

# Practice

## IRS Audit Selection and Classification Processes

*By Charles P. Rettig*

The U.S. Government Accountability Office (GAO) recently released two reports reviewing the processes and controls used by the IRS for selecting tax returns for audit.<sup>1</sup> The IRS performs audits to help improve overall reporting compliance and reduce the “tax gap”—the difference between taxes owed and those voluntarily paid on time, which is estimated at \$385 billion annually after late payments and enforcement actions.<sup>2</sup> Audits directly detect and correct noncompliance by the audited taxpayers and indirectly create an environment to encourage nonaudited taxpayers to comply voluntarily. The presence and visibility of the IRS among varying taxpayer communities create an inherent deterrent effect to those who might otherwise ignore their filing and reporting requirements. An empty police car parked in a visible location will cause people to slow down or stop, where appropriate.

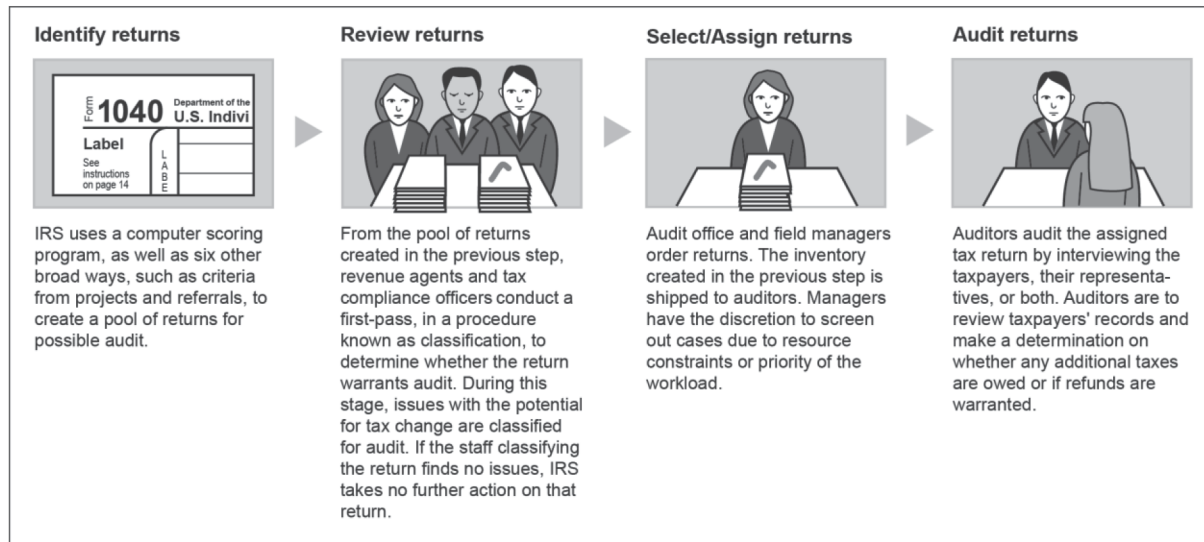
In November 2014, the IRS realigned its tax compliance divisions serving individual and small business taxpayers to improve efficiency and better identify emerging compliance issues while streamlining their decision-making processes. The realignment changed the taxpayer groups audited by both the Wage and Investment (W&I) division and Small Business and Self-Employed (SB/SE) division. W&I retained examinations focused on the Earned Income Tax Credit (EITC). Most post-refund discretionary programs moved from W&I to SB/SE except EITC post-refund work. Under the IRS realignment, W&I also became responsible for returns reporting income on Schedule C, Profit or Loss from Business. SB/SE’s enforcement responsibilities include auditing individual and business tax returns including 41 million self-employed individuals, nine million small corporations and seven million other taxpayers. SB/SE conducts audits through field offices located in seven regional areas.<sup>3</sup>

The IRS field audits generally are conducted by meeting with the taxpayer and/or his or her representatives. The field auditors include revenue agents who tend to audit the most complex returns and tax compliance officers who tend to audit simpler returns. The IRS also conducts audits through its four campuses—formerly called “service centers”—which are facilities where the IRS performs various operations, such as processing tax returns, handling taxpayer calls and conducting correspondence audits. Campus audits tend to be the



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FIGURE 1



simplest and are generally done by tax examiners through correspondence with the taxpayers.

The IRS generally selects potentially noncompliant tax returns for audit using a multiphase process intended to narrow the large pool of available returns to those that most merit investment of limited audit resources. For audits to be conducted in the field, this process generally includes (1) identifying an initial inventory of tax returns that have audit potential (*e.g.*, reporting noncompliance), (2) reviewing that audit potential to reduce the number of returns that merit selection for audit (termed “classification”), (3) selecting returns by assigning them to auditors based on a field manager’s review of audit potential given available resources and needs and (4) auditing selected returns. For campus audits, returns generally are not further reviewed by managers before starting the audit. Once returns are selected for audit, taxpayers are notified, and auditors are assigned the return after taxpayers respond. *See* Figure 1.

In addition to audits, the IRS conducts nonaudit “compliance checks,” which may lead to an audit. These checks include the Math Error, Automated Underreporter (AUR) and Automated Substitute for Return (ASFR) programs. The Math Error program electronically reviews tax returns as they are filed for basic computational errors or missing forms/schedules. Several months after returns have been filed, AUR electronically matches information reported by third parties, such as banks or employers, against the information that taxpayers report on their tax returns. This matching can identify potentially underreported income or unwarranted deductions or tax credits. ASFR also uses information return data to identify nonfilers;

constructs substitute tax returns for certain nonfilers; and assesses tax, interest and penalties based on those substitute returns.

## SB/SE Audit Selection Processes

Nearly 40 percent, or \$179 billion, of the tax gap can be attributed to the underreporting of both business income on individual income tax returns and the self-employment tax that is largely assessed on business income for self-employed taxpayers. An additional four percent of the tax gap, or \$19 billion, is attributed to underreporting by small corporations having less than \$10 million in assets. For fiscal year (FY) 2013, the IRS reported that SB/SE’s primary work-stream for field audits identified about 1.6 million returns as potentially most noncompliant—about 77,500 returns (five percent) were selected for audit, a much smaller pool of returns than was initially identified.<sup>4</sup> In FY 2014, SB/SE closed 823,904 audits, representing more than half of nearly 1.4 million closed audits across the IRS in FY 2014. Further, SB/SE audits resulted in over \$12 billion of the \$33 billion in total recommended additional taxes across all the IRS audits.<sup>5</sup>

The GAO report found that the SB/SE uses 33 separate methods, called “work-streams,”<sup>6</sup> to identify and review filed tax returns that may have significant audit potential. SB/SE initially identifies returns through seven sources which include referrals; computer programs that run filters, rules or algorithms to identify potentially noncompliant taxpayers; and related returns that are identified in the course of another audit. These sources are further identified as:

- *Referrals.* Service employees and units, as well as external sources, such as other agencies and citizens, can refer potentially noncompliant taxpayers to SB/SE. SB/SE may start an audit if the referral indicates significant potential for noncompliance. Referrals can involve, among others, those promoting shelters created to avoid taxation, whistleblowers and those not filing required tax returns. Referrals of nonfilers can come from the IRS staff, such as those involved with collecting unpaid tax debts, and from automated systems.
- *Related pickups.* After opening an audit, SB/SE may identify the taxpayer's prior- or subsequent-year returns or returns of related taxpayers to audit.
- *User-developed criteria.* These criteria use filters or rules embedded in computer software to identify returns with specific characteristics, often for projects. These characteristics generally involve a specific tax issue known or suspected to have high noncompliance in a particular geographic area, industry or population. For example, the criteria may be used for projects that explore or test ways to uncover noncompliance or improve compliance.
- *Computer programs.* Computer programs use rules or formulas to identify potential noncompliance across a type of tax return, rather than for a specific tax issue. For example, the IRS uses a computer algorithm, the discriminant function (DIF),<sup>7</sup> to determine the probability of noncompliance somewhere on the tax return. When a return receives a high-enough score, SB/SE may review the return for audit potential.
- *Data matching.* When information on a tax return—such as wages, interest and dividends—does not match information provided to the IRS by states, employers or other third parties, these discrepancies may prompt SB/SE to review returns for audit potential. An example of a work-stream that uses data matching is the payment card income pilot, which uses information from credit card transactions to identify income that may be underreported.
- *Taxpayer-initiated.* When taxpayers contact the IRS to request an adjustment to their respective tax returns, tax refunds or tax credits or request to have a previous audit reconsidered, SB/SE may initiate an audit after reviewing the request.
- *Random identification.* The National Research Program (NRP) studies tax compliance through audits of a randomly identified sample of tax returns. Specifically, NRP measures voluntary compliance in reporting income, deductions and credits, among other categories, and generalizes those measures to the population being studied. The IRS uses NRP data to

measure taxpayer compliance for strategic planning and budget purposes and to estimate the tax gap and update formulas used to identify tax returns for potential audits.

## W&I Audit Selection Process

GAO found that three offices in the W&I are responsible for selecting tax returns that may have significant audit potential. W&I audited more than 516,000 individual tax returns in FY 2014—accounting for 42 percent of the IRS's efforts to review individual taxpayers' returns in terms of overall audit volume. The IRS has previously estimated that for tax year 2006, the net tax gap of \$385 billion included \$235 billion from underreporting of individual income tax. At the end of FY 2015, W&I had approximately 47 tax compliance officers and 683 tax examiners of which about 584 conducted correspondence audits and the others did support work, including audit reconsiderations.

All W&I audits are correspondence audits—an audit conducted through mailed correspondence between the IRS and the taxpayer being audited. Audit programs in W&I mainly cover refundable credits reported on the Form 1040, *Individual Income Tax Return*. A refundable credit can give taxpayers a refund even if they owe no tax and are not otherwise required to file a tax return. Non-refundable credits also can reduce taxpayers' tax, but any excess is not refunded.

Most W&I returns are selected *via* computer systems that automatically send notices to taxpayers based on certain criteria, such as the validity of dependents. In FY 2014, about 59 percent of all W&I audits—more than 516,000—were selected with a specialized computer tool called the Dependent Database (DDb), while the remainder were selected through a combination of referrals and manual selection methods.

W&I's audit programs are managed out of an office called Return Integrity and Compliance Services (RICS), which operates three other offices that directly or indirectly review tax return data for potential audits. These other three offices include:

- *Refundable Credits Policy and Program Management (RCPPM).* The main tools RCPPM uses for selecting returns for audit are filters from the DDb.<sup>8</sup> These filters identify returns and use risk-based scoring to select the returns. DDb creates the scores after W&I enters tax return data but before refunds are issued. Scoring criteria include the use of taxpayer's dependent information, such as related children data, qualifying children claimed with multiple taxpayers,

birth parents and birth parents' Social Security numbers and dates of birth. If information from a tax return creates a sufficiently high score, the return may be made available for audit in Refundable Credits Examination Operations. If the return is audited, letters will systemically be issued to the taxpayers asking them to explain an issue or issues on the tax return.

- *Deputy Director's Return Integrity, and Compliance Services.* This office operates the Integrity and Verification Operations (IVO), which is not an audit program, but may refer returns with refundable credits for audit. IVO uses several computer systems, including DDb, to identify potential fraud and refund abuse across many types of taxes, including refundable credits. W&I annually reviews tolerances that IVO uses to search tax return data for potential fraud, abuse or other noncompliance. IVO also has a program that processes leads from external stakeholder partners, such as financial institutions, state agencies or other third parties. This program focuses on stopping fraudulent refunds from issuing and/or recovering fraudulent refunds that were issued and are identified *via* external sources.
- *Refundable Credits Examination Operations.* The Refundable Credits Examination Operations office performs classification duties and conducts audits. In W&I, classification is conducted on Form 1040x Amended Return submissions or returns that were referred from other parts of the IRS. These returns generally do not meet existing DDb criteria for return selection or were paper-filed amended returns submitted to the IRS. Referrals from other IRS business units are one of IRS's priority audit categories, which also includes new employee audits and mandatory work, such as nationally coordinated research projects. Once a classifier classifies the return and identifies the issues, the letter is generated and the audit is started. This inventory is not assigned to an auditor until correspondence is received. In some cases, W&I classifiers may send a return to another business unit, such as SB/SE. W&I also classifies returns filed with an Individual Tax Identification Number (ITIN) to check for tax noncompliance. For example, returns that are filed with an ITIN and that meet audit referral criteria for the refundable Additional Child Tax Credit are set aside for classification.

## Classification of Returns Selected for Audit

"Classification" is the process of experienced IRS examiners determining whether a return has potential

noncompliance, what issues should be examined and how the examination should be conducted.<sup>9</sup> Due to extremely limited resources, the IRS can actually only examine a small percentage of the returns filed. As such, the classifier's role is extremely important to ensure that these resources are used effectively.

Tax returns are selected and classified for audit by examiners who will not later be the examiner of the return. Classifiers use their technical expertise, local knowledge and experience to identify hidden, as well as obvious, issues. Classifiers also consider whether the taxpayer has insufficient income for the lifestyle indicated on the return, including efforts to determine family size and personal living expenses in relationship to the income stated on the return.

Classifiers generally consider the materiality of the potential audit issues within the return. Materiality includes the comparative size of the item within the return; the inherent character of the item—although the amount of an item may be insignificant, the nature of the item may be significant, *e.g.*, airplane expenses claimed on a plumber's Schedule C; evidence of intent to mislead—which may include missing, misleading or incomplete schedules or incorrectly showing an item on the return; the beneficial effect of the manner in which an item is reported—expenses claimed on a business schedule rather than claimed as an itemized deduction may be significant; relationship to other item(s) on the return—business expenses without corresponding income or a lack of reported dividends reported when Schedule D shows sales of stocks; permanency of the potential adjustment (a permanent adjustment is more material than one that will reverse itself in subsequent years); and timing adjustments—the longer the deferral/acceleration period, the more material the item.<sup>10</sup>

The classifier determines whether the return should be examined, and if so, whether by a tax examiner or revenue agent. Returns not selected for examination are accepted as filed. Returns selected for audit will be identified for assignment to a revenue agent or tax examiner based on the complexity of the issues involved, the degree of accounting and auditing skills required to conduct a quality examination and whether it can be effectively done by correspondence.<sup>11</sup> The planned time of an examination of a business return in office examination is substantially less than the planned time for field examination. The classifier will not exclude substantial issues as identified issues to convert what would be a revenue agent assignment, to a tax compliance officer assignment. Office examinations usually do not involve a visitation to the taxpayer's place of business. Field examinations often require a more in-depth knowledge of accounting principles.

Items that will generally lead to a field examination conducted by a revenue agent include issues that require on-site inspection of the taxpayer's books, records or assets; complex Schedule D transactions; returns with unusually complex rental income and expenses; tax shelter issues; donations of real property that would involve an engineering specialist; and alimony, if it appears there is a property settlement involving business property (*e.g.*, accounts receivable, inventory).<sup>12</sup> Business returns are often selected for field examination when there are anticipated voluminous records, a complex accounting method is involved, extensive time anticipated to complete the audit, an on-site inspection of business is advisable, inventories are substantial and material, the business activities have been terminated before the end of the tax year and issues that appear to be complex and time consuming to develop.

Individual returns identified for office examinations generally contain issues that require individual judgment in addition to direct verification of records. The number of issues for an office examination will generally be limited to no more than three or four and frequently include claimed dependency exemptions; income from tips, pensions, annuities, rents, fellowships, scholarships, royalties, and income not subject to withholding; deductions for business-related expenses; deductions for bad debts; determinations of basis of property; deductions for education expenses; capital gain versus ordinary income determinations; complex miscellaneous itemized deductions such as casualty and theft; losses where determinations of fair market value are required; and deductions for employees business expenses such as travel and entertainment.

Classifiers use various guidelines when identifying individual returns issues for examination. They will review the amount by which the itemized deductions exceed the standard deduction and verify that itemized deductions are not claimed elsewhere on the return when the standard deduction has been elected (*e.g.*, personal real estate taxes and mortgage interest deducted on rental schedule). Exemptions claimed by the noncustodial parent often have a significant audit potential. When married persons file separately, both taxpayers may not have made the same election for standard or itemized deductions. If dependent children are claimed, there will be an effort to determine whether the other spouse might also be claiming them.

Changes in address will be considered when reviewing real estate taxes (*e.g.*, Form W-2, *Wage and Tax Statement*, Form 1040 and Form 2119). Classifiers will check to see if charitable contributions exceed 50 percent of adjusted gross income (AGI), large donations made to questionable miscellaneous charities, payments that may represent tuition and large dollar noncash contributions. Gains

on sales of rental and other depreciable property, where the taxpayer has been using an accelerated method of depreciation, are often questioned since the taxpayer may have to report ordinary income. Loss on the sale of rental property, recently converted from a personal residence, is also a frequent issue. Current-year installment sales and exchanges of property are also scrutinized given the potential errors in computing the recognized gain. There may also be issues to determine whether the reported gain is large enough to require the alternative minimum tax computation.<sup>13</sup>

When reviewing issues involving rental properties, the classifier will consider whether repairs might instead be capital improvements, whether the cost of land is included in the basis and consider passive activity rules if rental losses are greater than \$25,000. In searching for potential unreported income, the classifier might look to determine whether the income is sufficient to support the claimed exemptions; tip income for those having a stated occupation as waiter, cab driver, porter, beautician, *etc.*, tip income is a productive issue; substantial interest expenses with no apparent source of funds to repay the loans; claimed business expenses for an activity that shows no income on the return (*e.g.*, beautician supplies, but no Form 1099 or Form W-2, for that occupation). Expenses for clubs, yachts, airplanes, *etc.*, are often productive audit issues as failing to satisfy the facilities definition of Code Sec. 274. Claimed employee business expenses should be reasonable when compared to the taxpayer's occupation and income level.

## Importance of Disclosures Within the Return

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The IRS return selection and classification processes support careful consideration of including an appropriate disclosure within the return to be filed. Practitioners are well aware of the general penalty avoidance afforded by attaching an appropriate disclosure on Form 8275 or Form 8275-R (if a return position is contrary to a regulation) summarizing potentially questionable positions set forth within the return. Further, entries within the return can sometimes be sufficient to satisfy the disclosure requirements, if set forth in the proper manner.<sup>14</sup>

The selection and classification review process is designed to ferret out items having a significant audit potential. The most efficient examinations for both the IRS and the taxpayer are those that do not occur or are limited in nature and scope. If otherwise significant or questionable items are appropriately disclosed and clearly explained

with the return, the review process might actually serve to avoid an examination. In this regard, when appropriate, the disclosure process affords a valuable opportunity for

the taxpayer and their representative to lead the classifier to possibly accept the return as filed or limit the nature and scope of any examination.

## Exhibit 1. Description of Small Business/Self-Employed (SB/SE) Selection Methods or Workstreams<sup>1</sup>

1. Area Office Referral - Area office field personnel refer potential leads with correspondence audit issues to Campus Reporting Compliance (CRC).
2. Audit Information Management Systems (AIMS)/AIMS Computer Information System (A-CIS)/Previously Adjusted Exam Issues on Subsequent-year Filings - Quarterly A-CIS reports are run to identify every campus case closed agreed or default in each of the discretionary audit programs. The subsequent year returns are classified for the same issues that are on the closed audit cases.
3. Audit Reconsideration - Reevaluates the results of a prior audit where additional tax was assessed and remains unpaid, or a tax credit was reversed. IRS also uses the process when the taxpayer contests a Substitute for Return determination by filing an original delinquent return.
4. Campus Reporting Compliance (CRC) Compliance Initiative Project (CIP) Usage - CRC uses CIP Authorization (Form 13498) to document approval for testing potential new inventory in correspondence audits.
5. Category A Claims for Refund - Accounts Management staff refer claims for refunds that meet criteria indicating audit potential directly to Classification and Claim Teams within the campuses.
6. Criminal Investigation Referral - CRC uses IRS's databases to determine if the issues Criminal Investigation identified exist on the referred returns.
7. Claim - A request for refund or an adjustment of tax paid or credit not previously reported or allowed.
8. Collection Referral - CRC receives two kinds of referrals from collection each year. CRC receives three referrals yearly of potential nonfiler leads from the collection queue. CRC also receives occasional referrals of Form 3949 Information Item referrals.
9. Compliance Data Environment Release 3 - Identifies potential audits through user-defined filters and queries, and forwards those selected to the correct treatment stream.
10. Compliance Data Warehouse/Potential Unreported Heavy Use Tax - Identifies Form 2290 returns (Heavy Highway Vehicle Use Tax Return) with potential unreported heavy use tax.
11. Compliance Initiative Project (CIP) - When IRS identifies potential noncompliance in specific groups of taxpayers, CIPs are used to contact or audit taxpayers or collect taxpayer data within that group when another method to identify such workload is not already in place.
12. Discriminant Function (DIF) - A mathematical technique to estimate or "score" the potential merit of auditing a particular tax return based on its characteristics.
13. Discretionary Exam Business Rules (DEBR) - DEBR rules were developed to identify non-Earned Income Tax Credit returns with the highest audit potential for additional tax assessment for certain return conditions.
14. Employee Audit - Any employee selected for audit under any and all methods of inventory identification (e.g., DIF, referrals). It also includes inventory that is specifically identified based on the individual's position within IRS. Inventory identification is designed to ascertain compliance among IRS employees while maintaining their right to privacy.
15. Employment Tax Referral - Specialty tax personnel refer potential audit leads relating to possible unfiled payroll tax returns to CRC.
16. Estate & Gift Tax Form 1041 - Filters identify Form 1041 returns reporting charitable contributions, fiduciary fees, and other miscellaneous deductions.
17. Estate & Gift (E&G) Referrals - E&G tax personnel refer potential audit leads relating to possible unreported executor fees to CRC.

18. Government Liaison and Disclosure (GLD) Referrals - GLD personnel refer information to CRC from sources outside IRS, such as states and the Puerto Rican Tax Authority (see definition below), that are potential audit leads.
19. High Income Nonfiler - Strategy designed to address the filing compliance of taxpayers with known sources of income exceeding \$200,000.
20. Information Reports - Reports and referrals that may include information on substantial civil tax potential and significant potential for fraud, or are related to returns for tax years not yet required to be filed.
21. National Research Program (NRP) - A comprehensive effort by IRS to measure compliance for different types of taxes and various sets of taxpayers. It provides a statistically valid representation of the compliance characteristics of taxpayers.
22. Offers-In-Compromise/Doubt as to Liability - An offer in compromise is an agreement between the taxpayer and IRS that settles a tax debt for less than the full amount owed. Doubt as to liability exists where there is a genuine dispute as to the existence or amount of the correct tax debt under the law.
23. Payment Card Income Pilot - Potential underreporters are flagged when Form 1099-K receipts, as a portion of gross receipts, are significantly greater than for similar taxpayers, suggesting cash underreporting.
24. Promoter Investigations and Client Returns - SB/SE auditors, as well as other IRS or external sources, refer potentially abusive transaction promoters/preparers for audit. Client returns are audited to determine whether penalties and/or an injunction are warranted.
25. Puerto Rican Tax Authority Nonfiler - The Puerto Rican Tax Authority provides information to IRS through the Government Liaison Office about residents in Puerto Rico who fail to file their federal tax return.
26. Research Referral - Research personnel refer potential audit leads relating to NRP, possible nonfilers, and problem preparers to CRC.
27. Return Preparer Program Action Cases and Client Returns - Clients of questionable preparers are audited to determine whether preparer penalties and/or injunctive actions are warranted. These are limited to preparer misconduct or incompetence that is pervasive and widespread.
28. Submissions Processing - Submission Processing staff refer potential audit leads relating to the Alternative Minimum Tax program, math error, and unallowables to CRC or campus classifiers.
29. State Audit Referral Program (SARP) - SARP utilizes the audit report information submitted to IRS by various taxing agencies to address areas of noncompliance.
30. State/Other Agency Referral - Federal, state, and local governmental agencies share relationships and data with IRS through the Governmental Liaison staff to increase compliance levels, reduce the tax gap, reduce taxpayer burden, and optimize use of resources.
31. Treasury Inspector General for Tax Administration (TIGTA) Referral - TIGTA personnel refer potential audit leads relating to TIGTA investigations to CRC.
32. Tip Program Referral - Employees who do not report at or above the tip rate as agreed upon by the employer under various agreements with IRS may be referred for audit.
33. Whistleblower Claim - Allegations of violation of federal tax laws made by a person who requests a reward.

## (ENDNOTES)

1 GAO-16-103 (Dec. 2015), Appendix 3, available at [www.gao.gov/assets/680/674228.pdf](http://www.gao.gov/assets/680/674228.pdf).

## ENDNOTES

<sup>1</sup> IRS Return Selection: Wage and Investment Division Should Define Audit Objectives and Refine Other Internal Controls, GAO-16-102: Published: Dec. 17, 2015. Publicly Released: Jan. 13, 2016; IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened,

GAO-16-103: Published: Dec. 16, 2015. Publicly Released: Jan. 13, 2016.

<sup>2</sup> In January 2012, the IRS estimated that the gross tax gap was \$450 billion in tax year 2006 (the most current estimate available). The IRS estimated that it would eventually recover about \$65 billion of the gross tax gap through

late payments and enforcement actions, leaving an annual estimated net tax gap of about \$385 billion.

<sup>3</sup> North Atlantic, South Atlantic, Central, Midwest, Gulf States, Western and Southwest Regions. Campus examinations occur through the Brookhaven, Cincinnati, Memphis and Ogden Campuses.

- <sup>4</sup> IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened, GAO-16-103: Published: Dec. 16, 2015. Publicly Released: Jan. 13, 2016.
- <sup>5</sup> These data for all IRS audits exclude excise tax returns filed with the U.S. Customs and Border Protection and the Alcohol and Tobacco Tax and Trade Bureau; returns of tax-exempt organizations, government entities, employee retirement benefit plans and tax-exempt bonds; and information returns.
- <sup>6</sup> The 33 different SB/SE Selection Methods or Work-streams are separately and more specifically identified in Exhibit 1 to this column.
- <sup>7</sup> DIF as referenced in IRM 4.19.11.1.4, *Sources of Returns for Classification*, is a mathematical technique used to score income tax returns for examination potential. These formulas were

developed based on available NRP data. Each return measured under DIF receives a DIF score by assigning weights to certain basic return characteristics. Generally, returns with the highest DIF scores are screened for examination potential. The DIF system is able to computer score individual, corporate and S corporate (returns having no balance sheet or assets under \$10 million), partnership and fiduciary returns. DIF mathematical formulas are confidential in nature and are distributed to IRS personnel only on a need-to-know basis. See IRM 4.1.3.2.1

- <sup>8</sup> DDb is a system that uses a set of rules/criteria and scoring models along with internal and external data to evaluate tax returns to identify taxpayers who potentially do not meet eligibility requirements for the credit. This system scores returns daily and selects questionable returns for review/audit. The data include: 1) taxpayer

data from IRS, 2) child custody information from the Department of Health and Human Services, 3) the dependent and child birth information from the Social Security Administration, and 4) prisoner information from the National Prisoner File to determine the validity of the claims on tax credits and refunds.

- <sup>9</sup> The criteria that classifiers use to decide what issues should be sent for audit are generally set forth in IRM 4.1.5 and IRM 4.19.11 (IRM 4.19.11.1.2).
- <sup>10</sup> IRM 4.1.5.1.5.1.1 (Oct. 24, 2006).
- <sup>11</sup> IRM 4.19.11.1.3.
- <sup>12</sup> IRM 4.1.5.1.11.1.
- <sup>13</sup> *Id.*
- <sup>14</sup> The IRS annually issues revenue procedures updating the items considered properly disclosed within the return. The most recent disclosure procedure is Rev. Proc. 2015-16, IRB 2015-7, 596.

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