

**The Internal Revenue Service Needs to Better  
Address Bankruptcy Automatic Stay  
Violations**

**September 2000**

**Reference Number: 2000-30-162**

**This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

September 27, 2000

MEMORANDUM FOR COMMISSIONER ROSSOTTI

A handwritten signature in cursive script that reads "Pamela J. Gardiner".

FROM: Pamela J. Gardiner  
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Internal Revenue Service Needs to  
Better Address Bankruptcy Automatic Stay Violations

This report presents the results of our review of the Internal Revenue Service's (IRS) compliance with Bankruptcy Code automatic stay provisions. In summary, the IRS needs to effectively prevent and identify violations of the bankruptcy automatic stay provisions, 143 of which we identified during our review. The IRS is vulnerable to taxpayers recovering damages when violations of the automatic stay occur and are not properly identified and corrected.

Management's response was due on September 25, 2000. As of September 26, 2000, management had not responded to the draft report.

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

**The Internal Revenue Service Needs to Better Address  
Bankruptcy Automatic Stay Violations**

---

**Table of Contents**

Executive Summary.....	Page i
Objective and Scope.....	Page 1
Background .....	Page 1
Results .....	Page 5
The Internal Revenue Service Is Not Always Identifying Violations of the Automatic Stay Provisions.....	Page 5
The Internal Revenue Service Needs to Ensure Timely Input of Bankruptcies to the Masterfile .....	Page 12
Conclusion.....	Page 14
Appendix I – Detailed Objective, Scope, and Methodology .....	Page 15
Appendix II – Major Contributors to This Report.....	Page 17
Appendix III – Report Distribution List.....	Page 18

## **The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations**

---

### **Executive Summary**

A debtor is a person or business that incurs financial liability and owes money to another person or business, which is considered the creditor. When debtors cannot meet financial obligations to their creditors, debtors can petition (file) for bankruptcy with the Federal Bankruptcy Court. The Bankruptcy Code, 11 U.S.C. Section 362, prohibits creditors from acting against individuals after they have filed for bankruptcy, which is known as the “automatic stay.” As long as the automatic stay is in effect, creditors generally cannot take actions, such as initiating or continuing lawsuits, garnishing wages, or even making telephone calls demanding payments.

During Fiscal Year (FY) 1999, approximately 1.35 million individuals and businesses filed for bankruptcy. While the Internal Revenue Service (IRS) is not a creditor for each debtor filing for bankruptcy protection, a significant number of the debtors have outstanding tax liabilities. For FY 1999, IRS data show approximately 575,000<sup>1</sup> debtors entered bankruptcy status owing the IRS \$3.4 billion.<sup>2</sup>

The IRS Restructuring and Reform Act of 1998 (RRA 98)<sup>3</sup> allows taxpayers to sue when an IRS employee willfully violates the automatic stay provisions. The Internal Revenue Code (I.R.C.), 26 U.S.C. Section 7433(e), generally provides that taxpayers can recover damages from the IRS if an employee willfully violates the provisions of the Bankruptcy Code (11 U.S.C.). The I.R.C. provides for actual damages up to \$1,000,000 for reckless or intentional disregard for provisions of the I.R.C. and \$100,000 for instances involving negligence.

Our overall objective was to determine if the IRS effectively prevents and identifies violations of the Bankruptcy Code automatic stay provisions.

### **Results**

The IRS is not always accomplishing its objective of effectively preventing and identifying violations of the Bankruptcy Code automatic stay provisions. For the 3 districts in our review, approximately 86,000 bankruptcies were input to the Automated

---

<sup>1</sup> Source: Collection Field function (CFf) Time District Office (Non-ACS) Activity Report NO-5000-23.

<sup>2</sup> Source: Individual Masterfile (IMF) Report of Bankruptcies NO-5000-31 and Business Masterfile (BMF) Report of Bankruptcies NO-5000-32.

<sup>3</sup> Pub. L. No. 105-206, Stat. 685 (1998).

## **The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations**

---

Insolvency System (AIS)<sup>4</sup> during FY 1999. Of the 86,000 bankruptcies, we identified 7,825 cases in which some collection actions (e.g., payments made) may have been taken after the taxpayers filed for bankruptcy. We reviewed a sample of 420 of the 7,825 cases and found violations of the automatic stay provisions in 143 (34 percent).

The IRS is vulnerable to taxpayers recovering damages when violations of the automatic stay occur and are not properly identified and corrected. As of January 2000, the IRS indicated that only one taxpayer nationwide had filed an administrative claim because of the IRS violating the automatic stay provisions. However, taxpayers may not be aware of their rights to file an administrative claim, and, should they become aware, this number could increase significantly.

### **The Internal Revenue Service Is Not Always Identifying Violations of the Automatic Stay Provisions**

The Special Procedures functions (SPf) in the IRS' field offices receive computer-generated litigation transcripts for accounts that are in bankruptcy status. These transcripts identify activity (e.g., payments) that has posted to the taxpayer's account after the bankruptcy status was input. However, the number of transcripts generated is voluminous, and the SPfs are not reviewing them for potential violations of the automatic stay in order for the IRS to identify and remedy the violations that may occur.

Our review of the 420 cases identified 115 payments received from taxpayers, 16 liens filed against taxpayers, and 12 credit transfers<sup>5</sup> made after the bankruptcy petition date. These situations are considered violations of the automatic stay provisions of the Bankruptcy Code. Since litigation transcripts were not effectively used, the SPfs did not identify these violations and did not correct them (e.g., returning the payments or releasing the liens).

Even when the IRS identifies payments received after the bankruptcy petition date, the payments are not being consistently refunded to the taxpayers or trustees. The IRS' procedures do not adequately address payments received from payroll deduction agreements, direct debit agreements, or installment agreements (i.e., monthly payment arrangements). As a result, the rights of taxpayers and other creditors are not being protected.

---

<sup>4</sup> The AIS is an automated control system of bankruptcy cases used by the IRS district offices to control and process bankruptcy cases.

<sup>5</sup> Payments transferred from one tax period to another.

## **The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations**

---

Finally, although they are not violations of the automatic stay, we identified 40 statutory assessments<sup>6</sup> made during the bankruptcy proceedings. In these cases, the 90-day statutory notice period did not expire prior to the bankruptcy petition date. As a result, these assessments are not valid. These cases could also be identified on the litigation transcripts if they were appropriately reviewed.

### **The Internal Revenue Service Needs to Ensure Timely Input of Bankruptcies to the Masterfile**

To prevent violations of the automatic stay, employees in the SPf input freeze codes to taxpayers' accounts located on the IRS computer system known as the Masterfile.<sup>7</sup> Generally, we did not identify any significant delays on the input of the bankruptcy freeze once the case had been recorded on the AIS. However, two controls to monitor this process could be improved.

- One important control is a report that measures the timeliness of initial case processing. This is the period from the IRS' receipt of bankruptcy notification to the input of the bankruptcy freeze. Instead of using the actual date the IRS received the bankruptcy notification, the measure is based on the date of input to the AIS, which can be days or weeks after the actual date received.
- Another control is the Potentially Invalid Taxpayer Identification Number (PIT) report that identifies differences between names and taxpayer identification numbers on the Masterfile and the AIS. Managers are not ensuring that SPf employees are timely and appropriately resolving the potential differences on this report to prevent inappropriate collection actions on the taxpayers' accounts. In 1 district, employees did not timely and effectively address the PIT report and, as a result, cases up to 2 months old were still appearing on the listings.

### **Summary of Recommendations**

IRS Collection function management needs to ensure that the bankruptcy examiners are monitoring the litigation transcripts upon receipt to identify any violations of the automatic stay and that appropriate action is taken if violations have occurred. They also need to determine if an electronic version of the transcripts can be matched against the

---

<sup>6</sup> The IRS has 3 years from the date a return was filed to make adjustments to a taxpayer's account based on an examination of the return. If the taxpayer does not agree with the proposed adjustments based on an examination of his/her return, the IRS issues a statutory notice (90-day letter) to furnish the taxpayer legal notice that the deficiency in tax exists and it will be assessed on his/her account.

<sup>7</sup> The Masterfile is the IRS' main computer system of taxpayer accounts.

## **The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations**

---

AIS so examiners can more easily identify and review cases that have payments, liens, or credit transfers after the bankruptcy was input. The Internal Revenue Manual needs to be updated to include procedures for refunding payments received after the bankruptcy petition is filed. Management needs to provide consistent guidelines on how and when to notify the Examination function that a taxpayer is currently in bankruptcy. The AIS also needs to be reprogrammed so the actual IRS receipt date of the case can be input to provide more accurate management information system data. Finally, steps need to be taken to ensure employees timely and effectively address the PIT report to resolve all cases appropriately and ensure posting of the bankruptcies to taxpayers' accounts.

Management's Response: Management's response was due on September 25, 2000. As of September 26, 2000, management had not responded to the draft report.

# The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

## Objective and Scope

*The overall objective of the review was to determine if the IRS effectively prevents and identifies violations of the Bankruptcy Code automatic stay provisions.*

Our overall objective was to determine if the Internal Revenue Service (IRS) effectively prevents and identifies violations of the Bankruptcy Code automatic stay provisions. We reviewed procedures of the Special Procedures function (SPf) in three districts and reviewed selected samples of bankruptcy cases in the three districts.

Our review was conducted between November 1999 and May 2000 in the North Florida, North Texas, and Southwest Districts. This audit was performed in accordance with *Government Auditing Standards*.

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

## Background

*During FY 1999, approximately 1.35 million individuals and businesses filed for bankruptcy.*

During Fiscal Year (FY) 1999, approximately 1.35 million individuals and businesses filed for bankruptcy. While the IRS is not a creditor for each debtor filing for bankruptcy protection, a significant number of the debtors have outstanding tax liabilities. For FY 1999, IRS data show approximately 575,000<sup>1</sup> debtors entered bankruptcy status owing \$3.4 billion.<sup>2</sup>

The laws governing bankruptcy date back to 1898. The bankruptcy laws are based on the underlying principle that debtors, unable to pay all creditors, should have a

---

<sup>1</sup> Source: Collection Field function (CFf) Time District Office (Non-ACS) Activity Report NO-5000-23.

<sup>2</sup> Source: Individual Masterfile (IMF) Report of Bankruptcies NO-5000-31 and Business Masterfile (BMF) Report of Bankruptcies NO-5000-32.



## The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

way to pay what they can afford to pay, while receiving forgiveness for any debts that cannot be paid.

The Bankruptcy Code provides for five basic types of bankruptcy cases:

- Chapter 7 is a court-supervised procedure where a trustee collects the assets of the debtor's estate, reduces them to cash, and distributes the cash to the creditors.
- Chapter 9 is a reorganization of a municipality, which includes villages, counties, taxing districts, municipal utilities, and school districts.
- Chapter 11 is generally used by businesses that want to continue to operate and repay creditors while they are reorganizing their business.
- Chapter 12 is used by farmers with regular annual income.
- Chapter 13 is designed for an individual debtor who has a regular source of income. The debtor proposes a plan to repay creditors over time.

*The Bankruptcy Code generally prohibits creditors from acting against debtors after they have filed for bankruptcy, which is known as the automatic stay.*

A debtor is a person or business that incurs financial liability and owes money to another person or business, which is considered the creditor. When debtors cannot meet financial obligations to their creditors, debtors can petition (file) for bankruptcy with the Federal Bankruptcy Court. The Bankruptcy Code, 11 U.S.C. Section 362, generally prohibits creditors from acting against debtors after they have filed for bankruptcy; this is known as the automatic stay. The automatic stay arises by operation of law and not by judicial action. As long as the automatic stay is in effect, creditors generally cannot initiate or continue any lawsuits, garnish wages, or even make telephone calls demanding payments.

The IRS Restructuring and Reform Act of 1998 (RRA 98)<sup>3</sup> allows taxpayers who suffer when the IRS

---

<sup>3</sup> Pub. L. No. 105-206, Stat. 685 (1998).

## The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

willfully violates the automatic stay provisions to sue the IRS. The Internal Revenue Code (I.R.C.), 26 U.S.C. Section 7433(e), generally provides that taxpayers can recover damages resulting from the IRS' willful violation of the provisions of the Bankruptcy Code. The I.R.C. provides for actual damages up to \$1,000,000 for reckless or intentional disregard for provisions of the I.R.C. and \$100,000 for instances involving negligence.

In addition to these provisions of the I.R.C., debtors may bring action under the Bankruptcy Code, 11 U.S.C. Section 362(h). This provides that an individual injured by any willful violation of the automatic stay shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.

The bankruptcy courts notify the creditors when a debtor files a petition for bankruptcy. The SPf in the district office receives the notice of bankruptcy either by electronic transmission or by mail.

*The SPf uses the AIS to control and process all bankruptcy cases.*

The SPf has responsibility for controlling and monitoring bankruptcy cases and ensuring the provisions of the automatic stay are not violated. The SPf maintains an automated control system of cases filed under the Bankruptcy Code called the Automated Insolvency System (AIS). This is a comprehensive control and processing application for the district offices to use when processing bankruptcy cases.

The SPf has an automated process to load electronic notices to the AIS. This reduces input time and data input errors. In addition, the SPf manually inputs bankruptcy notice information obtained through the mail or from Public Access to Court Electronic Records (PACER).<sup>4</sup>

---

<sup>4</sup> The PACER system is an electronic public access service that allows users to request case and docket information about a particular individual or case. It provides a listing of new cases each day and contains updates to active and recently closed bankruptcy cases. Each bankruptcy court maintains its own database with case information.

## The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

As a means to alert other IRS functions that a bankruptcy case has been filed and to prevent violations of the automatic stay, the SPf inputs a bankruptcy freeze code on taxpayers' accounts that are located on the IRS computer system known as the Masterfile.<sup>5</sup> This is accomplished using the Insolvency Interface Program (IIP), an automated interface between the AIS and the Integrated Data Retrieval System (IDRS).

In 1997, the IRS established a cross-functional working group to study the IRS' compliance with the Bankruptcy Code. The Bankruptcy Working Group (BWG) included representatives from the IRS Office of Chief Counsel, the IRS Collection function, and the Department of Justice. The BWG goals included reviewing actions that result in violations of the bankruptcy code, recommending improvements to the processes, and developing administrative procedures to pay for damages resulting from violations. The April 1998 BWG report made specific recommendations to address each of the Group's goals.

The BWG established a 5-workday time limit for the initial processing of all new bankruptcy filings. Initial processing includes:

- Loading the bankruptcy case information onto the AIS.
- Running the interface between the AIS and the IDRS to verify new account information and to input the bankruptcy freeze to taxpayer accounts. This is referred to as IIP Processes C and D.
- Resolving cases on the Potentially Invalid Taxpayer Identification Number (PIT) report.
- Contacting the appropriate Collection function to stop action on active collection cases.

---

<sup>5</sup> The Masterfile is the IRS' main computer system of taxpayer accounts.

## The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

The BWG also established a 2-workday target to complete corrective actions in instances where the IRS becomes aware of automatic stay violations.

### Results

*Our sample of 420 bankruptcy cases with collection actions after the bankruptcy petition date identified 143 violations of the automatic stay provisions.*

The IRS is not always accomplishing its objective of preventing and identifying violations of the bankruptcy automatic stay provisions. For the 3 districts in our review, approximately 86,000 bankruptcies were input to the AIS during FY 1999. Of the 86,000 bankruptcies, we identified 7,825 cases in which some collection actions (e.g., payments made) may have been taken after the taxpayers filed for bankruptcy. We reviewed a sample of 420 of the 7,825 cases and identified violations of the automatic stay provisions in 143 (34 percent).

The IRS is vulnerable to taxpayers recovering damages if such violations of the automatic stay occur and cases are not properly identified and corrected. As of January 2000, the IRS indicated that only one taxpayer nationwide had filed an administrative claim because of a violation of the automatic stay provisions. However, taxpayers may not be aware of their right to file administrative claims, and, should they become aware, this number could increase significantly.

---

### The Internal Revenue Service Is Not Always Identifying Violations of the Automatic Stay Provisions

---

The automatic stay provisions of the Bankruptcy Code, 11 U.S.C. Section 362, prohibit creditors, including the IRS, from taking actions against debtors after they have filed for bankruptcy. This includes:

- Any act to obtain possession of the property of the estate. In Chapter 13 bankruptcies, the assets and earnings of the debtor acquired after the filing of a

## The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

*The IRS is vulnerable to claims and law suits by taxpayers if violations of the automatic stay are not identified and corrected.*

bankruptcy petition are property of the bankruptcy estate.

- Any act to create, perfect, or enforce any lien against property of the estate or property of the debtor when the claim arose before the filing for bankruptcy.
- Any act to collect, assess, or recover a claim against the debtor that arose before the filing of the bankruptcy petition.

Taxpayer rights are not adequately protected when violations of the automatic stay occur. The IRS is at risk for claims or law suits by taxpayers affected by violation of the automatic stay. The I.R.C. provides for actual damages, including attorneys' fees, up to \$1,000,000 for reckless or intentional disregard of provisions of the I.R.C. and \$100,000 for instances involving negligence. The Bankruptcy Code, 11 U.S.C. Section 362(h), also provides that an individual injured by any willful violation of the automatic stay may recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.

The IRS' initial case processing procedures intended to prevent collection actions that may violate the automatic stay are not always effective. This is due to the involvement of various IRS functions in the process and because of timing differences between the bankruptcy petition date and the date IRS receives notice of the bankruptcy. Therefore, the SPf needs a backup control to identify potential actions that could violate the automatic stay. This control is the use of litigation transcripts, which are computer-generated documents for accounts that are in bankruptcy status. These transcripts identify transactions (e.g., payments, lien filings, and credit offsets<sup>6</sup>) that post to taxpayers' accounts after the input of the bankruptcy freeze.

Due to workload priorities and the volume of litigation transcripts, the SPf was not always reviewing the

---

<sup>6</sup> Payments transferred from one tax period to another.

## The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

transcripts. Also, when the IRS teller function was moved from IRS district offices to the IRS Submission Processing Centers, payments received through the bankruptcy estate were not removed from the litigation transcripts. This increases both the number of transcripts and the volume of information on them. These payments do not represent transactions that require further action, so their inclusion reduces the transcripts' overall effectiveness.

### **Payments received after bankruptcy petition filed**

*Our review identified 115 cases with payments posting to taxpayers' accounts after the bankruptcy petition date, in violation of the automatic stay.*

The IRS received payments after taxpayers filed for bankruptcy, through levies, payroll deductions, automated direct debit (i.e., payments from taxpayers' bank accounts), or installment agreements. We reviewed a random sample of 278 of 5,060 cases with payments posting to the taxpayers' accounts after the bankruptcy petition date and identified violations of the automatic stay on 115 cases (41 percent).

The SPf employees identify new bankruptcy cases where the taxpayers are in an active collection status from transcripts generated through the IIP. This includes taxpayers with monitored installment agreements and current collection activities being conducted by either the IRS Automated Collection System or the IRS Collection Field function. To prevent further collection actions, the SPf contacts the respective IRS function to inform it of the pending bankruptcies. However, payments from levies, payroll deduction agreements, direct debit agreements, or installment agreements on these 115 cases either were not stopped or not stopped timely.

## The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

For the 115 cases at the time of the bankruptcy filing, the taxpayers were in the collection statuses shown in the following table.

**Table 1.**

**Collection Status at Bankruptcy Filing**

Status	Chapter 7	Chapter 13	Total
Monitored Installment Agreements	17	33	50
Automated Collection System	13	25	38
Collection Field Function	4	5	9
Other <sup>7</sup>	3	15	18
Total	37	78	115

*Source: Integrated Data Retrieval System, FY 1999*

The IRS' procedures provide that actions to correct violations of the automatic stay must be initiated within 2 workdays after the violations are identified. The SPf identified payments received after the petition in 42 of the 115 cases. In 21 of the 42 cases, the SPf timely initiated refunds either to the taxpayer or trustee or moved payments from dischargeable<sup>8</sup> tax to non-dischargeable<sup>9</sup> tax. In the other 21 of 42 cases, the SPf either did not refund all payments received after the bankruptcy petition date or their actions were not within the 2-workday standard. In the remaining 73 cases, we

---

<sup>7</sup> These cases are in various other collection statuses (e.g., currently not collectible, notice status, deferred installment agreement).

<sup>8</sup> Tax that the taxpayer will not be required by law to pay at the conclusion of the bankruptcy proceeding.

<sup>9</sup> Tax that the taxpayer will be required to pay at the conclusion of the bankruptcy proceeding.

## The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

found no indication that the SPf was aware of the payment.

The IRS' procedures indicate that the SPf should turn over to the trustee or seek legal action for lifting of the automatic stay when funds from pre-petition levies are received. However, the IRS' procedures do not clearly indicate what actions are necessary when payments are received from payroll deduction agreements, direct debit agreements, or installment agreements.

The districts we reviewed refunded money received after the bankruptcy petition date if the taxpayer or his/her attorney called and requested refunding of the payments. However, in one district, when payments received in violation of the automatic stay were identified, the SPf contacted the taxpayer's attorney to determine what to do with payments received. In some instances, the attorney's office informed the SPf to keep the payments. However, the trustee, who is responsible for the distribution of the debtor's estate, was not informed of these agreements. Consequently, one taxpayer sued the IRS for damages and recovery of the post-petition payments.

### **Liens filed after bankruptcy petition**

*In 16 (37 percent) of 43 cases reviewed, a lien was filed/recorded after the bankruptcy petition date, in violation of the automatic stay provisions.*

We reviewed 43 of 49 cases where a lien indicator posted after the petition date and identified 16 instances (37 percent) where a lien was filed in violation of the automatic stay provisions. Most of the erroneous liens were not identified during initial case processing due to timing between the filing of the lien and the input of the bankruptcy freeze. In 1 of the cases, the lien was recorded 3 days after the bankruptcy petition and the IRS erroneously collected over \$12,000, which fully paid the taxpayer's account.

### **Credit offsets after bankruptcy petition filed**

*In 12 (12 percent) of the 99 cases reviewed, an offset was made after the taxpayer filed for bankruptcy, in violation of the automatic stay provisions.*

We reviewed 99 of 2,716 cases where a credit offset was made after the petition date and identified 12 instances (12 percent) that violated the automatic stay provisions. The violations occurred when the stay was not appropriately lifted or the credit offset was within the



## The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

period from the filing of the bankruptcy to the input of the bankruptcy freeze.

The ability to offset taxpayer credit balances differs from court to court. In one bankruptcy court, the IRS cannot offset any funds without the lifting of the automatic stay, while in another bankruptcy court, a standing order allows the IRS to offset any credit balance.

### **Posting a statutory assessment while the taxpayer is in bankruptcy**

Examination assessments can be made during bankruptcy if the taxpayer agrees to the assessment or if statutory notice procedures<sup>10</sup> do not apply. These procedures restrict assessment of tax until after the period for petitioning the tax court has expired. The taxpayer generally has 90 days from the issuance of the statutory notice of deficiency to petition the Tax Court. However, the period for petitioning in the Tax Court is suspended while the automatic stay is in effect and for 60 days thereafter. Also, if the assessments are not “made valid” by abatement and reassessment within the proper statute of limitations, the Government’s right to collection will be lost.

Of the 86,000 bankruptcies in the 3 districts, our analysis of Masterfile information identified 270 taxpayers who were assessed additional tax based on a statutory assessment. We reviewed all 111 cases where the statutory assessment posted to the taxpayers’ accounts during bankruptcy and identified 40 instances (36 percent) where the statutory notice period had not expired, making the assessments invalid. Effective use of the litigation transcripts could have identified these

---

<sup>10</sup> The IRS has 3 years from the date a return was filed to make adjustments to a taxpayer’s account based on an examination of the return. If the taxpayer does not agree with the proposed adjustments based on an examination of his/her return, the IRS issues a statutory notice (90-day letter) to furnish the taxpayer legal notice that the deficiency in tax exists and it will be assessed on his/her account.

## The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

invalid assessments so that valid assessments could be made. Taxpayers' rights could be violated if collection activity is subsequently pursued on these invalid assessments.

In 13 of the 40 cases, the bankruptcy freeze indicators were not timely input to the taxpayers' accounts. The AIS interface programming automatically inputs bankruptcy freeze indicators to taxpayers' accounts if a balance is due. However, in these cases there was no balance due, and the bankruptcy freeze indicator was not input to alert the Examination function to the bankruptcy condition.

In 27 of the 40 cases, the Examination function made assessments after the bankruptcy freeze indicators had posted to the accounts. In 25 of these 27 cases, the assessments were made by the Service Center Examination function. The SPf and the Examination function staff did not coordinate to ensure that the 90-day period had passed prior to the bankruptcy petition date.

### Recommendations

The Assistant Commissioner (Collection) should:

1. Ensure bankruptcy examiners are properly resolving violations of the automatic stay by reviewing the litigation transcripts on a timely basis.
2. Provide additional computer programming enhancements to improve the value of litigation transcripts. Management needs to determine if an electronic version of the transcripts can be matched against the AIS so exception cases can be automatically identified, giving examiners the ability to pinpoint those cases having the most potential risk of violations. In addition, payments that are received as part of the bankruptcy closure should be eliminated from the litigation transcripts.
3. Provide additional guidance to SPf employees on specific conditions that may be considered violations

## The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

of the automatic stay. This includes “voluntary” payments received outside of the Chapter 13 payment plan and payments received and applied to dischargeable tax from taxpayers who file under Chapter 7.

4. Provide specific guidance in the Internal Revenue Manual (IRM) so the field offices know when and how to refund payments received after the bankruptcy petition date.
5. Provide consistent guidelines to the SPf units on how to notify the Examination function that the taxpayer is in bankruptcy.

Management’s Response: Management’s response was due on September 25, 2000. As of September 26, 2000, management had not responded to the draft report.

---

## The Internal Revenue Service Needs to Ensure Timely Input of Bankruptcies to the Masterfile

---

As previously stated, the BWG established that the initial processing of new cases should be completed within 5 workdays of receipt.

*Initial case processing procedures could be improved.*

Controls to monitor the initial case processing could be improved. Generally, we did not identify any significant delays on the input of the bankruptcy freeze to the Masterfile once a case was input to the AIS. However, the AIS report used to inform management of the success of meeting the 5-workday goal for initial case processing is not reliable. Additionally, the PIT reports were not worked timely in one of the three districts reviewed. Without effective management information, the IRS cannot reliably evaluate compliance with the overall goal of processing new cases within 5 workdays of receipt to prevent violations of the automatic stay.

## The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

### **The 5-workday goal of inputting freeze codes cannot be effectively monitored**

Generally, we did not identify any significant delays between the input of the new case information to the AIS and the input of the bankruptcy freeze on the Masterfile. SPf staff input the new bankruptcy cases to the AIS and the bankruptcy freeze is then input to the Masterfile with the running of the IIP programs. The IIP programs identify potential mismatches between AIS information and Masterfile information. The SPf must then manually review and resolve these mismatches.

*The actual receipt date of the bankruptcy is not captured on the AIS.*

However, the AIS report used to inform IRS management of the success of meeting the 5-workday goal for initial case processing is not reliable. The AIS report uses the date of input to the system as the receipt date of the case because the AIS does not have a specific field to record the receipt of the bankruptcy notice. Additionally, SPf management believes that inputting of the receipt date would be too time consuming for the benefits derived. Consequently, the IRS calculates the percentage of cases meeting the 5-workday goal by assuming that a new case is added to the AIS within 1 day of receipt.

### **Management needs to ensure that the PIT reports are worked timely**

The PIT report identifies differences of name and taxpayer identification numbers between the Masterfile and AIS information. The SPf employees need to timely and appropriately resolve the potential differences on this report to prevent potential collection actions on a taxpayer's account. Cases continue to appear on the PIT report until the potential difference is resolved.

*In one district, the PIT report was not worked timely, and all cases were not resolved to ensure timely input of the bankruptcy freeze.*

In one of the three districts reviewed, managers did not ensure that employees were timely and effectively resolving differences on the PIT report. We reviewed a PIT report dated February 22, 2000, for this district. The report contained 161 potentially invalid taxpayer identification numbers, of which 68 related to bankruptcies that had been input to the AIS on or before

## **The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations**

---

December 31, 1999. Further review of the 68 cases found that a bankruptcy freeze had not been input to 2 taxpayers' accounts, and the bankruptcy freeze was not established timely in 12 instances.

### **Recommendations**

The Assistant Commissioner (Collection) should:

6. Request that the AIS be reprogrammed so that the actual receipt date of the case can be input into the system to provide management with more accurate data on timeliness of input of new case information.
7. Ensure that employees review the PIT report and resolve all cases promptly to ensure timely posting of the bankruptcy freeze to the taxpayer's account.

### **Conclusion**

The Bankruptcy Code generally prohibits the IRS from acting against taxpayers who have filed for bankruptcy, known as the automatic stay. These actions include initiating or continuing lawsuits, garnishing wages, filing liens, or even making telephone calls demanding payments. We identified 143 instances where the IRS violated the automatic stay provisions of the Bankruptcy Code by either processing a payment received after the petition date, filing a lien after the petition date, or making a credit transfer during bankruptcy. In these instances, the IRS is vulnerable to the taxpayer filing a claim or a lawsuit for willful violation of the automatic stay provisions. Therefore, if the IRS does not take action to effectively prevent and identify these violations, the IRS could be sued for actual damages up to \$1,000,000 for reckless or intentional disregard for provisions of the I.R.C. and \$100,000 for instances involving negligence.

## The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

---

### Appendix I

#### Detailed Objective, Scope, and Methodology

Our overall objective was to determine if the Internal Revenue Service (IRS) effectively prevents and identifies violations of the Bankruptcy Code automatic stay provisions.

- I. Determined if controls were adequate to ensure all bankruptcy cases are controlled on the Automated Insolvency System (AIS).
  - A. Interviewed Special Procedures function (SPf) management and processing clerks to identify and evaluate:
    1. Bankruptcy notification procedures.
    2. Procedures given to the field functions for forwarding bankruptcy notifications.
    3. Initial case processing procedures.
  - B. Selected a judgmental sample of 80 cases from SPf files and:
    1. Determined if case controls were present on the AIS.
    2. Determined if a bankruptcy freeze (Transaction Code [TC] 520) was established on the taxpayer's account.
  - C. Reviewed a random sample of 10 Electronic Notice System transmissions containing 768 cases and determined whether the cases were timely input to the AIS.
  - D. Reviewed a judgmental sample of 502 cases and determined whether AIS information accurately reflected bankruptcy notices received.
- II. Determined if controls were adequate to ensure the IRS does not violate taxpayers' rights and jeopardize the Government's interest by violating the Bankruptcy Code automatic stay provisions.
  - A. Interviewed SPf management and the processing clerks to:
    1. Evaluate their use of Insolvency Interface Program (IIP) Process C and Process D control logs.
    2. Identify and evaluate contact procedures for active collection cases.
    3. Identify and evaluate the frequency and depth of the work review process.

## **The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations**

---

4. Identify and evaluate the process/procedures followed for reviewing IIP Process D transcripts and for associating transcripts with case files.
- B. Reviewed the AIS Potentially Invalid Taxpayer Identification Number Report and determined whether mismatches identified were from recently initiated bankruptcy cases.
- C. Obtained a Masterfile<sup>1</sup> extract of taxpayers with bankruptcy freeze indicators with petition dates during Fiscal Year 1999.
1. Reviewed a random sample of 278 of 5,060 cases where payments (TC 670 with designated payment codes 05, 99, or blank) posted to taxpayers' accounts after the bankruptcy petition date. We reviewed the AIS information, Integrated Data Retrieval Systems (IDRS) transcripts, and case files to determine if payments were received in violation of the automatic stay.
  2. Reviewed 43 of 49<sup>2</sup> cases where a lien transaction (TC 582) posted to the taxpayer's account after the bankruptcy petition date. We reviewed the AIS information, IDRS transcripts, and case files to determine if a lien was filed in violation of the automatic stay.
  3. Reviewed a random sample of 99 of 2,716 cases where credit offset transactions occurred after the bankruptcy petition date. We reviewed the AIS information, IDRS transcripts, and SPf case files to determine if credit offset occurred in violation of the automatic stay.
  4. Reviewed all 111 cases where a statutory tax assessment (TC 300 Disposal code 10) posted after the bankruptcy petition date. We reviewed the AIS information, IDRS transcripts, and Examination function case files, when available, to determine if the 90-day statutory notice period expired prior to the bankruptcy petition date.

---

<sup>1</sup> The Masterfile is the IRS' main computer system of taxpayer accounts.

<sup>2</sup> We did not review six liens where the case was being worked at a post-of-duty. We reviewed all other liens identified for the districts included in our review.

**The Internal Revenue Service Needs to Better Address  
Bankruptcy Automatic Stay Violations**

---

**Appendix II**

**Major Contributors to This Report**

Gordon C. Milbourn III, Associate Inspector General for Audit (Small Business and Corporate Programs)

Parker F. Pearson, Director

Amy L. Coleman, Audit Manager

Mary C. Thomas, Senior Auditor

Todd M. Anderson, Auditor

Darryl J. Roth, Auditor

Lynn A. Rudolph, Auditor



**The Internal Revenue Service Needs to Better Address  
Bankruptcy Automatic Stay Violations**

---

**Appendix III**

**Report Distribution List**

Deputy Commissioner Operations C:DO  
Commissioner, Small Business/Self-Employed Division S  
Assistant Commissioner (Collection) OP:CO  
Director, North Florida District D  
Director, North Texas District D  
Director, Southwest District D  
Director, Legislative Affairs CL:LA  
Office of Management Controls CFO:A:M  
Office of the Chief Counsel CC  
Director, Office of Program Evaluation and Risk Analysis M:OP  
National Taxpayer Advocate TA  
Audit Liaison:  
    Assistant Commissioner (Collection) OP:CO:C:IE