



**U.S. Department of the Interior
Office of Inspector General**

Audit Report

Follow-up of Recommendation Relating to Internal Revenue Taxes, Bureau of Internal Revenue, Government of the Virgin Islands





United States Department of the Interior

OFFICE OF INSPECTOR GENERAL

Eastern Regional Office
381 Elden Street - Suite 1100
Herndon, Virginia 20170

August 29, 2003

Honorable Charles W. Turnbull
Governor of the Virgin Islands
No. 21 Kongens Gade
Charlotte Amalie, Virgin Islands 00802

Subject: Audit Report "Follow-up of Recommendations Relating to Internal Revenue Taxes, Bureau of Internal Revenue, Government of the Virgin Islands" (No. 2003-I-0059)

Dear Governor Turnbull:

This report presents the results of our follow-up review of recommendations contained in the December 1997 audit report "Internal Revenue Taxes, Bureau of Internal Revenue, Government of the Virgin Islands" (No. 98-I-188).

The Legislation, as amended, creating the Office of Inspector General, (5 U.S.C. app. 3) requires that we report to the Congress semiannually on all reports issued, actions taken to implement our recommendations and recommendations that have not been implemented. Therefore, this report will be added to the next semiannual report. In addition, the Office of Inspector General provides audit reports to the Congress.

Please provide a response to this report by September 30, 2003. The response should provide the information requested in Appendix 4 and should be addressed to Mr. Roger La Rouche, Assistant Inspector General for Audits, Office of Inspector General, U.S. Department of the Interior, 1849 C Street, NW (MS-5341), Washington, DC 20240; with a copy to our Caribbean Field Office, Ron deLugo Federal Building, Room 207, St. Thomas, VI 00802.

Sincerely,

William J. Dolan, Jr.
Regional Audit Manager

cc: Director, Virgin Islands Bureau of Internal Revenue

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EXECUTIVE SUMMARY

Despite Improvements, Some Deficiencies Still Exist in the Administration and Collection of Taxes

The Bureau of Internal Revenue (the Bureau) administers and collects most types of taxes in the Virgin Islands, including individual and corporate income, gross receipts, trade and excise, hotel occupancy, highway user, production, gift, inheritance, and fuel taxes. In fiscal year 2001, the Bureau collected taxes totaling \$484.1 million and in fiscal year 2002, a total of \$476.2 million. More than 31,500 income tax refunds totaling \$62.9 million were issued in fiscal year 2001.

We found that of the 14 recommendations made in our December 1997 audit report "Internal Revenue Taxes, Bureau of Internal Revenue, Government of the Virgin Islands," six had been fully implemented, seven had been partially implemented, and one had not been implemented. While improvements were made in the Bureau's operations, some problems still existed, particularly issues concerning prior period tax returns.

- The Bureau implemented a new computerized tax system, based on the one used in Guam, as part of a Tax Administration Improvement Project being undertaken with contract assistance from the IBM Corporation. In addition, the Bureau was in the process of integrating the withholding and hotel occupancy tax modules onto its mainframe computer. However, the Bureau did not (1) integrate excise taxes into the new computer system in order to easily access and research a taxpayer's entire tax payment history, (2) reverse at least \$308,000 in payments from taxpayer accounts for checks that were not honored by the banks from June 2001 and prior, and (3) timely resolve errors detected in more than 3,000 tax returns from tax years 2000 and prior.
- The Bureau hired five tax revenue clerks to address taxpayer inquiries and handle delinquent taxpayer accounts with balances of less than \$15,000. However, they did not (1) take action to collect \$4.8 million from delinquent taxpayers, (2) take action to collect a total of \$408,000 from 68 delinquent accounts before the statute of limitations expired, (3) file liens and levies on delinquent taxpayers to serve as the government's claim against their property, and (4) provide required supporting documentation for tax

penalty waivers totaling \$164,000.

- The Bureau conducted audits of casualty loss claims resulting from Hurricane Marilyn. However, they did not (1) document supervisory changes to tax audit workpapers that affected the amount of taxes due, and (2) process statutory notices of deficiency (90-day letters) in a timely manner.

Subsequent to the completion of our audit, the Bureau fully implemented its VITAX computerized tax system. Based on information provided by Bureau officials during the February 18, 2003 exit conference, it appears that the VITAX system will provide the capabilities needed to overcome many of the tax administration deficiencies that have been noted in prior Bureau audits. However, we believe that the Bureau still needs to strengthen its staffing in certain areas and make an effort to address deficiencies related to prior year tax returns as identified during this audit.

Recommendations to the Governor of the Virgin Islands

We made four recommendations which, if implemented, should improve the Virgin Islands administration and collection of taxes. A response received from the Director of Internal Revenue addressed the status of the prior audit recommendations but did not address the four new recommendations made in this report. Therefore, the four recommendations remain unresolved.

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INTRODUCTION

BACKGROUND

The Virgin Islands Code (33 V.I.C. Chapter 20) established the Bureau of Internal Revenue (the Bureau) to administer and enforce the laws imposing individual and corporate income, gross receipts, trade and excise, hotel occupancy, highway user, production, gift, inheritance, and fuel taxes in the Virgin Islands.

According to Bureau records, they collected \$484.1 million in taxes during fiscal year 2001 and \$476.2 million during fiscal year 2002. More than 31,500 income tax refunds totaling \$62.9 million were issued during fiscal year 2001.

The Bureau had five major units: Director's Office, Computer Operations, Processing Accounts and Returns, Delinquent Accounts and Returns, and Audit Enforcement. The Bureau had offices located on St. Thomas and St. Croix, with a combined staff of about 118 employees. Bureau personnel made periodic visits to St. John to assist individual and business taxpayers.

During fiscal year 2000, the Director of Internal Revenue developed a reorganization plan to improve the Bureau's effectiveness and efficiency. As part of the plan, the Director proposed to increase the Bureau's staff in order to conduct business within the time constraints provided by law. The Bureau also contracted with the IBM Corporation to perform a detailed review of Bureau operations. In October 2000, IBM issued its "Assessment & Recommendations Report for the Bureau of Internal Revenue, US Virgin Islands." The report concluded that:

“Our overall assessment of IRB [the Bureau] indicates major problems arising from poorly maintained computer systems, the lack of a comprehensive understanding of tax administration, absent or obsolete procedures, insufficiently trained staff and most importantly -- the lack of a strategic plan. These problems have slowly eroded IRB's ability to administer territorial taxes and the taxpayers' confidence in the system -- thus seriously compromising voluntary compliance.”

The report also stated, “Our analysis, along with extensive

interviews, confirmed many findings of the 1997 Department of [the] Interior (DOI) Audit.” IBM assisted the Bureau in implementing the new VITAX computerized tax system based on the system used in Guam, developing comprehensive standard operating procedures and making other internal changes to improve overall operations.

OBJECTIVE AND SCOPE

The objective of our audit was to determine whether (1) the Bureau of Internal Revenue implemented the recommendations contained in the December 1997 audit report “Internal Revenue Taxes, Bureau of Internal Revenue, Government of the Virgin Islands” and (2) any new recommendations should be made based on current operations at the Bureau.

To accomplish our audit objective, we interviewed Bureau officials and reviewed applicable laws, rules, and regulations. We examined the Bureau’s computerized database of delinquent accounts and returns, listings of dishonored checks, tax penalty waivers, and tax audit files. The scope of the audit included changes in policies and procedures made to implement the prior audit recommendations. The audit was conducted from May to October 2002.

We conducted our audit in accordance with the “Government Auditing Standards,” issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances.

Because of the limited objective and scope of the audit, we only evaluated internal controls to the extent that they related to corrective actions taken on the prior audit recommendations.

PRIOR AUDIT COVERAGE

In December 1997, the Office of Inspector General issued the audit report “Internal Revenue Taxes, Bureau of Internal Revenue, Government of the Virgin Islands” (No. 98-I-188). The report disclosed deficiencies in the areas of computer operations, delinquent accounts and returns, and audit enforcement. Specifically, the report concluded that:

- The Bureau did not realize all potential revenue collections because it could not access a taxpayer’s complete and accurate payment history for all classes of taxes from a single computer system. Additionally, (1) payments were not reversed from taxpayer accounts for unhonored checks,

(2) the Bureau's Code and Edit Unit (now the Error Resolution Section) did not correct mathematical and data entry errors in order to process tax returns in a timely manner, and (3) data produced by the Computer Operations Branch to detect nonfilers and filers of duplicate dependent claims were not made available to the Audit Enforcement Branch in a consistent and timely manner.

- The Delinquent Accounts and Returns Branch did not effectively use collection practices and tools to enforce the collection of amounts owed by taxpayers. Specifically, the Bureau did not (1) follow up or make reasonable efforts to collect amounts owed by delinquent taxpayers before the statute of limitations expired, (2) file liens and levies to serve as the government's claim on delinquent taxpayers' property, and (3) provide required supporting documentation for tax penalty waivers.
- The Audit Enforcement Branch did not implement adequate internal controls to effectively administer its audit function. Specifically, the Bureau did not (1) use computer printouts from the Computer Operations Branch to detect and prevent nonfilers, (2) begin audits of the casualty loss claims filed as a result of Hurricane Marilyn, (3) conduct a sufficient number of audits of high-income taxpayers and corporations, (4) document changes made to revenue agent findings, (5) mail statutory notices (90-day letters) to taxpayers in a timely manner, and (6) transmit closed cases to the Processing Branch in a timely manner for assessment.

Report No. 98-I-188 to the Governor of the Virgin Islands contained 14 recommendations to address the deficiencies disclosed by the audit. Based on a response received from the Governor in January 1998, we classified six recommendations as resolved and implemented, seven recommendations as resolved but not implemented, and one recommendation as unresolved.

RESULTS OF AUDIT

OVERVIEW

Of the 14 recommendations made in the December 1997 audit report, six had been fully implemented, seven had been partially implemented, and one had not been implemented. (Status of the recommendations and corrective actions taken are presented in Appendix 1.) Specifically, we found that the Bureau made improvements by (1) implementing the VITAX computerized tax system, which incorporates the processing of most types of taxes and has online capabilities to enhance overall tax administration, (2) hiring five tax revenue clerks for the Delinquent Account and Returns Branch to handle delinquent accounts of less than \$15,000, (3) providing on-the-job training for timely processing of tax returns and formal training pertaining to new tax law changes and the fundamental principles of tax administration, and (4) maintaining master inventory listings and case histories for delinquent taxpayer accounts.

However, we found that some deficiencies disclosed in the prior report still existed, particularly problems that related to prior year tax returns. For example, the Bureau should (1) reverse \$308,000 in tax payments for which the checks were not honored by the banks, (2) resolve errors detected in more than 3,000 tax returns being held for resolution, (3) collect accounts with delinquent taxes totaling \$4.8 million, (4) provide supporting documentation for tax penalty waivers totaling \$164,000, and (5) ensure that statutory notices of deficiency (90-day letters) are processed timely.

COMPUTER OPERATIONS

Our December 1997 report included four recommendations related to the Bureau's Computer Operations Branch. We found that one of those recommendations was fully implemented and three were partially implemented. The Bureau took action to improve the processing of income tax returns and refunds by implementing the new VITAX computerized system as part of the Tax Administration Improvement Project being undertaken with contract assistance from the IBM Corporation. However, at the time of our follow-up review, the Bureau had not incorporated excise tax information into the VITAX. This would allow access to a taxpayer's entire tax payment history. In addition, tax payment checks totaling at least \$308,000, which were not honored by the banks, had not been reversed from taxpayer accounts.

Further, the Bureau had more than 3,000 prior year tax returns that were being withheld from processing because of errors.

Information on All Types of Taxes Was Not Integrated into One Computer System

As of July 2002, the Bureau's new VITAX computerized tax system, based on the Guam tax system, contained only information on individual and corporate income tax returns for tax year 2001. Tax information on withholding, hotel occupancy, excise, and gross receipts had to be accessed from separate stand-alone computers that did not interact with the new computerized system. The Bureau had an initial target date of September 1998 for integrating all taxes on one system to allow easy access to a taxpayers entire tax history. However, this date was not met and, according to a Bureau official, the initial integration plans were abandoned because all efforts were being focused on implementation of the new tax system and compliance with Y2K requirements. A Bureau official told us that September 2002 is the new target date for placing all taxes on the new system. However, as of October 2002, this had not been accomplished.

IBM's "Assessment & Recommendations Report" confirmed our prior report's conclusion that the Bureau had a number of tax applications in place to support the administration of multiple taxes, but that a different stand-alone system was used for each of the major types of taxes. Additionally, the IBM report stated that there was little or no sharing of information across these systems and that the systems were implemented on different hardware and software platforms, using a variety of programming languages. The IBM report further stated that each of the systems was operating at less than full capacity or was inoperable in certain instances. IBM concluded that, without all classes of taxes on one system, the withholding tax administration was virtually nonexistent on St. Thomas. In addition, the Stop Tax Evasion Program (STEP) was not effective because of the inability to easily verify withholding tax compliance.

Seven months after release of the "Assessment & Recommendations Report," the Bureau entered into a 2-year contract with IBM, at a cost of \$7.8 million plus travel expenses not to exceed \$1.2 million, to improve the Bureau's customer service and revenue collection operations and to provide a framework for a customer-focused, "e-government" approach to processing taxes. At the time of our review, this project was still in progress.

Subsequent Actions. At the February 18, 2003 exit

conference, Bureau officials told us that subsequent to completion of the audit, processing of all types of taxes had been incorporated into the new VITAX system, with the exception of excise taxes. They stated that a stand-alone application based on the Microsoft Access software had been developed to process excise taxes. They said the decision to keep excise tax processing as a separate application was made because of the high volume of low dollar value transactions involved. However, Bureau officials noted that they were reevaluating the decision.

Taxpayers Accounts Were Not Adjusted for Dishonored Checks Returned by Banks

The Bureau maintained two different lists of taxpayers whose payment checks were not honored by the banks. Both lists were maintained on PC-based systems, one with Professional File software and the other with Microsoft Excel software. The systems were not able to interact with each other or with the Bureau's mainframe computer. Further, during the time of our review, Bureau personnel were unable to access the Professional File system and submitted a previously printed register of dishonored checks. The register showed that, during the period of September 1990 to June 2001, the Bureau received 1,016 checks, originally valued at \$1.5 million, which were not honored by the banks. These checks still had outstanding balances totaling about \$1.2 million.

We selected for detailed review a sample of 25 taxpayers who wrote 42 dishonored checks with a total value of \$308,000. We found that the Bureau attempted to collect delinquent funds by sending computer-generated letters reminding taxpayers of their obligation to pay -- requesting payment of the original amount, plus a \$15 insufficient funds fee and calculated interest. We identified four instances where the Bureau collected on dishonored checks. However, taxpayer accounts had been adjusted to show that the original tax amounts were still owed. As a result, at least \$308,000 in tax revenues shown on the Bureau's mainframe computer actually had not been collected. For example:

- On January 13, 2000, a construction company issued two checks of \$35,000 each for payment of delinquent taxes. The payments were posted on the Bureau's mainframe computer, but the revenue officer did not indicate on the case history sheet the tax periods or types of taxes for the \$70,000. The checks were later returned by the bank for insufficient funds. Although the Bureau sent the taxpayer

two notices demanding payment, the original payment transactions were not reversed from the taxpayer account because the Bureau could not determine how the \$70,000 payment had originally been applied.

The Bureau's Chief of Processing Accounts and Returns stated that dishonored checks received for payment of withholding, gross receipts, and excise taxes were not reversed. However, The Chief stated that dishonored checks for income tax payments were reversed. We attempted to verify the Chief's statement by reviewing the Bureau's debit advices for income taxes as far back as 1988, but did not find a single example of income tax payments being reversed as a result of dishonored checks.

We believe that the new computerized tax system should record all transactions having to do with dishonored checks so account balances are accurate. The IBM report concurred that this was an important issue. The report stated that when dishonored check payments are not reversed, "a fragmented business process exists that compromises effectiveness of tax administration. . . . This fragmented business process is totally inadequate, because it fails to restore a taxpayer's account to the balance that existed prior to the NSF [non-sufficient funds] payment so that the appropriate penalties or fees can be posted and collected."

Subsequent Actions. At the February 18, 2003 exit conference, Bureau officials told us that the new VITAX system incorporates the processing of dishonored checks. They stated that once the Bureau receives notification from the Department of Finance that a dishonored check has been returned by the bank, a bad check penalty will be assessed by the system. Further, the system will automatically create a document (Form 1331) to reverse the dishonored payment and will prepare a notice to inform the taxpayer of the dishonored check amount and the applicable bad check penalty.

Tax Returns Were Being Held Pending Correction of Errors or Receipt of Missing Information

The Bureau's Error Resolution Section (formerly the Code and Edit Unit) was responsible for ensuring that tax returns and accompanying forms were accurate and complete. If errors were found, the tax return was held until the taxpayer responded to a computer-generated letter requesting the needed tax information. At the time of our review, the Bureau was holding a total of 3,046 tax returns from tax years 1990 to 2000 because of either mathematical errors or missing information.

However, the Error Resolution Section was not effectively staffed to handle the workload.

A temporary employee was hired and five employees (three from the Audit Enforcement Branch and two from the Delinquent Accounts and Returns Branch) were temporarily reassigned to the Error Resolution Division. These employees received on-the-job training for their new duties but were assigned to process only tax year 2001 returns. This still leaves all of the 3,046 tax returns from tax years 1990 to 2000 to be processed which we believe will still require a massive effort.

We selected a sample of 30 tax returns from the Bureau's current error registers to determine whether delays were still occurring in clearing the registers. However, we were unable to determine the actual status of 26 of these returns. The Bureau could not locate 18 of the 26 returns and 8 other tax returns contained no indication as to why they were being held. As a result, we could not determine if the returns were reviewed for processing or not. We found that the four remaining tax returns selected in our review were quickly cleared from the register.

Subsequent Actions. At the February 18, 2003 exit conference, Bureau officials stated that candidates were being interviewed for vacant positions in the Error Resolution Section and that all current Section staff had online access to the VITAX system in order to expeditiously process tax returns. In addition, we were given a live demonstration of how existing staff use the VITAX system to review and resolve tax return errors online. For errors requiring additional information, the system can generate the necessary notices to be sent to the taxpayers.

**Information Was Not
Produced for Tax
Enforcement Purposes**

The Computer Operations Branch did not produce computerized reports that could be used by the Audit Enforcement Branch in identifying nonfilers, taxpayers who under-reported their income, and filers of duplicate dependent claims because it had not captured the Form 1099-MISC (miscellaneous income) and Form W-2 (wage and tax statement) information for tax years 1997 through 2001. In addition, the Computer Operations Branch could not easily prepare reports comparing gross sales amounts reported in business income tax returns with gross receipts reported on business gross receipts tax returns because the two types of information were maintained on separate computer systems.

As a result, important information that would have allowed the Audit Enforcement Branch to identify nonfilers, filers of duplicate dependent claims, and taxpayers who under-reported their income was not available.

The IBM assessment report confirmed our audit finding and stated, “The annual withholding transmittal documents, Forms W-2/W-3 and Form 1099 information are never processed, even though the law requires they be filed. This information is never reconciled against the individual income tax withholding credits claimed, so the bureau has an additional fraud exposure.” The report also stated that “the IRB lacks the capability to cross check information filed on information returns and that filed on tax returns.”

Subsequent Actions. At the February 18, 2003 exit conference, Bureau officials stated that there was no longer a need for the Computer Operations Branch to produce special reports for the Audit Enforcement Branch because the new VITAX system has flexible online query capabilities. They said that the Audit Enforcement Branch has developed detailed audit selection criteria, which can be used to query the tax database. Examples given were queries based on gross receipts taxes paid, withholding taxes paid, or tax credits claimed, among other criteria. Bureau officials also noted that the identification of duplicate dependent claims was an integral part of VITAX processing of income tax returns and that the system had identified more than 2,000 cases of duplicate dependent claims for tax year 2001 returns. In these cases, prior year tax returns were also reviewed for similar duplicate dependent claims.

DELINQUENT ACCOUNTS AND RETURNS

Our December 1997 report included five recommendations related to the Delinquent Accounts and Returns Branch. We found that two of those recommendations were fully implemented and three were partially implemented. The Bureau hired five tax revenue clerks in April 1998 to handle delinquent taxpayer accounts with balances of less than \$15,000 and to address taxpayer inquiries. However, the Bureau did not effectively perform collection enforcement activities, including the use of liens and levies, for taxpayers whose accounts were delinquent nor did they make reasonable efforts to protect the government’s interests before the statute of limitations expired. Additionally, the Bureau did not maintain required supporting documentation for tax penalty

waivers.

Collection Enforcement for Delinquent Accounts Was Ineffective

The Delinquent Accounts and Returns Branch was responsible for collecting unpaid taxes administered by the Bureau. We found, however, that for the majority of taxpayer cases reviewed, revenue officers did not enforce or follow up on the collection of taxes owed. We reviewed 40 taxpayer case files containing 540 taxpayer delinquent accounts with outstanding taxes totaling \$5.9 million. We found that, for 33 taxpayers with 214 taxpayer delinquent accounts totaling \$4.8 million, there was little or no collection effort undertaken by revenue officers in the form of liens, levies, or follow-up on defaulted taxpayer installment agreements. For example:

- ☐ For a taxpayer who owed income taxes for 1998 totaling about \$33,000, the case file showed that the assigned revenue officer did not make any collection efforts.
- ☐ For an air conditioning firm that owed income taxes for 1996, 1998, 1999, and 2000 totaling about \$37,000, the case file also showed that no collection efforts were made by the assigned revenue officer.
- ☐ For a restaurant owner who owed various taxes totaling more than \$18,000, the case file showed that no collection efforts were made by the assigned revenue officer during the period of November 16, 1999 to June 27, 2002.
- ☐ For another restaurant owner who owed gross receipts taxes for 1994 through 2000 and income taxes for 1999 totaling about \$75,000, the case file showed that the only collection efforts made by the assigned revenue officer were to execute two installment agreements, both of which were now in default. No further efforts were made to bring the defaulted agreements into compliance.
- ☐ For an engineering company that owed gross receipts and withholding taxes for 1996 through 2001 totaling about \$252,000, the case file showed that the only collection effort made by the assigned revenue officer was a 1996 installment agreement, which also was now in default. No further efforts were made to bring the defaulted agreement into compliance.

The revenue officers told us that liens or levies could not be

used without knowing the specific assessment dates, which should be documented on computer-generated taxpayer delinquent account forms (forms). These forms contain information detailing the types of tax returns filed, the taxes, penalties, and interest that were assessed, and the payments received. Using this information, liens and/or levies can be made and later documented on the forms. However, if the forms are not prepared, the revenue officers are unaware of any outstanding delinquent amounts. Despite the importance of the forms, the case files for 214 of the 540 taxpayer delinquent accounts reviewed did not have a form. A revenue officer told us that, in the majority of cases, they were not aware of the amount of delinquent taxes until taxpayers called to inquire about the status of their accounts.

We also found that the Bureau would be unable to collect on 68 of the 540 taxpayer delinquent accounts reviewed because the statute of limitations had expired. As a result, the Bureau lost the opportunity to collect about \$408,000 in delinquent taxes. In 41 of the 68 instances where the statute of limitations had expired, the revenue officers did not make any notations on the case history sheets or report to the Assistant Chief of Delinquent Accounts and Returns by means of Form 53D (Report of Currently Not Collectible Taxes) that the statute of limitations was about to expire. Moreover, the revenue officers did not maintain case history sheets to show if any collection activity was undertaken for 7 of the 40 taxpayer case files reviewed and did not adequately document collection activities for 24 other case files.

According to the Assistant Chief of the Delinquent Accounts and Returns Branch, although there were technically four revenue officers assigned to handle delinquent taxpayer accounts with balances of more than \$15,000, two of the revenue officers were currently on loan to the Bureau's Error Resolution Division and three revenue officers had previously been on loan to the Processing Accounts and Returns Branch for a period of 1 year. As a result, the Delinquent Accounts and Returns Branch was hampered in its collection efforts because the workload was too great to be handled effectively by the remaining staff.

The IBM report stated that one of the reasons it was nearly impossible for the Bureau to adequately administer taxes was

that “the Audit and Collection functions have tremendous clerical responsibilities, poor data quality, and misguided priorities.” We agree with this assessment and believe that the Bureau should place greater emphasis on the collection of delinquent taxes in the Virgin Islands.

Subsequent Actions. At the February 18, 2003 exit conference, Bureau officials stated that the Delinquent Accounts and Returns Branch continues to be short-staffed. For example, they pointed out that there are 5 vacant positions out of 11 in the St. Thomas office and 5 vacant out of 6 in the St. Croix office. They also said that, despite the staffing problems, since 2002 the Branch’s revenue officers and revenue representatives have been instructed to promptly follow-up with delinquent taxpayers.

Bureau officials also stated that the Delinquent Accounts and Returns Branch developed a Microsoft Access application, which includes the data elements recommended in the 1997 report, to maintain a master inventory of taxpayer accounts assigned to the revenue officers.

Further, Bureau officials said that liens and levies are being used as part of the collection enforcement process to the extent deemed necessary and appropriate by the revenue officers and their supervisors.

Tax Penalty Waivers Were Not Always Properly Documented

The Bureau did not maintain a listing of tax penalty waivers granted to delinquent taxpayers. Therefore, they provided us with two boxes containing waivers issued during 1998 to 2000, which were being held in storage. We found that during the 3-year period, the Bureau issued 396 tax penalty waivers totaling more than \$815,000. Of the 396 waivers issued, 263 were processed by the Delinquent Accounts and Returns Branch, 57 by the Processing Accounts and Returns Branch, 31 by the Director, 28 by the Legal Counsel, 12 by the Federal Disclosure Officer, 3 by the Audit Enforcement Branch, and 2 by the Deputy Director. Our review also disclosed that although taxpayers were required to submit to the Bureau written requests for waiver of tax penalties, 177 of the 396 tax penalty waivers, totaling about \$164,000, were processed without written decisions by the Bureau to support the waivers. Therefore, there was no assurance that the penalty waivers were issued in accordance with applicable regulations.

Subsequent Actions. At the February 18, 2003 exit conference, Bureau officials stated that the new VITAX system produces a Form 1331 that is used to capture and document the

reason for penalty waivers. They also pointed out that recent changes to the Internal Revenue Code no longer require that taxpayers submit requests for penalty waivers in writing. Telephonic requests are now also accepted.

AUDIT ENFORCEMENT

Our December 1997 report included five recommendations related to the Audit Enforcement Branch. We found that three of those recommendations were fully implemented, one was partially implemented, and one was not implemented. The Bureau conducted audits of casualty loss claims resulting from Hurricane Marilyn, but (1) had not hired senior revenue agents to handle complex tax cases and (2) did not process statutory notices of deficiency (90-day letters) in a timely manner.

Complex Tax Returns Were Not Routinely Reviewed for Possible Audit Issues

As had been the case during our prior audit, we found that the Audit Enforcement Branch continued to allocate most of its resources to auditing tax returns that claimed the earned income credit. A Bureau official explained that they focused their resources in this area because they felt they would be unable to recoup funds from low income taxpayers who had abused the credit but had already received a tax refund. However, complex tax returns were generally not reviewed to the same extent. For example, our review of the tax case inventory of the Bureau's revenue agents on St. Thomas and St. Croix showed that they had a total of 173 complex tax returns pending to be audited. However, of the 173 returns, 93 were for tax years 1990 through 1997. Therefore, the 3-year statute of limitations for making tax assessments on a filed income tax return had expired in all 93 cases.

As stated in our December 1997 report, we believe that a program of randomly selected tax returns for audit (for example, from business professionals, construction contractors, business license applicants, or regular taxpayers) would help to promote voluntary tax compliance.

Subsequent Actions. At the February 18, 2003 exit conference, Bureau officials stated that, based on available staff resources, the Audit Enforcement Branch had audited casualty loss claims related to Hurricane Marilyn on a random sample basis. Additionally, revenue agents had recently completed IRS training in the states, and the Bureau was planning to hire a retired IRS employee as a senior revenue agent next year.

Bureau officials also stated that the Audit Enforcement Branch

had performed audits of taxpayers in several professional categories, including doctors, attorneys, contractors, and service-station owners. Further, the new VITAX system gave the Audit Enforcement Branch the capability to establish specific criteria for selection of tax returns for audit. Bureau officials also said that during the summer the reviewer/conferee conducted a review of taxpayers based on 1099-MISC forms filed with the Bureau.

Changes to Tax Audit Workpapers Were Not Always Approved by a Supervisor

According to a computerized worksheet of closed cases provided by the Audit Enforcement Branch, 13,605 audit cases were closed during calendar years 1998 to 2001. We selected a judgmental sample of 50 case files for review, but 5 files could not be located by the Bureau. Of the 45 case files reviewed, we found eight instances in which the tax due amounts shown in the revenue agents' audit workpapers were changed by a total of \$100,594, but there were no supervisory approvals of the changes. We believe that all changes to the tax audit workpapers should be approved by a supervisor to ensure that the changes are legitimate.

We also attempted to determine the average time it took for revenue agents to process assigned taxpayer cases, but were unable to make that determination because assignment dates were not recorded. The Audit Enforcement Branch's group supervisor told us that knowing the assignment dates was "immaterial." However, we believe that such information is important because the Bureau has to make assessments within the 3-year statute of limitations. Therefore, tax return audits must be completed in sufficient time to meet the statutory limitation.

Of the 45 case files reviewed, 41 files did not indicate the date the return was assigned to a revenue agent, the date the review was completed by the revenue agent, nor the date the supervisor approved the case for closure. For the remaining four cases, it took from 17 to 99 working days for the cases to be processed and closed.

Subsequent Actions. At the February 18, 2003 exit conference, Bureau officials stated that documentation was now required for supervisory approvals of tax audit changes.

Statutory Notices of Tax Deficiency Were Not Issued Timely

Statutory notices of deficiency (90-day letter) are issued to taxpayers in audit cases where agreement on tax matters is not reached. Of the 45 cases reviewed, we found that 11 90-day letters were issued to the taxpayers. A taxpayer who receives a 90-day letter can either file a petition with the District Court of the Virgin Islands requesting a waiver for immediate assessment or wait for the deficiency to be assessed when the 90-day period has expired. Of the 11 90-day letters issued, 3 were not sent to the Processing Branch for assessment and 8 were not sent to the taxpayer in a timely manner. Therefore, in all 11 cases, the Bureau was precluded from initiating collection action on tax amounts due as a result of completed audits.

Subsequent Actions. At the February 18, 2003 exit conference, Bureau officials stated that they were reviewing the workflow between the Office of Chief Counsel and the reviewer/conferee to determine what changes can be made to ensure timely processing of the 90-day letters.

RECOMMENDATIONS

TO THE GOVERNOR OF THE VIRGIN ISLANDS

We recommend that the Governor of the Virgin Islands require the Director of Internal Revenue to:

1. Develop a plan of action for fully implementing recommendations from the December 1997 report that are classified as “partially implemented” or “not implemented.” The plan of action should include the title of responsible officials and the target dates for corrective actions, and should focus on pending issues related to prior period tax returns.
2. Coordinate with the Department of Finance to establish procedures to ensure that delinquent taxes are offset against payments made to government vendors and contractors.
3. Ensure that revenue officers use all available resources, including the use of liens or levies, to collect taxes owed on delinquent accounts. The Bureau should also take action to write-off old accounts that are deemed to be uncollectible.
4. Place a high priority on completing audits of tax returns selected for review that are nearing the end of the 3-year statute of limitations.

AUDITEE RESPONSE

We received a February 19, 2003 response (Appendix 3) to the preliminary draft report from the Director of Internal Revenue that addressed the status of the prior audit recommendations (see Appendix 1). We incorporated information from that response into the body of the report. However, we did not receive a follow-up response to the official draft report that addressed the four new recommendations made in the report. Therefore we consider Recommendations 1 through 4 to be unresolved (Appendix 4).

APPENDIX 1 - STATUS OF PRIOR RECOMMENDATIONS

Report No. 98-I-188 Internal Revenue Taxes, Bureau of Internal Revenue, Government of the Virgin Islands

Prior Recommendations	Status of Corrective Actions Taken
<p>A.1. Develop a detailed action plan that outlines the Bureau's implementation schedule for integrating the withholding, hotel occupancy, and excise taxes modules onto the mainframe computer so that this project is completed by the Bureau's September 1998 target date.</p>	<p>Partially Implemented. Although the Bureau did not meet its September 1998 target date, the Bureau's new VITAX system has since been implemented. It integrates the processing of income, withholding, gross receipts, and hotel occupancy taxes. At the exit conference, Bureau officials stated that they decided not to integrate excise taxes into the new system because of the high volume of low dollar value transactions. However, that decision was being reconsidered by the Bureau.</p>
<p>A.2. Ensure that entries for tax payments made with checks that have not been honored by a bank are reversed from taxpayer accounts as paid amounts within a reasonable time (such as 30 days) after the date that they were presented in payment of the accounts. Also, consideration should be given to integrating the listing of checks not honored onto the mainframe computer and developing a program to allow interaction between the listing and the payment posting process.</p>	<p>Partially Implemented. We reviewed 42 checks totaling \$308,000 that were paid by taxpayers but not honored by the banks, and found that none were reversed from taxpayer accounts. We further reviewed the Bureau's debit advices for income taxes as far back as 1988 and did not find any examples of reversed income tax payments. At the exit conference, Bureau officials stated that processing of dishonored checks was incorporated into the new VITAX system. Once the Bureau is notified by the Department of Finance that a check has been returned by the bank, a form is generated on the computer to assess the taxpayer for the original tax amount and the applicable bad check penalty.</p>

Prior Recommendations

A.3. Assess the causes for the delays in clearing income tax error registers and ensure that the Code and Edit Unit has sufficient staff resources, training, and computer access to process tax returns expeditiously.

A.4. Require the Computer Branch to produce printouts of nonfilers, filers of duplicate dependent claims, and comparisons of businesses' sales and gross receipts taxes paid on an annual basis and to provide the results to the Audit Enforcement Branch.

B.1. Ensure that Revenue officers in the Delinquent Accounts and Returns Branch follow up with all taxpayers within 10 days after a taxpayer misses the specific payment deadline in accordance with the Internal Revenue Code.

Status of Corrective Actions Taken

Partially Implemented. We were unable to determine the actual status of 26 of 30 returns selected for review because either they could not be located or there was no explanation as to why they were being held. At the exit conference, Bureau officials stated that the Code and Edit Unit was renamed the Error Resolution Section and candidates were being interviewed for vacant positions. Additionally, we were given a live demonstration of how existing staff use the new VITAX system to review and resolve tax return errors online. For errors requiring additional information from the taxpayers, the system generates the necessary notice to be sent to the taxpayers.

Implemented. Although the Computer Branch still did not produce the recommended printouts for tax audit purposes, the Bureau's new VITAX system includes the capability for online queries of the taxpayer database based on criteria developed by the Audit Enforcement Branch. For example, the Audit Enforcement Branch was able to identify and take action on more than 2,000 cases of duplicate dependent claims for tax year 2001. Additionally, the Audit Enforcement Branch can query the system based on such elements as gross receipts taxes paid, withholding taxes paid, or tax credits claimed.

Partially Implemented. We found that revenue officers did not perform follow-up collection activities on delinquent accounts or make reasonable collection efforts before the statute of limitations on collections expired for 68 taxpayer delinquent accounts totaling \$408,000. At the exit conference, Bureau officials stated that additional staff was being hired to fill vacant positions in the St. Thomas and St. Croix offices of the Delinquent Accounts and Returns Branch to ensure timely collection action.

Prior Recommendations

B.2. Ensure that Revenue officers maintain a master inventory listing and case histories for each taxpayer account assigned to them. The master inventory listing should identify when the statute of limitations will expire for each case, and the case histories should include the taxpayer's residential address and telephone number, each collection action taken by the Revenue officer, and a plan of action to close the case.

B.3. Enforce the provisions of the Virgin Islands Code regarding the use of liens and levies as collection tools.

B.4. Determine the feasibility of assigning, permanently or temporarily, tax revenue clerks and/or taxpayer representatives from other branches to the Delinquent Accounts Branch, who can address taxpayer inquiries, or of redirecting calls telephonically to other branches where taxpayer representatives are located.

B.5. Ensure that penalty waivers are granted only in accordance with established regulations. In that regard, each request for a penalty waiver should include a written request from the taxpayer and a written decision by the Bureau to approve or deny the request based on reasonable cause as defined by the Internal Revenue Code.

Status of Corrective Actions Taken

Implemented. For prior period tax returns, we found that 31 of 40 case history sheets reviewed either did not contain evidence of collection activity or did not document that adequate collection activity was undertaken. At the exit conference, Bureau officials stated that the Delinquent Accounts and Returns Branch had developed a computer program to maintain a complete inventory of assigned cases, including the information defined in the recommendation.

Partially Implemented. For prior period tax returns, we found that revenue officers did not use liens and levies as collection tools to enforce the collection of amounts owed in 33 of 40 taxpayer case files reviewed that comprised 214 taxpayer delinquent accounts totaling \$4.8 million. At the exit conference, Bureau officials stated that they were now using liens and levies when deemed necessary and appropriate.

Implemented. The Bureau hired five Tax Revenue Clerks in April 1998 to handle delinquent taxpayer cases with outstanding taxes totaling less than \$15,000, delinquent taxpayers without appointments, and taxpayer inquiries, and to redirect telephone calls to the appropriate employees in the other branches.

Partially Implemented. For prior period tax returns, we found 177 instances totaling \$164,000 where the Bureau did not document supervisory approval of penalty waivers. At the exit conference, Bureau officials stated that Internal Revenue Code changes removed the requirement for written requests for penalty waivers. Additionally, the new VITAX system provides for online processing of penalty waivers.

Status of Corrective Actions Taken

Prior Recommendations

C.1. Request that the legislature appropriate funds for the Bureau to hire qualified senior revenue agents to conduct audits of the casualty loss claims filed as result of Hurricane Marilyn and to conduct audits of complex tax issues. In addition, the senior revenue agents should provide on-the-job training to the Audit Branch's other revenue agents.

C.2. Require the Audit Branch to use the printouts that identify non-filers and filers of duplicate dependent claims produced by the Computer Branch and to establish audit criteria to select returns from these lists for audit examination based on the potential to produce additional revenue for the Bureau.

C.3. Require the Audit Branch to select for audit a random sample of taxpayers from sources such as business professionals, construction contractors, professional service contractors with the Government of the Virgin Islands, and business license applicants in order to have a more comprehensive universe of tax returns and to use available enforcement measures to promote taxpayer compliance.

C.4. Require the Audit Branch's reviewer/conferee and the group supervisors to document changes to workpaper files that affect tax amounts due and to include supervisory approval of these changes in revenue agents' workpaper files.

Partially Implemented. The Bureau did not hire senior revenue agents to audit the 1995 casualty loss claims and complex tax issues. However, formal training pertaining to the new tax law changes and the fundamental principles concerning taxation was provided to existing revenue agents. At the exit conference, Bureau officials stated that funding was being sought to hire a retired IRS employee as a senior revenue agent. They also stated that the casualty loss claims were audited on a random sample basis.

Implemented. The Computer Branch still did not produce listings of nonfilers and filers of duplicate dependent claims. However, the new VITAX system includes the capability for online queries of the taxpayer database based on criteria developed by the Audit Enforcement Branch. Additionally, at the exit conference, Bureau officials stated that the reviewer/conferee conducts an annual nonfiler review based on 1099-MISC forms submitted to the Bureau.

Implemented. We found that the Audit Enforcement Branch allocated most of its audit resources to auditing earned-income credit cases. However, at the exit conference, Bureau officials stated that they also had completed audits of tax returns in selected professions including doctors, attorneys, contractors, and service-station owners.

Implemented. We found that, in 8 of 19 cases, supervisory approvals of tax audit changes were not documented. At the exit conference, Bureau officials stated that documentation was now required for supervisory approvals of tax audit changes.

Status of Corrective Actions Taken

Prior Recommendations

C.5. Provide or allocate additional personnel to the reviewer/conferee's secretary to aid in the processing of the statutory notices of deficiency (90-day letters) in a timely manner and to remove the 90-day letters from the audit files for transmission to the Processing Branch for assessment in a timely manner.

Not Implemented. We found that additional personnel was not allocated to aid in the processing of the statutory notices of deficiency (90-day letter). Further, in 11 instances where statutory notices were issued, three were not forwarded to the Processing Branch for assessment and eight were not sent to the taxpayers in a timely manner. At the exit conference, Bureau officials stated that they were reviewing the work flow between the Office of General Counsel and the reviewer/conferee to determine what changes can be made to ensure timely processing of the 90-day letters.

APPENDIX 2 - MONETARY IMPACT

<u>Finding Area</u>	<u>Unrealized Revenues</u>
Computer Operations Dishonored Checks	\$308,000
Delinquent Accounts and Returns Delinquent Taxes Receivable	4,800,000
Lapsed Statute of Limitations	<u>408,000</u>
Totals	<u>\$5,516,000</u>

APPENDIX 3 - RESPONSE TO DRAFT REPORT

INSPECTOR GENERAL'S REPORT

RESPONSE FROM THE VIRGIN ISLANDS BUREAU OF INTERNAL REVENUE

COMPUTER OPERATIONS BRANCH

RECOMMENDATION:

A.1. DEVELOP A DETAILED ACTION PLAN WHICH OUTLINES THE BUREAU'S IMPLEMENTATION SCHEDULE FOR INTEGRATING THE WITHHOLDING, HOTEL OCCUPANCY, AND EXCISE TAXES MODULES ONTO THE MAINFRAME COMPUTER SO THAT THIS PROJECT IS COMPLETED BY THE BUREAU'S SEPTEMBER 1998 TARGET DATE.

NOT IMPLEMENTED.

BUREAU'S RESPONSE: THE VITAX PROGRAM, WHICH WAS IMPLEMENTED IN MAY OF 2001, INTEGRATES THE INCOME, GROSS RECEIPTS, HOTEL OCCUPANCY, AND WITHHOLDING PROGRAMS. THE BUREAU HAS MADE A MANAGEMENT DECISION TO UTILIZE THE ACCESS SOFTWARE PROGRAM FOR THE PROCESSING OF THE EXCISE TAXES.

AT THE PRESENT TIME, HOWEVER, THE BUREAU IS CONSIDERING INTEGRATING EXCISE TAX ACCOUNTS RECEIVABLE TO OFFER A COMPLETE DELINQUENT TAXPAYER PROFILE. THE BUREAU IS WEIGHING THE COST FACTOR OF THE INTEGRATION OF EXCISE TAX ONTO VITAX AGAINST THE SMALL BILLS THAT ARE GENERATED IN AN ATTEMPT TO MAXIMIZE OUR LIMITED RESOURCES.

A.2. ENSURE THAT ENTRIES FOR TAX PAYMENTS MADE WITH CHECKS THAT HAVE NOT BEEN HONORED BY A BANK ARE REVERSED FROM TAXPAYER ACCOUNTS AS PAID AMOUNTS

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WITHIN A REASONABLE TIME (SUCH AS 30 DAYS) AFTER THE DATE THAT THEY WERE PRESENTED IN PAYMENT OF THE ACCOUNTS. ALSO, CONSIDERATION SHOULD BE GIVEN TO INTEGRATING THE LISTING OF CHECKS NOT HONORED ONTO THE MAINFRAME COMPUTER AND DEVELOPING A PROGRAM TO ALLOW INTERACTION BETWEEN THE LISTING AND THE PAYMENT POSTING PROCESS.

NOT IMPLEMENTED.

BUREAU'S RESPONSE:

UNDER THE NEW VITAX, THE BAD CHECK PENALTY WILL BE IMMEDIATELY ASSESSED ONCE WE RECEIVE NOTICE THAT A CHECK HAS BEEN DISHONORED. A FORM 1331 WILL BE CREATED BY THE PROCESSING BRANCH TO REQUEST THE REVERSAL OF THE DISHONORED PAYMENT. IMMEDIATELY THEREAFTER, A NOTICE WILL BE GENERATED TO INCLUDE BOTH THE ORIGINAL TAX DUE AND THE ADDITIONAL BAD CHECK PENALTY.

WE HAVE SENT A REQUEST TO THE DEPARTMENT OF FINANCE TO FORWARD DISHONORED CHECKS TO OUR OFFICE AS SOON AS THEY RECEIVE SUCH NOTICES IN AN ATTEMPT TO SPEED UP THE PROCESS.

A.3. ASSESS THE CAUSES FOR THE DELAYS IN CLEARING INCOME TAX ERROR REGISTERS AND ENSURE THAT THE CODE AND EDIT UNIT HAS SUFFICIENT STAFF RESOURCES, TRAINING, AND COMPUTER ACCESS TO PROCESS TAX RETURNS EXPEDITIOUSLY.

PARTIALLY IMPLEMENTED.

BUREAU'S RESPONSE:

NO LONGER APPLICABLE UNDER THE VITAX SYSTEM.

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THE BUREAU IS PRESENTLY INTERVIEWING CANDIDATES FOR THE ERROR RESOLUTION SECTION (FORMERLY KNOWN AS CODE AND EDIT). ALL MEMBERS OF THE ERROR RESOLUTION UNIT HAVE COMPUTER ACCESS TO PROCESS TAX RETURNS EXPEDITIOUSLY.

A.4. REQUIRE THE COMPUTER BRANCH TO PRODUCE PRINTOUTS OF NON-FILERS, FILERS OF DUPLICATE DEPENDENT CLAIMS, AND COMPARISONS OF BUSINESSES' SALES AND GROSS RECEIPTS TAXES PAID ON AN ANNUAL BASIS AND TO PROVIDE THE RESULTS TO THE AUDIT BRANCH.

BUREAU'S RESPONSE:

NO LONGER APPLICABLE UNDER THE VITAX SYSTEM.

UNDER VITAX, THE COMPUTER OPERATIONS BRANCH WILL NOT HAVE TO PRODUCE ANY PRINTOUTS FOR ANY BRANCH. THE AUDIT BRANCH HAS DEVELOPED DETAILED AUDIT SELECTION CRITERIA, WHICH WILL BE QUERIED BY THE CHIEF AND ASSISTANT CHIEF TO MANAGE THE AUDITS. MANY REPORTS CAN NOW BE QUERIED BY THE MANAGEMENT STAFF BASED ON WHATEVER CRITERIA WE SELECT. FOR EXAMPLE, WE CAN QUERY GROSS RECEIPTS TAXES PAID ANNUALLY, THE AMOUNT OF CREDITS PAID OUT BASED ON RETURN TYPE, AND THE AMOUNT OF WITHHOLDINGS PAID BY VARIOUS RANKINGS.

THE DUPLICATE DEPENDENT ISSUE IS A SIGNIFICANT ASPECT OF THE VITAX. TO DATE, WE HAVE PROCESSED 2014 DUPLICATE DEPENDENTS ON THE 2001 RETURNS, WHICH IN TURN HAVE RESULTED IN CHANGES IN THE PRIOR YEARS OF THOSE SPECIFIC TAXPAYERS.

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DELINQUENT ACCOUNTS AND RETURNS BRANCH

RECOMMENDATION:

B.1. ENSURE THAT REVENUE OFFICERS IN THE DAR BRANCH FOLLOW UP WITH ALL TAXPAYERS WITHIN 10 DAYS AFTER A TAXPAYER MISSES THE SPECIFIC PAYMENT DEADLINE IN ACCORDANCE WITH THE INTERNAL REVENUE CODE.

NOT IMPLEMENTED.

BUREAU'S RESPONSE:

IMPLEMENTED AS OF 2002. THIS IS THE PROCEDURE FOR BOTH REVENUE OFFICERS AND REVENUE REPRESENTATIVES.

B.2. ENSURE THAT REVENUE OFFICERS MAINTAIN A MASTER INVENTORY LISTING AND CASE HISTORIES FOR EACH TAXPAYER ACCOUNT ASSIGNED TO THEM. THE MASTER INVENTORY LISTING SHOULD IDENTIFY WHEN THE STATUTE OF LIMITATIONS WILL EXPIRE FOR EACH CASE, AND THE CASE HISTORIES SHOULD INCLUDE THE TAXPAYER'S RESIDENTIAL ADDRESS AND TELEPHONE NUMBER, EACH COLLECTION ACTION TAKEN BY THE REVENUE OFFICER, AND A PLAN OF ACTION TO CLOSE THE CASE.

PARTIALLY IMPLEMENTED.

BUREAU'S RESPONSE:

THE DAR BRANCH HAS DEVELOPED A SPECIALIZED ACCESS PROGRAM FOR THE INDIVIDUAL INVENTORY, WHICH COVERS ALL ASPECTS OF THE RECOMMENDATION.

B.3. ENFORCE THE PROVISIONS FO THE VIRGIN ISLANDS CODE REGARDING THE USE OF LIENS AND LEVIES AS COLLECTION TOOLS.

NOT IMPLEMENTED.

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BUREAU'S RESPONSE:

THIS HAS BEEN IMPLEMENTED. LIENS ARE FILED AND LEVIES ARE SERVED WHEN DEEMED NECESSARY AND APPROPRIATE BY THE REVENUE OFFICER AND THE MANAGERS, WHICH IS IN ACCORDANCE WITH THE INTERNAL REVENUE CODE AND THE VIRGIN ISLANDS CODE.

B.4. DETERMINE THE FEASIBILITY OF ASSIGNING, PERMANENTLY OR TEMPORARILY, TAX REVENUE CLERKS AND/OR TAXPAYER REPRESENTATIVES FROM OTHER BRANCHES TO THE DAR BRANCH, WHO CAN ADDRESS TAXPAYER INQUIRIES, OR OF REDIRECTING TELEPHONICALLY TO OTHER BRANCHES WHERE TAXPAYER REPRESENTATIVES ARE LOCATED.

IMPLEMENTED.

B.5. ENSURE THAT PENALTY WAIVERS ARE GRANTED ONLY IN ACCORDANCE WITH ESTABLISHED REGULATIONS. IN THAT REGARD, EACH REQUEST FOR A PENALTY WAIVER SHOULD INCLUDE A WRITTEN REQUEST FROM THE TAXPAYER AND A WRITTEN DECISION BY THE BUREAU TO APPROVE OR DENY THE REQUEST BASED ON "REASONABLE CAUSE" AS DEFINED IN THE INTERNAL REVENUE CODE.

PARTIALLY IMPLEMENTED.

BUREAU'S RESPONSE:

VITAX'S REQUEST FOR PENALTY WAIVER IS IN THE FORM OF A 1331(FORM USED ON THE SYSTEM). THIS FORM CAPTURES A REASON FOR THE PENALTY WAIVER, MANY OF WHICH HAVE NOT REQUIRED TAXPAYER'S INTERACTION, BUT HAS BEEN DONE BY MANAGERS TO CLEAN UP THE SYSTEM. A REVIEW OF THE PROCEDURE FOR PENALTY WAIVERS WILL SHOW THAT THE REQUIREMENT OF A WRITTEN REQUEST IS NO LONGER NECESSARY IN ALL INSTANCES, BUT TAXPAYERS CAN NOW

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CALL THE IRS OFFICES AND REQUEST A PENALTY WAIVER
OVER THE TELEPHONE.

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AUDIT ENFORCEMENT BRANCH

RECOMMENDATIONS:

C.1. REQUEST THAT THE LEGISLATURE APPROPRIATED FUNDS FOR THE BUREAU TO HIRE QUALIFIED SENIOR REVENUE AGENTS TO CONDUCT AUDITS OF THE CASUALTY LOSS CLAIMS FILED AS A RESULT OF HURRICANE MARILYN AND TO CONDUCT AUDITS OF COMPLEX TAX ISSUES. IN ADDITION, SENIOR REVENUE AGENTS SHOULD PROVIDE ON-THE-JOB TRAINING TO THE AUDIT BRANCH'S OTHER REVENUE AGENTS.

PARTIALLY IMPLEMENTED.

BUREAU'S RESPONSE:

THE CASUALTY LOSS PROJECT WAS COMPLETED WITH THE BUREAU'S TIME FRAME, BASED ON A RANDOM SELECTION OF RETURNS CLAIMING A CASUALTY LOSS AND THE BUREAU'S RESOURCES.

REVENUE AGENTS RECENTLY COMPLETED IRS TRAINING IN NEW ORLEANS, LOUISIANA. IT IS OUR INTENTION TO PLACE FUNDING FOR THE SENIOR AGENT IN OUR NEXT YEAR'S BUDGET.

C.2. REQUIRE THE AUDIT BRANCH TO USE THE PRINTOUTS THAT IDENTIFY NON-FILERS AND FILERS OF DUPLICATE DEPENDENT CLAIMS PRODUCED BY THE COMPUTER BRANCH AND TO ESTABLISH AUDIT CRITERIA TO SELECT RETURNS FROM THESE LISTS FOR AUDIT EXAMINATION BASED ON POTENTIAL TO PRODUCE ADDITIONAL REVENUES FOR THE BUREAU.

NOT IMPLEMENTED.

BUREAU'S RESPONSE:

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NO LONGER APPLICABLE UNDER THE VITAX SYSTEM.

AS STATED UNDER THE COMPUTER BRANCH SECTION, THE AUDIT SELECTION CRITERIA WILL BE DONE ON-LINE. IN ADDITION, WE CONTINUE TO DO AN ANNUAL NON-FILERS PROGRAM EVERY SUMMER BY USING THE FORM 1099MISC FILED WITH OUR OFFICE. THIS PROGRAM IS DONE OUT OF THE REVIEWER/CONFeree SECTION OF THE DIRECTOR'S OFFICE.

C.3. REQUIRE THE AUDIT BRANCH TO SELECT FOR AUDIT A RANDOM SAMPLE OF TAXPAYERS FROM SOURCES SUCH AS BUSINESS PROFESSIONALS, CONSTRUCTION CONTRACTORS, PROFESSIONAL SERVICE CONTRACTORS WITH THE GOVERNMENT OF THE VIRGIN ISLANDS, AND BUSINESS LICENSE APPLICANTS IN ORDER TO HAVE A MORE COMPREHENSIVE UNIVERSE OF TAX RETURNS AND TO USE AVAILABLE ENFORCEMENT MEASURES TO PROMOTE TAXPAYER COMPLIANCE.

NOT IMPLEMENTED.

BUREAU'S RESPONSE:

THE AUDIT BRANCH HAS AUDITED VARIOUS PROFESSIONS, SUCH AS THE DOCTORS, CONTRACTORS, ATTORNEYS AND SERVICE STATIONS.

*PLEASE PROVIDE THE BASIS FOR YOUR FINDING THAT THE BUREAU HAD 173 COMPLEX CASES, BUT THE STATUTE EXPIRED ON 95 OF THEM.

C.4. REQUIRE THE AUDIT BRANCH'S REVIEWER/CLASSIFIER/CONFeree AND THE GROUP SUPERVISOR TO DOCUMENT CHANGES TO WORKPAPER FILES THAT AFFECT TAX AMOUNTS DUE AND TO INCLUDE SUPERVISORY APPROVAL OF THESE CHANGES IN REVENUE AGENTS' WORKPAPER FILES.

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PARTIALLY IMPLEMENTED.

THIS HAS BEEN IMPLEMENTED. PLEASE NOTE THAT THE REVIEWER/CLASSIFIER/CONFEREES TITLE NO LONGER EXISTS. THIS SECTION IS MANAGED BY THE REVIEWER/CONFEREES. THE CLASSIFYING DUTY REMAINS IN THE AUDIT BRANCH.

C.5. PROVIDE OR ALLOCATE ADDITIONAL PERSONNEL TO THE REVIEWER/CLASSIFIER/CONFEREES SECRETARY TO AID IN THE PROCESSING OF THE STATUTORY NOTICES OF DEFICIENCY (90-DAY LETTERS) IN A TIMELY MANNER AND TO REMOVE THE 90-DAY LETTERS FROM THE AUDIT FILES FOR TRANSMISSION TO THE PROCESSING BRANCH FOR ASSESSMENT IN A TIMELY MANNER.

NOT IMPLEMENTED.

BUREAU'S RESPONSE:

WE ARE REVIEWING THE WORK FLOW FROM THE OFFICE OF CHIEF COUNSEL TO THE REVIEWER/CONFEREES TO DETERMINE HOW THE LEGAL ASSISTANT CAN ASSIST IN THIS AREA.

APPENDIX 4 - STATUS OF RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
1 to 4	Unresolved.	Consider the recommendations and provide a response that states concurrence or nonconcurrence. If concurrence is stated, provide a corrective action plan that includes the target dates and titles of the officials responsible for implementation of the recommendations.

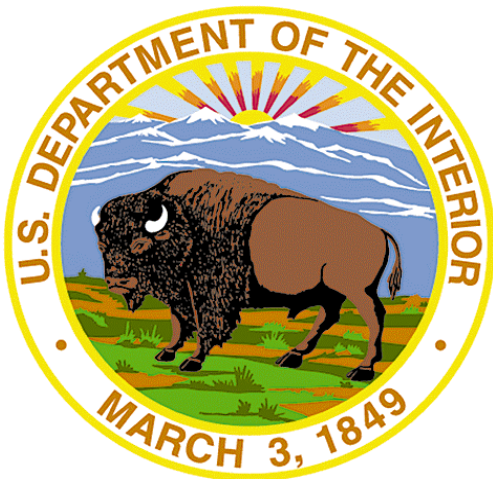
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