

**Opportunities Exist to Improve the
Effectiveness and Efficiency of the
Automated 6020(b) Program**

March 2005

Reference Number: 2005-30-053

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

March 31, 2005

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Pamela J. Gardiner

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Opportunities Exist to Improve the
Effectiveness and Efficiency of the Automated 6020(b) Program
(Audit # 200330032)

This report presents the results of our review of the Internal Revenue Service's (IRS) Automated 6020(b) Program. The overall objective of this review was to determine whether the IRS is effectively using the Automated 6020(b) Program to improve filing compliance among business taxpayers. Internal Revenue Code (I.R.C.) Section (§) 6020(b)¹ provides the IRS with the authority to prepare and process certain returns for a nonfiling business taxpayer if the taxpayer appears to be liable for the return, the person required to file the return does not file it, and attempts to secure the return have failed.²

In summary, the IRS consolidated its Automated 6020(b) Program operations into one location in 2002 and works only employment tax returns. For Tax Year 2001, the IRS estimated the gross tax gap³ attributable to the underreporting and underpaying of employment taxes was \$73.3 billion. However, the IRS has not extensively used the Automated 6020(b) Program to address filing noncompliance throughout most of the past decade due to various organizational changes, programming problems, and funding issues. The number of direct hours the IRS applied to the Automated 6020(b)

¹ I.R.C. § 6020(b) (2004).

² I.R.C. § 6020(b) also gives the IRS authority to prepare individual income tax returns. The Automated Substitute for Return Program prepares delinquent individual income tax returns based on information documents received from employers and financial institutions reporting wages, dividends, interest, nonemployee compensation, and other types of income.

³ The gross tax gap is the difference between the taxes taxpayers owe the Federal Government and the amount of taxes they voluntarily pay. The tax gap totals are for all taxpayers, as the IRS did not estimate the amount for employment tax nonfilers.

Program steadily declined from a high of 43,209 in Fiscal Year (FY) 1993 to a low of 1,151 in FY 2001 before increasing to 1,309 in FY 2002. The number of direct hours applied increased to 6,542 in FY 2003 after the Automated 6020(b) Program was centralized at the Ogden Campus.⁴ The amount of taxes assessed by the Automated 6020(b) Program declined from \$206.8 million in FY 1998 to \$3.6 million in FY 2002. The tax assessments increased to \$60.6 million in FY 2003.

We identified four ways in which the Automated 6020(b) Program could be improved to more effectively and efficiently address filing noncompliance. First, the successful operation of the Automated 6020(b) Program remains a significant challenge for IRS management because of an outdated computer system that results in inefficient manual work processes. During the first 6 months⁵ of FY 2004, tax examiners assigned to the Automated 6020(b) Program spent 57 percent of their time (1,494 of 2,618 staff hours) working lists of rejected cases that could not be automatically downloaded from the Automated Collection System (ACS).⁶

Second, opportunities exist to expand the Automated 6020(b) Program to reduce filing noncompliance by business taxpayers. Currently, only "stand-alone" Taxpayer Delinquency Investigations (TDI)⁷ that meet a relatively narrow low-dollar criterion are assigned to the Automated 6020(b) Program. As a result, the download from the ACS for FY 2004 (through June 2004) was limited to only 26,201 tax periods of nonfiled employment tax returns. By comparison, we estimate that TDIs for approximately 562,000 tax periods of nonfiled employment tax returns were assigned to the Collection Field function (Cff)⁸ or the Queue⁹ during the same 9-month period¹⁰ and that, as of June 2004, the Queue inventory included approximately 1.7 million employment tax TDIs. In all likelihood, these included a considerable pool of stand-alone TDIs that, due to resource constraints, are unlikely to be assigned to the Cff and could, instead, be made available for the Automated 6020(b) Program. In addition to the authority to prepare various types of employment tax returns, I.R.C. § 6020(b) gives the IRS the authority to prepare excise tax returns.¹¹ Although the IRS previously used this

⁴ The campuses are the data processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts. A campus is organized into three functions: Submission Processing, Accounts Management, and Compliance Services.

⁵ This excludes the 6-week period from November 23, 2003, through January 3, 2004, when documentation was not available.

⁶ The ACS is a computerized inventory system that maintains certain balance due accounts and return delinquency investigations. The ACS function attempts to resolve these cases by contacting the taxpayers by telephone.

⁷ A TDI involves a taxpayer who has not filed a required tax return. A stand-alone TDI is one for which there are no Taxpayer Delinquent Accounts (i.e., balance due accounts) involving the same taxpayer.

⁸ The Cff is the unit consisting of field employees who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled tax returns.

⁹ The Queue is an automated holding file for lower-priority cases.

¹⁰ The estimate is based on the Treasury Inspector General for Tax Administration analysis of Collection Activity Reports (CAR). The CARs are IRS management information reports that provide information about Collection function inventory and disposition.

¹¹ Excise tax returns include the Heavy Highway Vehicle Use Tax Return (Form 2290) and the Quarterly Federal Excise Tax Return (Form 720).

authority, only employment tax returns have been worked since the Automated 6020(b) Program was centralized at the Ogden Campus in 2002.

Third, overstated unemployment tax assessments on IRS-prepared returns can result in unnecessary burden for the employers as well as unnecessary work and unfavorable publicity for the IRS. During the period October 1, 2002, through December 31, 2003, these formulas resulted in overstated tax assessments on 36 of 47 substitute unemployment tax returns prepared by the IRS for which the proposed tax was \$20,000 or more.¹² The unemployment taxes assessed by the Automated 6020(b) Program averaged \$126,716 for these 36 cases. By comparison, the unemployment taxes reported on the prior year and subsequent year returns filed by these 36 employers averaged only \$3,758 and \$5,474, respectively, per return.

Finally, improvements are needed to ensure undelivered mail is worked before tax assessments are made. We reviewed undelivered tax proposal letter packages for 28 taxpayers covering 76 tax periods and found that, for 57 of the 76 tax periods, the time period to respond to the initial letters had expired, and the IRS had processed the Automated 6020(b) Program returns before the undelivered mail was reviewed and worked.

To improve the effectiveness and efficiency of the Automated 6020(b) Program for addressing filing noncompliance by business taxpayers, we recommended the Commissioner, Small Business/Self-Employed (SB/SE) Division, replace the computer system supporting the Automated 6020(b) Program with one that interfaces with the ACS and the Integrated Data Retrieval System (IDRS)¹³ or one that receives its inventory directly from the IDRS, raise the dollar criterion for assigning stand-alone TDIs to the Automated 6020(b) Program to pick up additional cases that may otherwise remain indefinitely in the Queue, modify the programming for the Automated 6020(b) Program system to add TDIs involving nonfiled excise tax returns, evaluate the computation used for assessing proposed Federal unemployment tax assessments, and revise the Mail Routing Guide to provide specific instructions for the handling and routing of undelivered mail for the Automated 6020(b) Program.

Management's Response: The Commissioner, SB/SE Division, concurred with the recommendations. The Commissioner, SB/SE Division, recognized the gains that can be achieved by the Automated 6020(b) Program system having interface with the IDRS and ACS. The Commissioner has submitted systemic change requests regarding this concern, and these changes will be operational in 2006. The Commissioner will explore additional opportunities to increase the cases worked by the Automated 6020(b) Program, which could include raising the dollar level of risk-based criteria for stand-alone TDIs as well as adding excise tax returns. The Commissioner evaluated the computation used by the Automated 6020(b) Program for assessing Federal

¹² The audit team used "total tax of \$20,000 or more" as its dollar criteria for identifying the 47 substitute unemployment tax returns prepared by the IRS.

¹³ The IDRS is a system which enables IRS employees to have instantaneous visual access to certain taxpayer accounts.

Unemployment Tax Act¹⁴ taxes and found that basic systemic calculations, using a Last Period Satisfied liability to determine taxable wages, are accurate. The Commissioner has revised the Mail Routing Guide to include specific instructions for handling and routing undelivered mail.

While the Commissioner, SB/SE Division, agreed with our recommendation to raise the dollar criterion for assigning stand-alone TDIs to the Automated 6020(b) Program to pick up additional cases, the Commissioner disagreed with our outcome measure. The Commissioner stated that, although the Automated 6020(b) Program could create a potential increase in revenue, the Program's primary goal is to encourage taxpayers to file outstanding returns or determine whether a tax liability exists. The Commissioner does not agree with the outcome measure because the potential assessment may not equate to the concomitant amount of additional revenue collected. Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment: Regarding the recommendation to raise the dollar level of the risk-based criteria for stand-alone TDI cases to increase the workload coming into the Automated 6020(b) Program, we agree the Automated 6020(b) Program is not intended to create revenue. However, our analysis showed that increasing the administratively set dollar ceiling would increase the number of cases coming into the Automated 6020(b) Program, which would potentially result in an increase in revenue.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Philip Shropshire, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs), at (215) 516-2341.

¹⁴ 26 U.S.C. §§ 3301-3312 (2003).

**Opportunities Exist to Improve the Effectiveness and Efficiency
of the Automated 6020(b) Program**

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Background

Federal law requires employers to withhold Federal income taxes and Social Security and Medicare taxes from their employees' wages. Employers are also generally required to pay a matching amount of Social Security and Medicare taxes on behalf of each employee. On a monthly or semiweekly basis, employers must deposit the income taxes withheld and the employer and employee shares of the Social Security and Medicare taxes with an authorized depository for Federal taxes. In addition, employers are required to deposit Federal unemployment taxes on a quarterly basis. The payment of these various employment taxes provides a substantial portion of the Federal Government's budget and is a key component of the voluntary tax system.

Employers must report the employment taxes withheld from their employees on the Employer's Quarterly Federal Tax Return (Form 941). Employers are also responsible for filing the Employer's Annual Federal Unemployment (FUTA) Tax Return (Form 940). Failing to file these required returns is a common method used to evade employment taxes.

For Tax Year (TY) 2001, the Internal Revenue Service (IRS) estimated the gross tax gap¹ attributable to the underreporting and underpaying of employment taxes was \$73.3 billion. In all likelihood, however, this amount substantially understates the employment tax gap because the IRS has no estimate of the unpaid taxes attributable to the nonfiling of employment tax returns, although it believes the amount is likely to be significant. An IRS study² identified approximately 5.8 million nonfiled

¹ The gross tax gap is the difference between the taxes taxpayers owe the Federal Government and the amount of taxes they voluntarily pay. The tax gap totals are for all taxpayers, as the IRS did not estimate the amount for employment tax nonfilers.

² Project Report: *Profile Report for the Employment Tax Nonfiler Market Segment*, Project 20.07, Wage and Investment Division Customer Research Group 1, dated December 2000.

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employment tax returns in 1997. Approximately 97 percent³ of these nonfiled returns were Forms 941 and 940.

When an employment tax return is not filed when required,⁴ the IRS sends one or more delinquency notices requesting the employer to file the return or explain why the return is not required. If the nonfiling condition is not successfully resolved, a Taxpayer Delinquency Investigation (TDI)⁵ is assigned to the Automated Collection System (ACS).⁶ If the TDI is not resolved through telephone calls by the ACS function, the case may be assigned to the Automated 6020(b) Program if it meets certain administratively set criteria.

Internal Revenue Code (I.R.C.) Section (§) 6020(b)⁷ provides the IRS with the authority to prepare and process certain returns for a nonfiling business taxpayer if the taxpayer appears to be liable for the return, the person required to file the return does not file it, and attempts to secure the return have failed.⁸ The Automated 6020(b) Program generates a letter to the employer providing a proposed tax assessment that is largely based on the assessed taxes on the last return filed by the taxpayer. If the taxpayer does not respond, the IRS will prepare the tax return on behalf of the taxpayer and assess the proposed taxes pursuant to its authority under I.R.C. § 6020(b).

³ Other employment tax returns are the Employer's Annual Federal Tax Return for Agricultural Employees (Form 943), Annual Return of Withheld Federal Income Tax (Form 945), and Annual Withholding Tax Return for U.S. Source Income of Foreign Persons (Form 1042).

⁴ The IRS identifies delinquent returns by making periodic computer comparisons of its record of return filings and return filing requirements.

⁵ A TDI involves a taxpayer who has not filed a required tax return.

⁶ The ACS is a computerized inventory system that maintains certain balance due accounts and return delinquency investigations. The ACS function attempts to resolve these cases by contacting the taxpayers by telephone.

⁷ I.R.C. § 6020(b) (2004).

⁸ I.R.C. § 6020(b) also gives the IRS authority to prepare individual income tax returns. The Automated Substitute for Return Program prepares delinquent individual income tax returns based on information documents received from employers and financial institutions reporting wages, dividends, interest, nonemployee compensation, and other types of income.

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These returns do not require issuance of a Statutory Notice of Deficiency.

To perform this audit, we interviewed IRS managers and program analysts and reviewed management information system reports and other documentation related to the operation of the Automated 6020(b) Program. Some of the data used in this report came from various IRS reports. We did not verify the accuracy of the information from those sources. This review was performed at the Small Business/Self-Employed (SB/SE) Division Headquarters office in New Carrollton, Maryland, and at the consolidated Automated 6020(b) Program Unit in Ogden, Utah, during the period January through August 2004. The audit was performed in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

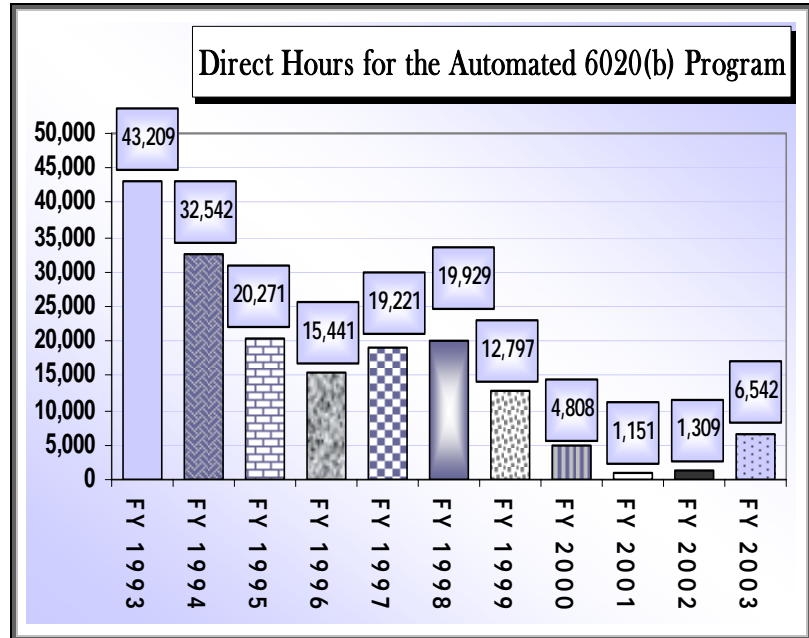
The Effectiveness of the Automated 6020(b) Program Has Been Limited by Organizational Changes, Programming Problems, and Funding Issues

Due to various organizational changes, programming problems, and funding issues, the IRS has not extensively used its Automated 6020(b) Program throughout most of the past decade to address filing noncompliance. As shown in Figure 1, the number of direct hours the IRS applied to the Automated 6020(b) Program steadily declined from a high of 43,209 in Fiscal Year (FY) 1993 to a low of 1,151 in FY 2001 before increasing to 1,309 in FY 2002. The number of direct hours applied increased to 6,542 in FY 2003 after the Automated 6020(b) Program was centralized at the Ogden Campus.⁹

⁹ The campuses are the data processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts. A campus is organized into three functions: Submission Processing, Accounts Management, and Compliance Services.

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Figure 1: Resources Applied to the Automated 6020(b) Program
FYs 1993-2003

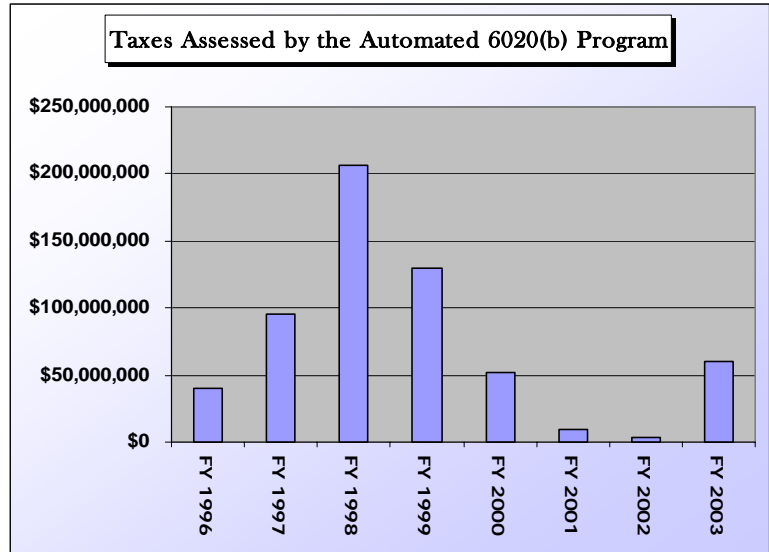


Source: Statistical reports from IRS staff.

Figure 2 shows that, as a direct result of the decline in resources, the taxes assessed by the Automated 6020(b) Program also declined from \$206.8 million in FY 1998 to \$3.6 million in FY 2002. The tax assessments increased to \$60.6 million in FY 2003.

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Figure 2: Taxes Assessed by the Automated 6020(b) Program
FYs 1996-2003



Source: Collection Activity Reports (FYs 1996-2003).

The decline in resources applied to the Automated 6020(b) Program can be attributed to various problems the IRS encountered in creating a national program. In the early 1990s, the IRS decided to create a national program in response to the need for standardization and uniformity among the 6020(b) Programs that were being locally operated in 10 campuses, formerly referred to as service centers. As part of this effort, the IRS planned to centralize the Automated 6020(b) Program at its Detroit Computing Center (DCC)¹⁰ by October 1993.

From the outset, however, the implementation of the Automated 6020(b) Program at the DCC was beset with problems. On June 10, 1995, the first 2 IRS service centers transferred their 6020(b) Program work to the DCC and, 2 weeks later, 3 additional service centers attempted to transfer their work. These attempts uncovered major programming problems, including the absence of a program

¹⁰ IRS Computing Centers support tax processing and information management through a data processing and telecommunications infrastructure. The impetus for centralizing the Automated 6020(b) Program at the DCC was the need for replacement work after the DCC had lost its payroll processing responsibilities for the IRS.

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that would calculate wages and tax assessments based on prior return information.

As a result, the IRS decided to move the 6020(b) Program work back to its 10 service centers and made plans to pilot a new Automated 6020(b) Program at its Philadelphia Service Center in January 1996, with implementation at the other service centers to begin the following month. However, several programming problems and print capability problems delayed implementation in the service centers for more than a year.

Because it was a very low-priority, discretionary program that did not always receive sufficient funding, the Automated 6020(b) Program was worked on an “ad hoc” basis in some service centers. One service center did not work the Program for months and, once the Program was started, the employees had no experience in Automated 6020(b) Program processing. In addition, the DCC was not applying sufficient resources to accomplish programming changes, and the Automated 6020(b) Program was shut down for an extended time until it could be made Y2K¹¹ compliant.

In January 2001, the IRS decided to consolidate the Automated 6020(b) Program at its Ogden Campus Collections Operation as part of a workload balancing strategy. The consolidation was accomplished in January 2002. A staff of 18 tax examiners was trained in October 2002, and they began working Automated 6020(b) Program cases for taxpayers nationwide in November 2002. Due to the low inventory of cases, however, the staff was reduced to 5 tax examiners on March 31, 2003.

Some of the inventory problems occurred because the ACS and the Automated 6020(b) Program computer system are not fully compatible. For example, the Automated 6020(b) Program received invalid information from the ACS that included Taxpayer Identification Numbers with alpha characters instead of the required numeric characters, cases

¹¹ Because computers were designed to recognize a change in only the last two digits of any given year, many were incapable of accurately recognizing the year 2000 (Y2K) without modifications in hardware and/or software.

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with nonexistent tax periods, and cases that were over 10 years old. The Automated 6020(b) Program also received inaccurate ACS data for a 6-week period in February and March 2004, and the weekly downloads were halted. At the end of this period, all of the cases were downloaded from the ACS.

In addition, potential Automated 6020(b) Program cases were not included with the cases sent to an outside vendor for telephone number research. Also, formatting problems occurred in December 2002 after several programs, including the Automated 6020(b) Program, were switched from one computer system to another.

Despite these problems, IRS management made adjustments to ensure the Automated 6020(b) Program was workable:

- In June 2003, manual telephone number look-ups were implemented for potential Automated 6020(b) Program cases.
- In September 2003, programming changes were made to include potential Automated 6020(b) Program cases with the ACS function cases sent to a vendor for telephone number research.
- In March 2004, procedures were changed to allow incoming cases from the ACS with no telephone numbers to be routed to the Automated 6020(b) Program Unit as an additional source of potentially workable cases.

The Automated 6020(b) Program Operations Are Hampered by Inefficient Manual Processes

The Automated 6020(b) Program resides on the Inventory Delivery System (IDS). A download tape from the ACS is loaded onto the IDS after the weekly Integrated Data Retrieval System (IDRS)¹² update of the ACS. The IDS is a stand-alone system, and the download allows the IDS to maintain the most current taxpayer information available for the Automated 6020(b) Program.

An efficient Automated 6020(b) Program system would be one in which the taxes would be automatically computed and the tax proposal letters would be automatically

¹² The IDRS is a system which enables IRS employees to have instantaneous visual access to certain taxpayer accounts.

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generated for most of the incoming workload. However, this is not the case with the existing system. Instead, the operation of the Automated 6020(b) Program remains a significant challenge for IRS management because of an outdated computer system that results in inefficient manual work processes.

When the weekly download occurs, cases that do not meet the criteria for Automated 6020(b) Program processing are identified on reject lists. In addition, all new cases are identified on new accounts lists. The rejected cases and most of the new cases require manual research by tax examiners before tax proposal letters can be computer generated.

Rejected cases are researched and, if subsequently accepted by the Automated 6020(b) Program, are manually researched again

From November 24, 2003, through March 25, 2004, the total weekly inventory of rejected cases ranged from a low of 7,161 to a high of 9,353. As of March 25, 2004, there were 6,890 taxpayer entities in 2 categories of rejected cases that are considered critical because they are a source of inventory.¹³ The remaining categories of rejected cases are considered a cleanup of the ACS database.

During the first 6 months of FY 2004, tax examiners spent 57 percent of their time (1,494 of 2,618 staff hours) working the reject lists.¹⁴ The tax examiners must manually research the IDRS to identify the specific tax periods for the nonfiled returns and to evaluate wage and tax credit information to determine if there would be sufficient tax due for processing by the Automated 6020(b) Program. The tax examiners must update the IDRS if the case should be closed as not liable or update the ACS to reflect the next ACS inventory designation if there is potential tax due. Those cases with tax potential will try to load back into the Automated

¹³ Subsequent to our onsite visit in March 2004, additional tax examiners were assigned to work the reject lists. As of July 12, 2004, there were 1,762 rejected cases in the 2 critical categories.

¹⁴ This excludes the 6-week period from November 23, 2003, through January 3, 2004, when documentation was not available.

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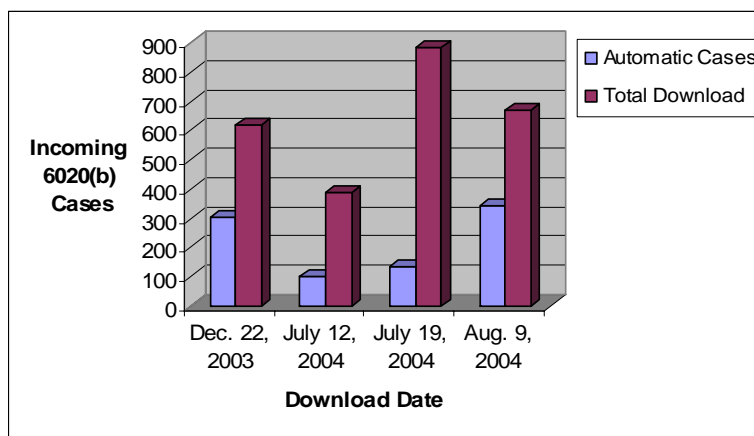
6020(b) Program in a subsequent week into a status that requires additional manual research before they are ready for computer-generated tax proposal letters to be sent to the taxpayers.

At the time we completed our review, management had requested programming changes for incoming cases as a means of filtering out some of the cases not meeting Automated 6020(b) Program requirements.

Most cases accepted by the Automated 6020(b) Program system require manual research prior to having the tax proposal letters sent to the taxpayers

In addition to the cases that reject during the weekly download from the ACS, most of the cases that successfully load onto the Automated 6020(b) Program system still require manual research. Figure 3 shows the results of the 4 weekly downloads between December 22, 2003, and August 9, 2004, for which detailed information was available. In total, only 882 (34 percent) of 2,557 cases automatically loaded into the Automated 6020(b) Program system.

Figure 3: Low Volume of Automatic Cases



Source: IRS program analyst query of the Automated 6020(b) Program system.

The “nonautomatic” cases include new accounts as well as other accounts for which the tax examiners need to research the IDRS to determine the amount of wages, analyze credits, and ensure the proposed tax is above the prescribed tolerance. The nonautomatic cases also include Power of

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Attorney (POA) cases for which the tax examiners must take additional steps to research the POA information on the IDRS and then manually enter the POA's name and address onto the Automated 6020(b) Program system. After perfecting the nonautomatic cases to make them workable, the tax examiners must then manually change the status on the Automated 6020(b) Program system so it is ready for the weekly run of tax proposal letters.

Tax proposal letters are manually researched and screened prior to mailing

Tax proposal letters¹⁵ are manually screened and researched to ensure they are accurate and are sent to only those taxpayers who still need to be reminded to file their delinquent returns. The tax examiners research the IDRS for each tax period covered in the tax proposal letter to ensure the tax returns have not been filed and processed during the last weekend update. In addition, the tax examiners research the IDRS for evidence of any balance due accounts assigned to the ACS function or to the Collection Field function (CFf);¹⁶ bankruptcy status; or conditions, such as an ongoing tax audit, that freeze activity on a taxpayer's account. If any of these conditions are found, the tax examiners are instructed to destroy the tax proposal letter and manually update the status on the Automated 6020(b) Program system.

Some computer-generated tax returns completed under the I.R.C. § 6020(b) authority show \$0 balance due and must be manually destroyed during the screening process. We were informed that this could occur if a tax examiner erroneously closed an input screen on the Automated 6020(b) Program system and proceeded to the next screen before the action was completed.

¹⁵ The tax proposal letter has enclosures which include appeal rights and computer-generated tax returns completed under the I.R.C. § 6020(b) authority for each delinquent tax period.

¹⁶ The CFf is the unit consisting of field employees who handle personal contacts with taxpayers to collect delinquent accounts or secure nonfiled tax returns.

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Additional problems provide further support for a new Automated 6020(b) Program system

Cases involving taxpayers with a POA have separate letters and labels generated for the taxpayer and the POA. However, the letter is not sent directly to the POA due to system limitations that will not allow both the taxpayer and the POA names to be printed on the same letter. To compensate, both letter packages are sent to the taxpayer with a stuffer stating, "This package has been printed in duplicate. The second copy is for your designated power of attorney." Any delays by taxpayers in forwarding the letters to their POAs lessen the time period to act before the IRS will begin processing the computer-assessed Automated 6020(b) Program return.

The database for the Automated 6020(b) Program has limits on its online query capability. In addition, the management information reports for the Automated 6020(b) Program system did not always produce correct data. At the time of our review, for example, the Management Information Summary Report understated the in-process inventory because it erroneously excluded counts from two of seven Automated 6020(b) Program work statuses. The Management Information Summary Report also had inaccurate counts of the downloaded tax module receipts from the ACS.

The IRS has not completed a security accreditation for the computer system supporting the Automated 6020(b) Program

Certification and accreditation, as defined and required by the Office of Management and Budget (OMB) for all Federal Government automated information systems,¹⁷ is a process to provide assurance that adequate security controls are in place over computer systems. Certification is the comprehensive evaluation of the technical and nontechnical security controls and the identification of any weaknesses with those controls or lack thereof. Accreditation is an authorization granted by a management official to operate the system based on the evaluation of the security controls.

¹⁷ OMB Circular A-130, *Management of Federal Information Resources*, dated February 1996.

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Systems should be certified and accredited before being implemented. Systems should also be certified and accredited at least every 3 years thereafter or when a significant change is made that affects the system, whichever occurs first.

The computer system supporting the Automated 6020(b) Program was unconditionally certified on September 26, 2002. At the time of our review in 2004, however, we were informed that the accreditation had not been completed. Because no IRS management official is accountable for the security of those systems that have not been accredited, unaccredited systems are more likely to become operational with known security vulnerabilities, thus placing the systems and their data at risk.¹⁸

Recommendation

1. To minimize the manual processes associated with the current Automated 6020(b) Program processing, the Commissioner, SB/SE Division, should replace the computer system supporting the Automated 6020(b) Program. This should be an integrated system that interfaces with the ACS and IDRS or a system that can receive inventory directly from the IDRS.

Management's Response: The Commissioner, SB/SE Division, recognized the gains that can be achieved by interfacing the Automated 6020(b) Program system with the ACS and IDRS. Several systemic change requests to address this concern have been submitted, and the changes will be operational in 2006.

Opportunities Exist to Expand the Inventory of the Automated 6020(b) Program

In addition to its I.R.C. § 6020(b) authority to prepare employment tax returns for nonfiling taxpayers, the IRS has I.R.C. authority to prepare individual income tax returns. The Automated Substitute for Return (ASFR) Program is used for this purpose. In FY 2003, there were 83,753 individual income tax cases assessed by the SB/SE Division ASFR Program – more than 7 times the

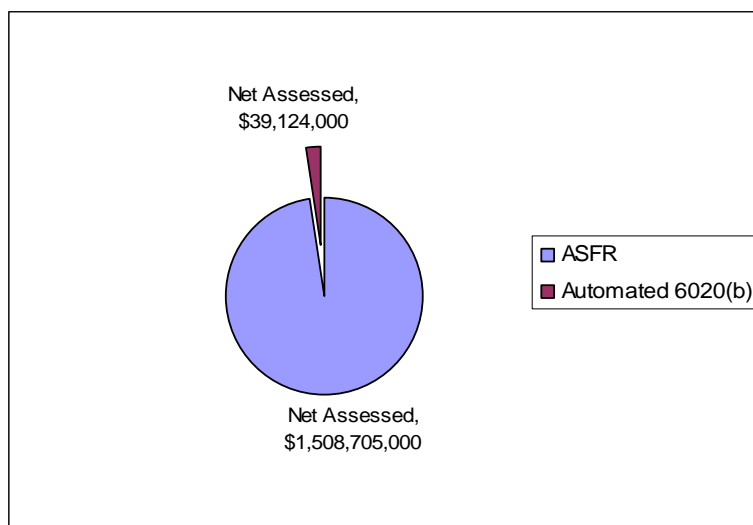
¹⁸ *The Certification and Accreditation of Computer Systems Should Remain in the Computer Security Material Weakness* (Reference Number 2004-20-129, dated August 2004).

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11,109 employment tax cases assessed by the Automated 6020(b) Program.

Figure 4 shows the SB/SE Division ASFR Program assessed \$1.5 billion in net taxes¹⁹ during FY 2003 – more than 38 times the \$39 million in net taxes assessed by the Automated 6020(b) Program. The average net tax assessment of \$18,014 by the SB/SE Division ASFR Program was also considerably higher than the average net tax assessment of \$3,522 by the Automated 6020(b) Program.

Figure 4: ASFR and Automated 6020(b) Program Comparison FY 2003



Source: Enforcement Revenue Information System,²⁰ Cycle 200417.

While these data suggest the SB/SE Division ASFR Program is a far more effective compliance tool than the Automated 6020(b) Program, it must be kept in mind that employment tax nonfilers pose particular problems because the IRS has no reliable indicator that a return is due with a predictor of the amount of tax at stake. Since there are legitimate reasons for not filing, such as termination of the business, the IRS assumes some inherent risk in expending time and resources on cases for which no return may be due.

¹⁹ Net taxes are the result of taxes assessed less taxes abated.

²⁰ A database that tracks the amount and timing of revenue from all IRS enforcement actions over time.

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

Nevertheless, we believe the IRS has opportunities to reduce filing noncompliance by revising the case creation criteria for the Automated 6020(b) Program to include higher-dollar employment tax cases that may currently be residing unworked in the Queue²¹ as well as excise tax returns.

The Automated 6020(b) Program works lower-dollar employment tax cases

When an employer does not file a return, the IRS sends one or more return delinquency notices. If the return cannot be secured or the nonfiling condition satisfactorily resolved, a TDI will be assigned for further action if the case meets the risk-level criteria developed by the IRS. These risk-level criteria, which include the dollar amount of the last filed return, were developed to identify workload for assignment to the ACS and CFf and to identify workload that should be assigned to the Queue for potential future selection by the ACS or CFf.

Currently, only “stand-alone” TDIs²² that are unresolved by the ACS and meet a relatively narrow low-dollar criterion are assigned to the Automated 6020(b) Program. As a result, the download from the ACS to the Automated 6020(b) Program system for FY 2004 (through June 2004) was limited to only 26,201 cases involving potentially nonfiled Forms 941 and 940.

Based on analysis of Collection Activity Reports (CAR)²³ for the same 9-month period of FY 2004, we estimate that TDIs for approximately 562,000 Forms 941 and 940 were

²¹ The Queue is an automated holding file for lower-priority cases.

²² A stand-alone TDI is one for which there are no Taxpayer Delinquent Accounts (i.e., balance due accounts) involving the same taxpayer.

²³ The CARs are IRS management information reports that provide information about Collection function inventory and disposition.

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

assigned to the Cff or the Queue.²⁴ Based on the CARs, we also estimate the Cff closed TDIs for Forms 941 and 940 on 299,781 tax periods during the same 9-month period.²⁵ These totals include TDIs worked in combination with TDAs for the same taxpayer, as well as stand-alone TDIs, since the CARs do not break down the TDIs by type or dollar level.

The majority of the TDI inventory resides in the ACS or the Queue, where it is unlikely to be worked due to resource constraints. Based on the CARs, we estimate the Queue inventory, as of June 2004, included 1.7 million TDIs involving nonfiled employment tax returns.²⁶

The potential tax due (based on the last return filed amount) from the stand-alone TDIs assigned to the Queue is greater than the potential tax due from the TDIs worked by the ACS function. In all likelihood, there is a considerable pool of stand-alone employment tax TDIs in the Queue that would otherwise not be assigned to the Cff and that could, instead, be made available for the Automated 6020(b) Program. By raising the administratively set dollar ceiling to increase the number of stand-alone TDIs assigned to the Automated 6020(b) Program inventory from approximately 26,000 to 98,000 cases, we conservatively estimate the IRS could reduce the employment tax gap by \$107 million per year. The number of additional tax examiners needed to work this increased inventory would bring the Automated 6020(b)

²⁴ To arrive at this estimate, we added the Cff's total TDI receipts of 263,659 to the total TDI receipts of 642,719 that were assigned to the Queue. Because cases are often assigned to the Queue and then transferred to the Cff, we subtracted the 237,134 tax periods that were transferred from the Queue to the Cff. The CARs do not break down TDI receipts by type of tax return. Therefore, we reviewed the closing codes in the CARs which showed that Forms 941 and 940 represented 84 percent of the business return TDI tax periods closed during that period. We applied this percentage to estimate the receipts of TDI tax periods for Forms 941 and 940.

²⁵ The total TDI closures for business TDIs of 380,876 were reduced by 23,994 nonwork closures (surveyed or shelved) which resulted in 356,882 TDIs. We multiplied the 356,882 TDIs by the 84 percent factor mentioned in footnote 24, which resulted in 299,781 TDIs.

²⁶ The actual total was 2,027,287 TDIs in the Queue. We multiplied this number by the 84 percent factor explained in footnote 24 to arrive at 1,702,921 TDIs.

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Program staffing back to the approximate level that was originally trained upon consolidation of the Program in the Ogden Campus. See Appendix IV for details.

The I.R.C. § 6020(b) authority could be applied to other types of business returns

In addition to the authority to prepare various types of employment tax returns, I.R.C. § 6020(b) gives the IRS the authority to prepare excise tax returns such as the Quarterly Federal Excise Tax Return (Form 720) and the Heavy Highway Vehicle Use Tax Return (Form 2290). The IRS previously used its I.R.C. § 6020(b) authority to prepare excise tax returns. Since the Automated 6020(b) Program was centralized at the Ogden Campus in 2002, however, the IRS has worked only employment tax returns.

More than \$69 billion was collected from excise tax returns in FY 2003.²⁷ The IRS estimated that 153,400 Forms 720 and 651,300 Forms 2290 would be filed in Calendar Year (CY) 2004.

Relatively little is known about excise tax filing compliance. The IRS has made no estimate of the tax gap that is attributable to the nonfiling of excise tax returns. However, an IRS study²⁸ of the excise tax nonfiler market segment, completed in June 2000, identified 206,000 returns that were not timely filed in CY 1997, including almost 16,000 nonfilings that were unresolved. Further, the study found the resolution rate²⁹ on nonfiled Forms 720 was only about 75 percent.

If the computer system that supports the Automated 6020(b) Program was replaced with a more efficient and streamlined process, there would be an opportunity to expand the

²⁷ IRS Statistics of Income Bulletin (Winter 2003-2004). In addition to the taxes collected from Forms 720 and 2290, the total collections include those from Occupational Tax and Registration Returns for Wagering (Form 11-C) and Monthly Tax Returns for Wagers (Form 730).

²⁸ Profile Report, *Excise Tax Nonfiler Market Segment*, Project 20.10, Arkansas-Oklahoma District Office Research and Analysis, dated June 15, 2000.

²⁹ The resolution rate is the percentage of nonfiler returns that were resolved by either the filing of a return or the determination that the taxpayer is not liable to file a return.

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

inventory beyond employment taxes as a means of reducing taxpayer noncompliance and the tax gap in the excise tax area.

Recommendations

To increase the impact of the Automated 6020(b) Program as a compliance tool for reducing the tax gap, the Commissioner, SB/SE Division, should:

2. Raise the dollar level of the risk-based criteria for stand-alone TDI cases as a means of increasing the workload coming into the Automated 6020(b) Program with cases that would otherwise remain unworked in the Queue.

Management's Response: The Commissioner, SB/SE Division, will review TDI case inventories to determine the potential of increasing the workload coming into the Automated 6020(b) Program. Although the Commissioner agreed the Automated 6020(b) Program could create a potential increase in revenue, the Commissioner stated the Program's primary goal is to encourage taxpayers to file outstanding returns or determine whether a tax liability exists. Therefore, the Commissioner disagreed with the potential \$534.8 million increase in revenue over a 5-year period because the potential assessment may not equate to the concomitant amount of additional revenue collected.

Office of Audit Comment: Regarding the recommendation to raise the dollar level of the risk-based criteria for stand-alone TDI cases to increase the workload coming into the Automated 6020(b) Program, we agree the Automated 6020(b) Program is not intended to create revenue. However, our analysis showed that increasing the administratively set dollar ceiling would increase the number of cases coming into the Automated 6020(b) Program, which would potentially result in an increase in revenue.

3. Modify the programming to add TDIs involving nonfiled excise tax returns (i.e., delinquent Forms 2290 and 720) to the Automated 6020(b) Program.

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

Overstated Tax Assessments Were Made on Unemployment Tax Returns Prepared by the Automated 6020(b) Program

Management's Response: The Commissioner, SB/SE Division, will review TDI case inventories involving excise tax returns to determine the potential of increasing the workload coming into the Automated 6020(b) Program. The Commissioner will also explore additional opportunities to increase the cases worked by the Automated 6020(b) Program.

Employers use Forms 940 to report Federal unemployment taxes. These taxes, with state unemployment systems, provide for payments of unemployment compensation to workers who have lost their jobs. Most employers pay both a Federal and a state unemployment tax. Only the employer pays Federal unemployment tax; it is not withheld from employee wages.

For TYs 1988 through 2003, the Federal unemployment tax rate was 6.2 percent, and only the first \$7,000 paid to each employee was subject to the tax. Generally, a credit up to 5.4 percent could be taken for amounts paid into state unemployment funds. If an employer was entitled to the maximum 5.4 percent credit, the net Federal unemployment tax rate after the credit was 0.8 percent.

The Automated 6020(b) Program relies on formulas to determine the proposed tax for nonfiled unemployment tax returns. This involves an analysis of the amount of wages reported on the unemployment tax returns that were previously filed by the employer and an analysis of any available credits for the delinquent tax period.

Generally, however, the formula used by the Automated 6020(b) Program for computing unemployment taxes simply multiplied the maximum tax rate of 6.2 percent by the entire amount of wages paid to all employees for the year. As a result, overstated unemployment tax assessments were made on some IRS-prepared returns.

We identified and reviewed all 47 cases in which employment taxes of \$20,000 or more were assessed by the Automated 6020(b) Program during the period

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

October 1, 2002, through December 31, 2003.³⁰ We found the tax assessments on 36 of the 47 IRS-prepared returns likely were far in excess of the taxpayers' actual liabilities.³¹

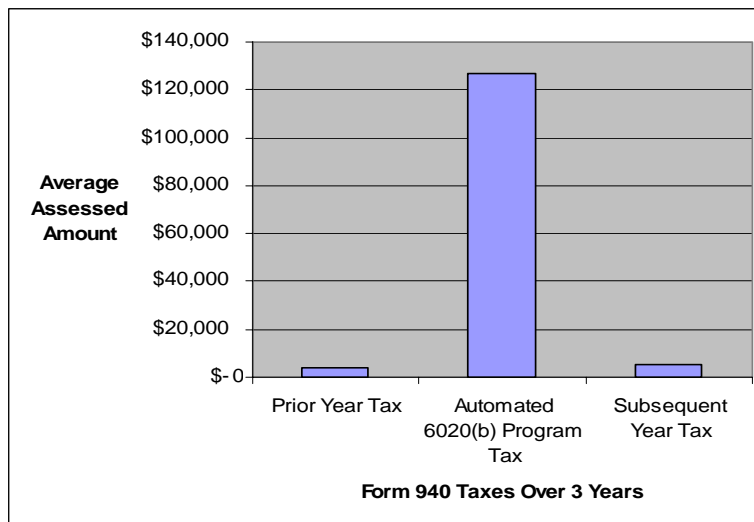
These 36 unemployment tax assessments totaled \$4,561,767 and averaged \$126,716 per return. The unemployment taxes on the prior year returns filed by these 36 employers totaled \$135,276 and averaged only \$3,758 per return. Similarly, the unemployment taxes on the subsequent year returns filed by these 36 employers totaled \$197,060 and averaged only \$5,474 per return. Figure 5 compares the unemployment taxes on the IRS-prepared returns with the unemployment taxes reported on the returns filed by these 36 taxpayers.

³⁰ The audit team used "total tax of \$20,000 or more" as its dollar criteria for identifying the 47 substitute unemployment tax returns prepared by the IRS.

³¹ The unemployment tax assessments on 11 IRS-prepared returns did not appear to be overstated. For these cases, the tax computations generally considered prior assessments, credits, and/or an inflation factor.

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

Figure 5: Comparison of Unemployment Tax Assessments - 36 Returns Prepared by the IRS and the Prior and Subsequent Returns Filed by the Employers



Source: Treasury Inspector General for Tax Administration analysis of IRS Master File³² data for 36 cases with Automated 6020(b) Program assessments of \$20,000 or more.

Overstated unemployment tax assessments on IRS-prepared returns can result in unnecessary burden for the employers as well as unnecessary work and unfavorable publicity for the IRS. At the time we completed our review, the IRS had abated the entire Automated 6020(b) Program assessments on 4 of the 36 tax returns and had abated nearly all of the Automated 6020(b) Program assessments for 14 additional tax returns. The abatements on these 18 returns totaled almost \$3.1 million and averaged nearly \$172,000 per return.

Of the remaining 18 unemployment tax assessments, 17 were in TDA status with balances due that ranged from \$12,457 to \$535,731 and averaged \$120,717. These TDAs would likely be assigned to revenue officers for enforced collection actions. The remaining unemployment tax assessment case was fully paid by the taxpayer.

³² The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

Recommendation

4. The Commissioner, SB/SE Division, should evaluate the computation used by the Automated 6020(b) Program for assessing Federal unemployment taxes to include an analysis of wages, credits, prior assessments, and the taxpayer's filing history using an inflation factor as needed.

Management's Response: The Commissioner, SB/SE Division, has evaluated the computation for assessing FUTA taxes and found that basic systemic calculations, using a Last Period Satisfied liability to determine taxable wages, are accurate. To avoid underestimating the liability amount, the IRS has developed procedures to use the total amount of wages reported on the Forms 941 as the basis of its tax assessments.

Improvements Are Needed to Ensure Undelivered Mail Is Worked Before Tax Assessments Are Made

When an Automated 6020(b) Program tax proposal letter package is returned to the IRS as undelivered mail, employees are required to check the IDRS for a different taxpayer address. If a new address is found, the original tax proposal letter package must be sent with another letter asking for verification of the new address. If a new address is not found, the taxpayer's account must be updated to show the IRS has been unable to locate the taxpayer. If the undelivered mail is received after the IRS-prepared Automated 6020(b) Program return has been processed and no new address is found, the account is closed as currently not collectible.

During March 2004, we reviewed undelivered Automated 6020(b) Program tax proposal letter packages for 28 taxpayers covering 76 tax periods. We determined that 57 IRS-prepared Automated 6020(b) Program returns had been processed for 18 taxpayers before the IRS researched the undelivered mail packages. These included:

- Fifteen taxpayers for whom the Automated 6020(b) Program returns were processed and assessed prior to the IRS research, which identified no new addresses. If the undelivered letters had been timely worked, the cases would have been closed as unable to locate and no assessments would have been made.

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

- Three taxpayers for whom new addresses were found after the Automated 6020(b) Program returns had been processed and assessed. The original tax proposal letter packages with the proposed returns were again sent to the taxpayers, but they were sent to the new addresses after the assessments had been made.

The time period for the 18 taxpayers to respond to the initial Automated 6020(b) Program tax proposal letter packages had expired, the IRS-prepared returns were submitted for processing, and the taxes were assessed. For example, the initial tax proposal letter packages for two taxpayers were mailed on September 4, 2003. Tax examiners in the Automated 6020(b) Program Unit researched lists that indicated the time period for a response had expired and there was no record that the taxpayers had sent in tax returns. As a result, the tax examiners updated the status of the cases on the Automated 6020(b) Program system on October 17, 2003, to cause copies of the IRS-prepared returns to be printed and processed. The IRS did not begin researching the undelivered Automated 6020(b) Program tax proposal letter packages until March 2004.

Mail is delivered on a daily basis to the main IRS building at the Ogden Campus where it is sorted and delivered to the other Campus buildings, including the building where the Automated 6020(b) Program Unit is located. We were unable to determine when the undelivered mail was delivered to the IRS mailroom and when the letters were routed back to the Automated 6020(b) Program Unit for research.

However, we reviewed the Mail Routing Guide and determined that it does not provide timeliness guidelines for handling undelivered mail, does not contain routing procedures for undelivered tax proposal letter packages, and does not always accurately list the appropriate mail stop for the Automated 6020(b) Program Unit.

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Recommendation

5. The Commissioner, SB/SE Division, should ensure the Mail Routing Guide contains specific instructions for the handling and routing of undelivered mail. In addition, controls should be established to ensure undelivered mail designated for the Automated 6020(b) Program Unit is properly routed to its destination.

Management's Response: The Commissioner, SB/SE Division, has taken corrective actions to address this recommendation.

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether the Internal Revenue Service (IRS) is effectively using the Automated 6020(b) Program¹ to improve filing compliance among business taxpayers.

To meet this objective, we:

- I. Determined whether the Automated 6020(b) Program is effectively designed and used to support the IRS strategies and goals to improve filing compliance and to achieve desired program results.
 - A. Reviewed the Strategy and Program Plans, the Compliance Operations Program Letter, and other relevant documentation to determine whether IRS management has developed quantifiable objectives, goals, and operational priorities for the Automated 6020(b) Program that are effectively linked to the strategic goals and mission and to the overall nonfiler strategy and/or return delinquency objectives.
 - B. Reviewed documentation and interviewed IRS management officials at the Small Business/Self-Employed Division Headquarters office and at the consolidated Automated 6020(b) Program Unit to identify program measures and determine the methods used to measure program accomplishments.
 - C. Obtained and reviewed management information reports or other documentation on Automated 6020(b) Program staffing, costs, and business results.
 - D. Evaluated the effectiveness of the case selection process for assigning cases to the Automated 6020(b) Program.
 - E. Explored methods for increasing the scope of the leads for the Automated 6020(b) Program, such as using Federal-State Agreements, and for expanding the compliance treatment to other types of business tax returns.
 - F. Evaluated Collection Reengineering and other initiatives to determine their effect on the Automated 6020(b) Program.

¹ The Automated 6020(b) Program is an IRS program authorized to prepare and process returns, under certain circumstances, for employers who are liable to file certain business returns, but have failed to do so. This Program generates a letter to the employer providing a proposed tax assessment that is largely based on the assessed taxes from the last return filed. If the employer does not respond, the Automated 6020(b) Program Unit will prepare the tax return and assess the proposed taxes pursuant to its authority under Internal Revenue Code Section 6020(b) (2004).

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

- G. Determined whether taxpayer rights are adequately protected in the Automated 6020(b) Program, the necessary security certification has been completed for the Automated 6020(b) Program, and an updated delegation order is in place.
- II. Determined whether the consolidated Automated 6020(b) Program operations are effectively and efficiently carrying out IRS policies and procedures.
- A. Evaluated the effectiveness of actions taken or planned to ensure an adequate and workable inventory of cases is available.
 - B. Reviewed lists and documentation for incoming cases that were rejected by the Automated 6020(b) Program system to determine whether there was a sufficient reason to close the nonfiler case or to determine the accuracy of the proposed Automated 6020(b) Program assessment. We selected a judgmental sample² of 30 new account cases and 30 rejected cases. The new account sample was obtained from the weekly New Account Centralized Authorization File (CAF) Research Lists dated October 13, 2003, and, November 24, 2003. The New Account sample included 17 cases with a CAF indicator and 13 cases from the New Account Research Lists dated November 24, 2003, and, January 5, 2004. The sample of 30 rejected cases was obtained from 2 priority categories: Insufficient Last Period Satisfied (ILPS) Listings for Master File Tax Code (MFT) 01 (10 cases) and ILPS Listings for MFT 10 (20 cases) that the Automated 6020(b) Program Unit worked on February 19, 2004, and March 2, 2004.
 - C. Evaluated the adequacy of the process for ensuring proposed tax assessments are correctly determined based on the best available data. To quantify the extent of the occurrences of overstated unemployment tax assessments identified during the new accounts and correspondence tests, we used the Treasury Inspector General for Tax Administration Data Center Warehouse's Business Master File³ Complete File 200353 to identify all unemployment tax assessments of \$20,000 or more⁴ made by both the Collection Field function (CFf)⁵ and the Ogden Campus⁶ to the file of Employer's Annual Federal Unemployment Tax Return (Form 940) TDI closures with unagreed Automated 6020(b) Program Ogden Campus cases.

² For tests described in this appendix, we used judgmental sampling due to resource constraints.

³ The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

⁴ The audit team used "total tax of \$20,000 or more" as its dollar criteria for identifying the 47 substitute unemployment tax returns prepared by the IRS.

⁵ The CFf is the unit consisting of field employees who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled tax returns.

⁶ The campuses are the data processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts. A campus is organized into three functions: Submission Processing, Accounts Management, and Compliance Services.

**Opportunities Exist to Improve the Effectiveness and Efficiency
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- D. Evaluated undelivered tax proposal letter packages received by the Automated 6020(b) Program Unit on March 1, 2004, through March 23, 2004, to determine the effectiveness of the process for handling undelivered tax proposal letter packages and to determine whether they are properly researched.
- E. Reviewed a judgmental sample of 30 cases (12 incoming telephone calls and 28 incoming pieces of correspondence) worked by the Automated 6020(b) Program Unit between November 20, 2003, and March 2, 2004, to determine whether the inquiries were properly addressed and timely worked.

**Opportunities Exist to Improve the Effectiveness and Efficiency
of the Automated 6020(b) Program**

Appendix II

Major Contributors to This Report

Philip Shropshire, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs)

William E. Stewart, Audit Manager

Robert A. Nicely, Lead Auditor

Cynthia Dozier, Senior Auditor

Denise M. Gladson, Auditor

Marcus D. Sloan, Auditor

**Opportunities Exist to Improve the Effectiveness and Efficiency
of the Automated 6020(b) Program**

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Director, Campus Compliance Services SE:S:CCS
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Management Controls OS:CFO:AR:M
Audit Liaison: Commissioner, Small Business/Self-Employed Division SE:S

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$107 million; over 5 years, \$534.8 million in increased net tax assessments by raising the dollar ceiling for assigning cases to the Automated 6020(b) Program¹ (see page 12).

Methodology Used to Measure the Reported Benefit:

By analyzing the weekly Management Information Summary Reports of Automated 6020(b) Program activity for Fiscal Year (FY) 2004 (through June 2004), we determined that Taxpayer Delinquency Investigations (TDI)² for 26,201 tax periods of nonfiled Employer's Quarterly Federal Tax Returns (Form 941) and Employer's Annual Federal Unemployment (FUTA) Tax Returns (Form 940) had been transferred from the Automated Collection System (ACS)³ to the Automated 6020(b) Program system during this 9-month period. We also obtained a report of the Queue⁴ inventory showing the stand-alone TDIs⁵ for employment tax returns that were not assigned for work as of September 2004. This report showed the number of stand-alone TDIs that exceeded the administratively set dollar ceiling for assignment to the Automated 6020(b) Program.

Based on analysis of the above reports, increasing the administratively set dollar ceiling by between 6 and 7 fold would make 35,267 additional taxpayer entities available to the Automated 6020(b) Program. Based on Collection Activity Reports⁶ for FY 2003, we compared the volume of tax periods assessed by the Automated 6020(b) Program to the volume of taxpayers

¹ The Automated 6020(b) Program is an Internal Revenue Service (IRS) program authorized to prepare and process returns, under certain circumstances, for employers who are liable to file certain business returns but have failed to do so. This Program generates a letter to the employer providing a proposed tax assessment that is largely based on the assessed taxes from the last return filed. If the employer does not respond, the Automated 6020(b) Program Unit will prepare the tax return and assess the proposed taxes pursuant to its authority under Internal Revenue Code Section 6020(b) (2004).

² A TDI involves a taxpayer who has not filed a required tax return.

³ The ACS is a computerized inventory system that maintains certain balance due accounts and return delinquency investigations. The ACS function attempts to resolve these cases by contacting the taxpayers by telephone.

⁴ The Queue is an automated holding file for lower-priority cases.

⁵ A stand-alone TDI is one for which there are no Taxpayer Delinquent Accounts (i.e., balance due accounts) involving the same taxpayer.

⁶ The CARs are the IRS management information reports that provide information about Collection function inventory and disposition.

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represented by those tax periods. We determined there was an average of 2.04 tax periods per taxpayer. We multiplied that average by 35,267 taxpayer entities to arrive at 71,945 tax periods. We compared the increase of 71,945 tax periods to the Automated 6020(b) Program's workload of 26,201 tax periods and determined this represented an increase of 275 percent ($71,945 \div 26,201$). According to the Enforcement Revenue Information System,⁷ the net tax⁸ assessed by the Automated 6020(b) Program for FY 2003 was \$39,124,000. Therefore, increasing the number of incoming cases by 275 percent would potentially increase the net tax assessments from the Automated 6020(b) Program by an estimated \$107,430,592 ($\$39,124,000 \times 2.7459$).

Next, we determined there were five tax examiners handling the Automated 6020(b) Program inventory during the time of our review. We project that the workload would increase by 275 percent to 98,146 tax periods ($26,201 + 71,945$). We multiplied the total of 5 tax examiners by the 275 percent increase to determine that 14 additional tax examiners would be needed to work the additional inventory. These additional tax examiners would bring the Automated 6020(b) Program staffing back to the approximate level that was originally trained upon consolidation of the program in the Ogden Campus.⁹

We determined the tax examiner entry-level (i.e., Grade 7, Step 1) salary, although availability can occur at any grade. We used the locality pay for the Ogden Campus at that grade level (\$33,071) to calculate annual salary costs of \$462,994 (14 additional examiners \times \$33,071). The projected annual net tax assessment of \$107,430,592 was then reduced by the salary costs of \$462,994, which meant the potential increased revenue per year is \$106,967,598 or \$534,837,990 over 5 years.

⁷ A database that tracks the amount and timing of revenue from all IRS enforcement actions over time.

⁸ Net taxes are the result of taxes assessed less taxes abated.

⁹ The campuses are the data processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts. A campus is organized into three functions: Submission Processing, Accounts Management, and Compliance Services.

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of the Automated 6020(b) Program

Appendix V

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

RECEIVED
MAR 28 2005

March 24, 2005

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kevin M. Brown *KMB*
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Opportunities Exist to Improve the
Effectiveness and Efficiency of the Automated 6020(b)
Program (Audit # 200330032)

We have reviewed the subject report and concur with your recommendations. We have made significant strides in improving the utility and efficiency of the Automated 6020(b) Program, and expect this progress to continue.

We recognize the gains that can be achieved by the system having interface with our Integrated Data Retrieval System (IDRS) and the Automated Collection System (ACS). We have submitted several systemic change requests to address this concern. The changes will be operational in 2006.

In the interim, we will explore additional opportunities to increase the cases worked by the Automated 6020(b) Program. This could include raising the dollar level of risk-based criteria for stand-alone Taxpayer Delinquency Investigations (TDI) cases as well as excise tax returns.

In the report, you recommended we evaluate the computation used by the Automated 6020(b) Program for assessing Federal Unemployment Tax Act (FUTA) taxes. We completed this evaluation and found that basic systemic calculations, using a Last Period Satisfied (LPS) liability to determine taxable wages, are accurate. These systemic calculations were developed prior to the implementation of the Employer's Annual Federal Unemployment Tax Return (Form 940EZ). Therefore, using the existing programming on the Form 940EZ would have the unintended consequence of affording the taxpayer a lower taxable wage amount, which could result in an underestimation of liability on the delinquent period. In order to address this issue, we developed procedures to use the total amount of wages as reported on the Forms 941 as the basis of our tax assessment.

Finally, although the Automated 6020(b) Program could create a potential increase in revenue, the program's primary goal is to encourage taxpayers to file outstanding returns or determine whether a tax liability exists. Therefore, we cannot agree with

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

2

TIGTA's assertion about the potential increase in revenue of \$534.8 million over a five year period, because the potential assessment may not equate to the concomitant amount of additional revenue collected.

Our comments on your recommendations follow:

RECOMMENDATION 1

To minimize the manual processes associated with the current Automated 6020(b) Program processing, the Commissioner, Small Business/Self-Employed (SB/SE) Division, should replace the computer system supporting the Automated 6020(b) Program. This should be an integrated system that interfaces with the Automated Collection System (ACS) and the Integrated Data Retrieval System (IDRS) or a system that can receive inventory directly from IDRS.

CORRECTIVE ACTION

We have submitted several systemic change requests to address these concerns.

IMPLEMENTATION DATE

January 15, 2006

RESPONSIBLE OFFICIAL(S)

Director, Filing & Payment Compliance, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

Program Manager, Filing Compliance, will advise the Director, Filing & Payment Compliance, of any delays.

RECOMMENDATION 2

To increase the impact of the Automated 6020(b) Program as a compliance tool for reducing the tax gap, the Commissioner, SB/SE Division, should raise the dollar level of the risk-based criteria for stand-alone TDI cases as a means of increasing the workload coming into the Automated 6020(b) Program with cases that would otherwise remain unworked in the queue.

CORRECTIVE ACTION

We will review TDI case inventories to determine the potential of increasing the workload coming into the Automated 6020(b) Program.

IMPLEMENTATION DATE

January 15, 2006

RESPONSIBLE OFFICIAL(S)

Director, Filing & Payment Compliance, Small Business/Self-Employed Division

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

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CORRECTIVE ACTION MONITORING PLAN

Program Manager, Filing Compliance, will advise the Director, Filing & Payment Compliance, of any delays.

RECOMMENDATION 3

To increase the impact of the Automated 6020(b) Program as a compliance tool for reducing the tax gap, the Commissioner, SB/SE Division, should modify the programming to add TDIs involving excise tax returns (i.e., delinquent Forms 2290 and 720) to the Automated 6020(b) Program.

CORRECTIVE ACTION

We will review TDI case inventories involving excise tax returns to determine the potential of increasing the workload coming into the Automated 6020(b) Program.

IMPLEMENTATION DATE

January 15, 2006

RESPONSIBLE OFFICIAL(S)

Director, Filing & Payment Compliance, Small Business/Self-Employed

CORRECTIVE ACTION MONITORING PLAN

Program Manager, Filing Compliance, will advise the Director, Filing & Payment Compliance, of any delays.

RECOMMENDATION 4

The Commissioner, SB/SE Division, should evaluate the computation used by the Automated 6020(b) Program for assessing Federal unemployment taxes to include an analysis of wages, credits, prior assessments and the taxpayer's filing history using an inflation factor as needed.

CORRECTIVE ACTION

We completed the evaluation and found the basic systemic calculations, using LPS liability to determine taxable wages, are correct.

IMPLEMENTATION DATE

Completed

RESPONSIBLE OFFICIAL(S)

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

Opportunities Exist to Improve the Effectiveness and Efficiency of the Automated 6020(b) Program

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RECOMMENDATION 5

The Commissioner, SB/SE Division, should ensure the Mail Routing Guide contains specific instructions for the handling and routing of undelivered mail. In addition, controls should be established to ensure undelivered mail designated for the Automated 6020(b) Program Unit is properly routed to its destination.

CORRECTIVE ACTION

Completed

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL(S)

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

If you have any questions, please call me at (202) 622-0600 or Robert L. Hunt, Director, Campus Compliance Services, Small Business/Self-Employed Division, at (202) 283-2200.