TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

High-Risk Work Is Selected From the Unassigned Delinquent Account Inventory, but Some Unassigned Accounts Need Management's Attention

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Phone Number | 202-927-7037
Email Address | Bonnie.Heald@tigta.treas.gov
Web Site | http://www.tigta.gov

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 10, 2006

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – High-Risk Work Is Selected From the Unassigned Delinquent Account Inventory, but Some Unassigned Accounts Need Management's Attention (Audit # 200430027)

This report presents the results of our review of the Internal Revenue Service's (IRS) unassigned delinquent account inventory. The overall objective of this review was to evaluate and profile Taxpayer Delinquent Accounts (TDA)[1] and Taxpayer Delinquency Investigations (TDI)[2] that either had been shelved[3] or were in the Queue[4] inventory.

Synopsis

The Collection function maintains an inventory of unassigned TDIs and TDAs in the Queue. As of April 18, 2005, there were 2.2 million TDI tax modules (tax periods) for 740,199 taxpayers in the Queue inventory. Also in the Queue, there were 2.1 million TDA tax modules for 633,602 taxpayers who had balance-due amounts totaling $23.3 billion. This represents a slight decrease for TDIs from the inventory at the end of Fiscal Year (FY) 2004, while the volume of TDAs was relatively unchanged.

TDIs and TDAs that are not likely to be assigned because of low risk scores and resource constraints are shelved. From FYs 2001 through 2004, 5.1 million TDI tax modules

[1] A TDA is a balance-due case of a taxpayer.
[2] A TDI is a case for an unfiled tax return of a taxpayer.
[3] Shelved cases are TDAs or TDIs that have been taken out of Collection function inventory because they are lower priority than other available cases.
[4] The Queue is an automated holding file for unassigned inventory. Inventory is placed in the Queue until it can be assigned as workload for Collection function employees or shelved due to lack of resources.

(2.6 million taxpayers) meeting our overall criteria were shelved. During the same time, 1.8 million TDA tax modules (934,000 taxpayers) with balances due totaling $7.8 billion were shelved. A significant number of noncompliant taxpayers with shelved cases will never be contacted to resolve collection-related issues other than through routine notices mailed to them.

Our review of accounts in the Queue and shelved accounts did not identify any large groups of high-risk inventory that are not being identified for assignment to Collection function personnel. Almost 81 percent of the business cases in the Queue involve trust fund tax[5] cases that are higher-priority workload. Conversely, almost 96 percent of the trust fund taxpayers that have shelved TDAs would not be identified as a high-risk case based on the total amount owed by the taxpayers. However, some Queue and shelved accounts warrant attention by the Collection function.

Some older[6] TDAs are maintained in the Queue. Just over 10 percent of the taxpayers have tax modules that have been in the Queue for at least 1 year, 3.5 percent have tax modules in the Queue for at least 2 years. With a constant flow of new workload to the Queue and limited field resources, it is unlikely cases that have aged in the Queue will ever be assigned for contact, especially if they do not meet another high-priority criterion.

In addition, many TDAs that have been shelved do not have Federal tax liens filed to protect the Federal Government's interest. Almost 200,000 taxpayers with balances due of $5,000 and over owe $5.1 billion, only $2.3 billion of which is protected by a lien. We raised this issue in a report dated June 2002[7] and recommended that the Commissioners Small Business/Self-Employed (SB/SE) and Wage and Investment Divisions develop a more uniform lien-filing policy to better protect the Federal Government's interest. The IRS agreed and included the issue in a research project. The project is not yet complete and the lien-filing policy on shelved accounts is pending the outcome of the project. However, while our review was ongoing, the IRS made changes in workload-selection criteria that should result in liens being filed on additional large-dollar TDAs.

The IRS shelved some TDIs without securing tax returns even though the taxpayers made large payments toward potential tax liabilities. More than 55,000 TDI tax modules that have a credit balance[8] of at least $5,000 were shelved in the last few years. About 800 of these tax modules had credit balances greater than $100,000. The credit balances, especially the larger ones, are an

[5] Trust fund taxes are employment taxes that are collected by employers from employees' wages and later deposited with the Federal Government.
[6] Generally, lower priority cases are removed from the Queue after 52 weeks unless they meet certain criteria.
[7] *The Internal Revenue Service Should Modify Its Federal Tax Lien Practices to Treat Taxpayers More Equitably and Better Protect the Government's Interest* (Reference Number 2002-30-106, dated June 2002).
[8] A credit balance on an unfiled tax return can be created when the taxpayer makes estimated payments for a potential tax liability, applies overpayments from other tax periods, makes a tax deposit when requesting an extension of time for filing a tax return, etc.

indication that the taxpayers expected to have taxable income or owe trust fund taxes for the year.

Recommendations

We recommended the Commissioner, SB/SE Division, ensure the Collection function continues to review the program that removes older cases from the Queue, establish lien-filing policies for shelved accounts, and include credit balances as a selection criterion for TDIs.

Response

The Commissioner, SB/SE Division, agreed with our recommendations. The Collection function will continue to review the automated program and has already identified several enhancements. Research project results will be used to determine and implement appropriate interim policy changes for lien filing. In addition, changes were requested to various automated systems to include credit balance amounts in the risk-based methodology. Management's complete response to the draft report is included as Appendix VIII.

Copies of this report are also being sent to IRS officials who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Curtis W. Hagan, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

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Background

Taxpayers that have not filed their tax returns or paid the full amount due on tax returns are not in compliance with Federal tax laws. The Internal Revenue Service (IRS) attempts to notify these taxpayers of their noncompliance through a combination of methods. At a minimum, this consists of routine notices sent to them through the mail. However, it can also include a telephone call and/or an in-person (field) contact. Since the Collection function is unable to work all inventory receipts with existing personnel, Taxpayer Delinquency Investigations (TDI) and Taxpayer Delinquent Accounts (TDA) are prioritized using risk scores. The risk scores are based upon a number of factors including the type of tax and amount owed. Workload is to be assigned for a telephone call and/or field contact based on the priorities. See Appendix IV for a Glossary of Terms.

The Collection function maintains an inventory of unassigned TDIs and TDAs in the Queue. The Queue inventory comes from many sources. Most of the Queue inventory is from either cases that have been assigned to Automated Collection System (ACS) personnel and not fully resolved or cases that bypass the ACS and go directly to the Queue when the delinquency was not resolved by routine notices mailed to the taxpayer.

The Queue inventory consists of prioritized cases that are not currently assigned to the Collection function and cases that will not be assigned due in part to resource constraints. These cases are mainly available for assignment to Collection Field function (CFf) personnel for in-person contact with the taxpayer. However, the cases can also be assigned to ACS personnel for contact by telephone. As of April 18, 2005, there were 2.2 million TDI tax modules (tax periods) for 740,199 taxpayers in the Queue inventory. Also in the Queue, there were 2.1 million TDA tax modules for 633,602 taxpayers who had balance-due amounts totaling $23.3 billion. This represents a slight decrease for TDIs from the inventory at the end of Fiscal Year (FY) 2004, while the volume of TDAs was relatively unchanged. See Appendix V, Figure 1, for an overview of trends in Queue tax module inventory by fiscal year.[1]

TDIs and TDAs that are not likely to be assigned because of low risk scores and resource constraints are shelved (removed from inventory). From FYs 2001 through 2004, 5.1 million TDI tax modules (2.6 million taxpayers) meeting our overall criteria (see Appendix I for criteria) were shelved. During the same time, 1.8 million TDA tax modules (934,000 taxpayers) with balances due totaling $7.8 billion were shelved. A significant number of noncompliant taxpayers with shelved cases will never be contacted to resolve collection-related issues other than through routine notices mailed to them.

[1] Many of the calculations throughout the report are affected by rounding. All initial calculations were performed using the actual numbers rather than the rounded numbers that appear in the report.

This review was performed at the Small Business/Self-Employed (SB/SE) Division National Headquarters in New Carrollton, Maryland, in the Office of the Director, Collection, during the period October 2004 through October 2005. The audit was conducted 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.

Results of Review

High-Risk Inventory Is Being Identified for Assignment to Collection Function Personnel

Our review of accounts in the Queue and shelved accounts did not identify any large groups of high-risk inventory that are not being identified for assignment to Collection function personnel. During FY 2001, the Collection function conducted reengineering projects to identify ways to make the function more efficient. The Queue inventory was studied at that time, and new risk-score and workload-prioritization criteria were implemented. As a result, collecting trust fund taxes became an even greater priority for CFf personnel. In addition, the Collection function implemented a last-in/first-out method for assigning these cases to prevent additional accumulation of unpaid taxes on subsequent tax periods. Prompt attention to trust fund taxes is necessary because these tax returns are due quarterly and tax deposits even more frequently.

Almost 94 percent of the Business Master File (BMF) TDA Queue inventory involves employment tax cases (see Appendix V, Figure 4) and about 81 percent specifically involves trust fund tax cases. As a result of the large percentage of trust fund tax accounts, approximately 67 percent of the BMF TDAs in the Queue inventory are rated as high risk by the workload prioritization process (Appendix V, Figure 6). Likewise, a large portion of the BMF TDI Queue inventory involves employment tax cases, resulting in a large percentage of high-risk TDI inventory being available for assignment (Appendix V, Figures 8 and 10).

We also determined that few high-priority TDAs are being shelved (Appendix V, Figures 14 and 15). Almost 99 percent of the Individual Master File (IMF) and 96 percent of the BMF trust fund taxpayers that have shelved TDAs would not be identified as a high-risk case for field assignment based on the total amount owed by the taxpayers. While the TDIs do receive a risk code score, the score is not available on the Master File. Therefore, we were unable to obtain risk levels for the closed TDIs.

Although high-risk work is selected from unassigned delinquent account inventories, some Queue and shelved accounts need Collection function attention:

- Some older TDAs maintained in the Queue are not likely to be assigned to Collection function personnel.
- Many shelved TDAs with large balance-due amounts do not have liens filed to protect the Federal Government's interest.
- Some TDIs were shelved without securing tax returns even though the taxpayers made large payments toward potential tax liabilities.

While our review was ongoing, the IRS took a corporate look at Collection function inventory and made some recommendations that are in various stages of implementation. These could have a positive impact on issues discussed in this report, especially on TDAs with large balance-due amounts. In addition, a Collection Governance Council has been formed that will continue to look at ways to better manage Collection function inventory and workload. Additional information regarding the concerns mentioned above and actions the IRS is taking based on these initiatives follows.

Some Older Taxpayer Delinquent Accounts Maintained in the Queue Are Not Likely to Be Assigned to Collection Function Personnel

An automated process is in place that, in general, should shelve lower-priority cases from the Queue after 52 weeks unless the cases meet other specific criteria. The CFf criteria for assignment of cases from the Queue are based on the age and type of delinquency. Cases are assigned based on a last-in/first-out methodology. This policy coincides with the long-held belief that collection potential diminishes as a case ages. In addition, the policy is to enable personnel to resolve existing delinquencies before additional delinquencies arise. With a constant flow of new workload to the Queue and limited resources, it is unlikely that older cases in the Queue will ever be assigned for contact, especially if they do not meet another high-priority criterion.

While 82 percent of the Queue TDAs (90 percent of the taxpayers) had at least 1 tax module for the taxpayer that was less than 1 year old (Appendix V, Figure 2), a significant number were more than 1 year old. Figure 1 shows the results of our analysis of the Queue inventory as of April 18, 2005. Tax modules with balances due totaling more than $3.9 billion have been in the Queue for more than 1 year and more than $1.6 billion in balances due has been in the Queue longer than 2 years. The IMF data were not limited by type of tax, but the BMF data includes only trust fund taxes.

Figure 1: Age of Queue Inventory

	In the Queue at Least 1 Year			In the Queue at Least 2 Years		
	IMF	BMF	Total	IMF	BMF	Total
Taxpayers	32,025	58,333	**90,358**	13,519	17,350	**30,869**
Percentage of Taxpayers	6.2%	15.8%	**10.2%**	2.6%	4.7%	**3.5%**
Tax Modules	120,679	207,088	**327,767**	47,334	64,611	**111,945**
Percentage of Tax Modules	11.7%	25.0%	**17.6%**	4.6%	7.8%	**6.0%**
Balance Due	$2,600,244,815	$1,361,932,950	**$3,962,177,765**	$1,190,927,427	$419,561,846	**$1,610,489,273**

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of Queue data.

As previously mentioned, a portion of the risk-level criteria includes the amount of tax owed. This is based on the amount owed per tax module and the total balance owed by the taxpayer. Based on the total balance due amount for the taxpayer, almost 64 percent of the taxpayers with accounts in the Queue more than 1 year and just over 62 percent of the taxpayers with accounts in the Queue more than 2 years would not be considered high risk.

By removing older cases from the Queue inventory that will not be assigned to Collection function personnel, management will have a better understanding of the makeup of the Queue and better information for inventory decisions.

Recommendation

Recommendation 1: The Commissioner, SB/SE Division, should ensure the Collection function staff continues to review the program for the automated process that removes cases from the Queue to ensure that it is operating properly.

> ***Management's Response*:** The SB/SE Division Collection function will continue to review the automated programming. The Commissioner, SB/SE Division, noted that several enhancements have already been identified.

Many Shelved Taxpayer Delinquent Accounts With Large Balance-Due Amounts Do Not Have Liens Filed to Protect the Federal Government's Interest

A Notice of Federal Tax Lien is recorded in the County or State in which the taxpayer has property. This protects the Federal Government's interest by publicly recording the debt owed by the taxpayer as a notice to possible future creditors. The lien attaches to property currently owned and to property the taxpayer may acquire in the future. Therefore, a lien may be filed even though specific assets have not been identified. The IRS generally requires employees to consider filing tax liens on assigned accounts when taxpayers owe $5,000 or more. Some exceptions include taxpayers in bankruptcy, out-of-business corporations, deceased taxpayers without assets, and other miscellaneous categories.

As Figure 2 shows, over 1.5 million tax modules (balances due totaling $6.2 billion) for 798,783 taxpayers were shelved between October 1, 2000 and September 30, 2004. Only $2.4 billion (38 percent) of the total amount due was protected by Federal tax liens. The percentage of shelved accounts protected with liens filed remained relatively constant for the 4 years. For accounts with a balance due of greater than $5,000, only $2.3 billion (45 percent) was protected by liens. Federal tax liens were filed for only 46 percent of the larger balance-due accounts (greater than $1 million).

For this analysis, we excluded some shelved tax modules that may have limited collection and/or lien potential.[2] The IMF tax modules include only those taxpayers that were alive (no date of death on the Master File) and between 20 and 65 years old. BMF tax modules exclude estates and include only those businesses that did not have a business-closed date entered on the Master File.

Figure 2: Shelved TDA Tax Modules and Taxpayer Accounts[3]

Balance-Due Amount	Tax Modules	Taxpayers	Total Amount Due	Amount Due With Liens	Percentage Protected
Total Shelved	1,544,375	798,783	$6.2 Billion	$2.4 Billion	38.05%
$5,000 and Over	603,671	197,337	$5.1 Billion	$2.3 Billion	45.10%
$25,000 and Over	212,838	54,277	$3.5 Billion	$1.6 Billion	45.19%
$50,000 and Over	84,441	19,665	$2.3 Billion	$1.0 Billion	44.08%
$100,000 and Over	27,272	5,741	$1.4 Billion	$619 Million	44.09%
$500,000 and Over	2,184	425	$441 Million	$201 Million	45.51%
$1 Million and Over	590	123	$231 Million	$106 Million	46.12%

Source: TIGTA analysis of Master File data.

Various TIGTA audit reports have been issued since August 2000 regarding the use of liens on accounts not in active collection status. In June 2002, we recommended that the Commissioners,

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[2] This is criteria we defined during our review, not IRS criteria.
[3] Appendix VI, Figures 1 and 2, separate the information contained in Figure 2 by the IMF and BMF.

SB/SE and Wage and Investment Divisions, develop a more uniform lien-filing policy to better protect the Federal Government's interest and to provide more consistent treatment of taxpayers.[4] This recommendation included shelved TDAs. The IRS agreed and responded that these lien-filing issues would be included in existing SB/SE Research Division projects. The project studying lien filing on shelved accounts has been extended and is not expected to be completed until May 2006. The IRS lien-filing policy on shelved accounts is pending the outcome of the project.

The Research Division project is tracking the impact of liens on shelved accounts for 1 year after the lien filing. This time period may be too short to capture the full impact of the liens since a lien remains in effect until the liability is satisfied, the liability becomes unenforceable by lapse of time, or a bond is accepted in the amount of the liability. In addition, the project includes only those accounts closed based on a part of the IRS' reengineered case-selection process and not those closed solely due to resource constraints. Many cases mentioned here were shelved due to resource constraints rather than through the case-selection process.

In addition, several of the recommendations from the IRS review of Collection function inventory should result in liens being filed on additional large balance-due cases. The recommendations included revising the TDA assignment criteria for large-dollar assessments. As a result, additional large-dollar cases should be assigned to both the ACS and CFf. Employees will be required to consider filing liens on these large-dollar cases based on existing IRS policy.

To further analyze these cases and obtain updated information on the shelved TDAs, we performed Integrated Data Retrieval System (IDRS) research on 50 IMF and 50 BMF (excluding estate) tax modules. We selected tax modules that had the largest balance-due amounts. We determined that:

- Twelve of the 100 modules did not currently warrant additional collection activity due to activity on the accounts since our data were obtained. In these cases the account is now fully paid or payments are currently posting, an Offer in Compromise was accepted or is pending, the taxpayer is bankrupt, the case was closed as hardship, or the shelving was reversed.
- Seven of the remaining 88 modules were never assigned to the ACS or CFf and would not have been subject to a lien-filing determination.[5]
- Forty-eight of the 88 modules did not have an indication of lien filing. The balance due on these tax modules totaled $28.7 million, an average of $599,000 per tax module.

[4] *The Internal Revenue Service Should Modify Its Federal Tax Lien Practices to Treat Taxpayers More Equitably and Better Protect the Government's Interest* (Reference Number 2002-30-106, dated June 2002).
[5] The 3 bullets for the 88 tax modules are not mutually exclusive.

    - Nine of 15 shelved IMF tax modules without a lien had a balance due because the IRS prepared a substitute for return (SFR) for the taxpayer.

- Seventy-two of the 88 modules have current filing requirements shown on the Master File.

Based on our research, we conclude that a significant number of shelved balance-due accounts warrant lien consideration to protect the Federal Government's interest. In addition, a lien would provide a viable incentive for taxpayers to arrange to pay their outstanding tax liabilities.

Recommendation

Recommendation 2: The Commissioner, SB/SE Division, should consider expanding the lien-filing Research Division project to capture the impact of lien filing past the initial 1-year period and establish a lien policy for shelved accounts based on the results. However, an interim policy should be implemented based on the project results at the end of the initial 1-year test period. In protecting the Federal Government's interest through lien filing, the policy should take into account the dollar value of the accounts and should include accounts already shelved and those that will be shelved in the future.

> ***Management's Response*:** The SB/SE Division Collection function will determine and implement any appropriate interim policy changes based on the data. In addition, the research project has been extended to capture the impact of lien filing for an additional year.

Some Taxpayer Delinquency Investigations Were Shelved Without Securing Tax Returns Even Though the Taxpayers Made Large Payments Toward Potential Tax Liabilities

More than 55,000 TDI tax modules for 37,813 taxpayers that had a credit balance of at least $5,000 were shelved in the last few years. Almost 800 of these tax modules had credit balances greater than $100,000. Figure 3 stratifies tax modules by amount where the taxpayer had not filed the tax return, there was a credit balance[6] on the tax module, and the tax module was shelved between October 1, 2000 and September 30, 2004. The IMF portion includes only those taxpayers that were alive and between 20 and 65 years old. The BMF portion includes only those taxpayers that did not have a business-closed date entered on the Master File.[7]

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[6] A credit balance on an unfiled tax return can be created when the taxpayer makes estimated payments for a potential tax liability, applies overpayments from other tax periods, makes a tax deposit when requesting an extension of time for filing a tax return, etc.

[7] This is criteria we defined during our review, not IRS criteria.

Figure 3: TDI Tax Modules Shelved With Credit Balances[8]

TDIs Shelved	Total Modules	Total Taxpayers
Overall Total	4,536,418	2,414,385
Total With Credit Balance	379,063	254,128
$5,000 and Over Credit	55,490	37,813
$25,000 and Over Credit	5,937	4,472
$50,000 and Over Credit	2,174	1,703
$100,000 and Over Credit	797	655
$500,000 and Over Credit	56	56
$1 Million and Over Credit	17	17

Source: TIGTA analysis of Master File data.

To further analyze and obtain updated information on shelved TDIs with a credit balance on the tax module, we performed IDRS research on 50 IMF and 50 BMF tax modules. We selected tax modules that had the largest credit balance amounts. We determined that:

- Forty-six (16 IMF and 30 BMF) of the 100 modules did not currently warrant additional collection activity to secure a tax return. On these cases, a tax return was filed, a SFR was prepared, the credit was refunded or transferred to another tax module, or the taxpayer no longer had a filing requirement.
- Fifty-four (34 IMF and 20 BMF) of the 100 modules could warrant additional collection activity to secure a tax return. The taxpayers have current filing requirements on the Master File and credit balances on the tax modules range from approximately $333,000 to $3 million. Of the 20 BMF tax modules, 13 are for employment taxes with credit balances ranging from approximately $333,000 to $2.4 million.

The credit balance amounts were primarily the result of tax deposits made during the tax year and amounts paid when the taxpayer requested an extension of time to file. One requirement for extensions of time to file is that the tax must be fully paid to avoid the assessment of interest and penalties. This is an additional indication that the taxpayer expected to have taxable income or owe trust fund taxes, especially since the extension requests are filed after the end of the tax year.

The IRS does not currently have a policy specifically for credit balance TDIs. The IRS selects TDIs for assignment using criteria that have traditionally been based on income and projected balance-due amounts. In addition, a TDI can be assigned as part of a TDA meeting the balance-due assignment criteria. Although credit-balance TDIs may not meet these criteria, they

[8] Appendix VII, Figures 1 and 2, separate the information contained in Figure 3 by the IMF and BMF.

present a good indication of noncompliance with tax return filing requirements based on payments the taxpayer submitted to the IRS. If these TDIs are not resolved, the taxpayers could become noncompliant on additional tax periods. In addition, the taxpayers may not have sufficient credits with which to satisfy the tax liabilities of the unfiled tax returns.

Recommendation

Recommendation 3: The Commissioner, SB/SE Division, should include credit-balance amounts as a TDI selection criterion to bring taxpayers into filing compliance. This criterion could include the size of the credit and current filing requirements shown on the Master File.

> ***Management's Response*:** The SB/SE Division Collection function has requested changes to the various automated systems that are used for case routing and assignment prioritization in order to incorporate credit balance amounts in their risk-based methodology. Changes have been completed to some of the applications; however, this change still needs to be synchronized with other automated systems.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate and profile cases (Taxpayer Delinquent Accounts (TDA) and Taxpayer Delinquency Investigations (TDI)) that either had been shelved or that were in the Queue inventory. See Appendix IV for a Glossary of Terms.

To accomplish our objective, we:

I. Determined if there have been any Internal Revenue Service (IRS) reviews of TDA and TDI inventories that are not actively worked, such as reviews conducted by the Research Divisions, the Small Business/Self-Employed (SB/SE) Division Headquarters Collection function, or the Office of Program Evaluation and Risk Analysis.

   A. Obtained and analyzed the results of any IRS reviews.

   B. Determined if additional reviews/studies are planned.

II. Determined the characteristics of TDAs and TDIs that have been shelved or put in the Queue.

   A. Obtained the following data:

      1. A Queue electronic Delinquent Investigation/Account Listing as of April 18, 2005, from SB/SE Division Headquarters staff. We did not validate the accuracy of this data other than to ensure that our record count matched the record count provided by the SB/SE Division staff. The output for TDAs consisted of 1,031,264 Individual Master File (IMF) and 1,104,242 Business Master File (BMF) tax modules for 343,392 IMF and 290,210 BMF taxpayers. The output for TDIs consisted of 520,482 IMF and 1,665,411 BMF tax modules for 325,117 IMF and 415,082 BMF taxpayers.

      2. Downloads from the Master File of:

         a) TDIs closed with Transaction Code (TC) 597 (Surveyed) or 598 (Shelved) dated between October 1, 2000, and September 30, 2004, that were not subsequently reversed or did not have a subsequent return posting (TC 150). The output consisted of 4,407,353 IMF and 15,793,365 BMF tax modules for 2,615,017 IMF and 6,278,294 BMF taxpayers. We verified the accuracy of the criteria in the download program by researching a judgmental sample of 87 accounts on the Integrated Data Retrieval System (IDRS).

b) TDAs closed with TC 530 (Currently Not Collectible), Closing Code 39 (TDAs closed due to low risk scores or resource constraints) dated between October 1, 2000, and September 30, 2004, that were not subsequently reversed and for which there was still a balance due and a Collection Statute Expiration Date later than September 30, 2004. The output consisted of 1,217,708 IMF and 565,411 BMF tax modules for 643,226 IMF and 290,342 BMF taxpayers. We verified the accuracy of the criteria in the download program by researching a judgmental sample of 199 accounts on the IDRS.

B. Ran queries to profile the data. Some characteristics considered included taxpayer age, type of taxpayer, dollars per module, dollars per taxpayer, modules per taxpayer, and repeater status of the taxpayer. We ran queries against data files containing all of the data meeting the criteria shown in Step II. A., not sample data.

C. Analyzed the query results to determine whether inventory priorities should be changed based on cases shelved or in the Queue.

1. Performed additional research on 100 shelved TDA and 100 shelved TDI tax modules using the IDRS to validate the results of our query analysis. These were judgmental samples. We selected tax modules with the largest balance-due amounts for 50 IMF and 50 BMF shelved TDAs. For the shelved TDIs, we selected 50 IMF and 50 BMF TDI tax modules with the largest credit balances.

Appendix II

Major Contributors to This Report

Curtis W. Hagan, Assistant Inspector General for Audit (Small Business and Corporate Programs)
Parker F. Pearson, Director
Amy L. Coleman, Audit Manager
Joseph P. Snyder, Senior Auditor
Denise M. Gladson, Auditor

Appendix III

Report Distribution List

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Appendix IV

Glossary of Terms

Automated Collection System (ACS) – A telephone contact system through which telephone assistors collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.

Business Master File (BMF) – The Internal Revenue Service (IRS) database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

Campus – The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayers accounts. They were formerly known as service centers.

Collection Field function (CFf) – The unit in the Area Offices consisting of Revenue Officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled tax returns.

Collection Statute Expiration Date – A time period established by law to collect taxes.

Computing Center – IRS Computing Centers support tax processing and information management through a data processing and telecommunications infrastructure.

Contact – A communication with the taxpayer to secure a tax return that is past due or payment on a balance-due account. Contacts can be made via notices mailed to the taxpayer, via telephone, or in person.

Corporate Income Tax Returns – U.S. Corporation Income Tax Returns (Form 1120) are returns used by corporations to report the corporate income tax.

Delinquent Investigation/Account Listing (DIAL) – An inventory list of Taxpayer Delinquent Accounts and Taxpayer Delinquency Investigations placed in an assignment location such as the Queue or a Collection function group.

Employment Tax Returns – Various Form 940 series returns (primarily Employer's Annual Federal Unemployment (FUTA) Tax Return (Form 940) and Employer's Quarterly Federal Tax Return (Form 941)) filed by businesses to report things such as Employer's Federal Unemployment Taxes and Federal Taxes Withheld.

Estate Tax Return – United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706) is the form to be filed on certain estates of deceased persons.

Individual Income Tax Returns – U.S. Individual Income Tax Returns (Form 1040 series) are annual income tax returns filed by citizens or residents of the United States.

Individual Master File (IMF) – The IRS database that maintains transactions or records of individual tax accounts.

Integrated Data Retrieval System (IDRS) – The IRS computer system capable of retrieving or updating stored information; it works in conjunction with taxpayer account records.

Hardship Closing – A method of closing an account as currently not collectible with a future income dollar amount that will trigger reactivation of the case if the taxpayer reports income of the amount or greater.

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

Offer in Compromise (OIC) – An offer submitted by the taxpayer to satisfy a tax liability when he or she does not have the financial means to satisfy the liability or when there is doubt as to the validity of the liability.

Queue – An automated holding file for unassigned inventory. Inventory is placed in the Queue until it can be assigned as workload for Collection function employees or shelved due to lack of resources.

Revenue Officer – Employees in the CFf who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by the IRS campuses or the ACS.

Shelved or Surveyed Cases – These are delinquent unpaid accounts or investigations of unfiled tax returns that have been taken out of Collection function inventory because they are lower priority than other available cases.

Substitute for Return – A tax return prepared by the IRS for a taxpayer, who did not file a tax return on his or her own, based on income information documents provided to the IRS by parties such as employers and financial institutions.

Taxpayer Delinquent Account (TDA) – A balance-due case of a taxpayer.

Taxpayer Delinquency Investigation (TDI) – A case for an unfiled tax return of a taxpayer.

Tax Module (Period) – The term tax module refers to each tax return filed by the taxpayer for a specific period (year or quarter) during a calendar year for each type of tax.

Trust Fund Recovery Penalty (TFRP) - A penalty, applicable to withheld income and employment (social security and railroad retirement) taxes or collected excise taxes, that is assessed against responsible individuals of a business when the business has failed to collect or pay over those taxes to the Federal Government.

Trust Fund Taxes – Employment taxes that are collected by employers from employees' wages and later deposited with the Federal Government.

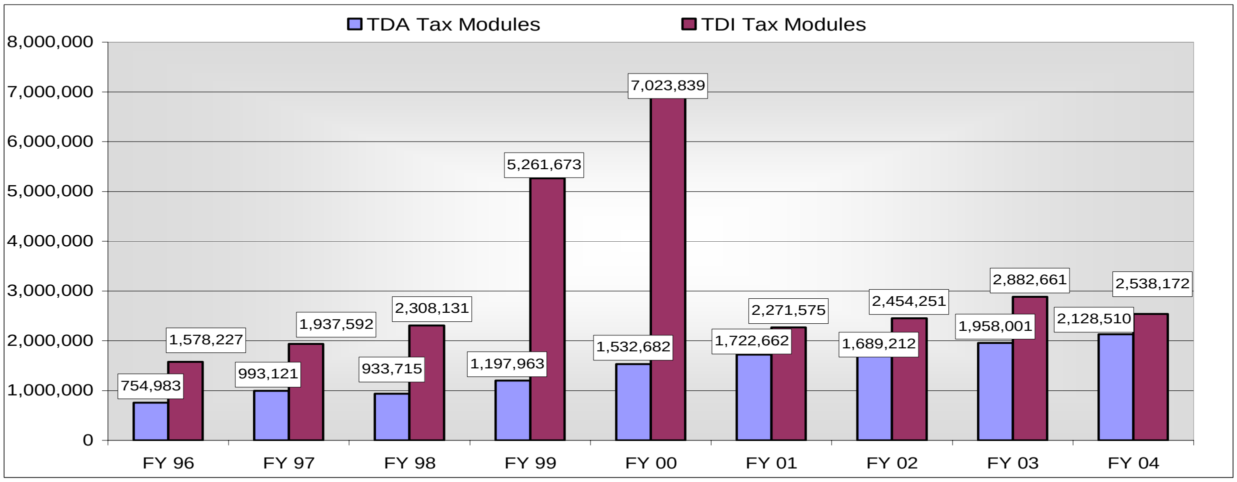
Appendix V

Detailed Figures of Statistical Information[1]

See Appendix IV for a Glossary of Terms.

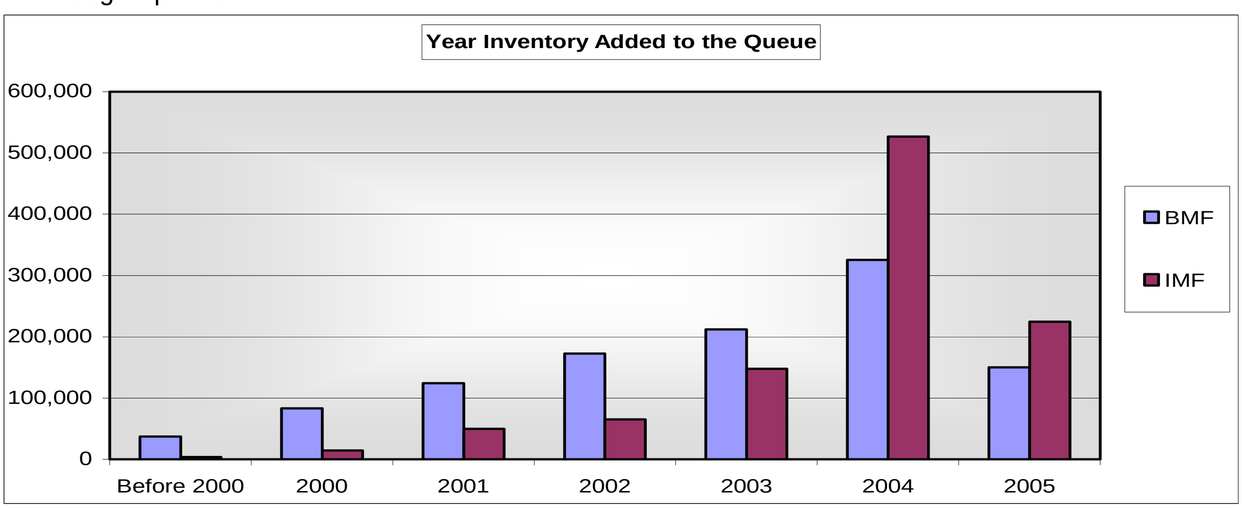
[1] Many of the calculations throughout this Appendix are affected by rounding. All initial calculations were performed using the actual numbers rather than the rounded numbers that appear in the report.

Figure 1. Number of Delinquent Accounts (Modules) in the Queue Each Year. The Taxpayer Delinquent Account (TDA) Queue inventory has been increasing during the last few years. This can be partially attributed to a change in the case-selection method for Revenue Officers; cases are assigned to the Queue before assignment to Revenue Officers. The volume of Taxpayer Delinquency Investigations (TDI) Queue inventory has increased slightly since Fiscal Year (FY) 2001. In addition, a large number of TDIs is shelved each year (see Figure 11).



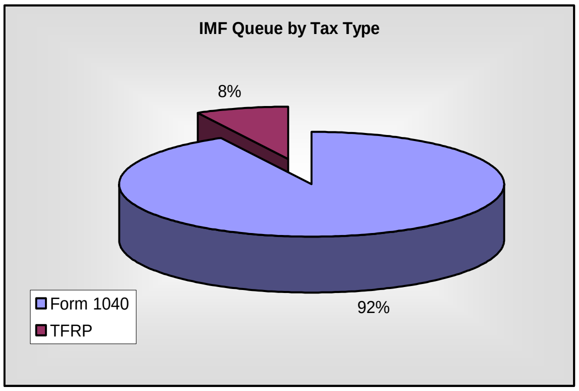
Source: Collection Reports 5000-2 and 5000-4.

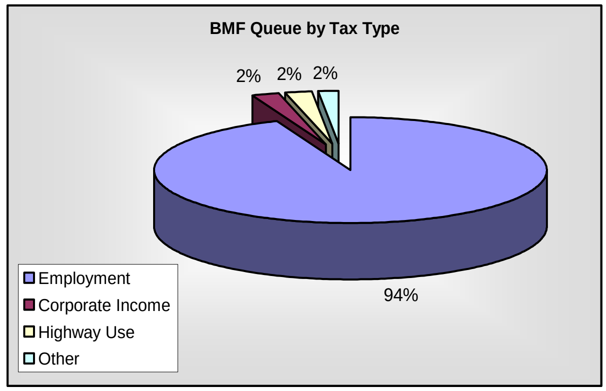
Figure 2. Individual Master File (IMF) and Business Master File (BMF) TDA Queue Inventory by Age. Almost 94 percent of all Queue TDAs (just over 95 percent of the IMF inventory and 92 percent of the BMF Trust Fund inventory) were added after January 1, 2003, while 88 percent of the IMF and 75 percent of the BMF Trust Fund Queue inventories were added after January 1, 2004. Data for 2005 are through April 18.



Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of Internal Revenue Service (IRS) Queue extract.

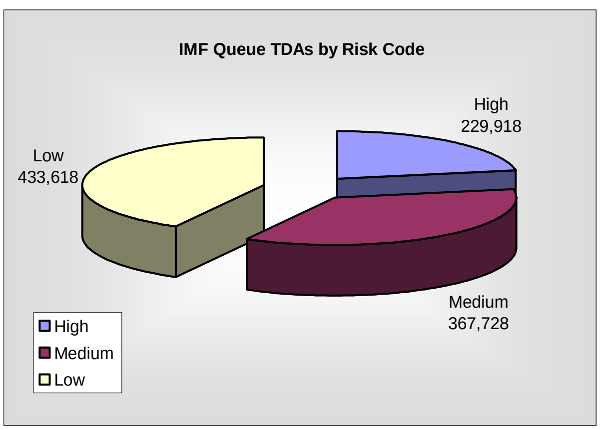
Figures 3 and 4. IMF and BMF TDA Queue Inventory by Type of Tax. IMF TDAs in Queue inventory are almost entirely individual income tax cases and BMF TDAs are almost entirely employment tax cases.

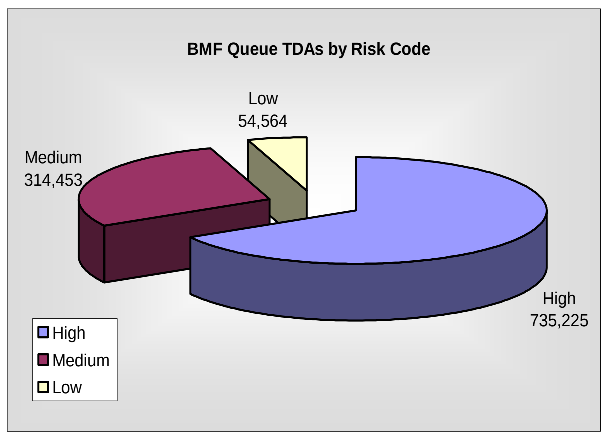




Source: TIGTA analysis of IRS Queue extract.

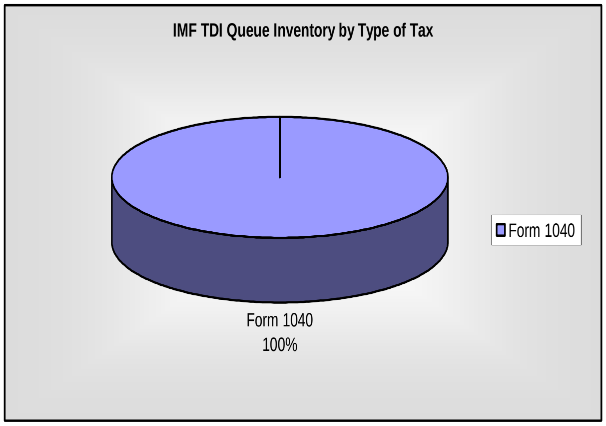
Figures 5 and 6. IMF and BMF TDA Queue Inventory by Risk Code. The Queue is a primary source for Collection Field function (CFf) workload. The vast majority of the BMF Queue inventory is high priority. This mainly consists of BMF trust fund cases (part of employment taxes).

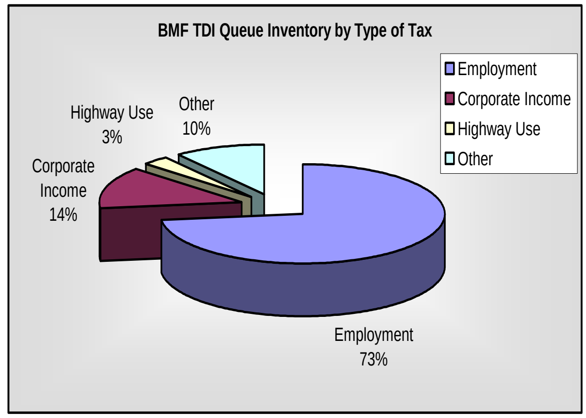




Source: TIGTA analysis of IRS Queue extract.

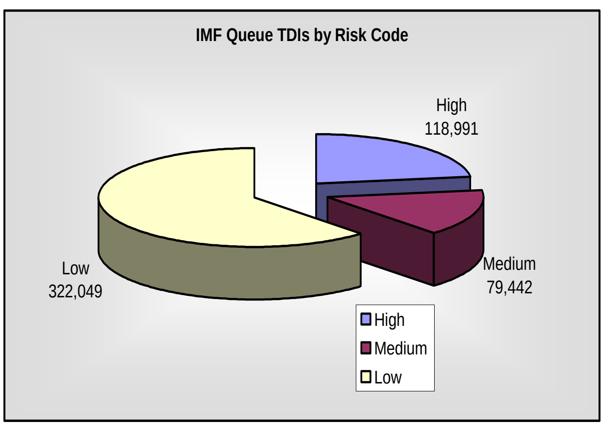
Figures 7 and 8. IMF and BMF TDI Queue Inventory by Type of Tax. All of the IMF Queue TDIs involve individual income tax returns. A large percentage of the BMF Queue TDIs involve employment taxes.

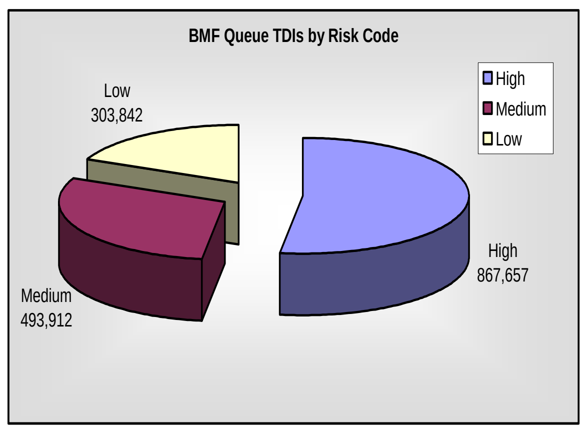




Source: TIGTA analysis of IRS Queue extract.

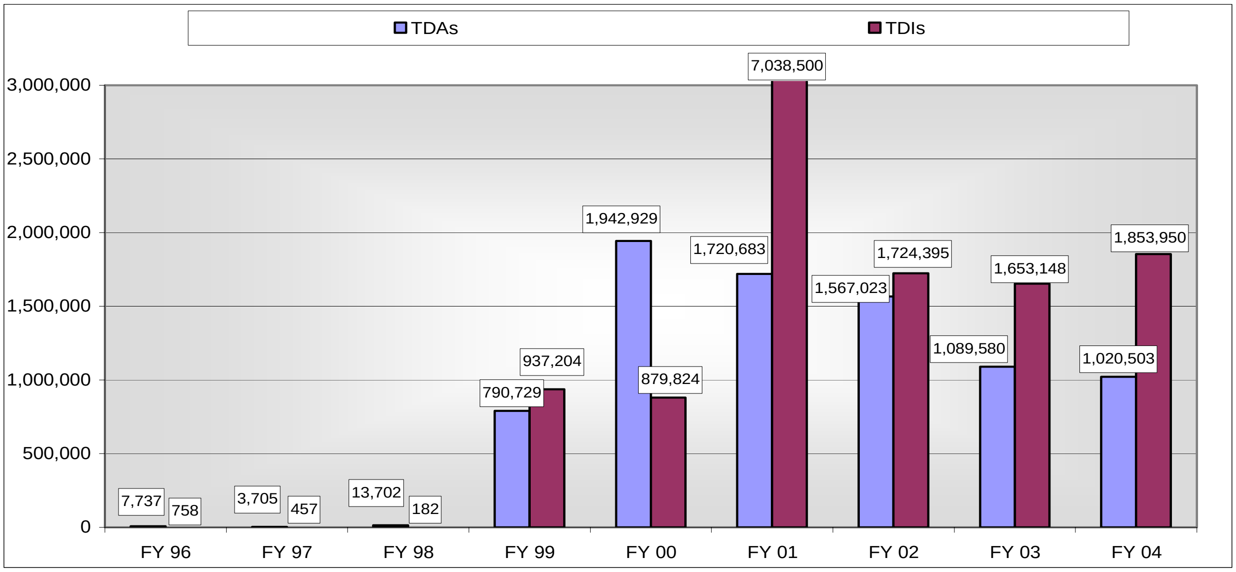
Figures 9 and 10. IMF and BMF TDI Queue Inventory by Risk Code. A large percentage of the BMF Queue TDI inventory is high risk.





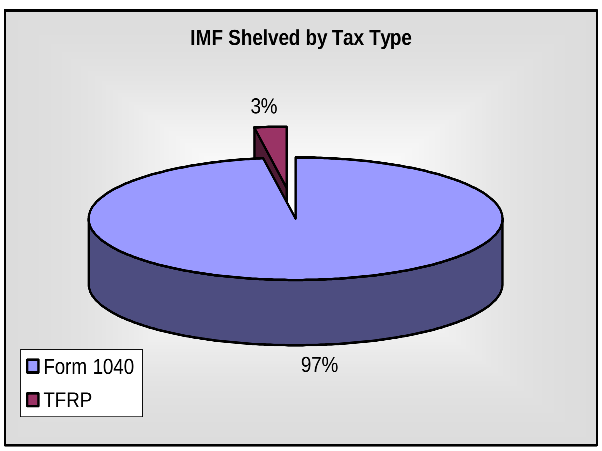
Source: TIGTA analysis of IRS Queue extract.

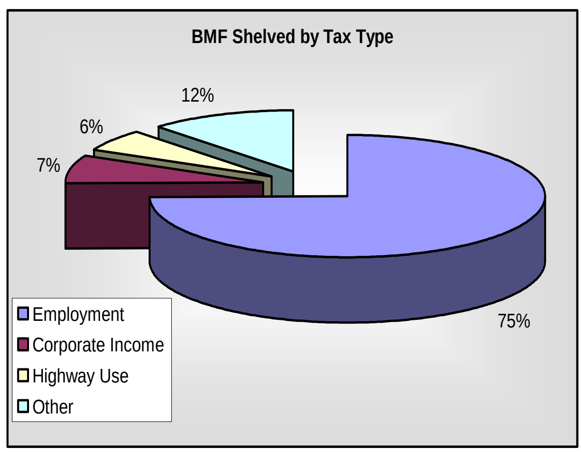
Figure 11. TDA and TDI Inventory Shelved Each Year. Large volumes of both TDAs and TDIs are shelved each year due to resource constraints. These cases can be removed from this inventory for assignment, but most will never be worked. This inventory is largely low-priority workload.



Source: Collection Reports 5000-2 and 5000-4.

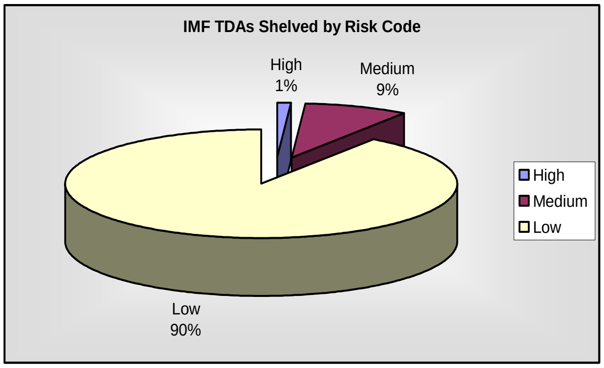
Figures 12 and 13. IMF and BMF TDA Shelved Inventory by Type of Tax. While a large percentage of the BMF shelved TDA inventory consists of employment taxes that include top-priority workload, the majority is not considered high-risk inventory, as is shown in Figures 14 and 15.

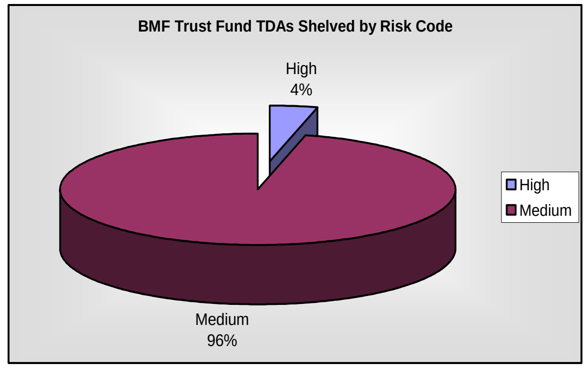




Source: TIGTA analysis of Master File extract of Transaction Code 530 (Currently Not Collectible), Closing Code 39 (TDAs closed due to low risk scores or resource constraints), tax module data.

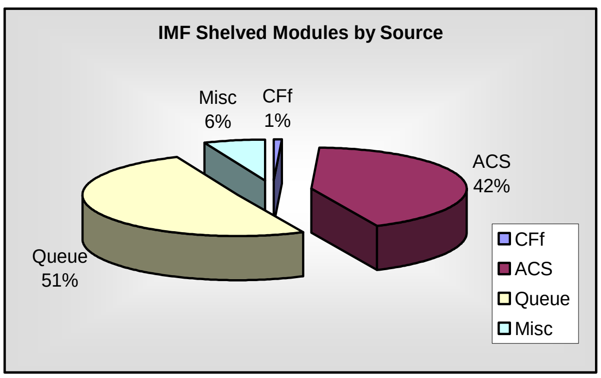
Figures 14 and 15. IMF and BMF Trust Fund TDA Shelved Inventory by Risk Code. The vast majority of the IMF and BMF trust fund TDA inventory shelved is lower priority workload.

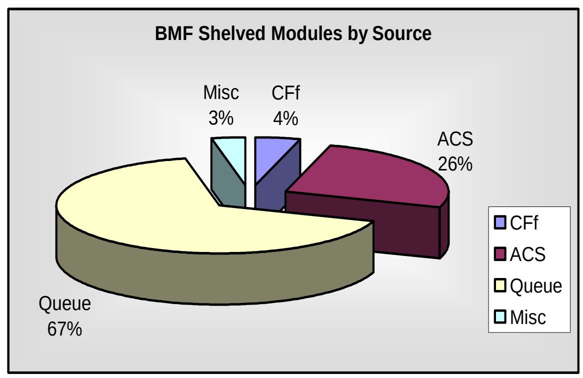




Source: TIGTA analysis of Master File extract of Transaction Code 530, Closing Code 39, tax module data.

Figures 16 and 17. IMF and BMF TDA Shelved Tax Modules by Source. The vast majority of the IMF and BMF TDA inventory is being shelved from the Queue.





Source: TIGTA analysis of Master File extract of Transaction Code 530, Closing Code 39, tax module data.

Appendix VI

Lien Filing on Shelved Accounts

Figure 1. Shelved Individual Master File (IMF) Taxpayer Delinquent Account (TDA) Tax Modules and Taxpayer Accounts. The IMF data includes only those taxpayers that were alive (no date of death entered on the Master File) and between 20 and 65 years old.[1]

Balance-Due Amount	Tax Modules	Taxpayers	Total Amount Due	Amount Due With Liens	Percentage Protected
Total Shelved	980,303	509,666	$4.9 Billion	$2.1 Billion	42.66%
$5,000 and Over[2]	449,075	145,795	$4.3 Billion	$2.1 Billion	48.35%
$25,000 and Over	186,281	47,801	$3.1 Billion	$1.4 Billion	46.18%
$50,000 and Over	71,750	17,394	$2.0 Billion	$907 Million	44.42%
$100,000 and Over	21,730	5,096	$1.2 Billion	$533 Million	43.58%
$500,000 and Over	1,552	356	$368 Million	$163 Million	44.38%
$1 Million and Over	397	100	$190 Million	$85 Million	44.49%

Source: *Treasury Inspector General for Tax Administration (TIGTA) analysis of Master File data.*

Figure 2: Shelved Business Master File (BMF) TDA Tax Modules and Taxpayer Accounts. The BMF data does not include businesses that had a business-closed date on the Master File or estates.[3]

Balance-Due Amount	Tax Modules	Taxpayers	Total Amount Due	Amount Due With Liens	Percentage Protected
Total Shelved	564,072	289,117	$1.3 Billion	$252 Million	19.98%
$5,000 and Over[4]	154,596	51,542	$845 Million	$243 Million	28.75%
$25,000 and Over	26,557	6,476	$435 Million	$166 Million	38.14%
$50,000 and Over	12,691	2,271	$289 Million	$121 Million	41.71%
$100,000 and Over	5,542	645	$182 Million	$87 Million	47.48%
$500,000 and Over	632	69	$73 Million	$37 Million	51.25%
$1 Million and Over	193	23	$40 Million	$22 Million	53.82%

Source: *TIGTA analysis of Master File data.*

[1] This is criteria we defined during our review, not Internal Revenue Service (IRS) criteria.
[2] The IRS requires lien determinations on assigned cases when the aggregate balance due is $5,000 and over.
[3] This is criteria we defined during our review, not IRS criteria.
[4] The IRS requires lien determinations on assigned cases when the aggregate balance due is $5,000 and over.

Appendix VII

Credit Balance Taxpayer Delinquency Investigations

Figure 1. Shelved Individual Master File (IMF) Credit Balance Taxpayer Delinquency Investigations (TDI). The IMF data includes only those taxpayers that were alive (no date of death entered on the Master File) and between 20 and 65 years old.[1]

TDIs Shelved	IMF Tax Modules	IMF Taxpayers
Overall Total	3,240,875	1,982,260
Total With Credit Balance	244,254	180,678
$5,000 and Over Credit	37,354	26,373
$25,000 and Over Credit	4,442	3,355
$50,000 and Over Credit	1,593	1,253
$100,000 and Over Credit	544	449
$500,000 and Over Credit	35	35
$1 Million and Over Credit	5	5

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of Master File data.

[1] This is criteria we defined during our review, not Internal Revenue Service (IRS) criteria.

Figure 2. Shelved Business Master File (BMF) Credit Balance TDIs. The BMF data do not include businesses that have a business-closed date on the Master File.[2]

TDIs Shelved	BMF Tax Modules	BMF Taxpayers
Overall Total	1,295,543	432,125
Total With Credit Balance	134,809	73,450
$5,000 and Over Credit	18,136	11,440
$25,000 and Over Credit	1,495	1,117
$50,000 and Over Credit	581	450
$100,000 and Over Credit	253	206
$500,000 and Over Credit	21	21
$1 Million and Over Credit	12	12

Source: TIGTA analysis of Master File data.

[2] This is criteria we defined during our review, not IRS criteria.

Appendix VIII

Management's Response to the Draft Report

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

RECEIVED
JAN 2 3 2006

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

January 20, 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – High Risk Work Is Selected from the Unassigned Delinquent Account Inventory, but Some Unassigned Accounts Need Management's Attention (Audit # 200430027)

We have reviewed your report and agree with the recommendations. We appreciate your recognition that we are identifying high-risk inventory in the Queue for assignment to collection personnel.

We are beginning to see positive results from the implementation of our risk based system for prioritizing the assignment of cases to Collection employees. Since 2003, we have closed more balance due work than we received and, consequently, we are reaching deeper into the moderate risk cases.

Identifying the next best case for assignment will continue to be a critical issue as long as we do not have sufficient resources to address all non-compliant taxpayers. In addition to traditional balance due work, non-filers also represent a significant compliance risk, plus the IRS has significantly increased the number of examination assessments, resulting in more complex balance due cases for collection employees.

Our comments on your recommendations follow:

RECOMMENDATION 1
The Commissioner, Small Business/Self-Employed (SB/SE) Division, should ensure that the Collection function staff continues to review the program for the automated process that removes cases from the Queue to ensure that it is operating properly.

CORRECTIVE ACTION
We agree with this recommendation and will continue to review the automated programming. We have already identified several enhancements. For example, we will change the program for selecting cases to be shelved so that when a single tax period qualifies, all the other related tax periods associated with that taxpayer entity will also be shelved.

2

IMPLEMENTATION DATE
January 15, 2007

RESPONSIBLE OFFICIAL(S)
Director, Planning and Analysis, Collection Division, Small Business/Self-Employed Operating Division

CORRECTIVE ACTION MONITORING PLAN
Program Manager, Collection Case Selection will advise the Director, Planning and Analysis, Collection Division, of any delays.

RECOMMENDATION 2
The Commissioner, SB/SE Division, should consider expanding the lien filing Research Division project to capture the impact of lien filing past the initial 1-year period and establish a lien policy for shelved accounts based on the results. However, an interim policy should be implemented based on the project results at the end of the initial 1-year test period. In protecting the Federal Government's interest through lien filing, the policy should take into account the dollar value of the accounts and should include accounts already shelved and those that will be shelved in the future.

CORRECTIVE ACTION
We agree with this recommendation. We will determine and implement any appropriate interim policy changes based on the data. We have extended the research project to capture the impact of lien filing for an additional year. This will provide additional data as to the ultimate collectibility generated by the filing of liens.

IMPLEMENTATION DATE
July 31, 2006

RESPONSIBLE OFFICIAL(S)
Director, Planning and Analysis, Collection Division, Small Business/Self-Employed Operating Division

CORRECTIVE ACTION MONITORING PLAN
Program Manager, Collection Case Selection will advise the Director, Planning and Analysis, Collection Division, of any delays.

RECOMMENDATION 3
The Commissioner, SB/SE Division, should include credit balance amounts as a Taxpayer Delinquency Investigation (TDI) selection criterion to bring taxpayers into filing compliance. This criterion could include the size of the credit and current filing requirements shown on the Master File.

CORRECTIVE ACTION

We agree with this recommendation. We have requested changes to the various automated systems that are used for case routing and assignment prioritization, in order to incorporate credit balance amounts in our risk based methodology. Changes have been completed to some of our applications; however, we still need to synchronize this change with our other automated systems.

IMPLEMENTATION DATE

January 15, 2007

RESPONSIBLE OFFICIAL(S)

Director, Planning and Analysis, Collection Division, Small Business/Self-Employed Operating Division

CORRECTIVE ACTION MONITORING PLAN

Program Manager, Collection Case Selection, will advise the Director, Planning and Analysis, Collection Division, of any delays.

If you have any questions, please contact me at (202) 622-0600 or Brady R. Bennett, Director, Collection, Small Business/Self-Employed Division at (202) 283-7660.

Enclosure