

**GAO**

Report to the Joint Committee on  
Taxation

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August 1989

**TAX  
ADMINISTRATION**

**IRS Can Improve the  
Process for Collecting  
100-Percent Penalties**



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United States  
General Accounting Office  
Washington, D.C. 20548

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**General Government Division**

B-232933

August 21, 1989

The Honorable Dan Rostenkowski  
Chairman, Joint Committee on Taxation

The Honorable Lloyd Bentsen  
Vice Chairman, Joint Committee  
on Taxation  
Congress of the United States

This report discusses the Internal Revenue Service's (IRS) collection of 100-percent penalties. At the request of the Committee's Chief of Staff, we reviewed IRS' collection process to see whether it could be improved. Specifically, we assessed whether 100-percent penalty cases could be processed more efficiently through IRS' Automated Collection System and whether IRS could improve the development and use of financial information in collecting the penalties.

As arranged with the Chief of Staff, we are sending copies of this report to the Commissioner of Internal Revenue and other interested parties. We will make copies available to others upon request.

The major contributors to this report are listed in appendix III. Please contact me on 275-6407 if you or your staff have any questions concerning the report.

A handwritten signature in cursive script that reads "Jennie S. Stathis".

Jennie S. Stathis  
Director, Tax Policy and  
Administration Issues

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# Executive Summary

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## Purpose

More than two-thirds of the \$886 billion in federal revenues collected in fiscal year 1987 came from employment taxes; a portion was paid directly by businesses, but most came from income and Social Security taxes withheld from workers' paychecks. Although businesses are required to pay these taxes to the federal government, nonpayment is a major problem. If the Internal Revenue Service (IRS) cannot collect the withheld taxes from a business, it may assess persons who failed to pay a penalty in the same amount as the withheld taxes. This penalty is called a 100-percent penalty. IRS' latest available data show that as of June 30, 1987, business delinquencies for these taxes were about \$15 billion, and outstanding penalties totaled more than \$5 billion.

The Joint Committee on Taxation asked GAO to review IRS' collection of 100-percent penalty assessments and to identify whether IRS could collect them more efficiently and effectively.

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## Background

When it is evident that a business will not be able to pay its employment taxes, IRS procedures require a revenue officer to start an investigation to identify responsible persons, such as corporate officers, who willfully failed to pay the taxes. When they are identified, IRS determines whether to assess a 100-percent penalty. Even though the penalty can be assessed in full against more than one person, it is IRS' policy to limit the collected amount to the business' delinquency plus interest from the date the penalties were assessed.

During the collection process, IRS sends a series of notices demanding payment. The final notice warns of IRS' intent to levy if the case is not resolved. Levy is the seizure of taxpayers' liquid assets (e.g., bank accounts, wages) in the possession of third parties (e.g., financial institutions and employers) to satisfy tax delinquencies. If a case is not resolved during the notice process, it is sent directly to a revenue officer for further action. For 100-percent penalties, IRS does not use its computerized collection system as it routinely does for other types of delinquencies.

GAO analyzed a random sample of 100-percent penalty cases from a universe of 793 cases in four IRS districts.

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## Results in Brief

IRS' collection efforts for 100-percent penalties are not benefitting from the efficiencies of automated procedures used for other tax delinquencies. Using the automated system and its collection staff would not only

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prioritize 100-percent penalty and other cases in terms of collectibility but, according to IRS statistics, close cases at about one-fourth the cost otherwise incurred.

IRS tested collection of 100-percent penalties using its computerized collection system between March and June 1989. GAO believes IRS should implement Service-wide processing as quickly as possible so that 100-percent penalties compete with other cases for collection resources and realize the benefits of automated processing.

IRS needs to ensure that obtaining pertinent taxpayer financial information is required when responsible parties are identified during initial investigation efforts and made available through the computer for use during collection efforts. IRS also needs to improve its accounting and internal controls to make it easier for collection staff to readily determine the correct account balance. Without a systematic means for monitoring and accounting for the status of collections when multiple parties are making payments to satisfy a single delinquency, collection staff may close cases with the wrong amount collected. Better accounting information on 100-percent penalties could also help IRS resolve a long-standing problem of accurately reporting its overall accounts receivable balance.

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## Principal Findings

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### Automated Collection System Can Process Cases More Efficiently

GAO believes that 100-percent penalty cases should be processed, like most other delinquencies, through the Automated Collection System. This system was designed to provide more efficient case management and more timely and effective collection efforts through improved computerized recordkeeping, telephone technology, and management control. IRS statistics show an average cost of \$57 to close a case through the Automated Collection System, or one-fourth of the \$247 spent to close a case in the field. (See pp. 15 to 17.)

Until the recent test in two IRS districts, 100-percent penalty cases bypassed the Automated Collection System and its staff and went directly to revenue officers for collection. IRS officials believed that this direct contact with taxpayers during the investigations and knowledge of the cases better enabled revenue officers to (1) collect the delinquency and (2) monitor the status of the delinquency when more than

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one person was assessed. However, these benefits can only be realized if the investigating revenue officer also handles collection, a situation that seldom occurred. (See p. 13.)

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### Financial Information Not Readily Available

Although not required to do so, revenue officers said they often obtain taxpayers' financial statements for the purpose of identifying levy sources during initial investigations. This financial information may be the only, or the most current, information that IRS has, but it is not being maintained for subsequent use by revenue officers collecting the delinquency. GAO found that the investigating revenue officers did not routinely arrange to have levy sources inputted into IRS' computerized levy source file. GAO also found that few financial statements are routinely included with the delinquency documents provided to collecting revenue officers.

The lack of documentation has resulted in collecting revenue officers asking taxpayers for financial statements and levy sources previously obtained. Also, to be of use to the Automated Collection System, financial statements and levy sources need to be included in IRS' computerized data bases. (See pp. 21 to 26.)

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### Inadequate Accounting and Internal Controls

GAO estimated that in 9 percent of the 793 cases in the universe, IRS collected an incorrect amount of money to satisfy the delinquencies because it has inadequate accounting and internal controls to ensure that the correct amount is collected. GAO was unable to determine the exact dollar amount of over- and under-collections because needed documentation was not available for all cases.

IRS is in the initial stages of developing procedures to make it easier to monitor the status of accounts. GAO believes that these procedures need to be developed and implemented as quickly as possible to correct the existing accounting and internal control problem. The information provided by these new procedures should also be used by IRS to more accurately present the accounts receivable balance applicable to 100-percent penalties. (See pp. 27 to 32.)

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### Recommendations

GAO recommends that the Commissioner of Internal Revenue establish a milestone for completing, as quickly as possible, Service-wide implementation of procedures for processing 100-percent penalty cases through the Automated Collection System.

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GAO also recommends that IRS revise its instructions to conform with the stated practice of obtaining financial information during initial investigations when appropriate and establish procedures to (1) document taxpayer financial statements and levy sources in IRS' computerized data bases, (2) accurately account for the status of delinquencies, and (3) accurately report the accounts receivable balance.

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## Agency Comments

IRS generally agreed with the report's recommendations and, in most cases, has initiatives planned that respond to the recommendations or their intent. (See app. II.) IRS did not agree to revise its instructions to conform to revenue officers' stated practice of obtaining taxpayer financial information during initial investigations. IRS did not believe that such data should be obtained during the course of all initial investigations. GAO recognizes it may not be appropriate to do so in all cases, and IRS could specify those situations in the recommended revision to its manual.

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# Introduction

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In 1987, about 68 percent of the \$886 billion in federal tax revenues collected were comprised of the employers' share of employment taxes and the income and Social Security taxes withheld by employers from employees' salaries and wages. Employers are required to withhold taxes from their employees and periodically deposit them along with the employers' share in an authorized financial institution or pay them directly to the government. However, some businesses use these funds for other purposes, such as paying other creditors, instead of paying IRS. Although employees receive full credit for their withheld income and Social Security taxes, nonpayment by employers is a major problem. IRS' latest available data show the total of such delinquencies, including the employers' share, was about \$15.2 billion as of June 30, 1987.

Congress has provided IRS with specific measures to deal with such delinquencies. One of these measures is the 100-percent penalty, which is the means by which responsible person(s), such as corporate officers, become personally liable for the withheld taxes they should have, but did not, pay as required. Although called a penalty, it is not a penalty in addition to the unpaid tax liability. It is essentially a means for transferring the unpaid tax liability to the individuals who were responsible for paying the tax on behalf of the business.

Section 6672 of the Internal Revenue Code gives IRS authority to assess a 100-percent penalty against responsible individuals who willfully fail to collect and/or pay the taxes to the government. Willfulness, for example, could mean that the responsible person knowingly used available funds to pay other creditors instead of IRS. The responsible persons are liable for the amount of withholding taxes that were not remitted to the federal government plus interest from the date they are assessed the penalty. The penalty may be assessed in full against more than one responsible individual. However, IRS' policy is to collect the amount of the tax only once. Thus, the cumulative payments made by the business and responsible parties should not exceed the tax liability plus interest from the date the penalty was assessed. IRS' latest information on the inventory of 100-percent penalties shows that as of June 30, 1987, there were 194,389 accounts with an outstanding balance of about \$5.6 billion.

## Process for Collecting the Business Delinquency

When a business fails to pay its employment taxes as reported on quarterly tax returns, IRS sends a series of computerized balance due notices to the business demanding payment. The final notice demanding payment is sent by certified mail and notifies the business of IRS' intent to levy business assets if there is no resolution of the case within 10 days. Levy is the seizure of a taxpayer's assets to satisfy a tax delinquency. IRS differentiates between the levy of liquid assets (e.g., bank accounts) that are in the possession of third parties, referred to as levies; and the levy of physical assets in the possession of the taxpayer, referred to as seizures. If the account is not resolved during the notice process, the delinquency is generally transferred to IRS' Automated Collection System (ACS) for more intensified collection action. ACS is a computerized inventory system designed to promote efficient case management and improved taxpayer contact. ACS staff can automatically dial the taxpayer's telephone number, access case information, update the taxpayer's case, and initiate enforcement actions.

When an account is transferred to ACS, the system is programmed to generate levies for those taxpayers on whom IRS has available information on assets held by third parties (levy sources). If the initial levy does not resolve the account and the taxpayer does not contact the Service, ACS staff, using existing or newly identified levy sources, may use additional levies to resolve outstanding delinquencies. ACS staff may also initiate and receive taxpayer and third party telephone contacts. If levy sources are not available, an ACS operator should attempt to contact the taxpayer to arrange payment and, as appropriate, identify levy sources. According to IRS' procedures, when ACS staff cannot resolve a delinquency or when a case requires actions beyond their authority, it is placed in a holding file and subjected to a case ranking system; i.e., it is prioritized along with other cases according to collection potential.

Based on district offices' workloads, cases with the highest potential for collection are to be assigned to revenue officers in the field for continued collection efforts. If the revenue officer fails to resolve the delinquency with the business, action can again be taken to levy the business' liquid assets and/or seize physical assets to satisfy the liability. If the business cannot make full payment, the revenue officer can establish an installment agreement or classify the account as currently not collectible. In order to accomplish either action, the revenue officer generally must obtain detailed information on the business' financial condition.

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## Process for Assessing 100-Percent Penalties

When it appears the taxes cannot be collected from the business, a revenue officer is to begin gathering information for the potential assessment of the 100-percent penalty against the responsible officials, such as corporate officers, who willfully failed to pay the withheld taxes. During this investigation, IRS frequently looks toward the officers and employees of the business who had the authority to sign checks and make disbursement decisions as the potentially responsible persons. The purpose of the investigation is to determine who within the business was responsible for withholding and paying the taxes and whether the individual or individuals willfully failed to do so.

During investigations, revenue officers are to focus on factors that tend to indicate responsibility. These factors may include determining who had bank signature authority and signed business checks and tax returns. In addition, the revenue officer may identify the person or persons who negotiated bank loans, obtain statements from employees as to which person or persons handled financial transactions for the company, and obtain articles of incorporation and corporate minutes. Determining willfulness is usually more subjective. However, IRS usually considers actions to be willful if the responsible person knew of the delinquency but paid another party instead of IRS.

Upon completion of the investigation, the revenue officer is to recommend whether or not an assessment of the penalty should be made against each person determined to be responsible. IRS is to notify the responsible persons of their appeal rights before actual assessment of the penalty.

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## Process for Collecting 100-Percent Penalties

Like other delinquent taxpayers, responsible parties in 100-percent penalty cases are to receive a series of computerized notices demanding payment. After these notices, the process for collecting 100-percent penalties differs from other delinquencies. Most other delinquencies, if not resolved during the notice process, are processed through ACS. However, according to IRS procedures, 100-percent penalty cases bypass ACS and proceed directly from the notice process to revenue officers in the field for collection action. Once cases are assigned to revenue officers, collection efforts for all cases—100-percent penalties and other delinquencies—are generally the same.

For 100-percent penalty cases, collection actions can be taken simultaneously against all responsible parties. Once the delinquent taxes and any accrued interest are collected in full from the business, one or more of

the responsible persons, or some combination of the business and responsible persons, IRS is to cease enforced collection. The business' liability for the withheld taxes and any remaining 100-percent penalty assessments against individuals are to be cancelled (abated) if no refund claims are filed within the statutory period for filing a claim for refund, generally 2 years.

## Objectives, Scope, and Methodology

At the request of the Joint Committee on Taxation, we reviewed IRS' collection of 100-percent penalties with emphasis on determining whether IRS could improve its processes. Specifically, we assessed whether such cases could be processed through ACS. We also assessed whether IRS could improve the development and use of levy source information. In this review, we define levy sources as liquid assets of the taxpayer (e.g., bank accounts or wages) that are in the possession of third parties (e.g., financial institutions or employers). We did our work at IRS'

- National Office in Washington, D.C.;
- Midwest and Southeast regional offices;
- Service centers in Austin, Texas; and Kansas City, Missouri;
- District offices in Chicago, Illinois; Dallas, Texas; New Orleans, Louisiana; and St. Louis, Missouri; and
- ACS call sites in Chicago, Illinois; Dallas and Houston, Texas; and St. Louis, Missouri.

To accomplish our objectives, we did the following:

- We obtained and analyzed information on IRS' policies and procedures pertaining to 100-percent penalty cases to determine how such cases should be processed.
- We analyzed available studies on the 100-percent penalty issue to identify changes being considered by IRS to improve its process.
- We selected and interviewed a judgmental sample of 33 revenue officers and 17 group managers with experience in processing 100-percent penalty cases in the district offices we visited. In addition, we interviewed the ACS Branch Chiefs at each of the four selected call sites.
- We interviewed members of IRS' 100-Percent Penalty Quality Improvement Project task force.
- We analyzed 100-percent penalty delinquencies being prepared at the Austin and Kansas City Service Centers for assignment to revenue officers, to determine how many taxpayers had levy sources available

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on the computerized levy source file at the time of delinquency. Specifically, we reviewed all such delinquencies for a 1-week period—December 7 to 11, 1987, in Austin, and November 23 to 27, 1987, in Kansas City.

- We analyzed a sample of 200 closed penalty case files selected at random from a universe of 793 such files closed during the 4-month period ended October 31, 1987, at four IRS district offices. We reviewed these cases to determine whether the revenue officers were following established procedures and whether the process could be improved. Appendix I provides a detailed description of the sampling methodology used.

We did our work between June 1987 and March 1989 and in accordance with generally accepted government auditing standards.

# Processing 100-Percent Penalties Through ACS Can Make More Efficient Use of Resources

IRS could make more efficient use of its collection resources by using ACS to collect 100-percent penalties, as it does for most other delinquencies. Since present procedures result in 100-percent penalties bypassing ACS and being sent directly to revenue officers in the field, the processing efficiencies of ACS are not realized nor do the cases compete on an equal basis with other delinquencies for collection resources.

IRS had considered it advantageous to assign 100-percent penalty cases directly to revenue officers rather than process them through ACS because of revenue officers' past contact with the taxpayers and knowledge of the cases. Our review and recent IRS studies showed that the possible advantages of sending cases directly to revenue officers are outweighed by the benefits of first processing these cases through ACS. IRS began testing the collection of 100-percent penalties through ACS in March 1989. On the basis of the test results, it will decide whether to implement the process Service-wide.

## IRS' Reasons for Special Treatment Were Not Valid

During our review, IRS officials had cited two benefits of processing 100-percent penalty cases differently from other delinquencies. According to these officials, revenue officers' past contact with taxpayers during the investigations and their knowledge of the cases allow them to more effectively (1) collect the delinquencies and (2) monitor the status of the delinquency when more than one person is assessed. However, these benefits can only be realized if the investigating revenue officer also handles collection.

These IRS officials told us that revenue officers were in the best position to collect 100-percent penalty delinquencies because of their involvement in the initial investigation. More specifically, one of these officials said that revenue officers develop a rapport with the taxpayer during the initial investigation that results in more effective collection. He also maintained that in most cases, the revenue officer who does the investigation also receives the delinquency for collection action. However, our analysis of the 200 sample cases showed that this seldom occurs. On the basis of our analysis, we estimate that 78 percent<sup>1</sup> of the 793 cases in our universe were assigned to a revenue officer other than the one who did the investigation. We also found that cases returned to the investigating revenue officer were subsequently transferred to one or more revenue officers during the collection process. Taking into account those

<sup>1</sup> Appendix I shows the sampling errors and confidence intervals for all attribute and variable estimates included in the report.

cases that were subsequently transferred, we estimate that 85 percent of the 793 cases were worked by at least two revenue officers.

Although returning cases to the same revenue officer who did the initial investigation could be beneficial, having the same revenue officer work the case in all instances is impractical for a number of reasons. For example, revenue officers may (1) work in a jurisdiction other than where the responsible parties reside, (2) be in training or assigned other duties when a case is assigned for collection, or (3) transfer to another IRS location or leave IRS.

The need to monitor the business and related parties is important because IRS frequently assesses the penalty against more than one responsible person for the same business delinquency. On the basis of our analysis, we estimate that 68 percent of the 793 cases in our universe involved two or more responsible parties. IRS had maintained that revenue officers were in the best position to deal with multiple responsible party assessments. However, our analysis showed that revenue officers were not doing an effective job of controlling these accounts.

We found that revenue officers have difficulty monitoring related party assessments and determining the balance due. The difficulty arises in part because payments can be made by the business, one or more of the responsible persons, or some combination of the business and responsible persons. The problem is compounded in cases where the revenue officer working the 100-percent penalty delinquency is unaware of a related party assessment. This can occur when the revenue officer receives incomplete documentation or no documentation showing related parties. To determine the balance due, the revenue officer has to be aware of related party assessments and manually analyze the tax accounts for the business and each responsible party.

Our analysis showed that revenue officers are not always able to determine the correct amount to collect. We estimate that the revenue officers over- or under-collected the delinquency in 9 percent of the 793 cases in our universe. For example, in one of these cases, two responsible parties and the business made payments toward satisfying the liability. As is IRS' procedure, each of these payments was posted to the account of whoever made the payment. Because the payments from the three sources were not considered in the context of the single delinquency, IRS overcollected the delinquency by more than \$14,700. After we brought this to the attention of IRS officials, they made appropriate adjustments to the accounts. We were unable to determine the exact dollar amount of

over- and under-collections for all cases because needed documentation was not available.

The need for improved procedures for determining the status of delinquencies is discussed in chapter 4.

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## Advantages of Collecting 100-Percent Penalties the Same Way as Other Delinquencies

Processing 100-percent penalty cases through the same collection process as other delinquencies would make more efficient use of existing collection resources. ACS offers advantages in collection operations, such as case inventory management, case research, and use of levies. Also, using ACS to do these operations costs less than using revenue officers. In addition, processing 100-percent penalty cases through the normal collection process would subject them to IRS' case ranking system and help ensure that revenue officers receive cases with the highest collection potential.

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## Utilize the Efficiencies of ACS

IRS developed ACS to promote more efficient case inventory management and more timely and effective collection efforts through improved computerized recordkeeping, telephone technology, and management control. One of ACS' first tasks is an automated analysis of delinquent cases to identify taxpayer levy sources and telephone numbers.

For delinquent cases with levy sources available, the system generates a levy. If the delinquency is not resolved, ACS staff can continue using levies if sources are available. If the delinquency is not resolved after three levies and the taxpayer has not contacted IRS, the ACS staff are to attempt telephone contact with the taxpayer. If levy sources are not available, ACS staff are to attempt telephone contact with the taxpayer.

If neither a levy source nor a telephone number is available, ACS staff do further research to identify the taxpayer's address, telephone number, and levy sources. If additional information is obtained, ACS staff use the information to attempt to resolve the case. When ACS can no longer take effective collection action, the case generally goes into a holding file, and the cases with the highest collection potential are to be assigned to revenue officers on the basis of the workload of the district offices.

Because of computer technology, ACS staff can do these collection actions and research more efficiently than revenue officers, thus reducing costs on those cases where collection is possible and perhaps speeding collection. In addition, on the cases ACS operators cannot resolve, they still

research the case. All of this saves revenue officers time if a case is subsequently assigned to the field for further collection action. The cost advantages of ACS are substantial, as reflected by IRS statistics showing the average cost of closing a case through ACS to be \$57, or less than one-fourth of the \$247 to close a case in the field. We did not verify the accuracy of these costs.

Of the 33 revenue officers we interviewed, 21 said it was practical to send 100-percent penalty cases to ACS before they are sent to a revenue officer, 1 was uncertain, and 11 said it was not practical. Several of those revenue officers who said it is practical commented that 100-percent penalty delinquencies are no different from any other delinquency and should be processed through ACS. The revenue officers generally believed that ACS staff would resolve the easier cases and do valuable research on the more difficult cases. Thus, revenue officers could make more productive use of their time.

The 11 revenue officers who said it was not practical to have 100-percent penalties processed through ACS told us that ACS staff lacked the expertise to effectively handle the complexity of 100-percent penalties, and sending these cases through ACS would slow down the collection process. In addition, they told us that because of past contact with taxpayers, revenue officers were in a better position than ACS to take effective collection action. We see no reason why ACS staff could not be trained to handle 100-percent penalty cases, and the ACS officials we interviewed agreed. They told us that although additional training would be required, they foresaw no problem since the ACS staff already received specialized training for other types of cases worked by ACS. Also, as previously stated, having a revenue officer collect the case can only be beneficial if the investigating revenue officer handles collection, a situation that seldom occurs.

To process 100-percent penalty cases through ACS, the availability of levy sources in IRS' computerized data base will be important because ACS relies on the computer to generate levies at the time a case reaches delinquent status. To determine the availability of levy sources for 100-percent penalty cases, we analyzed 536 delinquencies being prepared for assignment to revenue officers during a 1-week period at two service centers. Our analysis showed that for 78 percent, or 416 of 536 cases, IRS' computerized data base contained at least one levy source. And, for about 296 (or 71 percent) of the 416 cases, two or more levy sources were available. Accordingly, had these cases been processed through ACS, system-generated and subsequent levies could have been used, and

the cases might have been resolved without using more costly field collection resources.

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## Make for More Efficient Use of Revenue Officers

Since 100-percent penalty cases are sent directly to a revenue officer for collection, they do not compete with other delinquencies for available collection staff. If 100-percent penalty cases were processed through ACS and competed with other delinquencies for collection staff, revenue officers would no longer be working all of these cases. Rather, they would generally be assigned those cases that are unresolved by ACS and that have the highest potential for collection on the basis of IRS' scoring system.

All cases that progress beyond the notice process receive a score based on collection potential. For ACS cases, the score is used to prioritize the cases in the order in which they will be worked by ACS staff. When an operator determines that a case cannot be resolved within ACS, it is generally transferred to a holding file referred to as the queue. Once the cases are in the queue, they are automatically sequenced from highest to lowest priority on the basis of their score. The chief of the collection division in each IRS District establishes a cutoff score to regulate the flow of cases they receive from the queue for assignment to revenue officers.

Although 100-percent penalty cases receive a score like all other cases, they bypass ACS and the queue and go directly to revenue officers for further collection actions regardless of their collection potential. As a result, they do not compete against other delinquencies for collection resources before being assigned to revenue officers. For the districts in our review, we obtained the cutoff scores being used to regulate the flow of cases from the queue to revenue officers in the field. Our comparison of these scores to the scores of our 200 closed sample cases showed that many of them would not have met the criteria for transfer to the field. On the basis of our analysis, we estimate that 72 percent of the 793 cases in our universe would not have been transferred to the field for continued collection if the same cutoff scores were used.

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## IRS Studies of the 100- Percent Penalty Collection Process

During the past few years, two IRS task forces have studied ways to make more efficient use of collection resources, including looking at the potential for processing 100-percent penalty cases using ACS. More recently, in March 1989, IRS began testing procedures for processing 100-percent penalties through ACS at two ACS call sites.

In July 1987, a quality improvement project task force started reviewing various aspects of the 100-percent penalty process to identify whether portions of it could be improved. In May 1988, we met with IRS officials participating in this project to discuss their work. Their analysis showed that 100-percent penalty cases made up a large percentage of revenue officers' inventories even though they were not the most productive cases. These officials told us that 100-percent penalty cases should be processed through ACS as soon as possible, thus freeing revenue officers to work on cases with the greatest potential for collection.

In another study, IRS' Resource and Workload Management System Impact Assessment Task Force looked at the impact of IRS' priority system on resources, personnel, and management information. The task force concluded that all cases should compete for collection resources and, therefore, as great a percentage of cases as possible should be worked according to their collection potential. This task force subsequently recommended in January 1988 that 100-percent penalties be processed through ACS. Approximately 6 months later, IRS' computer services function approved a request for the necessary programming changes to allow 100-percent penalties to be routinely worked by ACS.

In January 1989, IRS began adding 100-percent penalty cases to the computer files at all ACS call sites and has experienced no problems with computer capacity. However, before implementing processing of 100-percent penalties Service-wide, IRS began a 90-day test in March 1989 at the Manhattan and the Seattle call sites. The purpose of the test was to evaluate whether ACS staff, given certain differences between 100-percent penalties and other delinquent accounts, can develop the expertise needed to process them and, if so, to determine the best procedures for processing these accounts through ACS. Other than at the two test sites, newly assessed 100-percent penalties are not being processed by ACS or revenue officers in the field.

IRS had no formal milestone for reaching its decision, but had completed the test at the two sites in June 1989. After analyzing the results of the test, IRS will decide whether to implement Service-wide processing of 100-percent penalty cases on ACS.

IRS officials have expressed concerns about (1) the ability of ACS staff to deal with payments from related parties, and (2) whether ACS will be unable to process cases and therefore have to transfer a high percentage of cases to revenue officers in the field when taxpayers question their 100-percent penalty assessments. They told us that if these concerns

materialize during the test, IRS may decide that it is not practical to routinely process 100-percent penalty cases through ACS. We recognize that processing problems could arise during the test. However, we would expect that if problems are identified, IRS would attempt to correct them before considering it impractical to process 100-percent penalties through ACS.

With regard to these concerns, tracking payments from related parties is already a problem experienced by revenue officers and will likely be encountered by ACS staff. As discussed in chapter 4, this is an internal control problem that needs to be addressed regardless of whether 100-percent penalty cases are handled by ACS or revenue officers in the field. On the second concern, we recognize that ACS staff may have difficulty responding, other than in a general way, to taxpayers' questions about their 100-percent penalty assessments. ACS staff, unlike revenue officers, will not have access to the hard copy investigation files that document assessment determinations. To the extent that these situations occur frequently, however, we believe the question is how can the quality of investigations and assessment determinations be improved, not should all 100-percent penalty cases bypass ACS and go directly to revenue officers because they are in the best position to deal with taxpayers' questions. Most taxpayers' questions about responsibility should be resolved during the investigation phase of the case; that is, before the cases are assigned to ACS or revenue officers for collection.

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## Conclusion

By having 100-percent penalty delinquencies bypass ACS, IRS is foregoing ACS' collection and research capabilities. ACS should be able to speed collection of the easier cases and more efficiently provide the research needed for revenue officers to initiate collection action on the more difficult cases. In addition, processing these cases on ACS would prioritize them and other cases in terms of collectibility and result in their competing for collection resources on an equal basis with other delinquencies. Thus, IRS would make more efficient use of its resources because revenue officers could concentrate on those cases with the highest collection potential.

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## Recommendation to the Commissioner of Internal Revenue

To ensure that IRS uses collection resources more efficiently, we recommend that the Commissioner of Internal Revenue establish a milestone for completing as quickly as possible Service-wide implementation of procedures for processing 100-percent penalty cases through the ACS.

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## Agency Comments and Our Evaluation

By letter dated June 9, 1989, the Acting Commissioner of Internal Revenue agreed with our proposal in a draft of this report that it establish a milestone for completing the 100-percent penalty test as quickly as possible. (See app. II.) The test was scheduled for completion in June 1989. IRS subsequently told us that the test was completed in June, and the results are being analyzed.

In its comments, IRS acknowledged that processing 100-percent penalty cases through ACS appears to be technically feasible from a collection standpoint and may be more efficient at inventory management than the current procedure. However, IRS expressed concern that unlike revenue officers, ACS personnel may be unable to provide ready answers to taxpayers' technical and assessment-related questions. IRS said if it decides to use ACS to collect 100-percent penalties, implementation will depend on further coordination with the field and any necessary revisions to the training materials.

We recognize IRS' concerns, and as discussed previously in this chapter (see pp. 16, 18, and 19), we believe they can be dealt with through improved initial investigations and training of ACS staff. Accordingly, as recommended, IRS now needs to establish a milestone for completing Service-wide implementation of procedures for processing 100-percent penalty cases through ACS. In establishing a milestone, we expect that the time IRS needs for any necessary field coordination and ACS staff training would be taken into account.

# IRS Needs to Ensure That Initial Investigation Information Is Available During Collection

One primary tool IRS uses to collect delinquent taxes is to levy taxpayers' assets held by third parties, such as financial institutions and employers. Revenue officers often obtain information on taxpayers' financial condition, including potential levy sources, when determining who was responsible for failing to collect and/or remit the withheld taxes. Although this financial information may be the only information, or the most current information that IRS has, it is not being maintained for efficient use by revenue officers who subsequently are to collect the 100-percent penalty assessments. By maintaining this information so that it is readily available during the collection phase, IRS can initiate collection actions more expeditiously and reduce the possibility of needing to gather the same information at a later date. Including these levy sources on IRS' existing computerized levy source file and financial statements on ACS will likewise facilitate collection of 100-percent penalties by ACS.

## Financial Information Obtained During the Investigation Is Important

During the initial investigation, revenue officers often interview potentially responsible parties and obtain statements of the responsible person's financial condition. Delinquent taxpayer financial information is a key element to the effective collection of delinquent taxes. Personal financial statements obtained from the taxpayer often provide information that shows whether the person is able to pay and what assets are available for levy or seizure. For example, the statements generally include an analysis of the responsible person's income and expenses; the name of the responsible person's current employer; a listing of financial accounts; and information on other assets that could be levied, such as life insurance cash values and dividends. Also, revenue officers sometimes identify potential levy sources through contacts with such organizations as state employment commissions and credit bureaus.

Both the group managers and the revenue officers we interviewed said that the best levy sources are those developed by revenue officers through contact with the taxpayer or third parties. This is because the sources developed by revenue officers are usually more current than those available from IRS' computer matching programs. Although the Internal Revenue Manual (IRM) makes no reference to obtaining financial information during the investigation for the purpose of identifying levy sources, district office collection officials said it is important to do so to facilitate subsequent collection. All 17 group managers we interviewed told us they emphasize that revenue officers should attempt to obtain financial information during the investigation. In addition, 29 of the 33 revenue officers interviewed said that in almost every case they try to

obtain financial information on all potentially responsible persons at the time of the investigation.

Our review of the investigation files for the sample cases showed that revenue officers do attempt to identify levy sources for responsible persons. On the basis of our analysis, we estimate that revenue officers attempted to identify levy sources in 63 percent of the 793 cases in our universe. Furthermore, we estimate that the revenue officers were successful in identifying one or more levy sources in 55 percent of those cases where they attempted to identify levy sources.

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## **Financial Information Obtained Is Not Readily Available During Collection**

IRS has established procedures to make financial information, including levy sources, available to the revenue officer attempting collection of the 100-percent penalty. Although we found that such information is being obtained during the investigation to determine whom to assess, our review of cases and discussions with IRS personnel indicate that this information is not readily available for use by the revenue officers attempting collection. Of the 33 revenue officers we interviewed, 31 said that financial information is almost never included with the delinquency documents received from the service centers. By not having this information available, collecting revenue officers may not have access to any, or the most current, financial statements or levy sources available.

Financial information and levy sources developed during the investigation are not readily available to collecting revenue officers for two primary reasons. First, the investigating revenue officers did not routinely arrange to have levy sources inputted into IRS' computerized levy source file. Second, the financial statements obtained by investigating revenue officers were not being routinely included with the delinquency documents provided to collecting revenue officers.

Revenue officers are not authorized to input levy sources into IRS' computerized levy source file, but procedures are available to have them inputted by authorized staff. However, investigating revenue officers apparently do not routinely arrange for the levy sources they identify to be inputted into IRS' computerized levy source file. For the cases in which levy sources were obtained during the investigation, we found no documentation in the investigation files to indicate they were being inputted into the computerized levy source file.

It was impractical for us to determine from the revenue officers who handled our sample cases why levy sources were not inputted. Therefore, we interviewed 33 revenue officers at the districts in our review and asked them how often they had levy sources inputted. For the 22 who said they did not routinely have the sources inputted, we asked them why. The revenue officers' reasons varied, some saying they did not see the need for such information to be inputted, some said they simply forgot to do it, some said they were not aware of the procedures for doing it, and others said they were not required to input levy sources.

The IRM does specify that financial statements, which may include levy sources obtained during the investigation, are to be forwarded to the service centers. The service centers, in turn, are to include the financial statements with the delinquency documents and forward them to the revenue officers responsible for collection. As indicated by our case analysis, investigating revenue officers do obtain financial statements. We estimate that financial statements were obtained in 19 percent of the 793 cases in our universe. However, of the 33 revenue officers interviewed, 31 said they rarely find a financial statement included with the delinquency documents they receive from the service centers.

We were unable to pinpoint the specific reason why the delinquency documents received from the service centers do not always include financial statements. It could be because they are not forwarded to service centers or because service centers are not including them with the delinquency documents sent to the field. Because the cases in our sample that had financial statements were closed cases and most had been in delinquent status for several years, we were unable to reconstruct whether the financial statements were (1) forwarded to service centers and included with the delinquency documents the revenue officers received from service centers, or (2) obtained directly by the collecting revenue officers from the investigation files.

To obtain a more up-to-date picture of how often financial statements were included with the delinquency documents, we reviewed current 100-percent penalty delinquencies being prepared at the Austin and Kansas City Service Centers for transfer to revenue officers. Our review of all 536 delinquencies being prepared at the service centers during a 1-week period showed that 11, or 2 percent, included financial statements. While the results of this analysis are not projectable, they suggest that few financial statements are being routinely obtained or forwarded to service centers.

When financial and levy source information from the investigation is not included with the delinquency documents, the collecting revenue officer can (1) request the file retained by the investigating revenue officer's district office to determine whether financial information was obtained during the investigation, or (2) contact the taxpayer for such information. About two-thirds of the revenue officers we interviewed told us they did not routinely request information from the investigation files. The two main reasons given for not requesting information from the file were that (1) the district was unable to locate or retrieve the information quickly or (2) they saw no need to request the information file unless they encountered a collection problem.

When the collecting revenue officers have not researched the investigation file for such information, the result has been that the taxpayer is contacted again for information previously obtained. When this occurs it wastes IRS' resources, upsets taxpayers, and hurts IRS' public image.

The need for maintaining financial information, including levy sources, for efficient use in the collection process will be equally if not more important than it is now if IRS begins processing 100-percent penalty cases through ACS. Since ACS is basically a paperless system that relies on computerized data, it would be impractical and inefficient for ACS staff to request financial information from hard copy investigation files. IRS has in place a computerized file from which taxpayer levy sources are transferred to ACS' data base at the time taxpayer delinquencies are assigned to ACS. Thus, current levy sources developed during the investigation could be helpful to ACS if revenue officers arranged to have them inputted into the computerized levy source file. For example, computerization of these levy sources would facilitate the use of system-generated levies, which is ACS' first collection action when levy sources are available. In addition, ACS is already designed to include information obtained from financial statements in its computerized data base. However, without a procedure for ensuring that data from the financial statements are entered into the ACS data base, the financial statements that investigating revenue officers obtain would not benefit ACS staff.

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## Conclusion

Financial information, including potential levy sources, obtained during the investigation of responsible persons is important to IRS' collection process. Information of this type is often the only information IRS has, or it is more up-to-date than information already in IRS' files. Obtaining levy sources at this initial phase may become even more critical if IRS begins processing 100-percent penalty cases through ACS. Although IRS

officials said they emphasize the need to obtain levy source information as a general practice, the Internal Revenue Manual does not include this step. Changing the manual to show that it is appropriate to obtain levy sources when responsible parties are identified would improve IRS' internal controls and provide more information for the collection phase.

Such information should also be documented in IRS' computerized levy source file to facilitate its subsequent use by revenue officers. In addition, to make the information available to the ACS call sites, the data will need to be supplied to the ACS computerized data base. Assuring that pertinent financial information is available at all steps in the process will reduce the need for gathering the same information at a later date and will avoid unnecessary taxpayer contacts.

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## Recommendations to the Commissioner of Internal Revenue

To help ensure that IRS uses its collection resources as efficiently as possible, we recommend that the Commissioner of Internal Revenue:

- Revise the Internal Revenue Manual to conform to the stated practice of obtaining financial information when responsible parties are identified during initial investigations and it is appropriate to do so.
- Establish appropriate controls to ensure that levy sources obtained during the 100-percent penalty investigations are documented in IRS' computerized levy source file so that they are readily available during the collection phase.
- Develop a procedure to ensure that financial statements obtained during the investigations are available on ACS' computerized data base to facilitate processing of 100-percent penalties through ACS.

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## Agency Comments and Our Evaluation

IRS agreed with our recommendation to establish appropriate controls to ensure that levy sources obtained during the 100-percent penalty investigations are documented in IRS' computerized levy source file. (See app. II.) IRS said it will complete an analysis by December 31, 1989, of various systems that are available for establishing appropriate controls. By September 30, 1990, IRS will put the most appropriate system into operation.

IRS also agreed with our recommendation to develop a procedure to ensure that financial statements obtained during the investigations are available on ACS' computerized data base to facilitate processing 100-percent penalties through ACS. IRS said it will develop a procedure similar to current procedures for other types of cases as described in IRM 5400.

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**Chapter 3**  
**IRS Needs to Ensure That Initial**  
**Investigation Information Is Available**  
**During Collection**

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IRS disagreed with our recommendation to revise the IRM to conform to the stated practice of obtaining financial information when responsible parties are identified during initial investigations. IRS' position is that the current IRM adequately defines those instances when financial information should be obtained, and IRS does not believe such information should be obtained during the course of all investigations. IRS said it would, however, issue a memorandum to remind collection managers of the procedures in the IRM and ask that they take steps to ensure the procedures are followed.

We do not believe the manual adequately defines when revenue officers should obtain financial information for the purpose of identifying levy sources. Although not required by the manual, revenue officers said they do obtain financial information when they identify responsible parties during initial investigations. We agree with revenue officers that whenever possible, it is useful to do so at that point in time to benefit subsequent collection efforts. Accordingly, we recommended that the IRM be expanded to include an additional procedure that would conform to their stated practice. We do, however, agree with IRS' position that it is not necessary to require that financial information be obtained during the course of all 100-percent penalty investigations. Therefore, the manual revision could also specify those situations where it would be inappropriate to do so; for example, when a person is investigated but it is unlikely that a responsibility determination will be made.

# Improvements Needed in IRS' Accounting and Internal Controls for 100-Percent Penalties

IRS needs more effective accounting and internal controls to ensure that collection employees can easily determine when the payments received and other account transactions relating to the business and responsible parties have satisfied the delinquency. Currently, IRS has no systematic means to determine the status of the delinquency when more than one responsible party is involved. This lack of internal controls can result in IRS (1) collecting more than the amount of the liability or (2) stopping collection action before collecting the full amount due.

In addition, the way IRS accounts for 100-percent penalties contributes to an overstatement of the accounts receivable balance. The balance is generally overstated because both the business and individual liabilities are included in accounts receivable, but the liability is collected only once.

## Accurate Delinquency Figures Not Readily Available

IRS does not have procedures to easily and accurately determine the balance due for taxes withheld but not paid to the government. When a payment is made to reduce or satisfy the delinquency, it is posted only to the account of the business or responsible party making the payment. IRS relies on its revenue officers to monitor transactions on the business and related party accounts and determine the net liability. However, various factors affect this determination and make it difficult for revenue officers to accurately determine the status of the delinquency. One of these factors is that in some cases the revenue officer does not know the name of the business or all of the responsible parties. Thus, any payments or adjustments involving those accounts may not be known to the revenue officer. Another factor is that revenue officers have difficulty keeping track of account transactions, such as refund offsets. Thus, without effective internal controls, IRS could collect either too much or too little.

Revenue officers responsible for collection should know the business name, business identification number, delinquent tax periods, and the names and Social Security numbers of the responsible persons. The IRM requires that this information be included with the delinquency documents when cases are assigned to revenue officers. However, the results of our analysis of delinquencies being prepared for assignment to revenue officers at two IRS service centers showed that revenue officers responsible for collection are not always receiving all this information. In addition, 23 of 33 revenue officers we interviewed in the four districts said the information was not always attached to the delinquency documents they received from the service centers. We could not pinpoint

the specific reason why the delinquency documents received from the service centers do not always include background information on the business and responsible parties involved. Without this basic information, it is difficult for the revenue officer to accurately identify related parties and determine the status of delinquencies. Unless this information is provided, the revenue officer has to rely on the delinquent taxpayer or another revenue officer to provide information about the business and any other responsible parties.

Even when the revenue officer has information on the business and other responsible parties, it is still difficult to determine the amount of payments made or other transactions to date and the remaining balance. The difficulty in monitoring the balance due arises in part because payments can come from the business, one or more of the responsible persons, or some combination of the business and responsible persons, but they are not posted to a central "control" account. Rather, IRS posts the payments to the individual account of the business or responsible party making the payment. In addition, computation of the balance due is affected by such things as the number of tax periods the business was delinquent, the number of responsible parties, interest, any refund offsets, abatements, and other credits that reduce or satisfy the liability. To adhere to IRS' policy of collecting the liability for unpaid taxes only once, revenue officers must manually identify and analyze all accounts for the business and responsible parties and compute the balance due.

We estimate that because of the lack of accounting and internal controls for monitoring the balance, the revenue officers over- or under-collected the delinquency in 9 percent of the 793 cases in our universe. In one example, IRS used its authority to prepare the business' employment tax return for an uncooperative taxpayer. This return served as a basis for assessing a 100-percent penalty of approximately \$21,000. Subsequently, the taxpayer's power of attorney filed an amended return reducing the liability to about \$6,000. The revenue officer had received the amended return and was aware of a reduction in the liability. However, he had difficulty in determining the correct balance due and levied the taxpayer's wages for the original \$21,000 liability. The proceeds of this levy, plus an offset of the taxpayer's refund of which the revenue officer was unaware, overpaid the amount for which the taxpayer was actually liable. The wage levy was subsequently released, and the taxpayer was issued a refund check.

In another example, a revenue officer abated the outstanding unpaid liability on the basis of a taxpayer's claim that the balance had been paid

in full. This case had three responsible persons, and all had credits applied to reduce their liability. A revenue officer levied against one responsible person's bank account, but for an amount less than the actual balance due. The levy source paid the full amount of the levy, and the revenue officer stopped collection action. After expiration of the 2-year period for filing a refund claim, an IRS tax examiner determined the liability was not paid in full and sent it to a revenue officer for further collection action. The taxpayer, however, insisted the account was satisfied because the full amount of the levy was paid. In analyzing the case, IRS could not document the taxpayer's contention that the liability was paid in full. Nevertheless, IRS abated the remaining liability because the revenue officer who originally handled the case had told the taxpayer that the liability had been paid in full.

IRS needs to improve its accounting and internal controls to make it easier to readily determine the correct account balance. In our opinion, the best way IRS can accomplish this is to establish procedures for monitoring the status of 100-percent penalty collections. The need for such procedures will become even more critical when IRS begins processing 100-percent penalties through ACS. Without a mechanism for efficiently and effectively controlling the status of collections when multiple parties are making payments to satisfy a single delinquency, ACS staff as well as revenue officers will encounter problems in determining the balance due and may over- or under-collect the delinquency.

IRS management recognized the need for improvements in controls to ensure that revenue officers have information needed to efficiently and effectively collect outstanding delinquencies. As a result, IRS has developed a 100-percent penalty Cross Reference History Module (CRHM) that will be on IRS' computer system and will contain information on the business and responsible parties. IRS tested CRHM in the Memphis Service Center and in March 1989 was in the process of implementing it Service-wide.

Although the CRHM will facilitate revenue officers' identification of businesses and responsible parties, it does not contain information on payments or other account transactions. Individual transactions will continue to be posted to the accounts of the business and responsible parties. Thus, collection staff will still need to separately identify account transactions to determine the status of each delinquency. IRS is aware of the difficulty revenue officers have in coordinating the 100-percent penalty collection efforts, and is in the initial stages of developing procedures to make monitoring the status of delinquencies easier.

The potential for over- or under- collecting will exist for the foreseeable future, as IRS has no timetable for finalizing these procedures.

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## Accounts Receivable Balance Is Overstated

When IRS assesses the 100-percent penalty against one or more responsible parties of the business, the business' liability for the unpaid taxes remains and is included in IRS' accounts receivable balance. Each 100-percent penalty assessment is likewise included in the accounts receivable inventory. This practice creates an inflated accounts receivable balance because it is IRS' policy to collect the delinquent taxes only once. For example, we estimate that for the 793 cases in our universe, IRS assessed businesses a total of about \$18 million for unpaid taxes. In addition, we estimate that IRS subsequently assessed \$37 million in 100-percent penalties against an estimated 1,604 responsible parties from these businesses. Thus, the estimated \$55 million in business and responsible party assessments resulted in an estimated \$37 million overstatement of the accounts receivable balance for the 793 cases in our universe.

As of September 30, 1988, IRS' accounts receivable balance was \$59.0 billion, but we were unable to determine how much of the balance represented 100-percent penalty assessments. IRS' latest information shows that as of June 30, 1987, \$5.6 billion of outstanding 100-percent penalties were included in the then \$53.2 billion accounts receivable balance. The true makeup of IRS' accounts receivable and the amount that is collectible is a broader issue than the 100-percent penalty aspect. That issue was beyond the scope of our review. Nevertheless, it appears to us that the procedures being developed to better account for the status of delinquencies, as discussed in the preceding section, could likewise be used by IRS to more accurately report the accounts receivable balance with respect to 100-percent penalties. For example, IRS could footnote or adjust the reported accounts receivable balance to more accurately reflect the amount of 100-percent penalties that otherwise overstate the accounts receivable balance.

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## Conclusion

IRS does not have adequate internal controls in place to assure that the correct amount of delinquent tax is collected. Revenue officers are unable to readily determine the status of delinquencies, particularly when they are not aware of all related party assessments. Lacking such information, revenue officers have relied on information obtained from

the responsible taxpayers themselves as a control for preventing overpayment. Requiring or relying on a taxpayer to prove to IRS that a delinquency has already been collected damages the Service's public image and relies on information from a potentially biased source. Also, this lack of internal control has resulted in over-collection of some delinquencies and under-collection of others.

IRS needs to record payments and other account transactions in a manner that will enable collection personnel, ACS staff, and revenue officers to quickly and accurately determine the status of the unpaid liability without extensive manual analyses of each business and related party account. Recognizing this, IRS is taking steps to improve internal controls by developing procedures to make monitoring the status of delinquencies easier. IRS has not established a milestone for completing development and implementation of these procedures, but it is important that IRS does so as soon as possible. In addition to producing more accurate data on the status of delinquencies, we believe that IRS should use the account information provided by these new procedures to more accurately present that portion of the accounts receivable applicable to 100-percent penalties.

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## Recommendations to the Commissioner of Internal Revenue

To improve accounting and internal controls, we recommend that the Commissioner of Internal Revenue establish milestones for

- completing the development of procedures to systematically provide collection employees with the information needed to accurately determine the status of delinquencies and
- developing a way to more accurately report the accounts receivable balance as it relates to 100-percent penalties.

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## Agency Comments and Our Evaluation

IRS agreed with our recommendation to establish milestones for completing the development of procedures to systematically provide collection employees with the information needed to accurately determine the status of delinquencies. IRS also agreed with our recommendation to establish milestones for developing a way to more accurately report the accounts receivable balance as it relates to 100-percent penalties. IRS informed us it is working with the Department of the Treasury to ensure the 100-percent penalties are accurately reflected in the accounts receivable balance. (See app. II.)

IRS said it will implement a proposal for systemic changes that will allow employees to readily determine correct account balances of related 100-percent penalty cases. IRS plans to begin system acceptability testing on May 11, 1990, and will do a pilot test in one service center beginning June 1, 1990. IRS anticipates implementing a Service-wide system by July 1, 1990.

IRS' immediate plans, however, deal only with payments made by related parties, not payments made by the business involved. IRS established July 1, 1991, as the date for exploring alternatives for dealing with payments made by the business. In the meantime, IRS will continue to manually adjust the 100-percent penalty accounts to reflect payments made to the related business accounts. IRS said a system change to account for business payments is a long-range objective because they occur infrequently. In addition, IRS said there are substantial difficulties involved in determining the amount to be applied to the 100-percent penalty account because only payments applied to the trust fund liability, i.e., the withheld taxes rather than the employer's share, result in an adjustment to the 100-percent penalty account balance.

We agree with IRS that payments from a business do not occur frequently, but we disagree that the relative infrequency of such payments warrants dealing with the internal control problem as a long range objective. In considering IRS' position, we analyzed all of our sample cases and found that business payments, although infrequent, represented almost one-half of the total dollars collected. Accordingly, from an internal control standpoint, we believe procedures for dealing with business payments should be developed within the same time frame as those for dealing with related party payments. This should ensure that IRS can effectively reduce the possibility that it will collect too much or too little in relation to the balance due.



# Sampling and Data Analysis Methodology

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This appendix describes how we selected our sample and how we projected the sample data. Included in this appendix is a table showing the statistical sampling errors for the figures in the report.

Statistical sampling enables us to make estimates and draw conclusions about the universe on the basis of information in a sample of that universe. Our particular sample covers 100-percent penalty cases closed in four IRS district offices during a 4-month period.

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## Sample Selection and Scope

We planned to take a random sample from a universe of 100-percent penalty cases closed during fiscal year 1987. However, IRS did not maintain data identifying such cases. As a result, we had to restrict our universe to cases closed from active collection inventory during a specified time period at four district offices. Accordingly, we randomly selected 50 sample cases at each district from a universe of 100-percent penalty cases closed from active inventory between July 1 and October 31, 1987. Although our results may not be representative of all 100-percent penalty cases closed in other periods or districts, IRS officials agreed with our sampling methodology and said that even though the results cannot be projected, they would generally reflect IRS's 100-percent penalty collection efforts nationwide.

We initially used a simple random sample of 50 cases from each IRS district office. We established the arbitrary sample size of 50 cases since we had no direct knowledge of total universe size. By combining the four independently determined samples, we created a stratified sample.

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## Universe and Sample Sizes

Table I.1 shows the universe, the modified universe, and the sample sizes for the four IRS district offices selected. We corrected the original universe on the basis of the percentage of cases removed from the sample.

**Table I.1: Universe and Sample Sizes of 100-Percent Penalties Closed Between July 1 and October 31, 1987**

IRS district location	Original universe	Modified universe	Cases removed from sample <sup>a</sup>	Sample size used
Chicago	340	123	88	50
Dallas	436	325	17	50
New Orleans	332	291	7	50
St. Louis	55	54	1	50
<b>Totals</b>	<b>1,163</b>	<b>793</b>	<b>113</b>	<b>200</b>

<sup>a</sup>Removed because of incomplete data. For example, we examined 138 cases out of 340 possible at the Chicago District and found that 88 of the examined cases (63.8 percent) were unusable.

## Sampling Errors for Key Estimates Used in the Report

An estimate's sampling error measures the variability among the estimates obtained for all the possible samples. Sampling error is thus a measure of the precision or reliability with which an estimate from a particular sample approximates the results of a complete census. From the sample estimate, together with an estimate of its sampling error, interval estimates can be constructed with prescribed confidence that the interval includes the average result of all possible samples. Table I.2 shows the projections and confidence intervals for the major attribute and variable estimates reported.

**Appendix I  
Sampling and Data Analysis Methodology**

**Table I.2: Sampling Errors for Key Attribute and Variable Estimates Used in the Report**

Description of universe estimates	Unweighted universe percent	Weighted universe percent	Sample error	95% confidence interval estimated range	
				Upper limit	Lower limit
Percent of cases where the 100% penalty delinquency was assigned to a revenue officer other than the one who did the investigation (see p. 13)	73.50	77.50	5.85	83.35	71.65
Percent of cases worked by at least two revenue officers (see p. 14)	83.00	84.80	5.04	89.84	79.76
Percent of cases with two or more responsible parties (see p. 14)	68.50	67.80	6.70	74.50	61.10
Percent of cases where revenue officers over- or under-collected the delinquency (see pp. 14 and 28)	10.00	9.41	4.04	13.45	5.37
Percent of cases that did not meet criteria for transfer to the field (see p. 17)	65.00	71.50	6.02	77.52	65.48
Percent of cases where revenue officers attempted to identify levy sources (see p. 22)	64.00	62.60	6.85	69.45	55.75
Percent of cases in which revenue officers identified levy sources (see p. 22)	66.41	54.80	9.39	64.19	45.41
Percent of cases in which a financial statement was obtained during the investigation (see p. 23)	21.50	19.06	5.36	24.42	13.70
Amount of unpaid business taxes in millions (see p. 30)	\$4.0	\$17.6	\$4.2	\$21.8	\$13.4
Amount of 100-percent penalties assessed in millions (see p. 30)	\$7.8	\$37.0	\$11.3	\$48.3	\$25.7
Number of responsible parties (see p. 30)	379	1,604	137	1,741	1,467
Amount of accounts receivable for unpaid business taxes and 100-percent penalties in millions (see p. 30)	\$11.8	\$54.5	\$14.7	\$69.2	\$39.8

# Agency Comments



COMMISSIONER

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

JUN 9 1989

Mr. Richard L. Fogel  
Assistant Comptroller General  
United States General Accounting Office  
Washington, DC 20548

Dear Mr. Fogel:

We have reviewed your recent draft report entitled "Tax Administration: IRS Can Improve the Process for Collecting 100-Percent Penalties".

We concur with GAO that IRS should complete its test of using the Automated Collection System (ACS) to collect the 100-percent penalty from corporate officers. As indicated in the enclosure, we are pursuing various systemic and procedural changes to enhance the collection of and accounting for 100-percent penalty cases, and testing whether we should process these accounts through the Automated Collection System. This test is scheduled for completion in June, at which time we will determine the future use of ACS in collecting 100-percent penalties.

We hope you find these comments useful.

With best wishes.

Sincerely,

  
Acting Commissioner

Enclosure

Appendix II  
Agency Comments

IRS COMMENTS ON RECOMMENDATIONS  
CONTAINED IN GAO DRAFT REPORT ENTITLED  
"TAX ADMINISTRATION: IRS CAN IMPROVE THE PROCESS FOR  
COLLECTING 100-PERCENT PENALTIES"

Chapter 2 Recommendation:

To ensure that IRS more efficiently uses collection resources, we recommend that the Commissioner of Internal Revenue establish milestones for completing as quickly as possible (1) the 100-percent penalty test and (2) Service-wide implementation of procedures for processing 100-percent penalty cases through the Automated Collection System.

Comment:

We concur with the proposal to complete the 100-percent penalty test as soon as possible, and have established milestones as recommended. This test was initiated in March 1989 and is scheduled for completion in June.

Processing 100-percent penalty accounts through the Automated Collection System (ACS) appears to be technically feasible from a collection standpoint, and may be more efficient at inventory management than our current procedure, which utilizes revenue officers to collect these amounts. However, we are concerned that ACS personnel may not be able to provide ready answers to technical and assessment-related questions. In response to this report, both the Taxpayer Ombudsman and experienced revenue officers expressed concern that taxpayers required to pay these penalties would have more difficulty dealing with ACS employees than face-to-face with revenue officers charged with explaining the rules and collecting the accounts. Once completed, the test currently underway in two districts will be used to weigh all the factors and to make a decision. If we decide to use ACS to collect these penalties, implementation will depend on further coordination with the field, and any necessary revisions to training materials before release.

Chapter 3 Recommendations

To help ensure that IRS uses its collection resources as efficiently as possible, we recommend that the Commissioner of Internal Revenue: 1) Revise the Internal Revenue Manual to conform to the stated practice of obtaining financial information when responsible parties are identified during initial investigations and it is appropriate to do so....

Comment:

We disagree with the recommendation. The recommended procedure is already referenced several times in the current Internal Revenue Manual (IRM), and we see no need to revise it.

Appendix II  
Agency Comments

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We will, however, issue a memorandum reminding Collection managers of these procedures and ask that they take steps to ensure they are followed. However, we do not believe it is necessary to require that financial information be obtained in the course of all 100-percent penalty investigations..

Chapter 3 Recommendation

...2) Establish appropriate controls to ensure that levy sources obtained during the 100-percent penalty investigations are documented in IRS' computerized levy source file so that they are readily available during the collection process.

Comment:

We agree with this recommendation. By December 31, 1989, we will complete an analysis of various systems that are available for establishing appropriate controls to ensure that the levy sources obtained during a 100-percent penalty investigation are input to IRS' levy source file. By September 30, 1990, we will put into operation the most appropriate system.

Chapter 3 Recommendation

... 3) Develop a procedure to ensure that financial statements obtained during the investigations are available on ACS' computerized data base to facilitate processing of 100-percent penalties through ACS.

Comment:

We agree. We will develop a procedure that ensures that financial data secured during 100-percent penalty investigations is also input to the data base for ACS use. This procedure will be similar to current procedures in IRM 5400 for other types of cases.

Chapter 4 Recommendations

To improve accounting and internal controls, we recommend that the Commissioner of Internal Revenue establish milestones for: 1) completing the development of procedures to systematically provide collection employees with the information needed to accurately determine the status of delinquencies and 2) developing a way to more accurately report the accounts receivable balance as it relates to 100-percent penalties.

Appendix II  
Agency Comments

-3-

Comment:

We agree with the recommendations and have been improving the quality of our accounting system for 100-percent penalty cases. Recently our Computer Services function agreed to implement a proposal for systemic changes which will allow employees to readily determine correct account balances of related 100-percent penalty cases. The request for data services was submitted in May 1989. We plan to begin system acceptability testing on May 11, 1990. Beginning June 1, 1990, we will pilot the system in one service center. That service center will be selected by January 1, 1990. Nationwide implementation of the system is scheduled for July 1, 1990. We will continue to manually adjust 100-percent penalty cases for payments to the related corporate account. We have established July 1, 1991, as the date by which we will explore possibilities for system notification on 100-percent penalty accounts of any corporate payments. This is a long range objective because payments to the corporate account occur infrequently. There also are substantial difficulties involved in determining the amount to be applied to the 100-percent penalty account, because only payments to the corporate trust fund balance result in adjustment of the 100-percent penalty account balance. In addition, we are currently working with the Department of Treasury to ensure that 100-percent penalties are accurately reflected in the accounts receivable balance.

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