The Internal Revenue Service Can Improve the Estate Tax Collection Process

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INSPECTOR GENERAL
for TAX
ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

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MEMORANDUM FOR COMMISSIONER ROSSOTTI

Margaret E. Begg

FROM: for Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Internal Revenue Service Can Improve the Estate Tax Collection Process

This report presents the results of our review to assess the effectiveness of the Internal Revenue Service's (IRS) process for collecting estate taxes and to determine whether taxpayers' rights were protected during the process.

In summary, we found the IRS' process for collecting estate taxes was not effective in protecting the government's interest and in protecting taxpayers' rights. IRS employees did not take necessary actions when granting installment agreements and payment extensions. These actions included securing a bond or lien before granting installment agreements, properly evaluating payment extension requests, properly calculating and billing interest, and providing taxpayers the publication that explains their rights.

IRS employees also did not properly record or release estate tax liens. IRS records indicate that 1,270 estate accounts have tax liens against their assets even though the tax balance has been paid. In addition, the IRS computer system did not calculate the collection statute of limitations expiration correctly, causing tax amounts owed to be abated prematurely or late.

This report makes 11 specific recommendations in these areas to help increase revenue and protect taxpayer rights during the estate tax collection process. A draft of this report was provided to the IRS on February 15, 2000, with a 30 calendar day response period. However, as of the date of this report, IRS management had not provided a formal response to the draft report.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions, or your staff may call Gordon C. Milbourn III, Associate Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

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Executive Summary

Approximately 95,000 estate tax returns are filed with the Internal Revenue Service (IRS) annually totaling $17.0 billion in tax liability. Since estates usually have a significant net worth before a tax return is required, estate taxes should be collectable in most cases. However, in September 1998, there were 11,375 estate accounts with tax balances due totaling $3.2 billion. This review covered the IRS' efforts to effectively collect estate taxes while protecting the rights of taxpayers.

Results

The IRS can improve its estate tax collection processes for evaluating installment agreements and payment extensions, filing and releasing liens, and calculating the statute of limitations. Overall, weaknesses in these processes led to difficulty in collecting revenue, increased costs to administer tax laws, inaccurate records, and taxpayer burden.

Internal Revenue Service Employees Did Not Take Necessary Actions When Granting Installment Agreements and Extensions of Time to Pay

Estates may need to sell assets to pay the estate tax. To minimize taxpayer burden, the Internal Revenue Code (I.R.C.) allows estates low-interest installment agreements or payment extensions if certain requirements are met. However, the IRS did not consistently follow provisions to protect the government's interest or rights of taxpayers.

Estate Tax Installment Agreements Were Not Secured by a Bond or a Lien for the Full Term of the Agreement

An estate may elect to pay its tax liability in low-interest installments if a closely held business accounts for at least 35 percent of its assets. These installments can last for over 14 years. The I.R.C. allows the IRS to secure a bond or a lien when granting this type of installment agreement. However, the IRS offices we reviewed did not secure bonds or liens at the time these installment agreements were established. Nationwide, $1.3 billion of the $1.4 billion in tax balances (93 percent) under this type of installment agreement were not secured with a bond or lien for the full term of the agreement.

These unsecured installment agreements increase the risk that the IRS will not be able to collect the taxes. At the time of our review, the IRS was attempting to collect $177 million in overdue tax balances involving 187 defaulted installment agreements that do not have bonds or liens. The IRS has also determined that $50 million due from 252 estates with defaulted installment agreements and without bonds or liens are no longer collectable.

Requests for Extension of Time to Pay the Estate Tax Were Not Properly Evaluated

The I.R.C. allows an extension of time to pay estate taxes if the estate can show reasonable cause. However, for a sample of 243 estate accounts (totaling $182 million) that were granted payment extensions, 84 accounts (totaling $57 million) did not include enough information to demonstrate reasonable cause.

Granting payment extensions for estates that do not show reasonable cause increases the risk that the IRS may not be able to collect the taxes. At the time of our review, the IRS was attempting to collect $67 million from 338 estates that did not pay the tax by the extended due date. It has also determined $33 million is no longer collectable from 271 estates that did not pay by the extended due date.

Estates With Payment Extensions Were Not Assessed Interest

An extension of time to pay prevents penalties for late payments; however, interest continues to be assessed from the due date of the tax return. The IRS manually calculates the interest for estates with payment extensions. From a sample of 243 estates with payment extensions, $941,000 of interest was not assessed on 10 of the estates.

Estates with Extensions to Pay and Installment Agreements Were Not Properly Advised of Their Taxpayer Rights

The IRS is required by the Taxpayer Bill of Rights[1] to provide all taxpayers with a tax balance and explanation of their collection rights. When an estate is granted a payment extension or installment agreement, the IRS uses a special computer code to identify the estate. Using this computer code when processing the tax return prevents these estates from receiving a tax balance due notice with an explanation of their rights. Nationwide, 9,300 estates with payment extensions or installment agreements did not receive a balance due notice with an explanation of their rights.

Collection Employees Did Not Properly Record or Release Estate Tax Liens

The IRS can file a notice of federal tax lien with a county or state to record its interest in the assets of an estate until the tax obligation is paid. Tax liens that have been filed with a county or state on many estate accounts were not recorded properly on IRS computer systems and were not released timely.

IRS computer files indicate 1,270 estate accounts still had tax liens in effect an average of 3.6 years after the tax balance had been paid. This total may be much higher since collection cases with tax liens are sometimes not shown on any IRS computer system.

[1] Pub. L. No. 100-647, 102 Stat. 3730-3751 (1988)

The Internal Revenue Service Computer System Did Not Calculate the Collection Statute of Limitations Expiration Correctly

For a sample of 100 estate accounts reviewed, tax totaling $36.8 million on 55 estate accounts was abated prematurely by an average of 6.4 years. In addition, tax totaling $10.9 million on 31 estate accounts was abated late by an average of 4.4 years. The tax was improperly abated because a computer system had not calculated the Collection Statute Expiration Date (CSED) accurately. In many cases the CSED has since been corrected; however, some estate tax balances have not yet been reinstated. Incorrect calculation of the CSED is not unique to estates; $99.5 million in tax balances from over 10,000 non-estate accounts was also abated prematurely.

Summary of Recommendations

The IRS must apply the provisions of the law to help ensure that estate taxes are collected timely and that estates are treated equitably. To accomplish this, the IRS must ensure its records are accurate and that employees are provided guidance needed to adequately evaluate estate tax documents and requests. One action the IRS can take immediately is to reconcile liens in its case files to its information systems to ensure liens are properly recorded and released on estate accounts.

Additionally, guidance is needed to ensure that executors requesting an estate tax installment agreement provide a bond or elect a lien that lasts the full term of the agreement. Management review is also needed to help employees properly evaluate whether requests for extensions of time to pay show adequate reasonable cause. A processing change for both of these types of requests is needed so that required notices are sent to provide estates information about taxpayer rights.

Finally, the IRS needs to review the CSED computer programming to ensure all calculations are accurate, reinstate tax on accounts that have been abated prematurely, and abate the tax on accounts that are past the expiration date.

Management's Response: A draft of this report was provided to the IRS on February 15, 2000, with a 30 calendar day response period. However, as of the date of this report, IRS management had not provided a formal response to the draft report.

Objectives and Scope

Our review evaluated the IRS' estate tax collection process to determine whether the IRS efficiently collects estate taxes and protects taxpayers' rights during the process.

The objectives of this review were to assess the effectiveness of the Internal Revenue Service's (IRS) process for collecting estate taxes and to determine whether taxpayers' rights were protected during the process. To achieve these objectives, we reviewed the IRS process for:

- Granting installment agreements to estates with a closely held business and extensions of time to pay estate taxes.
- Recording and releasing federal tax liens on estate assets.
- Abating estate taxes due to the expiration of the collection statute of limitations.

We conducted fieldwork at the Brookhaven, Fresno, Kansas City, and Ogden Service Centers as well as the Illinois, Manhattan, Northern California and Rocky Mountain District Offices. The audit work was conducted from December 1998 through July 1999. This audit was performed in accordance with *Government Auditing Standards.*

Details of our objectives, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

Background

An estate tax return, Form 706, is required when the estate's assets are more than $625,000.

A United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706) is required to be filed for every deceased citizen or resident whose assets were more than $625,000. Approximately 95,000 estate tax returns are filed with the IRS annually, totaling $17 billion in tax liability.

Since estates usually have a significant net worth before a tax return is required, estate taxes should be collectable in most cases. In September 1998, however, there were 11,375 estate accounts with tax balances due totaling $3.2 billion. Of these estates, 5,194 with balances due totaling $2.3 billion were paying the tax in installments or had extensions of time to pay. The IRS had also written off $127 million as not collectable and had abated $72 million because the collection statute of limitations had expired.

Results

Improvements can be made to ensure that taxpayers' rights and the government's interest are protected.

The IRS' estate tax collection process was not effective in protecting the government's interest or in protecting taxpayers' rights. Improvements are needed for processing estate tax installment agreements and payment extensions, filing and releasing tax liens, and abating taxes when the collection statute expires.

Internal Revenue Service Employees Did Not Take Necessary Actions When Granting Installment Agreements and Extensions of Time to Pay

Estates may need to sell personal or business assets to pay the estate tax. To minimize taxpayer burden, the Internal Revenue Code (I.R.C.) allows estates low-interest installment agreements or payment extensions if certain requirements are met. However, the IRS did not consistently follow the I.R.C. provisions to protect the government's interest or taxpayers' rights.

Estate Tax Installment Agreements Were Not Secured By a Bond or a Lien for the Full Term of the Agreement

An estate may elect to pay the tax in low-interest installments if a closely held business accounts for at least 35 percent of its assets. These installments can last over 14 years. Since the estate tax lien provided by federal statute lasts only 10 years, the I.R.C. allows the IRS to secure a bond or a lien when granting this type of installment agreement. Despite this provision, the IRS did not always secure a bond or a lien.

A lien or bond was not secured on 93 percent of estates granted an installment agreement.

At the time of our review, the IRS' records showed $1.3 billion of the $1.4 billion (93 percent) tax owed by estates making installment agreements was not secured with a bond or lien for the full term of the agreement. This includes 733 estates totaling $215 million in tax balances that were past the expiration of the 10-year statutory lien. A sample of cases reviewed at selected IRS service centers confirmed that most installment agreements were not secured for the full term of the agreement. Of the 415 accounts reviewed, 380 accounts (92 percent) did not indicate that a lien or bond had been secured. In addition, 103 (25 percent) of the total accounts reviewed were past the 10-year statutory estate tax lien.

Securing a lien for the full term of the installment agreement helps to ensure that assets are not sold or borrowed upon during the life of the agreement without part or all of the proceeds being used to pay down the tax liability. Unsecured installment agreements increase the risk that the IRS will not be able to collect the tax balances. At the time of our review, the IRS was attempting to collect $177 million in overdue tax balances involving 187 defaulted installment agreements that did not have liens or bonds. The IRS had also written off as uncollectable 252 estates with defaulted installment agreements, totaling $50 million, that did not have liens or bonds.

IRS guidelines recommend securing a lien or bond at the time the installment agreements are approved.

Even in the cases when the IRS did file an estate tax lien, it was often just before the expiration of the 10-year statutory lien. These liens may no longer have the same priority on assets they would have had if filed at the beginning of the agreement. IRS guidelines recommend that the lien be secured at the time the installment agreement is approved.

Bonds and tax liens were not secured because of the lack of procedures.

Service center employees were responsible for determining whether to accept or reject installment agreements, but district office employees were required to determine whether bonds or tax liens should be secured. However, bonds or tax liens were not secured because service center employees had no procedures to notify district office employees when a determination was needed for an installment agreement.

<u>Requests for Extension of Time to Pay the Estate Tax Were Not Properly Evaluated</u>

Estates with a balance due may request an extension of time to pay if reasonable cause can be demonstrated.

Estates may extend the time for payment of estate taxes. To qualify, the estate must complete the Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes (Form 4768) and attach a statement of reasonable cause. The statement must establish why it is not possible or practical for the executor to pay the full amount of the estate tax by the due date. If an extension is granted, the estate pays only interest on the account and no penalties are charged for failure to pay the tax timely.

From a review of granted payment extensions, 34 percent did not show reasonable cause.

The IRS approved requests to extend the due date even though taxpayers had not provided a reasonable cause. We reviewed all 243 granted payment extension requests, totaling $182 million, in 4 of the 10 service centers. Of the 243 requests reviewed, 37 (15 percent) did not include a statement of reasonable cause and 47 (19 percent) did not include enough information to demonstrate reasonable cause. The 84 requests totaled $57 million in tax balances.

Extensions to pay should be carefully considered because it is often more difficult to collect the tax at a later date. At the time of our review, the IRS was attempting to collect a total of $67 million in overdue tax balances from 338 estates that were past the extended payment due date. The IRS had discontinued collection activity on 271 estate accounts (totaling $33 million) that did not pay by the extended payment due date. These accounts were determined to be no longer collectable.

Employees granting payment extensions lacked managerial review and approval.

Managers in the service centers had not conducted reviews and approved requests for payment extensions as required. Instead, managers had delegated approval responsibility to their employees. However, the managers did not properly review and approve the extensions granted by employees.

Estates With Payment Extensions Were Not Assessed Interest

While an extension of time to pay prevents penalties from being assessed for late payments, interest continues to be assessed from the due date of the tax return. The interest must be calculated manually on these tax accounts. IRS employees did not calculate interest assessments accurately on some accounts with payment extensions. For the 243 extensions reviewed, $941,000 of interest was not assessed on 10 of the estates.

Interest on payment extensions is billed yearly, usually 30 days prior to the due date of the extension. The service centers should receive a notice and establish a filing system in chronological order to remind them that billing is due on the account.

The lack of managerial review also caused $941,000 of interest to not be assessed.

At one service center, an employee had not been properly trained on this procedure. Another service center had not established the proper filing system to monitor accounts to assess interest. In addition, at the service centers we reviewed, managers had not been sufficiently involved in reviewing these cases.

Estates with Extensions to Pay and Installment Agreements Were Not Properly Advised of Their Taxpayer Rights

Settlement notices should be sent out to all taxpayers with balance due accounts. Enclosed in these settlement notices is Your Rights as a Taxpayer (Publication 1), which provides taxpayers an explanation of their rights as required by the Taxpayer Bill of Rights.[1]

Over 9,300 estate accounts did not receive a settlement notice prior to an installment agreement or payment extension.

The IRS has a special status code for estate accounts requesting an extension to pay or an installment agreement. The IRS service centers were immediately assigning the status code to these accounts upon receipt of the return or request and not allowing normal processing to issue the publication explaining taxpayer rights. Over 9,300 estates identified did not receive the required publication.

Recommendations

1. Collection and service center management should assign the responsibility for determining whether a bond or tax lien should be secured to the service center employees who process the installment agreements, instead of to the district offices. Management should also ensure that procedures require the determination and the securing of bonds or liens before installment agreements are accepted.
2. Service center management should review and approve all requests for payment extensions. The review should ensure the estate has demonstrated reasonable cause before granting the extension.
3. Service center management should conduct reviews to ensure that employees use the prescribed filing system needed to monitor, assess, and bill estates with payment extensions.

[1] Pub. L. No. 100-647, 102 Stat. 3730-3751 (1988)

4. Service center management should develop procedures to ensure estates requesting installment agreements or payment extensions are sent a settlement notice and Publication 1 explaining their taxpayer rights. The special status code for estates should not be used until the proper notification has been sent and the installment agreement or extension request has been granted.

Management's Response: Management's formal response to the draft report was not available at the time this report was released.

Collection Employees Did Not Properly Record or Release Estate Tax Liens

The IRS can file a notice of federal tax lien with a county or state to record its interest in the assets of an estate until the tax obligation is paid. Failure to release the liens after the tax is paid could result in litigation against the government and considerable burden to estates attempting to sell or borrow on assets.

The IRS uses the Automated Lien System (ALS) to automatically file, record, and release tax liens. Information on the ALS is used to update estates' tax accounts. Nonetheless, tax liens that have been filed with a county or state on many estate accounts were not recorded properly on IRS computer systems and were not released timely.

A review of IRS computer files indicated that many liens were not recorded properly.

We compared information on the ALS to information in estates' tax accounts and found the following differences indicating that liens had been improperly recorded:

- 1,382 tax liens on the ALS were not recorded on the estates' tax accounts.
- 1,499 estates were charged lien fees although no tax liens were recorded on the tax accounts.

- 1,074 estates with tax liens recorded on tax accounts were not charged lien fees that could cost the government $10,700.

Problems with the recording of liens have also led to significant delays in releasing liens. IRS computer files indicate that 1,270 estates still had tax liens in effect an average of 3.6 years after the tax balance had been paid. These liens are long overdue for release.

Many more tax liens may not be recorded or released because they were not shown on any computer system.

The problem may be even greater than indicated above because we found tax liens that had not been recorded on any IRS computer systems. In 4 district offices, we randomly selected a sample of 487 case files from a total of 2,463. This sample had 168 tax liens that had not been recorded on the estate account or on the ALS. In addition, 22 of these unrecorded tax liens should have been released.

This problem occurred because responsible managers had no procedure for reconciling liens on the ALS with lien information on estates' tax accounts. In addition, some employees were not aware that the ALS could be used to record all types of estate tax liens.

Recommendations

5. Collection management should instruct managers and employees to conduct a 100 percent review of all current estate cases to ensure active tax liens are input to the ALS, tax liens and lien fees are properly reflected on the taxpayer accounts, and all tax liens are released on accounts that have no tax obligation.
6. Collection and Information Systems (IS) management should develop procedures to periodically reconcile tax liens on the ALS with information shown on the taxpayer accounts.
7. Collection management should clarify procedures to employees that all estate tax liens should be recorded on the ALS.

Management's Response: Management's formal response to the draft report was not available at the time this report was released.

The Internal Revenue Service Computer System Did Not Calculate the Collection Statute of Limitations Expiration Correctly

Generally, the length of time the IRS has to collect tax is limited to 10 years from the date of assessment. There are factors that extend the length of time for collecting estate tax, including installment agreements, payment extensions, litigation, and bankruptcy.

A total of $36.8 million on 55 estate accounts was abated prior to the expiration of the collection statute.

To determine if estate tax was abated timely, we reviewed the 100 highest dollar accounts from a computer extract of 902 estate tax accounts with abatements due to the expiration of the Collection Statute Expiration Date (CSED). Our sample represented $56 million of the $72 million that had been abated.

The IRS abated taxes prematurely in some cases and late in others because the CSED had been calculated incorrectly. The following table summarizes our results.

Accounts Abated Because the Statute of Limitations Expired

Status of Abated Amount	Number of Estates	Statute Abatement Amount	Average Difference from the Correct CSED
Should be reinstated	26	$21.8 million	5.9 years
Too late to reinstate	12	$6.9 million	3.2 years
Already reinstated	17	$8.1 million	9.6 years
Total Premature Statute Abatements	55	$36.8 million	6.4 years
Total Late Statute Abatements	31	$10.9 million	4.4 years
Total Correct Statute Abatements	14	$8.3 million	
Review Total	**100**	**$56.0 million**	

Source: *IRS Masterfile*

The IRS should reinstate $21.8 million in estate taxes because of improper collection statute abatements.

Because many of the accounts with prematurely abated taxes still have not been reinstated, there is significant potential for loss of revenue. From the above sample, 26 estates, totaling $21.8 million, had improper collection statute abatements in which the balances should be reinstated on the accounts. Although the IRS will not likely be able to collect this entire amount, it can minimize loss of revenue by attempting to collect as much as possible from these and similar accounts.

Inequitable taxpayer treatment could result from the IRS not properly administering the statute of limitations for collection.

In addition, tracking the collection statute of limitations improperly can negatively impact taxpayer rights and cause inequitable taxpayer treatment. Estates with late statute abatements were subject to the collection process for a much longer period than allowed by law. In our sample, 31 estates, totaling $10.9 million, were abated after the statute time period had expired. On average, abatements happened over four years after the correct collection statute date.

Over 10,000 non-estate accounts with $99.5 million in tax balances were abated prematurely.

Because of concerns regarding collection statute abatement of estate taxes, we analyzed non-estate accounts to determine if abatements were correct for these types of accounts. Based on IRS computer records, over 10,000 non-estate accounts with $99.5 million in tax balances were also abated prematurely. Of this amount, 789 accounts with $5 million can be reinstated because they have not yet reached the actual statute of limitations.

The problems with incorrect estate collection statute abatements were caused by several factors:

- Computer computations failed to properly account for installment agreements and litigation that should have extended the period to collect the tax.
- The IRS made a programming change in January 1999 that recomputed and corrected some of the CSED computations. However, the programming did not reinstate tax amounts that had not yet reached the correct statute expiration date.

- Guidelines requiring a review of accounts with expired CSEDs were not followed. Personnel in four service centers and four districts indicated that a computer listing of accounts with current collection statute abatements was not reviewed due to other priorities.
- According to the earliest CSED, estate accounts that have multiple assessments with different collection statute dates were not identified for partial abatements. Instead, the total balance due amount was abated according to the last CSED. Not only were tax balances overstated, but interest and penalty calculations were also incorrect because they were based on amounts that should have been partially abated.

Recommendations

8. Collection and IS management should coordinate to review the collection statute abatement programming for accurate CSED calculations. The program should specifically check for calculations related to installment agreements and litigation. In addition, the corrected program should be used to recalculate CSEDs for all estate accounts to ensure correct collection statute dates.
9. Collection management should ensure tax is properly reinstated, including recalculation of penalties and interest, for accounts abated prematurely. Not only will this resume any necessary collection enforcement action, it will also correct IRS financial accounts.
10. Collection and service center management should ensure all estate tax accounts with collection statute abatements are manually reviewed to verify or correct CSED calculations.
11. Collection and IS management should coordinate to develop a procedure to identify accounts with multiple assessments and collection statute dates to

ensure partial abatements occur when the earliest CSED is reached.

Management's Response: Management's formal response to the draft report was not available at the time this report was released.

Conclusion

The IRS needs to improve guidance and controls governing the estate tax collection process.

The IRS can take action in several areas to improve its estate tax collection process and to protect taxpayers' rights during the process. These actions include the following:

- Taking the proper steps up front when processing installment agreements and payment extensions to avoid the need for later estate tax collection enforcement action.
- Ensuring estate tax liens are properly recorded and released timely.
- Reviewing tax abatements due to the collection statute of limitations to ensure the abatements do not occur prematurely or late.

The recommendations in this report should help the IRS improve its estate tax collection process by increasing revenue and reducing enforcement costs, inaccurate records, and taxpayer burden.

Appendix I

Detailed Objectives, Scope, and Methodology

Our objectives were to assess the effectiveness of the Internal Revenue Service's (IRS) process for collecting estate taxes and to determine whether taxpayers' rights were protected during the process. We obtained nationwide computer extracts of estate information from the IRS' Masterfile and the Automated Lien System (ALS). We compared a sample of Masterfile data to account transcripts to validate the accuracy of this extract.

In addition, we reviewed estate procedures and cases at the Brookhaven, Fresno, Kansas City, and Ogden Service Centers as well as the Illinois, Manhattan, Northern California, and Rocky Mountain District Offices.

To evaluate the IRS' estate collection processes, we:

I. Reviewed the IRS process to establish and monitor tax installment agreements for estates with closely held businesses under Internal Revenue Code (I.R.C.) § 6166. To accomplish this, we:

   A. Analyzed the Masterfile containing estates that elected an installment agreement involving a closely held business.

   B. Obtained national guidelines from the I.R.C., IRS manuals, and the United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706) instructions for granting and monitoring estates that elected an installment agreement involving a closely held business, including guidelines for making a lien or bond determination.

   C. Reviewed the procedures at four service centers for granting and monitoring estates that elected an installment agreement involving a closely held business, including procedures for making a lien or bond determination. We also selected a statistical random sample of 415 cases from the 2,636 open cases in the 4 service centers to compare their procedures to current operations.

   D. Reviewed the procedures at four district offices for granting and monitoring estates that elected an installment agreement involving a closely held business, including procedures for making a lien or bond determination.

II. Reviewed the IRS process to establish and monitor estates with extensions of time to pay under I.R.C. § 6161. To accomplish this, we:

A. Analyzed a computer extract from the Masterfile containing estates that elected an extension of time to pay.

B. Obtained national guidelines from the I.R.C., IRS manuals, and the Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes (Form 4768) instructions for granting and monitoring estates that elected an extension of time to pay. This included guidelines for making a lien or bond determination and guidelines for assessing and billing interest.

C. Reviewed the procedures at four service centers for granting extensions and monitoring estates that elected an extension of time to pay. This included guidelines for making a lien or bond determination and guidelines for assessing and billing interest. We also selected all 243 open cases in the 4 service centers to compare their procedures to current operations.

D. Reviewed the procedures at four district offices for granting extensions and monitoring estates that elected an extension of time to pay. This included guidelines for making a lien or bond determination and guidelines for assessing and billing interest. We also selected all 23 open cases in the 4 district offices to compare their procedures to current operations.

III. Determined if estates are being advised of their taxpayer rights prior to being granted an extension of time to pay under I.R.C. § 6161 or granted an installment agreement involving a closely held businesses under I.R.C. § 6166. To accomplish this, we:

A. Analyzed the above computer extract from the Masterfile containing estates that elected an extension of time to pay or an installment agreement involving a closely held business. The computer extract was reviewed to determine if notices were sent at the proper time.

B. Reviewed the I.R.C. and IRS national guidelines to determine requirements for notifying taxpayers of their rights regarding a tax balance due.

C. Reviewed the tax return processing procedures at four service centers to determine how installment agreements and payment extensions affect notices. We also selected a statistically valid random sample of 658 cases from the 2,878 open cases in the 4 service centers to compare their procedures to current operations.

IV. Determined if the IRS properly records and timely releases tax liens or bonds on estate assets. To accomplish this, we:

A. Obtained and analyzed a computer extract from the ALS involving estates. The computer extract was compared to the Masterfile computer extract for consistency between the systems in recording and releasing tax liens. We compared the computer extract data to Masterfile account transcripts and the ALS for a random sample of 130 estates in order to verify the accuracy of our computer extract.

B. Reviewed the I.R.C. and IRS national guidelines to determine when tax liens and bonds should be recorded and released on the Masterfile and the ALS.

C. Reviewed the procedures at four service centers for recording and releasing tax liens and bonds. We also selected a statistically valid random sample of 658 cases from the 2,878 open extensions of time to pay and installment agreements involving closely held businesses in the 4 service centers to compare their procedures to current operations.

D. Reviewed the procedures at four district offices for recording and releasing tax liens and bonds. We also selected a statistically valid random sample of 487 cases from the 2,463 open and closed estate cases in the 4 district offices to compare their lien procedures to current operations.

V. Reviewed estate tax abatements that occurred due to the expiration of the 10-year statute of limitations. To accomplish this, we:

A. Obtained and analyzed a computer extract from the Masterfile containing estates with abated estate tax balances because of the expiration of the 10-year collection statute of limitations.

B. Obtained national guidelines from the I.R.C. and IRS manuals for when tax balances should be abated because of the expiration of the 10-year collection statute of limitations.

C. Reviewed the top 100 estate accounts on the Masterfile where an abatement resulted from the expiration of the 10-year collection statute of limitations. The top 100 are those with the largest tax balances before the abatement occurred. These 100 cases were also used to verify the accuracy of our Masterfile computer extract.

D. Reviewed the procedures at 4 service centers and 4 district offices for reviewing abated tax balances caused by the expiration of the 10-year collection statute of limitations.

Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

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- Assistant Commissioner (Examination) OP:EX

Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Finding and recommendations:

Collection employees do not take necessary actions up front to avoid the need for later estate tax collection enforcement action. This report recommended the Internal Revenue Service (IRS) take additional steps to secure bonds or liens on long-term estate tax installment agreements, review reasonable cause criteria on payment extensions, and notify taxpayers of their rights during the collection process (see page 2).

Type of Outcome Measure:

- Increased revenue (potential and actual)
- Taxpayer rights (actual)

Value of the Benefits:

- Increased revenue by reducing defaulted installment agreements and inappropriate payment extensions. The IRS is attempting to collect $244 million ($177 million from defaulted installment agreements and $67 million from inappropriate payment extensions). It has determined that another $83 million ($50 million from defaulted installment agreements and $33 million from inappropriate payment extensions) is not collectable.
- Increased revenue by assessing interest on estate tax accounts with payment extensions. For a sample of estates with payment extensions, the IRS did not assess and bill $941,000 of interest involving 10 estates.
- Improved taxpayer rights by notifying estate tax accounts of their rights during the collection process. The IRS did not properly notify over 9,300 estates of their rights.

Methodology Used to Measure the Reported Benefits:

The benefits from reducing defaults on installment agreements and inappropriate payment extensions were obtained from a November 1998 computer extract of the Masterfile. Proper corrective action minimizes future uncollectables while maximizing revenue before defaults occur.

The assessment of $941,000 for 10 estates was identified from a review of 243 cases involving extensions of time to pay. These cases were open at the time of our visit to four service centers. We confirmed the cases and amounts with the service centers. Proper corrective action ensures assessment of interest in order for the correct revenue to be collected.

The over 9,300 estate tax accounts that did not receive proper notices were obtained from a November 1998 computer extract of the Masterfile. Proper corrective action ensures that over 9,300 accounts will receive their appeal rights timely.

Finding and recommendation:

Estate tax liens are not properly recorded or released. This report recommended that the IRS test its Automated Lien System (ALS) and reconcile liens recorded on the ALS and the Masterfile. In addition, the IRS should review manual case records to ensure liens are properly recorded and released timely (see page 7).

Type of Outcome Measure:

- Reliability of information (actual)
- Cost savings (potential)
- Taxpayer rights (actual)

Value of the Benefits:

- Improved reliability of information by reducing the number of liens that are not properly recorded on IRS information systems. The IRS showed 1,382 tax liens on the ALS that were not recorded on the estate tax accounts. The IRS charged lien fees on 1,499 estate tax accounts but did not record a tax lien.
- Cost savings by charging lien fees when appropriate. The IRS recorded tax liens on 1,074 estate tax accounts but did not charge lien fees that could cost the government $10,700.
- Improved taxpayer rights by releasing tax liens from at least 1,270 full paid estate accounts.

Methodology Used to Measure the Reported Benefits:

The 1,382 tax liens not recorded on the estate tax accounts were obtained from November 1998 computer extracts of the Masterfile and the ALS. Proper corrective action ensures the reliability of computer data for 1,382 estates.

The 1,499 tax accounts with no liens recorded were obtained from a November 1998 computer extract of the Masterfile. Proper corrective action ensures the reliability of computer data for 1,499 estates.

The 1,074 tax accounts which IRS had not charged lien fees were obtained from a November 1998 computer extract of the Masterfile. The $10,700 cost savings for lien fees that the IRS is currently absorbing is based on an average fee of $10 per lien. Proper corrective action ensures the reliability of computer data for 1,074 estates and the government is reimbursed for costs associated with tax liens.

The 1,270 liens that had not been properly released were obtained from a November 1998 computer extract of the Masterfile. Proper corrective action ensures compliance with taxpayer rights.

Finding and recommendation:

The expiration of the collection statute of limitations was not calculated correctly, causing premature and late estate tax abatements. This report recommended the IRS take additional action to correct the computer programming and to reinstate taxes that have been prematurely abated (see page 9).

Type of Outcome Measure:

- Reliability of information (actual)
- Increased revenue (potential)
- Taxpayer rights (potential)

Value of the Benefits:

- Improved reliability of information and increased revenue by reinstating taxes that had been abated prematurely. The IRS prematurely abated over 10,000 tax accounts totaling $128 million in taxes, of which 815 tax accounts totaling $26.8 million can be reinstated.
- Improved taxpayer rights by abating taxes timely when the collection statute expires. A review of tax accounts showed the IRS delayed the abatement of $10.9 million for 31 estates when the collection statute expired.

Methodology Used to Measure the Reported Benefits:

The over 10,000 tax accounts totaling $128 million in taxes and the 815 tax accounts totaling $26.8 million that can be reinstated were obtained from 2 computer extracts of the Masterfile. The first Masterfile computer extract in November 1998 identified 902 estates with tax abatements due to the collection statutory limit. From a sample of 100 estates with the largest tax abatements, we identified 38 estates totaling $28.7 million that were prematurely abated and not already reinstated. Of these estates, 26 totaling $21.8 million could be reinstated. The second Masterfile computer extract in April 1999 contained non-estates with tax abatements due to the collection statutory limit. We analyzed the extract to determine over 10,000 non-estates totaling $99.5 million were prematurely abated. Of these non-estates, 789 accounts totaling $5 million could be reinstated. Proper corrective action ensures the reliability of computer data for over

10,000 records and potentially increases revenue by reinstating $26.8 million on tax accounts for collection enforcement action.

The 31 estates totaling $10.9 million in taxes were obtained from a November 1998 computer extract of the Masterfile. The extract identified 902 estates with tax abatements due to the collection statutory limit. From a sample of 100 estates with the largest tax abatements, we identified $10.9 million for 31 estates that were not abated timely. Proper corrective action ensures taxpayers' rights are protected when collection statute limits expire.