United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

December 1993

TAX ADMINISTRATION

Changes Needed to Cope With Growth in Offer in Compromise Program

GAO/GGD-94-47

GAO

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

150619

General Government Division

B-255786

December 23, 1993

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

This report responds to your request to assess the Internal Revenue Service's (IRS) Offer in Compromise Program. Offers in compromise are taxpayer proposals to settle tax debts for less than the amount owed. Our report discusses IRS' new emphasis on the program as a collection tool and a means to encourage future compliance. It points out variability in the program's use among IRS' 63 district offices and recommends several changes IRS needs to make in light of the program's fast growth.

Amounts collected through the Offer in Compromise Program are small relative to IRS' overall collections—$106 million in accepted offers versus $24.2 billion in overall collections in fiscal year 1992. Nonetheless, the program has grown rapidly since IRS began emphasizing it in February 1992. A comparison of IRS' fiscal year 1991 data with data from the first 10 months of fiscal year 1993 shows that (1) the number of offers IRS received increased from 8,711 to 40,843, (2) overall acceptance rates increased from 25 percent to 53 percent, (3) accepted offer amounts increased from $37.1 million to $165.9 million, and (4) the overall tax debt forgiven increased from approximately 73 percent to approximately 85 percent.

Results in Brief

IRS is pleased with the initial results of the revised offer program, but it has yet to demonstrate that use of offers in compromise will meet the program's overall objectives of increased collections and improved compliance. To accomplish this, IRS must systematically capture the data needed to measure the effectiveness of the program. It must also improve the efficiency of the program in order to make the best use of collection resources. Finally, it must ensure that the program is being implemented consistently in different offices. IRS recognizes inefficiencies in the program and is attempting to improve its processing of offers in compromise and its record keeping.

Our case studies of 120 accepted and 60 rejected offers in compromise that were closed in fiscal year 1992 showed that IRS staff followed

prescribed procedures in processing taxpayer offers. We identified several things IRS needs to consider, however, as part of its improvement process.

First, IRS needs reliable data on the offer program. IRS uses paper records to track the number of offers received and amount of tax debt compromised—a process we found subject to error. Once IRS has reliable data, it needs better indicators of the program's effectiveness. We believe key effectiveness indicators include measures of (1) the program's yield (revenue collected versus resources expended), (2) revenues collected that would not have been otherwise collected, (3) the extent that noncompliant taxpayers are brought back into the tax system, and (4) the extent that participating taxpayers remain compliant in future years. IRS is developing an automated system to determine whether taxpayers remain compliant after having an offer accepted, but the system does not systematically measure the other three indicators.

Second, IRS needs to continue improving the efficiency of the offer program. For example, its recent decision to streamline the processing of offers involving tax debts of less than $10,000 should help reduce administrative costs. At the same time, however, IRS needs to be cautious about overreliance on in-house information sources to substantiate taxpayers' asset claims. In addition, IRS is required by law to obtain a legal opinion on all offers with tax liabilities of $500 or more—a process that increases administrative costs. IRS has proposed raising the review threshold to $50,000. Because the legal complexity of offers is not always directly related to the amount of the tax liability, a better option would be to give IRS discretionary authority to decide when offers need legal review. IRS also relies on time-consuming, manual methods to monitor accepted offers to ensure that taxpayers comply with the conditions of the offer. Automating the monitoring process could improve its efficiency.

Third, while we have no data to indicate that IRS' increased compromising of tax debts might adversely affect voluntary compliance, we believe IRS needs to be mindful of the effect that settling for less than the full tax liability might have on taxpayers who pay their taxes in full. Congress recognized the potential fairness and equity issues linked to offers in compromise and, as part of the program, required that the names of taxpayers whose debts are compromised, the amount of the debt compromised, and the amount accepted by the government be made public information. IRS might defuse this potential issue if it is able to demonstrate the overall benefits of the offer program through use of the indicators discussed above.

While IRS' policy has long been to accept an offer when there is doubt about collecting the tax liability in full and the amount offered reasonably reflects collection potential, IRS made a number of changes to expand the offer program. The changes included

- clarifying its willingness to use offers in compromise as a collection tool;
- streamlining application forms;
- simplifying offer investigation and acceptance requirements;
- delegating approval authority to lower levels—for example, the requirement that District Office Directors approve offers for tax liabilities over $100,000 has been delegated to collection division chiefs, and all other offers can be approved by branch chiefs;
- reducing investigation time—IRS' goal is to process offers within 6 months of the application; and
- requiring taxpayers to stay current with their tax liabilities for the next 5 years as a condition of the compromise—IRS has the option of reinstating the liability if the taxpayer does not comply.

The Offer Process

An offer in compromise is a legal contract between IRS and an individual or business taxpayer to settle a tax debt for less than the amount of the debt. The offer must be supported by a current statement of the taxpayer's financial condition, including data on existing assets, liabilities, and a monthly income and expense analysis. Taxpayers certify under penalty of perjury that the information in their financial statements is true, and the information is subject to verification by IRS. The verification is to include reviewing prior year tax returns and, depending on the amount and type of taxpayer assets, bank, courthouse, and state motor vehicle records.

Offers are initiated by taxpayers or their representatives, although sometimes these parties may be made aware of the program by the IRS revenue officer working their cases. When IRS receives an offer, it is assigned to a revenue officer or an offer specialist. The latter, generally experienced revenue officers who have been assigned full-time to investigate and process offers, are used by some districts. The officer/specialist determines if the offer is reasonable by reviewing and verifying the taxpayer's financial data and comparing the amount offered with what IRS can reasonably expect to receive through other collection methods, i.e., installment agreements or an enforced collection action such as a levy or seizure.

An offer is accepted if, upon verification, the amount offered equals or exceeds (1) the taxpayer's current net realizable equity (equity adjusted for the revenue it would bring if it were liquidated); (2) the present value of the taxpayer's future expendable income (future income, typically over the next 5 years, after necessary living expenses are deducted); (3) payments available from third parties; and (4) assets available to the taxpayer but beyond the reach of the government (e.g, property outside the United States).

IRS' new procedures emphasize building the present value of future expendable income directly into the offer amount. However, if there are indications that the taxpayer might have a substantial increase in income because, for example, the release of a lien might allow the taxpayer to obtain credit to expand a business activity, IRS might also have taxpayers sign collateral agreements that require additional payments if their future income exceeds a given amount.

Taxpayers pay offers immediately after notification of acceptance or by making deferred payments for up to 5 years. If the deferred payment option is used, the taxpayer must also pay accrued interest.

If the offered amount does not meet IRS' requirements, taxpayers are given an opportunity to increase or withdraw the offer. If a taxpayer's final offer does not meet IRS' requirements, procedures call for rejecting the offer and notifying the taxpayer of the reason(s) and the right to appeal.

IRS can reject an offer for several reasons, such as (1) the taxpayer's net realizable equity exceeds the offer amount, (2) the taxpayer does not provide requested information, or (3) IRS managers believe public knowledge of the accepted offer would be detrimental to voluntary compliance. For example, if IRS judges that accepting an offer from an individual widely suspected to be an organized crime figure, who might have hidden assets, would be viewed unfavorably by the public, it might reject the offer.

Increased Taxpayer Use of Offers

Offers IRS received increased approximately 358 percent from almost 9,000 in fiscal year 1990 to almost 41,000 in the first 10 months of fiscal year 1993, according to IRS data. Although the growth has been substantial, the program is not large in terms of IRS' overall collections. In 1992, IRS collected $24.2 billion in delinquent taxes. During the first 10 months of

fiscal year 1993, IRS accepted $165.9 million in taxpayer offers to satisfy $1.5 billion in tax debts. Table 1 shows the program's growth.

Table 1: Growth in the Offer in Compromise Program—Fiscal Years 1990 to July 31, 1993

	1990	1991	1992	1993 (as of 7/31/93)
Offers received	8,919	8,711	17,749	40,843
Offers processed	8,000	8,098	9,773	26,439
Offers rejected	4,173	4,072	3,209	6,265
Offers withdrawn	1,855	2,031	2,208	6,177
Offers accepted	1,972	1,995	4,356	13,997
Acceptance rate	25%	25%	45%	53%
Tax delinquency (millions)	$128.4	$139.7	$661.1	$1,121.7
Offer amount (millions)	$37.3	$37.1	$106.2	$165.9
Percent of delinquency satisfied	29.2%	26.6%	16.1%	14.8%
Percent of offers processed in 6 months or less	N/A	N/A	N/A	54%

Source: IRS Reports on Offer in Compromise Activity (No. 5000-108) for fiscal years ending 1990, 1991, and 1992, and as of July 31, 1993.

IRS Assessments of the Revised Offer Program

IRS is attempting to make the Offer in Compromise Program more efficient as it studies various options for improvement. It has conducted several studies and is considering the feasibility of the studies' recommendations for improvement. In April 1993, a study team composed of IRS National Office officials and field managers forwarded an offer in compromise report to the Assistant Commissioner for Collections. The report identified immediate and longer term actions for study and debate and contained 36 policy, management, and legal recommendations to modify the offer program. Policy recommendations included prescribing minimal offer amounts and limiting the terms of deferred payments to 2 years from the current 5-year period. Management recommendations included implementing a revised training package and supporting field initiatives for alternative methods to process offers. Legal recommendations included redefining the scope of counsel reviews of offers and endorsing the imposition of user fees. In September 1993, the National Office manager of the Offers in Compromise Program told us that IRS was considering the study team's recommendations. However, the IRS official told us that some of the study team's recommendations may not be feasible to implement because they may limit the number of taxpayers who are able to benefit from the program.

In a May 1993 report, IRS' Internal Audit Division made five recommendations to improve administration of the Offer in Compromise Program. The recommendations included (1) reemphasizing to field staff the need to consider offers in compromise prior to designating an account currently not collectible; (2) improving measures of processing timeliness; (3) establishing limited investigations of small dollar offers; (4) assigning offer investigative duties to the revenue officer currently working the case, if feasible; and (5) issuing guidelines so managers and employees know what type of cases should be considered by district directors. IRS' Internal Auditors reported that the Assistant Commissioner for Collection agreed with all of their recommendations and was in the process of making the necessary changes.

Objectives, Scope, and Methodology

Our objectives were to (1) assess IRS' experiences with the revised Offer in Compromise Program and (2) examine the reasons for variability in district offices' offer acceptance rates.

To address the first objective we did the following:

- We reviewed IRS internal audit and management reports concerning the Offer in Compromise Program.
- We interviewed collection officials in IRS' National Office and directors, assistant directors, and collection staff in 13 district offices.
- We obtained views on IRS' Offer in Compromise Program from the American Institute of Certified Public Accountants.
- We reviewed a sample of 120 accepted and 60 rejected offers that were closed in fiscal year 1992 to examine how the cases were processed and identify differences in the way cases were processed. Our samples were not representative of how all small, large, and rejected offers are processed. Our cases included

  - 47 randomly selected accepted offers with assessed tax liabilities of $50,000 or less from 4 service centers (drawn from 1,099 offers that met these criteria);

  –73 offers to compromise the largest individual debts (debt ranging from $50,700 to $3,610,356) and business debts (debt ranging from $58,300 to $1,888,129) from 4 service centers; and

  –60 rejected offers randomly selected from 2 service centers (drawn from 508 rejected offers).

- We compared the data in IRS' statistical reports with data provided directly by 10 randomly selected and 7 judgmentally selected district offices for the period April 1992 through September 1992. The seven judgmentally selected districts were selected in an attempt to determine why records in district offices differed from records in National Office reports. Thus, we reviewed data from 2 districts whose individual records on number of offer receipts differed by 19 or more offers and 5 districts whose records of offer receipts differed by 2 or fewer offers.

To address the second objective we

- analyzed IRS' statistical reports for fiscal years 1990 through July 1993 and compared the number of offers processed and accepted by IRS regions and district offices and
- interviewed 12 district office directors to discuss why acceptance rates varied among district offices.

We did our work at the IRS National Office; the Central Region; the Cincinnati, Ohio, District Office; and the Cincinnati Service Center. We also obtained data from the Atlanta, GA; Austin, TX; and Kansas City, MO, Service Centers and the Augusta, ME; Albany, NY; Birmingham, AL; Boise, ID; Brooklyn, NY; Burlington, VT; Buffalo, NY; Chicago, IL; Cleveland, OH; Columbia, SC; Detroit, MI; Fargo, ND; Greensboro, NC; Hartford, CT; Helena, MT; Honolulu, HI; Houston, TX; Indianapolis, IN; Jacksonville, FL; Las Vegas, NV; Little Rock, AR; Louisville, KY; Milwaukee, WI; Newark, NJ; Omaha, NE; Parkersburg, WV; Phoenix, AZ; Pittsburgh, PA; and St. Louis, MO, District Offices and the International Division. We did our work between August 1992 and July 1993 in accordance with generally accepted government auditing standards.

On September 2, 1993, we met with IRS National Office officials responsible for overseeing the implementation of the Offer in Compromise Program to obtain their comments on a draft of this report. IRS representatives at that meeting included the Assistant Commissioner for Collection and the Chief of Special Procedures Support Function. On the basis of that meeting, we revised our report and incorporated IRS' comments where appropriate.

Better Data Needed to Evaluate the Offer Program

IRS believes that it obtains revenue through offers that it may not have access to through other collection methods. For example, taxpayers sometimes use money provided by relatives, spouses, employers, and friends to settle their accounts. Also, some taxpayers using the program

settle accounts that IRS previously classified as currently not collectible. Our case reviews contained examples of both instances. However, at present, IRS does not systematically gather this type of information.

IRS needs to have processes in place to assess the effectiveness of the offer program. We believe key indicators of effectiveness are (1) program yield (revenue collected versus resources expended), (2) the amount of revenues collected that would not have been collected through other collection methods, (3) the extent to which noncompliant taxpayers return to the tax system, and (4) the extent to which participating taxpayers remain compliant in future years.

The offer program was revised in February 1992, and IRS is beginning to gain sufficient experience to judge how effective the program may be in keeping taxpayers compliant in future years. IRS plans to begin automated monitoring of taxpayer compliance rates in January 1994. However, we question whether IRS will have good information regarding the yield of the offer program, the additional collections resulting from the offer program, and the number of noncompliant taxpayers who have returned to the tax system. Without this information, IRS will not know whether the program is successful.

Before IRS can begin measuring the effectiveness of the offer program, it needs reliable data. IRS relies on Offer Activity Reports prepared by each of its 63 district offices to track data on offers, such as (1) the number of offers received, (2) the number and amount of offers accepted, and (3) the amount of tax debt compromised. Our initial review of the source data for the Offer Activity Reports showed that the amount of tax debt reported as compromised was often understated because the data failed to include all accrued interest and penalties. These inaccurate program data were used by the National Office to monitor offer activity. District offices were directed by IRS' National Office to begin using a more up-to-date source document—the Offer Acceptance Report—in November 1992.

Table 2 shows that the data in the two reports contain numerous differences.

Table 2: Comparison of Offer in Compromise Information From 2 IRS Reports

District	Number of offers: Offer Acceptance Report	Number of offers: Offer Activity Report	Number of offers: Difference	Amount of tax debt: Offer Acceptance Report ($000)	Amount of tax debt: Offer Activity Report ($000)	Amount of tax debt: Difference ($000)
Albany	23	23	0	$1,442	$1,358	$84
Brooklyn	13	14	1	$1,640	$1,205	$435
Hartford	23	24	1	$2,466	$1,658	$808
Greensboro	27	24	3	$2,898	$970	$1,928
Louisville	92	86	6	$9,183	$5,664	$3,519
Fargo	27	29	2	$1,173	$817	$356
Milwaukee	139	138	1	$8,799	$8,889	$90
Omaha	59	61	2	$2,664	$1,771	$893
St. Louis	215	228	13	$13,401	$11,215	$2,186
Honolulu	28	26	2	$4,491	$4,118	$373
	Median difference		2	Median difference		$622

Note: In measuring difference between the two reports, we used aggregated Offer Activity Report data. Therefore, we could not make a one-for-one match of offers contained in the two reports. As a result, our computed differences may be less than the actual differences to the extent that errors may have cancelled each other.

Source: Offer Activity Reports and Offer Acceptance Reports from 10 randomly selected district offices. Period covered: April 1 to September 30, 1992.

As shown in table 2, information in the two reports differed. Some of the differences may have resulted from the fact that accrued interest and penalties were more current on the Offer Acceptance Report. Other errors occurred because some Offer Acceptance Reports were missing from district office files or were incomplete. The National Office Collection Support Function Chief, who is responsible for overseeing implementation of the Offer in Compromise Program, told us that such errors as misfiling and delayed updating are typically associated with a manual reporting system like the one used in maintaining these reports. He said personnel in the Southwest Region are designing an automated system for collecting data for reporting purposes. IRS plans to install the system in its service centers by January 1994, but, according to the National Office Collection Support Function Chief, some district offices will not be able to supply offer data to the system until they receive equipment upgrades.

Duplicate reporting of some tax debts also contributed to inaccurate Offer Activity Reports. Tax debts related to the trust fund recovery penalty[1] sometimes result in more than one offer to compromise the same tax delinquency because several officers in a business may be individually assessed a penalty. IRS district offices maintain a report for each offer it accepts. Eliminating duplicate offers from tax debts associated with Offer Acceptance Reports in table 2, for example, would reduce the total reported tax debt from approximately $48.2 million to approximately $46.8 million. We believe reporting will be more accurate if it does not include duplicate accounting for trust fund recovery penalties.

Rapid Growth Causes Need to Improve Program Efficiency

Our case reviews of 180 offers in compromise (120 accepted offers and 60 rejected offers) closed in fiscal year 1992 showed that IRS revenue officers generally followed prescribed procedures in investigating and processing taxpayer offers. However, the rapid growth of the Offer in Compromise Program requires IRS to consider more efficient ways to administer the program to both optimize its use and prevent it from draining collection resources.

Some Offer in Compromise Program managers in IRS district offices believe the program may grow so large that it could ultimately impinge on other collection activity. According to these managers, continued growth may require additional staff or affect the priority of district office collection work.

IRS' Offer Processing Costs Sometimes Exceed Amounts Collected

Currently, the proceeds from some offers do not cover IRS' administrative costs. According to the National Office Collection Support Function Chief, it costs between $500 and $1,000 to process an offer. Of the 795 offers accepted by 17 IRS district offices during the 6-month period ending September 30, 1992, that we reviewed, 51 were for amounts under $1,000. The median offer was $800 on a median tax debt of $7,132.

IRS recognizes that something needs to be done to reduce the costs of processing offers in comprise. In fact, it claims to already have made some improvements. Through July of fiscal year 1993, it estimated that collection staff spent about 23 hours to process an offer, down from almost 36 hours in fiscal year 1992. Additionally, IRS National Office officials expect that the grade level of staff who process offers will

[1]The trust fund recovery penalty (formerly known as the 100 percent penalty) occurs when IRS makes individual taxpayers responsible for paying the delinquent employment taxes of a business.

decrease. They believe that GS-9 level staff can process up to two-thirds of all offer cases, which previously were processed primarily by GS-12 staff.

IRS officials agree that more could be done to reduce offer processing costs, particularly for those offers involving small tax liabilities. In September 1993, the IRS Director of Operations for Collections authorized collection staff to rely on in-house resources, such as prior year tax returns, to verify financial data submitted by certain offer applicants (individuals and out-of-business sole proprietors) with tax debts of less than $10,000. IRS' usual investigative process may include more time-consuming checks of external sources such as property and bank records. The Director also authorized the use of GS-5 through GS-9 service center and collection staff to assist in offer investigations.

Although we support IRS' efforts to streamline offer investigations, IRS needs to be cautious about adopting techniques that could hamper the validation of taxpayers' asset claims. IRS in-house records will not disclose asset values or even the existence of some assets, unless the existence and value of assets have already been established through prior collection efforts. Evidence is currently not available to support the complete reliance on in-house sources to substantiate taxpayers' claims of assets and their values. In the absence of such evidence, we believe IRS might, at least initially, spot-check taxpayer asset claims using outside sources of information. These checks would help IRS objectively evaluate the risks of relying on in-house records. If the spot-checks indicate that assets are missed, IRS might still achieve efficiencies by searching easily accessible outside sources, such as those that can be accessed by computer. Such sources could include automated Department of Motor Vehicle Records or, where available, automated property records.

Another method of streamlining the offer process involves reducing the involvement of IRS' District Counsel. Section 7122 of the Internal Revenue Code requires an opinion from the "General Counsel for the Treasury or his delegate" on every offer with a tax liability of $500 or more. Because offers are legally binding contracts, IRS district counsel representatives are required to review them to determine if they are legally sound. District Counsels also assist in the offer process by answering questions that arise from examining the taxpayer's financial condition.

We agree that requiring District Counsel opinion on offers with tax liabilities as low as $500 is probably an unnecessary involvement that increases offer processing costs and adds to the legal staff's workload. IRS'

counsel in the Central Region told us that they do not devote a lot of time to reviewing these "low dollar" cases, but the review process does take time that could be used for more pressing work. The Regional Counsel also said that eliminating legal reviews of offers involving small tax debts would be a low-risk change.

In January 1993, IRS proposed legislation to raise the legal review threshold to $50,000. That proposal has not become law, and IRS Collection Division officials are now considering proposing that the threshold be raised to $100,000. Another option might be to give IRS the authority to determine the extent of district counsel involvement in offer reviews. We believe the need for legal review is related not only to the amount of debt compromised, but also to the legal complexity of the case. Counsel representatives in IRS' Central Region told us the amount of the tax liability was not necessarily related to the legal complexity of an offer. They said, for example, that offers based on taxpayer assets that were legally entangled would likely require counsel assistance, regardless of the amount of taxes owed.

Manual Monitoring Strains Collection Resources

IRS relies on time-consuming, manual methods to monitor taxpayer compliance with the conditions of the offer. As the program continues to expand, it could put a strain on collection resources.

In accepted offer agreements, taxpayers settle their accounts by lump sum and/or deferred payments. In addition, taxpayers who agree to future income collateral agreements usually pay those amounts annually. Collection staff at each of IRS' 10 service centers manually monitor taxpayer accounts to determine if (1) deferred and lump sum payments were made as agreed and (2) taxpayers complied with the provisions of future income collateral agreements. To accomplish this, service center staff use paper files to track taxpayers' compliance with the payment requirements of their offer agreements.

When we asked the National Office Collection Support Function Chief about the feasibility of automating the monitoring process, he expressed reservations about the costs of developing and implementing an automated monitoring system for collateral agreements, given IRS' reliance on building the present value of future income into offer amounts in lieu of using collateral agreements. He also doubted whether the short-term nature of deferred payments warranted a separate automated system to monitor deferred payments. He added, however, that IRS is developing a

capability to monitor receipts of deferred payments as part of an automated system being designed and tested by IRS' Southwest Region to gather and compile program data on the Offer in Compromise Program. We believe the Southwest Region's automated system, if made available to all service centers, will reduce inefficiencies associated with manual monitoring.

The Effect of the Offer Program on Overall Compliance

Although IRS' Offer in Compromise Program is designed to be used only when it is unlikely that IRS will ever collect the full liability, the fact that IRS is settling for less than the full liability raises a fairness issue that could affect overall voluntary compliance. While it is too early to determine what reaction the general taxpaying population will have to the expanded use of offers, IRS needs to be mindful of the possibility that the program could adversely affect voluntary compliance.

We have no data to indicate what effect IRS' increased compromising of tax debts will have on voluntary compliance, but several people involved in collecting debts have raised concerns about settling debts for less than the full amount. In August 1993, a state tax official questioned whether IRS' increased willingness to compromise tax debts may make taxpayers more willing to incur such debts. Our contacts with private sector companies involved in collecting debts also raised concerns over the potential adverse effects that compromising debts could have on other debtors. One private sector official stated that his company rarely settled accounts for less than the full amount owed because of the potential adverse effect it may have on other debtors.

Congress recognized the potential fairness and equity issues linked to offers in compromise and, as part of the program, required under section 6103 of the Internal Revenue Code that the names of the taxpayers whose debts are compromised, the amount of debt compromised, and the amount accepted by the government be made public information. We believe that public disclosure is important to ensure that information is available to alleviate any concerns about fairness and equity. It is important that IRS continue to publicly disclose information that fully supports its position that compromising tax debts is in the best interest of the government and taxpaying public.

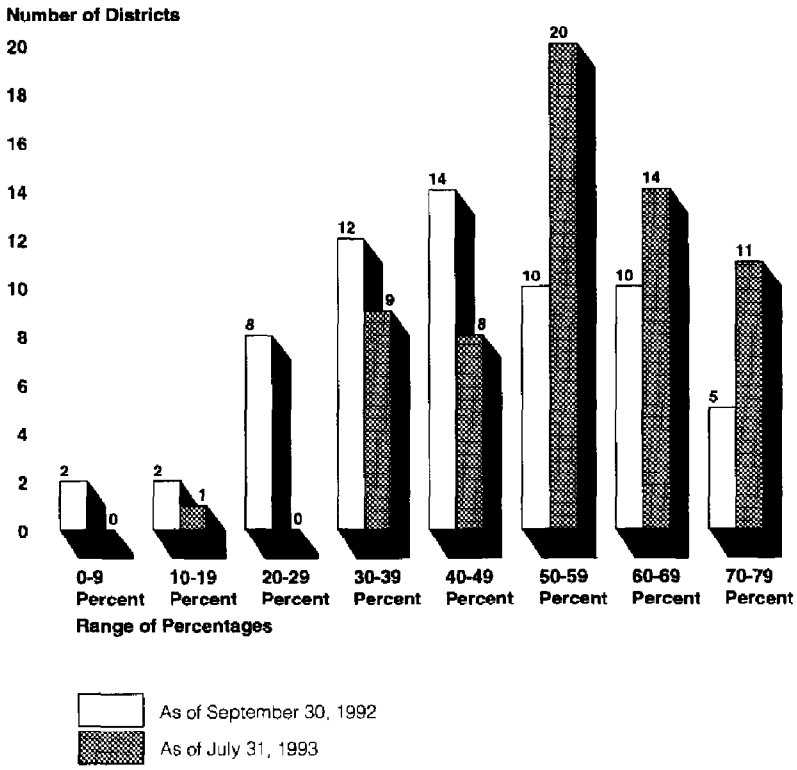
Acceptance Rates Vary Among District Offices and Debt Recovery Varies by the Type of Taxpayer

According to IRS reports, wide variability occurred in the rates at which offers were accepted among the district offices. This variability occurred despite IRS' clarification of its policy and procedures for accepting offers. Also, we found that the amount of taxes paid varied by the type of taxpayer.

Offer Acceptance Rates Vary Among the District Offices

IRS' district offices have experienced wide variability in acceptance rates since the compromise program was revised. In fiscal year 1992, district office acceptance rates ranged between 3 percent and 79 percent. For the end of the July 1993 reporting period, acceptance rates ranged between 17 percent and 79 percent. Figure 1 shows the number of district offices whose acceptance rates fell within certain ranges. Appendix I lists offer acceptance rates for each district office.

Figure 1: IRS District Offices' Acceptance Rates



Source: IRS Reports on Offer in Compromise Activity (No. 5000-108) for fiscal year ending 1992 and as of July 31, 1993.

To determine the reasons for acceptance rate variability among district offices, we reviewed a sample of 60 rejected offers from 14 IRS district offices. Among other things, we assessed whether the districts followed IRS' procedures in deciding to reject the offer. We did not identify any differences that would explain the wide variations. Each district appeared to be following IRS' requirement that an offer amount equal or exceed a taxpayer's net realizable equity.

We also interviewed officials from 12 IRS district offices with higher acceptance rates (rates ranging between 30 and 68 percent in fiscal years 1990 and 1991) and lower acceptance rates (rates ranging between 2 and 19 percent in fiscal years 1990 and 1991) concerning offer acceptance practices. Officials from three district offices with lower acceptance rates

said that in the past they tended to be more cautious about the offer program as a collection tool. They stated that at least until IRS' new policy came into being, they or their predecessors tended to view the program as a "give away" program, and they had concerns about how taxpayers who normally pay their taxes in full perceive IRS settling a tax debt for less than the full amount owed. A high proportion of "frivolous" offers or offers from taxpayers and/or tax practitioners who did not understand the program's requirements was also cited as a reason for lower acceptance rates in some districts. Officials from districts with high acceptance rates told us that the offer program was a valuable collection tool in terms of giving taxpayers a fresh start and collecting additional revenue. Officials from both higher and lower acceptance rate districts agreed that the recently issued policies and procedures clarified IRS' expectations regarding administration of the revised offer program.

Proportion of Tax Debt Paid Differs by the Type of Taxpayer and Type of Tax

Our 120 case studies showed that the amount of debt paid generally related to the type of taxpayer and the type of tax. Business taxpayers, who usually owed employment taxes, paid a larger percentage of the tax debt involved than individual taxpayers. Businesses paid 49.2 percent of their tax debts (the tax liability plus accrued interest and penalties), while individuals paid 16.4 percent of their tax debts. Also, businesses paid almost 96.0 percent of their tax assessments (taxes without interest and penalties), while individuals paid about 39.2 percent of their tax assessments.

IRS' policy is to accept only those business offers in which the offer at least equals the original tax assessment, especially where employment taxes are involved. According to IRS officials, in certain situations IRS accepts less than the original tax assessment, but not less than the business' net realizable equity. This might occur, for example, if the business were current on other taxes or jobs would be lost if the business had to offer more money.

Another reason that individuals in our sample paid a smaller amount of their tax debts than businesses was that 40 of the 89 individuals owed trust fund recovery penalties. Their offers amounted to about 11.1 percent of their total tax debt, compared to 19.4 percent for the other individuals. These taxpayers generally relied on personal assets to pay off large tax debts incurred by businesses in which they were responsible officers, according to the case files we reviewed. Often their assets were not

sufficient to make a larger offer, and, in most cases, the business was defunct or in bankruptcy.

Table 3 shows the differences in taxes paid by type of taxpayer.

Table 3: Comparison of Tax Debt Paid by Individual and Business Taxpayers

Type of taxpayer	Original tax assessment ($000)	Total tax debt ($000)	Offer amount ($000)	Percent of original tax assessment	Percent of total tax debt
Individual taxpayers with tax debts greater than $50,000 (28 accounts)	$6,658	$20,630	$3,957	59.4	19.2
Individual taxpayers with tax debts $50,000 and under (20 accounts)	$258	$535	$167	64.7	31.2
Individuals assessed trust fund recovery penalties (40 accounts)	$6,945	$11,841	$1,316	18.9	11.1
Total individual	**$13,860**	**$33,006**	**$5,440**	**39.2**	**16.5**
Business taxpayers with tax debts greater than $50,000 (16 accounts)	$4,004	$7,776	$3,830	95.7	49.3
Business taxpayers with tax debts $50,000 and under (16 accounts)	$189	$366	$180	95.2	49.2
Total business	**$4,193**	**$8,142**	**$4,010**	**95.6**	**49.3**

Source: GAO Sample of 88 individual and 32 business offers accepted during fiscal year 1992.

Conclusions

IRS believes its revised Offer in Compromise Program is an effective means of improving taxpayer compliance while collecting more taxes. However, IRS does not have the indicators in place to measure whether the program is accomplishing these objectives. Such information is important because the program's growth may strain IRS' collection resources and because the program could adversely affect voluntary compliance if taxpayers believe the program is too liberal.

One effect of the program's growth is the added costs for IRS to investigate all taxpayer offers. In some instances, the cost to process taxpayer offers appears to exceed the amount collected. The growing workload of offers and limited collection resources have created a need to improve the efficiency of the offer program by streamlining the investigation of low-dollar cases; reducing inefficient, manual monitoring of deferred payment receipts; and providing IRS authority to determine which offers need to be reviewed by legal counsel. The latter requires a change to the tax laws.

Despite new IRS procedures to clarify its policy towards offers, IRS district offices continue to show wide variability in their offer acceptance rates. While some variability is understandable, we believe the extent is enough to require that IRS determine the causes in order to ensure consistent treatment of taxpayers.

Recommendations

To improve administration of the offer program, we recommend that the Commissioner of Internal Revenue:

- Develop the indicators necessary to evaluate the Offer in Compromise Program as a collection and compliance tool. The indicators should be based on accurate data (resolving the errors we identified) and include (1) the yield of the program in terms of costs expended and amounts collected, (2) the amount of revenues collected that would not have been collected through other collection means, (3) a measure of noncompliant taxpayers who returned to the tax system, and (4) a measure of participating taxpayers who remained compliant in future years.
- Determine the causes of variability in district office acceptance rates and, where appropriate, take steps to mitigate any inconsistent treatment of taxpayers.

Matter for Consideration by the Congress

Congress should consider amending Section 7122 of the Internal Revenue Code to remove the requirement that the Treasury General Counsel or his delegate review all offers of $500 or more and widen IRS' discretionary authority to decide which offers require review.

Agency Comments

We discussed the contents of this report with the IRS Assistant Commissioner for Collections and his staff on September 2, 1993, and included their comments where appropriate. Although IRS officials were pleased with the initial results of the revised offer program, they acknowledged that more information is needed to evaluate the program as a collection and compliance tool. IRS officials agreed that consideration needs to be given to making offer processing more cost effective by streamlining investigations and limiting the reviews of offers by the Treasury General Counsel. IRS supports current legislation being considered that would amend Section 7122 of the Internal Revenue Code to raise the review threshold to $50,000. The legislation also provides for "continuing quality reviews" of compromises from the legal perspective. We regard this as consistent with the alternative we suggested that Congress consider.

IRS officials agreed in principle that the variability in district office offer acceptance rates should be monitored; however, they did not believe this should be given a high priority because offer procedures appeared to be consistently followed throughout the district offices. We believe that consistent adherence to procedures can best be ensured by monitoring and that IRS needs to analyze the causes of variability because they can be perceived as inconsistent treatment even if they are not.

As arranged with the Subcommittee, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Commissioner of Internal Revenue and other interested parties. We will make copies available to others upon request.

Major contributors to this report are listed in appendix II. Please contact me on (202) 512-5407 if you or your staff have any questions.

Sincerely yours,

Jennie S. Stathis

Jennie S. Stathis
Director, Tax Policy and
Administration Issues

Contents

Letter		1
Appendix I District Office Acceptance Rates		24
Appendix II Major Contributors to This Report		27
Tables	Table 1: Growth in the Offer in Compromise Program—Fiscal Years 1990 to July 31, 1993	6
	Table 2: Comparison of Offer in Compromise Information from 2 IRS Reports	10
	Table 3: Comparison of Tax Debt Paid by Individual and Business Taxpayers	18
Figure	Figure 1: IRS District Offices' Acceptance Rates	16

Abbreviations

IRS Internal Revenue Service

District Office Acceptance Rates

District offices	Offers processed FY92	Offers processed FY93[a]	Offers accepted FY92	Offers accepted FY93[a]	Acceptance rate (percent) FY92	Acceptance rate (percent) FY93
National total	**9,773**	**26,439**	**4,356**	**13,997**	**45%**	**53%**
Albany	40	157	25	122	63	78
Augusta	89	96	55	63	62	66
Boston	110	282	8	117	7	41
Brooklyn	52	262	15	83	29	32
Buffalo	113	395	41	230	36	58
Burlington	16	17	10	11	63	65
Hartford	119	324	35	146	29	45
Manhattan	34	544	9	201	26	37
Portsmouth	56	105	30	58	54	55
Providence	35	104	17	71	49	68
North Atlantic total	**664**	**2,286**	**245**	**1,102**	**37**	**48**
Baltimore	211	398	83	280	39	70
Newark	96	480	49	146	51	30
Philadelphia	144	441	83	186	58	42
Pittsburgh	70	111	21	36	30	32
Richmond	236	612	85	233	36	38
Wilmington	36	56	11	34	31	61
Mid Atlantic total	**793**	**2,098**	**332**	**915**	**42**	**44**
Atlanta	347	880	179	538	52	61@
Birmingham	32	223	11	101	34	45
Columbia	57	178	26	90	46	51
Fort Lauderdale	184	1,271	62	664	34	52
Greensboro	73	653	29	416	40	64
Jackson	50	349	23	272	46	78
Jacksonville	208	1,152	63	624	30	54
Little Rock	64	193	22	125	34	65
Nashville	212	410	84	283	40	69
New Orleans	160	565	43	376	27	67
South East total	**1,387**	**5,874**	**542**	**3,489**	**39**	**59**
Cincinnati	69	199	48	123	70	62
Cleveland	87	217	63	123	72	57
Detroit	223	404	40	226	18%	56%
Indianapolis	76	188	30	84	39	45
Louisville	187	437	138	291	74	67

(continued)

District offices	Offers processed FY92	Offers processed FY93[a]	Offers accepted FY92	Offers accepted FY93[a]	Acceptance rate (percent) FY92	Acceptance rate (percent) FY93
Parkersburg	77	208	51	126	66	61
Central total	**719**	**1,653**	**370**	**973**	**51**	**59**
Aberdeen	74	116	39	69	53	59
Chicago	323	624	81	317	25	51
Des Moines	157	210	94	161	60	77
Fargo	52	112	40	88	77	79
Helena	94	125	74	94	79	75
Milwaukee	320	718	210	448	66	62
Omaha	151	133	90	77	60	58
St. Louis	357	947	270	667	76	70
St. Paul	252	835	135	612	54	73
Springfield	98	156	52	91	53	58
Mid West total	**1,878**	**3,976**	**1,085**	**2,624**	**58**	**66**
Albuquerque	93	147	46	87	49	59
Austin	182	431	49	162	27	38
Cheyenne	20	75	4	29	20	39
Dallas	487	1,037	205	391	42	38
Denver	177	319	73	132	41	41
Houston	197	421	32	178	16	42
Oklahoma City	205	481	90	253	44	53
Phoenix	173	707	5	406	3	57
Salt Lake City	98	249	52	178	53	71
Wichita	180	347	99	209	55	60
South West total	**1,812**	**4,214**	**655**	**2,025**	**36**	**48**
Anchorage	122	324	71	164	58	51
Boise	89	214	57	168	64	79
Honolulu	86	91	41	52	48	57
Laguna Niguel	426	1,596	196	264	46	17
Las Vegas	135	287	35	165	26	57
Los Angeles	318	547	99	175	31	32
Portland	166	428	101	322	61	75

(continued)

District offices	Offers processed FY92	Offers processed FY93[a]	Offers accepted FY92	Offers accepted FY93[a]	Acceptance rate (percent) FY92	Acceptance rate (percent) FY93
Sacramento	285	1,159	111	654	39%	56%
San Francisco	165	320	79	171	48	53
San Jose	309	749	131	318	42	42
Seattle	367	538	177	362	48	67
Western total	**2,468**	**6,253**	**1,098**	**2,815**	**44**	**45**
International total	**52**	**85**	**29**	**34**	**56**	**54**

[a]Through July 1993.

Source: IRS Reports on Offer in Compromise Activity (No. 5000 - 108) for fiscal year ending 1992 and as of July 31, 1993.

Major Contributors to This Report

General Government Division, Washington, D.C.

Cornelia M. Blanchette, Assistant Director, Tax Policy and Administration Issues
Robert J. McArter, Assistant Director, Tax Policy and Administration Issues
Charlie W. Daniel, Assignment Manager
Dorothy Maxwell, Secretary

Chicago Regional Office

Thomas D. Venezia, Assignment Manager

Cincinnati Regional Office

Richard C. Edwards, Evaluator-in-Charge
Deborah Y. Smith, Senior Evaluator
William E. Haines, Evaluator
Marcelline W. Kilpatrick, Evaluator
Robert I. Lidman, Issue Area Manager

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1000
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000 or by using fax number (301) 258-4066.

PRINTED ON RECYCLED PAPER

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

[redacted]

[redacted]