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

COMMISSIONER

August 10, 2000

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MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

FROM: Charles O. Rossotti
Commissioner of Internal Revenue

SUBJECT: Treasury Inspector General for Tax Administration (TIGTA) Draft Report - The Internal Revenue Service Processed Most Estate and Gift Tax Returns Accurately, but Some Estates Did Not Receive the Maximum Tax Credit (Audit No. 1999930114)

Thank you for the opportunity to review and comment on your draft report entitled "The Internal Revenue Service Processed Most Estate and Gift Tax Returns Accurately, but Some Estates Did Not Receive the Maximum Tax Credit." We are pleased you were able to confirm that most estate and gift tax returns were processed accurately. We work to ensure our systems and procedures result in accurate, timely, and reliable tax assessments and the proper crediting of accounts. We also appreciate your recommendations, which helped us improve our service to taxpayers.

As you noted in your report, most estate and gift tax returns were processed accurately and the new legislation was properly implemented. However, because of the recent increase in the maximum applicable credit amount (formerly called the unified credit amount), some taxpayers understated the amount of credit to which they were entitled. Our procedures were not designed to identify these returns and increase the allowable credit until you brought the situation to our attention.

The understatements occurred because on prior versions of Form 706, United States Estate Tax Return, the maximum amount of the unified credit, which was unchanged for 10 years, was pre-printed on the applicable line. The maximum credit increases incrementally between 1998 and 2006, when $1 million will be exempted from transfer tax. On the revised form, the line is blank and the taxpayer uses a chart to determine the appropriate amount. When taxpayers used a prior year Form 706, they often did not change the lower pre-printed amount, and we did not adjust it.

IDENTITY OF RECOMMENDATION/FINDING #1

The Acting Assistant Commissioner (Forms and Submission Processing) should review the applicable documents requesting computer programming changes to the annual exclusion amount in order to rule out a systemic programming problem.

ASSESSMENT OF CAUSE(S):
The Taxpayer Relief Act of 1997 increased the maximum annual exclusion amount that can be applied against a taxpayer's estate or gift tax. The documents submitted to request programming changes were submitted on time and reflected the correct maximum dollar amounts, limitations, and exclusions. Our computer systems are not programmed to identify the understated amounts as possible errors because the taxpayer can correctly claim less than the maximum applicable credit amount.

CORRECTIVE ACTION(S):
As stated in our memorandum to you dated May 9, 2000, we reviewed the Requests for Information Services and the Functional Specifications package to ensure the changes related to the annual exclusion amount were made correctly. We found the requirements were written, documented, and programmed correctly.

IMPLEMENTATION DATE:
May 9, 2000

RESPONSIBLE OFFICIAL:
Sheldon D. Schwartz
Acting Assistant Commissioner (Forms and Submission Processing)

IDENTITY OF RECOMMENDATION/FINDING #2
The Acting Assistant Commissioner (Forms and Submission Processing) should study the Code and Edit and Error Resolution instructions in the Internal Revenue Manual (IRM) to determine the cause of this processing problem.

ASSESSMENT OF CAUSE(S):
Taxpayers who used prior year forms that were pre-printed with a lower credit amount on line 11 may not have received the maximum applicable tax credit. Processing procedures were not in place to identify and correct the understated credit entered on outdated forms.

CORRECTIVE ACTION(S):
We updated processing instructions to ensure the maximum credit is allowed when an outdated Form 706 is filed. Instructions were issued on March 20, 2000, to update procedures in the Returns and Document Analysis and Error Resolution IRMs for Estate Tax Returns. The revised procedures address corrections to the Maximum Applicable Credit and Allowable Applicable Credit amounts when a taxpayer files an outdated version of Form 706.

IMPLEMENTATION DATE:
Completed: March 20, 2000

RESPONSIBLE OFFICIAL:
Sheldon D. Schwartz
Acting Assistant Commissioner (Forms and Submission Processing)

MONETARY BENEFIT(S):
At this time, we believe the $1.8 million estimate of overpaid estate taxes filed in 1999 on outdated forms is valid. However, we are working with your office to ensure the affected taxpayers have the opportunity to correct their accounts. Once we receive the list of taxpayers from TIGTA, we will contact them and decide if they were eligible for the full credit. We expect that once we have finished making corrections to the accounts, the actual amount of overpaid taxes will be much smaller.

The estimated $11.6 million of estate taxes that would have been overpaid in 1999 if we had not corrected our procedures, appear to be based upon valid assumptions but cannot be absolutely confirmed.

If you have any questions, please call Sheldon D. Schwartz, Acting Assistant Commissioner (Forms and Submission Processing), at (202) 622-2875.