GAO Accountability • Integrity • Reliability

Highlights

Highlights of GAO-10-968, a report to the Committee on Finance, U.S. Senate

September 2010

TAX GAP

IRS Can Improve Efforts to Address Tax Evasion by Networks of Businesses and Related Entities

Why GAO Did This Study

A taxpayer can control a group of related entities—such as trusts, corporations, or partnerships—in a network. These networks can serve a variety of legitimate business purposes, but they also can be used in complex tax evasion schemes that are difficult for the Internal Revenue Service (IRS) to identify.

GAO was asked to (1) describe what IRS knows about network tax evasion and how well IRS's traditional enforcement programs address it and (2) assess IRS's progress in addressing network tax evasion and opportunities, if any, for making further progress. To do this, GAO reviewed relevant documentation about IRS programs and interviewed appropriate officials about those programs and IRS's plans for addressing such tax evasion. GAO also interviewed relevant experts and agency officials in developing criteria needed to perform the assessment.

What GAO Recommends

Among other items, GAO recommends that IRS establish an IRS-wide strategy that coordinates its network tax evasion efforts. Also, IRS should assess its network programs and tools and should evaluate adding more data to its current tools. IRS generally agreed with these recommendations and noted additional organizational changes the agency is making that will address networks.

View GAO-10-968 or key components.
For more information, contact James White at (202) 512-9110 or whitej@gao.gov.

What GAO Found

IRS views network-based tax evasion as a problem but does not have estimates of the associated revenue loss in part because data do not exist on the population of networks. IRS does know that at least 1 million networks existed involving partnerships and similar entities in tax year 2008. IRS also knows that many questionable tax shelters and abusive transactions rely on the links among commonly owned entities in a network.

IRS generally addresses network-related tax evasion through its examination programs. These programs traditionally involve identifying a single return from a single tax year and routing the return to the IRS division that specializes in auditing that type of return. From a single return, examiners may branch out to review other entities if information on the original return appears suspicious. However, this traditional approach does not align well with how network tax evasion schemes work. Such schemes can cross multiple IRS divisions or require time and expertise that IRS may not have allocated at the start of an examination. A case of network tax evasion also may not be evident without looking at multiple tax years.

IRS is developing programs and tools that more directly address network tax evasion. One, called Global High Wealth Industry, selects certain high-income individuals and examines their network of entities as a whole to look for tax evasion. Another, yK-1, is a computerized visualization tool that shows the links between entities in a network. These efforts show promise when compared to GAO's criteria for assessing network analyses. They represent new analytical approaches, have upper-management support, and cut across divisions and database boundaries. However, there are opportunities for more progress. For example, IRS has no agencywide strategy or goals for coordinating its network efforts. It has not conducted assessments of its network tools, nor has it determined the value of incorporating more data into its network programs and tools or scheduled such additions. Without a strategy and assessments, IRS risks duplicating efforts and managers will not have information about the effectiveness of the new programs and tools that could inform resource allocation decisions.

Network Scheme Example: Installment Sale Bogus Optional Basis Transaction (iBOB)

An iBOB is an example of a network-related tax evasion scheme that shows how networks pose enforcement challenges for IRS. In an iBOB, a taxpayer uses multiple entities, all owned or controlled by the taxpayer, to artificially adjust the basis of an asset to evade capital gains taxes. The scheme can involve multiple transactions and take place over many tax years, making it difficult for IRS to detect. A short video illustrating an iBOB is available at http//:www.gao.gov/products/GAO-10-968.