



*The Federal Payment Levy Program Needs to  
Reduce Taxpayer Burden and Maximize  
Revenue*

**February 20, 2009**

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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.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

February 20, 2009

**MEMORANDUM FOR** COMMISSIONER, WAGE AND INVESTMENT DIVISION

**FROM:** *Michael R. Phillips*  
Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – The Federal Payment Levy Program Needs to Reduce Taxpayer Burden and Maximize Revenue (Audit # 200840005)

This report presents the results of our review to determine the effectiveness of the Federal Payment Levy<sup>1</sup> Program (FPLP) in collecting delinquent taxes and whether the Program adequately protects taxpayers' rights. This report was conducted as part of the Treasury Inspector General for Tax Administration Office of Audit Fiscal Year 2008 Annual Audit Plan.

*Impact on the Taxpayer*

The Internal Revenue Service (IRS) is authorized to continually levy against certain types of Federal Government payments issued to taxpayers and contractors with outstanding tax debts.<sup>2</sup> The IRS uses the FPLP to impose systemic levies on these types of payments. However, in some cases, these systemic levies have caused hardships for taxpayers. In addition, some Federal Government payments that should have been levied on were not identified for levy, and some levy fees paid by the IRS were excessive. These conditions increase taxpayer burden, reduce the amount of tax revenue collected, and increase operating costs for the IRS.

*Synopsis*

Congress has expressed concern that some Federal Government contractors, vendors, and employees who received Federal Government payments were delinquent in meeting their tax

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<sup>1</sup> See Appendix IV for a glossary of terms.

<sup>2</sup> Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of 5 U.S.C., 19 U.S.C., 26 U.S.C., 29 U.S.C., 31 U.S.C., 42 U.S.C., and 46 U.S.C. app.).



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obligations. Accordingly, Congress amended the tax code<sup>3</sup> and authorized the IRS to continuously levy against specified Federal Government payments through the FPLP. The FPLP was created to systemically levy against these payments.

In Fiscal Year 2004, IRS collections on delinquent taxes through the FPLP totaled \$114 million. In Fiscal Year 2007, the total collections through the FPLP rose to \$345 million. The increase in collections can be directly attributed to the efforts of the FPLP in accessing additional Federal Government payment streams that were previously not available for levy. However, even with this growth, IRS management still could do more to reduce the cost of collection and maximize delinquent tax collections through the FPLP while preventing hardships on low-income taxpayers.

We identified a number of areas in the FPLP that need to be improved. Some low-income Social Security beneficiaries are experiencing hardship due to the FPLP. Initially, the IRS had an income threshold in place. If a taxpayer's overall income amount as reported on the most recently filed tax return was less than this threshold, the taxpayer was excluded from the Program. However, starting in July 2005, the income threshold began to be phased out. It was first reduced by one-half; 6 months later, it was completely removed. Since then, the Taxpayer Advocate Service has experienced a large increase in the number of Social Security beneficiaries claiming hardship due to the issuance of FPLP automated levies. Although the previous income threshold criteria were flawed in some respects, some method of screening is needed.

In addition, the FPLP did not identify for levy Federal Government payments made to 163 taxpayers from 6 Federal Government entities with taxes due. The IRS did not take adequate steps to ensure that all available Federal Government payment sources were included in the FPLP, such as researching available data to isolate unidentified payment sources. As a result, available levy sources went unidentified.

Finally, levy fees for low-dollar cases are excessive. The IRS paid per-transaction fees averaging 51 percent to collect certain low-dollar levy payments. We determined that the Department of the Treasury Financial Management Service (FMS) provided 1,986 levy payments that fell below the debt and levy threshold for 923 taxpayer accounts. For nearly three-fourths (1,468) of these levies, the IRS was charged a levy processing fee of \$8.25 to \$10.20.<sup>4</sup> Overall, for these 1,468 low-dollar levies, the IRS paid \$12,809 (51 percent) to collect \$25,113 in delinquent taxes owed. Under the IRS' Interagency Agreement with the FMS, the IRS should not be reimbursing the FMS for low-dollar levies under the debt threshold unless those levies are collecting a tax debt balance that, at one time, was larger.

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<sup>3</sup> Taxpayer Relief Act of 1997.

<sup>4</sup> The IRS is not charged a levy fee if the amount of the levy payment is less than the fee amount. Therefore, the other 518 cases (1,986 – 1,468) involved levy payments that were less than the fee amounts, and the IRS was not charged fees for these cases. The FMS fee charged the IRS for levying Federal Government payments in Fiscal Year 2007 was \$10.20. In Fiscal Year 2008, the fee was set at \$12.65.



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### *Recommendations*

We recommended that the Commissioner, Wage and Investment Division, 1) establish specific criteria to identify and exclude from the FPLP those Social Security beneficiaries for whom a levy would create a hardship situation, 2) implement a process to periodically match Federal Government payment documents with available levy source lists, and 3) ensure that the IRS does not pay the per-transaction levy fee for those levies not covered by the FPLP Interagency Agreement and ensure that the cost of collection on a per-transaction basis is reasonable and does not exceed the cost of alternative IRS collection methods.

### *Response*

IRS management partially agreed with two of our three recommendations and disagreed with one recommendation. IRS management agreed with the principle of the first recommendation, but does not know if the model currently under development to screen low-income taxpayers for potential hardship is feasible to implement; therefore, management did not agree with the recommendation as written.

IRS management disagreed with the recommendation to match taxpayers not previously identified against information return documents received by the IRS but continues to work with the FMS to implement additional payment streams into the FPLP. Management stated that all six of the payment sources identified were from the Department of Defense or the Defense Financial Accounting Services.

IRS management is aware that some of the Non-Department of the Treasury disbursing offices are sending payments less than the payment threshold. The FMS is not the disbursing agent for these payments. While they do not have authority to force other agencies to make programming changes, they will meet with the FMS and the other agencies by June 15, 2009, to encourage them to adjust their payment thresholds so they can exclude payments below the payment threshold amount. The IRS is unable to provide an implementation date for the non-Department of the Treasury disbursing offices to complete this programming but it will diligently work with these agencies to reach a resolution to this issue. Management's complete response to the draft report is included as Appendix V.

### *Office of Audit Comment*

We are concerned with IRS management's approach to putting a solution in place to prevent as many hardships as possible for low-income taxpayers using a filter. It has been 7 years since the IRS first put in place a filter to prevent hardships. There has been more than enough time to refine and test the criteria. Delays come at the expense of low-income taxpayers who experience



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hardship due to levies on their Social Security payments. The IRS has an operational responsibility to reduce taxpayer burden and protect taxpayer rights.

The IRS provided additional information in its response that it did not provide upon our request during the audit. Upon review of the additional supporting documentation, we agree that two of the six exceptions were supported. However, for the other four exceptions, two were identified for levy of salaries but did not include the contractor/vendor payments, and the documentation for the remaining two was not sufficient to indicate that the payment streams should not be levied by the FPLP. Therefore, our recommendation remains valid that a process is needed to identify Federal Government payments for taxpayers who owe tax to the IRS. Finally, we accept management's partial agreement and planned actions to reach a resolution to the cost of collecting balance-due accounts.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services), at (202) 622-5916.



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*Abbreviations*

FPLP	Federal Payment Levy Program
FMS	Financial Management Service
FY	Fiscal Year
GAO	Government Accountability Office
IRS	Internal Revenue Service



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## *Background*

Congress has expressed concern that some Federal Government contractors, vendors, and employees who received Federal Government payments were delinquent in meeting their tax obligations. Accordingly, Congress amended the tax code<sup>1</sup> and authorized the Internal Revenue Service (IRS) to establish a continuous levy<sup>2</sup> program on specified Federal Government payments. This change in the law allowed the IRS to levy on (take) up to 15 percent of individual and recurring specified payments. The American Jobs Creation Act of 2004<sup>3</sup> further amended the IRS' continuous levy authority by providing for a 100 percent levy on specified Federal Government contractor/vendor payments. These continuous levies are separate from the internal IRS process of applying taxpayer refunds to outstanding tax debts.

***The Federal Payment Levy Program was created to address Congressional concerns about delinquent taxpayers who receive payments from Federal Government entities.***

In response to changes in the law, the IRS created the Federal Payment Levy Program (FPLP) and coordinated with the Department of the Treasury Financial Management Service (FMS) to levy against specified Federal Government payments made to taxpayers with outstanding tax debts. The FMS' mission is to act as the disbursing agent for many of the Federal Government payments. In addition, it acts as a centralized debt collection service for Federal Government agencies. For example, it collects delinquent student loans for the Department of Education and delinquent child support payments for the Office of Child Support Enforcement. Through the FMS, the IRS collections on delinquent taxes with the FPLP have increased from \$114 million in Fiscal Year (FY) 2004 to \$345 million in FY 2007.

The IRS entered into an Interagency Agreement with the FMS to issue automated levies under the FPLP. Four steps are taken to identify the available Federal Government payments and to issue automated levies against those payments.

- **Case and Module Selection** – Each week, the IRS transmits to the FMS a file containing a list of taxpayers with outstanding tax debts.
- **Match and Notice** – From this file, the FMS matches the taxpayer information against the same information in its Federal Government payment file. The FMS then transmits a weekly file to the IRS listing the taxpayers who matched. The IRS sends each of those

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<sup>1</sup> Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of 5 U.S.C., 19 U.S.C., 26 U.S.C., 29 U.S.C., 31 U.S.C., 42 U.S.C., and 46 U.S.C. app.).

<sup>2</sup> See Appendix IV for a glossary of terms.

<sup>3</sup> Pub. L. No. 108-357, 118 Stat. 1418.





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taxpayers a notice, which provides the taxpayer with an opportunity to comply by paying the delinquent tax debt in full or by setting up a tax payment agreement.<sup>4</sup>

- Levy – Once the notice process is complete and the taxpayer has not appealed or resolved the case within the appropriate time period, the IRS will direct the FMS to continuously levy against the taxpayer's Federal Government payments until the levy is released.
- Levy Payment – The FMS takes the appropriate amount from the Federal Government payments and transmits those withholdings to the IRS. At the same time, the FMS sends the remaining part of the Federal Government payment to the taxpayer, along with a notice informing the taxpayers that the payment was subjected to an IRS levy. Once the IRS receives the withheld amount from the FMS, a payment is applied to the taxpayer's outstanding tax debt.

The IRS and FMS operate the FPLP under an Interagency Agreement that was established to identify the responsibilities and estimated transaction fees to be charged for each levy issued. The current agreement began in FY 2007 and includes options for services through FY 2011. The per-transaction fee in FY 2007 was \$10.20. Based on the Interagency Agreement, the per-transaction fee is estimated to rise to \$19.75 in FY 2011. The projected cost for the services provided by the FMS over the life of the Agreement (through FY 2011) is estimated at \$159 million. While most financial institutions and other Government agencies pass on the cost of a levy to the individual with the outstanding balance, the IRS is prohibited by law to pass on the cost and pays the processing costs of levies from its enforcement funds.

This review was performed at the IRS National Headquarters office of the Chief Financial Officer in Washington, D.C., the Wage and Investment Division Headquarters in Atlanta, Georgia, and the Department of the Treasury FMS National Headquarters in Washington, D.C., during the period August 2007 through September 2008. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>4</sup> The IRS issues the final notice, Notice of Intent to Levy and Notice of Your Right to a Hearing (Form CP90 or CP297). If the taxpayer is a Social Security recipient and does not respond to the final notice within a specified time period, the IRS issues a Final Notice Before Levy on Social Security Benefits (Form CP91 or CP298).



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## *Results of Review*

### ***Some Low-Income Social Security Beneficiaries Are Experiencing Hardship Due to the Federal Payment Levy Program***

When the FPLP began assessing levies against Social Security benefits in February 2002, low-income Social Security beneficiaries were excluded from the Program because the IRS had an established income threshold. If a taxpayer's overall income amount as reported on the most recently filed tax return was less than this threshold, the taxpayer was excluded from the FPLP. However, starting in July 2005, the income threshold began to be phased out. The threshold was first reduced by one-half; 6 months later, it was completely removed.

The IRS' change in the FPLP income threshold stemmed from a Government Accountability Office (GAO) review of the Program soon after Social Security benefits began to be levied against. In an FY 2003 report,<sup>5</sup> the GAO concluded that the IRS used inaccurate income criteria when determining "ability to pay" for taxpayers receiving Social Security benefits. In the GAO's opinion, the income threshold was not a good indicator of a taxpayer's actual ability to pay delinquent taxes. The IRS responded that it would work with the National Taxpayer Advocate and program administrators to assess the deficiencies in the current process and develop a solution. However, the IRS' final solution was to eliminate the income threshold entirely, which exposed a large number of Social Security beneficiaries to FPLP levies. As recommended by the GAO, after eliminating the income threshold, the IRS continued to rely only on a dual notice process that informs the Social Security beneficiaries who are burdened by the levy of how they might claim a financial hardship. Other than the dual notice process, the IRS has not implemented any procedures to minimize the volume of Social Security beneficiaries who encounter a financial hardship because of the FPLP, and the number of hardship cases has continued to increase.

The Taxpayer Advocate Service has experienced a large increase in the number of Social Security beneficiaries claiming hardship and considers the FPLP automated levy process to be one of the most serious problems facing taxpayers. While in FY 2007 only about 8.5 percent of the FPLP levies were against Social Security beneficiaries, during FYs 2004 through 2007, more than 80 percent of all the Federal Government payments levied through FPLP were imposed against monthly Social Security benefit payments (these Social Security levies accounted for more than 60 percent of the total revenue collected by the FPLP during the same period). The

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<sup>5</sup> *TAX ADMINISTRATION: Federal Payment Levy Program Measures, Performance, and Equity Can Be Improved* (GAO-03-356, dated March 2003).



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National Taxpayer Advocate<sup>6</sup> has expressed concern that the automatic levies might cause economic hardship for a large number of low-income Social Security beneficiaries and other at-risk taxpayers. With no income threshold in place, the IRS has no effective mechanism for excluding low-income taxpayers from the FPLP continuous levy.

We reviewed a randomly selected statistical sample of 57 FY 2006 Taxpayer Advocate Service hardship cases and determined that:<sup>7</sup>

- 44 (77 percent) subsequently had the FPLP levy released.
- 10 (18 percent) were closed with no action due to the taxpayer's non-responsiveness or the taxpayer's withdrawal of the request.
- 3 (5 percent) were determined to be properly levied on as there was no hardship.

Of the 44 FPLP cases for which the levies were released, 30 were placed in "currently not collectible" status after being reviewed by the Taxpayer Advocate Service. This means that at the time of our review, the taxpayers were considered unable to pay any amount based on his or her financial situation. To classify a taxpayer's account as currently not collectible, the IRS must first review the taxpayer's situation, which includes requesting financial information<sup>8</sup> and the filing of any delinquent returns. A taxpayer whose account is in currently not collectible status is informed that changes in his or her financial condition could result in future enforcement actions being taken. IRS management stated that if a case was placed in currently not collectible status after a Taxpayer Advocate Service review, a hardship existed at the time of levy.

In FY 2007, IRS management and the Taxpayer Advocate Service started a joint research project (the Automated Levy Issuance Research Project) to identify criteria that could exclude from the FPLP those Social Security beneficiaries who might experience hardships from the Program's levies. This research project's June 2008 report stated that a workable model to exclude hardship cases could not be created because of insufficient or incomplete data. The report conclusion stated, "The IRS continues to work towards meeting the goal of developing a filter that will systemically prevent FPLP taxpayers from experiencing a financial hardship that might result from the levy of their Social Security benefits." However, the IRS has not specified the action it plans to take or the time period for action.

The overall intent of the original GAO recommendations was for the IRS to implement a more effective process to ensure the equitable treatment of taxpayers. While the IRS did take actions

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<sup>6</sup> *National Taxpayer Advocate 2006 Annual Report to Congress*, January 2007, and *National Taxpayer Advocate 2005 Annual Report to Congress*, January 2006.

<sup>7</sup> Of the 57 cases reviewed, 55 involved levies on Social Security benefits and 2 involved levies on Federal Government wages.

<sup>8</sup> Some taxpayers are required to complete the Collection Information Statement, which includes employment and financial statement information (e.g., bank accounts, cash, life insurance, vehicles, real property, and other assets).



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to address the report's recommendations, the fact that the number of FPLP hardship cases coming to the Taxpayer Advocate Service continues to increase<sup>9</sup> indicates that these actions need to be reexamined. Although the previous income threshold criteria were flawed in some respects, some method of screening is needed.

Until further actions are taken, the IRS will continue to include Social Security beneficiaries and others who might face hardships in the FPLP. Moreover, the results presented above represent only those taxpayers who formally requested assistance from the Taxpayer Advocate Service. There might be other taxpayers who are also affected but did not go through the formal process of claiming an economic hardship.

### ***Recommendation***

***Recommendation 1:*** The Commissioner, Wage and Investment Division, should develop a viable method for screening low-income taxpayers for potential hardship and then establish specific criteria to identify and exclude from the FPLP those Social Security beneficiaries and other low-income taxpayers for whom a levy would create a hardship situation.

***Management's Response:*** IRS management agreed with the principle, but does not know if the model currently under development will be feasible to implement; therefore, management did not agree with the recommendation as written. As reported, the joint research project concluded that the data available to them does not lend itself to provide a model that would identify Social Security Administration beneficiaries at risk for financial hardship with any degree of confidence. The Taxpayer Advocate is considering and evaluating other options, including a low-income filter based on allowable living expenses and/or poverty level analysis. However, the reliability of any such model must be established before it can be implemented.

***Office of Audit Comment:*** We are concerned with management's approach on this issue. It has been 7 years since the IRS first put in place a filter to prevent hardships. There has been more than enough time to refine and test the criteria. Delays come at the expense of low-income taxpayers who experience hardship due to levies on their Social Security payments. The IRS has an operational responsibility to reduce taxpayer burden and protect taxpayer rights.

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<sup>9</sup> *TAXPAYER ADVOCATE SERVICE: Caseload Has Grown and Taxpayers Report Being Satisfied, but Additional Measures of Efficiency and Effectiveness Are Needed (GAO-07-156, February 2007).*



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## **Some Federal Government Payment Sources Were Not Identified for Levy Through the Federal Payment Levy Program**

In response to a February 2004 GAO report<sup>10</sup> and at Congress' request, the IRS, FMS, and other Federal Government agencies began working together and formed the Federal Contractor Tax Compliance Task Force, with the intent to improve tax compliance by Federal Government contractors. The GAO report concluded that thousands of Department of Defense contractors continued to receive Federal Government payments while still owing millions in unpaid taxes. Since the Federal Contractor Tax Compliance Task Force was formed, progress has been made, including:

- Adding payments from a variety of Federal disbursement entities that were previously inaccessible through the FPLP.
- Increasing the frequency with which the FMS processes payments from participating agencies, to capture more payments under the FPLP.
- Identifying new ways to prevent Federal Government contract awards to taxpayers/contractors who abuse the tax system.

However, despite the progress made by the Federal Contractor Tax Compliance Task Force, we identified six Federal Government entities whose payments were not being matched for levy by the FPLP. The six entities were Defense Finance and Accounting Service or other Department of Defense offices whose contractor payments were not included in the FPLP. At the time of our review, there were 163 taxpayers who had balance-due accounts that were not matched for levy by the FPLP even though the IRS had information return documents (e.g., Form 1099 series) readily available for review which showed the taxpayers received significant Federal Government payments from the 6 entities. The IRS should have been using this internal data to ensure that all Federal Government payments for delinquent taxpayers were being accessed by the FPLP. If not, the IRS should have taken adequate steps to ensure that the available Federal Government payment sources were either included in the FPLP or otherwise issued levies using existing collection methods. As a result, available levy sources might have gone unidentified.

### **Recommendation**

**Recommendation 2:** The Commissioner, Wage and Investment Division, should implement a process to periodically match taxpayers who were not previously identified as receiving Federal Government payments by the FPLP against information return documents received by

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<sup>10</sup> *FINANCIAL MANAGEMENT: Some DOD Contractors Abuse the Federal Tax System with Little Consequence* (GAO-04-95, dated February 2004). DOD = Department of Defense.



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the IRS. Once identified, the IRS should provide the information on unmatched sources to the FMS for collection via levy.

**Management's Response:** IRS management disagreed with this recommendation and continues to work with the FMS to implement additional payment streams into the FPLP. All six of the payment sources identified were from the Department of Defense or the Defense Financial Accounting Services. The IRS made an informed decision to exclude two of these payment streams from the FPLP and two others are already included in the FPLP. The remaining two include Non-Appropriated Funds payment streams that are not disbursed through the Defense Financial Accounting Service, and thus not currently subject to the Treasury Offset Program used by the FMS to collect delinquent taxes from Federal payments under the FPLP. A Miscellaneous Income (Form 1099-MISC) is used for income reporting, and the payment information reported does not always mean that payment can be levied through the FPLP or that the paying agency should be added to the Program. The Defense Financial Accounting Service explained the Form 1099-MISC forms were used to report one-time payments to beneficiaries of deceased employees as well as other payments that are not vendor payments. The payments made by these entities were not contractor payments and were in fact payments to active and retired military which the IRS made a policy decision not to process through the FPLP. For a few small Federal payment sources, such as the two Non-Appropriated Fund payment streams identified, the programming to add them into the Treasury Offset Program and the FPLP might be cost prohibitive. However, the IRS will continue to work with the FMS, Congress, and large disbursing agencies to ensure that the majority of Federal payments are included in the FPLP.

**Office of Audit Comment:** The IRS provided additional information in its response that it did not provide upon our request during the audit. Upon review of the additional supporting documentation, we agree that two of the six exceptions were supported. However, for the other four exceptions, two were identified for levy of salaries but did not include the contractor/vendor payments, and the documentation for the remaining two was not sufficient to indicate that the payment streams should not be levied by the FPLP. Therefore, our recommendation remains valid that a process is needed to identify Federal Government payments for taxpayers who owe tax to the IRS.

### ***Levy Fees for Low-Dollar Cases Are Excessive***

The FPLP generally incurs a lower collection cost than that incurred by the regular IRS collection process. The overall cost of all in-house IRS collections is estimated to be 14 percent, while the FPLP cost is 4 percent to 6 percent. Nonetheless, the IRS could make the FPLP more efficient and reduce the cost for some cases.



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The FPLP Interagency Agreement between the IRS and the FMS establishes the roles and responsibilities for both agencies with regard to the automated, continuous tax levy of the specified Federal Government payments. In addition, the functional requirements document identifies and defines the functional, data, and technical requirements for the FPLP. To implement the requirements, the FMS applies two criteria when levying on Federal Government payments:

- A debt threshold determines the amount that the FMS can collect. If the tax debt is less than the debt threshold, the FMS does not impose a levy unless the levy would be the final payment for a once larger tax debt amount. The debt threshold limit is an FMS criterion, and it has been the standard for all agencies.
- A levy threshold determines the base Federal Government payment amount needed before the FMS should impose a levy. Because the IRS can generally collect only 15 percent of a Federal Government payment,<sup>11</sup> the Federal payment amount should be at least the IRS' levy threshold.

The IRS cost for collections made through the FPLP is determined as the percentage of the total fees paid for all amounts collected. However, if the population of FPLP cases is examined on a per-transaction basis, in some instances the IRS is incurring debt collection costs substantially higher than those that would have been incurred by its regular collection process. We determined that the IRS was receiving money on low-dollar FPLP levies that were not supposed to take place and was paying excessive per-transaction fees for these levies.

We determined that the FMS provided 1,986 levy payments that fell below the debt and levy threshold for 923 taxpayer accounts. For nearly three-fourths (1,468) of these levies, the IRS was charged a levy processing fee of \$8.25 to \$10.20.<sup>12</sup> Overall, for these 1,468 low-dollar levies, the IRS paid \$12,809 (51 percent) to collect \$25,113 in delinquent taxes owed.

Both FMS and IRS management stated that they were aware of these low-dollar levies. The levies were being processed through non-Department of the Treasury disbursing offices.<sup>13</sup> According to FMS management, these disbursing offices do not have appropriate threshold filters to restrict levies to Federal Government payments that meet the IRS' levy threshold. Therefore, levies below the debt and levy thresholds continue to occur. Although IRS management was aware of these low-dollar collections (which were mainly levies on salary payments), the IRS has taken no action to stop payment of the fee to the FMS in accordance with the Interagency Agreement.

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<sup>11</sup> Under the American Jobs Creation Act of 2004, contractor payments can be levied at 100 percent.

<sup>12</sup> The IRS is not charged a levy fee if the levy payment is less than the fee amount. Therefore, the other 518 cases (1,986 – 1,468) involved levy payments that were less than the fee amounts, and the IRS was not charged fees for these cases. The FMS fee charged the IRS for levying Federal Government payments in FY 2007 was \$10.20. In FY 2008, the fee was set at \$12.65.

<sup>13</sup> Payments made by non-Department of the Treasury disbursement offices are not processed by the FMS.



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Also, the IRS has not taken any action to evaluate the suitability of the debt threshold for its program. In FY 2007, the levy fee charged by the FMS was set at \$10.20 per transaction. Because the fee is fixed per transaction, smaller levy payments have larger fee percentage costs. For example, a levy payment of \$25 results in a fee percentage cost of 41 percent ( $\$10.20/\$25$ ). However, a levy payment of \$375 results in a fee percentage cost of only 3 percent ( $\$10.20/\$375$ ).<sup>14</sup>

If the IRS revised the FPLP debt threshold criteria so that the fee percentage cost is similar to the average cost cited for IRS in-house collections (14 percent), the minimum levy payment for FY 2008 should be about \$90.<sup>15</sup> This would increase the IRS' levy threshold payment amount. We found that nearly 10 percent, or 163,593, of the levy payments made to the IRS in Calendar Year 2006 cost the IRS more than 14 percent. For these levy payments, the IRS paid \$1,477,958 (19 percent) to collect \$7,615,657 in taxes owed. The small size of these individual levy payments is not indicative of the size of the respective balances due. In many cases, especially for large balances due, other collection methods could be more effective.

Because the levy fee charged by the FMS increases annually, the fee percentage cost on a per-transaction basis will also rise. If the fee projections in the Interagency Agreement are realized, in FY 2011, the fee for each Federal Government payment levied will be \$19.75. If the debt threshold is not revised, the per-transaction levy cost on the base Federal Government payment amount for the IRS' levy threshold will rise to 79 percent. IRS management needs to regularly evaluate the FPLP fees being incurred to collect balance-due accounts to ensure that those fees are reasonable and that the FPLP levy is the best collection approach. The IRS and FMS established the debt threshold for FPLP levies and agreed not to levy on Federal Government payments of less than the IRS levy threshold. However, neither agency has considered making adjustments to ensure that the costs of collection are efficient.

## ***Recommendation***

***Recommendation 3:*** The Commissioner, Wage and Investment Division, should ensure that the IRS, in accordance with the Interagency Agreement, does not pay the per-transaction levy fee for those levies that fall below the established debt and levy thresholds. In addition, the Commissioner should work with the FMS and other relevant agencies to eliminate these low-dollar levy payments and ensure that the cost of collection, on a per-transaction basis, is reasonable and does not exceed the cost of alternative IRS collection methods.

***Management's Response:*** IRS management partially agreed with this recommendation. They are aware that some of the non-Department of the Treasury

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<sup>14</sup> The associated Federal Government payment that would result in a \$375 levy payment is \$2,500 ( $\$2,500 \times 15$  percent = \$375). The FY 2007 FMS fee was \$10.20 ( $\$10.20/\$375 = 2.7$  percent).

<sup>15</sup> The associated Federal Government payment that would result in a \$90 minimum levy payment would be \$600 ( $\$600 \times 15$  percent = \$90). The FY 2008 FMS fee was \$12.65 ( $\$12.65/\$90 = 14.1$  percent).





*The Federal Payment Levy Program Needs to Reduce  
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disbursing offices are sending payments less than the payment threshold. The FMS is not the disbursing agent for these payments. While they do not have authority to force other agencies to make programming changes, they will meet with the FMS and the other agencies by June 15, 2009, to encourage them to adjust their payment thresholds so they can exclude payments below that amount. The IRS is unable to provide an implementation date for the non-Department of the Treasury disbursing offices to complete this programming but it will diligently work with these agencies to reach a resolution to this issue.

**Office of Audit Comment:** We accept management's partial agreement and planned actions to reach a resolution to the cost of collecting on balance-due accounts.



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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

The overall objective of this review was to determine the effectiveness of the FPLP<sup>1</sup> in collecting delinquent taxes and whether the Program adequately protects taxpayers' rights. To accomplish the objective, we:

- I. Determined whether Wage and Investment Division management provided oversight of the IRS/FMS Interagency Agreement for the FPLP fees charged when automated levies are issued. We evaluated efforts by the IRS and the FMS to collect the per-transaction fee associated with processing automated levies directly from the taxpayers with outstanding tax debts.
  - A. Reviewed the IRS and FMS FY 2008 Budget In Brief documents to identify proposals for passing on the costs of issuing automated levies to the taxpayers with outstanding tax debts.
  - B. Reviewed the FPLP Interagency Agreement and modifications to the Agreement to determine whether the IRS and the FMS complied with the provisions in the Agreement. We reviewed controls established to ensure that the correct fees were paid for the automated levies that were processed.
  - C. Analyzed the IRS' Calendar Year 2006 automated levy payment file to determine whether the IRS paid for only those automated levies that met the conditions identified in the FPLP functional requirements document.
- II. Determined whether the Wage and Investment Division Compliance function identified and pursued new available Federal Government payment levy sources for the FPLP. We also determined whether the FPLP process was the best collection method and taxpayers were appropriately notified.
  - A. Reviewed the process the Filing and Payment Compliance function follows for including delinquent taxpayer accounts in the FPLP and collecting taxes.

For Calendar Year 2006, used IRS Information Returns Master File data and identified 649 Federal Government agencies that filed information returns reporting payments to taxpayers. To validate the data, we selected 25 records and traced the

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<sup>1</sup> See Appendix IV for a glossary of terms.



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## *The Federal Payment Levy Program Needs to Reduce Taxpayer Burden and Maximize Revenue*

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data for each to the Integrated Data Retrieval System<sup>2</sup> to ensure the accuracy of the data contained in the extracts.

We first accessed the Integrated Data Retrieval System to determine whether the names associated with the 649 payer Employer Identification Numbers were Federal Government agencies. We also used the Integrated Data Retrieval System to determine whether there were appropriate payment documents reported to the payees receiving payments from the 649 Federal Government agencies.

We compared the documents identified for the primary and secondary Taxpayer Identification Numbers associated with the FPLP tax accounts to identify a population of FPLP taxpayers who had received Federal payments from at least 1 of the 649 Federal Government agencies. We eliminated those taxpayers who were levied against through the FPLP and identified the Federal Government agencies associated with the payments that appeared not to be matched. Overall, we examined documentation obtained from the FMS, the Defense Finance and Accounting Service, and the IRS Information Returns Master File and Integrated Data Retrieval System to determine the number of Federal Government contractors selected for levy via the FPLP during Calendar Year 2006.

Using IRS Information Returns Master File data, we identified a total of 649 Federal Government entities that reported 77,523,058 Federal payments to 305,231 taxpayers during Calendar Year 2006. These taxpayers included contractors, Federal Government retirees, and Federal employees. We then determined how many of the information return documents were from entities for which FPLP levies were already being made and eliminated those entities from our analysis. There were 78 entities remaining whose payments were not being levied against, and they made payments to 133,575 taxpayers.

We then performed additional analysis using FMS data to determine whether the FMS had access to the payments from the 78 entities. We were able to eliminate all but 16 entities using this criterion. Because the IRS had made a policy to not process levies against military retirees and employees, we also eliminated the Defense Finance and Accounting Service and Department of Defense entities that were solely making salary and/or retirement payments. The remaining 6 entities reported payments to 163 taxpayers on a Calendar Year 2006 Miscellaneous Income (Form 1099-MISC). These were contractor payments and 100 percent of them were eligible for levy. However, we could not determine the exact taxpayer balances due at the time of the Federal Government payments.

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<sup>2</sup> We did not independently assess the reliability of the Integrated Data Retrieval System.



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For FY 2006 taxpayers identified as being levied against through the FPLP, we accessed the taxpayers' Master File accounts to determine whether they received a notice of the IRS' intent to levy. To validate the data, we selected 25 records and traced the data for each to the Integrated Data Retrieval System to ensure the accuracy of the data contained in the extracts. We accessed the Integrated Data Retrieval System to determine whether the accounts contained a specific FPLP levy notice code. We electronically analyzed the taxpayers' accounts to determine whether 1) the IRS received a return receipt card indicating that the taxpayer received the notice of levy, 2) the file showed that the notice was undeliverable, or 3) the account was not documented.

- III. Determined what actions the Wage and Investment Division Compliance function took to protect the increasing number of taxpayers who might face hardships due to issuance of automated levies through the FPLP.
- A. Reviewed the prospectus for the Automated Levy Issuance Research Project and the final report to determine what actions would be taken to make changes to the FPLP.
  - B. Researched the FY 2006 inventory of the Taxpayer Advocate Management Information System database to identify cases assigned to each of the five FPLP categories. We identified 4,133 cases categorized as FPLP cases. We reviewed 25 cases to validate that the cases were worked in FY 2006 and that each case was assigned one of the FPLP primary issue codes.
  - C. Randomly selected a statistical sample of 72<sup>3</sup> cases from the 4,133 FPLP cases.
  - D. Analyzed the 57 FPLP hardship cases to determine whether the levies were released after the cases had been reviewed by employees in the Taxpayer Advocate Service.

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<sup>3</sup> The sample of 72 cases was reduced to 57 cases because 15 (21 percent) were misclassified as FPLP hardship cases in the Taxpayer Advocate Management Information System database.



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**Appendix II**

*Major Contributors to This Report*

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James D. O'Hara, Audit Manager  
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Andrea R. McDuffie, Auditor



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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner - Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
National Taxpayer Advocate TA  
Chief Financial Officer OS:CFO  
Deputy Commissioner, Wage and Investment Division SE:W  
Director, Compliance, Wage and Investment Division SE:W:CP  
Director, Strategy and Finance, Wage and Investment Division SE:W:S  
Chief, Performance Improvement, Wage and Investment Division SE:W:S:R:PI  
Chief Counsel CC  
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Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
    Chief Financial Officer OS:CFO  
    Senior Operations Advisor, Wage and Investment Division SE:W:S



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## Appendix IV

### *Glossary of Terms*

**Automated Levy Issuance Research Project** – A cross-functional task force whose goal is to develop a systemic filter designed to distinguish between hardship and non-hardship cases with a high degree of accuracy. The task force includes representatives from the IRS Research function, Wage and Investment Division Compliance function, and Taxpayer Advocate Service.

**Continuous Tax Levy** – The continuous tax levy process was initiated by the FMS in July 2000. Under a continuous tax levy, delinquent Federal income tax debts are collected by levying against non-tax payments until the debt is satisfied, as authorized by the Taxpayer Relief Act of 1997.<sup>1</sup>

**Defense Finance and Accounting Service** – The primary finance and accounting operation that services military departments and defense agencies. The Defense Finance and Accounting Service has overall payment responsibility for goods and services purchased by the Department of Defense.

**Federal Contractor Tax Compliance Task Force** – A multi-agency task force developed to identify and implement short and long-term operational changes to improve the Federal tax compliance of Federal contractors. The Federal Contractor Tax Compliance Task Force was recommended by the Permanent Subcommittee on Investigations in response to the GAO's 2004 report related to defense contractors and the FPLP.

**Federal Disbursement Entities (Disbursing Offices)** – These are offices that disburse Federal payments such as salary, retirement, bonuses, awards, and contract payments.

**Federal Payment Levy Program** – A program created by the IRS in coordination with the FMS. This automated system matches IRS records against those of the FMS to locate Federal payment recipients who have delinquent income tax debts.

**Financial Management Service** – A Department of the Treasury bureau charged with implementing the Government's delinquent debt collection program. Through the debt collection program, the FMS provides an extremely valuable Government-wide service, assisting with the collection of delinquent Federal debt.

**Functional Requirements Document** – A document that identifies and defines the functional, data, and technical requirements for the FPLP.

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<sup>1</sup> Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of 5 U.S.C., 19 U.S.C., 26 U.S.C., 29 U.S.C., 31 U.S.C., 42 U.S.C., and 46 U.S.C. app.).



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**Information Returns Master File** – The portion of the IRS Master File where Individual Master File and Business Master File taxpayer information documents are compiled. The documents contain data often used for filing, verifying, and validating income and expenses.

**Integrated Data Retrieval System** – An IRS computer system with the capability to instantaneously retrieve or update stored information. It consists of databases and operating programs that support IRS employees working active tax cases within each business function across the entire IRS. The System manages data that were extracted from various other IRS systems allowing IRS employees to access information and take specific actions on taxpayer accounts, track status, and post transaction updates back to the Master Files.

**Interagency Agreement** – A written agreement entered in between two Federal agencies which specify the goods, services, or tasks to be accomplished.

**Levy** – A levy generically refers to seizure of property to collect a debt. For tax debts, it is the legal process by which the IRS orders a third party to turn over property in its possession (e.g., the Federal Government payment) that belongs to the tax debtor.

**Levy Fee** – The fee the IRS pays the FMS to recover FMS administrative expenses for operating the FPLP. The fee is paid on a pro rata, per levy basis and determined annually based on the projected volume of levies.

**Levy Payment** – The proceeds of a levy taken by the FMS against Federal payments and remitted to the IRS under the FPLP.

**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.

**National Taxpayer Advocate** – An independent advisor within the IRS who helps taxpayers resolve problems with the IRS and recommends changes to the IRS to prevent the same or similar problems in the future.

**Non-Department of the Treasury Disbursing Offices** – Disbursing offices are agencies outside the Department of the Treasury whose Federal payments (e.g., contract, salary, retirement, etc.) are not disbursed through the Department of the Treasury FMS systems.

**Notice** – A computer-generated message resulting from an analysis of the taxpayer's account on the Master File.

**Program Administrators** – IRS personnel responsible for administering and implementing the FPLP.

**Specified Payments** – Any Federal Government payment other than one for which eligibility is based on the income and/or assets of a payee. These Federal Government payments include Federal salary, retirement, Social Security, and contractor payments. The IRS does not levy against unemployment benefits, workers' compensation, or certain public assistance payments.





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**Taxpayer Advocate Management Information System** – An Oracle web-based inventory control and report system used to control and track Taxpayer Advocate Service cases and provides management information.

**Taxpayer Advocate Service** – An IRS function headed by the National Taxpayer Advocate designed to promptly respond to sensitive or complex taxpayer issues, complaints, or inquiries. The Taxpayer Advocate Service provides assistance to taxpayers who have problems that the IRS has not resolved through normal channels.

**Treasury Offset Program** – The name given internally by the FMS to the centralized offset process that intercepts Federal payments of payees who owe delinquent debts to Federal agencies.



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**Appendix V**

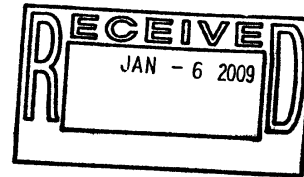
*Management's Response to the Draft Report*



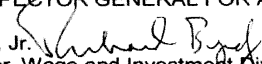
COMMISSIONER  
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

JAN - 6 2009



MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr.   
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – The Federal Payment Levy Program  
Needs to Reduce Taxpayer Burden and Maximize Revenue  
(Audit #200840005)

The Federal Payment Levy Program (FPLP) provides an automated process for serving tax levies and collecting delinquent unpaid taxes from federal payments through the Financial Management Service (FMS). We are continuously looking for ways to improve the effectiveness of the FPLP. We have changed the selection and exclusion criteria to increase the tax debts available. The tax debts available for the FPLP increased from \$73 billion in 2004 to \$133 billion in 2008. Consequently, we collected \$405 million in Fiscal Year (FY) 2008 compared to \$345 million during FY 2007. Over the same period, collections from delinquent federal contractors also increased to \$66.5 million from \$48 million.

The FPLP is a critical component of IRS's efforts to reduce the tax gap. Since the implementation of the program in July 2000, we have collected \$1.53 billion from delinquent taxpayers. We recognize that a few taxpayers levied through this program may experience a hardship situation; thus, we have procedures in place for these taxpayers to self-identify and be excluded from the FPLP.

While we appreciate your review of the FPLP, we believe your report does not adequately acknowledge the efforts we have expended in trying to develop a low income hardship filter for taxpayers with Social Security benefits. In June 2003, we convened a cross-functional task force which included representatives from the National Taxpayer Advocate's Office, to explore alternatives to the Total Positive Income (TPI) exclusion criterion.



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## *The Federal Payment Levy Program Needs to Reduce Taxpayer Burden and Maximize Revenue*

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This group looked at data from the Information Returns Program along with existing hardship criteria used by the IRS. After careful consideration, the group concluded that the IRS had no systemic means of predicting taxpayer hardship. As a result, the IRS agreed to phase out use of the TPI exclusion criterion based on a prior Government Accountability Office (GAO) recommendation and finding that TPI is not a reliable hardship indicator.<sup>1</sup> We met with the Social Security Administration (SSA) in January 2007 to determine if SSA indicators could be used to develop a low income filter. After SSA explained their indicator codes could not be used to determine if a taxpayer has low income, IRS initiated a research project to determine how such a filter could be developed.

As your report states, the results of this research project indicated that data available to the IRS does not lend itself to provide a model with a reasonable degree of confidence in identifying SSA beneficiaries at risk for financial hardship. However, we are in discussions with the National Taxpayer Advocate to develop models using allowable living expenses and/or poverty level analysis. The models have not yet been finalized and testing has not been completed. We are hopeful the results of these efforts will enable us to implement a model that will help identify taxpayers who have a hardship situation.

As in the past, IRS will continue to work with FMS to implement additional payment streams into the FPLP. Your report identified six payment streams not included in the FPLP. These six payments streams are from the Department of Defense (DOD) or the Defense Financial Accounting Service (DFAS). Two of the six are active military salary and retiree payments, which IRS decided not to include in FPLP. One included contractor payments that already go through one of the 20 DFAS vendor pay systems included in FPLP; two include Non-Appropriated Fund (NAF) instrumentalities. The NAF payment streams are not disbursed through DFAS and are not required to be included in the Treasury Offset Program. Research would need to be conducted to determine if these payments would be eligible for FPLP and to determine the feasibility and costs to the NAF entities to systemically interface with FMS. The remaining payment stream you identified included DOD civilian salaries, which we added to FPLP in June 2008. Based on the data you provided, we do not believe it would be wise to invest valuable programming resources to create the automated exchange programs you recommended for the payment streams not already included in FPLP. However, we will continue to work with FMS to identify and include other cost-effective payment streams not currently in FPLP.

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<sup>1</sup> TAX ADMINISTRATION: *Federal Payment Levy Program Measures, Performance, and Equity Can Be Improved* (GAO-03-356, dated March 2003).



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Although the IRS does not have the authority to require other agencies to make programming changes, we will work with FMS and these agencies to develop a process to exclude levy payments less than the payment threshold.

Attached are our comments to your recommendations. If you have any questions, please call me at (404) 338-7060, or members of your staff may contact Brady Bennett, Director, Compliance at (202) 283-7144.

Attachment



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Attachment

**RECOMMENDATION 1**

The Commissioner, Wage and Investment Division, should develop a viable method for screening low income taxpayers for potential hardship and then establish specific criteria to identify and exclude from the FPLP those Social Security beneficiaries and other low income taxpayers for whom a levy would create a hardship situation.

**CORRECTIVE ACTION**

While we agree with the principle, we do not know if the model currently under development will work or its feasibility of implementation. Therefore, we can not agree with the recommendation as written. As you reported, the joint IRS – Taxpayer Advocate Research project concluded that the data available to the IRS does not lend itself to provide a model that would identify Social Security Administration (SSA) beneficiaries at risk for financial hardship with any degree of confidence. The Taxpayer Advocate is considering and evaluating other options, including a low income filter based on allowable living expenses and/or poverty level analysis. However, the reliability of any such model must be established before it can be implemented.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**RECOMMENDATION 2**

The Commissioner, Wage and Investment, should implement a process to periodically match taxpayers who were not previously identified as receiving Federal Government payments by FPLP against information return documents (e.g., Form 1099 series) received by IRS. Once identified provide the information on unmatched sources to the FMS for collection via levy.

**CORRECTIVE ACTION**

We disagree with this recommendation. The IRS continues to work with the Financial Management Service (FMS) to implement additional payment streams into the Federal Payment Levy Program (FPLP). The audit team did not identify any payment streams the IRS was not currently aware of. All six of the payment sources identified were from the Department of Defense or the Defense Financial Accounting



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Service (DFAS). The IRS made an informed decision to exclude two of these payment streams from FPLP. Two others are already included in the FPLP. The remaining two include Non-Appropriated Fund (NAF) payment streams that are not disbursed through the DFAS, and thus not currently subject to the Treasury Offset Program used by the FMS to collect delinquent taxes from federal payments under the FPLP.

A Form 1099-MISC (U.S. Information Return) is used for income reporting. The payment information reported does not always mean that payment can be levied through the FPLP or that the paying agency should be added to the program. Some of these Form 1099-MISC payments are "other" payments which are not vendor payments. The DFAS explained the Form 1099-MISC forms were used to report one-time payments to beneficiaries of deceased employees as well as other payments that are not vendor payments. The payments made by these entities were not contractor payments as Treasury Inspector General for Tax Administration (TIGTA) identified, and were in fact payments to active and retired military which IRS made a policy decision not to process through FPLP.

For a few small federal payment sources, such as the two NAF payment streams identified by TIGTA, the programming to add them into the Treasury Offset Program and the FPLP may be cost prohibitive. However, IRS will continue to work with FMS, Congress, and large disbursing agencies to ensure the majority of federal payments are included in the FPLP.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**RECOMMENDATION 3**

The Commissioner, Wage and Investment Division, should ensure that the IRS, in accordance with the Interagency Agreement, does not pay the per-transaction levy fee for those levies that fall below the established debt and levy thresholds.

The Commissioner should work with the FMS and other relevant agencies to eliminate these low-dollar levy payments and ensure that the cost of collection, on a per-transaction basis, is reasonable and does not exceed the cost of alternative IRS collection methods.



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**CORRECTIVE ACTION**

We partially agree with this recommendation. We are aware that some of the Non-Treasury Disbursing Offices (NTDOs) are sending payments less than the payment threshold. The FMS is not the disbursing agent for these payments. While we do not have authority to force other agencies to make programming changes, we will meet with FMS and the other agencies by June 15, 2009, to encourage them to adjust their payment thresholds so they exclude payments below that amount. We are unable to provide an implementation date for the NTDOs to complete this programming but we will diligently work with these agencies to reach a resolution to this issue.

**IMPLEMENTATION DATE**

June 15, 2009

**RESPONSIBLE OFFICIAL**

Director, Filing and Payment Compliance, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

We will monitor this corrective action as part of our internal management control process.