

SUMMARY OF GAO REPORT ON THE
COLLECTION OF DELINQUENT TAXES BY THE
INTERNAL REVENUE SERVICE

In a recent report, entitled "What IRS Can Do To Collect More Delinquent Taxes" (GGD-82-4), the General Accounting Office (GAO) reviewed the Internal Revenue Service's (IRS') attempts to collect delinquent taxes from taxpayers who claim they cannot immediately pay their delinquent taxes in full.

In fiscal year 1979, the IRS collected \$4.9 billion in delinquent taxes through special collection efforts. At the end of fiscal year 1979, IRS' total accounts receivable amounted to \$13.3 billion, with \$3.3 billion classified as "currently not collectible". By the end of fiscal year 1980, IRS' total inventory of accounts receivable had increased to \$15.8 billion. According to the GAO, the IRS could collect millions of dollars in additional delinquent taxes if it increased its use of taxpayer financial information and changed its collection procedures.

In its report, the GAO reviews three approaches for dealing with delinquent taxpayers: (1) allowing taxpayers to pay delinquencies through installment agreements; (2) suspending collection action by classifying accounts as currently not collectible; and (3) accepting offers in compromise to settle delinquent accounts. The GAO also reviewed other factors that impair IRS collection programs. Each of these items is summarized below, along with a listing of GAO's recommendations to the Commissioner of Internal Revenue and IRS' comments thereon.

I. INSTALLMENT AGREEMENTS

GAO Findings and Conclusions

The Internal Revenue Code does not provide guidelines for the payment of delinquent taxes in installments. However, according to the GAO, about 97 percent of delinquent taxpayers are given the option by the IRS to pay delinquent taxes in installments, without a determination of their ability to pay, with their third deficiency notice. The GAO believes that this "automatic" program is ineffective because it delays payments from delinquent taxpayers who immediately could pay their delinquencies in full, and it allows taxpayers who do not have the ability to pay to enter into installment agreements and possibly default at a subsequent date. However, the GAO also concluded that the automatic installment-agreement-by-mail program has some benefits in the case of low-dollar accounts that would not be sent to IRS district offices for collection action.

The GAO notes that the IRS needs accurate and reliable financial information in order to determine whether taxpayers can make installment payments and, if so, how much those payments should be, or whether delinquencies should be classified as currently not collectible because payments by the taxpayers would result in undue financial hardships. The GAO concluded that the IRS has overlooked available financial information and/or has accepted erroneous and questionable financial information with the result that the collection of delinquent taxes has been delayed until taxpayers deem it convenient to pay. Furthermore, the GAO believes that the IRS does not adequately determine taxpayers' incomes nor does it place enough emphasis on requiring delinquent taxpayers to attempt to secure loans in order to pay their tax liabilities.

Finally, the GAO concluded that although the IRS has greatly increased its use of installment agreements over the last few years, it has not taken adequate steps to ensure that they are used as an effective collection tool. In addition to the foregoing problems, the GAO noted that IRS has not (1) placed enough emphasis on the use of payroll deductions to collect monthly payments; (2) taken adequate enforcement action when taxpayers miss payments; or (3) determined the reasons for the 54-percent default rate on installment agreements closed during the 6-month period ending March 31, 1980, in order to take additional steps to reduce it.

GAO Recommendations to the IRS

The GAO recommends that the Commissioner of Internal Revenue:

(1) Discontinue the current installment-agreement-by-mail program except with respect to those accounts that ordinarily would not be sent to a district office for intensified collection action;

(2) Develop guidelines based on equity in assets, gross income, income over expenses, and amount of tax liability to identify cases with loan potential and require taxpayers who meet those guidelines to seek loans to pay their tax delinquency and to provide written documentation of any loan rejections;

(3) Establish more specific guidelines for IRS employees to use in evaluating and analyzing financial statements;

(4) Require taxpayers to provide information on credit card expenses to ensure that expenses are not duplicated and that they are for necessities;

(5) Require taxpayers to provide proof of income and certain expense items that may be questionable;

(6) Require IRS employees, when taxpayer liabilities are paid off, to increase the amount of installment payments, speed up installment payments, or reactivate currently not collectible accounts;

(7) Develop a more detailed quality review of financial statements to ensure that (a) all information is considered in arriving at the decision to grant an installment agreement and (b) the information is mathematically correct;

(8) Establish installment payments based on taxpayers' ability to pay, regardless of whether the payments cover interest charges, and increase payments when possible;

(9) Place more emphasis on the use of payroll deductions as a means to collect the monthly installment payments;

(10) Establish procedures to better enforce installment agreements before defaulted agreements will be reinstated and give collection employees guidelines on acceptable reasons for missed payments; and

(11) Develop an evaluation system that would consider dollars collected, case dispositions, and costs of collecting taxes through installments in order to determine the effectiveness of the program, reasons for defaults, and possible corrective actions.

IRS Comments

The IRS currently disagrees with GAO's recommendation to discontinue the installment-agreement-by-mail program. IRS noted that this program was instituted as one means to address the problem of rising delinquent account inventories, on the one hand, and diminishing resources, on the other hand. However, IRS indicated that it would reevaluate the recommendation after it completes a study of the program in March 1982.

IRS agreed with GAO's recommendations to improve the use of taxpayer financial information in collecting delinquent taxes. However, it felt that formal guidelines regarding a taxpayer's ability to borrow would not be practical.

IRS agreed with GAO's recommendations to better enforce installment agreements and to develop an evaluation system. However, IRS stated that its current procedures adequately encourage the use of payroll deductions both at the time an installment agreement is made and before reinstatement of a defaulted agreement.

II. CURRENTLY NOT COLLECTIBLE ACCOUNTS

GAO Findings and Conclusions

In its investigation of delinquent accounts, the IRS finds that some accounts cannot currently be collected (however, collection action may still be taken until the 6-year statute of limitations runs). When an account is classified as currently not collectible, it is removed from active collection status to a suspended status. Accounts are classified as currently not collectible if delinquent taxpayers demonstrate a financial hardship, cannot be located or contacted, or owe less than a preselected dollar amount ("tolerance" cases). If an account is classified as currently not collectible based on financial hardship, the IRS selects a closing code based on an income level it believes will enable the taxpayer to make some tax payments. If the taxpayer subsequently files a return showing that income level or higher, the account is reactivated.

The GAO found that, as of September 30, 1979, 400,000 individual taxpayers owed \$1.2 billion that was classified as currently not collectible. (This represented about one-third of the total business and nonbusiness tax delinquencies that IRS had classified as currently not collectible.) Further, at the end of 1979, \$134 million of \$465.6 million that IRS dropped from its accounts receivable inventory due to expiration of the statute of limitations were for individual accounts. Finally, the GAO found that from 1974 until the end of 1979 the value of the currently not collectible tax inventory for individual taxpayers approximately doubled.

The GAO concluded that IRS could more efficiently process accounts determined to be currently not collectible if it improved its procedures for classifying such accounts, received more information on audit cases, and expanded the work performed by its office branches.

GAO Recommendations to the IRS

The GAO recommended that the Commissioner of Internal Revenue:

- (1) Establish more specific guidelines for setting closing codes for accounts classified as currently not collectible due to financial hardship to ensure that prompt and timely follow up is made to collect delinquent taxes;
- (2) Require the Examination and Collection Divisions to make arrangements for referring taxpayers to Collection or having

Examination personnel obtain financial statements from those taxpayers who agree, but are unable, to pay their tax delinquencies in full.

(3) Develop a system to code delinquent accounts resulting from audits issued to the field to show whether the delinquency resulted from a no-contact audit;

(4) Develop a statistical information system for audit-originated cases to be used to determine potential problems and as feedback for the Examination Division to show the collection outcome of audit cases; and

(5) Establish more specific guidelines for IRS office branches to use in processing delinquent accounts to ensure that they take all available collection actions before referring the case to the field branches.

IRS Comments

The IRS agreed to most of GAO's recommendations regarding the handling of currently not collectible accounts and already has implemented many of these recommendations. However, the IRS does not agree that Examination Division personnel should obtain financial statements from taxpayers, because it prefers to refer the taxpayer to the Collection Division. Further, IRS disagreed with the recommendation to develop a statistical information system for audit-originated cases, because they indicate that the cost of implementing a tracking system to show collection outcome by income classes and other criteria would be prohibitive when measured against the resulting benefits.

III. OFFERS IN COMPROMISE

GAO Findings and Conclusions

The IRS has had authority to compromise tax debts since 1864. However, the GAO found that this tool has not been used in an effective or uniform manner.

The GAO concluded that the IRS should establish firm and uniform criteria for suggesting and accepting offers in compromise and set up a system to measure and evaluate the effectiveness of offers in compromise. In addition, the GAO concluded that the IRS should take more advantage of the information it develops while investigating offers in compromise to help it collect delinquent taxes.

GAO Recommendations to the IRS

The GAO recommends that the Commissioner of Internal Revenue:

- (1) Conduct a comprehensive study to determine the most effective use of offers in compromise and the type of case where offers should be suggested;
- (2) Establish specific policies and procedures showing when and how compromises should be used as an effective collection tool;
- (3) Ensure that IRS' review of currently not collectible accounts includes a procedure to determine if revenue officers are suggesting offers in appropriate cases;
- (4) Periodically evaluate the effectiveness of the compromise program as a collection tool; and
- (5) Set up procedures to ensure that financial information developed during the offer investigation is used in follow-up collection action and that accounts previously classified as currently not collectible are reactivated when financial information indicates that collection is possible.

IRS Comments

The IRS agreed with GAO's recommendations and plans to complete a study during fiscal year 1982 to determine the most effective use of offers in compromise and the type of case where offers should be accepted.

IV. OTHER FACTORS CONTRIBUTING TO COLLECTION PROBLEMS

GAO Findings and Conclusions

According to the GAO, inadequate use of taxpayer financial information is a major hindrance to IRS' collection programs. However, the GAO found that the following factors also impair IRS' collection programs:

- (1) Because of criticism concerning the way IRS handles delinquent taxpayers, it has taken a more lenient approach toward collecting deficiencies;
- (2) Because of IRS' limited management information, it has relied heavily on a single quantitative figure--case closings--to measure district performance; and
- (3) Because resources have not kept pace with the increasing number of delinquencies, the quality and type of IRS collection programs have been governed by resource considerations.

The GAO believes these factors are interrelated and caused, in part, by the lack of an adequate management information system. The GAO notes that the IRS should establish a comprehensive evaluation system to ensure that accounts are closed fairly and appropriately, not just quickly.

GAO Recommendations to the IRS

The GAO recommends that the Commissioner of Internal Revenue:

(1) Take strong collection action when appropriate, based on more accurate and reliable financial information, to resolve delinquencies in the best interests of the Government;

(2) Establish a more comprehensive means of setting goals and measuring performance, including such criteria as dollars collected and type of disposition; and

(3) Determine what resources are need to adequately work a delinquent account and ensure accurate and reliable financial information, request the additional resources from the Congress, and inform the Congress of the cases IRS will not be able to work under various staffing levels.

IRS Comments

IRS agreed with the GAO's recommendations.

AVAILABILITY OF GAO REPORT

Copies of the GAO report (GGD-82-4) are available from the U.S. General Accounting Office, Document Handling and Information Services Facility, P.O. Box 6015, Gaithersburg, MD 20760; or phone 275-6241.



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