



Treasury Inspector General for Tax Administration Office of Audit

SIGNIFICANT REVENUE CONTINUES TO BE LOST BECAUSE OF UNASSESSED FAILURE TO PAY TAX PENALTIES

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Highlights

Highlights of Report Number: 2009-30-052 to the Internal Revenue Service Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

Congress established the Failure to Pay (FTP) penalty to encourage taxpayers to pay their Federal income taxes on time and authorized the Internal Revenue Service (IRS) to charge this penalty on tax accounts when taxes are not paid when due. Interest should also be charged on the penalty until it has been paid in full. However, because of the procedures used by the IRS to administer the penalty, interest is being fully assessed on the penalty for only some accounts while on most accounts it is not. As a result, hundreds of millions of dollars in revenue owed to the Federal Government is lost every year and taxpayers are not treated equitably.

WHY TIGTA DID THE AUDIT

This audit was a followup review to TIGTA's prior report *Procedures Regarding the Failure to Pay Tax Penalty Result in Inconsistent Treatment of Taxpayers and Hundreds of Millions of Dollars in Lost Revenue* (Reference Number 2005-30-052, dated March 2005). The objective of the review was to determine whether the IRS implemented corrective actions necessary to ensure that interest was charged on the FTP penalty.

WHAT TIGTA FOUND

In response to TIGTA's prior report, the IRS committed to a computer programming change to have the accrued FTP penalties assessed in conjunction with the ongoing issuance of annual balance-due reminder notices. TIGTA found that the IRS' programming changes had minimal effect, and the IRS continues to lose hundreds of millions of dollars in interest annually because the penalties accrue instead of being assessed. Over 90 percent of the accounts reviewed did not have penalty accruals assessed that would enable applicable interest to be charged on the penalty. The penalty accruals were not assessed because taxpayers never received annual balance-due reminder notices

or the programming changes did not work as expected.

Also, the IRS is not administering the tax law equitably because it charges certain taxpayers interest on the FTP penalties. These taxpayers have accounts that have to be administered by the IRS manually rather than by computer. IRS personnel periodically calculate and assess the penalties on these accounts because certain variables associated with the accounts are not programmed into IRS computers. Because the manually computed penalties are periodically assessed, interest is charged on the penalties on these accounts.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS develop and follow consistent procedures for assessing accrued FTP penalties on a regular basis on all balance-due accounts where such an assessment is not prohibited by statute. TIGTA also recommended the IRS request clarifying legislation to address whether or not separate notices must be issued to taxpayers each time penalties are assessed and interest is charged on the penalties.

IRS management partially agreed with both of our recommendations. They reexamined TIGTA's sample of cases and found that, at most, 25 of the 278 cases should have received a notice but did not. The IRS made no plans to address our second recommendation other than to work closely with the Office of Chief Counsel to review available options.

TIGTA's review did not focus solely on cases that should have received annual notices, but on whether or not accrued FTP penalties had been assessed to allow for the accrual of interest. The IRS' procedure of associating the assessment of the FTP penalty with the issuance of an annual reminder notice is not effective. Moreover, the lack of effective corrective action allows for continued inconsistent treatment of taxpayers.

TIGTA is concerned with the lack of specific corrective action to address our second recommendation and will provide a copy of the report to the Assistant Secretary of the Treasury for Tax Policy for consideration of a legislative proposal to clarify the law. If the law is clarified to state that the original notice and demand issued to taxpayers at the time the FTP penalty is first assessed suffices for future assessments, the IRS should ensure that the penalty is assessed regularly and applicable interest is charged on all taxpayer accounts. If the law is clarified to state that a new notice must be issued each time the penalty is assessed, then the IRS should address the selective and inconsistent manner in which the penalty is now being assessed.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response go to:
<http://www.treas.gov/tigta/auditreports/2009reports/200930052fr.pdf>.

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