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BY THE COMPTROLLER GENERAL

# Report To The Congress

OF THE UNITED STATES

## What IRS Can Do To Collect More Delinquent Taxes

The number and amount of delinquent tax accounts are increasing faster than IRS can deal with them. In 1979 delinquent taxes owed the Government exceeded \$13 billion. Although IRS collected almost \$5 billion in delinquencies that year, delinquencies grew by \$2 billion, totaling more than \$15 billion by the end of fiscal year 1980.

Passive collection policies, inadequate use of taxpayer financial information, inefficient collection program operations, lack of management information, and limited resources all contribute to this increase in tax delinquencies.

IRS has made several changes to correct many of the problems GAO identified. The changes IRS has instituted will help ensure that IRS employs the most effective and efficient actions to collect the greatest amount of delinquent tax revenue in the shortest time period and help reduce the Government's need to borrow to finance its operations.



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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON D.C. 20548

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To the President of the Senate and the  
Speaker of the House of Representatives

This report discusses the Internal Revenue Service's efforts to collect delinquent taxes from taxpayers who claim they cannot pay them in full. We made this review because of the current interest in collecting debts owed the Government in a timely manner and decreasing the amount of Federal borrowing. The report points out the need for the Service to obtain and use taxpayer financial information to determine whether delinquent taxpayers can pay in full or in installments. It also shows that improvements in the procedures for dealing with taxpayers who do not fully pay their taxes would increase the efficiency and effectiveness of these programs.

Copies of the report are being sent to the Director, Office of Management and Budget; the Secretary of the Treasury; the Commissioner of Internal Revenue; and other interested parties.

A handwritten signature in cursive script that reads "Charles A. Bowker".

Comptroller General  
of the United States



D I G E S T

The Internal Revenue Service (IRS) could collect millions of dollars in additional delinquent taxes if it increased its use of taxpayer financial information and changed its collection procedures. These changes would help ensure that IRS employs the most effective and efficient actions to collect the greatest amount of delinquent tax revenue in the shortest time period.

In fiscal year 1979, IRS collected \$4.9 billion in delinquent taxes through its special collection efforts. However, during the same fiscal year, IRS classified \$845.6 million as currently not collectible and wrote off \$465.6 million because the 6-year time period for collecting these taxes expired. At the end of fiscal year 1979, IRS' total accounts receivable inventory was \$13.3 billion. Of this amount, \$3.3 billion was classified as currently not collectible, and taxpayers were making installment payments against \$272 million in delinquencies. By the end of fiscal year 1980, the total inventory of accounts receivable increased to \$15.8 billion.

Because of the magnitude of these delinquent taxes and the concerns of the Congress and others about improving the collection of tax revenues and decreasing Federal borrowing, GAO reviewed IRS' activities to collect delinquent taxes from taxpayers who claim they cannot immediately pay their delinquent taxes in full.

COLLECTION PROCESS

IRS attempts to obtain payment of delinquent taxes through a series of written notices and demands. With the third notice, most individual taxpayers are given the option to make installment payments.

If delinquent taxpayers do not pay, accounts meeting a certain dollar criterion are referred to Collection Division personnel for intensified collection actions.

If a taxpayer then claims that full payment cannot be made, IRS requests a written financial statement from the taxpayer to determine if the claim is valid or if the taxpayer can make installment payments. If the taxpayer cannot make any payments, the account is classified as currently not collectible. At any time during the collection process the delinquent taxpayer can attempt to reduce the total tax delinquency by making an offer in compromise. (See pp. 3 to 5.) GAO identified problems throughout the collection process, and these are presented in the order in which they occur.

IRS SHOULD STOP GRANTING INSTALLMENT AGREEMENTS WITHOUT DETERMINING TAXPAYERS' ABILITY TO PAY

IRS offers an estimated 97 percent of individual delinquent taxpayers sent third notices the option to pay through installments without considering their ability to pay. This option is offered by mail before the accounts are sent to district offices for intensified collection action. At the time of GAO's review, IRS was also offering first-time delinquent taxpayers this option after referring the accounts for more intensified collection action.

GAO's review of installment agreements in four IRS districts showed that many taxpayers with substantial incomes or otherwise with an apparent ability to pay were taking advantage of the program. GAO estimated that 20 percent of the taxpayers in the four districts had incomes exceeding the high income levels for each district as defined by the Department of Labor, which range from \$24,700 to \$27,200. Nearly 15 percent of the taxpayers could have paid their liabilities immediately with savings identified by interest income shown on their tax returns. In one case, a taxpayer earning about \$77,000 a year was granted an installment agreement for a \$3,000 liability. (See pp. 10 to 12.)

As a test, GAO requested IRS to obtain information on ability to pay from individual delinquent taxpayers who would have been automatically granted installment agreements. As a result of

the test, IRS requested full payment from 25 percent of such delinquent taxpayers. (See pp. 12 and 13.)

Although IRS initiated installment agreements without determinations of ability to pay under its policy to be more lenient with first-time delinquents, it has not taken adequate steps to ensure that only first-time delinquents are given this option. GAO estimates that 38 percent of the taxpayers taking advantage of this program in the four districts were repeaters. (See p. 13.)

#### GAO RECOMMENDATION AND IRS COMMENTS

The Commissioner of Internal Revenue should discontinue the current installment-agreement-by-mail program except for those accounts which would ordinarily not be sent to a district office for intensified collection action.

IRS presently disagrees with GAO's recommendation. However, IRS is currently studying the mail program and expects to complete the study in March 1982. At that time IRS said it would reevaluate the recommendation.

GAO believes that the current mail program allows many taxpayers to delay payment of their taxes even though they have the ability to pay in full. IRS did not consider this fact when it initiated the program and is not considering it in the current study. Also, IRS stated that the mail program was one way to handle its increasing delinquency problem. However, GAO found that the program was not having any significant effect on reducing the delinquent account workload. Therefore, GAO continues to believe that the installment-agreement-by-mail program, in its present form, should be discontinued. (See p. 15.)

#### BETTER DETERMINATION OF TAXPAYERS' ABILITY TO PAY WILL INCREASE COLLECTIONS

Even when IRS obtains taxpayer financial information it does not always use it to the fullest extent. GAO estimates that of 5,116 installment agreements in four IRS districts, ability

to pay was not used to determine the most effective method to handle cases in 85 percent of the agreements.

Inadequate determination of ability to pay severely hampers the effective use of installment agreements. In addition, classifying accounts as currently not collectible based on inadequate financial information is a greater problem since these taxes may never be collected.

GAO estimates that IRS did not adequately:

- Use equity information to require taxpayers to secure loans in 28 percent of the 5,116 installment agreements with financial statements. (See pp. 18 and 19.)
- Use the information shown on personal financial statements as a basis for classifying 10 percent of 11,884 taxpayers as currently not collectible. GAO estimates that IRS could have collected \$1 million in the four districts in the first year if it required taxpayers with accounts inappropriately classified as currently not collectible to make payments. (See p. 20.)
- Verify income in 38 percent of the installment agreement cases and in over 28 percent of the currently not collectible cases where taxpayers understated their income by at least \$2,000. In this connection, GAO estimates that 1,762 of the 4,638 taxpayers with installment agreements (having financial statements and tax returns on file) understated their income by \$8.5 million and that 1,856 of the 6,538 taxpayers with accounts classified as currently not collectible understated their income by \$6 million. (See pp. 20 and 21.)
- Question expenses in 37 percent of the 5,116 installment agreement cases and in 21 percent of the currently not collectible cases for such items as campers, boats, travel trailers, music and dancing lessons, coin clubs, and maid service. (See pp. 21 to 23.)
- Consider when other liabilities would be paid off in 33 percent of the 5,116 installment agreement cases and in 15 percent of the currently not collectible cases. GAO estimates

that, had IRS used this information it could have requested taxpayers to pay an additional \$2.2 million during the first 2 years of the installment agreements and collected an additional \$1 million during the first year after classifying accounts as currently not collectible. (See pp. 23 and 24.)

--Review financial statements for mathematical accuracy in 11 percent of the 5,116 installment agreement cases. GAO noted errors ranging from overstating the taxpayer's ability to pay by \$200 to understating the taxpayer's ability by \$1,000 a month. (See pp. 24 and 25.)

#### GAO RECOMMENDATIONS AND IRS COMMENTS

The Commissioner of Internal Revenue should establish more specific guidelines for employees to use in evaluating and analyzing taxpayer financial statements, including guidelines defining necessary expenses.

GAO made a number of other recommendations to improve IRS' determination of the taxpayer's ability to pay. (See pp. 26 and 27.)

IRS agreed with GAO's recommendation to establish more specific guidelines for evaluating and analyzing taxpayer financial information. Other IRS comments are shown on pages 27 and 28 of the report.

#### IRS NEEDS TO BETTER MANAGE THE INSTALLMENT AGREEMENT PROGRAM

Although voluntary payroll deductions are considered one of the best means of making payments, IRS has made only limited use of this procedure. GAO estimates that only 9 percent of an estimated 7,388 wage earners with installment agreements in four districts were using payroll deductions. (See pp. 29 and 30.)

Also, IRS has not taken adequate enforcement action when taxpayers miss payments. Thirty-five percent of taxpayers with installment agreements in the four districts missed at least one payment and were reinstated. In some cases taxpayers missed as many as five payments and each time had their agreements reinstated. (See p. 30.)

Even though many agreements are reinstated, the default rate is high. IRS has not taken adequate steps to determine the reasons for the 54-percent default rate on closed agreements. This high default rate raises serious questions about the effectiveness of IRS' use of installment agreements, particularly since many taxpayers could have fully paid their tax delinquencies. (See pp. 30 and 31.)

GAO RECOMMENDATIONS AND IRS COMMENTS

The Commissioner of Internal Revenue should:

- Place more emphasis on the use of payroll deductions as a means to collect monthly installment payments.
- Develop an evaluation system that would consider dollars collected, case disposition, and cost of collecting through installments to determine the effectiveness of the program.
- Establish procedures to better enforce installment agreements before reinstatement of defaulted agreements and give collection employees a guide on acceptable reasons for missed payments.

IRS agreed with two of GAO's recommendations but felt that procedures already adequately encourage the use of payroll deductions. However, GAO does not believe that sufficient emphasis is given to payroll deduction use. For example, one region visited by GAO encouraged payroll deductions which were used for 24 percent of wage earner installment agreements. The three other districts visited by GAO did not encourage payroll deductions and their use ranged from 1 to 6 percent. Therefore, GAO believes that, with emphasis, the use of payroll deductions can increase. (See pp. 32 and 33.)

BETTER DETERMINATION OF  
FOLLOWUP CODES NEEDED

After IRS classifies an account as currently not collectible, followup collection action can take place if IRS receives information that reverses the reason the account was so classified.

When an account is classified as currently not collectible based on financial hardship, IRS selects a closing code based on an income level IRS believes will enable the taxpayer to make some tax payments. Once the taxpayer files a tax return showing that income level or higher, the account will be reactivated. GAO found that the closing codes were set too high in 39 percent of the cases reviewed, thereby precluding prompt followup action to collect the delinquencies. (See pp. 36 to 39.)

#### GAO RECOMMENDATION AND IRS COMMENTS

The Commissioner of Internal Revenue should establish more specific guidelines for setting closing codes for accounts classified as currently not collectible due to financial hardship so as to ensure that prompt and timely followup is made to collect delinquent taxes.

IRS agreed and has revised procedures for setting closing codes. (See p. 46.)

#### EXAMINATION DIVISION NEEDS TO DO MORE TO ASSIST IN COLLECTING DELINQUENCIES

When the Examination Division reaches agreement with a taxpayer on the results of an audit, it requests payment. However, if the taxpayer indicates an inability to pay, there are no procedures for routinely referring the taxpayer to the Collection Division or obtaining financial information. If the Examination Division was unable to contact the taxpayer neither this fact nor information on the attempts made to contact the taxpayer is passed on to the Collection Division. (See pp. 39 to 42.)

IRS statistics show that 21 percent of the individual delinquent accounts sent to districts nationwide originated from audits. GAO found that 40 percent of the currently not collectible cases reviewed in the four districts were audit cases, indicating that the audit cases pose a bigger collection problem than other accounts. Review of 272 audit cases showed that:

--In 113, or 42 percent, of the cases, the Examination Division contacted the taxpayer and obtained agreement with the audit results. However, in 13 percent of the 113 cases the Collection Division was later unable to contact or locate the taxpayer. In 77 percent of the 113 cases, the accounts were classified as currently not collectible due to financial hardship. (See pp. 40 and 41.)

--In 55, or 20 percent, of the cases the Examination Division contacted the taxpayer but was unable to obtain agreement with the audit results. In 27 percent of the 55 cases the Collection Division was later unable to contact or locate the taxpayer. In 58 percent of the 55 cases, the accounts were later classified as currently not collectible due to financial hardship. (See p. 41.)

--In 104, or 38 percent, of the cases the Examination Division was unable to contact the taxpayer. In 50 percent of the 104 cases the Collection Division was also unable to contact or locate the taxpayer. In 37 percent of the 104 cases the accounts were later classified as currently not collectible due to financial hardship. (See p. 41.)

Neither the Examination Division nor the Collection Division knew the full extent to which audit assessments are classified as currently not collectible because of the lack of adequate statistical data. (See pp. 41 and 42.)

#### GAO RECOMMENDATIONS AND IRS COMMENTS

The Commissioner of Internal Revenue should require the Examination and Collection Divisions to make arrangements for referring taxpayers to Collection or have Examination personnel obtain financial statements from those taxpayers who agree to but are unable to pay their tax delinquencies in full.

GAO made a number of additional recommendations to improve IRS procedures for handling currently not collectible accounts. (See pp. 45 and 46.)

IRS generally agreed with GAO's recommendations. However, IRS disagreed with the recommendation to have Examination Division personnel obtain financial statements from taxpayers, preferring to refer the taxpayers to Collection. GAO agrees with this preference but believes that if Collection Division personnel are not available Examination Division personnel should collect some taxpayer financial information. (See pp. 46 and 47.)

IMPROVEMENTS IN OFFICE BRANCH  
COLLECTION ACTIVITIES COULD  
REDUCE EXPENSE OF WORKING CASES

Delinquent accounts are first worked in the districts' office branch and if the accounts are not resolved there, they are sent to the field where higher graded personnel work the case. GAO found that 22 percent of the 335 cases closed in the field could have been closed by office branches. The higher graded field personnel took no action that could not have been taken by office branch personnel, and the accounts were within the criteria for office branches to close. (See pp. 42 to 44.)

GAO RECOMMENDATION AND IRS COMMENT

The Commissioner of Internal Revenue should establish more specific guidelines for office branches to use in processing delinquent accounts to ensure that they take all available actions before transferring cases to the field branches.

IRS agreed with this recommendation and is developing appropriate guidelines. (See p. 46.)

IRS NEEDS A FIRM POLICY ON THE  
USE OF OFFERS IN COMPROMISE

Although IRS' authority to compromise tax debts dates from the 19th century, the Commissioner has yet to establish uniform criteria to help revenue officers decide when to consider using and when to accept offers in compromise. The use and acceptance of offers thus depends on district office policy and has been limited and

inconsistent. (See pp. 48 to 53.) Taxpayers initiate offers in compromise, usually on their own volition and not based on any suggestion by IRS. IRS has little input into who submits an offer and does not know whether the most qualified taxpayers are submitting offers.

Although IRS recognized the inconsistent use of offers and placed added emphasis on the program beginning in March 1979, little change has occurred. Overall, the number of offers received and the acceptance rate have decreased from fiscal year 1978 through the first half of 1980 when only 820 offers were received and 163 accepted. Use of offers varied considerably between districts. In fiscal year 1979, one large IRS district received 25 offers and accepted 2, while a similar-sized district received 217 offers and accepted 75. (See pp. 50 to 53.)

In addition, IRS' procedures for collecting liabilities on offers not accepted have not been very effective. Even after investigations revealed an ability to pay, IRS did not automatically reactivate 90 percent of the accounts that had been previously classified as currently not collectible. Similarly, revenue officers are not always provided financial information developed during the offer investigation to assist in collecting the liabilities. Although IRS determined that 50 of the 103 offers rejected or withdrawn in 1978 in the four districts reviewed were for amounts less than what the taxpayer could pay, IRS collected only 78 percent of the amount offered. In fact, only 17 of 50 taxpayers did pay more than was offered. (See pp. 53 to 56.)

#### GAO RECOMMENDATIONS AND IRS COMMENT

The Commissioner of Internal Revenue should establish procedures to ensure that financial information developed during the offer investigation is used in followup collection action and that accounts previously classified as currently not collectible are reactivated when such information indicates that collection is possible.

GAO made a number of other recommendations to improve IRS' use and acceptance of offers in compromise and to make better use of information developed during the offer investigation. (See pp. 58 and 59.)

IRS agreed with GAO's recommendations and has taken several steps to improve the use of offers in compromise. (See p. 59.)

OTHER FACTORS CONTRIBUTING TO THE  
INADEQUATE HANDLING OF DELINQUENCIES

Although inadequate use of taxpayer financial information is a major hindrance to IRS' collection programs, three other factors also impair them. (See p. 60.)

--Because of the many criticisms of the way IRS handles delinquent taxpayers, it has taken a more lenient approach to collecting delinquencies. Some of the problems GAO identified can be related in part to this collection philosophy. (See pp. 60 and 61.)

--Because of limited management information, IRS has relied heavily on a single quantitative figure--case closures--to measure district collection performance. The type of disposition and dollars collected are not considered in IRS evaluation programs. Relying on a single measure can result in more emphasis being placed on meeting this goal than on collecting taxes in the most efficient and effective way. (See pp. 61 to 63.)

--Because resources have not kept pace with the increasing number of delinquents, the quality and type of IRS collection programs have been governed by resource considerations. IRS has taken actions to reduce the workload in district offices but contends it still does not have adequate resources to work cases. (See pp. 63 and 64.)

It appears that more resources are needed to adequately perform the collection function. However, IRS does not know what resources are needed because it does not have cost information.

IRS is taking actions to deal with these problems but the actions are not enough. (See pp. 64 and 65.)

GAO RECOMMENDATIONS AND IRS COMMENTS

The Commissioner of Internal Revenue should determine what resources are needed to adequately work a delinquent account and ensure accurate and reliable financial information, request such resources from the Congress, if necessary, and inform the Congress of the cases IRS will not be able to work under varying staffing levels.

Other recommendations are on page 66.

IRS agreed with these recommendations and noted that new case processing and information systems will provide more reliable information for better evaluating resource needs. (See pp. 66 and 67.)

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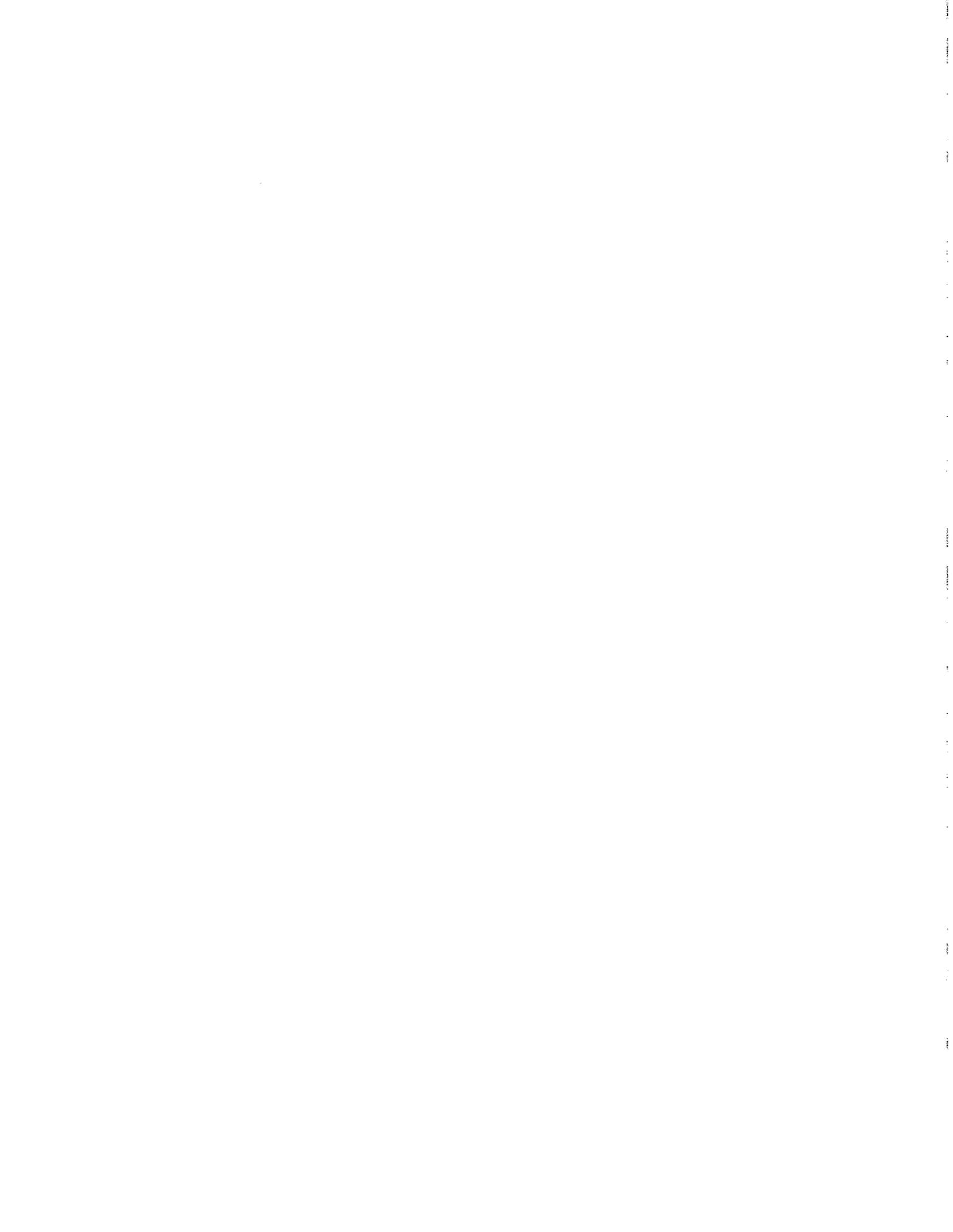
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ABBREVIATIONS

GAO	General Accounting Office
IRS	Internal Revenue Service



## CHAPTER 1

### INTRODUCTION

Taxes are the primary source of Federal revenues, accounting for 96 percent of the \$465.9 billion collected in fiscal year 1979. However, Federal revenues are not always large enough or collected fast enough to cover expenditures. Therefore, the Government must borrow money. In fiscal year 1980, the Government paid \$74.8 billion in interest on this borrowed money.

The Internal Revenue Service (IRS) collects most taxes. For this massive job IRS relies heavily on the voluntary compliance of millions of taxpayers. The majority of taxpayers accurately determine and pay their taxes on time. However, some taxpayers attempt to avoid paying their taxes or are not able to pay their taxes when due. IRS' compliance programs--examining tax returns, securing delinquent returns from nonfilers, investigating taxpayers who evade their tax responsibilities, and collecting delinquent taxes--are aimed at identifying these taxpayers and collecting their tax liability.

In fiscal year 1979, taxpayers voluntarily paid IRS almost \$419 billion in taxes. Through its special collection efforts IRS collected \$4.9 billion in delinquent taxes. However, in fiscal year 1979, IRS classified \$845.6 million as currently not collectible and wrote off \$465.6 million because the statutory period for collection expired. <sup>1/</sup> The total inventory of accounts receivable at the end of fiscal year 1979 was \$13.3 billion. Of this amount \$3.2 billion was classified as currently not collectible, and taxpayers were making installment payments against \$272 million in delinquencies. By the end of fiscal year 1980, the total inventory of accounts receivable increased to \$15.8 billion.

IRS' Collection Division is responsible for collecting delinquent taxes. The Division is decentralized among 7 regions, 58 districts, and 10 service centers. The actual collection of delinquent taxes is carried out by IRS personnel in the district offices and service centers. In addition to collecting delinquent taxes, the Division is responsible for securing unfiled returns and for identifying and preventing future delinquencies.

The number of delinquent accounts sent to IRS district offices for collection is increasing faster than Collection Division resources. In fiscal year 1979, 2.34 million delinquent accounts were sent to district offices for collection, an increase of 14 percent from 1978. IRS estimates that the number

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<sup>1/</sup>Generally, IRS has 6 years from the date of assessment to collect the taxes.

of delinquencies will continue to increase. In 1979, IRS' Collection Division staff totaled 11,753, an increase of only 4 percent from 1978. Although total staffing in fiscal year 1980 and the budget request for 1981 show increases in total staff, the figures include a transfer of 821 service center positions to the Collection Division.

The following table shows actual and estimated staffing by fiscal year for IRS' Collection Division.

	1978 <u>Actual</u>	1979 <u>Actual</u>	1980 <u>Actual</u> (note a)	1981 <u>Estimate</u> (note a)
Collection of delinquent accounts	8,780	8,932	9,416	10,018
Delinquent return investigations	2,511	2,586	3,145	2,989
Return compliance programs	<u>(b)</u>	<u>235</u>	<u>241</u>	<u>266</u>
Total	<u>11,291</u>	<u>11,753</u>	<u>12,802</u>	<u>13,273</u>

a/Total increase includes 821 positions transferred from the Returns Processing and Accounting Division. Service center personnel in these positions were previously performing collection activities but not budgeted in the Collection Division.

b/IRS did not break out staff resources for returns compliance programs until fiscal year 1979.

Although IRS district offices close most of the delinquent accounts they receive each year, the inventory of delinquent accounts being actively worked in IRS' district offices is increasing. From July 1, 1976, to January 1, 1980, the inventory more than doubled from 614,000 to 1.25 million accounts. The dollar value of these accounts increased from \$1.7 billion to \$3.2 billion. IRS estimates that the inventory may exceed 2 million accounts totaling \$6.3 billion by the end of fiscal year 1982. If this trend continues without changes in staffing or productivity, the inventory may reach 4 million accounts by 1984 and represent more than \$10 billion. These figures only represent delinquent accounts being actively worked in IRS' district offices. They do not include other accounts receivable, such as those classified as currently not collectible, deferred because the dollar liabilities are under a specific dollar level 1/, handled under installment

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1/Specific dollar criteria used by IRS during its collection process are not shown in this report. Disclosure of these dollar amounts could have an adverse effect on IRS' collection activities.

agreements or still receiving balance due notices from the service centers. The inventory of delinquent accounts not being actively worked in the districts at the end of fiscal year 1979 was over four times that of those being actively worked.

#### COLLECTION PROCESS

Taxpayers are delinquent if they (1) file returns but do not pay the required taxes, (2) fail to file returns, or (3) file incorrect returns which understate their tax liabilities. Once IRS determines through its processing, examination, or collection functions that additional tax liabilities are due, the process to collect the delinquencies begins. If the tax liability is determined through audit of a tax return, IRS' Examination Division personnel may solicit payment at the completion of the audit. However, they cannot demand payment because IRS has not legally assessed the additional taxes at that time.

After the delinquent taxes are legally assessed, IRS sends the delinquent taxpayer a notice and demand. The Internal Revenue Code states that if payment is not made within 10 days after notice and demand, IRS can levy 1/ the taxpayer's property. IRS rarely takes such action immediately after the 10-day period. If payment is not received in 5 weeks, a second notice is sent, which includes a publication explaining the collection process (see app. II). After an additional 3 weeks, a third notice is sent if the account is still not satisfied. With the third notice individual taxpayers with liabilities under a certain dollar amount receive an application for an installment agreement (see app. III). A delinquent taxpayer can pay the tax delinquency in 12 or fewer equal monthly payments. A fourth and final notice is sent 4 weeks later if the account is still unpaid or if arrangements have not been made to pay in installments. (See app. IV for copies of the notices.)

Three weeks after the last notice is sent all unresolved delinquent accounts over a certain dollar amount are sent to the district offices for further collection action. Normally delinquent accounts are first handled by the districts' office branch where IRS personnel attempt to contact taxpayers through letters, telephone calls, or personal contacts. Office branch personnel can accept installment agreements from taxpayers, classify accounts as currently not collectible, serve levies, and file tax

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1/IRS can legally levy (the power of distraint and seizure by any means) a taxpayer's property or rights to property if the taxpayer refuses to pay the tax. IRS has two types of classifications: (1) seizure of assets in the possession of third parties generally banks and employers (levy) and (2) seizure of property in the possession of the taxpayer (seizure).

liens. If office branch personnel cannot resolve the accounts, the accounts are forwarded to higher graded revenue officers in the field. Revenue officers attempt to contact the taxpayers, preferably through personal visits, and demand full payment. In addition to performing the same functions as office branch personnel, revenue officers can seize and sell taxpayers' property to satisfy the tax debt. Revenue officers may also advise the taxpayers of their right to submit offers in compromise. (See app. V for flow chart of the normal processing of a delinquent account.)

This report deals with IRS' activities to collect delinquent taxes from taxpayers who do not immediately pay their tax delinquencies in full. Three approaches for dealing with these delinquent taxpayers were reviewed: (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. We identified problems throughout the collection process which are reported in the order they occur.

#### Installment agreements

No specific statutory authority exists for allowing taxpayers to liquidate delinquent accounts by installment agreements. Prior to April 1976, IRS would grant installment agreements only if the taxpayer's financial statement showed an inability to fully pay the delinquency. Use of this collection approach increased after April 1976 when IRS instituted its first-time delinquent program in its districts. This program allowed taxpayers to automatically enter installment agreements without providing detailed financial information. The program was further liberalized in July 1979 when all individual taxpayers with delinquencies under a certain dollar amount were offered by mail the option to pay their liabilities through installments without providing financial information.

The inventory of delinquent taxes being paid through installments at the end of fiscal year 1979 totaled \$272 million. During the first 6 months of fiscal year 1980, IRS granted installment agreements for 211,996 accounts, totaling \$184.4 million in delinquent taxes. By the end of fiscal year 1980, taxpayers were paying off \$363 million in delinquencies through installments.

#### Currently not collectibles

Delinquent accounts may be classified as currently not collectible at any time after the first tax due notice is mailed. This classification suspends active collection action on delinquent accounts. Accounts are considered currently not collectible when taxpayers cannot be located, are unemployed, have no assets, or for some other reason cannot pay the taxes. In 1978

IRS classified 503,822 accounts totaling \$702 million as currently not collectible. In fiscal year 1979, IRS classified 537,966 delinquent accounts totaling \$845.6 million as currently not collectible. At the end of fiscal year 1979, the total inventory of currently not collectible accounts was \$3.3 billion.

IRS can reinitiate collection action or collect additional monies on currently not collectible accounts. For example, if IRS obtains information through subsequent tax returns indicating that taxpayers can make payments on their delinquency, the accounts may be automatically reactivated. Also, IRS will use any refunds due the delinquent taxpayers to offset their liabilities until the 6-year statute of limitations on collections expires. In 1978 IRS collected \$51.3 million through refund offsets on about 92,000 delinquent accounts classified as currently not collectible.

#### Offers in compromise

Offers in compromise are proposals by taxpayers to settle their tax liabilities for less than the amount assessed. Section 7122 of the Internal Revenue Code provides the statutory authority for the Secretary of the Treasury to compromise liabilities arising under the Internal Revenue laws. IRS' Collection Division can compromise tax liabilities on the basis of doubt about collectibility. The general objective of accepting offers is to obtain the most money with the least possible loss or cost to the Government. Generally, IRS will not ask taxpayers to submit an offer in compromise, but it can advise taxpayers of their rights to submit offers. During fiscal years 1978 and 1979 IRS received 2,335 and 1,766 offers in compromise and accepted 527 and 421, respectively.

#### Use of taxpayer financial information

The basis for determining the collection action is the taxpayer's financial condition. Analysis of the taxpayer's assets, liabilities, income, and expenses is used to determine whether the taxpayer has the ability to immediately pay in full, borrow on assets to pay within a short period of time, pay in installments based on having excess income over necessary living expenses, or not currently pay anything because necessary living expenses exceed income. (See app. VI for the primary financial statement used by IRS to obtain this information and more detailed financial statement used for offers in compromise.)

## OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this review was to determine IRS' effectiveness in collecting delinquent taxes from taxpayers who claim they cannot immediately pay their taxes in full. The review was initiated because of the many concerns of the Congress and others about improving the collection of revenues and decreasing Federal borrowing in addition to concern about the large amount of taxes being classified as currently not collectible.

We reviewed and evaluated IRS' policies, procedures, and practices for collecting delinquent taxes and evaluating its collection activities. We interviewed IRS national, regional, service center, and district personnel in the Collection, Examination, and Data Processing Divisions. We also reviewed internal audit reports and discussed internal audit activities with IRS personnel.

### IRS locations selected for review

We selected for review IRS districts and their respective regions and service centers based on obtaining a geographical mix of districts considering size of the district, available GAO resources, and the impact of conducting our review on the collection activities of IRS.

The following locations were selected for review:

- IRS headquarters, Washington, D.C.;
- IRS regional offices in Atlanta, Chicago, and San Francisco;
- IRS service centers in Chamblee, Georgia; Kansas City, Missouri; Memphis, Tennessee; and Ogden, Utah; and
- IRS district offices in Atlanta; Chicago; Greensboro, North Carolina; and Seattle.

### Sample case selection procedure

We reviewed samples of installment agreements and currently not collectible cases. At the four district offices, we reviewed all offers in compromise submitted during 1978 that were closed at the time of our review.

Although 1978 was the year selected for review, IRS did not have accurate information on installment agreements granted during that year. Our sample cases, therefore, do not always cover the same time periods for each program.

IRS does not identify on its master computer files those accounts which have been granted installment agreements. We, therefore, had to obtain from IRS a special listing of installment agreements in effect as of July 1, 1979. Using this listing we randomly selected individual and business installment agreements at each of the four districts. The following table shows the universe size, sample size, and the number of accounts which were reviewed. We were unable to review all cases sampled because IRS could not find all the cases we requested.

District	Total universe (note a)	<u>Individual agreements</u>			<u>Business agreements</u>		
		Universe (note a)	Sample size	Cases reviewed	Universe (note a)	Sample size	Cases reviewed
Atlanta	3,866	3,693	150	123	173	30	19
Chicago	3,687	3,364	150	115	323	30	28
Greensboro	2,419	2,229	150	142	190	30	28
Seattle	1,129	1,022	150	128	107	30	26
Total	<u>11,101</u>	<u>10,308</u>	<u>600</u>	<u>508</u>	<u>793</u>	<u>120</u>	<u>101</u>
Total nation-wide	96,472	89,036			7,436		

a/Universe figures used to project our findings do not always correspond to the actual universe for the four districts because we used conservative estimates based on available IRS information. The statistical projections in the report are based on the sample results using stratified random sampling methodology. (See app. VII.)

We did not review sample cases from IRS' installment-agreement-by-mail program because the program was just beginning at the time our review started. However, many of the sample agreements reviewed in IRS districts were issued under the first-time delinquent program, which was more restrictive than the mail program. Therefore, we believe that the problems identified in the first-time delinquent program would also apply and may be magnified in the mail program.

In selecting currently not collectible accounts to review, we used IRS' register of currently not collectible accounts dated July 1979. Because our review was geared primarily to IRS' use of financial statements and most of these hardship cases were individuals, we limited our review of currently not collectibles to individual accounts. Using the register and IRS statistics on the number of accounts classified as currently not collectible by district in 1978, we established sample sizes for review. The following table shows the universe sizes, sample sizes, and cases

reviewed in each district. As with the installment agreement cases, IRS was unable to locate all cases selected for review.

District	Taxpayers (note a)	Accounts	Amount of delinquencies	Taxpayer sample size	Taxpayers with accounts reviewed	Accounts reviewed	Amount of accounts reviewed
Atlanta	8,771	12,808	\$ 14,894,431	232	204	292	\$ 244,680
Chicago	8,356	11,147	14,253,917	222	204	279	916,734
Greensboro	5,249	7,745	7,124,641	225	212	343	362,164
Seattle	2,590	3,603	4,034,463	214	167	249	409,210
Total	<u>24,966</u>	<u>35,303</u>	<u>\$ 40,307,452</u>	<u>893</u>	<u>787</u>	<u>1,163</u>	<u>\$1,932,788</u>
Total nation- wide	194,388	274,544	\$346,176,976				

a/Universe figures used to project our findings do not always correspond to the actual universe for the four districts because we used conservative estimates based on available IRS information. The statistical projections in the report are based on the sample results using stratified random sampling methodology. (See app. VII.)

Because of the few offers in compromise cases based on doubt about collectibility received by IRS in 1978, we selected all cases in the four districts for review. We did not review those cases which were still open. The following table shows the number of offers received in 1978 by district and the number we reviewed.

District	Offers received	Offers reviewed
Atlanta	32	32
Chicago	35	29
Greensboro	33	30
Seattle	28	26
Total	<u>128</u>	<u>117</u>
Total nationwide	2,335	

To evaluate IRS actions on the sample cases, we reviewed district and service center case files, master file transcripts, tax returns, and information from the Integrated Data Retrieval System. We also discussed questionable cases with cognizant IRS personnel.

## CHAPTER 2

### GRANTING INSTALLMENT AGREEMENTS THROUGH THE MAIL WITHOUT DETERMINATION OF TAXPAYERS' ABILITY TO PAY SHOULD BE DISCONTINUED

No statutory right exists for taxpayers to pay their delinquencies through installments. However, about 97 percent of individual delinquent taxpayers sent third notices are given the option to pay in installments without IRS determining their ability to pay. This "automatic" program is ineffective because it delays payments from delinquent taxpayers who could immediately pay their accounts in full and because it allows taxpayers who do not have the ability to pay to enter into installment agreements and possibly default. In addition, granting installment agreements in effect provides low interest loans. This was previously addressed in our report "New Formula Needed To Calculate Interest Rate On Unpaid Taxes" (GGD-81-20, Oct. 16, 1980). 1/

### PAYING DELINQUENT TAXES THROUGH IN- STALLMENT AGREEMENTS IS BECOMING EASIER

Until the mid-1970s IRS considered installment agreements as a privilege to be used only when no other alternative was available. However, in 1975 a report by the Administrative Conference of the United States criticized this limitation and recommended that the program be liberalized. The report, however, stated that installment agreements should be based on the financial condition of the delinquent taxpayer.

In April 1976, IRS liberalized its use of installment agreements when it initiated the first-time delinquent program in the district offices. The program provided installment agreements to first-time delinquent taxpayers with liabilities under a certain dollar amount without requiring the taxpayers to provide financial information. In July 1977 IRS started a program where service center employees phoned delinquent taxpayers between the third and fourth notices and attempted to secure full payment. If the taxpayers could not pay, the employees were authorized to grant installment agreements using the same criteria as the district's first-time delinquent program. IRS further liberalized the program in September 1978 by raising the delinquency dollar limit for automatically granting installment agreements.

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1/On August 13, 1981, the President signed the "Economic Recovery Tax Act of 1981" which revised the procedures for calculating the interest rate on delinquent taxes. The procedures will result in an interest rate which more closely approximates the market rate and thereby negate some of the present problems caused by the low interest rate.

The most significant change took effect in July 1979 when IRS initiated the installment-agreement-by-mail program. This program replaced the telephone contacts. Taxpayers no longer needed to be first-time delinquents to be eligible for the program and were given up to 12 months to pay off their delinquency. With the mail program in operation, IRS dropped the first-time delinquent program in the districts in July 1980.

Because of these changes the number of installment agreements is increasing. At the end of fiscal year 1972, IRS had an inventory of about 48,000 delinquent accounts being paid through installment agreements. As of July 1, 1979, this inventory was 140,561 delinquent accounts and as of March 31, 1980, the inventory of these accounts increased to 247,359. At the end of fiscal year 1979, total delinquent taxes being paid through installments was \$272 million and this figure increased to \$363 million by the end of fiscal year 1980.

At the time of our review the first-time delinquent program was in effect. Our sample cases included taxpayers from this program. We did not review specific agreements issued from the installment-agreement-by-mail program because it was just beginning at the time our review started. However, since the criteria for the mail program are less stringent than for the first-time delinquent program, the problems identified may also be found in the mail program.

FINANCIAL INFORMATION  
SHOULD BE MANDATORY

Granting installment agreements without obtaining taxpayer financial information should be discontinued. Installment agreements were offered to 531,000, or 97 percent, of the 549,000 individual delinquent taxpayers sent third notices during the 6-month period ending March 31, 1980. While the current congressional emphasis is on speeding up the collection of revenues, this program has the opposite effect. Delinquent taxpayers earning substantial incomes and others with the ability to fully pay are paying their delinquent taxes in installments.

Under its policy of treating first-time delinquents more leniently than repeaters, IRS initiated this program as a cost savings measure and as a means of reducing its districts' workload. However, IRS did not take adequate steps to ensure that only first-time delinquents were given this option, nor has it adequately analyzed the cost effectiveness of the program. Also, it does not appear that the program is having any significant impact in reducing the districts' workload.

Satisfying tax delinquencies with installment agreements is a viable method for taxpayers who cannot immediately pay the delinquency in full. However, allowing the use of installment agreements without regard to the taxpayer's ability to pay is a

significant change in tax collection procedures which gives delinquent taxpayers additional rights not given to the general taxpaying public.

In effect, IRS is giving taxpayers an additional year or more to pay their taxes at a minimal cost. <sup>1/</sup> This is contrary to the many cash management changes being made or proposed to speed revenues to the Treasury.

This installment agreement program permits taxpayers to defer payments of some or all of their taxes until the following year and pay the liability as if it were any other charge liability. Substantial increases in the number of taxpayers electing to pay taxes in this manner could cause a significant drain on the budget.

Without taxpayer financial information  
IRS grants installments to those who could  
fully pay and those who do not have the  
ability to keep agreement commitments

Granting installment agreements without obtaining taxpayer financial information allows taxpayers with substantial incomes and others with the ability to pay in full to elect to pay off their delinquencies in installments. IRS also grants installment agreements to taxpayers who do not have the ability to pay, and this practice may result in defaults.

Review of tax returns for 1978 showed that 104, or 58 percent, of the 178 sampled taxpayers granted installment agreements without providing financial information were earning over the intermediate income level as defined by the Department of Labor. Over 20 percent of these 178 taxpayers were earning over the high income level. The following table shows the results of our review of tax returns in the four districts.

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<sup>1/</sup>Currently, taxpayers electing to pay taxes through installments are charged 12 percent per annum interest and a 0.5 percent per month penalty. As a result of the "Economic Recovery Act of 1981," the interest rate on delinquent taxes should more closely approximate the market interest rate.

<u>District</u>	<u>Tax returns reviewed</u>	<u>Intermedi-ate income level</u>	<u>Taxpayers earning over inter-mediate income</u>		<u>Taxpayers earning high over high income level</u>		
			<u>income</u>	<u>Percent</u>	<u>income level</u>	<u>Percent</u>	
Atlanta	69	\$16,897	41	59	\$24,686	9	13
Chicago	28	18,794	13	46	27,169	6	21
Greensboro	40	18,074	25	63	25,923	8	20
Seattle	41	18,671	25	61	26,567	13	32
Total	<u>178</u>		<u>104</u>	58		<u>36</u>	20

While income alone does not give a true financial indication of the taxpayer's ability to pay, it does provide strong indications of this ability, particularly when income is large and the liability small. Twenty taxpayers earning over \$30,000 in 1978 had liabilities of \$2,000 or less each. Also, 16 of the 36 taxpayers earning over the high income level in 1978 had liabilities under \$1,000. One taxpayer earning over \$77,000 a year was granted an installment agreement for a liability under \$3,000.

On the basis of savings identified by interest income shown on their tax returns, we project that in the four districts nearly 15 percent of the estimated 3,182 taxpayers granted installment agreements without financial statements could have immediately paid their tax liability in full. An estimated additional 9 percent of the 3,182 taxpayers had savings but not enough to fully pay their tax liabilities. In 21 percent of the sample cases that could have fully paid, the interest income alone exceeded the tax liability. For example, three taxpayers showed interest income over \$2,400 while the tax liabilities were less than \$2,000.

In a further attempt to determine taxpayers' ability to pay, IRS obtained at our request financial statements from 65 individuals who would have been granted installment agreements without providing financial statements during November 1979. IRS then took collection action based on the financial information.

The results of IRS' collection actions follow.

- In 16 cases IRS demanded full payment of the tax liabilities.
- In 22 cases IRS classified the accounts as currently not collectible.
- In 17 cases IRS granted installment agreements for less than 9 months.
- In 10 cases IRS granted installment agreements for 9 months or more.

According to an IRS official, under the program in operation at that time, these 65 taxpayers would have been automatically granted installment agreements for 9 months. By using the financial information IRS was able to collect taxes faster in 51 percent of the cases. In the 34 percent of the cases classified as currently not collectible, the taxpayers might have defaulted had they been given installment agreements. IRS would then have re-activated these accounts and further taxpayer contact would have resulted.

IRS' lenient treatment was given  
to repeat delinquent taxpayers

IRS started granting installment agreements without obtaining financial information under its policy to be more lenient with first-time delinquents than with repeaters. However, IRS did not ensure only first-time delinquents were granted lenient payment methods. Only limited checks were made under the districts first-time delinquent program and no attempts are made under the installment-agreement-by-mail program to identify repeaters.

Under the first-time delinquent program, IRS relied on the taxpayer and limited checks of its computer system of current delinquencies to determine if the taxpayer was a repeater. About 38 percent of the estimated 3,488 taxpayers in the four districts were repeaters and were granted installment agreements without providing financial information. No check is made under the mail program in which an estimated 97 percent of the individual delinquent taxpayers sent third notices are given the option to pay in installments. IRS estimates that less than 20 percent of all individual delinquent taxpayers are repeaters.

IRS' current capabilities require a manual search to determine if a taxpayer is a repeater. IRS has not established procedures to perform this search by computer because of time and cost constraints.

Installment agreements by mail may  
not be reducing district workload

One reason for using the installment-agreement-by-mail program was to reduce the number of delinquent accounts sent to the districts. However, there has been no significant reduction in delinquent accounts.

To measure the effect of the mail program on reducing delinquent accounts sent to the districts, statistics were compared on first notices and delinquent accounts sent to the districts during two 6-month periods, one prior to the mail program and one after. We were unable to obtain specific information on individual delinquencies, but the following statistics on all delinquencies do not show any significant reduction.

<u>Period</u>	<u>First notices</u>	<u>Delinquent accounts sent to IRS districts</u>	<u>Percent of delinquent accounts to first notices</u>
7/1 - 12/31/78	4,185,447	1,110,327	26.5
7/1 - 12/31/79	5,354,446	1,386,788	25.9

These statistics show that the number of delinquent accounts as a percentage of first notices decreased slightly after the mail program started. However, the number of delinquent accounts sent to the districts increased almost 25 percent.

Three reasons may account for the fact that the mail program is not reducing the districts' workload of delinquent accounts. First, IRS estimates that 70 percent of these installment agreements are for liabilities below the dollar deferral level and would not have been sent to the districts anyway. Second, the 50 percent default rate for closed installment agreements causes cases to be sent to the districts to be worked after the default. Finally, some delinquent taxpayers may have fully paid the liability before the account was sent to the district if they were not given the option to pay in installments.

#### CONCLUSIONS

Installment agreements are a legitimate means of collecting delinquent taxes when taxpayers cannot otherwise fully pay their tax liability. However, the use of the installment agreements to resolve delinquencies should be based on the taxpayers' ability to pay so as to ensure that IRS is collecting delinquent taxes as quickly as possible and that only those taxpayers who truly cannot pay their delinquencies immediately are granted installment agreements.

Establishing a program where almost all individual delinquent taxpayers are eligible to pay their delinquencies in installments is ineffective because it (1) delays payments from taxpayers who could pay in full and (2) may result in defaults by taxpayers who cannot make installment payments. Such a major shift in tax collection philosophy is not practical when the emphasis of the Government is to speed up revenue collections. Providing such a lenient means to pay delinquencies could prompt many taxpayers to shift from our current "pay-as-you-go" system to "pay later."

We believe this automatic installment-agreement-by-mail program has some benefits for low dollar accounts which would not be sent to the districts for collection action. IRS could increase its potential for collecting these delinquents by offering this option after the normal notices have been sent. IRS should give the taxpayers with delinquencies under the deferral level the

option to pay in installments at the same time the other accounts are sent to the districts for further collection action.

#### RECOMMENDATION

We recommend that the Commissioner of Internal Revenue discontinue the current installment-agreement-by-mail program except for those accounts which would ordinarily not be sent to a district office for intensified collection action.

#### IRS COMMENTS AND OUR EVALUATION

IRS presently disagrees with our recommendation to discontinue the current installment-agreement-by-mail program. IRS stated that the program was instituted as one means to address the problem of rising delinquent account inventories and diminishing resources. IRS says this problem still exists. IRS also stated that it would reevaluate our recommendation after it completes a study of the mail program in March 1982.

We appreciate IRS' concerns over its increasing delinquency problem and limited resources and discuss these concerns in chapter 7 of this report. However, we do not believe that these concerns should be dealt with through the installment-agreement-by-mail program because

- the program is not significantly reducing the number of accounts being sent to the district offices,
- the program has a high default rate, and
- the program allows many taxpayers with the ability to pay their delinquencies in full to pay in installments.

Furthermore, by giving delinquent taxpayers who have the ability to pay in full the option to pay in installments, IRS may appear to be changing its pay-as-you-go tax collection system to a deferred installment payment system. This change could have a detrimental effect on voluntary compliance by prompting more taxpayers to defer payment of their taxes. In addition, such a change could increase the drain on the Treasury because of increased Government borrowing costs resulting from deferred tax payments. IRS did not consider these problems when it first initiated the installment-agreement-by-mail program and is not considering them in its current study.

For the reasons cited in this report chapter and the additional above comments, we believe that IRS should reconsider our recommendation to discontinue the program now and should not wait until after its current study is completed.

### CHAPTER 3

#### BETTER DETERMINATION OF TAXPAYERS' ABILITY TO PAY WILL INCREASE COLLECTIONS

IRS needs accurate and reliable financial information to determine taxpayers' ability to pay. This information is needed to determine whether (1) the taxpayers can make installment payments and, if so, how much or (2) the delinquencies should be classified as currently not collectible because any payments by the taxpayers would cause undue financial hardship on them. Although IRS obtains such information, it has not used it effectively to determine the taxpayers' ability to pay. Because IRS has overlooked the available information and/or accepted erroneous and questionable financial information provided by taxpayers, the collection of delinquent taxes has been delayed until taxpayers deem it convenient to pay.

We estimate that in 85 percent of the 5,116 installment agreements in the four districts where IRS obtained financial information, it did not use the information to its fullest to determine the taxpayers' ability to pay. Similarly, IRS classified delinquent taxes as currently not collectible without adequately using financial information.

IRS does not adequately

- use equity information to require taxpayers to attempt to secure private loans or sell an asset to satisfy the tax liability,
- use the amounts shown on the financial statement as a basis for determining whether an installment payment can be made,
- verify income or expense items,
- question expense items as to their necessity or reasonableness, and
- review financial statements for mathematical accuracy.

#### FINANCIAL STATEMENTS ARE THE BASIS FOR DETERMINING COLLECTION ACTION

The Internal Revenue Manual states that the taxpayer's financial condition should be the basis for determining the method of payment. The first step is to analyze assets for immediate payment or for a means of borrowing or liquidating to fully pay a delinquency. If analysis of assets does not provide an obvious means for paying the liability, then income and expenses are to

be analyzed. The take-home pay or net business income in excess of necessary living expenses should be available for payment of tax liabilities. The manual states that prudent judgment should be used in determining necessary living expenses. The manual also states that dates when payments on loans and installment purchases terminate should be used to determine when additional funds will be available to pay off the tax liabilities.

The manual further states that before reporting an account as currently not collectible, collection employees should verify financial information to an extent commensurate with the type and amount of tax due. If the total delinquency is less than \$2,000 and the amounts listed on the financial statement seem reasonable, the taxpayer's financial condition need not be verified. In August 1980, IRS expanded its verification requirements and now includes the following categories:

- The taxpayer is not a wage earner.
- The amounts listed on the financial statement are unreasonable or out of the ordinary.
- The accounts are being reported currently not collectible because of financial hardship without benefit of a financial statement.

Verification is required in all cases if the total assessed balance is \$2,000 or more. Verification requires (1) researching local property records, such as real estate and motor vehicle, to identify all assets and determine whether the tax can be collected through seizure of assets and (2) reviewing the taxpayer's latest income tax return. No such requirements exist if the taxpayer agrees to pay in installments.

Pro forma financial statement needs revision

IRS uses the same financial statement for individuals and businesses. We identified weaknesses in the financial statement that make determination of ability to pay difficult, if not impossible. The statement does not indicate the number of people that the expenses relate to. Although the number of dependents was shown in about 79 percent of the estimated 5,078 installment agreements where revised financial statements were used in the four districts, it was strictly up to the IRS employee to obtain the information. In the cases where the information was not shown, IRS officials may have obtained the information through interviews, but this was not shown in the case files. Without information on the number of dependents neither the IRS employee making the initial determination on ability to pay nor any future

reviewing official can adequately determine the taxpayer's ability to pay. Also, because the form provides for both personal and business expenses, some taxpayers furnish both, making determination of ability to pay difficult, if not impossible.

The use of one statement makes actual determination of a business' ability to pay difficult. IRS accepts other information from businesses, such as balance sheets and profit and loss statements, in lieu of its form. These do not, however, provide uniform information to determine ability to pay. Profit and loss statements and balance sheets do not always adequately reflect the cash flow of a business. Depreciation, while a standard business deduction, does not truly reflect a cash expense of the business. Because of the small sample of business installment agreements and the fact that 76 of the 97 cases reviewed were based on individual financial information, we did not have enough information to evaluate the handling of the pure business cases. However, our observations showed a need for a separate financial statement to adequately reflect the financial abilities of a business to pay.

At the time of our review IRS was revising the financial statement used for determination of ability to pay and was including a question on the number of people covered by expenses. It was also working on a separate financial statement for businesses. IRS subsequently completed this work and now has two separate financial statements, one for individuals and one for businesses.

#### IRS NEEDS TO MAKE BETTER USE OF TAXPAYER EQUITY INFORMATION

IRS is not placing enough emphasis on requiring delinquent taxpayers to attempt to secure loans in order to pay off their tax liabilities. We estimate that IRS considered loans in 12 percent of the estimated 8,589 installment agreements in the four districts reviewed. However, in 58 percent of the sample cases where loans were considered, the taxpayers' financial statement did not show any assets on which to secure the loan. About 28 percent of the estimated 5,116 taxpayers submitting financial statements in the four districts reviewed had over \$5,000 equity in real property, enough to justify IRS' requesting them to attempt to secure loans. However, only an estimated 30 percent of these taxpayers attempted to secure loans.

The following table shows the results of our review of samples in four IRS districts.

District	Installment agreements with financial statements	Taxpayers with equity over \$5,000					
				Attempting to secure loans		Tax liability smaller than equity	
		Number	Percent	Number	Percent	Number	Percent
Atlanta	49	14	29	7	50	14	100
Chicago	85	25	29	1	4	22	88
Greensboro	100	25	25	14	56	21	84
Seattle	76	20	26	4	20	19	95
Total	<u>310</u>	<u>84</u>	<u>a/27</u>	<u>26</u>	<u>a/31</u>	<u>76</u>	90

a/Sample results do not exactly correspond with the projected figures because we used a stratified random sampling methodology. (See app. VII.)

The average equity for these taxpayers was \$20,000, over \$16,000 of which was in homes, with a high of \$85,000. As shown in the table above, 90 percent of the taxpayers had equity exceeding their tax liabilities. The differences between districts in the number of taxpayers attempting to secure loans could not be attributed to any specific procedures but could be attributed to lack of specific guidance from the IRS national office and to the varying attitudes of district collection officials.

A review of the case files did not indicate if attempts were made to secure loans or if the taxpayer was just questioned about the possibility. However, since the equity in assets exceeded the liability, it would appear that some of the taxpayers who stated they were unable to obtain loans may have had the financial capacity to do so. For example, one taxpayer had an income of over \$20,000 in 1978 and equity of \$50,000 in a home and his income exceeded expenses by over \$200 a month. However, the taxpayer claimed he was unsuccessful in securing a loan to pay his \$6,000 tax bill.

IRS officials stated that Collection Division employees should request the taxpayer to secure loans to pay off the tax liabilities. However, it is easy for taxpayers to say they were refused loans. IRS officials also said it is not difficult to get written proof that a loan was denied. All the taxpayer has to do is present a bleak financial future to the lending institution and the loan request will be rejected. This belief about the ease with which taxpayers could obtain rejections may be one of the reasons for limited emphasis on having taxpayers attempt to secure loans.

IRS SHOULD REQUIRE MINIMUM PAYMENTS  
IF TAXPAYERS' INCOME EXCEEDS EXPENSES

During 1978 IRS determined financial hardship conditions for an estimated 11,884 taxpayers at the four districts reviewed, 10 percent of whom could have made payments based on their financial statements at the time the account was classified as currently not collectible. These taxpayers showed a net income exceeding expenses and IRS could have collected an estimated \$1 million during the first year after the accounts were classified as currently not collectible if IRS had required these taxpayers to make installment payments. 1/

Before August 1980 IRS sometimes allowed accounts to be reported currently not collectible even though future payments could be made. Generally such cases involved large tax liabilities and relatively small or sporadic payments. In August 1980, IRS revised its manual to provide that whenever regular future monthly payments of at least \$10 are to be made on an account, the account should be processed as an installment agreement rather than reported currently not collectible. However, if only sporadic payments are anticipated, the account should still be reported as currently not collectible if it meets hardship criteria.

IRS NEEDS TO ACCURATELY  
IDENTIFY TAXPAYERS' INCOMES

IRS does not adequately determine taxpayers' incomes. We estimate that, in the four districts reviewed, IRS verified income in

--11 percent of the estimated 5,116 installment agreements with financial statements, and

--21 percent of the estimated 11,884 taxpayers who had accounts classified as currently not collectible because of financial hardship.

Our verification of income disclosed that, in 38 percent of the estimated 4,638 installment agreements and 28 percent of the 6,538 taxpayers with financial hardship currently not collectible cases where tax returns could be associated with financial statements, taxpayers understated their annual income by over \$2,000 or more on their financial statements.

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1/In calculating the potential additional collections we deducted any payments or offsets made to the taxpayer's account.

We compared net incomes on the financial statements with comparable tax return incomes adjusted to reflect take-home pay. We estimate that 1,762 of the 4,638 taxpayers with installment agreements omitted \$8.5 million and 1,856 of the 6,538 taxpayers with accounts classified as currently not collectible omitted \$6 million in annual income from their financial statements. Taxpayers who were not employed at the time they prepared their financial statement were not included in our comparisons. Of the estimated 1,856 taxpayers with accounts classified as currently not collectible who understated their income, 1,601 could have made payments if their correct income had been known.

Under IRS' philosophy to be more lenient to first-time delinquents, less verifying of financial statements is done for these taxpayers if installment payments are to be made. However, as shown in the following table there is little difference between the two groups of taxpayers in understating income.

<u>Type of delinquency</u>	<u>Number of cases reviewed</u>	<u>Income understated by at least \$2,000</u>	<u>Percent of cases reviewed</u>
First-time	99	43	43
Repeater	<u>156</u>	<u>61</u>	39
Total	<u>255</u>	<u>104</u>	41

IRS NEEDS TO REESTABLISH PAYMENT OF DELINQUENT TAXES AS A PRIORITY TAXPAYER EXPENSE

With few exceptions, IRS accepts all taxpayer-identified expenses for payment priority over delinquent taxes. IRS' wish to avoid taxpayer and congressional criticism has led it to shy away from a confrontation that could result from questioning the necessity or reasonableness of taxpayers' expenses.

Little guidance is given IRS employees to distinguish between taxpayer hardship and inconvenience in determining the taxpayer's ability to pay. The manual does not define necessary living expenses and merely states that prudent judgment should be used in determining which expenses are necessary.

IRS officials said that the type and amount of verification depends on the dollar liability. The main factor in determining the extent of verification is the revenue officer's judgment on what appears reasonable. Most revenue officers stated that little, if any, verification is done on financial statements if installment agreements are obtained. The time involved in verifying financial statements is a major concern of IRS because of its workload and limited resources. IRS employees estimate that it

takes anywhere from 20 minutes to 24 work hours to obtain, verify, and evaluate a financial statement. They estimate that 5 minutes to 16 work hours of this time is devoted to verification.

The extent of verification varies considerably between districts. Local district philosophy generally governs the verification of financial statements. One district emphasized verifying assets by searching courthouse records. Another district verified divorce-related expenses, such as alimony and child support. A third district usually verified income.

Questioning items as to their reasonableness or necessity was also based on local district philosophy. In one district credit card expenses were not accepted unless the taxpayer showed that they were for necessary living expenses. In the other three districts credit card expenses were accepted without question.

Of the estimated 5,116 installment agreements with financial statements in the four districts reviewed, IRS questioned the reasonableness or necessity of expenses in only 8 percent. An estimated additional 37 percent of the taxpayers had expenses that could have been questioned. For example, taxpayers claiming expenses for campers, boats, cable television, book clubs, coin clubs, and maid service were not questioned. Other questionable items accepted by IRS included possible duplicate payments where the taxpayer was showing monthly credit card expenses to an oil company and was also claiming a monthly expense for gasoline. Some excessive amounts were also being claimed for utilities and groceries. For example, one taxpayer claimed a heating expense of \$156 a month for an apartment in Chicago. While heating bills in 1978 could easily run that high in the winter, the average monthly expense would probably be much lower. In other cases IRS accepted an expense of \$400 a month for "various" things and \$120 a month allowance for children.

Of the estimated 11,884 financial hardship cases, we estimate that 21 percent contained questionable expense items. The case files showed no indication that IRS took issue with these questionable expenses, which fell into three categories:

- Luxury or unnecessary items, such as expensive automobiles, boats, travel trailer, cable T.V., and music and dancing lessons.
- Excessive expenses, such as utility bills for heavy-use months and high monthly telephone bills accepted as constant expenses.
- Duplicative expense items, such as itemized costs for haircuts, beauty shop, cigarettes, laundry and cleaning, in addition to a flat allowance for miscellaneous expenses.

IRS officials said they cannot tell a taxpayer how to live by questioning expense items when attempting to collect delinquent taxes. One regional official acknowledged that individuals can avoid paying taxes if they live beyond their means.

In arriving at our estimates of taxpayers with items not questioned by IRS, we did not consider all the possible duplicate payments where taxpayers claimed expenses for all-purpose charge cards. Because these cards can be used for all types of expenses, including entertainment, food, liquor, luxury items, and cash advances, the questionable expenses accepted by IRS may be much larger.

IRS NEEDS TO CONSIDER WHEN TAX-  
PAYERS WILL PAY OFF OTHER CREDITORS

The Internal Revenue Manual states that in the analysis of the taxpayer's financial statement, consideration should be given to the funds available to the taxpayer when other creditors are to be paid off. However, IRS increased the amount of installment payments in only 5 percent of the estimated 8,589 installment agreements and in only 4 percent of the 14,624 currently not collectible cases did IRS require followup prior to the procedural 65-week period for followup. IRS relies on the automatic followup system of hardship closing codes associated with the taxpayer's adjusted gross income to reactivate the account where the taxpayer will pay off liabilities in the next 12 months. This system delays collection action for at least 65 weeks and could allow the taxpayer to incur additional liabilities before IRS can take any collection action. Although IRS can designate the account for mandatory followup at an earlier date if the taxpayer's ability to pay is expected to improve, the Internal Revenue Manual states that this option should be used only with bankrupt taxpayers.

If IRS used information on when other creditors would be paid off during the first 2 years of the installment agreements to increase monthly payments, we estimate that the length of the agreements could have been reduced by at least 3 months in 33 percent of the estimated 5,116 installment agreements with financial statements in the four districts. IRS could have speeded up collection of an additional \$2.2 million, or 20 percent more than the estimated \$11.1 million that was scheduled to have been collected under installment agreements in the four districts. We also estimate that if IRS used this information to require the estimated 15 percent of the 11,884 taxpayers with accounts classified as currently not collectible to start making payments, an estimated additional \$1 million could have been collected during the first year after the account was classified as currently not collectible.

The following table shows our projections for taxpayers with other liabilities being paid off within the first and second years of the installment agreements.

	Estimated collections under current agreement	Additional collection if available funds were considered when other creditors were paid off			Percent of estimated collection
		--Liabilities paid off in--			
		First year of agreements	Second year of agreements	Total	
First year	\$ 7,047,663	\$ 636,650	-0-	\$ 636,650	9
Second year	<u>4,068,411</u>	<u>379,117</u>	<u>\$1,160,846</u>	<u>1,539,963</u>	38
Total	<u>\$11,116,074</u>	<u>\$1,015,767</u>	<u>\$1,160,846</u>	<u>\$2,176,613</u>	20

IRS officials said that available funds may be considered at the time the agreement is entered into and an amount larger than the financial statement shows as income over expenses might be agreed to as payments. In our calculations we deducted any such amounts before determining the additional revenues that could be collected.

Generally, IRS officials did not want to adjust payment amounts after the installment agreement was made because they feared the taxpayer might default. The Chief of Collections in one district stated that, once a taxpayer begins to pay, it was best not to change anything since eventually the Government would collect all the taxes due. IRS officials also stated that once the other liabilities were paid off the taxpayer would likely incur additional liabilities. However, this is all the more reason to increase the payments to assure that the Government is paid as soon as possible and is not considered secondary to the taxpayer's other creditors. In some situations a taxpayer might incur additional liabilities which are justifiable, and in these cases the taxpayer could contact the district office to adjust the payments.

IRS NEEDS TO ENSURE  
MATHEMATICAL ACCURACY  
OF FINANCIAL STATEMENTS

IRS employees who prepare, evaluate, and review financial statements have not adequately ensured that the statements are mathematically correct. About 11 percent of the estimated 5,116 financial statements used to support installment agreements in the four districts had mathematical errors affecting taxpayers' monthly ability to pay by \$10 or more. In an estimated 59 percent of these cases the taxpayers' ability to pay was overstated and in the other 41 percent the taxpayers' ability was understated. The errors ranged from overstating a taxpayer's monthly ability to pay by \$200 to understating a taxpayer's ability by \$1,000.

The following table shows the errors by district reviewed.

District	Number of financial statements	Error understating taxpayers' monthly ability to pay			Error overstating taxpayers' monthly ability to pay		
		Number	Amount	Average	Number	Amount	Average
Atlanta	49	2	\$ 80	\$ 40	6	\$ 470	\$78
Chicago	85	4	238	60	7	466	67
Greensboro	100	0	0	0	4	165	41
Seattle	<u>76</u>	<u>8</u>	<u>1,225</u>	153	<u>3</u>	<u>65</u>	22
Total	<u>310</u>	<u>14</u>	<u>\$1,543</u>	\$110	<u>20</u>	<u>\$1,166</u>	\$58

PROBLEMS NOTED WITH INDIVIDUAL INSTALLMENT AGREEMENTS ALSO APPLY TO BUSINESSES

Generally, IRS' collection actions against business taxpayers are stronger than for individuals. This is because most business tax delinquencies involve trust fund taxes which were withheld from employees' wages and not paid over to IRS. These trust fund delinquencies pose the biggest collection problem for IRS. For these reasons, fewer businesses have the option to pay their liabilities through installments. Although IRS works more business delinquencies than individual, only 8 percent of the installment agreements in effect on July 1, 1979, were for business liabilities.

Most of the business liabilities in our sample were from sole proprietorships that had since closed. In an estimated 61 percent of the installment agreements with business liabilities in the four districts reviewed, the taxpayers were treated as individuals in regard to their financial condition. The business taxpayers treated as businesses usually submitted prepared statements in lieu of or in addition to the IRS financial statement. Generally, the statements submitted did not provide adequate cash flow information to determine the monthly payment the taxpayer was able to make.

The problems with financial statements were also evident with business taxpayers treated as individuals. The following table shows projections of these problems for the estimated 483 business taxpayers treated as individuals in the four districts reviewed.

	<u>Percent of cases</u>
Taxpayers with questionable expense items on financial statements	34
Cases where monthly payment should have been increased based on liabilities being paid during first year of agreement	19
"    "    "    second year of agreement	24
Taxpayers with over \$5,000 equity in assets	42
Financial statements with mathematical errors	11
Agreements made for monthly payments greater than ability shown on financial statement	48
Agreements made for monthly payments less than ability shown on financial statement	19

#### CONCLUSIONS

If taxpayers claim they cannot immediately fully pay their tax delinquencies, IRS needs accurate and reliable financial information to determine what collection action is needed. Without this information IRS has allowed taxpayers to avoid paying their taxes or to pay when they deem it convenient.

Millions of dollars are lost because IRS does not verify income claimed by the taxpayer and millions more are not collected because it does not use information shown on the financial statements, such as when other creditors will be paid off.

IRS has not provided sufficient guidelines on the use of taxpayer financial information and what are necessary living expenses. IRS employees must make their own judgments on what are reasonable and necessary expenses and in many cases have just accepted everything that the taxpayer provides. Therefore, taxpayers are not being required to pay on the basis of their ability.

This inadequate use of taxpayer financial information hampers the effective collection of taxes through installment agreements; but if the account is classified as currently not collectible, the problem is worse because the delinquencies may never be collected.

#### RECOMMENDATIONS

We recommend that the Commissioner of Internal Revenue:

- Develop a guide based on equity in assets, gross income, income over expenses, and amount of tax liability to identify cases with loan potential and require taxpayers meeting this potential to seek loans and provide written documentation of rejections.
- Establish more specific guidelines for employees to use in evaluating and analyzing financial statements, including guidelines defining the necessity and amount of expenses.
- Require taxpayers to provide information on credit card expenses to ensure that expenses are not duplicated and are for necessities.
- Require taxpayers to provide proof of income and certain expense items which may be questionable.
- Require employees to use dates when liabilities are paid off in order to increase the amount of installment agreement payments, obtain advanced dated installment agreements, or reactivate currently not collectible accounts.
- Develop a more detailed quality review of financial statements to ensure that (1) all information is considered in arriving at the decision to grant an installment agreement or classify the account as currently not collectible and (2) the information is mathematically correct.
- Establish installment payments based on taxpayers' ability to pay regardless of whether the payments cover interest charges and increase payments when possible.

#### IRS COMMENTS AND OUR EVALUATION

IRS agreed with our recommendations to improve the use of taxpayer financial information in collecting delinquent taxes. In addition to reemphasizing current procedures, IRS has taken or planned the following actions which should improve IRS' use of financial information:

- IRS has developed two separate financial statements, one for businesses and one for individuals.
- IRS revised procedures and is requesting taxpayers appearing for interviews to bring copies of their latest income tax return as well as other information necessary to establish their financial condition. IRS compares information on the financial statements with the tax returns and other documents provided by the taxpayers. If items on the financial statements appear to be overstated or understated, or out of the ordinary, the taxpayers are asked to explain and substantiate the items.

--IRS has developed instructions on the quality of financial information to be considered by employees who secure and review installment agreements and financial statements.

--IRS is developing better criteria for necessary living expenses.

IRS said that although it agreed that additional guidance regarding a taxpayer's ability to borrow is needed, a formal guide is impractical. IRS said that local economic conditions, rising interest rates, and fluctuations in the economy determine loan availability and make loan potential unpredictable.

We agree that economic conditions govern the availability of loan money and the potential for anyone to secure a loan, but we still believe some additional guidance is needed. A formal guide that would take into consideration economic conditions would not only be impractical but useless, since it would probably be outdated before it was circulated to all employees.

However, a general guide to identify those cases where loans should be sought is both practical and needed. Such a guide could provide information on income levels as defined by the Department of Labor, a ratio of equity in assets to tax liabilities, and an amount of monthly income exceeding necessary living expenses which would indicate at what point revenue officers should request delinquent taxpayers to attempt to secure loans in order to pay their delinquent taxes.

CHAPTER 4

BETTER MANAGEMENT OF INSTALLMENT AGREEMENTS  
COULD IMPROVE PROGRAM

Although IRS has greatly increased the use of installment agreements over the past few years, it has not taken adequate steps to ensure that they are used as an effective collection tool. In addition to the problems noted in chapters 2 and 3, IRS has not

- placed enough emphasis on the use of payroll deductions to collect monthly payments,
- taken adequate enforcement action when taxpayers miss payments, or
- 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.

PAYROLL DEDUCTIONS  
SHOULD BE EMPHASIZED

Voluntary payroll deductions are the best means to obtain payments. However, IRS has made limited use of this procedure. Of the estimated 7,388 individual delinquent wage earners with installment agreements in the four districts reviewed, only 9 percent were using payroll deductions. The default rate for these taxpayers was only 2 percent.

The use of payroll deduction by districts is shown in the table below.

<u>District</u>	<u>Wage earners</u>	<u>Payroll deductions</u>	<u>Percent of wage earners</u>
Atlanta	110	7	6
Chicago	92	1	1
Greensboro	128	31	24
Seattle	<u>105</u>	<u>5</u>	5
Total	<u>435</u>	<u>44</u>	a/10

a/Sample results do not exactly correspond with the projected figures because we used a stratified random sampling methodology.

IRS has not had much success in getting taxpayers or employers to agree to the use of voluntary payroll deductions. In many cases, IRS claims that taxpayers are afraid they may lose their jobs if their employers were asked to make payroll deductions.

In other cases taxpayers just do not want their employers to know they are delinquent in their taxes. These concerns are valid and must be considered in making decisions on the use of payroll deductions. However, these concerns could be used to strengthen the installment agreement program if taxpayers were adequately informed that missed payments would result in a levy of their paycheck or a mandatory consideration of payroll deduction before an installment agreement would be reinstated.

#### BETTER ENFORCEMENT OF INSTALLMENT AGREEMENTS IS NEEDED

If a taxpayer misses an installment payment, IRS tries to reinstate the agreement rather than allow it to default in order to prevent it from being sent to the district for collection action. Prior to July 1979 IRS attempted to contact each taxpayer who missed a payment to determine the reason and what action to pursue. In most cases IRS would reinstate the agreement based on the taxpayer's explanation, which may have been just a statement that he or she did not have the money that month. After July 1979 IRS discontinued calls to taxpayers and allowed them an automatic reinstatement upon the first missed payment. These taxpayers would be notified in writing that the account was being reinstated and that if such taxpayers missed another payment, levy action would be taken unless the taxpayers contacted IRS and explained why they could not make the payment. However, all the taxpayer had to do was contact the district and the agreement would usually be reinstated.

Thirty-five percent of the taxpayers in our sample missed at least one payment and were reinstated. In some cases taxpayers missed as many as five payments and each time had their agreements reinstated. The reinstatement of the agreement was based solely on the taxpayer's explanation.

Under current procedures, on the second missed payment IRS is to take levy action against the taxpayer. This change in procedures is a step in the right direction. However, if the taxpayer calls IRS and provides some explanation for the missed payment the agreement would be reinstated. While some taxpayers may have justifiable reasons to have their agreements reinstated, without adequate guidance on what is a reasonable justification for a missed payment IRS employees may continue to accept most reasons for reinstatement.

#### IRS NEEDS TO DETERMINE THE REASONS FOR THE HIGH DEFAULT RATE AND TAKE ACTION TO REDUCE IT

IRS has not taken adequate steps to determine the reasons for the combined 54-percent default rate for individuals and businesses. The 54-percent default rate covers all installment agreements nationwide closed in a 6-month period ending March 31, 1980. The high default rate raises serious questions about the

effectiveness of IRS' use of installment agreements, particularly since many taxpayers could have fully paid their delinquencies. The following table shows the breakdown of individual tax cases by whether they were district or service center agreements.

<u>IRS location</u>	<u>Total closed</u>	<u>Fully paid</u>	<u>Defaulted</u>	<u>Individual default rate (note a)</u> --(percent)--
District	61,875	24,234	37,641	61
Service Center	<u>201,938</u>	<u>100,044</u>	<u>101,894</u>	50
Total	<u>263,813</u>	<u>124,278</u>	<u>139,535</u>	53

a/The default rate was calculated by dividing the number of agreements that defaulted by the total number of agreements closed. In July 1980, IRS revised its method of calculating defaults to include active agreements with the closed cases. Using this method, the default rate for the year ending March 31, 1981, was 27 percent for individuals and 42 percent for businesses.

The default rate for businesses during the same period is much higher as shown below.

<u>IRS location</u>	<u>Total closed</u>	<u>Fully paid</u>	<u>Defaulted</u>	<u>Business default rate (note a)</u> --(percent)--
District	7,543	1,528	6,015	80
Service Center	<u>490</u>	<u>131</u>	<u>359</u>	73
Total	<u>8,033</u>	<u>1,659</u>	<u>6,374</u>	79

a/See note a above.

We believe that the high default rate is caused partly by the inadequate use of taxpayer financial information and the inadequate enforcement of agreements when payments are missed. However, other factors may also be involved, and IRS needs to fully analyze the defaulted agreements to determine the reasons for defaults and what can be done to reduce them. As a start IRS needs to improve its use of taxpayer financial information, make better use of payroll deductions, and take stronger actions on taxpayers who miss payments.

#### CONCLUSIONS

Until IRS improves the management of its installment agreement program, its effectiveness as a collection tool will be questionable. Reinstating installment agreements when taxpayers miss payments with little or no justification can give taxpayers the

impression that they do not have to take their commitments seriously. More emphasis on payroll deductions and better enforcement on defaulted agreements would improve the program and show taxpayers that their agreements must be met.

The high default rate demonstrates, in part, IRS' ineffective use of installment agreements. While we believe that better use of taxpayer financial information, more emphasis on payroll deductions, and tighter enforcement of the agreements should improve the program, IRS needs to analyze the reasons for defaults and take whatever additional corrective actions are needed to lower the rate.

#### RECOMMENDATIONS

We recommend that the Commissioner of Internal Revenue:

- Place more emphasis on the use of payroll deductions as a means to collect the monthly installment payments.
- Establish procedures to better enforce installment agreements before defaulted agreements will be reinstated and give collection employees a guide on acceptable reasons for missed payments.
- Develop an evaluation system that would consider dollars collected, case disposition, and cost of collecting through installments to determine the effectiveness of the program, reasons for defaults, and possible corrective action.

#### IRS COMMENTS AND OUR EVALUATION

IRS agreed with our recommendations to better enforce installment agreements and to develop an evaluation system. IRS has already instituted the following procedural changes:

- A requirement for managerial approval to reinstate agreements when the taxpayer has defaulted on a previous installment payment on the same account or has alerted IRS of an inability to make a payment and has been allowed to skip more than two consecutive payments in a 12-month period.
- Guidelines for acceptable reasons for permitting a taxpayer to miss an installment agreement payment.

Regarding the evaluation system IRS said it would consider the programming changes to implement such a system after the service center computer replacement system is completed. The present system cannot be modified to provide the cost information needed to make the evaluation.

IRS stated that its current procedures adequately encourage the use of payroll deductions both at the time the agreement is made and before reinstatement of a defaulted agreement. IRS stated that while payroll deductions are effective under certain circumstances, many employers will not cooperate. Because employer participation is voluntary, use of payroll deductions cannot be made a requirement.

We recognize that payroll deductions are voluntary on the part of the employer and that their use could not be obtained on all wage earner installment agreements and have revised our recommendation accordingly. However, we found that when additional emphasis is placed on the use of payroll deductions, its use increases substantially. The Greensboro district was the only district we reviewed which placed additional emphasis on the use of payroll deductions before a defaulted agreement was reinstated. We found that 24 percent of the wage earners with installment agreements in Greensboro were using payroll deductions compared to the 1 to 6 percent use of payroll deductions in the other three districts reviewed. We believe that these statistics show that with additional emphasis IRS could increase its use of payroll deductions.

## CHAPTER 5

### CHANGES IN IRS OPERATIONS COULD RESULT IN MORE EFFICIENT HANDLING OF CURRENTLY NOT COLLECTIBLES

As of September 30, 1979, 400,000 individual taxpayers owed \$1.2 billion or one-third of the total delinquencies which IRS had classified as currently not collectible. At the end of 1979, \$134 million, of the \$465.6 million IRS dropped from its accounts receivable inventory because the statutory period for collection expired, were for individual accounts. From 1974 to the end of 1979 the value of the currently not collectible inventory nearly doubled. The yearly amounts classified as currently not collectible and those lost when the statutory period expires are increasing. (See chart on p. 35.) As discussed in chapter 3, we believe that much of this growth resulted from IRS' inadequate determination of taxpayers' ability to pay. However, we also believe 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.

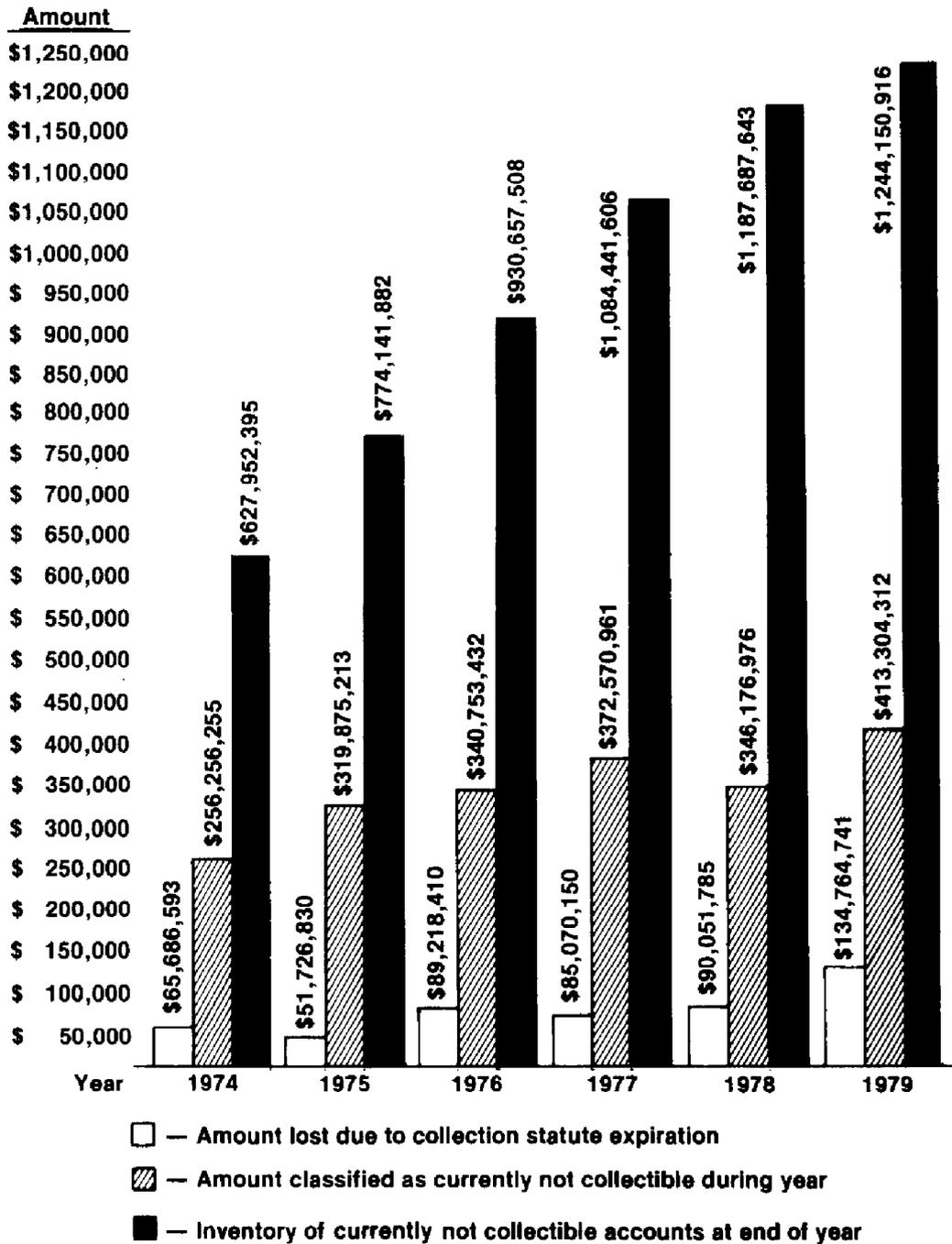
#### HOW ACCOUNTS GET CLASSIFIED AS CURRENTLY NOT COLLECTIBLE

In the course of investigating delinquent accounts, IRS finds that some accounts cannot currently be collected. Classifying an account as currently not collectible removes it from active collection status to a suspended status.

Accounts are termed "currently" not collectible because IRS may still take collection action until the 6-year statutory collection period expires. In general, collection action is resumed when the condition prompting the classification is reversed, such as when the taxpayer is located or is earning sufficient income. IRS also checks all delinquent taxpayers' accounts each year for any refunds due and applies them to the delinquencies. However, once the 6-year period expires, IRS has no means of collecting the delinquency unless the taxpayer volunteers payment.

IRS district collection personnel in both the office and field branches can classify accounts as currently not collectible. Since it is not known at the time of receipt whether the account will be classified as currently not collectible, all accounts are initially processed in the same manner. Generally, office branch personnel attempt to collect or otherwise close the account. If they do not succeed, the account is sent to the field branch where higher graded revenue officers attempt to collect or otherwise close the account.

## INCREASING ACTIVITY ON INDIVIDUAL CURRENTLY NOT COLLECTIBLE ACCOUNTS



Office branch personnel are to dispose of as many accounts as possible at the earliest practical point in the processing cycle. According to the Internal Revenue Manual, authorizing these employees to report accounts as currently not collectible stops unnecessary paperwork and should assure that they refer only the more difficult cases to the revenue officers. However, office branch personnel may not work accounts above a certain dollar amount or beyond a certain period.

Accounts are classified as currently not collectible if the delinquent taxpayer demonstrates a financial hardship, cannot be located or contacted, or owes less than a preselected dollar amount--tolerance cases.

At the end of fiscal year 1979, financial hardship cases accounted for 70 percent of the national inventory of individual taxpayers' accounts classified as currently not collectible.

IRS reports delinquent taxpayers as "unable to locate" when all appropriate efforts to locate the taxpayers and their available assets have failed. To report an account as "unable to contact," IRS must have only a mail drop address where the taxpayer cannot be contacted, rather than the taxpayer's permanent address.

"Tolerance cases" are smaller dollar accounts for which IRS has determined that collection resources could otherwise be better used because of its limited resources. Accounts under a certain dollar level may be reported currently not collectible. Tolerance accounts are reactivated if at some later date the delinquencies, including penalties and interest, exceed the dollar minimum.

IRS NEEDS TO PROVIDE FOR  
TIMELY FOLLOWUP ON CURRENTLY  
NOT COLLECTIBLE ACCOUNTS

In an estimated 39 percent of the financial hardship cases, IRS set closing codes that did not assure prompt followup. In most cases IRS relies on a computer check of reported income to reactivate accounts. However, the procedure precludes any followup for 65 weeks. Only 4 percent of the hardship cases were scheduled for mandatory followup, assuring that these cases will be examined again before the statutory collection period could expire. For the other 96 percent of the cases, IRS' future collection action depends on the taxpayers (1) filing tax returns after the hardship determinations, (2) having adjusted gross incomes sufficient enough to reactivate the accounts, and (3) improving their financial conditions to permit payment of the delinquent taxes. IRS also relies on taxpayer refund offsets and voluntary taxpayer payments to collect these delinquencies.

Proper selection of hardship closing codes  
can improve followup collection actions

IRS set the hardship closing code (adjusted gross income) too high for about 39 percent of the accounts reported currently not collectible. Setting the hardship closing code too high delays and may eliminate completely the possibility of followup collection actions on currently not collectible accounts.

Accounts which meet hardship criteria are closed under one of several hardship closing codes. Hardship closing codes are dollar amounts that the IRS employee selects to represent a large enough increase in the taxpayers' income to warrant additional collection effort. For example, selecting code 32 means that followup on the account will automatically begin when the taxpayer files a return with an adjusted gross income of \$20,000 or more. The IRS computer program is written so that no hardship account will be reactivated until 65 weeks have elapsed from the date the account is reported currently not collectible. If an earlier followup is needed, IRS personnel can request that manually generated mandatory followup be made.

Before 1980 the Internal Revenue Manual stated only that the closing code should be set high enough so that subsequent collection action will be warranted. In 1980 the manual was made more specific by listing the following factors to be considered in selecting the closing code:

- Adjusted gross income necessary to meet basic taxpayer living expenses.
- Inflation's impact on the taxpayer's income and expenses.
- Anticipated changes in taxpayer's financial condition, such as a reduction in financial obligations.
- Nontaxable sources of income, such as social security, that increases spending money without affecting adjusted gross income on the tax return.
- Unusual factors, which should be documented in the case file.

These changes still do not adequately define necessary living expenses nor do they provide any instructions for developing a payment plan to ensure that delinquent taxes are eventually collected.

Our analysis of IRS' use of hardship closing codes showed that even after allowing all taxpayer expenses shown on their financial statements plus a 30 percent factor for withheld taxes

and inflation, the codes and associated gross incomes were set too high in about 39 percent of the cases. An improper closing code may delay reactivation of the case beyond the earliest possible date, sometimes until the statutory period runs out.

The 65-week minimum inactive status for financial hardship accounts does provide sufficient time for a taxpayer to file a return after the initial currently not collectible determination. However, IRS has no information to show that collection is improved by waiting this particular time period rather than any other. In fact, as accounts receivable grow older, the collection potential may decrease.

Our analysis of collection results on 554 financial hardship cases with delinquencies of \$1.1 million for approximately a year following their currently not collectible determination disclosed that in 286, or 52 percent, of these cases payments or offsets were made totaling almost \$140,000. The following table shows a breakdown of these payments and offsets.

	Number of taxpayer cases	Percent of cases reviewed	Dollars collected	Percent of tax liability
Taxpayer payments made	136	25	\$ 66,021	6
IRS collection by refund offsets	<u>194</u>	35	<u>73,608</u>	7
Total payments and/or offsets <u>a/286</u>		52	<u>\$139,629</u>	13

a/Some taxpayers made voluntary payments and also had refunds offset against their liabilities.

We also reviewed the filing status of the 1978 tax return for taxpayers who had accounts reported currently not collectible in 1978 and found the following:

	Number of taxpayer cases	Percent of total cases reviewed
Taxpayers fully paid 1978 taxes	234	42
Taxpayers with delinquent 1978 tax balance	<u>a/115</u>	21
Taxpayers did not file a return or there was no IRS tax transcript record	<u>205</u>	<u>37</u>
Total	<u>554</u>	<u>100</u>

a/Delinquent tax balances totaled \$83,749

The preceding tables show not only that IRS has little success in collecting financial hardship accounts once it suspends collection actions but also that the collection of future taxes from these taxpayers is in question. If the taxpayer does not file subsequent tax returns or delays doing so, his account may not be reactivated for collection.

THE EXAMINATION DIVISION COULD DO MORE TO ASSIST IN THE COLLECTION OF DELINQUENCIES RESULTING FROM AUDITS

Delinquent accounts originating from audits of tax returns pose a significant collection problem. IRS' statistics show that 21 percent of the individual delinquent accounts sent to district offices originated through audits. Our review of 852 currently not collectible cases disclosed that 345, or 40 percent, were audit cases. While the high proportion of delinquent accounts resulting from audit is itself a matter of concern, the disproportionately high number of currently not collectible delinquencies resulting from audit indicates that such delinquencies are harder to collect than other delinquencies and that the Examination Division should do more to assist in the collection of delinquencies resulting from audit.

Our review of 272 of 345 audit case files which were available disclosed that 42 percent of the taxpayers agreed with the audit results. In these cases IRS' Examination Division had some contact with the taxpayer and at that time could have possibly determined the taxpayer's ability to pay. If the additional tax is not collected at the end of the examination, several months can pass before district collection personnel take action.

Fifty-eight percent of the taxpayers did not agree with the audit results or could not be contacted. In 38 percent of the audit cases, tax assessments were determined without Examination Division contacting the taxpayers. When the Collection Division receives these cases, they do not show that the Examination Division was unable to contact the taxpayer. Therefore, the Collection Division must make time-consuming and often futile attempts to locate and contact the taxpayer. In 50 percent of the no-contact audits, it was unable to locate or contact the taxpayer. In 35 percent of the unagreed cases, the taxpayers were contacted by the Examination Division but did not agree to the audit results.

The following table shows whether taxpayers agreed with the audits, whether the Examination Division contacted the taxpayers, and the reasons for classifying the accounts as currently not collectible.

	<u>Total</u>	<u>Agreed</u>	<u>Unagreed</u>		<u>Total</u>
			<u>Contact</u>	<u>No Contact</u>	
Hardship	158	87	32	39	71
Unable to locate or contact	82	15	15	52	67
Tolerance	24	9	7	8	15
Deceased	<u>8</u>	<u>2</u>	<u>1</u>	<u>5</u>	<u>6</u>
Total accounts originating from audits	<u>272</u>	<u>113</u>	<u>55</u>	<u>104</u>	<u>159</u>
Total sample 852					

#### Agreed audit cases

If the taxpayer agrees with the audit results, IRS can request payment but not demand it because the additional taxes have not been legally assessed. Taxpayers who do not pay at that time and indicate an inability to pay when the first bill is sent are told to contact the Collection Division to arrange a means to pay the subsequent assessment. For taxpayers living in IRS-designated high crime areas who do not pay the additional tax determined through audit, Examination personnel are required to contact the Collection Division. If Collection Division personnel are not available, the Examination personnel will prepare or have the taxpayer prepare a financial statement. These statements are sent daily to the Collection Division.

Although the Examination Division had contact with the taxpayers and obtained agreements to the audit results, the Collection Division was unable to locate or contact 15 taxpayers, or 13 percent of the 113 agreed cases.

Examination Division's collection efforts at the four district offices consist mainly of requesting payment of additional taxes on agreed cases. One district office, although not on a regular basis, completes a collection information statement, (taxpayer's name, address, employer, and bank account) if the taxpayer agrees with the audit results but does not pay the full amount due. This information is generally available to the Collection Division only if it requests the audited tax return. Overall, the Examination Division determines the amount, if any, of taxes due; the Collection Division attempts to collect any amount not paid.

Although no uniform procedures have been set up, some IRS Examination groups do refer taxpayers to Collection at the conclusion of the audit if the taxpayers indicate that they will not be able to immediately pay the additional taxes in full. However, this practice varied among districts and seemed to

be more likely to occur in smaller areas where Examination and Collection employees work near each other. IRS Examination officials stated that in large districts it would be too time-consuming to have Examination personnel take taxpayers to the Collection Division, unless a Collection employee was located nearby.

#### Unagreed audit cases

If the taxpayer does not agree with the audit results at the time of contact or is not contacted by IRS, Examination personnel cannot request payment. If Examination personnel cannot contact the taxpayer, then this information alone would be helpful to Collection personnel. When there is contact with the taxpayer, Examination personnel can obtain information such as current address and sources for potential levy that would be helpful to Collection personnel.

In 104, or 38 percent, of the 272 delinquencies resulting from audits which we reviewed, Examination personnel were unable to contact taxpayers. In 52, or 50 percent, of the 104 cases, Collection personnel were also unable to locate or contact taxpayers. Because Collection personnel do not know that taxpayers were not contacted during the audit, they work these delinquencies as any other cases. If Collection personnel knew whether taxpayers were contacted during audit and what efforts were made to attempt to contact them, the collection efforts could be concentrated on locating taxpayers through other sources and potentially save valuable resources.

In 55, or 20 percent, of the 272 audit liabilities reviewed, IRS Examination personnel had made contact with taxpayers but did not obtain agreements with the audit results. Collection personnel classified 32, or 58 percent, of these cases as currently not collectible based on hardship. In 15, or 27 percent, of the 55 cases, Collection personnel were later unable to locate or contact the taxpayers.

#### IRS does not know the extent to which delinquencies resulting from audits are collected

IRS has no statistics which show the collection results of delinquencies resulting from audits that are sent to district offices. In 1980 IRS developed some statistics on the number of delinquent accounts that resulted from audits but did not know the extent to which these accounts were classified as currently not collectible. Without statistics showing the extent of the problem, IRS Examination personnel may not feel that collection efforts are needed. An IRS Examination official stated that statistics on the audit cases classified as currently not collectible would help in emphasizing the importance of having the Examination Division assist in collections and would also help justify any added work.

A joint Department of the Treasury and IRS Accounts Receivable Study report issued in October 1980 recommends that new emphasis be placed on the collection of taxes by the Examination Division. The recommendation was based on the high number of delinquencies resulting from audits and preliminary statistics developed in our review on the extent of audit cases classified as currently not collectible. The study group chairman stated that in the past the Examination Division did more to assist the Collection Division, but emphasis had decreased in recent years. We believe that the lack of information showing the extent of the problem is one reason why the Examination Division is not doing more.

IMPROVEMENTS IN OFFICE BRANCH  
COLLECTION ACTIVITIES  
COULD REDUCE EXPENSE

District collection activities are performed in the Collection Division's office and field branches. Office branches, including their revenue representatives, can perform much of the same functions as the higher graded revenue officers in the field but at a much lower cost. Improving office branches' collection activities could improve the efficiency of working delinquent accounts.

At three of the four IRS districts reviewed, the office branches reported about half of the total individual accounts during 1978 that were determined currently not collectible. In the other district 75 percent of the cases were reported by the office branch. In 1979 IRS expanded the office branch authority for determining accounts currently not collectible in an attempt to increase the number of cases closed by office branches. However, office branch delinquent account processing is still limited by time constraints and lack of specific collection action guidelines.

IRS' failure to use the office branches more is particularly critical for currently not collectible accounts. Using the field branch for these accounts means higher grade personnel are used in nonproductive collection efforts. IRS estimated that the office branches close cases at one-fourth the cost of revenue officers (field branch).

IRS needs to ensure that office  
branches perform consistently

During 1978 about 85 percent of the accounts reported currently not collectible for individuals were within the office branch 1978 dollar criteria for closing cases. However, during this same period the office branches reported only 57 percent of the total accounts closed as currently not collectible. While there are other considerations besides dollar amounts that de-

termine whether the office branch or the field branch closes a case, the potential shown by these percentages indicate an opportunity for office branches to do more. In addition, analysis of the currently not collectible cases disclosed inconsistencies in the office branch attempts to locate taxpayers. The following table shows our sample results for the four districts reviewed.

District	Currently not collectible cases reviewed	Cases closed by office branch		Cases closed by field branch	
		Number	Percent	Number	Percent
Atlanta	204	153	75	51	25
Chicago	204	113	55	91	45
Greensboro	212	102	48	110	52
Seattle	<u>167</u>	<u>84</u>	50	<u>83</u>	50
Total	<u>787</u>	<u>452</u>	57	<u>335</u>	43

Of the 335 cases closed by the field branch, 74, or 22 percent, could have been closed by the office branch based on the criteria in effect at that time. None of these cases met the criteria requiring a field visit, and the field branch did nothing more than could have been done by the office branch.

Inconsistencies in locating taxpayers were noted at three district offices. The cases closed by the office branch generally showed a greater number of sources checked when it closed a case than when it transferred the case to the field branch.

The Internal Revenue Manual states that the specific sources to be checked to locate the taxpayer will depend on the circumstances of each case. Also, the manual states that before an account may be reported currently not collectible because the taxpayer could not be located, the investigating employee must take the following actions:

- Check routine internal sources such as directories, active file data, and closed files.
- Confirm with the Post Office that the taxpayer has moved and left no forwarding address.
- Review the most current income tax return to locate the taxpayer or assets for account balances over \$2,000.
- Conduct a field investigation to a taxpayer's last known address and perform a neighbor check for cases meeting established dollar levels.

These guidelines apply to the Collection Division in general, and office branch employees have no firm guidelines to follow in determining at which point they close the case, do more work,

or transfer the case to the field branch. Accordingly, we estimate that 22 percent of the cases transferred to the field branch could have been closed by the office branch.

Office branch processing is restricted by the availability and use of revenue representatives. Revenue representatives, if available, handle the office branch taxpayer contacts. Revenue representatives may be used either in the office or in the field. However, regardless of where the revenue representatives are located, the accountability for their case dispositions remains with the office branch. The maximum aggregate balance for taxpayer cases that can be assigned for revenue representative processing is \$5,000. Cases over this amount must be assigned to revenue officers. Also, if for some reason, such as extensive caseload, revenue representatives with an assigned caseload are unlikely to dispose of cases within their time limit--4 months with a possible 2-month extension 1/ --these cases are assigned to higher grade revenue officers.

Since not all districts visited had a sufficient number of revenue representatives available to make field visits, revenue officers had to make them. Officials at two district offices said constraints on the length of time revenue representatives can hold cases precludes them in some instances from taking all the collection actions they could.

At the four IRS district offices the field branch closed 47 percent of the unable-to-locate-or-contact currently not collectible cases. Because these cases can involve time-consuming attempts to locate and contact taxpayers, it is particularly costly for IRS to use the higher graded revenue officers.

Officials at the IRS district offices reviewed were generally in agreement that the office branches could take more collection actions than they currently do. The accounts receivable study stated that the office branch should take all collection actions available to it prior to transferring the cases to the field branch.

#### CONCLUSIONS

The steady growth since 1974 of the dollar inventory of accounts currently not collectible and the dollars lost because the collection statute period expired indicates a need for IRS to

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1/The limit for a revenue representative's field activity without an assigned caseload is 30 workdays with a possible 20-workday district office extension and a 30-workday regional office extension.

handle these delinquent accounts more efficiently. Better determinations of closing codes, better coordination with Examination Division and improvements in office branch collection activities could increase the efficiency and effectiveness of IRS' handling of currently not collectible accounts.

Inaccurately setting closing codes can result in lost revenues since the accounts will not be reactivated for collection action when the taxpayer has the ability to pay. Ultimate collection of the delinquency may be lost entirely if the statutory period for collections expires before the taxpayer files a return with the income level that IRS has designated for followup.

In not pursuing collection at the time additional taxes are determined through audits IRS is increasing the chances for these accounts to be reported currently not collectible. To arrange for payment methods or to document important taxpayer collection information at the conclusion of an audit can only improve the potential for collection of taxes due and reduce the number of collection actions subsequently needed.

Moreover, IRS, by not utilizing the office branch to its full potential in the collection process, has made its cost to report accounts as currently not collectible more expensive than it need be. Underutilization of the office branch has resulted in higher graded field branch staff working the cases. By giving the office branch sufficient time and specific guidelines for taking collection actions IRS can reduce the number of currently not collectible cases reported by revenue officers.

#### RECOMMENDATIONS

We recommend that the Commissioner of Internal Revenue:

- 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 followup is made to collect delinquent taxes.
- 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 to but are unable to pay their tax delinquencies in full.
- 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.

- 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.
- Establish more specific guidelines for office branches to use in processing delinquent accounts to ensure that they take all available collection actions before transferring the cases to the field branches.

#### IRS COMMENTS AND OUR EVALUATION

IRS agreed with most of our recommendations regarding the handling of currently not collectibles and has taken or plans to take the following actions.

- IRS revised its guidelines for setting the closing codes for accounts classified as currently not collectible due to financial hardship. According to IRS, these guidelines, in conjunction with procedures for mandatory followup, will provide for reactivation of cases most likely to produce additional revenue.
- IRS is developing specific guidelines for office branches to use in processing delinquent accounts to ensure that they are taking all available collection actions before transferring the cases to the field branches.
- IRS' Collection and Examination Divisions will jointly determine the desirability of developing a system to code delinquent accounts issued to the field to show whether the delinquency resulted from a no-contact audit.
- IRS is revising the Examination Division's procedures to emphasize that examiners are to solicit advance payment of delinquency in all completed agreed cases.
- IRS is considering procedures to require the Examination Division to make immediate contact with Collection Division personnel for cases meeting certain dollar criteria.

IRS does not agree that Examination Division personnel should obtain financial statements from taxpayers. IRS prefers instead to refer the taxpayers to the Collection Division. According to IRS, the Examination Division does not have the resources to gather this information and its personnel are not trained in the specialized techniques and procedures required for collection purposes.

We agree that it is preferable to have Collection Division personnel deal with delinquent taxpayers. However, when Collection personnel are not available, it is not very efficient for

IRS not to have Examination Division personnel obtain some financial information. To some extent the Examination Division is already obtaining financial information. If a taxpayer lives in a high crime area, IRS procedures require that Examination personnel obtain a financial statement from the taxpayer if Collection Division personnel are not available. Also, Examination Division personnel in some districts had local procedures to obtain financial information from taxpayers who claimed they could not pay the additional taxes in full.

IRS disagreed with our recommendation to develop a statistical information system for audit-originated cases. IRS said that, for the present, the cost of implementing a tracking system to show collection outcome by income classes and other criteria is prohibitive when measured against the resulting benefits. Management information systems can be complex or simple depending on the extent of the various information categories that are being developed.

We had not envisioned a complex system but rather a simple statistical system showing the results of collection action--fully paid or currently not collectible--and whether the taxpayers were contacted and agreed with the audit results. Without this type of information IRS cannot determine whether its collection actions on audit-originated delinquencies are effective. We therefore continue to believe that IRS should develop basic statistical information concerning audit-originated cases.

## CHAPTER 6

### A FIRM POLICY AND IMPROVED PROCEDURES WOULD MAKE OFFERS IN COMPROMISE A MORE EFFECTIVE COLLECTION TOOL

Although IRS has long had the power to accept something less than the full amount of tax liabilities, it has not used this tool effectively or uniformly. IRS has not established firm and uniform criteria for suggesting and accepting offers in compromise nor set up a system to measure or evaluate its effectiveness. Also, IRS does not always take advantage of the information it develops while investigating offers to help it collect delinquent taxes.

Offers to compromise delinquent taxes have been decreasing over the past few years: 2,335 taxpayers made offers in fiscal year 1978, 1,766 in 1979, and only 820 during the first 6 months of 1980. The four IRS districts we visited received 117 offers in 1978 that were closed at the time of our review:

	<u>Number</u>	<u>Offer amount</u> (Thousands)	<u>Percent of liability</u>
Received	117	\$1,261	27.3
Accepted	14	96	33.0
Rejected or withdrawn	103	1,165	27.0

As of December 29, 1979, IRS had collected 53 percent of the total amount offered, or 14.5 percent of the liabilities owed by these taxpayers. Because IRS has 6 years from the date of assessment to collect these taxes, it may ultimately collect more.

### A UNIFORM POLICY FOR SUGGESTING AND ACCEPTING OFFERS IN COMPROMISE COULD INCREASE COLLECTIONS

Although IRS' authority to compromise tax debts dates from the 19th century, the Commissioner has yet to establish uniform criteria to help revenue officers decide when to suggest and when to accept offers in compromise. Suggestion and acceptance of offers thus depend on district office policy and have been both limited and inconsistent. The four districts we reviewed rejected a number of offers because they determined the taxpayers could pay more, yet they later classified the liabilities as currently not collectible.

## IRS has long had the power to compromise liabilities

An 1831 law first gave the Secretary of the Treasury the authority to compromise a Federal debt. In 1864 the Congress authorized the Commissioner of Internal Revenue to compromise all suits involving taxes. This power was clarified and revised between 1866 and 1878 to its current scope, stated in Section 7122 of the Internal Revenue Code:

"The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense."

The Attorney General in 1933 and 1934 ruled that taxes can be compromised for two reasons only: doubt about liability and doubt about collectibility. In this report we are only concerned with offers based on doubt about collectibility, that is when IRS cannot be sure it will be able to collect the full amount of a liability it has established.

### How offers are processed

IRS has established detailed instructions for processing offers received, although it has provided only limited guidance on when and how district offices should use offers as a collection tool. Detailed processing instructions are necessitated by the fact that offers are legally binding contracts.

IRS service centers establish initial control of offers and send them to the districts for investigation. The district's first steps are to review the offers for completeness and to research district files for other information on the taxpayers. Offers then go to senior revenue officers for investigation.

The investigating revenue officer reviews the offer package, which includes a detailed financial statement. If the revenue officer determines that the offer is frivolous or made simply to delay collection action, the offer may be summarily rejected. Otherwise, the taxpayer will be contacted and a meeting arranged to verify the financial statement information.

The financial statement used for offers in compromise is a detailed 8-page form requiring specific financial data. The investigating revenue officer verifies the information shown on this financial statement and evaluates the taxpayer's future earning ability to determine the minimum offer acceptable.

According to IRS guidance, the minimum offer acceptable should reflect the taxpayer's total equity in assets as well as future earning capabilities to protect the Government's interest fully.

Although offers are usually made for a specific amount payable in one lump sum or in installments, revenue officers generally require collateral agreements permitting IRS to later collect funds beyond the amount of the offer and possibly the full liability. The most common collateral agreement provides for payments from future income.

Revenue officers can reject offers at any time during the investigative process if they cannot work out an acceptable compromise with the taxpayer. Since Collection Division compromises are based on the taxpayer's inability to pay the full amount, the most common reason for rejection deals with financial information. However, IRS can also reject offers for public policy reasons. These public policy rejections should be rare, according to IRS, and may be based on the taxpayer's notoriety or involvement with criminal activity or on IRS' desire not to set a precedent in areas where it is attempting to increase compliance with the tax laws.

When only the taxpayer's financial condition is at issue, IRS requires the investigating revenue officer to determine what amount is acceptable and work with the taxpayer to obtain an offer of at least that amount. If the officer determines that the taxpayer can fully pay the liability or could pay more than the amount offered, the offer is rejected. However, before rejecting an offer, the taxpayer is so advised and requested to withdraw the offer. A withdrawn offer saves IRS time since little justification is required; however, the taxpayer loses the right to appeal.

Once an offer is rejected or withdrawn, the rejection or withdrawal letter and the summary report are held in the district to be associated with the reissued delinquent account. However, if the account was previously classified as currently not collectible, it will not automatically be reactivated when the offer is rejected or withdrawn.

#### Uniform policy needed to promote offers in compromise

Although IRS has detailed instructions for processing offers in compromise, it has not established a uniform policy on when revenue officers should suggest offers. Consequently, districts have established their own varying policies, and offers have remained infrequent, even though IRS' national office has tried to promote use of offers in compromise.

### Policy varies among districts

Lacking specific guidance from headquarters, district offices have followed disparate policies on when revenue officers should suggest a compromise. In general, they have not emphasized this collection method, despite headquarters' encouragement.

The Internal Revenue Manual states that:

"When an account is not collectible in full and criminal proceedings are not contemplated or pending, an offer in compromise may be suggested. However, care will be exercised to ensure that frivolous offers are not encouraged and in no event will an offer be suggested merely to stay collection or when the liability is collectible in full.

"The compromise provision of the law shall be administered with the general objective of effecting maximum collection with the least possible loss or cost to the Government."

The manual also states that in some cases more tax revenues can be collected through compromise than through any other collection method.

However, IRS has not established specific criteria to help revenue officers decide when to suggest offers in compromise to taxpayers. Instead, it has left regions and districts to set their own policies, and these have varied widely. A regional official said IRS' compromise program has the most disparity of all its programs because national office guidance has not been specific.

Whether to offer a compromise or not is and should be left up to the taxpayer; however, IRS has not taken adequate steps to ensure that in appropriate cases its revenue officers suggest that compromise may be an acceptable means of satisfying the liability. It is IRS' policy not to "solicit" offers, but its revenue officers may suggest them to the taxpayers. IRS management officials generally agreed that offers should be suggested, but most revenue officers said they would not normally discuss the possibility unless the taxpayer first raised the question. The Chief of Collections in one district said a revenue officer should rarely suggest an offer.

IRS has recognized this limited and inconsistent use of compromises and has taken some action to improve. In March 1979, the Deputy Commissioner issued a memorandum to all regional commissioners stressing IRS' commitment to make compromise a viable and uniformly applied collection tool. The Internal Revenue Manual

was reorganized and rewritten to simplify instructions for handling offers in compromise.

Offers remain infrequent

Nevertheless, the incidence of offers in compromise has remained low and inconsistent among districts and has actually decreased overall since the March 1979 memorandum. The following table shows offers received during fiscal years 1978 and 1979 and the first half of 1980 in four similar-sized districts (two of which we reviewed) and two smaller districts we reviewed.

	<u>Offers received</u>		
	<u>1978</u>	<u>1979</u>	<u>First half of 1980</u>
Larger districts (note a)			
Atlanta	28	29	16
Chicago	35	25	21
Newark	297	217	103
San Francisco	143	89	38
Smaller districts			
Greensboro	28	29	9
Seattle	41	31	11
Nationwide	2,335	1,766	820

a/Size of districts for this comparison was based on the number of accounts classified as currently not collectible in calendar year 1978.

Nationwide, offers represented less than 0.5 percent of accounts classified as currently not collectible. Among the four larger districts, the proportion varied from 0.1 percent in Atlanta to 1.5 percent in Newark. 1/

Uniform criteria are needed for  
evaluating offers in compromise

Just as with the suggestion of offers in compromise, the lack of adequate national office guidance has led to inconsistent evaluation and infrequent acceptance of offers. Different districts are using different criteria to determine the minimum acceptable amount.

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1/These figures were derived by comparing offers received during fiscal year 1978 with currently not collectible accounts for calendar year 1978.

IRS officials disagreed on what assets revenue officers should consider in arriving at the minimum amount and how they should value them. In two districts we reviewed, revenue officers considered only those assets which IRS could secure through its levy and seizure actions and valued these assets at their quick sale value. Another district's revenue officers considered all assets available to the taxpayer, regardless of whether IRS could secure them through its collection actions, and valued the assets at their fair market value. Although the Internal Revenue Manual states that assets should be valued at their quick sale value, regional and district officials using the fair market value justified their position by quoting the portion of the manual which requires IRS to consider the taxpayer's equity and not what IRS could realize through seizure. One headquarters official stated that while revenue officers should consider all assets, the difference between what IRS could obtain through its collection action and the total assets available to the taxpayer could be the subject of negotiating an offer in compromise. Others contended that revenue officers should include all assets in arriving at the minimum acceptable offer.

Inconsistent policies were reflected in low and varying acceptance of offers in compromise as shown in the following table.

<u>District</u>	<u>Accepted Offers in Compromise</u>					
	<u>Fiscal year 1978</u>		<u>Fiscal year 1979</u>		<u>First half of fiscal year 1980</u>	
	<u>Percent</u>		<u>Percent</u>		<u>Percent</u>	
	<u>Number</u>	<u>of offers</u>	<u>Number</u>	<u>of offers</u>	<u>Number</u>	<u>of offers</u>
<b>Larger districts</b>						
Atlanta	5	17.9	12	41.4	-	-
Chicago	1	2.9	2	8.0	-	-
Newark	67	22.6	75	34.6	10	9.7
San Francisco	56	39.2	24	27.0	11	28.9
<b>Smaller districts</b>						
Greensboro	6	21.4	2	6.9	-	-
Seattle	2	4.9	2	6.5	1	9.1
Nationwide	527	22.6	421	23.8	163	19.9

Nationwide, IRS accepted 421 offers in fiscal year 1979. During the same period IRS classified 538,000 accounts as currently not collectible.

BETTER USE OF INFORMATION DEVELOPED  
DURING OFFER INVESTIGATIONS COULD  
INCREASE COLLECTIONS

IRS may have increased collections by making better use of information developed in the offer investigation or accepting

more offers. At the offices we reviewed, IRS collected a greater share of the liability from taxpayers who compromised than it collected from taxpayers whose offers it rejected or had withdrawn because it believed they could pay more.

The following tables show collection results as of December 29, 1979, for offers the four districts received in 1978.

	Number of offers	Amount owed	Amount offered	Collected		
				Amount	Percent of offer	Percent of liability
				----- (Thousands) -----		
Accepted	14	\$ 290	\$ 96	\$ 96	100	33
Rejected or with- drawn	103	4,323	1,165	575	49	13

IRS collected less than half of the offered amount from taxpayers whose offers it did not accept. However, some offers were rejected or withdrawn for public policy reasons or because taxpayers did not supply necessary information, so these statistics do not directly reflect the effectiveness of offer evaluations. Therefore, we analyzed the 50 cases rejected or withdrawn because IRS determined that the taxpayer could pay more. Collection statistics as of December 29, 1979, broken down by district are as follows.

District	Number of offers	Amount owed	Amount offered	Collected			Cases where IRS collected more than offered
				Amount	Percent of offer	Percent of liability	
				----- (Thousands) -----			
Atlanta	10	\$ 226	\$ 88	\$114	130	50	5
Chicago	12	551	121	73	60	13	1
Greensboro	17	204	70	70	100	34	8
Seattle	11	332	99	36	36	11	3
Total	50	\$1,313	\$378	\$293	78	22	17

Although IRS had determined that these 50 taxpayers could pay more than the amount offered, only 17 did. Of the remaining 33, 16 paid nothing and IRS classified 10 of these cases as currently not collectible. The other 17 taxpayers paid some of their liability, but not as much as they had offered: six of these accounts were later classified as currently not collectible. Thirteen accounts were still open at the time of our review, so further collection is possible. Thus, 16 of these 50 cases were classified as currently not collectible, even though IRS had determined that the taxpayer was able to pay more than the offered

amount. In these cases at least, it appears that IRS would have collected more money had it made better use of the information obtained or accepted the offers.

IRS' procedures for following up on withdrawn or rejected offers to collect liabilities have not been very effective. Even when the investigations reveal an ability to pay, IRS does not have a procedure to reactivate accounts that have been previously classified as currently not collectible. Similarly, revenue officers are not always provided financial information from the offer investigation to ensure the most effective and efficient collection of taxes on open delinquent accounts. Current procedures only require that a copy of the rejection or withdrawal letter sent to or received from the taxpayer and the summary report on rejection or withdrawal be filed with the delinquent account for followup collection action.

According to IRS officials, although there is no formal procedure for using financial information obtained through the offer investigation, the revenue officers would be informed of any significant information developed. This would be done by the group managers responsible for both the offer investigation and the collection action or through contact between the revenue officers themselves. Also, these officials said the revenue officer doing the followup can request the offer investigation files. The files, however, are maintained at the service center, and obtaining the information may take weeks.

At the completion of the offer investigation, accounts previously classified as currently not collectible are reactivated only upon district officials' specific request. Of the 50 offers rejected or withdrawn because IRS determined that an amount larger than offered could be collected, 10 accounts had previously been classified as currently not collectible. Only 1 of these 10 was reactivated. Although others may be reactivated at a later date for some other reason, the information developed in the offer investigations may not be useful at that time.

Even when accounts are open, IRS has not taken adequate collection action based on financial information in the offer case file. Although IRS determined that the 50 taxpayers could pay an amount greater than they offered, as of December 1979 only 17 of these taxpayers did pay more than was offered. Also, in some cases rejected or withdrawn for other reasons, financial information in the offer file could have helped in collection actions. For example:

A taxpayer offered \$28,000 to compromise a \$58,000 liability. The offer was rejected because the taxpayer was uncooperative in furnishing needed information. The liability was classified as currently

not collectible without any additional money being collected. However, the taxpayer's financial statement for the offer showed that the taxpayer had over \$40,000 equity in a home, over \$5,000 cash surrender value in life insurance policies, and \$4,500 in cash.

A taxpayer offered \$5,000 on a \$13,000 liability. IRS rejected the offer because the taxpayer had not submitted sufficient information to evaluate the offer. The account was later classified as currently not collectible and no additional money was collected. The financial statement showed that the taxpayer owned \$3,600 worth of property.

A taxpayer offered \$20,000 on a \$32,000 liability. IRS rejected the offer because the taxpayer failed to supply additional information. The liability was classified as currently not collectible after less than \$100 was collected. The taxpayer's financial statement showed that he had equity of \$22,000 in rental property and \$21,000 in his residence.

#### FURTHER STUDY NEEDED TO IMPROVE THE USE OF OFFERS IN COMPROMISE

IRS' studies of offers in compromise have not addressed their effectiveness as a collection tool or the appropriateness of their use. To improve its use of compromise, IRS needs information on the cost of processing and investigating offers, factors that influence collectibility, and the effects of compromises on voluntary compliance.

IRS evaluates the offer-in-compromise program by regional office review of cases and national office review of regional involvement. In addition, IRS analyzes statistical reports on offers received and accepted and the length of time cases are open. These evaluations are good, but more depth is needed.

While the case evaluations are needed to assess procedures for handling individual cases and the appropriateness of dispositions, they do not address the overall effectiveness of the program. The statistical reports compare districts' receipts and acceptance rates and information on the length of time cases are open. These statistics are not good indicators of effectiveness, according to IRS officials, because of the small number of offers received.

The IRS national office's last comprehensive study of offers was in 1977. The purpose of the study was to standardize the consideration of offers. The study identified the following

factors as affecting the volume and distribution of offers received and accepted.

- Many revenue officers found the offer procedures too complex and seldom considered compromise a useful collection alternative.
- The socioeconomic makeup of taxpayers differed from district to district.
- Regional and district management held varying attitudes toward the use of offers in compromise as a collection tool.
- Regional involvement in the compromise program was not adequate.

IRS then took various steps to assure uniformity. The Internal Revenue Manual section on offers was rewritten and training material was revised. Authority to accept offers on outstanding liabilities over \$100,000 was delegated to regional commissioners, and the regions have been required to perform post reviews of closed offer cases. IRS is also stressing the use of offers in compromise during collection staff meetings.

However, the study did not address the effectiveness of offers or the appropriateness of their use. In evaluating these aspects of the program, IRS must consider the cost of processing and investigating offers, factors influencing the potential for collecting liabilities, and the effects of the offer in compromise program on voluntary compliance. IRS has little information on these factors.

Investigating and processing an offer is costly. Estimates developed during our review based on information provided by IRS showed that the cost of revenue officer time was about \$500 per offer. Accepted offers required more work, therefore costing more than the average, while withdrawn offers were less costly. Therefore, IRS should determine a dollar level for offers above which it would be economical to work. This dollar figure should be used only to determine in which cases revenue officers would suggest an offer, not to reject offers.

IRS currently determines the potential collectibility of delinquencies by reviewing an 8-page financial statement; however, revenue officers must determine without detailed information when to suggest an offer.

The last area needing study, the program's effects on voluntary compliance, will be the most difficult to measure and will require constant monitoring of the type of offers being made. Substantial increases in offers from persons who can fully pay would cost IRS' Collection Division heavily in resources to investigate these cases.

## CONCLUSIONS

IRS has not used offers in compromise uniformly and effectively to satisfy tax liabilities. While we are not advocating widespread use of compromises, the program could be better used to ensure the collection of taxes not otherwise available to the Government. IRS needs to establish specific policies and procedures for the use of offers.

Although IRS has taken some steps to improve the use of offers in compromise, these have not been enough. Lack of guidance is still resulting in limited and inconsistent suggestion and acceptance of offers. IRS needs to study the most efficient and effective use of offers in compromise. Three factors must be considered to determine when offers should be encouraged: processing and investigating costs, the potential to collect, and the effect on voluntary compliance. Once these are determined, IRS needs to establish a means to evaluate delinquent accounts to ensure that revenue officers are adequately considering the use of offers in compromise and are suggesting them in appropriate cases.

By not fully using information developed in the offer investigation, IRS may be losing revenues and wasting its Collection Division's most valuable resource--revenue officer time. Better procedures for using this information would improve the use of IRS' limited resources and possibly collect additional revenue.

## RECOMMENDATIONS

We recommend that the Commissioner of Internal Revenue:

- Conduct a comprehensive study to determine the most effective use of offers in compromise and the type of case where offers should be suggested.
- Establish specific policies and procedures showing when and how compromises should be used as an effective collection tool. These procedures should identify how assets should be evaluated to arrive at a minimum acceptable compromise amount.
- Ensure that IRS' review of currently not collectible accounts includes a procedure to determine if revenue officers are suggesting offers in appropriate cases.

- Periodically evaluate the effectiveness of the compromise program as a collection tool.
- Set up procedures to ensure that financial information developed during the offer investigation is used in followup collection action and that accounts previously classified as currently not collectible are reactivated when financial information indicates that collection is possible.

#### IRS COMMENTS AND OUR EVALUATION

IRS agreed with our 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 cases where offers should be accepted. After completion of the study IRS intends to issue more specific guidelines on when and how offers in compromise should be used and how assets should be evaluated to arrive at a minimum acceptable compromise amount. This comprehensive study of offers will also provide for followup reviews of any procedural changes and for periodic evaluations of the offer in compromise program.

IRS also intends to revise its procedures to require that the Rejection and Withdrawal Memorandum include detailed financial information developed during the offer investigation and that the detailed financial statement be attached to the delinquent accounts for followup collection action. In addition, IRS will develop a procedure to require that currently not collectible accounts are reactivated when the investigation of the offer shows that further collection is possible.

IRS has already taken some action by revising its procedures to provide that, before a liability is reported as currently not collectible, compromise of the liability will be considered and discussed with the taxpayer in appropriate cases.

## CHAPTER 7

### OTHER FACTORS CONTRIBUTING TO IRS' INADEQUATE HANDLING OF DELINQUENT ACCOUNTS

Although inadequate use of taxpayer financial information is a major hindrance to IRS' collection programs, three other factors impair the way these programs operate.

- Because of the many criticisms of the way IRS handles delinquent taxpayers, it has taken a more lenient approach to collecting delinquencies.
- Because of IRS' limited management information, it has relied heavily on a single quantitative figure--case closures--to measure district performance.
- Because resources have not kept pace with the increasing number of delinquents, the quality and type of IRS collection programs have been governed by resource considerations.

These factors are all interrelated and caused in part by the lack of an adequate management information system. IRS needs to establish a comprehensive evaluation system to ensure that accounts are closed fairly and appropriately, not just quickly.

### IRS IS TAKING A MORE LENIENT APPROACH TO THE COLLECTION OF DELINQUENT TAXES

Constant criticism of IRS' use of its strong collection powers has caused it to change its approach to the collection of delinquent taxes. While the intent of these changes is good, IRS has gone too far in this direction without committing the necessary resources to ensure efficient and effective collection actions. As shown in the preceding chapters, IRS is allowing taxpayers who could pay their delinquencies fully to pay in installments or possibly avoid paying. One of the underlying reasons according to IRS is this lenient approach.

In 1974 under a project termed "Collection Initiatives," IRS started shifting to a more lenient approach to collecting delinquent taxes. The use of installment agreements has expanded to the point where an estimated 97 percent of all delinquent individual taxpayers sent third notices are given this option, without regard to their financial ability to pay. The number of seizures decreased from 18,000 in 1975 to about 5,000 in 1978 and increased to about 6,000 in 1979. According to IRS officials, this lenient philosophy has spread throughout its collection activities and is partly responsible for some of the problems we have identified.

For several years, the Congress, the news media, and public interest groups have charged that IRS has abused its collection powers. One of the prime criticisms came from an Administrative Conference of the United States report submitted in 1976 to the Subcommittee on Oversight, House Ways and Means Committee. This report proposed a more lenient collection approach in such areas as installment agreements, levies, and seizures but stressed the importance of basing collection action on the taxpayer's financial ability to pay delinquent taxes.

Criticism of IRS' collection actions continues. Abuses of IRS' collection powers were cited in hearings to justify an amendment to IRS' fiscal year 1980 appropriations, requiring IRS to follow certain provisions of the Fair Debt Collection Practices Act. Taxpayer complaints of abuses were raised before the Subcommittee on Oversight, House Ways and Means Committee in May 1980 hearings which dealt with taxpayer complaints against IRS. In July 1980 IRS testified before the Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs on allegations it was putting pressure on revenue officers to increase the number of seizures. Also, a bill has been proposed which requires IRS to obtain a court order before taking any levy or seizure action. Although it is too early to say for sure, this new wave of criticism may act to weaken collection activities more.

Numerous IRS officials in regional and district offices have expressed their concern that this lenient approach may be one reason for the increasing number of delinquent taxpayers. IRS officials informed us that they are not supposed to question the taxpayers' lifestyle and that even though the taxpayers may be earning a substantial salary they could avoid paying taxes by living beyond their means. One regional official informed us that taxpayers could basically select whatever method they wished to pay their delinquency.

This concern about the effects of a lenient collection approach is also demonstrated in a recent IRS study. According to an October 1980 report by IRS and the Department of the Treasury, among internal causes division managers cited for the increase in delinquent accounts, the most common were resource constraints and IRS actions that field personnel interpreted as a softening in delinquent tax collection policy.

#### IRS' MANAGEMENT INFORMATION SYSTEM AND EVALUATIONS HAVE BEEN LIMITED

IRS has not developed a comprehensive means for evaluating its collection activities. The only quantitative information for measuring regional and district performance has been the

number of case closures. IRS has not developed a centralized management evaluation system relating to the type of disposition and the amount collected. According to IRS officials, regional and district personnel consider collection results on a case-by-case basis during their quality case review.

Relying on this single case closure measure can place emphasis on meeting a goal of closing cases quickly rather than collecting delinquent taxes in the most efficient and effective way. One district chief of collections stated that case closures were very important and that employees were pressured to close cases, but he said these employees would not forego the collection of taxes just to close cases. Nothing in our review leads us to believe that collection employees would intentionally forego collecting taxes; however, this pressure to close cases, we believe, is one of the reasons cases are not always worked to the Government's best advantage.

Present criticism of IRS provides an example of how using this single factor to evaluate performance can hamper collection activities. Recognizing that its trend toward leniency may have gone farther than just protecting taxpayer rights, IRS has recently been stressing the importance of using a balanced collection effort which includes stronger use of its collection powers. However, a number of revenue officers testified before the Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs, that pressures and quotas were being established to force them to take unjustified seizure actions on businesses.

The easiest way to measure stronger collection action is by counting seizures. Therefore, some IRS field personnel have picked up the idea that taking stronger action means increasing seizures. However, stronger collection action may also include strengthened demands for payments, tightened control over installment agreements, and requiring taxpayers to obtain loans. While increased seizures may be one result of a shift to a more balanced approach, the fact that it is the only available measurement of the shift can cause IRS officials to emphasize it inappropriately. Similarly, measuring performance by the speed of case closures can result in quick settlement of an account taking precedence over the Government's best interest.

Several IRS officials agreed that a more comprehensive evaluation system is needed. Moreover, regional collection officials stated that the lack of an adequate management information system for collections is one of the biggest problems facing the Division. IRS' Collection Division has had numerous problems seeking meaningful management information. In 1977 IRS attempted to develop a consolidated data base and expand the data available for management decision making. The comprehensive system proved too massive for IRS' computers, and the system was abandoned in 1978.

Because earlier reporting systems had been discontinued in anticipation of the new system, IRS had little statistical information until a new system was started on October 1, 1979.

The new reports provide information on dollars collected and type of disposition, but no measurable goals have been established. The only report that shows any measure of accomplishments deals with the number of delinquent accounts sent to the districts and case closures. IRS has long range plans to develop more performance measures, but meanwhile the single measure will continue to influence collection actions.

#### IRS' COLLECTION RESOURCES AND THE INCREASING DELINQUENCY PROBLEM

IRS is faced with increasing numbers of delinquents and a collection force that is not keeping pace. The inventory of delinquent accounts being actively worked in the districts more than doubled in the past 4 years and is expected to increase even further. Staffing has not kept pace with the increasing number of delinquents; therefore, IRS has sought methods to deal with increasing inventories within its staffing levels. However, collections may have suffered.

IRS' primary efforts to deal with this problem are aimed at reducing the number of delinquent accounts sent to the district offices for collection work. Some of these attempts include raising the dollar limit for cases that will be sent to the districts for collection action, starting a control system which also limits the type of cases sent to the districts to be worked, and expanding the service center collection activities. The first two methods do not resolve the delinquency; they only delay and possibly forego further collection action.

The dollar amount used to determine whether to send accounts to the districts has increased 1,900 percent in the past 13 years. The figure is set simply to reduce the number of delinquent accounts sent to the districts and is not based on the cost of collecting a delinquency. The accounts that are not forwarded are held in suspense and any refunds due taxpayers are used to offset their liabilities. If the liability increases through penalties and interest or additional delinquencies beyond the established dollar amount, the account will then be forwarded. A drawback to this approach is that if the taxpayer does not have refunds to offset the delinquency and the total liability never exceeds the forwarding level, the liability will eventually be lost when the 6-year statutory period for collections expires.

The control system withholds low priority delinquent accounts from the field branch if there are not enough resources to work all cases. The priority is based on type of tax and dollar amount.

This system is fine for controlling workloads, but it only postpones the handling of accounts until a later date. While this system allows districts to work with manageable inventories until field branch resources are available, collecting the low priority accounts at a later date may be harder because the accounts will be older.

The expansion of service center collection activities started in 1976 with the telephoning of delinquent taxpayers between the third and fourth notices. In July 1979 the telephone contacts were dropped in favor of installment-agreements-by-mail. As shown in chapter 2, the installment-agreement-by-mail program may not be in the Government's best interest and may not even have any significant effect on reducing the district offices' workload.

Limited resources also restrict work on individual cases. IRS officials informed us that although they would like to have accurate and reliable financial data on taxpayers, they do not always have the resources to obtain and verify this information.

IRS NEEDS INFORMATION ON COST AND  
TIME IT WILL TAKE TO ACCURATELY  
DETERMINE TAXPAYERS' ABILITY TO PAY

IRS does not know how long it takes to obtain accurate and reliable taxpayer financial information. Estimates of the time spent for obtaining, verifying, and evaluating financial statements ranged from 20 minutes to 24 work hours depending on the complexity of the taxpayer's financial condition.

Several steps can be taken to minimize the time required to obtain, verify, and evaluate financial information while keeping it as accurate as possible. Guidelines on acceptable expenses and expense ranges would minimize the number of items that would be questioned or verified. Requiring taxpayers to provide proof of income and questionable expense items would cut down on verification time. However, IRS would still have to expend additional resources to obtain accurate and reliable collection information.

The investment in additional resources would be beneficial in two ways. Not only would IRS collect more taxes in less time but it would have a more reliable basis for using its collection powers fairly, thus avoiding criticism of its use of strong collection powers.

IRS ACTIONS

IRS is taking actions to deal with these problems. It is trying to balance its collection approach by making better use of its stronger collection powers. However, increased use of strong

powers must be based on accurate and reliable financial information to avoid the possibility of abuses. Additional management information reports are being developed, and IRS' long range plans include evaluations of each program's cost effectiveness.

At present, however, cost information is not detailed enough to determine the additional resources needed for specific activities such as obtaining, verifying, and evaluating financial information. IRS is seeking additional resources but does not know if they will be enough. Even with the increase requested for fiscal year 1981, IRS intends to continue its measures for reducing delinquent accounts going to the district offices, including installment-agreements-by-mail.

### CONCLUSIONS

To ensure efficient and effective collection of delinquent taxes from taxpayers who claim they cannot pay in full immediately, IRS needs accurate and reliable financial information. IRS must then use this information in a firm and fair collection program, using its collection powers when appropriate. Also, IRS needs to establish a comprehensive evaluation system to ensure that accounts are settled fairly and appropriately, not just quickly.

A lenient approach to collecting delinquent taxes allows taxpayers to unfairly avoid or delay payment of their delinquencies. This approach may encourage delinquencies in the future, since taxpayers may decide to pay off other creditors instead of the Government.

Without adequate information and evaluation systems, IRS employees may emphasize the closing of cases rather than the most efficient collection of taxes. Accurate and reliable financial information will often not be obtained, and the actions taken will be governed by what is the fastest way to close the case. Granting an installment agreement or classifying an account as currently not collectible based on information provided by the taxpayer may be expedient, but verifying and questioning the information may be in the Government's better interest.

Without adequate resources to meet the growing delinquency problem, IRS is faced with a decision to either work fewer cases or do less with the delinquencies it works. It has tried to do a little of both. It does not work all delinquent accounts and has continually raised the dollar level of cases it does not work to reduce its workload. It also has cut back on the work per taxpayer by not adequately verifying or questioning taxpayer financial information.

IRS should continue to shift more of its collection work to service centers and office branches to more efficiently use its

resources. However, if taxpayers claim they cannot fully pay their taxes, then accurate and reliable information is needed to determine what collection action should follow. IRS needs to determine and request from the Congress the resources it needs to effectively collect delinquent taxes and specifically to ensure that accurate and reliable financial information is available for collection decisions. In requesting these resources, IRS should alert the Congress to the dollar cutoff for sending delinquent accounts to district offices at different resource levels.

### RECOMMENDATIONS

We recommend that the Commissioner of Internal Revenue:

- Take strong collection action when appropriate based on more accurate and reliable financial information to resolve delinquencies in the best interest of the Government.
- Establish a more comprehensive means of setting goals and measuring performance, including such criteria as dollars collected and type of disposition.
- Determine what resources are needed 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 AND OUR EVALUATION

IRS agreed with our recommendations. IRS said that resolving delinquencies in the best interest of the Government is the premise on which the Collection Division operates and it continually reviews, studies, tests, and revises operating procedures to ensure that this is accomplished. IRS also said that at the same time it must provide for uniform treatment of taxpayers and recognize and respond to true hardship situations. However, IRS did say that the procedural changes underway will ensure that more accurate and reliable financial information is available to better resolve delinquencies.

In its response IRS also said it recognized the need for a more comprehensive means of setting goals and measuring performance and has several projects underway to assist in accomplishing this. For example, a system designed to capture the time required to perform certain tasks involved in processing cases in the Collection Division will be tested in two districts beginning in

fiscal year 1981. Also, a discriminant function scoring system 1/ is being developed for case selection and eventual resource allocation. Results and recommendations from a recently completed Accounts Receivable study are being used with present and planned IRS systems to ensure clear criteria are created for dollars collected and types of disposition. IRS plans to make continual refinements to achieve a more comprehensive system for establishing organizational goals and measuring achievements. Through its planned automated case processing system and other management information systems, IRS says it will have more reliable information to better evaluate resource needs for the various collection programs.

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1/This type of scoring system was first developed for use in selecting tax returns for audit. The system will use formulas to weigh various characteristics of the case to arrive at the potential collectibility of the delinquent account.

## COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

Jul 1 1981

Mr. William J. Anderson  
Director, General Government Division  
United States General Accounting Office  
Washington, DC 20548

Dear Mr. Anderson:

Thank you for the opportunity to review your draft report entitled "Better Use of Taxpayer Financial Information and Improvements in Collection Programs Will Increase Collection of Delinquent Taxes".

The Collection Division operates on the premise of resolving outstanding delinquencies in the best interest of the Government while providing for uniform treatment of taxpayers and appropriately recognizing and responding to true hardship situations.

As your draft report recognizes, the Collection Division has been faced with rising inventories and diminishing resources at the same time. To meet this challenge, much time and effort were devoted to reviewing, studying, testing and developing program guidelines that would close delinquent accounts and produce the highest possible amount of revenue using available resources. As a result, many of the recommendations in the report were already in various stages of implementation or consideration at the time of GAO's review.

The draft report offers many constructive suggestions summarized in recommendations covering the installment agreement, currently not collectible, and offer in compromise programs.

You may be assured that we will continue to balance available resources devoted to these programs against the other serious needs of tax administration and improvements in the efficiency of these programs.

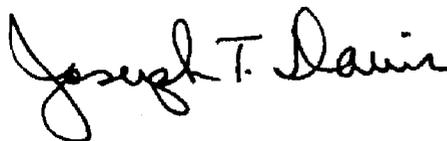
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Mr. William J. Anderson

Our response to your specific recommendations is enclosed.

With kind regards,

Sincerely,

A handwritten signature in cursive script that reads "Joseph T. Davis". The signature is written in dark ink and is positioned above the typed name.

Acting Commissioner

Enclosure  
Responses to Recommendations

Page 14

We recommend that the Commissioner of Internal Revenue:

-- Discontinue the current installment-agreement-by-mail program except for those accounts which would ordinarily not be sent to a district office for intensified collection action.

Response:

The installment-agreement-by-mail program was instituted as one means to address the problem of rising delinquent account inventories and diminishing resources. Since this problem still exists, we must disagree with this recommendation. We are currently reviewing the installment-agreement-by-mail program and have completed a study on those taxpayers whose liabilities are below the dollar level used to determine whether the accounts are sent to the districts for intensified collection efforts. A study for those taxpayers whose liabilities are above the dollar deferral level is in progress and scheduled to be completed in March 1982. After we have analyzed the results of the latter study, we will re-evaluate this recommendation.

Page 26

-- Develop a guide based on equity in assets, gross income, income over expenses, and amount of tax liability to identify cases with loan potential and require taxpayers meeting this potential to seek loans and provide written documentation of rejections.

Response:

Although we agree that additional guidance regarding a taxpayer's ability to borrow is needed, a formal guide is impractical. Local economic conditions, rising interest rates and fluctuations in the economy dictate loan availability and make loan potential unpredictable.

We are considering the recommendation to require written documentation of loan rejections, while being aware that implementation could cause inconvenience to both the taxpayer and lending institution and cause an additional drain on our resources. Experience has shown that taxpayers who do not want to borrow can easily secure a loan rejection statement from a financial institution.

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Page 26

-- Establish more specific guidelines for employees to use in evaluating and analyzing financial statements, including guidelines defining the necessity and amount of expenses.

Response:

We agree with the recommendation and have taken steps to implement it.

We recently developed improved financial statements and now have one statement for individual taxpayers and another statement for business taxpayers. In addition, we are developing better criteria for necessary living expenses. Dollar criteria are difficult to establish because of variables in geography, family circumstances, economic fluctuations, etc. However, we are investigating a number of approaches to revise procedural guidelines.

Page 26

-- Require taxpayers to provide information on credit card expenses to ensure that expenses are not duplicated and are for necessities.

Response:

We agree with this recommendation and will take the necessary actions to implement it.

Page 26

-- Require taxpayers to provide proof of income and certain expense items which may be questionable.

Response:

We agree with this recommendation and have recently instituted procedural changes within its framework. For example, taxpayers when asked to appear for an interview, are requested to bring a copy of their latest income tax return as well as other information necessary to establish their financial condition. Interviewers compare information on the Collection Information Statement (CIS) with the copy of the return and other documents provided by the taxpayer. If items on the CIS appear to be over or understated, or out of the ordinary, the taxpayer will be asked to explain and substantiate them.

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Page 26

--Require employees to use dates when liabilities are paid off in order to increase the amount of installment agreement payments, obtain advanced dated installment agreements, or reactivate currently not collectible accounts.

Response:

We agree with this recommendation. Existing procedures provide for increasing the amount of installment agreement payments when other liabilities are paid. We will reemphasize this provision to our field offices.

Currently not collectible procedures now provide for follow-up action when satisfaction of other liabilities will allow the taxpayer to begin payments on tax obligations.

Page 26

-- Develop a more detailed quality review of financial statements to ensure that (1) all information is considered in arriving at the decision to grant an installment agreement or classify the account as currently not collectible, and (2) the information is mathematically correct.

Response:

We agree with the recommendation and are currently taking actions to implement it. We have initiated instructions on quality elements to be considered by employees who secure and review installment agreements and Collection Information Statements.

Page 26

-- Establish installment payments based on taxpayers' ability to pay regardless of whether the payments cover interest charges and increase payments when possible.

Response:

We agree with this recommendation. Current procedures require that the agreement be reviewed periodically and that the payment be increased if warranted.

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Page 30

-- Place more emphasis on the use of payroll deductions as a means to collect the monthly installment payments.

Response:

Under certain circumstances, payroll deduction agreements are effective tools. However, in many cases, we do not get the cooperation of the employer. Many employers do not want the additional paperwork involved. To the extent that a payroll deduction agreement is practicable, our procedures now adequately encourage its use.

Page 30

-- Establish procedures to better enforce installment agreements, such as, requirements for payroll deductions or levy action before defaulted agreements will be reinstated, and give collection employees a guide on acceptable reasons for missed payments.

Response:

We essentially agree with the recommendation and have instituted the following procedural changes to implement it:

- (1) A requirement to secure managerial approval on installment agreements when the taxpayer has defaulted on a previous installment payment on this account or the taxpayer alerts us to inability to make payment and has been allowed to skip more than two consecutive payments or three in a 12 month period;
- (2) Guidelines for acceptable reasons for permitting a taxpayer to miss an installment agreement payment.

In addition, our procedures already specify that a payroll deduction agreement will be considered before a defaulted agreement is reinstated. This cannot be made a requirement since payroll deduction agreements must be acceptable to the employer. Moreover, the requirement would not be appropriate for non-wage-earner cases.

Page 30

-- Develop an evaluation system that would consider dollars collected, case disposition, and cost of collecting through installments to determine the effectiveness of the program and reasons for defaults and possible corrective action.

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Response:

We agree. The effectiveness of the installment agreement program should be evaluated by an analysis which would include dollars collected, case disposition and costs of collection. However, our current computer program is not able to provide dollar yield and we cannot modify the program until after the Service Center Replacement System is completed. We will consider programming changes to implement the recommendation at that time.

Page 42

-- 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 followup is made to collect delinquent taxes.

Response:

We agree with this recommendation and recently revised our procedures accordingly. The revised guidelines for selecting an appropriate closing code, used in conjunction with mandatory follow-up procedures, provide reactivation of cases which are most likely to produce additional revenue.

Page 42

-- 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 to, but are unable to fully pay, their tax delinquencies.

Response:

We concur that in cases where the taxpayer advises Examination that they are not able to pay the tax, additional action by Examination is warranted. Examination procedures are being revised to emphasize to examiners that they are to solicit advance payment of deficiency in all completed agreed cases.

We are considering procedures where Examination, on cases meeting certain dollar criteria, will make immediate contact with Collection Division personnel.

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We do not agree that Examination Division personnel should obtain financial statements from taxpayers. Resources are not available to gather this information. In addition, Examination personnel are not versed in the specialized techniques and procedures required for Collection purposes.

Page 42

-- 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.

Response:

We agree. Collection and Examination will jointly determine the desirability and feasibility of developing such a code.

Page 43

-- 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.

Response:

We disagree with the recommendation since for the present, the cost of implementing a tracking system to show collection outcome of audit cases by income classes and other criteria is prohibitive in view of the resulting benefits.

Page 43

-- Establish more specific guidelines for office branches to use in processing delinquent accounts to ensure that they take all available collection actions before transferring the cases to the field branches.

Response:

We agree with the recommendation and are presently developing more specific guidelines to meet this objective.

Page 54

-- Conduct a comprehensive study to determine the most effective use of offers in compromise and the type of case where offers should be suggested.

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Response:

We agree with the recommendation. A study will be completed during FY 1982.

Page 54

-- Establish specific policies and procedures showing when and how compromises should be used as an effective collection tool. These procedures should identify how assets should be evaluated to arrive at a minimum acceptable compromise amount.

Response:

We agree with the recommendation. Once the study mentioned in the previous recommendation is completed, we will issue more specific offer in compromise guidelines.

Page 54

-- Ensure that IRS' review of currently not collectible accounts includes a procedure to determine if revenue officers are suggesting offers in appropriate cases.

Response:

We agree and have revised our procedures to provide that before a liability is reported as currently not collectible, compromise of the liability will be considered and discussed with the taxpayer in appropriate cases.

Page 55

-- Periodically evaluate the effectiveness of the compromise program as a collection tool.

Response:

We agree. The comprehensive study of offers to be completed in FY 1982 will provide for follow-up reviews of any procedural changes made and for periodic evaluations of the offer in compromise program.

Page 55

--Set up procedures to ensure that financial information developed during the offer investigation is used in followup collection action and that accounts previously classified as currently not collectible are reactivated when financial information indicates that collection is possible.

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Response:

We agree with the recommendation and will revise our procedures to require that Form 1271, Rejection and Withdrawal Memorandum, include detailed financial information developed during the offer investigation. In addition, a copy of the Form 433, Statement of Financial Condition and Other Information, will be attached to the TDAs. These documents will be used in follow-up collection actions.

We will also develop a procedure to require that currently not collectible accounts be reactivated when the investigation of the offer shows that further collection is possible.

Page 62

-- Take strong collection action when appropriate based on more accurate and reliable financial information to resolve delinquencies in the best interest of the Government.

Response:

We agree with the recommendation. It is the premise by which the Collection Division operates. We continually review, study, test and revise operating procedures to ensure that delinquencies are resolved in the best interest of the Government. At the same time, however, we must also provide for uniform treatment of taxpayers and recognize and respond to true hardship situations. Procedural changes underway will ensure that more accurate and reliable financial information is available to better resolve delinquencies.

Page 62

--Establish a more comprehensive means of setting goals and measuring performance, including such criteria as dollars collected and type of disposition.

Response:

We recognize the need for a more comprehensive means of setting goals and measuring performance and have several projects underway to assist us in accomplishing this. For example, a system designed to capture the time required to perform certain tasks involved in processing cases in the Collection Office function will be tested in two districts beginning in FY 1981. Also, a DIF (discriminant function) scoring system is being developed for case selection and eventual resource allocation. An Accounts Receivable study has been completed, and the results of the recommendations are being melded with present and planned systems to ensure that clear criteria are created for dollars collected and types of dispositions. Continued refinements will be made to achieve a more comprehensive system for establishing organizational goals and measuring achievements.

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Page 62

--Determine what resources are needed 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.

Response:

We agree that further efforts are needed for cost analysis of delinquent accounts to more accurately provide the Congress with our resource needs and the impact of alternative staffing levels. With the advent of case processing through an automated system based on DIF (discriminant function), and our planned Collection Resource Information System (CRIS), we will have more reliable information to better evaluate resource needs for the various Collection programs.

GAO Note: Page references refer to the draft report and do not necessarily correspond to the final report.

IRS PUBLICATION 586A "THE COLLECTION PROCESS (INCOME TAX ACCOUNTS)"  
DATED JANUARY 1980

Publication 586A  
(Revised January 1980)

# The Collection Process (Income Tax Accounts)

Existe una versión de esta publicación en español, la Publicación 586S, que puede obtener en la oficina local del Servicio de Impuestos Internos.

Department of the Treasury  
Internal Revenue Service

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## I. Introduction

This booklet is designed to explain your rights and duties as a taxpayer owing a bill for taxes. It also explains our statutory obligation to collect overdue taxes, and how we fulfill this obligation. It is not intended to be a precise and technical analysis of the law in this area.

## II. Liability for Unpaid Taxes

### A. Notice and Demand

Each return filed with Internal Revenue Service is checked for mathematical accuracy and to see whether appropriate payment has been made. If tax is owing, a notice of tax due will be sent to you.

We are required to issue you this bill, which is demand for payment. You are then required by law to make payment within 10 days of the date of this bill. If the tax remains unpaid after the 10 day period has passed, a statutory lien attaches to your property.

### B. Accelerated Notice and Demand

While the routine billing procedure is followed in the great majority of cases involving unpaid taxes, situations arise when the normal 10 day notice and demand period must be shortened. Accelerated billings are made if we have reason to believe that delay will cause the situation to worsen. These bills become immediately due and payable after de-

livery of the notice and demand to you, and collection action may begin if payment is not made at once.

## III. Payment Procedure

By law you are required to pay a bill within 10 days after receiving the notice and demand. Most taxpayers respond to this first notice and pay the full amount owed.

If your tax is not paid on time, the law provides for interest and penalty for late payment.

**Interest**—Beginning February 1, 1980, the rate will be 12 percent a year on the unpaid tax from the due date of the return. (By law, the interest rate is subject to periodic adjustment. For the two years prior to February 1, 1980, a 6 percent rate applied.)

**Penalty for Late Payment**—is 1/2 of 1 percent of the unpaid tax for each month, or part of a month the tax remains unpaid. The penalty cannot exceed 25 percent of the unpaid amount.

**Penalty for Failure to File**—If you fail to file your return by the prescribed due date, you will be penalized 5 percent per month, or any fraction of a month that the return is late, up to a maximum of 25 percent. (However, when the liability for both the failure to file and failure to pay penalty exists in the same month, the failure to file penalty will be reduced by 1/2 percent per month, so that the total combined penalty does not exceed 5 percent for any given month.)

The penalties for late payment and filing may be eliminated if you show reasonable cause for not making the payment or filing timely (see Section VI G).

Accounts should be paid promptly to keep interest and penalty charges to a minimum. Whenever you make tax payments, be sure to enclose a copy of your bill, and enter your social security number and tax period on your check, money order or postal note, to ensure that your payment is correctly credited to your account. **If you believe your bill is wrong, or believe you can't pay, you should immediately write the office from which the bill was sent, or telephone or visit your local Internal Revenue Service Office.** Ordinarily, the local IRS office address and telephone number are located under the headings of "United States Government" in the white pages of your local telephone directory.

### A. If You Believe Your Bill is Wrong

If you believe that your bill contains an error, you should reply in writing to the office from which the bill was sent, or telephone or visit your local Internal Revenue Service office. It is important that you provide any records (always retain a copy for your files) you believe would help in correcting the mistake, such as cancelled checks (photocopies of both sides of the checks), or tax returns. If you are correct, the necessary adjustment will be made to your account. You will be asked to pay any tax, interest and penalty still due after the correction is made.

## B. If You Believe You Can't Pay

If you believe that you cannot immediately pay your bill in full, contact your local Internal Revenue Service office. If you come in, bring your bill as well as records you have which would be useful in establishing your financial condition (such as loan payment books, information concerning current living expenses, income and assets, mortgage or rent books, unpaid bills, etc.). Explain the problem to our representative.

### 1. Submission of Collection Information Statements

#### (a) Immediate Full Payment

We may ask you to complete a Collection Information Statement. One of our employees will be available to aid you in the preparation of the statement. Once you have completed the statement, our employee will carefully review your financial condition to determine how you can pay the amount due.

### 2. Immediate Full Payment

Our employee may point out assets which could readily be sold, mortgaged or used to secure funds to pay the tax; or discuss your ability to secure a commercial loan for such purposes. If your financial condition shows that you have the ability to pay your tax in full, we will request that you do so promptly. If you neglect or refuse to pay in full, enforced collection action may be taken.

### 3. Installment Payments

The examination of your financial condition may indicate that you cannot make immediate full payment, but you do have the ability to pay through installments. In this case, we will help you prepare a form itemizing your monthly income and expenses. After studying this information, we may determine that an installment agreement is in order and, if so, it will be based on our determination of your maximum ability to pay. In certain cases we can arrange, through a payroll agreement, for your employer to withhold and regularly pay to us amounts deducted from your pay. In other cases you will be given the opportunity to give us post-dated checks to be deposited as your installment payments become due. You may, depending on the amount owed and other criteria, be given an installment agreement without submitting detailed financial information. We will not enter into installment agreements unless you agree to remain current in paying your future taxes. If an installment agreement is made, you must make each payment on time. Collection action may be promptly taken if you miss an installment without contacting us and discussing the circumstances causing the failure to pay. Also, during the time you are making payments, you may be required to appear for a review of your financial condition. The review will enable us to determine if you are able to increase the amount of your installment payments.

### 4. Delayed Collection

If your financial condition indicates that you cannot make any payment towards your liability

at this time, we may decide to delay collection temporarily. This does not mean your debt is forgiven, or that penalty for late payment and interest stop accruing. Collection action is merely suspended until your financial condition has improved to the point where you can pay.

## C. Refund Offset

If you become entitled to a refund at the time when you owe a tax liability, we will offset the refund due you against your unpaid liability. Only the excess refund, if any, will be paid to you. However, we will generally not withhold collection pending refunds you feel you may be entitled to in the future on returns not yet filed.

## D. Summary

The most important step for you in the collection process is to contact the Internal Revenue Service. Contact us by mail or telephone or come into our local office. When you come to our office, we will assist you in determining the best way to pay your tax.

## IV. Enforced Collection Policy

If you do not follow the recommendations just discussed, the law provides that we may take enforced collection action against your property or rights to property. The following is an explanation of our enforcement activity and your rights in relation to it.

### A. Federal Tax Lien

Once notice and demand for payment (that is a bill for the tax due) is sent and you neglect or refuse to pay the tax, a statutory lien attaches to your property and rights to property. This lien is not valid against claims which certain of your creditors may have until a Notice of Federal Tax Lien has been filed. The filing of the Notice of Federal Tax Lien constitutes public notice to your creditors that a tax lien exists against your property, including property acquired after the Notice of Federal Tax Lien is filed.

Under normal circumstances, we don't need to file a Notice of Federal Tax Lien, because most taxpayers pay the tax due after receiving a bill. But if you neglect to pay the tax due, we must determine whether filing the Notice of Federal Tax Lien is necessary in order to protect the interest of the Government in your property. Once a Notice of Federal Tax Lien is filed, it becomes a matter of public record and may adversely affect your business transactions or other financial interests. (For example, it could impair your credit rating.) Therefore, it is normally filed only after we have tried to contact you and afford you the opportunity to pay.

In situations where the account is being paid through an installment agreement, a Notice of Federal Tax Lien may also be filed to secure the government's interest until the final payment is made. In addition, a Notice of Federal Tax Lien may be filed when collection action is delayed temporarily.

Generally, the Notice of Federal Tax Lien is filed with an office designated by State law.

A Federal Tax Lien will be released when the tax due (including interest and other additions to the tax) has been fully satisfied by payment or adjustment. All fees charged by the State for both filing and releasing a Notice of Federal Tax Lien will be added to the balance you owe.

## B. Levy

The Internal Revenue Code provides that if you are liable to pay tax and you neglect or refuse to pay the tax within 10 days after the date of notice and demand, the tax may be collected by levy on any property, or rights to property, belonging to you.

A levy is the taking of property to satisfy a tax liability. Levy can be made on property either in the hands of third parties (employers, banks, etc.) or in your possession (automobile, boat, etc.). We take levy action only after you have had an opportunity to respond and make satisfactory disposition of the tax and have failed to do so. This does not apply, however, in situations where delay is likely to negatively affect collection of the tax.

A levy on salary or wages, once served, continues in effect until the tax bill(s) for which it was served is satisfied or becomes unenforceable due to lapse of time. The Service will notify your employer or other person against whom the levy was served when the tax is fully paid. The law provides a minimum exemption from levy on wages, salary and other income as explained in 1(j) below.

Generally court authorization is not required before levy action is taken unless collection personnel must enter into private premises to accomplish their levy action. (See Section VI. J. below). The only legal requirements are that the tax is owed and that a notice and demand for payment has been sent to your last known address; if payment is not made within the 10 day period stated on the notice and demand, it is lawful to levy immediately. As noted earlier, in situations when it is likely to have a negative effect on collection of the tax, this 10 day notice and demand period may be shortened.

If, at any point, during the levy process you establish reasonable doubt as to the correctness of the tax bill, the levy may be released. Further, the levy will be released in full or in part if you pay your tax bill or agree to an acceptable installment agreement.

### 1. Property Exempt from Levy

Certain types of property are exempt from levy by Federal Law. They are:

- (a) Wearing apparel and school books. (However, expensive items of wearing apparel, such as furs, are luxuries and are not exempt from levy.)
- (b) Fuel, provisions, furniture and personal effects, not to exceed \$500 in value.\*
- (c) Books and tools used in your trade, business or profession, not to exceed \$250 in value.\*
- (d) Unemployment benefits.

- (e) Undelivered mail.
- (f) Certain annuity and pension payments.
- (g) Workmen's Compensation
- (h) Salary, wages or other income subject to a prior judgment for court-ordered child support payments.
- (i) Deposits to the special Treasury fund made by members of the armed forces and Public Health Service employees on permanent duty assigned outside the United States or its possessions.
- (j) A minimum exemption for wages, salary and other income of \$50 per week, plus an additional \$15 for each legal dependent.

\* As a matter of policy, the Service generally excludes \$1500 in personal effects and \$1000 in business property from levy, if it is concluded that levy action on property below these amounts would cause severe hardship.

The Internal Revenue Service employee levying on property of the type described above will appraise and set aside to you, when applicable, the amount of such property declared to be exempt. If you object at the time of the levy to the valuation fixed by the employee making the levy, you can request a valuation by three disinterested individuals.

#### 2. Property Generally Not Levied On

As a matter of policy, some types of property are generally not levied on, or are levied on only in flagrant and aggravated cases of refusal to pay. These include, for example, the following:

- (a) Social Security benefits.
- (b) Medicare payments.
- (c) Welfare payments.
- (d) Payments under the Manpower Development and Training Act of 1962 or the Area Redevelopment Act.
- (e) Cash loan value of insurance policies.
- (f) Death benefits.
- (g) Pension plan proceeds.
- (h) Contributions to individual retirement accounts (IRA) and KEOGH Accounts.
- (i) Household property, for a head of household, up to \$1,500 and business property up to \$1,000, if it is concluded that levy action on property below these amounts would cause severe hardship.

### C. Seizures and Sales

#### 1. Seizures

Any type of property (including residential and business property) may be seized and sold to satisfy your tax bill. However, before seizing property, IRS considers factors such as your equity in the property and the sale value of the property. Serious consideration is given to all other alternatives before determining to seize a family home.

#### 2. Sales

After property is seized for nonpayment of taxes, we then take action to sell it. Except in the case of perishable property which must be sold immediately, sales are not made until

at least 10 days after notice to you and to the public about the proposed sale. Prior to sale, we compute a minimum acceptable price and advise you of the amount. If you are in disagreement, you may request a Service valuation engineer or a private appraiser to assist the Internal Revenue Service employee in re-evaluating the computation figures.

#### 3. Proceeds of Sale

Sale proceeds are applied first to the expenses of the levy and sale; the remaining amount is then applied against the tax bill. If the sale proceeds are less than the tax bill and expenses of levy and sale, the unpaid portion will, of course, be subject to further collection action. When sale proceeds exceed the tax bill and expenses of levy and sale, the surplus money is held by IRS pending a request for distribution. Unless a person, such as a mortgagee or other lienholder, submits a claim superior to yours, these excess funds will be credited or refunded to you upon request.

#### 4. Redemption of Property

You have the right to redeem your property at any time prior to the sale. Redemption consists of paying the tax due, including interest and penalties, together with the expenses of the seizure. Also, real estate may be redeemed at any time within 120 days after the sale by paying the purchaser the amount he/she paid for the property plus interest of 20 percent per annum.

### V. Claim Procedure

#### A. How to Claim a Refund or Credit

Once you have paid your tax bill, you have the right to file a claim for refund or credit if you feel the tax is erroneous or excessive. You can obtain the necessary forms and information about filing your claim by calling or visiting any Internal Revenue Service office. You should file your claim by mailing it to the Internal Revenue Service Center where the original return was filed. A separate form must be filed for each tax year involved. You should attach to such form a statement supporting your claim, including an explanation of each item of income, deduction or credit on which you are basing your claim.

#### B. Time for Filing a Claim for Refund or Credit: General Rule

A claim for refund or credit must be filed within three years from the date the return was filed (returns filed before the due date are considered to have been filed on the due date) or within two years from the date the tax was paid, whichever date is later.

#### C. Limit on Amount of Refund or Credit

Limits on amounts of refund or credits are governed by the time period between the date your tax return was filed and the date your claim is filed. For claims filed within three years of the date of a timely filed tax return,

the credit or refund may not exceed the amount of tax paid within that three year period. This would include amounts paid prior to the due date of the tax return (such as tax withheld from your wages and estimated tax payments) since these amounts are considered paid on the due date. If you do not file your claim within three years of the date of a timely filed tax return, the credit or refund may not exceed the amount of the tax paid within the two years immediately preceding the filing of your claim.

#### D. Processing Claims for Refund or Credit

Claims are usually processed shortly after they are filed. Your claim may be accepted as filed, or may be subject to examination. If your claim is examined, the procedures are the same as in the examination of a tax return. (Publication 556, "Examination of Returns, Appeal Rights and Claims for Refund" is available at your local IRS office to explain our procedures for examining returns and claims.)

#### E. Rejected Claims—Filing Suit in District Court and Court of Claims

If your claim is rejected, you will receive a statutory notice of disallowance of your claim. After receiving a notice of disallowance, you may file a suit for refund in a U.S. District Court or in the U.S. Court of Claims. You must file suit within 2 years from the date the notice of disallowance is mailed to you. Also, if we have not acted on your claim within six months from the date you filed it, you can then file suit for refund. If you seek prompt court action, without availing yourself of an IRS determination, a request in writing, that the claim be immediately rejected, must accompany your claim for refund. You can obtain information about procedures for filing suit in the District Court by contacting the Clerk of your District Court. You can obtain information about procedures for filing suit in the Court of Claims from the Clerk of the Court of Claims, 717 Madison Place, N.W., Washington, D.C. 20005.

### VI. Rights

The following section contains an explanation of taxpayer rights. Read this section carefully to be sure that you are aware of the rights which may pertain to your tax account.

#### A. Representation

You may represent yourself or you may be represented by an attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service. If your representative attends a conference without you or telephones on your behalf, your representative must file a power of attorney or a tax information authorization before receiving or inspecting confidential information.

Form 2848, "Power of Attorney", or 2848D, "Authorization and Declaration", (or any

other properly written power of attorney or authorization) may be used for this purpose. Copies of these forms may be obtained from any Internal Revenue Service office.

### B. Transfer of Your Tax Case to Another Geographical Area

In any case where your tax problem can be handled more quickly and conveniently in another district, you may request that the case be transferred to that district. If you give a valid reason when making your request, the case will be transferred. For example, this would be done when your place of residence changes either before or during the discussion of your tax case.

### C. Interest on Refunds

You will receive interest at the rate of 6 percent a year up to January 31, 1980, and at the rate of 12 percent a year after that, on any refund delayed more than 45 days after either the filing of your return or the due date of the return, whichever is later. (By law, the interest rate is subject to periodic adjustments.)

### D. Receipts

You have the right to a receipt for any payment you make, including a receipt for all cash payments. You also have the right to receive copies of all contractual arrangements (such as an installment agreement) made with us.

### E. Privacy Act Notice

The Privacy Act of 1974 says that each Federal agency that asks you for information must tell you the following:

- Its legal right to ask for the information and whether the law says you must give it.
- What major purposes the agency has in asking for it, and how it will be used.
- What could happen if the agency does not receive it.

For the Internal Revenue Service, the law covers:

Tax returns and any papers filed with them.

Any questions we need to ask you so we can—

- Complete, correct, or process your return.
- Figure your tax.
- Collect tax, interest, or penalties.

Our legal right to ask for information is Internal Revenue Code sections 6001 and 6011 and their regulations. They say that you must file a return or statement with us for any tax you are liable for. Code section 6109 and its regulations say that you must show your social security number on what you file. This is so we know who you are, and can process your return and papers.

You must fill in all parts of the tax form that apply to you. But you do not have to check the boxes for the Presidential Election Campaign Fund.

We ask for tax return information to carry out the Internal Revenue laws of the United

States. We need it to figure and collect the right amount of tax.

We may give the information to the Department of Justice and to other Federal agencies, as provided by law. We may also give it to States, the District of Columbia, and U.S. commonwealths or possessions to carry out their tax laws. And we may give it to foreign governments because of tax treaties they have with the U.S.

If a return is not filed, or if we don't receive the information we ask for, the law provides that a penalty may be charged. And we may have to disallow the exemptions, exclusions, credits, deductions, or adjustments shown on the tax return. This could make the tax higher or delay any refund. Interest may also be charged.

Please keep this notice with your records. It may help you if we ask you for other information.

If you have questions about the rules for filing and giving information, please call or visit any Internal Revenue Service office.

This is the only notice we must give you to explain the Privacy Act. However, we may give you other notices if we have to examine your return or collect any tax, interest, or penalties.

### F. Confidentiality of Tax Matters

You have the right to have your tax case kept confidential. The IRS has a duty under law to protect the confidentiality of your tax return information. However, if a levy is served or if a Notice of Lien or lawsuit is filed, certain aspects of your tax case, such as the amount of tax due and type of tax owed, may become a matter of public record.

### G. Elimination of Penalty—Reasonable Cause

The Internal Revenue Code provides for elimination of penalties when you show reasonable cause rather than willful neglect for either late filing of a return or late payment of a tax.

Reasonable cause, broadly defined, is a cause which arises despite ordinary care and prudence exercised by you. If you believe you have reasonable cause for elimination of a penalty, discuss your reason with our representative. If he or she agrees, your penalty will be eliminated upon your supplying us a written statement setting forth the facts establishing reasonable cause. (Under the law, interest cannot be eliminated due to reasonable cause.) If our representative does not believe you have established reasonable cause, you may appeal this determination to the Regional Director of Appeals. You may make known your desire to appeal, either in writing or orally to our representative. You will then be contacted and a conference will be arranged at a time and place that is mutually convenient.

### H. Offers In Compromise

By law you have the right to submit an offer in compromise on your tax bill. The Commis-

sioner of the Internal Revenue Service has the authority to compromise all taxes (including any interest, penalty, additional amount or addition to tax) arising under the Internal Revenue laws, except those relating to alcohol, tobacco, and firearms.

A compromise may be made on one or both of two grounds—(1) doubt as to the validity of the amount owed or (2) doubt as to your ability to make full payment of the amount owed. The doubt as to the validity of the amount owed must be supported by evidence and the amount acceptable will depend upon the degree of doubt found in the particular case. In the case of inability to pay, the amount offered must exceed the total value of your equity in all your assets. The amount must also give sufficient consideration to your present and future earning capacity which may require a written agreement to pay a percentage of future earnings as part of the offer. A written agreement may also be required to relinquish certain present or potential tax benefits. (Individual hardship of a temporary nature alone is not a basis for our accepting an offer.)

Submission of an offer in compromise does not automatically suspend collection of an account. If there is any indication that the filing of the offer is solely for the purpose of delaying collection of the tax or that delay would negatively affect collection of the tax, collection efforts will be continued.

All forms necessary for filing an offer in compromise plus additional information regarding the procedure, can be obtained at many local Internal Revenue Service offices.

### I. Supervisory Review of Employee Decisions

If at any step in the Collection process you do not agree with the recommendations of our employee, you have the right to discuss the matter with his/her supervisor. Our employees will tell you the name and location of the immediate supervisor.

### J. Entry upon Private Property

You have the right to refuse to permit Collection personnel to enter upon your private property when the purpose of the visit is to conduct a seizure of your assets. If you decide to avail yourself of this right, the IRS may then decide to seek court authorization to enter upon the property to carry out the seizure action.

### K. Problem Resolution Program (PRP)

The PRP is designed for taxpayers who have been unable to achieve a resolution to their tax problems through the other avenues of review explained in this booklet. To use the service you should contact the Problem Resolution Officer, who is available in each of our District offices. You may contact the Problem Resolution Officer on our toll free telephone system or visit him/her in the District office.

INSTALLMENT AGREEMENT FORM USED BY IRS

Form <b>433-M</b> (Rev. June 1980)	Department of the Treasury—Internal Revenue Service <h2 style="margin: 0;">Installment Agreement</h2>	
<b>Note</b>	Complete and mail this agreement form to IRS within 10 days from the date of the enclosed notice.  Please read the enclosed notice about the amount you owe on your Federal income tax. You may pay the amount you owe in installments if (1) you cannot pay the total amount due at this time, (2) you agree to the terms and conditions below, and (3) you give the information required. If you want to pay your tax in installments, fill in Sections 1 and 2 below. Please do not use this form if you have already made other payment arrangements with IRS.	
<b>Section 1 Terms and Conditions</b>		
<b>Terms</b>	<b>Terms of Payment</b> I understand that I can take up to 12 months to pay and each payment must be at least \$10. I agree to pay the total amount I owe on my Federal income tax for the year _____ in _____ equal monthly payments of \$ _____. I will make my payments by the _____ day of each month. I am enclosing my first payment with this agreement.	
<b>Conditions</b>	<b>Interest and Penalty Charges</b> I understand that I will be charged interest and a late payment penalty at the rates shown in the Notice 394 that is enclosed with this form. Interest will continue to be charged (as well as the penalty up to the maximum amount) to my account until my tax is paid in full. IRS will bill me for the total amount due, and I will pay all remaining charges with my final installment.  <b>Tax Refunds</b> IRS will credit against my unpaid tax for the above year any refunds due me from other taxes.  <b>Agreement Withdrawn</b> I understand that this agreement will be withdrawn if— I don't pay an installment on time; I file late any Federal tax returns; I pay late any other Federal taxes; or If IRS determines that the entire amount of my tax should be collected. IRS may then collect the balance due by filing a levy on my income (deducting money for tax owed from my salary), by seizing my property, or by filing a tax lien against my property. I understand that IRS can do this without giving me any further notice.  <b>Approval</b> IRS will let me know whether this agreement is approved. If I have not heard from IRS before my next installment is due, I will send my payment to IRS according to the above terms.	
<b>Section 2 Information Required (Please use the back of this sheet if you need more space.)</b>		
Names and Addresses (including ZIP codes) of Employers		Names, Addresses (including ZIP codes) and Account Numbers of Banks—Checking and Savings Accounts
If you owe any other Federal tax, show the number of the tax return form, the amount of tax due IRS, and the social security or employer identification number shown on the return.		
Below, please print your name, address (including ZIP code), and social security number as they appear on the enclosed notice.		
Name and Address (including ZIP code)	Business Phone  Home Phone	Your Social Security Number  Spouse's Social Security Number
Your Signature	Date	Spouse's Signature (if joint return)
<b>Mailing Instructions</b>	Please return this sheet, fully completed, with your payment and the enclosed notice to the Internal Revenue Service in the envelope provided.	

Form <b>433-M</b> (Rev. June 1980)	Department of the Treasury—Internal Revenue Service <h2 style="margin: 0;">Installment Agreement</h2>
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<b>Note</b>	<p>▶ Complete and mail this agreement form to IRS within 10 days from the date of the enclosed notice. Please read the enclosed notice about the amount you owe on your Federal income tax. You may pay the amount you owe in installments if (1) you cannot pay the total amount due at this time, (2) you agree to the terms and conditions below, and (3) you give the information required. If you want to pay your tax in installments, fill in Sections 1 and 2 on Part 1 of this form. Please do not use this form if you have already made other payment arrangements with IRS.</p>
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**Section 1 Terms and Conditions**

<b>Terms</b>	<p><b>Terms of Payment</b>                  I understand that I can take up to 12 months to pay and each payment must be at least \$10. I agree to pay the total amount I owe on my Federal income tax for the year _____ in _____ equal monthly payments of \$_____. I will make my payments by the _____ day of each month. I am enclosing my first payment with this agreement.</p>
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<b>Conditions</b>	<p><b>Interest and Penalty Charges</b>                  I understand that I will be charged interest and a late payment penalty at the rates shown in the Notice 394 that is enclosed with this form. Interest will continue to be charged (as well as the penalty up to the maximum amount) to my account until my tax is paid in full. IRS will bill me for the total amount due, and I will pay all remaining charges with my final installment.</p> <p><b>Tax Refunds</b>                  IRS will credit against my unpaid tax for the above year any refunds due me from other taxes.</p> <p><b>Agreement Withdrawn</b>                  I understand that this agreement will be withdrawn if—                  I don't pay an installment on time;                  I file late any Federal tax returns;                  I pay late any other Federal taxes; or                  If IRS determines that the entire amount of my tax should be collected.                  IRS may then collect the balance due by filing a levy on my income (deducting money for tax owed from my salary), by seizing my property, or by filing a tax lien against my property. I understand that IRS can do this without giving me any further notice.</p> <p><b>Approval</b>                  IRS will let me know whether this agreement is approved. If I have not heard from IRS before my next installment is due, I will send my payment to IRS according to the above terms.</p>
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**Payment Instructions**

	<p>When you make each installment payment, please be sure to—</p> <ol style="list-style-type: none"> <li>1. Write your social security number on the check or money order.</li> <li>2. Make the payment in an amount at least equal to that specified in the agreement. For example, if your monthly payment is \$50, you must pay at least \$50 each month. If you pay \$100 for one month's payment, you cannot skip the next month's payment without notifying us.</li> <li>3. Mail your payment to the IRS office shown on the return envelope sent to you.</li> <li>4. Contact the nearest IRS office immediately if you cannot meet the terms and conditions of this agreement.</li> </ol>
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TAX DUE NOTICES SENT BY IRS

FIRST NOTICE

Department of the Treasury
Internal Revenue Service

If you have any questions, refer to this information:

Date of this Notice:
Social Security Number:
Document Locator Number:
Form Tax Year Ending:

Call:
or

Write: Chief, Taxpayer Assistance Section
Internal Revenue Service Center

If you write, be sure to attach the bottom part of this notice.

Request For Payment

Balance Due By:

Our records show a balance due of \$ on your income tax. If you believe this amount is not correct, please see the other side of this notice. Make your check or money order payable to the Internal Revenue Service. Please write your social security number on your payment and mail it with the bottom part of this notice. An envelope is enclosed for your convenience. If your name, address, or social security number are incorrectly shown on this notice, please make corrections on the bottom part. Thank you for your cooperation. Allow for enough mailing time to be sure that we receive your payment by

Tax Statement

Total Tax on Return \$

Tax Withheld \$
Estimated Tax Payments
Other Credits
Other Payments
Total Payments and Credits

Unpaid Tax on Return
Penalty\*
Interest\*

Balance Due IRS \$

Subtract Payments We Haven't Included
Pay Adjusted Balance Due \$

\* See codes on the back for an explanation of penalty and interest charges.

To make sure that IRS gives courteous and correct information to taxpayers, a second IRS employee sometimes listens in on telephone calls.

This part of the notice is for your records.

Form 3446 (Rev. 1-81)

Detach this part of the notice and return it with your payment or inquiry. Please correct any errors in your name, address, or social security number.

Department of the Treasury
Internal Revenue Service

Date of this Notice:
Social Security Number:
Document Locator Number:
Form Tax Year Ending:

Balance Due IRS \$
Subtract Payments We Haven't Included
Pay Adjusted Balance Due \$

Form 3446 (Rev. 1-81)

**Explanation of Penalty and Interest Charges**

**Code 01—Filing and Paying Late**

A penalty has been added because your return was filed late with taxes due. The penalty is figured at 5 percent of the underpaid tax for each month or part of a month the return was late, and cannot be more than 25 percent of the tax paid late. (See "Elimination of Penalty—Reasonable Cause," on this page.)

**Code 02—Underpayment of Estimated Tax**

A penalty has been added because your estimated tax was underpaid. The penalty, as provided by law, is figured on a daily basis for the period the estimated tax remains unpaid. Generally, to avoid an underpayment, a taxpayer must have paid 80 percent of the tax shown on a return before it is filed. However, a penalty on an underpayment can be excused if the taxpayer meets one of the exceptions listed in the instructions on the enclosed Form 2210 (Underpayment of Estimated Tax by Individuals). The only exceptions to the penalty that can be accepted are on Form 2210.

**Code 04—Dishonored Check**

A penalty has been added because your check to us was not honored by your bank. For checks of \$5 or more, the penalty is \$5 or 1 percent of the total, whichever is greater, for checks of less than \$5 it is the amount of the check. (See "Elimination of Penalty—Reasonable Cause," on this page.)

**Code 06—Negligence**

A penalty of 5 percent of the underpaid tax has been added for negligence.

**Code 07—Paying Late**

A penalty has been added because your tax was not paid when due. The penalty is 1/2 of 1 percent of the tax not paid on time. It is figured for each month or part of a month the payment was late and cannot be more than 25 percent of the tax paid late. However, any period used in figuring a penalty explained in Code 01 has not been included in figuring the late payment penalty. (See "Elimination of Penalty—Reasonable Cause," on this page.)

**Code 08—Missing Social Security Number**

A penalty has been added because your return did not include your social security number, or your spouse's number if married and filing a joint return or married and filing separate returns. The penalty is \$5 for each time a required number was not included. (See "Elimination of Penalty—Reasonable Cause," on this page.)

**Code 09—Interest**

Interest as provided by law is figured on unpaid tax from the due date of the return to the date of full payment or to the date of this notice. Beginning February 1, 1980, the interest rate is .0328767 percent per day on the unpaid tax. This is an annual rate of 12 percent. If your taxes were due before February 1, 1980, please see the enclosed Notice 394 for the rates that applied.

**Elimination of Penalty—Reasonable Cause**

With the exception of Underpayment of Estimated Tax and Negligence penalties, the law provides that the penalties explained above can be removed if you have an acceptable reason. If you believe that you have a good reason but have not yet sent us an explanation, please send it to us. We will review it and let you know what our decision is.

**Note:** You can avoid additional interest and penalties by sending your payment along with your reason. All or part of the penalty portion of your payment will be refunded if the reason is acceptable.

**Information About Balance Due**

**For Payments Made Within The Last 4 Weeks**

If we have not credited a payment made within the last 4 weeks, we will do so soon. No further action is required by you if you paid the entire amount due. However, if there still is a balance, subtract the payment not credited and send us the adjusted balance due. Be sure to send the bottom part of this notice with your payment.

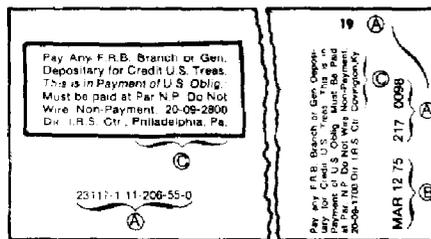
**For Payments Made More Than 4 Weeks Ago**

If the payment not credited was made more than 4 weeks ago, complete the form below and return it to us with your payment for any balance due. If you are unable to complete the form, please attach a legible copy of your canceled check (both sides), money order stub, or cashier's receipt, and send it with the bottom part of this notice, along with a payment for any balance due.

**If You Paid by Check**

The information we need to locate the missing payment will appear on the back of your canceled check. This information —

- A) Number stamped on check by IRS,
- B) Date endorsed by IRS, and
- C) Location of IRS office that endorsed check — is shown in the examples below. Please write this information in the related boxes A, B, C, on the form below.



This part of the notice is for your records.

Detach this part of the notice and return it with your payment or inquiry.

If You Paid By Check	Amount \$	Date of Payment	If check has cleared your bank, please fill in blocks A B, and C →	A) Number stamped on check by IRS
	B) Date endorsed by IRS	C) Location of IRS office that endorsed check		
If You Paid By Money Order	Amount \$	Date of Purchase	(Check one) <input type="checkbox"/> U.S. Postal <input type="checkbox"/> Other (Explain)	
	Number on Money Order Receipt	Issuing Station (Name and Address)		
If You Paid Cash	Amount \$	Date on Cashier's Receipt	Number of Receipt	

Please let us know if you believe the balance due is incorrect for reasons other than uncredited payments. Just return this part of the notice with the correct payment and an explanation to account for the difference.

SECOND NOTICE

Department of the Treasury  
Internal Revenue Service

If you inquire about your account, please refer to these numbers or attach this letter	▶	Date of This Letter
	▶	Taxpayer Identifying Number
	▶	Document Locator Number

Dear Taxpayer:

We have previously written to you about the Federal tax shown below. It is overdue and you should pay the total amount due immediately to avoid additional interest and penalties.

If you cannot pay this amount in full, please write or call us immediately and let us know your intentions concerning payment of the amount due. We have enclosed a copy of Publication 586A, The Collection Process (Income Tax Accounts), which provides information about our collection procedures and your rights in relation to them. Your attention is specifically directed to our Enforced Collection Policy on page 2.

Make your check or money order payable to the Internal Revenue Service and write the above taxpayer identifying number on it. Include this letter with your payment so we can quickly identify and credit your account. If you think the amount shown below is incorrect because of a recent payment or for any other reason, please send the amount you believe is due and explain the difference on the back of this letter. Use the enclosed envelope to mail us your payment. The copy of this letter is for your records.

Sincerely yours,

Chief, Collection Branch

Enclosures:  
Envelope  
Copy of this letter  
Publication 586A  
Telephone Number Notice

Tax Form Number .....  
Tax Period Ended .....

Balance of Prior Assessments \$  
Late Payment Penalty .....  
Interest .....

Reply to:

Total Amount Due ..... \$

**PAYMENT INFORMATION**

If you previously paid any part of the amount shown on the front of this letter, please send us a copy of both sides of your check, or the information asked for below.

Amount of Payment		Date of Payment	
If You Paid by Check	IF CHECK HAS CLEARED YOUR BANK, PLEASE ENTER →	A. NUMBER STAMPED ON CHECK BY IRS	B. DATE ENDORSED BY IRS
	LOCATION OF INTERNAL REVENUE SERVICE OFFICE WHICH ENDORSED CHECK		
If You Paid by Money Order	(CHECK ONE) <input type="checkbox"/> U.S. POSTAL <input type="checkbox"/> OTHER (EXPLAIN)		
	NUMBER ON MONEY ORDER RECEIPT	ISSUING STATION (NAME AND ADDRESS)	
If You Paid In Cash	DATE ON CASHIER'S RECEIPT	NUMBER OF RECEIPT	
	Office Which Issued Receipt		

PLEASE CORRECT YOUR TAXPAYER IDENTIFYING NUMBER, NAME, OR ADDRESS, IF INCORRECTLY SHOWN ON THE FRONT.

**ADJUSTMENT INFORMATION**

If your account was adjusted by some means other than the payment referred to above, please explain.

Signature	Current Address	Home Telephone Number
		Office Telephone Number

THIRD NOTICE

Department of the Treasury  
Internal Revenue Service

Date of This Letter

Taxpayer Identifying Number

Document Locator Number

If you inquire about  
your account, please  
refer to these numbers  
or attach this letter

Dear Taxpayer:

We have previously written you asking for payment of the Federal tax identified below, but we have no record of receiving it. The tax is overdue and the law authorizes us to file a notice of Federal tax lien and seize your property, wages, or other assets to satisfy your unpaid tax. The total amount due includes interest and penalty and should be paid within 10 days from the date of this letter to avoid additional charges.

Make your check or money order payable to the Internal Revenue Service, show your taxpayer identifying number (social security or employer identification number) on it, and send it to us with this letter to assure prompt and accurate credit. An envelope is enclosed for your convenience. The copy of this letter is for your records.

If the total amount due as shown below is incorrect because of a recent payment or other adjustment, please send us any balance due, and explain the difference on the back of this letter. If you cannot send us full payment or if you want to apply for installment payments, contact any Internal Revenue Service office within 10 days from the date of this letter. The telephone number is on the enclosed notice.

Sincerely yours,

Enclosures:  
Envelope  
Copy of this letter  
Telephone Number Notice

Chief, Collection Branch

Tax Form Number .....  
Tax Period Ended .....

Balance of Prior Assessment \$  
Late Payment Penalty .....  
Interest.....

Total Amount Due ..... \$

Reply to:

**PAYMENT INFORMATION**

If you previously paid any part of the amount shown on the front of this letter, please send us a copy of both sides of your check, or the information asked for below.

AMOUNT OF PAYMENT		DATE OF PAYMENT	
If You Paid by Check	IF CHECK HAS CLEARED YOUR BANK, PLEASE ENTER →	A. NUMBER STAMPED ON CHECK BY IRS	B. DATE ENDORSED BY IRS
	LOCATION OF INTERNAL REVENUE SERVICE OFFICE WHICH ENDORSED CHECK		
If You Paid by Money Order	(CHECK ONE) <input type="checkbox"/> U.S. POSTAL <input type="checkbox"/> OTHER (EXPLAIN)		
	NUMBER ON MONEY ORDER RECEIPT	ISSUING STATION (NAME AND ADDRESS)	
If You Paid in Cash	DATE ON CASHIER'S RECEIPT	NUMBER OF RECEIPT	
	OFFICE WHICH ISSUED RECEIPT		

**ADJUSTMENT INFORMATION**

If your account was adjusted by some means other than the payment referred to above, please explain.

Signature	Current Address, if different from that shown on the front	Home Telephone Number
		Office Telephone Number

**APPENDIX IV**  
**FOURTH NOTICE**

**APPENDIX IV**

**Department of the Treasury**  
**Internal Revenue Service**

**Past Due**  
**Final Notice**  
**Read Carefully**

If you inquire about  
your account, please  
refer to these numbers  
or attach this letter

Date of this Letter

Taxpayer Identifying Number

Document Locator Number

Dear Taxpayer:

Although notices and demand have been made for payment of your Federal tax liability shown below, we have no record of receiving the amount due. This is your final notice before we proceed with enforcement action.

To prevent such action, send us, within 10 days from the date of this letter, your check or money order for the total amount due, payable to the Internal Revenue Service. Show your taxpayer identifying number (social security or employer identification number) on it and enclose this letter to assure prompt and accurate credit. An envelope is enclosed for your convenience. The copy of this letter is for your records.

If you have recently paid the amount due but your payment has not been credited to your account, or if you cannot pay this amount in full, contact the office shown below within 10 days from the date of this letter. The telephone number is shown on the enclosed notice.

If we do not receive your payment or if you do not contact our office, enforcement action may be taken at any time after 10 days from the date of this letter without any further notice to you. Salary or wages due you may be levied upon, as provided by section 6331 of the Internal Revenue Code, by serving a notice of levy on your employer. Bank accounts, receivables, commissions, or other kinds of income you have are also subject to levy. Property or rights to property, such as automobiles, may also be seized and sold to satisfy your tax liability.

Enclosures:  
Envelope  
Copy of this letter  
Telephone Number Notice

Chief, Collection Branch

**Reply within 10 days**  
**to avoid enforcement action**  
**and additional penalties.**

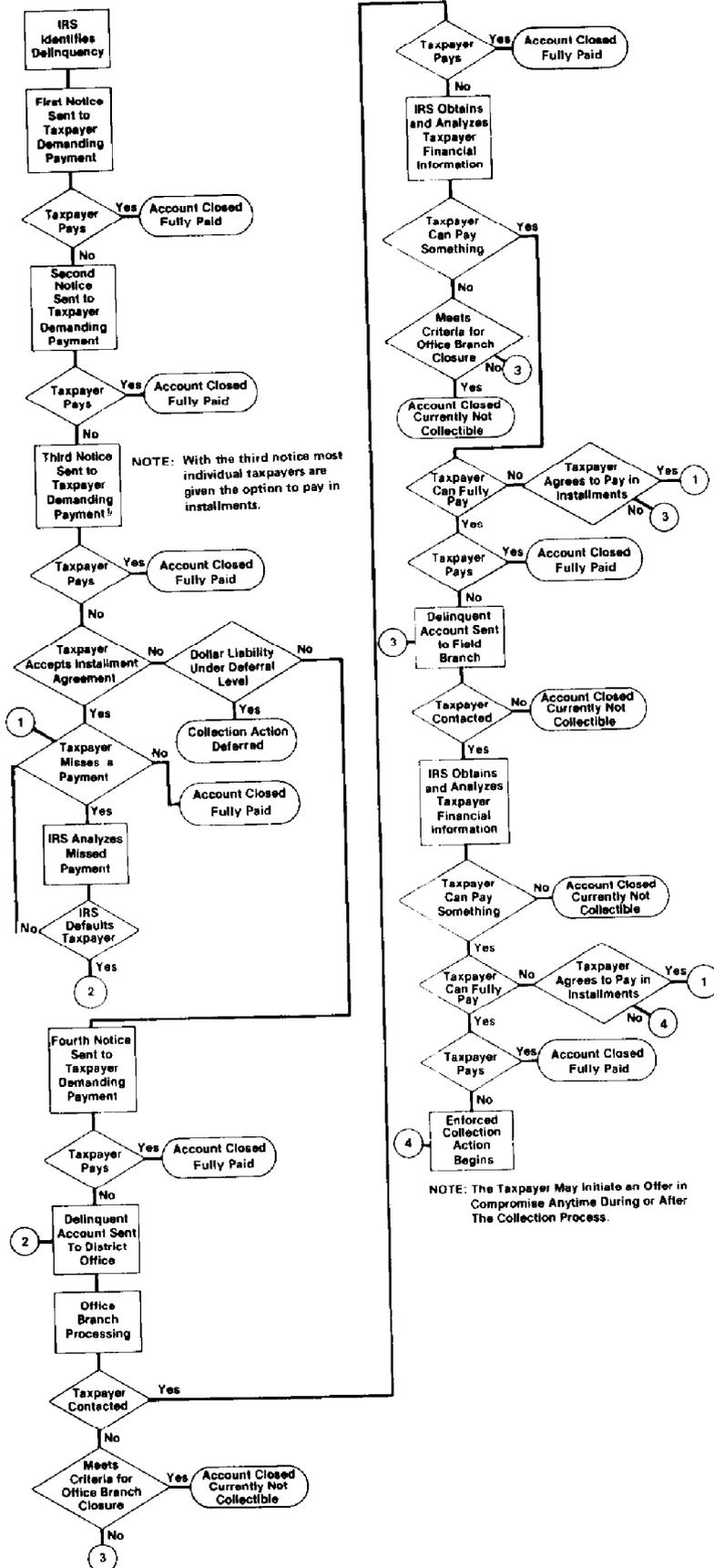
Tax Form Number .....  
Tax Period Ended .....

Balance of Prior Assessment\$  
Late Payment Penalty .....  
Interest .....

Total Amount Due ..... \$

Reply to:

### NORMAL PROCESSING OF A DELINQUENT ACCOUNT



COPIES OF FINANCIAL STATEMENTS USED BY IRS

FINANCIAL STATEMENT USED FOR INSTALLMENT AGREEMENTS AND CURRENTLY NOT COLLECTIBLE ACCOUNTS

Form <b>433-AB</b> (Rev. August 1980)	Department of the Treasury - Internal Revenue Service <b>Collection Information Statement</b> <i>(If you need additional space, please attach separate sheet.)</i>		
1. Taxpayers' Names and Address	2. Home Phone Number	3. Please check appropriate box: Individual <input type="checkbox"/> Partnership <input type="checkbox"/> Corporation <input type="checkbox"/>	
<b>Section A - If you are an individual, please complete this section</b>			
4.(a) Taxpayer's Employer <i>(Name and address)</i>	(b) Business Phone Number	(c) Social Security Number	(d) Paydays
5.(a) Spouse's Employer <i>(Name and address)</i>	(b) Business Phone Number	(c) Social Security Number	(d) Paydays
<b>Section B - If you are a partnership or corporation, please complete this section</b>			
6. Employer Identification Number		7. Estimated Average Net Income for Next 6 Months	
8. Net Income for Past 2 Years		\$	
19		19	
\$		\$	
<b>Please give the following information about officers or partners</b>			
9. Name and Title	10. Home Address	11. Number of Shares or Interest	
<b>Section C - General Information (Please complete this section in all cases)</b>			
12. Bank Accounts <i>(Names and addresses of banks)</i>	13. Motor Vehicles <i>(Description and license number of each vehicle you own)</i>		
14. Real Property <i>(Brief descriptions and locations)</i>			
15. Additional Information-Please include a statement about any court proceedings pending, recent transfers of assets at less than full value, prospects for increase in income or assets, etc.			

(Over)



**FINANCIAL STATEMENT USED FOR OFFERS IN COMPROMISE**

Form <b>433</b> (Rev. Nov. 1979)	Department of the Treasury Internal Revenue Service		
<b>Statement of Financial Condition and Other Information</b> <i>(Please file in duplicate with offer in compromise)</i>			
Please furnish the information requested in this form with your offer in compromise, if the offer is based in whole or in part on inability to pay the liability. If you need help in preparing this statement, call on any Internal Revenue office. It is important that you answer all questions. If a question does not apply, please enter N/A. This will speed up consideration of your offer.			
1a. Name(s) of Taxpayer(s)		b. Social Security Number	c. Employer Identification Number
d. Business Address		e. Bus. Tel. No.	2. Name and Address of Representative, if any
f. Home Address		g. Home Tel. No.	
3.	Kind of tax involved	Taxable period	Amount due
a.			Amount offered
b.			
c.			
d.			
e.			
4. Due and unpaid Federal taxes, (except those covered by this offer in compromise)			
	Kind of tax	Taxable period	Amount due
a.			
b.			
c.			
5. Names of banks and other financial institutions you have done business with at any time during past 3 years—			
a. Name and address		b. Name and address	
c.		d.	
e. Do you rent a safety deposit box in your name or in any other name? <input type="checkbox"/> No <input type="checkbox"/> Yes (If yes, give name and address of bank)			
6. If income withholding or employment tax is involved, please complete 6a through f			
a. Were the employees' income withholding or employment taxes, due from employees on wages they received from employment, deducted or withheld from the wages paid during any period shown above? <input type="checkbox"/> Yes <input type="checkbox"/> No			
b. If so, was the tax paid or deposited to the Internal Revenue Service? <input type="checkbox"/> No <input type="checkbox"/> Yes		c. If deducted but not paid or deposited to IRS, how did you dispose of the deducted amounts?	
d. Has business in which you incurred such taxes been discontinued? <input type="checkbox"/> No <input type="checkbox"/> Yes			e. If so, on what date was it discontinued?
f. How did you dispose of assets of discontinued business?			
7. Offer filed by individual			
a. Name of Spouse		b. Age of Spouse	c. Age of Taxpayer
d.	Names of dependent children or relatives	Relationship	Age
(1)			
(2)			
(3)			
(4)			
(5)			
(6)			
(7)			

Please furnish your most recent financial information. In the columns below, show the cost and fair market value of each asset you own directly or indirectly. Also show all your interests in estates, trusts, and other property rights, including contingent interests and remainders.

8. Statement of assets and liabilities as of _____ (date)		
a. Assets	Cost*	Fair market value
(1) Cash	\$	
(2) Cash surrender value of insurance (See item 9)		
(3) Accounts receivable (See item 11)		
(4) Notes receivable (See item 11)		
(5) Merchandise inventory (See item 12)		
(6) Real estate (See item 13)		
(7) Furniture and fixtures (See item 14)		
(8) Machinery and equipment (See item 14)		
(9) Trucks and delivery equipment (See item 15)		
(10) Automobiles (See item 15)		
(11) Securities (See item 16)		
(12)		
(13)		
(14)		
(15)		
(16)		
(17)		
(18)		
(19)		
(20)		
(21)		
(22)		
(23)		
(24)		
(25)		
(26)		
(27) Total assets	\$	\$
b. Liabilities	Amount	
(1) Loans on insurance (See items 9 and 10)	\$	
(2) Accounts payable		
(3) Notes payable		
(4) Mortgages (See item 13)		
(5) Accrued real estate taxes (See item 13)		
(6) Judgments (See item 17)		
(7) Reserves (Itemize)		
(8)		
(9)		
(10)		
(11)		
(12)		
(13)		
(14)		
(15)		
(16)		
(17)		
(18)		
(19)		
(20)		
(21)		
(22) Total liabilities	\$	

(\*Less depreciation, if any)

9. Life insurance policies now in force with right to change beneficiary reserved							
Number of Policy	Name of Company	Amount of Policy	Present Cash Surrender Value Plus Accumulated Dividends	Policy Loan	Date Made	Automatic Premium Payments*	Date Made
a.		\$	\$	\$		\$	
b.							
c.							
d.							
e.							
f.							
g.							
h.							
i.							
j.							

\*Show only those made before date notice of levy was served on the insurance company.

10. Life insurance policies assigned or pledged on indebtedness

If any of the policies listed in item 9 are assigned or pledged on indebtedness, except with insurance companies, give the following information about each policy:

Number of Policy Assigned or Pledged	Name and Address of Pledgee or Assignee	Amount of Indebtedness	Date Pledged or Assigned
a.		\$	
b.			
c.			
d.			
e.			
f.			
g.			

11. Accounts and notes receivable

Name	Book Value	Liquidation Value	Amount of Indebtedness if Pledged	Date Pledged
a. Accounts Receivable				
(1)	\$	\$	\$	
(2)				
(3)				
(4)				
(5)				
(6)				
(7)				
(8)				
(9)				
(10)				
(11)				
(12) Total	\$	\$	\$	
b. Notes Receivable				
(1)	\$	\$	\$	
(2)				
(3)				
(4)				
(5)				
(6)				
(7)				
(8)				
(9)				
(10)				
(11) Total	\$	\$	\$	

12. Merchandise inventory					
Description	Cost	Fair Market Value	Liquidation Value	Amount of Indebtedness If Pledged	Date Pledged
a. Raw material	\$	\$	\$	\$	
b. Work in progress					
c. Finished goods					
d. Supplies					
e. Other (Specify)					
<b>f. Total</b>	\$	\$	\$	\$	

13. Real estate					
Description	Cost*	Fair Market Value	Balance Due on Mortgage	Date Mortgage Recorded	Unpaid Interest and Taxes
a.	\$	\$	\$		\$
b.					
c.					
d.					
e.					
f.					
g.					
h.					
<b>i. Total</b>	\$	\$	\$		\$

14. Furniture and fixtures — Machinery and equipment					
Description	Cost*	Liquidation Value	Amount of Indebtedness If Pledged	Date Pledged	
a. Furniture and fixtures (Business)	\$	\$	\$		
b. Furniture (Household-residence)					
c. Machinery (Specify kind)					
d.					
e.					
f.					
g. Equipment (Except trucks and automobiles) (Specify)					
h.					
i.					
j.					
<b>k. Total</b>	\$	\$	\$		

15. Trucks and automobiles					
Description	Cost*	Liquidation Value	Amount of Indebtedness If Pledged	Date Pledged	
a. Trucks	\$	\$	\$		
b.					
c.					
d.					
e.					
f.					
g. Automobiles (Personal or used in business)					
h.					
i.					
j.					
k.					
l.					
<b>m. Total</b>	\$	\$	\$		

(\*Less depreciation, if any)

**16. Securities (Bonds, stocks, etc.)**

Name of company	Number of Units	Cost	Fair Market Value	Amount of Indebtedness If Pledged	Date Pledged
a.		\$	\$	\$	
b.					
c.					
d.					
e.					
f.					
g.					
h.					
<b>i. Total</b>		\$	\$	\$	

**17. Judgments**

Name of Creditor	Amount of Judgment	Date Recorded	Where Recorded
a.	\$		
b.			
c.			
d.			
<b>e. Total</b>	\$		

**18. Statement of income - Corporation**

**IMPORTANT:** If the offer in compromise is from a corporation, please furnish the information requested below (from income tax returns, as adjusted, for past 2 years and from records for current year from January 1 to date).

	19	19	Jan. 1 to	19
<b>a. Gross income</b>				
(1) Gross sales or receipts (Subtract returns and allowances)	\$	\$	\$	
(2) Cost of goods sold				
(3) Gross profit - trading or manufacturing				
(4) Gross profit - from other sources				
(5) Interest income				
(6) Rents and royalties				
(7) Gains and losses (From Schedule D)				
(8) Dividends				
(9) Other (Specify)				
<b>(10) Total income</b>	\$	\$	\$	
<b>b. Deductions</b>				
(1) Compensation of officers	\$	\$	\$	
(2) Salaries and wages (Not deducted elsewhere)				
(3) Rents				
(4) Repairs				
(5) Bad Debts				
(6) Interest				
(7) Taxes				
(8) Losses				
(9) Dividends				
(10) Depreciation and depletion				
(11) Contributions				
(12) Advertising				
(13) Other (Specify)				
(14)				
<b>(15) Total deductions</b>	\$	\$	\$	
<b>c. Net income (loss)</b>	\$	\$	\$	
<b>d. Nontaxable income</b>	\$	\$	\$	
<b>e. Unallowable deductions</b>	\$	\$	\$	

**19. Salaries paid to principal officers and dividends distributed — Corporation**

**IMPORTANT:** If the offer in compromise is from a corporation, please show salaries paid to principal officers for past 3 years and amounts distributed in dividends, if any, during and since the taxable years covered by this offer.

a. Salaries paid to (Name and Title)		19	19	19
(1)	, President	\$	\$	\$
(2)	, Vice President			
(3)	, Treasurer			
(4)	, Secretary			
(5)				
(6)				
(7) Total		\$	\$	\$

b. Year	Dividends Paid	Year	Dividends Paid	Year	Dividends Paid
(1)	\$	(8)	\$	(15)	\$
(2)		(9)		(16)	
(3)		(10)		(17)	
(4)		(11)		(18)	
(5)		(12)		(19)	
(6)		(13)			
(7)	\$	(14)	\$	(20) Total	\$

**20. Statement of income — Individual**

**IMPORTANT:** If the offer in compromise is from an individual or an estate, please furnish information requested below (from income tax returns as adjusted for past 2 years).

a. Gross income		19	19
(1)	Salaries, wages, commissions	\$	\$
(2)	Dividends		
(3)	Interest		
(4)	Income from business or profession		
(5)	Partnership income		
(6)	Gains or losses (From Schedule D, Form 1040)		
(7)	Annuities and pensions		
(8)	Rents and royalties		
(9)	Income from estates and trusts		
(10)			
(11)			
(12)			
(13)			
(14)			
(15) Total income		\$	\$
b. Deductions			
(1)	Contributions	\$	\$
(2)	Interest paid		
(3)	Taxes paid		
(4)	Casualty losses (by fire, storm, etc.)		
(5)	Medical expenses		
(6)	Bad debts		
(7)			
(8)			
(9)			
(10)			
(11)			
(12) Total deductions		\$	\$
c. Net income (loss)		\$	\$
d. Nontaxable income		\$	\$
e. Unallowable deductions		\$	\$



**22. Disposal of assets**—From the beginning of the taxable period covered by this offer in compromise to the present date, have you disposed of any assets or property with a cost or fair market value of more than \$500, except for full value at the time of sale, transfer, exchange, gift or other disposition?

No  Yes (If yes, please furnish the following information)

Description of Asset	Date of Transfer	Fair Market Value When Transferred	Consideration Received	Relationship of Transferee to Taxpayer
		\$	\$	

**23. Interest in or beneficiary of estate or trust** — Have you any life interest or remainder interest, either vested or contingent in any trust or estate, or are you a beneficiary of any trust?

No  Yes (If yes, please furnish a copy of the instrument creating the trust or estate — Also give the following information)

Name of Trust or Estate	Present Value of Assets	Value of Your Interest	Annual Income Received From This Source
	\$	\$	\$

**24. Grantor, donor, trustee or fiduciary** — Are you the grantor or donor of any trust, or the trustee or fiduciary for any trust?

No  Yes (If yes, please furnish a copy of the instrument creating the trust. Also give present value of corpus of trust, and any other pertinent information.)

**25. Any other assets or interests in assets** — Have you any other assets or an interest in assets either actual or contingent, other than those listed here (i.e., Profit-sharing plan or pension plan)?

No  Yes (If yes, please describe the assets)

<b>26a.</b> Are foreclosure proceedings pending on any real estate which you own or have an interest in? <input type="checkbox"/> No <input type="checkbox"/> Yes	<b>b.</b> If yes, please give location of real estate	<b>c.</b> Was the government made a party to the suit? <input type="checkbox"/> No <input type="checkbox"/> Yes
--	---	--

<b>27a.</b> Are bankruptcy or receivership proceedings pending? <input type="checkbox"/> No <input type="checkbox"/> Yes	<b>b.</b> If a corporation, is it in process of liquidation? <input type="checkbox"/> No <input type="checkbox"/> Yes
---	--

**28. Is the sum offered in compromise borrowed money?** (If yes, please give name and address of lender and list collateral, if any, pledged to secure the loan.)

No  Yes

**29.** What is the prospect of an increase in value of assets or in present income? (Please give general statement)

**30. Affidavit**

Under penalties of perjury, I declare that I have examined the information given in this statement and, to the best of my knowledge and belief, it is true, correct, and complete, and I further declare that I have no assets, owned either directly or indirectly, or income of any nature other than as shown in this statement.

a. Date of this statement	b. Signature
---------------------------	--------------

DATA ANALYSIS METHODOLOGY

Statistical sampling enables one to draw conclusions about a universe of subjects on the basis of information contained in a sample of that universe. The results of a random selection of any sample are always subject to some uncertainty ("sampling error") because only a portion of the universe has been selected for analysis. The sampling error consists of two parts: "confidence level" and "range." The confidence level indicates the degree of reliability that can be placed in the estimates of a characteristic derived from the sample. The range is the upper and lower limits between which the actual value of the characteristic will, at the confidence level of certainty, be found.

For example, suppose a sample of 150 taxpayers having installment agreements was randomly selected from a universe of 3,693 and that 123 of the 150 had the characteristic of interest. On the basis of the sample and the sampling error, a confidence level of 95 percent could be set, meaning that we could be 95 percent confident that the number of taxpayers having this characteristic would be  $3,028 \pm 235$ . Thus if all 3,693 taxpayers were checked, the chances are 95 in 100 that the actual number having this characteristic would be between 2,793 and 3,263.

In statistical surveys, the implementation of a sampling design does not always proceed exactly as planned because one does not have complete control of the sample. In this review, IRS did not or could not provide all the selected tax returns; thus, we adjusted our universe to reflect only the tax returns which GAO received. By this procedure, we are projecting to an adjusted universe while knowing nothing about the proportion which we have not received from IRS. This is a common statistical procedure and provides conservative estimates since no statement is made about the characteristics of the unknown segment of the universe.

Since we had data from four IRS districts, we used a stratified random sample design for our analysis. Consequently, the percentages and dollars shown in this report are combined for the four districts in our sample and are shown at a 95 percent confidence level.

INDIVIDUAL INSTALLMENT AGREEMENTSAdjusted Sample Design For  
Individual Installment Agreements

<u>Sample category</u>	<u>IRS district</u>	<u>Initial universe</u>	<u>Initial sample</u>	<u>Cases not in sample category</u>	<u>Adjusted sample size</u>	<u>Adjusted universe</u>
Individual installment agreement cases received	Atlanta	3,693	150	27	123	3,028
	Chicago	3,364	150	35	115	2,579
	Greensboro	2,229	150	8	142	2,110
	Seattle	<u>1,022</u>	<u>150</u>	<u>22</u>	<u>128</u>	<u>872</u>
	Total	<u>10,308</u>	<u>600</u>	<u>92</u>	<u>508</u>	<u>8,589</u>
Taxpayers with individual installment agreements who are wage earners	Atlanta	3,693	150	40	110	2,708
	Chicago	3,364	150	58	92	2,063
	Greensboro	2,229	150	22	128	1,902
	Seattle	<u>1,022</u>	<u>150</u>	<u>45</u>	<u>105</u>	<u>715</u>
	Total	<u>10,308</u>	<u>600</u>	<u>165</u>	<u>435</u>	<u>7,388</u>
Individual installment agreements with financial statements	Atlanta	3,693	150	101	49	1,206
	Chicago	3,364	150	65	85	1,906
	Greensboro	2,229	150	50	100	1,486
	Seattle	<u>1,022</u>	<u>150</u>	<u>74</u>	<u>76</u>	<u>518</u>
	Total	<u>10,308</u>	<u>600</u>	<u>290</u>	<u>310</u>	<u>5,116</u>

	<u>IRS district</u>	<u>Initial universe</u>	<u>Initial sample</u>	<u>Cases not in sample category</u>	<u>Adjusted sample size</u>	<u>Adjusted universe</u>
Individual installment agreements with revised financial statements that do not show number of dependents relating to financial information	Atlanta	3,693	150	102	48	1,182
	Chicago	3,364	150	65	85	1,906
	Greensboro	2,229	150	50	100	1,486
	Seattle	<u>1,022</u>	<u>150</u>	<u>76</u>	<u>74</u>	<u>504</u>
	Total	<u>10,308</u>	<u>600</u>	<u>293</u>	<u>307</u>	<u>5,078</u>
Individual installment agreements with financial statements and related tax returns	Atlanta	3,693	150	105	45	1,108
	Chicago	3,364	150	66	84	1,883
	Greensboro	2,229	150	52	98	1,456
	Seattle	<u>1,022</u>	<u>150</u>	<u>122</u>	<u>28</u>	<u>191</u>
	Total	<u>10,308</u>	<u>600</u>	<u>345</u>	<u>255</u>	<u>4,638</u>
Individual taxpayers granted installment agreements under first-time delinquent program without financial statement	Atlanta	3,693	150	76	74	1,822
	Chicago	3,364	150	120	30	673
	Greensboro	2,229	150	107	43	639
	Seattle	<u>1,022</u>	<u>150</u>	<u>98</u>	<u>52</u>	<u>354</u>
	Total	<u>10,308</u>	<u>600</u>	<u>401</u>	<u>199</u>	<u>3,488</u>

	<u>IRS district</u>	<u>Initial universe</u>	<u>Initial sample</u>	<u>Cases not in sample category</u>	<u>Adjusted sample size</u>	<u>Adjusted universe</u>
Tax returns received for individual taxpayers granted installment agreements under first-time delinquent program without financial statements	Atlanta	3,693	150	81	69	1,699
	Chicago	3,364	150	125	25	561
	Greensboro	2,229	150	109	41	609
	Seattle	<u>1,022</u>	<u>150</u>	<u>104</u>	<u>46</u>	<u>313</u>
	Total	<u>10,308</u>	<u>600</u>	<u>419</u>	<u>181</u>	<u>3,182</u>
Individual installment agreements with financial statements showing \$5,000 or more equity in assets	Atlanta	3,693	150	136	14	345
	Chicago	3,364	150	125	25	561
	Greensboro	2,229	150	125	25	372
	Seattle	<u>1,022</u>	<u>150</u>	<u>130</u>	<u>20</u>	<u>136</u>
	Total	<u>10,308</u>	<u>600</u>	<u>516</u>	<u>84</u>	<u>1,414</u>

Table of Sample Results For Individual  
Installment Agreements

<u>Sample characteristic</u>	<u>Estimated universe</u>	<u>Number of cases found in district samples</u>				<u>Estimate (percentage)</u>	<u>Sampling error(±)</u>	<u>Range</u>	
		<u>Atlanta</u>	<u>Chicago</u>	<u>Greensboro</u>	<u>Seattle</u>			<u>Low</u>	<u>High</u>
I 1	8,589	10	4	46	2	12.0	5.0	7.0	17.0
I 2	8,589	4	4	14	4	4.9	3.9	1.0	8.8
I 3	7,388	7	1	31	5	9.3	4.9	4.4	14.2
I 4	5,116	40	81	75	63	84.9	8.0	76.9	92.9
I 5	5,116	14	25	25	20	27.6	10.5	17.1	38.1
I 6	5,116	16	6	23	11	18.5	8.8	9.7	27.3
I 7	5,116	15	39	27	25	35.5	11.0	24.5	46.5
I 8	5,116	7	9	7	13	11.1	7.6	3.5	18.7
I 9	5,116	3	20	7	6	13.0	7.5	5.5	20.5
I10	5,116	3	6	7	12	7.7	6.4	1.3	14.1
I11	5,116	15	48	24	13	37.0	10.7	26.3	47.7
I12	5,116	14	28	34	33	33.3	11.0	22.3	44.3
I13	5,116	8	11	4	11	11.3	7.5	3.8	18.8
I14	5,078	36	68	80	61	79.1	7.9	71.2	87.0
I15	4,638	17	32	32	23	38.1	11.6	26.5	49.7
I16	3,488	37	9	7	16	38.0	13.2	24.8	51.2
I17	3,182	9	3	6	15	15.1	9.4	5.7	24.5
I18	3,182	4	3	5	7	9.0	7.6	1.4	16.6
I19	1,414	7	1	14	4	30.4	18.5	11.9	48.9

Description of Sample Characteristics  
Individual Installment Agreements

- I 1 Indications in the case file that a loan was considered to pay tax delinquency.
- I 2 Installment agreements where monthly payment was increased during term of agreement.
- I 3 Taxpayers with installment agreements who were wage earners and were using payroll deductions to pay tax delinquencies.
- I 4 Installment agreements with financial statements that were not used to the fullest extent by IRS.
- I 5 Installment agreements with financial statements showing over \$5,000 equity in assets.
- I 6 Monthly payment amounts less than ability to pay as shown on the financial statement by \$10 or more.
- I 7 Monthly payment amounts greater than ability to pay as shown on the financial statement by \$10 or more.
- I 8 Indications in case file that IRS verified income shown on financial statement.
- I 9 Indications in case file that IRS verified some expense item on the financial statement.
- I10 Indications in case file that IRS questioned the necessity of some expense item on the financial statement.
- I11 Financial statements with questionable expenses that were not questioned by IRS.
- I12 Installment agreements that could have been reduced by at least 3 months had IRS used information on the financial statement showing when other creditors would be paid off to increase the monthly payment amounts.
- I13 Financial statements with mathematical errors which affected taxpayer's monthly ability to pay by \$10 or more.
- I14 Case files which showed number of people expenses were for even though the revised financial statements used did not provide for that information.

- I15 Cases where income tax returns show that taxpayer understated annual income on financial statement by \$2,000 or more.
- I16 Taxpayers granted installment agreements under the first-time delinquent program (financial statements not obtained) who were repeat delinquents.
- I17 Taxpayers granted installment agreements under the first-time delinquent program (financial statement not obtained) where interest income claimed on tax returns indicated sufficient savings to immediately pay tax delinquency in full.
- I18 Taxpayers granted installment agreements under the first-time delinquent program (financial statements not obtained) where interest income claimed on tax returns indicated some savings but not enough to immediately pay tax delinquency in full.
- I19 Taxpayers with over \$5,000 equity in assets shown on their financial statements and case file showed indications that a loan was considered.

We reviewed the available tax returns related to the time period of the financial statements for the individual installment agreement sample in the four IRS districts to determine whether taxpayers understated their income on their financial statements. From this analysis, we estimated the total income understated on the financial statements for the universe of 4,638 taxpayers. The following results were obtained:

<u>Estimate of understated income</u>	<u>Sampling error (<math>\pm</math>)</u>	<u>Range</u>	
		<u>Low</u>	<u>High</u>
\$8,513,480	\$1,652,212	\$6,861,268	\$10,165,692

We also analyzed the financial statements to determine the amount of additional revenue IRS could have collected if monthly installment agreement payments had been increased when other creditors were paid off. This analysis was done for the first 2 years of the installment agreements.

Under the current terms of the installment agreements, we estimate that IRS should collect the following:

	<u>Estimate of collections</u>	<u>Sampling error (<math>\pm</math>)</u>	<u>Range</u>	
			<u>Low</u>	<u>High</u>
First year	\$7,047,663	\$836,359	\$6,211,304	\$7,884,021
Second year	4,068,411	598,734	3,469,677	4,667,145

If IRS increased payments based on liabilities being paid off during the first year of the agreement, we estimate the following additional collections could have been made in the first year:

<u>Estimate of additional collections</u>	<u>Sampling error (<math>\pm</math>)</u>	<u>Range</u>	
		<u>Low</u>	<u>High</u>
\$636,650	\$211,592	\$425,058	\$848,242

Similarly, in the second year of the agreement, the following additional collections could have been made if IRS increased monthly payments based on liabilities being paid off in both the first and second years of the agreement:

<u>Liabilities paid off in</u>	<u>Estimate of additional collections</u>	<u>Sampling error (<math>\pm</math>)</u>	<u>Range</u>	
			<u>Low</u>	<u>High</u>
First year	\$ 379,117	\$161,481	\$217,636	\$ 540,598
Second year	1,160,846	246,666	914,180	1,407,512

BUSINESS INSTALLMENT AGREEMENTSAdjusted Sample Design For  
Business Installment Agreements

<u>Sample category</u>	<u>IRS district</u>	<u>Initial universe</u>	<u>Initial sample</u>	<u>Cases not in sample category</u>	<u>Adjusted sample size</u>	<u>Adjusted universe</u>
Taxpayers with business installment agreements whose financial statements were prepared using personal income and expenses	Atlanta	173	30	20	10	58
	Chicago	323	30	14	16	172
	Greensboro	190	30	3	27	171
	Seattle	<u>107</u>	<u>30</u>	<u>7</u>	<u>23</u>	<u>82</u>
	Total	<u>793</u>	<u>120</u>	<u>44</u>	<u>76</u>	<u>483</u>
Wage earner taxpayer with business installment agreements whose financial statements were prepared using personal income and expenses	Atlanta	173	30	28	2	12
	Chicago	323	30	25	5	54
	Greensboro	190	30	19	11	70
	Seattle	<u>107</u>	<u>30</u>	<u>20</u>	<u>10</u>	<u>36</u>
	Total	<u>793</u>	<u>120</u>	<u>92</u>	<u>28</u>	<u>172</u>

Table of Sample Results For Business  
Installment Agreements

<u>Sample characteristic</u>	<u>Estimated universe</u>	<u>Number of cases found in district samples</u>				<u>Estimate (percentage)</u>	<u>Sampling error (<math>\pm</math>)</u>	<u>Range</u>	
		<u>Atlanta</u>	<u>Chicago</u>	<u>Greensboro</u>	<u>Seattle</u>			<u>Low</u>	<u>High</u>
B 1	793	10	16	27	23	60.9	16.3	44.6	77.2
B 2	483	3	6	9	7	33.9	24.7	9.2	58.6
B 3	483	2	3	6	3	19.2	20.9	-	40.1
B 4	483	1	3	9	6	24.1	21.5	2.6	45.6
B 5	483	5	6	12	9	41.7	25.5	16.2	67.2
B 6	483	1	-	4	6	10.9	12.7	-	23.6
B 7	483	6	10	10	11	47.7	25.3	22.4	73.0
B 8	483	3	1	8	3	18.5	19.2	-	37.7
B 9	483	2	5	11	10	35.3	24.3	11.0	59.6
B10	172	-	-	2	-	7.4	17.9	-	25.3

Description of Sample Characteristics  
Business Installment Agreements

- B 1 Business installment agreements where financial analysis was based on the individuals' personal income and expenses.
- B 2 B 1 cases with questionable expense items that were not questioned by IRS.
- B 3 B 1 cases where taxpayer had other liabilities that would have been paid off during first year of the installment agreement and IRS did not use this information to increase monthly payments.
- B 4 B 1 cases where taxpayer had other liabilities that would have been paid off during second year of the installment agreement and IRS did not use this information to increase monthly payments.
- B 5 B 1 cases with financial statements showing over \$5,000 equity in assets.
- B 6 B 1 cases with mathematical errors on financial statements that affected taxpayer's monthly ability to pay by \$10 or more.
- B 7 B 1 cases where monthly payment amounts were greater than ability to pay as shown on the financial statements by \$10 or more.
- B 8 B 1 cases where monthly payment amounts were less than ability to pay as shown on the financial statements by \$10 or more.
- B 9 B 1 cases where individual was a wage earner.
- B10 Wage earner taxpayers with business installment agreements using payroll deductions to pay tax delinquency.

INDIVIDUAL CURRENTLY NOT COLLECTIBLES

Adjusted Sample Design For Currently  
Not Collectible Financial Hardship Cases

<u>Sample category</u>	<u>IRS district</u>	<u>Initial universe</u>	<u>Initial sample</u>	<u>Cases not in sample category</u>	<u>Adjusted sample size</u>	<u>Adjusted universe</u>
Cases classified as currently not collectible based on financial hardship	Atlanta	8,771	232	65	167	6,314
	Chicago	8,356	222	142	80	3,011
	Greensboro	5,249	225	56	169	3,943
	Seattle	<u>2,590</u>	<u>214</u>	<u>102</u>	<u>112</u>	<u>1,356</u>
	Total	<u>24,966</u>	<u>893</u>	<u>365</u>	<u>528</u>	<u>14,624</u>
Cases classified as currently not collectible based on financial hardship with financial statements	Atlanta	8,771	232	121	111	4,196
	Chicago	8,356	222	146	76	2,861
	Greensboro	5,249	225	71	154	3,593
	Seattle	<u>2,590</u>	<u>214</u>	<u>112</u>	<u>102</u>	<u>1,234</u>
	Total	<u>24,966</u>	<u>893</u>	<u>450</u>	<u>443</u>	<u>11,884</u>
Cases classified as currently not collectible based on financial hardship with financial statement and related tax return	Atlanta	8,771	232	164	68	2,571
	Chicago	8,356	222	192	30	1,129
	Greensboro	5,249	225	135	90	2,100
	Seattle	<u>2,590</u>	<u>214</u>	<u>153</u>	<u>61</u>	<u>738</u>
	Total	<u>24,966</u>	<u>893</u>	<u>644</u>	<u>249</u>	<u>6,538</u>

Table of Sample Results For Individual  
Currently Not Collectible Financial  
Hardship Cases

<u>Sample characteristic</u>	<u>Estimated universe</u>	<u>Number of cases found in district samples</u>				<u>Estimate (percentage)</u>	<u>Sampling error (±)</u>	<u>Range</u>	
		<u>Atlanta</u>	<u>Chicago</u>	<u>Greensboro</u>	<u>Seattle</u>			<u>Low</u>	<u>High</u>
CNC 1	14,624	56	4	15	10	18.7	6.0	12.7	24.7
CNC 2	14,624	1	-	9	29	4.1	2.5	1.6	6.6
CNC 3	11,884	22	33	10	14	20.8	7.6	13.2	28.4
CNC 4	11,884	17	13	19	13	14.6	7.0	7.6	21.6
CNC 5	11,884	27	14	36	12	21.3	8.0	13.3	29.3
CNC 6	11,884	14	4	13	14	9.7	5.8	3.9	15.5
CNC 7	11,884	49	17	59	63	39.0	9.2	29.8	48.2
CNC 8	6,538	20	8	28	12	28.4	11.9	16.5	40.3
						1,856 (tax-payers)	780	1,076	2,636
CNC 9	6,538	17	8	23	10	24.5	11.5	13.0	36.0
						1,601 (tax-payers)	750	851	2,351

Description of Sample Characteristics  
Individual Currently Not Collectible  
Financial Hardship Cases

- CNC 1      Cases without financial statements.
- CNC 2      Cases where mandatory followup was used.
- CNC 3      Cases with questionable expense items on financial statements which were not questioned by IRS.
- CNC 4      Cases with financial statements showing other creditors being paid off within one year from date account classified as currently not collectible.
- CNC 5      Indications in case file that IRS verified income shown on financial statements.
- CNC 6      Cases where financial statements showed an ability to make monthly payments of \$10 or more.
- CNC 7      Cases with financial statements where closing code (income level for reactivation) was set too high.
- CNC 8      Case where income tax return showed that the taxpayer understated annual income on financial statement by \$2,000 or more.
- CNC 9      Taxpayers in CNC 8 who had the ability to start making payments on their liabilities based on the amount of understated income.

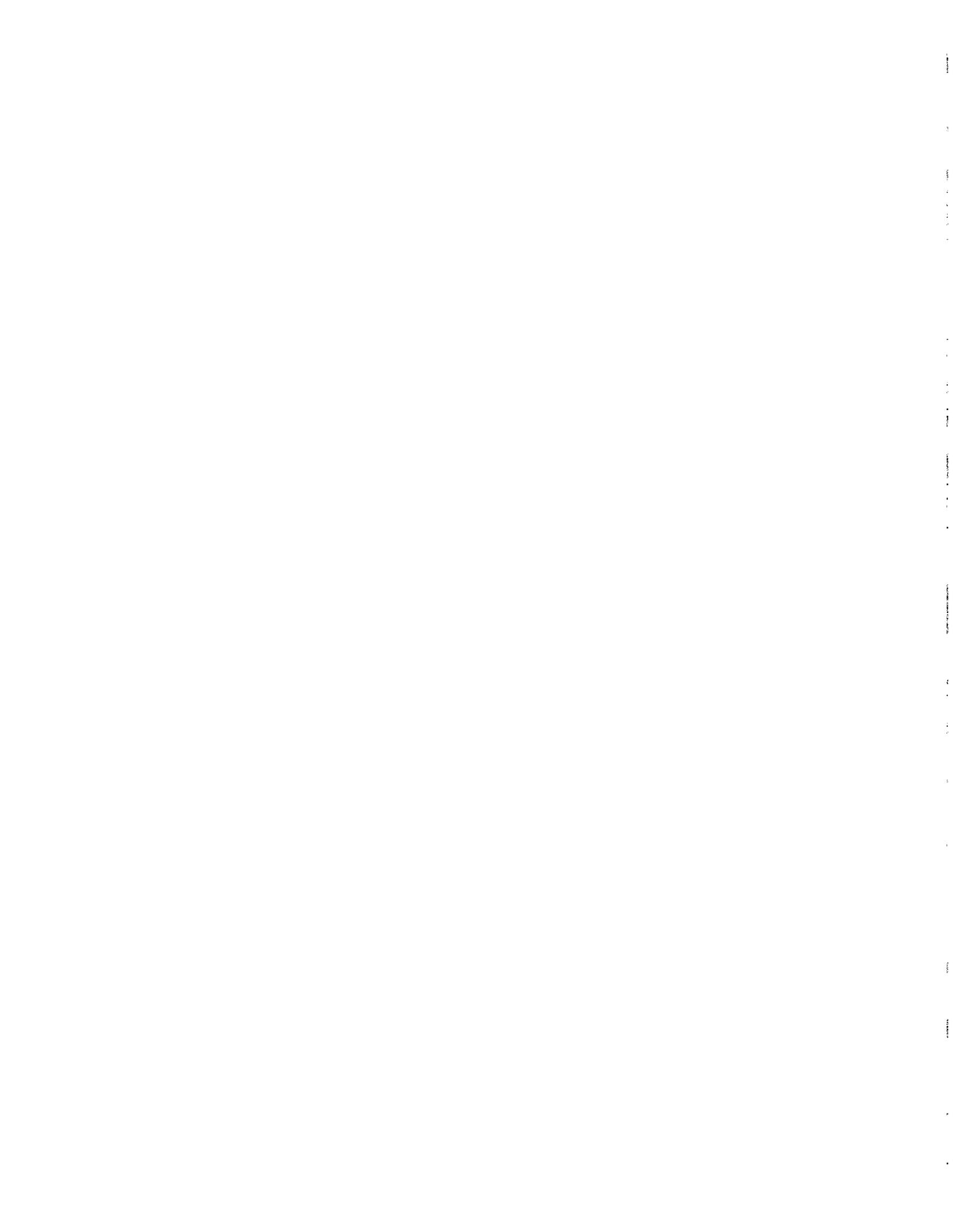
We reviewed the available tax returns corresponding to the time period of the financial statements for our sample of individual currently not collectible hardship cases in the four IRS districts to determine the amount of income understated on the financial statement less any excess expense shown on the financial statement. Using this information we estimated the total understated income on the financial statements for the universe of 6,538 taxpayers. The following results were obtained:

<u>Estimate of understated income</u>	<u>Sampling error (±)</u>	<u>Range</u>	
		<u>Low</u>	<u>High</u>
\$5,945,622	\$1,868,526	\$4,077,096	\$7,814,148

We also analyzed the financial statements for hardship cases in our sample to determine the amount of income exceeding expenses that was available to pay off the tax liability. Similarly, we determined the amount of money that would be available to pay the tax delinquency when taxpayers paid off other liabilities during a 1-year period after the account was classified as currently not collectible. Using this information we projected for the universe of 11,884 taxpayers the total money available to pay off the tax liabilities after considering any excess expenses over income shown on the financial statement. We obtained the following results:

	<u>Estimate</u>	<u>Sampling error(±)</u>	<u>Range</u>	
			<u>Low</u>	<u>High</u>
Income exceeding expenses	\$974,846	\$452,471	\$522,375	\$1,427,317
Money available when other liabilities paid	\$1,039,420	353,684	685,736	1,393,104

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