal Revenue Service harassed Mississippi civil rights activists through extensive audits of their tax returns. We found no evidence to support those allegations.

As arranged with the Subcommittee, when you publicly announce the report's contents, we will send copies of it to interested parties and make copies available to others upon request.

Sincerely yours,
Frederic B. Atchefs

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO
THE SUBCOMMITTEE ON OVERSIGHT
HOUSE COMMITTEE ON WAYS AND MEANS

ALLEGATIONS THAT IRS
HARASSED MISSISSIPPI
CIVIL RIGHTS ACTIVISTS
UNSUPPORTED

D I G E S T

GAO found no evidence to support allegations in a newspaper article that the Internal Revenue Service (IRS) harassed 28 Mississippi civil rights activists through extensive audits of their income tax returns.

To investigate the allegations, GAO examined tax returns, audit case files, computerized data, intelligence records, and other IRS data. GAO received IRS' full cooperation in this investigation, including access to all records. GAO did not solicit formal IRS comments on this report; it discussed its findings and conclusions informally with appropriate IRS officials. (See p. 1.)

The 28 taxpayers were audited a total of 45 times for tax years 1970 through 1975. With possibly one exception, IRS followed normal procedures in selecting the returns for audit. The exception involved a return that was pulled for audit after the audit of a prior year's return was closed "unagreed." (See pp. 3 to 7.)

IRS followed normal procedures in initiating, conducting, and closing the audits. Among other things, taxpayers were given time to provide additional information, and were allowed to reschedule appointments, provide information by mail if they preferred, and exercise their appeal rights if they so desired. (See pp. 19 to 21.)

IRS also followed normal procedures in obtaining limited information on some of the 28 taxpayers through its intelligence-gathering apparatus and in using that information. (See pp. 27 to 31.)

It was alleged that it is statistically improbable for the tax returns of such a well-defined group of individuals to be selected

for audit by purely random methods. However, IRS does not select returns randomly.

A return's chances of being audited vary depending on the type of return (business or nonbusiness), the income level involved, and the characteristics of the return (such as the type and size of itemized deductions). Most returns are selected for audit because they have been evaluated by a computer and one or more persons and have been found to have good audit potential. Other returns are selected because they contain specific characteristics that IRS is looking for, such as an unallowable item. (See pp. 17 and 18.)

To support the charge that IRS harassed the taxpayers, the news article noted that none of the audits suggested serious taxpayer misconduct and only two produced over \$2,000 in additional tax. The purpose of an audit, however, is not to uncover serious taxpayer misconduct but rather to verify a person's reported tax liability. Also, the average tax change of the audits in question (\$655) approximates the national average (\$720). (See pp. 22 and 23.)

Considering that (1) no one enjoys being audited or being told he owes more taxes and (2) audits are conducted in an adversary atmosphere, it is easy to understand why a taxpayer might feel harassed.

A taxpayer might understandably feel harassed when

- he provides what he believes to be adequate support for his deductions or exemptions only to be told that the support is inadequate,
- he comes back with more support only to be thwarted again,
- he finds himself in a position of trying to support a return prepared by his since-deceased spouse,

- the examiner disallows a deduction that the taxpayer believes he is entitled to and the taxpayer has to spend a considerable amount of time and money to appeal his case,
- his audit drags on for months, or
- he is audited for 2, 3, or more years in succession.

None of these situations is unique to the audits in question; they can occur anytime. Likewise, a feeling of harassment would not be unique to the Mississippi taxpayers. GAO heard or noted similar complaints from taxpayers during previous reviews of IRS' audit function in California, Delaware, Kansas, Louisiana, Maryland, Missouri, Nevada, Pennsylvania, Washington, D.C., and Wyoming. Indeed, it is not unreasonable to assume that an IRS examiner may, on occasion, go beyond the limits of propriety, and contrary to policy, harass a taxpayer. It would be difficult for any organization with 85,000 employees, like IRS, to assure proper conduct by all of its employees all of the time. (See p. 25.)

The allegations in this instance, however, did not charge that a particular examiner harassed a particular taxpayer during a particular audit. The allegations charged instead that IRS, as an organization, purposefully used its audit authority to harass Mississippi civil rights activists. GAO found no evidence to support that allegation.

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ABBREVIATIONS

DIF discriminant function
GAO General Accounting Office
IRS Internal Revenue Service

CHAPTER 1

INTRODUCTION

A June 13, 1975, article in the Delta Democrat-Times alleged that the Internal Revenue Service (IRS) had harassed 28 Mississippi civil rights activists through extensive audits of their income tax returns. The article named the 28 persons and provided specific information about several of their audit experiences.

The Subcommittee on Oversight, House Committee on Ways and Means, asked IRS to respond to the allegations. In September 1976, IRS sent the Subcommittee a written response, but the Subcommittee never received it. Because we had recently issued two reports on how IRS selects individual income tax returns for audit and how it audits them, ^{1/} the Subcommittee asked us to (1) obtain and examine IRS' response to determine whether it satisfactorily answered the charges raised in the news article and (2) obtain and evaluate any information we deemed necessary to determine whether certain tax returns may have been selected as part of racial harassment. (See apps. I and II.)

SCOPE OF OUR INVESTIGATION

We examined tax returns, audit case files, computerized data, and other IRS documents to determine

- whether the returns in question were audited;
- how and by whom the returns were selected for audit and whether their selection appeared reasonable; and
- how and by whom the returns were audited, what the audit results were, and whether the audits appeared reasonable.

We also

- interviewed appropriate IRS district, regional, and national office officials and IRS employees who were

^{1/}"How the Internal Revenue Service Selects Individual Income Returns for Audit" (GGD-76-55, Nov. 5, 1976) and "Audit of Individual Income Tax Returns By the Internal Revenue Service" (GGD-76-54, Dec. 2, 1976).

personally involved in selecting the returns for audit and/or auditing them;

--reviewed the personnel files of involved IRS employees and took other steps to determine if there was any evidence of bias or harassment during their employment at IRS;

--reviewed IRS' intelligence files to determine if there was any evidence of intelligence efforts being directed at blacks or civil rights activists and whether any audits were the direct result of intelligence-gathering activities; and

--solicited information and opinions from the taxpayers in question.

We did our work at IRS' national office in Washington, D.C., its regional appellate branch office in Birmingham, Alabama, and its district office in Jackson, Mississippi. We received IRS' full cooperation in this investigation, including complete access to all records.

We did not solicit IRS' formal comments on this report; we discussed our findings and conclusions informally with appropriate IRS officials.

CHAPTER 2

MOST OF THE TAXPAYERS WERE AUDITED

According to the news article, all 28 taxpayers had been audited by IRS at least once "in recent years." Although the author did not mention a specific time frame, the details in the article indicated that he was talking almost exclusively about tax returns for 1970 through 1974, and those were the years IRS was told to consider in responding to the allegations. In its September 1976 response, IRS noted that all but 5 of the taxpayers had been audited at least once for tax years 1970 through 1974, for a total of 40 audits. We verified IRS' response and found it to be substantially, but not precisely, correct. We also expanded our review to cover tax year 1975 (1975 returns filed in 1975) so that we might have a more up-to-date record of the taxpayers' audit histories.

For the 6 years involved (1970 through 1975), the 28 taxpayers filed 161 individual income tax returns. Of those returns, 45, or 28 percent, were audited.

<u>Tax year</u>	<u>Number of returns</u>	
	<u>Filed</u>	<u>Audited</u>
1970	25	3
1971	27	7
1972	26	14
1973	28	12
1974	28	4
1975	<u>27</u>	<u>5</u>
Total	<u>161</u>	<u>a/45</u>

a/This total does not include one return that may have been audited. Although IRS could not locate the return or any related audit files, we were able to piece together the following. While auditing a 1972 return, the examiner secured a delinquent 1973 return from the taxpayer involving over \$3,000 in tax liability. The examiner probably looked over the return and may have even audited it; available documentation only shows that he closed the case without changing the reported tax liability on the delinquent return. IRS did not include this as an audit in its September response. Although it could be classified as having been audited, we are treating this return separately because we were unable to determine whether the examiner actually audited the return or just looked it over when he got it from the taxpayer. Any further discussion in this report about audits of the 28 taxpayers will be limited therefore to the 45 audits we are certain of.

Our total of 40 audits for 1970 through 1974 differs from IRS' total of 40 because:

- IRS excluded a taxpayer from its response so as not to jeopardize an ongoing prosecution for tax fraud. We included that taxpayer (one audit) in our total.
- IRS mistakenly excluded a second taxpayer (involving three audits) from its response and substituted a taxpayer (involving four audits) who was not mentioned in the article but whose name had come up during a conversation between the author of the article and an IRS official in Jackson. We could find no one in IRS who knew about this mistake or how it happened.

Of the 45 audits for 1970 through 1975, 13 involved low income returns (adjusted gross income of less than \$10,000), 26 involved medium income returns (adjusted gross income of at least \$10,000 but less than \$50,000), and 6 involved high income returns (adjusted gross income of \$50,000 or more). Of the 28 taxpayers involved, 1 was audited for 5 years, 6 for 3 years, 5 for 2 years, and 12 for 1 year. According to the information available to us, the other 4 taxpayers were not audited for any of the years in question 1/, which would appear to contradict the allegation that each of the 28 taxpayers was audited at least once.

One of the taxpayers who was not audited, according to IRS' files, did have a refund due on his 1974 return adjusted downward by \$21 because of a math error. The taxpayer may have considered the math correction to be an audit. A second taxpayer who, according to IRS' files was not audited for the years in question, was audited for tax years 1968 and 1969. Those audits, according to IRS' records, were not closed until 1971 and 1972, respectively. In these two cases, we were able to verify that IRS' files pertained to the same taxpayers cited in the article. As explained below, however, we were unable to do the same for the other two taxpayers that IRS' records showed as not being audited and for one other taxpayer whose only audit, according to IRS' files, came after the news article was published.

1/We show four taxpayers not audited whereas IRS showed five because one taxpayer was audited only for tax year 1975-- a year not covered in IRS' response.

Because the article did not provide social security numbers or street addresses, IRS was at a disadvantage in trying to assure that the audit files it had accumulated pertained to the taxpayers cited in the article. For 23 of the taxpayers, we were able to verify that IRS had accumulated the correct audit files because information in the article on the taxpayer's city of residence, his occupation, the tax years audited, the issues audited, and/or the audit results compared favorably with the information in IRS' files. Also, we obtained addresses on two other taxpayers cited in the article that enabled us to verify that IRS had accumulated the correct files on them.

For the other three taxpayers, we have reason to believe that IRS accumulated the wrong files; we were unable, however, to find the correct ones. In the first case, the article provided specific information which clearly indicated that the taxpayer had dependents and had been audited for 2 years. IRS files, however, pertained to a taxpayer who had the same name but who had not been audited, was a student with no dependents, and lived in a city other than the one mentioned in the article. In the second case, the article provided specific information about the taxpayer's occupation and about a 1974 audit. IRS files pertained to a taxpayer with the same name but a different occupation who had not been audited. In the third case, the article noted that the taxpayer had been audited in 1974 for the 2 preceding years. IRS files showed only one audit, and it did not begin until May 1976, almost a year after the article was published.

We took various steps to try to ascertain whether IRS had amassed the correct files on the three taxpayers and, if not, to obtain the correct ones. Without knowing the taxpayers' social security numbers or at least their street addresses, however, we were stymied.

We were finally able to obtain street addresses for two of the three taxpayers and additional information on the third which further indicated that IRS had accumulated the incorrect files. IRS was unable, however, to find any record in its computerized files of taxpayers at those addresses.

CONCLUSIONS

The allegation that the 28 taxpayers were audited is basically true. The information available to us indicates that four of the taxpayers were not audited during the years in question and a fifth was not audited until after the article alleging that he had been audited was published. We

have reservations, however, about the validity of the information in three of those cases, and there are circumstances in the other two cases that could explain the apparent discrepancy.

Whether or not the taxpayers were audited is not really the most important issue. More important is whether the returns were selected for audit and audited under IRS' normal operating procedures or whether they were selected and/or audited with the intent to harass. Although we are uncertain about 3 taxpayers, we had enough information on the other 25 to address that issue. We do so in the following chapters.

CHAPTER 3

NO EVIDENCE OF HARASSMENT IN THE WAY

THE RETURNS WERE SELECTED FOR AUDIT

The news article alleges that the 28 Mississippi taxpayers were victims of political harassment by IRS and that it is statistically improbable for the tax returns of such a well-defined group of individuals to be selected for audit by purely random methods.

IRS' review of the allegations uncovered nothing improper. It claimed that most of the returns were selected for audit through its computerized selection process. Our review supports IRS' contention. With possibly one exception, involving a return that was pulled for audit after an audit of the taxpayer's prior year's return was closed "unagreed," IRS followed normal operating procedures in selecting the returns for audit. We found no evidence of any effort or intent by IRS to harass the taxpayers.

HOW IRS NORMALLY SELECTS RETURNS FOR AUDIT

In our report, "How the Internal Revenue Service Selects Individual Income Tax Returns for Audit" (GGD-76-55, Nov. 5, 1976), we noted that most of the individual income tax returns selected for audit nationwide are selected through IRS' discriminant function (DIF) system. In fiscal year 1975, for example, DIF accounted for 67 percent of the returns selected for audit.

Under this system, each individual income tax return is scored by a computer using a mathematical formula that assigns weights to certain predetermined characteristics on the return. The sum of the weights represents the return's DIF score; the higher the score, the greater the return's audit potential. There are different formulas for different income levels and types of returns. For example, a non-business return (one with no schedule C or F attached) involving adjusted gross income under \$10,000 would be scored by a different formula than would a business return with the same adjusted gross income or a nonbusiness return involving adjusted gross income of \$10,000 or more. A minimum DIF score is established for each formula; every return with a score above the minimum is listed on a DIF inventory file which makes that return available for audit under the DIF system.

Periodically, a district office will order a specific number of returns from the service center where they are filed. The returns are usually ordered by formula. Using the inventory file, the service center will pull the highest DIF-scored returns in the formula or formulas ordered and send them to the district where they are manually screened by classifiers (tax auditors and revenue agents assigned to screen returns) to eliminate those that don't need to be audited.

In other words, the computer evaluates the audit potential of every individual income tax return filed, and by assigning scores, separates those with a high likelihood of tax change from those with less likelihood. Then the classifier, using judgment based on experience, makes sure an audit is warranted, and in most cases, indicates on a checksheet what specific items on the return should be covered during the audit.

As further explained in our November 1976 report, a return might be selected for audit for many reasons other than its DIF score. During an audit, for example, the examiner may find it necessary to review returns filed by other taxpayers that may have a bearing on the return being audited. Included in this category, which IRS calls related pickups, are returns filed by the taxpayer's business partners or family members. Also, during an audit the examiner may determine that he needs to audit returns filed by the same taxpayer in earlier or later years to see, for example, if adjustments to one return apply to other years' returns. IRS calls these multiyear audits.

Certain returns, such as those involving an adjusted gross income of \$100,000 or more, are automatically identified by the computer to be manually screened regardless of their DIF scores. Other returns are selected for audit under IRS' Taxpayer Compliance Measurement Program--a program whereby IRS measures and evaluates taxpayer compliance characteristics through comprehensive audits of randomly selected tax returns. The cumulative results of these audits are used to develop the DIF formulas.

Some returns are selected for audit because IRS has reason to believe that the preparer of the return--someone other than the taxpayer--is unscrupulous, or because IRS has received information from a third party indicating that an audit of a particular taxpayer's return will result in additional tax liability. Someone might inform IRS,

for example, that a business associate is underreporting his income or inflating his business expenses.

Still other returns are selected for audit because the taxpayer has claimed something that appears unallowable by law, such as claiming a casualty loss without deducting the first \$100 of that loss, or because the taxpayer appears to have erroneously claimed the unmarried head of household tax rate.

HOW THE RETURNS IN QUESTION
WERE SELECTED FOR AUDIT

The 45 returns in question were selected for audit as follows:

<u>Reason for selection</u>	<u>Number of returns selected</u>
DIF	a/31
Multiyear audit	6
Unallowable item	2
Taxpayer Compliance Measurement Program	1
Head of household	1
Referral from Intelligence Division	1
Reference and information return	1
Not certain of reason	b/2
Total	<u>45</u>

a/This includes one return that was automatically sent to the district for manual screening because it involved an adjusted gross income of over \$100,000 and which was selected for audit as a result of that screening. For statistical reporting purposes, IRS includes "automatics" with regular DIF-selected returns because both are initially identified by the computer. We have combined them to facilitate comparison with IRS statistics.

b/We did not determine how these two returns were selected for audit because of problems in obtaining necessary documentation. One return was still being audited; the other was tied up in litigation.

This analysis, developed through our review of audit case files and related documentation, agrees with the information in IRS' September 1976 response except that (1) IRS' response included one taxpayer not mentioned in the article and excluded two who were mentioned, (2) IRS' response did not cover tax year 1975, (3) IRS classified

one return as being selected under DIF whereas we classified it as being selected as part of a multiyear audit, and (4) IRS classified one return as being selected because of an unallowable item whereas we classified it as "head of household."

The fact that most of the 45 returns were selected for audit under the DIF system is consistent with IRS' experience nationwide.

Returns selected for reasons
other than DIF or multiyear audit

We examined IRS' bases for selecting the six returns that were selected for reasons other than DIF or a multiyear audit. Two returns were selected for audit because of an unallowable item--one because the taxpayer failed to reduce his casualty loss by \$100, as required by law, before claiming it as a deduction and the other because the taxpayer calculated his child care deduction incorrectly. These are but two of the many types of taxpayer errors that IRS corrects under its Unallowable Items Program. IRS followed normal procedures and applied normal criteria in selecting these two returns for audit.

One return was selected because the taxpayer appeared to have erroneously claimed the unmarried head of household tax rate. IRS' computer automatically identifies any return in which the taxpayer claims the head of household tax rate but only claims one exemption. IRS verifies the taxpayer's eligibility to use the rate. The return in question met the criteria for selection.

Another return was selected for audit as part of IRS' Taxpayer Compliance Measurement Program. To determine if this selection was proper, we reviewed IRS' written procedures for selecting the 50,000 individual income tax returns to be audited during the 1973 phase of the Program. The procedures provided that any 1973 individual income tax return filed in 1974 having a schedule C attached, adjusted gross income over a specified amount, and business receipts under a specified amount would be selected for audit under the Taxpayer Compliance Measurement Program if the last two digits of the taxpayer's social security number were one of three specified combinations. The tax return in question met these criteria and thus was properly selected for audit under the Program.

One return was selected for audit as a result of a referral from IRS' Intelligence Division. The chain of events, as can best be determined from available documentation, was as follows. In November 1971, the Intelligence Division received information from an anonymous source about the taxpayer's financial affairs. It evaluated the information, decided that it did not have fraud potential, and referred it to the Audit Division for its evaluation. The Audit Division evaluated the information in light of the taxpayer's return and decided that an audit was warranted. This is neither an uncommon nor an improper procedure.

The specific information provided by the anonymous source was not part of the audit case file and could not be located in the Intelligence Division files. Therefore, we cannot express an opinion as to whether the information appeared significant enough to warrant an audit. The Jackson District Director advised us that normal procedure would call for the item to be filed in the Audit Division, but that according to the Audit Division, all "information items" filed in that Division prior to 1975 have been destroyed.

We found a formal record of the information in the Intelligence Division's files, but that record showed only the source of the information, the date it was received, the name of the taxpayer, the type of tax involved, and the action taken on that information by the Intelligence and Audit Divisions. Considering that (1) the information was received in 1971 and the audit was closed in 1972, (2) we have encountered incomplete case files during other reviews at IRS, and (3) the audit resulted in an additional tax liability of about \$3,800, we attach no significance to our inability to find the information.

The last of the six returns is classified as being selected because of a "reference and information return." The term simply refers to a tax return that an examiner has obtained from the service center for reference or information purposes. Because the form used to order such a return was not in the audit case file, we do not know all the specifics. We do know enough, however, to satisfy ourselves that IRS did nothing improper.

In preparing his 1970 return, the taxpayer computed his tax liability on the basis of 10 exemptions but failed to list any dependents in the space provided. The service center recomputed his tax on the basis of two exemptions (husband and wife) and sent the taxpayer a bill for the

additional tax. The taxpayer advised IRS that he had erred by failing to list his eight children on the return. The service center accepted his explanation and revised its previous adjustment. When the taxpayer filed his 1971 return, he showed all 10 exemptions. Because his 1970 return showed only 2 exemptions and his 1971 return showed 10, an audit was triggered to reconcile the difference. Only after the audit began was it clarified that the taxpayer was entitled to all 10 exemptions.

Although one could argue that IRS should not have had to audit the 1971 return since the problem was apparently resolved after the taxpayer filed his 1970 return, there should be no doubt that IRS had a sound reason for selecting the return for audit--an apparent large increase in exemptions from one year to the next. Moreover, IRS had a nationwide program underway, at that time, whereby 1971 returns were automatically identified for audit if they reflected five or more exemptions than were reflected on the 1970 return. This taxpayer's 1971 return met the criteria established for that program.

DIF selected returns

Of the 45 returns, 31 were selected for audit through the DIF system, which consists of two phases--computer scoring and manual screening.

Because all returns of the same type and income level are scored by the same DIF formula, the chances for abuse in that phase of the system are minimal. Abuse could only occur through some conspiracy to alter or bypass the scoring process. We found no evidence of any such conspiracy.

Each of the 31 returns selected through DIF was scored by the computer. We manually scored 23 of those returns using the same formulas used by the computer and verified, with one exception, that the scores shown on IRS' records were accurate. The one exception was a return that the computer scored at 179 but which we scored at 127. A knowledgeable IRS employee verified our score and surmised that IRS' miscalculation was caused by an error in transcribing information from the tax return into the computer. As a result, the computer applied the DIF formula to incorrect data.

In scoring the returns, we saw nothing in the makeup of the formulas that would bias them against blacks or activists. The formulas were not constructed, for example,

to consider the taxpayer's address, his employer, or the type of organizations to which he contributed.

We also verified that each score, including the recomputed one, was above the applicable minimum DIF score, which meant that each of the 31 returns was properly included in DIF inventory and available for manual screening. The fact that a return is in inventory and available for screening does not mean that it will be audited or even considered for audit because the inventory includes more returns than the district will ever need.

Under normal DIF procedures, a district would periodically order a batch of returns from the service center, for example, 500 nonbusiness returns with an adjusted gross income of less than \$10,000. The service center would pull the 500 highest scored returns of that type and income level from its inventory and would send them to the district for manual screening. We reviewed Jackson's orders for DIF returns and records showing the DIF scores of returns sent to Jackson for manual screening. We were interested in whether IRS had taken any unusual steps to insure that the 31 returns got to Jackson. We found no such evidence. The district followed normal procedures in ordering returns, and the DIF scores of the 31 returns were higher than the lowest scored returns sent to Jackson for screening.

We noted, however, that the return with the miscomputed DIF score would not have been sent to Jackson for manual screening under the DIF system if its score had been correctly computed. IRS records showed that no return of that same type and income level was sent to Jackson with a score lower than 140. Thus, if the return had been correctly scored at 127 instead of 179 it probably would not have been audited.

The second phase of the DIF system--manual screening--is more susceptible to abuse. The screener, or classifier, is a necessary part of the system because by looking at the entire return, something the computer cannot do, and by drawing on his experience, he can weed out those returns that in his judgment do not warrant audit. A classifier could abuse his role in the system, however. He could, for example, recognize the taxpayer as someone involved in civil rights activities and decide, on that basis alone, that the return should be audited. Although always possible, the chances for such abuse are generally small because the classifier's decisions are subject to review.

The classification operation in Jackson, however, caused us some concern. From 1970 through 1976, the district had one person who screened most of the returns that came into the district. Other examiners would be temporarily assigned to screen returns if the workload became too heavy for the "permanent" classifier to handle, but otherwise that one classifier did all the screening. We were told the permanent classifier did not sign the checksheets she prepared on returns selected for audit and filled out her checksheets in red. Based on that, we identified 18 of the 31 DIF-selected returns that appeared to have been screened by her.

Even recognizing that classifier's decisions are subject to various reviews, we were concerned about the presence of a permanent classifier because the natural tendency might be to review that person's work less closely than the work of a temporary classifier, and because, in the absence of effective review, the district's entire audit program could be adversely affected by that one person's biases.

Although the situation lent itself to abuse, we saw no evidence of any in talking to the permanent classifier, or more importantly, in reviewing her decisions. Jackson no longer has a permanent classifier; returns are now being screened by examiners detailed to that function for periods of 1 to 3 weeks.

We talked to the permanent classifier and nine other Jackson examiners who classified individual income tax returns. When asked whether the fact that a taxpayer was black or involved in civil rights activities would affect their classification decisions, eight including the permanent classifier said "no," one said he did not think so, and the other said he did not know. 10 asserted that they had never been instructed to look specifically for returns filed by certain individuals and were unaware of anyone else being so instructed.

The permanent classifier also told us that she would look at each return to see if it warranted audit and whether the tax impact appeared significant and that her decisions in that regard were based on judgment. She further said that she (1) could not find a civil rights activist if she were asked to, (2) paid no attention to a taxpayer's name or address in classifying returns, (3) was interested in a taxpayer's occupation only in determining if the taxpayer's reported income and expenses were consistent with that occupation, and (4) was only interested in the organizations

to which a taxpayer contributed if she had a question about their tax exempt status.

Classifiers' decisions were generally appropriate

In addition to asking classifiers about harassment, we wanted to independently determine, as best we could, if there was any evidence of harassment in classifying the 31 returns that had been selected for audit under DIF.

In our November 1976 report on how IRS selects individual income tax returns for audit, we noted that when screening returns, classifiers (1) evaluate whether the income and deductions reported on the return would leave the taxpayer with enough money to cover necessary non-tax-deductible expenditures, such as for food and clothing, (2) look for inconsistencies such as those between the type of employee business expenses claimed and the taxpayer's occupation, (3) look for such things as misclassifications of long- and short-term capital gains and losses, suspiciously rounded figures, and areas where past experience has shown that taxpayers are more apt to make errors, such as bad debts, and (4) evaluate the adequacy of the amount of gross receipts or cost of goods sold for the type of business conducted.

With the above in mind, we reviewed the case files for each of the 31 returns in question. The classifiers identified a variety of questionable items in screening those returns including gross business receipts, exemptions, contributions, alimony, income, education expenses, employee business expenses, casualty loss, travel, self-employment tax, sick pay exclusion, and medical expenses.

After reviewing the tax returns and IRS' files and evaluating the classifier's actions, we determined that the classifiers in Jackson, including the permanent classifier, had valid bases for selecting the returns for audit, although we did not always agree with their decisions about which items on the returns should or should not be audited. In a couple of instances, for example, the classifier decided that contributions should be audited even though the amount involved seemed insignificant (less than 2 percent of adjusted gross income). In two other instances, the classifier did not identify automobile expenses for audit even though those expenses seemed high considering the taxpayer's occupation.

Because a classifier's decisions are highly judgmental, however, it is reasonable to expect that another person looking at the same return might see things a little differently. The important point is that we found nothing in reviewing those judgments that indicated an intent to harass.

Multiyear audits

Six returns were selected for audit in conjunction with multiyear audits. In three cases, the first return was selected for audit through DIF and the examiner decided to audit the next year's return; in another case, the first return was selected through DIF and the examiner decided to audit the prior and subsequent years' returns; in the final case, the first return was selected for audit under the Taxpayer Compliance Measurement Program and the examiner decided to audit the next year's return.

The theory behind multiyear audits is basically sound--if a taxpayer erred in preparing one return, he might very well have erred in preparing others. Thus it is not uncommon, during an audit of 1 year's return, for an examiner to inspect prior and subsequent years' returns filed by the same taxpayer. In light of his audit findings on the first return, the examiner decides whether any of the other returns warrant audit. If he decides they do, he audits them.

Compared to other selection procedures, the procedures for selecting a return for multiyear audit are very susceptible to abuse. Most returns, such as those selected under DIF, are selected for audit by the computer and/or by someone other than the person who will be auditing the return, which greatly limits the chances for abuse. Still, other returns, such as those selected under the Taxpayer Compliance Measurement Program and the Unallowable Items Program, are selected under such specific criteria that judgment plays only a minor role in the process, which also limits the chances for abuse. The decision to select a return for multiyear audit, however, is made under very broad criteria by the same person who will examine it.

With that background, we reviewed the six returns and related case files. We paid particular attention to the audit issues involved and the examiner's procedures during the audit to see whether he had a valid basis for deciding to audit the prior or subsequent year's return and whether any evidence existed to suggest that his decisions were influenced by an intent to harass. We found no such evidence in five of the six audits.

We are not as confident about the sixth audit, however. In that instance, the examiner first audited the taxpayer's 1974 return and recommended substantial adjustments. The examiner closed the case "unagreed" after the taxpayer apparently failed to respond to the audit report. After closing the 1974 audit unagreed, the examiner, with his supervisor's approval, obtained the taxpayer's 1975 return from the service center and audited it. Although the issues he pursued on the 1975 return seemed worthy of pursuing, we are concerned about the examiner's motive in deciding to audit the return.

In the other multiyear audits, the examiner finished auditing each return before submitting his audit report to the taxpayer and soliciting his agreement. In this case, the examiner audited one return and submitted his report; only after the case was closed unagreed did the examiner decide to audit the other return. By so doing, the examiner was leaving himself open to charges of harassment. Certainly the taxpayer would have reason to feel harassed and to wonder, as we do, whether the examiner would have decided to audit the 1975 return if the taxpayer had agreed to the 1974 audit findings.

IRS officials, after reviewing the files on this case, found no reason to question the examiner's motives. They noted that (1) the 1974 audit report was prepared in March 1976 after the taxpayer failed to keep an appointment, (2) the examiner closed the 1974 audit unagreed in April 1976 after the taxpayer failed to keep another appointment and requisitioned the 1975 return because the additional tax proposed for 1974 was about \$1,200, and, (3) closing of the 1974 audit would have been unnecessarily delayed if the examiner had waited to get the 1975 return, which was filed in April 1976, before preparing his report.

CONCLUSIONS

We found no evidence of any IRS program or effort to harass the 28 taxpayers by selecting their returns for audit.

The main argument the news article presented as evidence of harassment was the statement that "* * * it is statistically improbable that random selection alone could account for so many audits of such a well-defined group of individuals." If IRS selected returns randomly, that argument would probably be valid. In fact, however, IRS does not select returns randomly. A return's chances of being

audited vary depending on the type of return (business or nonbusiness), the income level involved, and the characteristics of the return (such as the type and size of itemized deductions). Most returns are selected for audit because they have been evaluated by a computer and one or more persons and have been found to have good audit potential. Other returns are selected for audit because they contain specific characteristics that IRS is looking for, such as an unallowable item or an unscrupulous preparer. Only returns audited under the Taxpayer Compliance Measurement Program are selected randomly and only 1 of the 45 audits fell in that category.

Considering how IRS selects returns for audits, therefore, " * * * so many audits of such a well-defined group of individuals" is not statistically improbable, especially over a period of 6 years.

CHAPTER 4

NO EVIDENCE OF HARASSMENT IN

AUDIT PROCEDURES AND RESULTS

In further support of the charge that IRS harassed the 28 taxpayers, the news article noted that none of the audits suggested serious taxpayer misconduct and only two produced over \$2,000 in additional tax. IRS did not specifically address those remarks in its September response; it limited its response to a factual summary of each audit, including the examiner's name and the results. Our investigation showed generally that the absence of any suggestion of serious misconduct and audit results of less than \$2,000 are invalid indicators of harassment. Specifically, our review of audit case files showed no evidence of any IRS effort or intent to harass blacks or civil rights activists. Certain taxpayers may have had reason to feel harassed because of their personal audit experiences, but that is not an uncommon feeling among taxpayers.

HOW IRS NORMALLY AUDITS RETURNS

In our report, "Audit of Individual Income Tax Returns by the Internal Revenue Service" (GGD-76-54, Dec. 2, 1976), we discussed in considerable detail IRS' audit procedures. We are summarizing those procedures in this report.

A person's tax return may be audited by one of IRS' 10 service centers or one of its 58 district offices. Service center audits generally involve relatively simple and readily identifiable problems that can be resolved easily by mail, such as unallowable items. Most returns audited by the district office involve issues that are not as readily identifiable or as easily resolved.

A service center audit generally involves sending the taxpayer a letter which (1) notifies him about the problem with his return, (2) advises him of the impact on his tax liability and (3) tells him what to do if he agrees or disagrees. If the taxpayer agrees, the case is closed; if he disagrees, he can (1) submit information to support his disagreement which the service center will evaluate, (2) request that the case be transferred to a district office examiner, or (3) take advantage of his appeal rights.

The district office audit process consists of (1) notifying the taxpayer of the audit and its scope, (2) examining

his records and taking written or oral testimony, (3) evaluating the adequacy of the records and testimony and (4) advising him of the audit findings. If the examiner decides, after evaluating the taxpayer's records and testimony, that the return is correct or that the errors are insignificant from a tax standpoint, he closes the case "no change." If the examiner determines that the taxpayer owes more taxes or had paid too much and is due a refund, an audit report is prepared so advising the taxpayer. If the taxpayer agrees, the case is closed; if he disagrees, he can appeal.

A district office audit can be conducted by either a tax auditor or a revenue agent depending on the complexity of the issues involved and the degree of accounting and auditing skills required to properly perform the audit. Tax auditors, who generally audit the less complex returns, conduct their audits either by correspondence or by interview--usually at an IRS office. Audits are handled by correspondence when the information needed can be furnished by mail and when the audit can probably be resolved by this method. Revenue agents, who generally audit the more complex returns, conduct their audits by interview, usually at the taxpayer's home or at the taxpayer's or his representative's place of business.

HOW THE RETURNS IN
QUESTION WERE AUDITED

The 45 returns in question were audited as follows:

<u>Audited by</u>	<u>Number of returns</u>
Service center	4
District office:	
Revenue agent	12
Tax auditor/correspondence	5
Tax auditor/interview	23
Unknown	<u>1</u>
Total	<u><u>45</u></u>

IRS followed normal procedures in initiating, conducting, and closing these audits. Taxpayers were given time to provide additional oral and written information. They also were allowed to reschedule appointments, provide information by mail if they preferred, and exercise their appeal rights if they so desired.

W. noted also that the group manager was personally involved in many of these audits, especially those done by tax auditors. If an examiner sends a taxpayer an audit report and the taxpayer fails to respond by either indicating his agreement or voicing his disagreement, IRS can proceed to close the case and assess the additional tax called for in the report. In many of the Jackson case files we reviewed, however, the group manager took an extra step. He sent a letter reminding the taxpayer that he had not responded, telling him that IRS was reluctant to close the case without his response, and advising him to agree to the findings, furnish additional information to support his position, come in for an informal meeting with the group manager, or exercise his formal appeal rights.

In addition to evaluating audit procedures, we analyzed the audits for similarities that might indicate some impropriety. We found none. For example, at least 29 examiners were involved in the audits, and only two examiners audited more than two taxpayers--both audited three. Also, we saw no unusual similarities in audit issues. The issues audited most often were contributions, interest expenses, business expenses, exemptions, and income; but the audits also involved such diverse issues as rental loss, self-employment tax, fellowships, education expenses, sick pay exclusion, alimony, office-in-home expenses, and child care.

AUDIT FINDINGS APPEARED
GENERALLY APPROPRIATE

Because it is difficult to evaluate an examiner's audit findings without being present during the audit, we cannot be certain that the examiners had valid bases for their decisions. We had to limit ourselves to reviewing the examiner's workpapers and determining solely from the information in those workpapers whether the examiner appeared to have good reason for his findings.

Generally the workpapers supported the audit findings. According to the workpapers, for example, examiners

- disallowed exemptions because someone else had claimed the same exemption and/or the taxpayer could not satisfactorily establish that he provided over one-half the support for the person claimed as an exemption,
- disallowed travel expenses because the taxpayer had been reimbursed by his employer or could not support the amount claimed,

- disallowed education expenses because the education qualified the taxpayer for a new trade or business,
- disallowed a sick pay exclusion because the taxpayer did not satisfy the waiting period requirements,
- disallowed deductions for contributions, taxes, interest, and medical expenses because the taxpayers were unable to support the amounts claimed, and
- increased the taxpayer's reported income because the taxpayer had not included money received before the end of the year but not deposited until the following year or because the examiner had determined, through special techniques, that the taxpayer had not reported all of his business income.

We did note instances, however, in which the workpapers were incomplete or unclear. One examiner, for example, adjusted a taxpayer's travel expenses after determining that the taxpayer used his automobile for business 60 percent of the time instead of the 85 percent claimed. The workpapers did not show how the examiner arrived at 60 percent. The problem of incomplete or unclear workpapers is not unique to Jackson; we observed the same problem during our review of IRS' audits of individual income tax returns in four districts and during our ongoing review of the quality of IRS' audits in another district.

We also reviewed the results of the audits in question to see how they compared with the results of IRS audits nationwide.

Because only 4 of the 45 audits were done by the service centers and because those audits involved relatively clear-cut issues, we limited our analysis of audit results to the 41 district office audits. Of those 41, 4 were still open at the time of our analysis and thus the additional tax liability, if any, had not been determined. The other 37 audits resulted in an average increase in tax liability, not including interest, of \$655. IRS statistics show that nationwide, from July 1970 to June 1976, district office audits of individual income tax returns resulted in an average recommended tax increase, not including interest, of \$720. The \$720 average relates to tax increases as recommended by the Audit Division; it does not reflect changes as a result of taxpayer appeals beyond that Division. Our average of \$655 reflects final tax adjustments after all appeals. Thus the averages are even closer than the figures indicate.

The additional tax liabilities ranged from \$0 to \$3,814 as follows:

<u>Additional tax liability</u>	<u>Number of audits</u>
None	4
\$1 to \$100	3
\$101 to \$200	7
\$201 to \$500	9
\$501 to \$1,000	6
\$1,001 to \$2,000	5
In excess of \$2,000	<u>3</u>
Total	<u>37</u>

The primary purpose of an audit is to verify the reported income, exemptions, credits, and deductions. As IRS says in the form letter it uses to advise taxpayers that their returns are being audited: "* * * an audit does not suggest a suspicion of dishonesty or criminal liability." Nevertheless, during an audit an examiner is expected to be alert to indications of fraud and is to take steps to refer any such case to the Intelligence Division. The Intelligence Division decides whether the case warrants prosecution; if it decides negatively, the case is returned to the Audit Division.

In fiscal year 1976, for example, 6,381 audit cases were referred to the Intelligence Division nationwide; 2,449 of those were accepted for further investigation. Of the 28 taxpayers in our review, 2 had their cases referred to Intelligence--one case is in litigation; the other was returned to Audit after Intelligence determined that prosecution was not warranted.

REACTIONS OF IRS AUDIT
PERSONNEL TO ALLEGATIONS

We talked to 22 IRS employees in the Jackson district who were involved in auditing or supervising the audits of the 28 taxpayers. They told us that the taxpayer's involvement in civil rights activities and/or the taxpayer's race would have no bearing on their actions or decisions, except for one employee who said that blacks often have inadequate records, another who said that examiners have to be careful not to take advantage of older blacks because they tend to agree to anything, and four who said that if they knew a taxpayer was involved in civil rights activities they would worry about possible ramifications--being falsely accused of harassment.

The employees said unanimously that they had never been instructed to take any special action against or in favor of blacks and/or civil rights activists, and that they were unaware of anyone else having received such instructions.

Of the 22 employees, 19 said they knew of no examiner or group manager who treated blacks and/or civil rights activists differently from other taxpayers, and they had no reason to believe that anyone in the Audit Division had harassed blacks or activists. Two employees said that blacks are treated differently by some examiners, but not in the form of harassment. One employee noted, for example, that an examiner may address a white taxpayer by his last name but address a black taxpayer by his first name. A third employee said that blacks are probably treated more leniently because they cannot afford a representative.

TAXPAYERS MAY HAVE
REASON TO FEEL HARASSED

We wrote 22 of the 28 taxpayers 1/ asking them for any information about their audit experiences that might be helpful to us in investigating the charges of harassment. Three taxpayers responded.

One said that he felt harassed because he had been audited 2 years in a row; another said that his name was often in the papers and he could have easily fallen victim to IRS scheming, but that he had no direct proof that he was victimized by unlawful or otherwise improper procedures; the third said that (1) he was audited three times in the 1970s, (2) it took more than 2 years for him to successfully appeal IRS' position on a particular issue, (3) the audits took a lot of time and cost him hundreds of dollars in accounting fees, and (4) he was convinced that IRS purposely delayed his audits.

Although we saw no evidence of any effort or intent by IRS to harass the 28 taxpayers, we can understand why some of them might feel harassed as a result of their personal audit experiences.

1/We did not send questionnaires to six taxpayers because (1) we had reason to believe, at the time, that five of the taxpayers for whom we had addresses were not the same five taxpayers cited in the article and (2) we did not want to risk interfering in ongoing litigation involving a sixth taxpayer.

A taxpayer might understandably feel harassed when

--he provides what he believes to be adequate support for his deductions or exemptions only to be told that the support is inadequate,

--he comes back with more support only to be thwarted again,

--he finds himself in a position of trying to support a return prepared by his since-deceased spouse,

--the examiner disallows a deduction that the taxpayer believes he is entitled to and the taxpayer has to spend a considerable amount of time and money to appeal his case,

--his audit drags on for months, or

--he is audited for 2, 3, or more years in succession.

None of these situations, however, is unique to the audits in question; they can occur anytime. Likewise, a feeling of harassment would not be unique to the 28 taxpayers. During our review of repetitive audits in California, Delaware, Kansas, Missouri, Nevada, and Pennsylvania, we noted several complaints from taxpayers about being audited repeatedly. ^{1/} During our review of IRS' audit of individual income tax returns, we asked taxpayers in California, Louisiana, Maryland, Washington, D.C., and Wyoming about their audit experiences. Of the taxpayers in those areas who experienced a district audit, 7 percent felt they were treated discourteously or somewhat discourteously, 21 percent felt that IRS had little regard for the taxpayer's position during the audit, and 18 percent considered the effort needed to gather documentation for the audit unreasonable or somewhat unreasonable. Although we did not ask those taxpayers specifically about harassment, several volunteered the opinion that IRS harasses taxpayers and/or subjects them to unnecessary audits, IRS employees are discourteous, and/or the audit process is untimely.

CONCLUSIONS

Our review of audit procedures and results disclosed no evidence of an organized effort or intent by IRS to harass the 28 taxpayers.

^{1/}"Repetitive IRS Audits of Taxpayers are Justified" (GGD-77-74, Nov. 18, 1977).

Contrary to the inferences drawn in the news article, the fact that only three audits resulted in additional tax of more than \$2,000 does not indicate harassment. In fact, the average tax change resulting from the audits in question was consistent with the average tax change of all IRS audits. Likewise, the article erred in attempting to show harassment by noting that the audits did not disclose any indications of serious taxpayer misconduct. The primary purpose of an audit is to verify a person's reported tax liability, not to uncover fraud or "serious misconduct."

To say that we found no evidence of any organized effort or intent to harass, however, is not to say that none of the 28 taxpayers had reason to feel harassed. Because no one enjoys being audited or being told he owes more taxes and because audits are conducted in an adversary atmosphere, it is easy to understand why a taxpayer might feel harassed even if the examiner did nothing improper. Indeed, it is not unreasonable to assume that an examiner may, on occasion, go beyond the limits of propriety, and contrary to policy, harass a taxpayer. It would be difficult for any organization with 85,000 employees, like IRS, to assure proper conduct by all of its employees all of the time.

The article did not allege, however, that a particular examiner harassed a particular taxpayer during a particular audit. The article alleged that IRS, as an organization, purposely used its audit authority to harass Mississippi civil rights activists. We found no evidence to support that allegation.

CHAPTER 5

NO EVIDENCE OF HARASSMENT

IN INTELLIGENCE-GATHERING ACTIVITIES

Except for reference to one taxpayer being prosecuted, the news article said nothing about the involvement of IRS' Intelligence Division or other IRS information-gathering activities in the alleged harassment. We felt it necessary, however, to expand our investigation to cover this area because it directly affects and is directly affected by IRS' audit activity.

A sizable portion of the Intelligence Division's workload is generated by audit referrals. As noted in chapter 4, 2 of the 28 taxpayers had their audit cases referred to Intelligence. Conversely, the Intelligence Division's information-gathering activities can lead to audits. We reviewed those activities in Jackson, therefore, to determine (1) if the 28 taxpayers were subjected to unusual or concerted intelligence gathering and (2) if any of the taxpayers' audits were generated by or somehow influenced by such activity.

We also reviewed the files accumulated by the since abolished Special Services Staff ^{1/} to determine what information, if any, had been gathered on the 28 taxpayers and whether any of their audits were generated or influenced by that information.

Although some of the taxpayers were the subjects of intelligence gathering, we saw no evidence that audits were improperly generated or affected by that activity.

INFORMATION GATHERING BY THE INTELLIGENCE DIVISION

To evaluate the extent and propriety of Intelligence Division activities involving the 28 taxpayers, we reviewed

^{1/}According to the final report of the Senate Select Committee to Study Governmental Operations with Respect to Intelligence Activities, the Special Services Staff was not an Intelligence Division project but was a centralized information gathering project in which some of the information gathered was transmitted to the field for action.

information items received and information-gathering efforts initiated during the years in question. Our review included, but was not limited to, records and files related to or collected under the since-abolished Intelligence Gathering and Retrieval System and Joint Compliance Program.

In reviewing those activities, we drew on knowledge of the Intelligence Division gained during our review of IRS' use of confidential informants 1/ and our ongoing review of IRS' intelligence activities nationwide.

We found information in the Intelligence Division's files on three taxpayers who had names similar to the persons cited in the news article--two that we know are the same persons referred to in the article and one that we are unsure of.

<u>Type of activity</u>	<u>Number of taxpayers</u>
Information items	3
Information gathering:	
Intelligence Gathering and Retrieval System	1
Joint Compliance Program	-
Other	-
Total	<u>a/4</u>

a/Total exceeds three because one taxpayer showed up in two files.

Information items

An information item is an allegation received from a private citizen, a Federal agency, or some other source that a particular individual, group or business has violated the tax laws. Although the Intelligence Division receives many such items, most are of no value to IRS. In fiscal year 1976, for example, the Intelligence Division disposed of 207,900 items nationwide--9,900 were determined to have intelligence potential; 39,500 were referred to the Audit and Collection Divisions for their evaluation; and 158,500 were determined to have no intelligence, audit, or collection potential.

1/"Internal Revenue Service's Controls Over the Use of Confidential Informants: Recent Improvements Not Adequate" (GGD-77-46, Sept. 1, 1977).

We found six information items on three taxpayers with names similar to the names cited in the article--two that we know are the same taxpayers referred to in the article and one that we are unsure of. Three of the items came from anonymous public sources, one came from a Federal agency, and one was prepared by an Intelligence Division employee based on a newspaper article. We do not know the source of the other item. Of the six items, three were determined to have no audit or intelligence potential, one generated an audit (see p.11), and two may have generated or influenced an audit. (This is one of the two audits shown on p. 9 for which we could not identify the reason for selection.)

Intelligence Gathering and Retrieval System

The Intelligence Gathering and Retrieval System was implemented nationwide in May 1973 to provide an effective, uniform means of gathering, evaluating, crossindexing, and retrieving intelligence data. The system was officially discontinued in June 1975 after IRS' Internal Audit Division reported problems relating to supervisory control over information entering the system, retrieval and evaluation of information, and compliance with instructions. At the time it was discontinued, the system contained information on about 465,000 names.

Although the system was discontinued, the Jackson district still had the files it had accumulated when the system was operational and a manual index to those files. We found information in those files on one taxpayer; we found no evidence that the information led to or affected the taxpayer's audit.

Joint Compliance Program

The Joint Compliance Program was a nationwide, coordinated Audit/Intelligence effort directed at identifying geographical areas and occupational groups in which noncompliance with the Internal Revenue laws and regulations existed. The Jackson district initiated 34 joint compliance projects between initiation of the Program and its termination in 1976. Of those projects, we identified two that, by their nature, might have involved some of the 28 taxpayers. We reviewed the files relating to and information accumulated under those two projects and found no reference to any of the taxpayers.

OTHER IRS INFORMATION-
GATHERING ACTIVITIES

The Special Services Staff, which operated between August 1969 and August 1973, has been the subject of much discussion in the last few years.

In a June 1975 report, the staff of the Joint Committee on Taxation noted that the purpose of the Special Services Staff was to coordinate IRS' compliance activities involving

"ideological, militant, subversive, radical, and similar type organizations; to collect basic intelligence data; and to insure that the requirements of the Internal Revenue Code concerning such organizations have been complied with."

The report noted that the Staff, which operated out of IRS' national office,

"* * * generally operated by receiving information from other investigative agencies and congressional committees, establishing files on organizations and individuals of interest, checking IRS records on file subjects, and referring cases to the field for audit or collection action."

The report pointed out that at the time it was disbanded, the Special Services Staff had compiled 11,458 files on individuals and organizations and had referred about 250 cases to the field. The report noted that:

"Based on a random sample of the files examined by the Staff, approximately 41 percent of the [Special Services Staff] files are on Black (and ethnic) organizations associated with violence, confrontations and civil disturbance (as well as some not associated with such activities) and their leaders, employees, and members."

The Commissioner of Internal Revenue abolished the Special Services Staff because he believed its activities were "antithetical" to proper tax administration.

We reviewed the files accumulated by the Special Services Staff and found information on seven taxpayers whose

names matched the names of taxpayers cited in the article-- four that we know are the same taxpayers referred to in the article and three that we are unsure of. The information consisted primarily of FBI reports and newspaper articles, which is consistent with the Joint Committee staff's findings.

Because any inquiry into IRS's basis for collecting the information on these seven taxpayers would require a detailed investigation into the Special Services Staff, which the Joint Committee staff has already done, we limited our review to the question of whether any of that information led to or played any part in the audits of those taxpayers. We found no evidence that it did; we found no evidence, in fact, that any of the information on those seven taxpayers had been referred to the field.

CONCLUSIONS

Except for the Special Services Staff, we found no evidence of any unusual accumulation of information on the 28 taxpayers. We did not attempt to evaluate whether IRS had a valid basis for gathering the information it did, because that kind of inquiry gets to the heart of IRS intelligence-gathering activities. The Joint Committee had addressed that issue in its review of the Special Services Staff and we are addressing that issue in our ongoing review of IRS intelligence activities nationwide. Certainly the reasons for abolishing the Special Services Staff and the Intelligence Gathering and Retrieval System raise questions about IRS' basis for gathering data in the past, but those questions would affect thousands of taxpayers, not just the 28 cited in the news article.

We saw no deviation from normal procedures in how IRS obtained the information it had or how it used that information. Even the way the Special Services Staff obtained and used the information it had on the seven taxpayers was consistent with its normal procedures, as outlined by the Joint Committee staff.

More importantly, we saw no evidence that any audit was improperly generated or affected by the information gathered.

APPENDIX I

CHARLES A. VANIK, OHIO, CHAIRMAN
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APPENDIX I

NINETY-FOURTH CONGRESS

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J. P. BAKER, ASSISTANT CHIEF COUNSEL
JOHN K. MEASNER, MINORITY COUNSEL

SUBCOMMITTEE STAFF
LAWRENCE J. ROSS, COUNSEL

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, D.C. 20515

SUBCOMMITTEE ON OVERSIGHT

December 13, 1976

Honorable Elmer B. Staats
Comptroller General
General Accounting Office
Washington, D. C. 20548

Dear Mr. Staats:

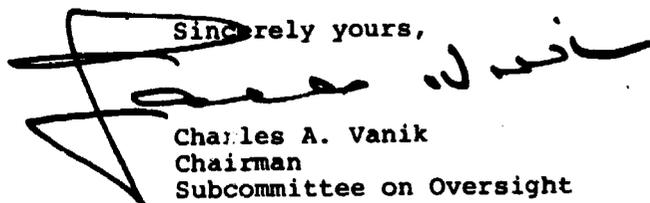
Enclosed is a file of correspondence between the Ways and Means Oversight Subcommittee, Representative Charles Rangel of New York, and the Internal Revenue Service regarding a series of charges by investigative reporter Jason Berry (Mr. Berry's articles are enclosed).

As my letter to Rep. Rangel of November 23rd explains, the IRS' use of the mails to transmit a particular report has resulted in a potential disclosure situation.

The issues in Mr. Berry's articles involve IRS audit selection-- a subject of two recent reports by the General Accounting Office. Therefore, I would like to request your Office's assistance in examining the September 25, 1976 letter from the IRS (available in the office of the Commissioner's Special Assistant, Mr. Tom Glynn) to determine whether it answers, to the satisfaction of the GAO, the charges raised by Mr. Berry. If you believe additional information is necessary to determine whether certain tax returns may have been selected as part of racial harassment, I would like to request your assistance in requesting the information from the IRS and evaluating it.

Thank you for your assistance in this matter.

Sincerely yours,



Charles A. Vanik
Chairman
Subcommittee on Oversight

CAV/jee

Encl.

GAO note: The enclosure referred to in this letter has not been included as part of this appendix.

Honorable W. Michael Blumenthal

Page 2

provided by the GAO will be maintained in a secure manner by the Subcommittee.

Thank you for your assistance in this matter.

Sincerely,



Al Ullman
Chairman

AU:eb

PRINCIPAL OFFICIALS RESPONSIBLE FORADMINISTERING ACTIVITIESDISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
SECRETARY OF THE TREASURY:		
W. Michael Blumenthal	Jan. 1977	Present
William E. Simon	Apr. 1974	Jan. 1977
George P. Shultz	June 1972	Apr. 1974
John B. Connally	Feb. 1971	June 1972
David M. Kennedy	Jan. 1969	Feb. 1971
COMMISSIONER OF INTERNAL REVENUE:		
Jerome Kurtz	May 1977	Present
William E. Williams (acting)	Feb. 1977	May 1977
Donald C. Alexander	May 1973	Feb. 1977
Raymond F. Harless (acting)	May 1973	May 1973
Johnnie M. Walters	Aug. 1971	Apr. 1973
Harold T. Swartz (acting)	June 1971	Aug. 1971
ASSISTANT COMMISSIONER (COMPLIANCE):		
Singleton B. Wolfe	Mar. 1975	Present
Harold A. McGuffin (acting)	Feb. 1975	Mar. 1975
John F. Hanlon	Jan. 1972	Jan. 1975
John F. Hanlon (acting)	Nov. 1971	Jan. 1972
Donald W. Bacon	Sept. 1962	Nov. 1971
DISTRICT DIRECTOR, JACKSON, MISSISSIPPI:		
William Daniel	Oct. 1973	Present
Richard J. Stakem	Aug. 1972	Sept. 1973
John W. Henderson	Oct. 1971	July 1972
James G. Martin, Jr.	Jan. 1964	Sept. 1971

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