TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Installment Agreement User Fees Were Not Properly Calculated or Always Collected

May 13, 2008

Reference Number: 2008-40-113

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.

Redaction Legend:
1 = Taxpayer Return Information
3(d) = Identifying Information - Other Identifying Information of an Individual or Individuals

Phone Number | 202-622-6500
Email Address | inquiries@tigta.treas.gov
Web Site | http://www.tigta.gov

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

May 13, 2008

MEMORANDUM FOR DEPUTY COMMISSIONER FOR OPERATIONS SUPPORT
DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Installment Agreement User Fees Were Not Properly Calculated or Always Collected (Audit # 200640006)

This report presents the results of our review to evaluate controls over establishing the amount of installment agreement user fees, recognizing installment agreement user fee revenue, accounting for installment agreement user fees, and correcting duplicate user fee payments. This audit was conducted as part of our Fiscal Year (FY) 2006 Annual Audit Plan.

Impact on the Taxpayer

Each year, the Internal Revenue Service (IRS) initiates approximately 1.5 million installment agreements with taxpayers that allow them to pay delinquent Federal tax in installment payments. The IRS charges a user fee for setting up these agreements. Our review of the IRS cost estimates for determining the amount of the installment agreement user fees indicates that the user fees charged taxpayers were set incorrectly. Furthermore, user fees were sometimes waived without justification, and some taxpayers were charged duplicate fees.

Synopsis

When taxpayers do not have the funds necessary to fully pay their taxes, the IRS may allow taxpayers to make installment payments over a period of time. The resulting installment agreement is considered a special service and taxpayers are charged a fee to offset the IRS' cost of providing that service. In FY 2006, after years of charging the same amounts for installment agreement user fees, the IRS submitted and the Office of Management and Budget approved a fee increase from $43 to $105 for new agreements and from $24 to $45 for reinstated/restructured agreements. The Office of Management and Budget also approved a reduced $52 user fee for taxpayers who entered into installment agreements by direct debit payment method and a user fee of $43 for low-income taxpayers. In January 2007, the IRS implemented the approved user fee increases.

The IRS cost estimates supporting user fee adjustments should be based on the best available records and represent the full cost of providing the service. Reviews are required to be conducted every 2 years to keep the cost estimates current, which allows the IRS to recover the actual cost of providing an installment agreement. However, we found that the IRS did not routinely perform the required reviews every 2 years, and that new installment agreement user fees were based on inaccurate cost estimate assumptions and contained calculation errors and unsupported costs. This resulted in a higher user fee estimate than was justified by the supporting documentation. Based on our recalculations, the IRS is potentially overcharging taxpayers $16.85 for initiating an installment agreement and $7.77 for restructuring/reinstating an installment agreement. Since the new rate increase went into effect in January 2007, we estimate that the IRS has collected excess amounts for user fees that could total $10.3 million for initial installment agreements and $2.5 million for restructured/reinstated installment agreements.

IRS examiners were also improperly waiving user fees and failing to adequately document the reasons behind the waivers. The amount of uncollected installment agreement user fees could be $629,021 as a result of improperly waiving the user fees for initiating an installment agreement, and another $457,982 in waived restructured/reinstated installment agreement user fees were questionable due to the lack of documentation. Duplicate user fees were also being charged with 15 percent of those duplicate user fees going uncorrected, which could have resulted in 435 taxpayers being overcharged user fees totaling $18,705 in the second quarter of FY 2006.

Because of the problems identified with its FY 2004 cost estimate and subsequent to our analysis, the IRS examined its approach for setting installment agreement cost estimates and claims significant revisions were made to the methodology. However, the new methodology is still currently under review by IRS management. In its new methodology, the IRS has added and changed cost factors it believes should be incorporated into the fee rate. Consequently, IRS management believes that its current fees are not overstated. The data supporting this new methodology were not available at the time of our review. Because of the problems we identified with its previous methodology, we believe that IRS management should thoroughly review the new methodology and supporting data for compliance with Office of Management and Budget requirements for setting user fees before using the methodology as the basis for any decisions.

Recommendations

We recommended that the Chief Financial Officer ensure that the methodology used to support installment agreement user fee rates is properly revised and that the best data available are used to justify the rate increases. The new methodology and the cost estimating process should be adequately supported and designed to be fair and equitable to the affected taxpayers.

We also recommended that the Commissioner, Wage and Investment Division, establish a system control to ensure that fees for initiating an installment agreement are not waived. An additional review process should be implemented to ensure that the justification for waiving restructured/reinstated installment agreements is appropriately documented on the taxpayer's account. To ensure collection of the user fee, the process for processing installment agreement tax payments without a coupon should be revised to first deduct the installment agreement user fee from the payment before applying the balance of the payment to taxes due. The information provided to examiners on duplicate payments should also be expanded to include information on the number of duplicates that exist. This would allow the examiners to prioritize for correction those accounts showing more than one duplicate. Managers should also be reminded of the importance of requiring examiners to make direct taxpayer contact when it becomes evident that the taxpayer might be repeatedly submitting the initial payment coupon, causing duplicate postings of the user fee. A modification to the coupon and programming should be considered to ensure that the fee is charged on the first payment and to eliminate the possibility of double charging the fee. Also, there should be a control/report developed to ensure that once examiners identify duplicate user fees, these duplicates are reversed.

Response

IRS management agreed with five of our recommendations and partially agreed with one recommendation. In response, management will:

- Publish Internal Revenue Manual guidance related to calculating the full cost of the services related to user fees. IRS management will continue to validate the information used in the most recent calculation of the user fee rates developed during the FY 2007 biennial review. The validation will be completed in May 2009.
- Pursue a systemic correction that will prevent waiving user fees when initiating an installment agreement.
- Implement a process which systemically transfers the appropriate fee amount into a taxpayer's user fee account, regardless of whether a coupon was submitted.

- Work with the Modernization and Information Technology Services organization to explore options to enhance the Installment Agreement Account Listing to better identify duplicate user fee payments.
- Work to reduce or eliminate the possibility of charging erroneous duplicate user fees to taxpayers by coordinating with Submission Processing function Lockbox staff to eliminate split payment processing that often results in duplicate fees.
- Continue to monitor the issue of duplicate fees during Operational, Managerial, and Quality reviews.

While IRS management agreed that user fee costs for new installment agreements and reinstated/restructured agreements were incorrectly calculated during the 2005 review process, it does not believe that taxpayers were overcharged or that the user fee for the direct debit installment agreements was higher than appropriate. IRS management states that its revised costing methodology developed during its 2007 biennial review showed that the user fees proposed and implemented in January 2007 were actually below full cost. As such, IRS management does not believe that excess user fee collections and the portion of user fees waived for restructured/ reinstated installment agreements should be included as outcome measures. IRS management's complete response to the draft report is included in Appendix VII.

Office of Audit Comment

We are concerned with the IRS' assertions related to its most recently revised user fee cost estimate. In its response, the IRS did not state what it believes is the full cost of administering an installment agreement; rather it only states that its current fees are below cost. The revised methodology used in the FY 2007 biennial review is still under review and the final validation is not expected to be completed until May 2009. In November 2007, IRS management first discussed the tentative results of its recent biennial review but, at that point, the results were not final or approved by IRS management. At the IRS' request, we conducted a limited review of the proposed changes. Based on this limited review, we identified and communicated to IRS staff specific concerns we had with its new approach.

Requirements from the Office of Management and Budget Circular A-25 state that the results of the IRS' biennial review of user fees and any resultant proposals be included in its Chief Financial Officers Annual Report, and that any exceptions should be forwarded to the Office of Management and Budget for approval. The IRS completed its 2007 biennial review but did not include the results in its Chief Financial Officers Annual Report and did not submit an exception request to the Office of Management and Budget. Its new data and methodology have not been reviewed by the Office of Management and Budget and its reliability has not been determined. As such, we believe that the related outcome measure indicating that the IRS collected excess amounts for user fees which could total $10.3 million for initial installment agreements and

$2.5 million for restructured/reinstated installment agreements are based on the best information available.

We do not agree with IRS management's position regarding the outcome measure for increased revenue. IRS management did not agree that the full portion of fees waived for restructured/reinstated user fees should be included in the measure. While IRS management agreed that documentation was lacking to support waiving the fee, they do not believe it would be correct to assume that all of these fees were waived incorrectly. Nevertheless, documentation to justify any waiver is required by IRS procedures. There is no other practicable way to determine whether the waiver was justified. Therefore, we believe our estimated outcome is appropriately presented.

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 (Wage and Investment Income Programs), at (202) 622-5916.

Table of Contents

Abbreviations

CAR	Collection Activity Report
FY	Fiscal Year
IRS	Internal Revenue Service
OMB	Office of Management and Budget

Background

All taxpayers are expected to pay the full amount of taxes owed when they file their tax returns. However, when taxpayers do not have the funds necessary to make a full payment, the Internal Revenue Service (IRS) may allow taxpayers to make installment payments. Such an agreement between the IRS and the taxpayer allows payment over a prescribed period of time with interest and penalties. The installment agreement may originate during written and verbal contact with a taxpayer who has a balance-due account. Installment agreements can be granted for a period of time not to exceed the collection statute of limitations (which is generally 10 years from the date of assessment of the tax liability) with taxpayers making regularly scheduled payments until the tax debt is paid.[1]

Each year, the IRS initiates approximately 1.5 million installment agreements with taxpayers that allow them to pay delinquent Federal tax in installment payments. To offset the costs of administration, the IRS charges a user fee for establishing an installment agreement. In Fiscal Year (FY) 2006, the IRS reported that it collected approximately $79 million in user fees for initiating and restructuring/reinstating installment agreements. For FY 2007, the IRS received approval to increase the fee from $43 to $105 for new agreements and from $24 to $45 for reinstated/restructured agreements. With the fee increase, the IRS estimated that the user fee revenues would increase to about $101 million in FY 2007.

User fees are required by Federal law for services that primarily benefit individual recipients over and above any benefit that might accrue to the general public.[2] Office of Management and Budget (OMB) Circular A-25, *User Charges*, established Federal policy regarding fees assessed for Federal Government services. The Circular provides information on the scope and types of activities subject to user fees and the basis upon which user fees can be established. Per OMB Circular A-25, user fees should only offset the full cost of providing a special service, and the fees should be reviewed biennially and adjusted as necessary. Both the Department of the Treasury and the OMB must approve new and increased user fees proposed by the IRS. Once approved, the proposed regulation change to increase the fees is published in the Federal Register for public comment.

User fees offset the cost of providing services that primarily benefit individual recipients over and above any benefit that may accrue to the general public.

[1] Streamlined installment agreements can be granted for balance-due accounts less than $25,000, which must be paid within 5 years. Non-streamlined installment agreements can be for a longer duration but cannot exceed the collection statute extension deadline, which is 10 years from the date of the assessment of the tax liability.
[2] 31 U.S.C. § 9701 (2000 suppl. 5), Fees and Charges for Government Services and Things of Value.

The IRS was first authorized to charge user fees for installment agreements in 1995. The basis for authorizing this fee was that a taxpayer using this collection method was receiving a personal benefit by paying a tax debt over time, rather than satisfying the outstanding debt in a single payment. From FY 1995 through FY 2006, the fees were $43 to initiate a new installment agreement and $24 to restructure or reinstate an installment agreement.[3]

Figure 1 shows the volume and amount of installment agreement user fees collected for the 11 years ending in FY 2006. The figure is shown in descending order from FY 2006 to FY 1996.

Figure 1: Installment Agreement User Fee Volumes and Collections

Fiscal Year	New (Initial) Installment Agreements ($43)		Restructured / Reinstated Agreements ($24)		Total Annual Revenue
	Volume	Revenue	Volume	Revenue	
2006	1,514,800	$65,136,393	568,512	$13,644,279	$78,780,672
2005	1,528,983	$65,746,271	551,030	$13,224,726	$78,970,997
2004	1,201,158	$51,649,780	459,254	$11,022,103	$62,671,883
2003	1,359,274	$58,448,790	537,141	$12,891,377	$71,340,167
2002	1,332,910	$57,315,115	447,077	$10,729,836	$68,044,951
2001	1,412,359	$60,731,442	533,380	$12,801,127	$73,532,569
2000	1,355,972	$58,306,807	500,277	$12,006,645	$70,313,452
1999	1,597,484	$68,691,803	515,051	$12,361,226	$81,053,029
1998	1,914,603	$82,327,949	447,077	$10,729,836	$93,057,785
1997	1,728,882	$74,341,913	471,744	$11,321,846	$85,663,759
1996	1,812,963	$77,957,407	550,049	$13,201,173	$91,158,580

Source: IRS Chief Financial Officer.

To ensure that the user fees being assessed are periodically adjusted to reflect any changes in the cost of providing the installment agreement, under OMB Circular A-25, the IRS is required to review every 2 years the cost of providing installment agreements to taxpayers. The results of this review for user fees charged by the IRS and any resultant proposals must be disclosed in the Chief Financial Officer Annual Report required by the Chief Financial Officers Act of 1990.[4] OMB

[3] 26 Code of Federal Regulations 300.
[4] Pub. L. No. 101-576, 104 Stat. 2838 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 42 U.S.C.).

Circular A-25 also requires that records of these reviews be maintained. This would include the information used to justify the user fee charges and the specific methods used to determine the fee structure.

In FY 1998, the IRS attempted to adjust the installment agreement user fees by proposing an increase for initiating an installment agreement to $51 and for reinstating/restructuring an installment agreement to $31. The IRS calculated costs for initial installment agreements at $68.59 and restructuring/reinstating installment agreements at $35.95. However, the OMB would not approve the lower rates because they did not comply with the full cost of providing services as established in OMB Circular A-25.

The IRS did not pursue another request to raise the installment agreement user fees until FY 2005, when it developed a proposal for an increase in the fee from $43 to $105 for new installment agreements and from $24 to $45 for reinstated/restructured installment agreements based on a FY 2004 cost estimate using 2003 data. The IRS also proposed a reduced user fee of $52 for new direct debit installment agreements. The IRS believed that charging less than full cost for installment agreements paid through a direct debit would encourage taxpayers to choose to pay by this method, thereby saving the IRS processing time and cost.

In September and early October 2006, comments received in response to the Federal Register notice proposing to raise the installment agreement user fees took exception to increasing the fee for low-income taxpayers.[5] As a result of those comments and through support of the National Taxpayer Advocate, the IRS proposed and the OMB agreed to keep the fee for initiating an installment agreement at $43 for low-income taxpayers. However, the low-income taxpayer exception did not apply to the increased fee of $45 for restructuring/reinstating an installment agreement. In January 2007, the IRS implemented the approved fee increases.

As a result of the fee increase, in FY 2007 the IRS collected $122.1 million and in FY 2008 it expects to collect $150.3 million from initial and restructured/reinstated installment agreement user fees. This includes $2.9 million in FY 2007 and an anticipated $7.3 million in FY 2008 from direct debit installment agreement user fees.[6] The IRS was originally authorized to retain user fee collections to augment its operating budget with a ceiling of $119 million.[7] However, the FY 2006 Appropriation Bill lifted the ceiling, and the IRS will now be allowed to retain all user fees.

This review was performed at the IRS National Headquarters, the Office of the Chief Financial Officer, and the Small Business/Self-Employed Division in Washington, D.C., and the Wage and Investment Division in Atlanta, Georgia, during the period November 2006 through November 2007. We conducted this performance audit in accordance with generally accepted government

[5] Low-income taxpayers are defined as those taxpayers earning less than 250 percent of the poverty level.
[6] Revenue projections as of April 2007.
[7] Treasury, Postal Service and General Government Appropriations Act of 1995, Pub. L. No. 103-329, 108 Stat. 2388 (1994).

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.

Results of Review

The Internal Revenue Service Incorrectly Estimated Installment Agreement User Fees

OMB Circular A-25 provides Federal policy on preparation of cost estimates for user fees and establishes requirements for documenting that process. Cost estimates should be based on the best available records and represent the full cost of providing the service. Reviews are required every 2 years to keep the cost estimates for providing the special service current and to allow the IRS to recover its actual costs for providing an installment agreement.

The IRS did not perform reviews of installment agreement user fees every 2 years as required by the OMB. Reviews were performed in FY 1996 and FY 1998, but the next review was not performed until FY 2004. Furthermore, the IRS did not adequately document the three reviews that were performed, so we were unable to fully assess its overall decision process for these reviews. Documenting this review process is important to provide justification that the user fees are set fairly and only offset the cost of providing installment agreement services.

The IRS implemented new user fees from its FY 2004 cost estimate and from our review of the supporting documentation, we determined that the new installment agreement user fees were based on inaccurate cost estimate assumptions, calculation errors, and unsupported costs. This resulted in higher user fees being collected than was justified.

User fee increases were based on inaccurate assumptions, calculation errors, and unsupported costs.

The FY 2004 cost estimate was the basis for the user fee rate increase proposed in FY 2006.[8] During our analysis of the FY 2004 cost estimate, IRS management described its overall approach and assumptions. The IRS followed the FY 1994 calculations when preparing the updated cost estimate and proposing the subsequent installment agreement user fee rate increases to the Department of the Treasury and the OMB. However, we determined that the assigned cost analyst and IRS management did not examine the prior cost estimate assumptions to ensure that they remained valid and to ensure that the data used were the best data available for the FY 2004 cost estimate.

[8] The FY 2004 cost estimate was based on FY 2003 data and was limited to assessing the cost associated with providing installment agreements to taxpayers under the assumption that all taxpayers were making monthly paper check payments.

Our review of the cost estimate was limited to specific line items. These items are highlighted in Appendix V. Figure 2 summarizes the recalculated installment agreement user fee cost estimates for the errors we identified and the effects of the recalculations for the labor, non-labor, and indirect overhead cost categories.

Figure 2: Cost Recalculations for Installment Agreement User Fee

Cost Category	New (Initial) User Fee		Restructured/Reinstated User Fee	
	IRS Calculation	**Recalculated**	**IRS Calculation**	**Recalculated**
Labor	$32.66	$32.55	$13.80	$13.75
Non-Labor	$29.58	$21.55	$12.50	$9.10
Indirect Overhead	$39.17	$34.05	$16.55	$14.38
Total	**101.41**	**$88.15**	**$42.85**	**$37.23**
Difference	**$13.26**		**$5.62**	

Source: The IRS FY 2004 cost estimate and our review of that estimate.

The difference between the FY 2004 cost proposal for the IRS user fee estimates and our recalculated user fee estimates was $13.26 for an initial installment agreement and $5.62 for a restructured/reinstated installment agreement.[9] However, the IRS actually proposed and established user fees of $105 for an initial installment agreement and $45 for a restructured/reinstated installment agreement, potentially overcharging taxpayers $16.85 for an initial installment agreement and $7.77 for a restructured/reinstated installment agreement.

The issues we identified with the overall cost estimate for the new installment agreement user fees were that the IRS could not provide adequate support and made calculation errors. More details on the adjustments are included in Appendix VI. Overall, the IRS:

- Applied a 2.3 percent burden rate to the direct labor cost without adequate support.
- Incorrectly and inconsistently applied inflation rates for FYs 2004, 2005, and 2006 and did not have support for all the rates applied.

[9] These differences represent the errors we identified from our review of specific line items identified in Appendix V. This was not a comprehensive review of the entire cost estimate but a focus on some of the most significant line items.

- Made rounding errors when applying the overhead rates for direct labor and employee benefits.

The following are issues we identified with the new installment agreement user fees cost assumptions resulting in our adjustments (except as noted). More details on the adjustments are included in Appendix VI. Overall, the IRS did not use the best data. For example, the IRS:

- Overstated installment agreement totals by incorrectly including taxpayers who were subject to continuous wage levies and taxpayers given an extension of time to pay their tax debt.[10]
- Overestimated the average number of payments per installment agreement.
- Overstated the installment agreement totals by double counting 395,763 agreements.

In addition, the IRS' reduced fee of $52 for direct debit installment agreements was not based on a cost analysis; rather, it was set at one-half of the $105 user fee for an initial installment agreement. The IRS needs to change the way it estimates the cost of providing installment agreements to ensure that costs associated with sending notices and processing checks are not allocated to those with direct debit installment agreements. Because of the significant benefit of direct debit to both taxpayers and the IRS, it is important for the IRS to ensure that the fee is not set higher than the actual cost to provide the service to the taxpayer.

Based on the type and number of errors identified in the FY 2004 cost estimate, we believe that the IRS rate increase proposals in FY 2005 were not adequately supported. Looking solely at the information the IRS presented as its best available data for estimating the cost associated with providing installment agreements, we do not believe that the IRS presented adequate justification for recommending the current installment agreement user fees of $105 and $45 for initial and restructured/reinstated installment agreements, respectively. Also, the IRS did not have any documentation to justify the $52 reduced user fee for direct debit installment agreements.

Consequently, we estimate that the IRS may have collected excess amounts in user fees on 940,821 accounts totaling $10.3 million for initiating installment agreements (616,728 accounts)

[10] Continuous wage levies and extensions of time to pay are not installment agreements. Therefore, they are not subject to user fees. Using available data, the IRS could not readily separate accounts with continuous wage levies and extensions to pay from the actual installment agreement accounts used in the FY 2004 calculation. Therefore, we could not correct the number of installment agreements used in the labor and non-labor calculations and, by doing so, estimate the amount of the resulting error in the FY 2004 cost estimate.

and $2.5 million for restructuring/reinstating installment agreements (324,093 accounts) since the new rate increase went into effect in January 2007.[11]

Because of the problems identified with its FY 2004 cost estimate and subsequent to our analysis, the IRS examined its approach for setting installment agreement cost estimates and claims significant revisions were made to the methodology. However, the new methodology is still currently under review by IRS management. In its new methodology, the IRS has added and changed cost factors it believes should be incorporated into the fee rate. Consequently, IRS management believes that its current fees are not overstated. The data supporting this new methodology were not available at the time of our review. Because of the problems we identified with its previous methodology, we believe that IRS management should complete a thorough quality review of the new methodology and supporting data for compliance with OMB requirements for setting user fees before using the methodology as the basis for any decisions.

Recommendation

Recommendation 1: The Chief Financial Officer should ensure that the methodology used to support installment agreement user fee rates is properly revised and that the best data available are used to justify the rate increases. The new methodology and the cost estimating process should be adequately supported and designed to be fair and equitable to the affected taxpayers.

> ***Management's Response:*** IRS management agreed with this recommendation and will publish Internal Revenue Manual guidance related to calculating the full cost of the services for user fees. This guidance will include information on the type of direct and indirect costs to be included in calculating user fees. On an annual basis, the affected business units will be provided the overhead rates and the inflation rates to be included in the user fee rate calculations. The business units will remain responsible for assuring the completeness and correctness of the direct and indirect costs.
>
> IRS management will continue to validate the information used in the most recent calculation of the user fee rates developed during the FY 2007 biennial review. The validation will be completed in May 2009.
>
> IRS management disagreed with the conclusion that they overcharged taxpayers for installment agreement user fees and the outcome measure that the IRS may have collected $10.3 million in excess user fees.

---

[11] Our review of the cost estimates in the calculation was limited to specific line items (see Appendix V) in which we evaluated the assumptions and data used by the IRS. We recalculated the installment agreement user fee cost estimate by accounting for the errors we identified based on the data the IRS originally used. We developed a table to show the cumulative effects of the recalculations for the labor, non-labor, and indirect overhead cost categories (see Appendix VI). The results and projections were limited by the data available. However, better data may have been available originally which the IRS either did not develop or use.

Office of Audit Comment: We are concerned with the IRS' assertions related to its most recent revised user fee cost estimate. In its response, the IRS did not state what it believes is the full cost of administering an installment agreement. Rather, it only states that its current fees are below cost. The revised methodology used in the FY 2007 biennial review is still under review and the final validation is not expected to be completed until May 2009. In November 2007, IRS management first discussed the tentative results of its recent biennial review but, at that point, the results were not final or approved by IRS management. At the IRS' request, we conducted a limited review of the proposed changes. Based on this limited review, we identified and communicated to IRS staff specific concerns we had with its new approach.

Requirements from OMB Circular A-25 state that the results of the IRS' biennial review of user fees and any resultant proposals be included in its Chief Financial Officers Annual Report, and that any exceptions should be forwarded to the OMB for approval. The IRS completed its 2007 biennial review but did not include the results in its Chief Financial Officers Annual Report and did not submit an exception request to the OMB. Its new data and methodology have not been reviewed by the OMB and its reliability has not been determined. As such, we believe that the related outcome measure indicating that the IRS collected excess amounts for user fees, which could total $10.3 million for initial installment agreements and $2.5 million for restructured/reinstated installment agreements, are based on the best information available.[12]

IRS management also disagreed that the user fee for Direct Debit Installment Agreements may have been higher than appropriate. However, IRS management did not provide a cost analysis supporting its reduced fee of $52 for direct debit installment agreements.

Some Installment Agreement User Fees Were Waived Without Proper Justification

The IRS' internal procedures require that installment agreement user fees be collected and should never be waived when establishing an initial installment agreement. However, under certain circumstances, the fee can be waived when restructuring/reinstating an existing installment agreement. While there are a few instances that allow for a restructured/reinstated installment agreement waiver, the procedures caution that: "The user fee cannot be waived at the whim of an IRS employee." In those rare instances where fees are waived, the employee is required to document the reason for waiving the fee.

We obtained data on taxpayer accounts with active installment agreements during the period October 1, 2005, through September 30, 2006, in which the accounts indicated there had been installment agreement user fees recorded as due, paid, or waived during FY 2006. There were

[12] The excess collections were calculated from January through September 2007.

1,426,083 taxpayer accounts in this data extract. Of these, we identified 37,259 taxpayer accounts that appeared to have waived user fees. From this population, we reviewed a statistical sample of 63 records to evaluate the reason the fees were waived. Figure 3 shows the results of our review.

Figure 3: Waived Installment Agreement User Fees

Documentation	Number of Accounts	Percentage
Adequate Documentation	6	9.5%
No Documentation	52	82.6%
Documentation, but a Waiver Was Not Authorized	5	7.9%
Total	**63**	**100%**

Source: Our review of waived installment agreement user fees during the period of October 1, 2005, through September 30, 2006.

There was adequate documentation to support waiving the user fee for six accounts. However, in the remaining 57 accounts, there was either no documentation to explain the reason for waiving the fee or the documented reason was not authorized under the IRS' internal procedures. Of the 57 waived user fee accounts, 32 were user fees for initiating a new installment agreement which, according to IRS procedures, should never be waived. We discussed our results with IRS management who agreed there was a problem and immediately issued an alert reminding managers and employees that the user fee for initiating a new installment agreement can never be waived, and that user fees for reinstating/restructuring an installment agreement can only be waived in the circumstances listed in the IRS' internal procedures.

We interviewed 15 IRS employees who we identified as having waived an initial installment agreement user fee for the taxpayer accounts sampled. The 15 employees interviewed suggested 2 potential explanations why a user fee for an initial installment agreement might have been waived: (1) an IRS error caused a new user fee charge or (2) the employee made an error when inputting the user fee code. These employees had been alerted by management about the impropriety of waiving user fees prior to our interviews, so employee answers might have been influenced by the recent management communication. While the employees could have recorded the wrong user fee code, the IRS procedures are clear that employees should not waive user fees for initiating an installment agreement. Nevertheless, there were 32 waivers involving the user fees for initiating a new installment agreement. The remaining 25 waivers involved the user fee for reinstating/restructuring installment agreements which could be authorized. For example, if an account was reinstated after bankruptcy, the IRS internal procedures authorize waiving the fee for reinstating the agreement. However, we were unable to determine if waiving the fees was justified because, in all 25 cases, the employees did not document the reasons for the waiver as required by internal procedures.

Prior to our audit, there were no specific corrective actions taken to prevent inappropriately waiving fees and to ensure that employees documented the reasons for waiving user fees as required. Based on the results of our sample, we estimate for the population of 37,259 records that 33,711 (90 percent) user fees were either inappropriately waived or waived without providing adequate documentation to justify the waiver. Based on the results of our sample, we estimate that the amount of uncollected installment agreement user fees could be $629,021 as a result of improperly waiving the user fee for initiating an installment agreement. We could not determine the actual amount of reinstated/restructured user fees that were improperly waived as the required justification was not documented. Without adequate justification, $457,982 in restructured/reinstated installment agreement user fees may have been waived inappropriately.

Installment agreement user fees were sometimes not collected from the first payment

The normal process is for the user fee to be taken out of the first payment after the installment agreement was initiated or restructured/reinstated. The initial reminder notice[13] contained the statement: "We charge a $43 user fee to cover the cost of providing installment agreements. The $43 fee will be taken from your first monthly payment."[14] However, the IRS' success in obtaining the user fee depended on the taxpayer returning the coupon attached to the first payment notice. If the coupon was not returned with the taxpayer's payment, the user fee would not be properly applied. Without the payment coupon, the installment agreement payment is processed manually with the entire amount of the payment applied to the tax owed and the user fee still outstanding. The next opportunity the IRS has to collect the unpaid user fees is through a process in which a periodic system check identifies accounts where a user fee has been assessed but remains uncollected. For the accounts identified during this system check, the user fee is systemically deducted from a subsequent payment.

We reviewed a random sample of 138 taxpayer accounts from a population of 333,816 where installment agreement user fees were identified through the system check. We evaluated these accounts to determine when the user fee was collected and whether the fee was taken from an installment agreement payment or from some other source. In all 138 accounts, the user fee was collected from the taxpayer's account.[15] In 129 accounts, the fee was taken from an installment payment and in 9 accounts the fee was taken from another source (e.g., tax payment or levy). In

[13] Installment Agreement Reminder Notice, CP521.
[14] For a user fee related to a restructured/reinstated installment agreement the fee noted was $24.
[15] Because in every case sampled the IRS did recover the installment agreement user fee due, we can be 95 percent confident that the true error rate would not exceed 2.2 percent of the population, or 7,169 records.

55 accounts, the fee was taken from the first installment agreement payment, and in 74 accounts the fee was taken from a subsequent installment agreement payment.[16]

By not deducting the user fees from the first installment agreement payment, the taxpayers might have received a minor benefit as the interest and penalty calculations were affected, because the entire payment amount was applied against the taxes owed and not to user fees. This affected the interest calculations, as the recorded tax payments were overstated by $43 or $24 depending on whether the agreement was an initial installment agreement or a reinstated/restructured installment agreement. While the amounts of interest lost would be minimal, the failure of the process to ensure the collection of the installment agreement user fees upfront causes extra effort, because the IRS must manually process payments due to missing coupons and then systemically follow up to ensure that the appropriate user fees are collected.

Recommendations

Recommendation 2: The Commissioner, Wage and Investment Division, should establish a system control to ensure that fees for initiating an installment agreement are not waived. Until such a control is in place, revise established procedures to require a periodic review of waived installment agreement user fees through the Installment Agreement Account Listing or another process to ensure that fees for initiating installment agreements are not being waived. Also, implement a review process to ensure that the justification for waiving restructured/reinstated installment agreements is appropriately documented on the taxpayers' accounts.

> ***Management's Response:*** IRS management agreed with this recommendation and has submitted a programming request that would systemically prevent the waiving of user fees when initiating an installment agreement. Until the requested programming is in place, management will periodically request a run of installment agreement accounts to look for fees improperly waived. The results will be reviewed with appropriate feedback being provided to the functional areas as problems are identified. IRS management does not plan to implement a supplemental review process to ensure that the justification for waiving restructured or reinstated installment agreements is appropriately documented on the taxpayers' accounts, but will continue to assess the adequacy of documentation during Operational, Managerial, and Quality reviews.
>
> IRS management also disagreed with our Increased Revenue outcome measure because they had concerns with the sample size and did not believe that the full portion of fees waived for restructured/reinstated user fees should be included in the measure. Although IRS management agreed that documentation was lacking to support waived fees, they did not agree that it was correct to assume that all of those fees were waived incorrectly.

---

[16] The periodic system check deducts the user fee from the last recorded payment on the account.

Office of Audit Comment: The corrective actions that IRS management proposes should help reduce the numbers of inappropriately waived user fees. Using the Operational, Managerial, and Quality reviews as a test for adequate documentation will help identify whether the problem continues. If these reviews operate as intended, it should be sufficient to address our recommendation.

We do not agree with IRS management's position regarding the outcome measure for increased revenue. IRS management did not agree that the full portion of fees waived for restructured/reinstated user fees should be included in the measure. While IRS management agreed that documentation was lacking to support waiving the fee, they do not believe it would be correct to assume that all of these fees were waived incorrectly. Nevertheless, documentation to justify any waiver is required by IRS procedures. There is no other practicable way to determine whether the waiver was justified. Therefore, we believe our estimated outcome of $1,087,003 is appropriately presented.

Recommendation 3: The Commissioner, Wage and Investment Division, should revise the procedures for processing installment agreement tax payments without a coupon. When there is an outstanding user fee due, examiners should be instructed to first deduct the installment agreement user fee from the payment before applying the balance of the payment to taxes due.

Management's Response: IRS management agreed with this recommendation and has implemented a process which systemically transfers the appropriate fee amount into a taxpayer's user fee account, regardless of whether a coupon was submitted. IRS management believes this to be the best approach, as tax examiners will no longer be required to manually deduct installment agreement user fees from payments made by taxpayers.

Some Duplicate Installment Agreement User Fees Were Not Identified and Corrected

The tax examiners in the Wage and Investment Division Compliance Services Collection Operation function did not thoroughly research taxpayer accounts and correct duplicate user fee collections. The Compliance Services Collection Operation function examiners focused their case reviews on the most recent user fee entry that caused the duplicate to appear on the Installment Agreement Account Listing, a weekly monitoring tool which provides an alert of accounts requiring attention. The Compliance Services Collection Operation function requires that all accounts appearing on the Installment Agreement Account Listing be reviewed and corrected within 5 business days. For the second quarter of FY 2006, the accounts with potential duplicate installment agreement user fee charges made up approximately 1.5 percent of the

Installment Agreement Account Listing workload.[17] The tax examiners were to research these accounts and correct any duplicate user fee charges by reversing the duplicate fee entry and applying the excess user fee collection to the tax due.

We obtained data on taxpayer accounts that had multiple installment agreement user fee payments of $43 occurring during the period October 1, 2000, through June 1, 2006.[18] From this population, we isolated 4,039 records (2,920 taxpayer accounts) showing multiple user fee payments for initiating an installment agreement during the second quarter of FY 2006 (January through March 2006).[19] Of the 94 sampled taxpayer accounts, 27 accounts had duplicate user fees inappropriately charged.

- In 14 accounts (15 percent), the duplicate user fee charges were inappropriate and the Compliance Services Collection Operation function did not identify or correct the duplicate payments during the Installment Agreement Account Listing reviews. In 5 of the 14 accounts, while the examiner identified the problem, the examiner did not make the necessary reversing entry in the system.
- In 13 accounts (14 percent), the duplicate user fees were inappropriately charged; however, the Compliance Services Collection Operation function did effectively correct the error when the Installment Agreement Account Listing was worked.

Projections from our population of 2,920 taxpayer accounts with potential duplicate user fee payments indicated that 435 taxpayer accounts could have duplicate installment agreement user fee payments that went unaddressed in the second quarter of FY 2006. The 435 taxpayer accounts would represent $18,705 in uncorrected excess collections.[20]

For the population of 2,920 taxpayer accounts, we also determined that 425 (15 percent) of those accounts appeared on the second quarter FY 2006 Installment Agreement Account Listing multiple times for having duplicate user fee payments. These accounts had to be repeatedly reviewed and, if necessary, corrected. The Compliance Services Collection Operation function examiners and IRS management stated that they believed the user fee duplicates kept reoccurring due to the taxpayer error of repeatedly sending copies of the first payment coupon from which the installment agreement user fee is identified and collected. We were unable to verify this because the actual payment coupons were not retained.

[17] The second quarter FY 2006 Installment Agreement Account Listing contained 129,466 records requiring review. Included in this total were 1,941 records with potential duplicate installment agreement user fee charges.
[18] Until January 2007, the IRS charged $43 for establishing an installment agreement. At that time, the rate for establishing an installment agreement was increased to $105.
[19] See Appendix IV for supplemental information on sample selection, data analysis, and the audit report projections.
[20] This would be a conservative estimate as 4 (29 percent) of the 14 exception cases in our sample had more than one unresolved duplicate payment.

1, 3(d)

In such situations, Compliance Services Collection Operation function procedures recognize that more than one duplicate user fee being deducted might indicate that the taxpayer is submitting copies of the initial Installment Agreement Reminder Notice with subsequent payments. The procedures instruct the examiner to make contact with the taxpayer with the objective to prevent this from reoccurring. If the taxpayer cannot be contacted directly, a letter should be mailed to explain the proper method of making installment agreement payments.[21] However, the taxpayers were not being contacted in every case. We were able to determine that the examiners made an attempt to contact the taxpayers regarding the duplicate user fee payments in only 7 (26 percent) of the 27 accounts having duplicate user fees inappropriately charged.[22] When reoccurring duplicate user fees are evident, taxpayers should be contacted so the payment discrepancies can be resolved. This contact could have had a positive secondary impact by helping to reduce the number of future problems and workload if the taxpayers used the correct payment coupon.

Numerous accounts appear on the Installment Agreement Account Listing multiple times.

Recommendations

Recommendation 4: The Commissioner, Wage and Investment Division, should coordinate with the Modernization and Information Technology Services organization to modify the Installment Agreement Account Listing to expand the information currently provided on accounts with duplicate user fees to include information on the number of duplicates that exist, allowing the examiner to prioritize for correction those accounts showing more than one duplicate.

> ***Management's Response:*** IRS management agreed with this recommendation and will work with the Modernization and Information Technology Services organization to explore options to enhance the Installment Agreement Account Listing to better identify duplicate user fee payments. IRS management will also provide employees with revised requirements for working the Installment Agreement Account Listing with duplicate user fees required to be worked as a priority.

[21] Under Internal Revenue Manual 5.19.1.12.12 (10), taxpayer contact should be made using Form Letter 3127C.

[22] In 9 (33 percent) of the 27 cases, we could not perform a complete analysis because the required data had dropped from the system. Once an account is paid, some data related to the installment agreement are removed and no longer accessible.

Recommendation 5: The Commissioner, Wage and Investment Division, should reinforce with first-line managers the importance of complying with the IRS' internal procedures requiring direct taxpayer contact when it becomes evident that the taxpayer may be repeatedly submitting the initial payment coupon. Furthermore, a modification to the coupon and programming should be considered to ensure that the fee is charged on the first payment and to eliminate the possibility of double charging the fee.

> ***Management's Response:*** IRS management agreed with this recommendation. To reduce or eliminate the possibility of charging erroneous duplicate user fees to taxpayers, IRS management is working with the Submission Processing function Lockbox staff to eliminate split payment processing that often results in duplicate fees. IRS management indicated that modification of the coupon will not be necessary because their corrective action to Recommendation 3 will ensure proper payment applications.
>
> ***Office of Audit Comment:*** We agree that the corrective action planned is sufficient to reduce or eliminate the possibility of charging erroneous duplicate user fees to taxpayers. In a subsequent discussion with IRS management, we were informed that its current efforts to change these procedures in the Internal Revenue Manual could take from 6 months to a year to complete.

Recommendation 6: The Commissioner, Wage and Investment Division, should develop a control/report which ensures that once examiners identify duplicate user fees, these duplicates are reversed.

> ***Management's Response:*** IRS management partially agreed with this recommendation. Due to the corrective actions currently planned or taken, IRS management expects the volume of duplicate user fees to be greatly reduced, which can be confirmed through the results of the periodic data run discussed in response to Recommendation 2. Therefore, management does not believe an additional control or report would be necessary but agreed to continue to monitor the issue of duplicate fees during the Operational, Managerial, and Quality reviews.
>
> ***Office of Audit Comment:*** Once the corrective actions currently planned or taken regarding duplicate user fees are implemented, we agree that IRS management can expect the volume of duplicate user fees to be reduced. Therefore, we agree that an additional control/report would not be necessary at this time. If, after continuing to monitor the issue of duplicate fees during its Operational, Managerial, and Quality reviews, it is determined that duplicates are still going uncorrected, management should reconsider this recommendation.

Appendix I

Detailed Objective, Scope, and Methodology

The objective of this audit was to evaluate controls over establishing the amount of installment agreement user fees, recognizing installment agreement user fee revenue, accounting for installment agreement user fees, and correcting duplicate user fee payments. To accomplish our objective, we:

I. Determined whether the new installment agreement user fees offset the cost of the services provided as required by statute, regulation, and any supplemental guidance from the OMB, the Department of the Treasury, and the IRS.

A. Determined whether the installment agreement user fees imposed in January 2007 were designed to offset the cost of providing the service as required under OMB Circular A-25, *User Fees*. We reviewed OMB Circular A-25 and related guidance that should have been followed when preparing the proposed installment agreement user fee cost estimates. We obtained the costing for the proposed installment agreement user fee increase and analyzed and recalculated specific line items. We held discussions and obtained supporting documentation related to the costing from Chief Financial Officer's office and Small Business/Self-Employed Division personnel. Our analysis showed differences which were discussed with IRS management. Using our results, we recalculated the overall impact the identified errors could have on taxpayers paying installment agreement user fees from January through September 2007.

B. Verified whether the IRS performed the OMB required biennial reviews of installment agreement user fees to ensure that the full cost of the installment agreement program was being offset and the reviews were documented. We reviewed OMB Circular A-25 and OMB Circular A-123, *Management Accountability and Control*, to identify requirements. We reviewed the documentation obtained for the reviews performed (1994, 1998, and 2004) and held discussions with Chief Financial Officer's personnel to discuss discrepancies.

II. Determined whether the IRS collected the appropriate installment agreement user fee amounts from taxpayers who elected to pay their tax liabilities using installment agreements and, if user fees were waived, whether the waiver was appropriate.

A. Determined whether the IRS ensured that installment agreement user fees were properly waived. We obtained and reviewed the Internal Revenue Manual, IRS memos, and documentation provided by an examiner on controls established to ensure that waived installment agreement user fees were justified. We obtained a data extract from the Individual Master File – Taxpayer Information File[23] identifying a population of 90,948 unique waived initial user fee and restructured/reinstated user fee records. To validate the data, we selected 25 records and traced the data for each to the Integrated Data Retrieval System[24] to ensure the accuracy of the data contained in the extracts. There were 44,088 unique taxpayer accounts represented in the 90,948 records. We developed a sampling plan using a 95 percent confidence level, an expected error rate of 5 percent, and a precision of ±5 percent, which resulted in an initial random sample size of 73 waived records.[25] We assessed the Integrated Data Retrieval System and Desktop Integration[26] to determine whether the waived installment agreement user fees on selected accounts were authorized and, if authorized, properly justified. We discussed the exceptions with Wage and Investment Division management.

B. Determined whether the IRS ensured that user fees were properly collected once assessed. We obtained a FY 2006 extract from the IRS Master File[27] in which the user fee was not initially collected but later was systemically deducted from a subsequent taxpayer payment. To validate the data, we verified that all of the records that were in the mainframe files were included in the data provided. We developed a sampling plan using a 95 percent confidence level, an expected error rate of 10 percent, and a precision of ±5 percent, which resulted in a random sample of 138 taxpayer accounts from a population of 333,816. We evaluated these accounts to determine when the user fee was collected and whether the payment was taken from an installment agreement payment or from some other source. We discussed associated issues with IRS management.

III. Determined whether the IRS properly identified and corrected erroneous duplicate installment agreement user fees charged against individual taxpayer accounts.

A. Determined whether centralization of duplicate user fee resolution by the Compliance Services Collection Operation function improved by comparing workload statistics by quarter from October 1, 2003, through the March 31, 2006. However, with the results inconclusive, we elected to sample a population of accounts showing multiple user fee payments for initiating an installment agreement during the second quarter of

[23] The Individual Master File is the IRS database that maintains transactions or records of individual tax accounts. The Taxpayer Information File is an internal IRS database which allows for easy access to individual, business, and other sources of data.
[24] An IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.
[25] This sample was later reduced to 63. See Appendix IV for details on the sampling results and methodology.
[26] The Desktop Integration is a common interface that allows users of multiple IRS systems to view history and comments from other systems and to access a variety of case processing tools.
[27] The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

FY 2006 (January through March 2006). There were 2,920 unique taxpayer accounts represented in the 4,039 records. We developed a sampling plan using a 95 percent confidence level, an expected error rate of 10 percent, and a precision of ±6 percent, which resulted in a random sample size of 94 accounts. We reviewed the sample to determine whether the duplicate payments were justified. When not justified, we evaluated each account to determine whether the duplicates were effectively resolved. We discussed the exceptions with IRS management.

Appendix II

Major Contributors to This Report

Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs)
Mary V. Baker, Director
Marybeth H. Schumann, Director
Bryce Kisler, Acting Director
James D. O’Hara, Audit Manager
William Simmons, Acting Audit Manager
Tanya Boone, Senior Auditor
Gwendolyn Green, Senior Auditor
Cindy Harris, Senior Auditor
Kristi Larson, Senior Auditor
Ronnie Summers, Senior Auditor
Sylvia Sloan-Copeland, Auditor
Robert Carpenter, Information Technology Specialist
Arlene Feskanich, Information Technology Specialist
Judith Harrald, Information Technology Specialist
Layne Powell, Information Technology Specialist

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Wage and Investment Division SE:W
National Taxpayer Advocate TA
Chief Financial Officer OS:CFO
Associate Chief Financial Officer for Corporate Performance Budgeting OS:CFO:CPB
Associate Chief Financial Officer for Revenue Financial Management OS:CFO:R
Director, Communications and Liaison, Wage and Investment Division SE:W:C
Director, Communications, Liaison, and Disclosure, Small Business/Self-Employed Division SE:S:CLD
Director, Compliance, Wage and Investment Division SE:W:CP
Director, Strategy and Finance, Small Business/Self-Employed Division SE:S:SF
Director, Filing and Payment Compliance, Wage and Investment Division SE:W:CP:FPC
Chief Counsel CC
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
- National Taxpayer Advocate TA
- Chief Financial Officer OS:CFO
- Director, Communications and Liaison, Wage and Investment Division SE:W:C
- Director, Communications, Liaison, and Disclosure, Small Business/Self-Employed Division SE:S:CLD

Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; the IRS might have collected excess amounts in user fees on 940,821 accounts totaling $10.3 million for initiating installment agreements (616,728 accounts) and $2.5 million for restructuring/reinstating installment agreements (324,093 accounts) since the new rate went into effect in January 2007 (see page 5).

Methodology Used to Measure the Reported Benefit:

To determine the potential excess amounts of installment agreement user fees collected, we obtained the FY 2004 cost estimate for the proposed installment agreement user fee increase. We reviewed the estimate and identified problems with source data and costs the IRS used in the FY 2004 cost estimate that could not be supported. Our review of this estimate was limited to specific line items in the calculation (Appendix V). The installment agreement user fee cost estimates were recalculated addressing the individual errors. We developed a table to show the cumulative effects of the individual recalculations for the labor, non-labor, and indirect overhead cost categories. The recalculated initial user fee estimate was $88.27 and reinstated user fee was $37.29 based on the individual error calculations (Appendix VI). However, the IRS actually proposed and established user fees of $105 for initiating an installment agreement and $45 for restructuring/reinstating an installment agreement, potentially overcharging taxpayers $16.73 [$105 - $88.27] and $7.71 [$45 - $37.29], respectively, based on our limited review.[1]

We obtained the FY 2007 installment agreement user fee collection data as of September 28, 2007. From that data, we determined that the volume of new initial and restructured/reinstated user fee collections from January through September 2007 to be 616,728 and 324,093, respectively, for a total of 940,821 accounts. Using these volumes, we

[1] The actual reduction using the cumulative error adjustments would be $16.85 ($105.00 - $88.15) for initiating an installment agreement and $7.77 ($45.00 - $37.23) for restructuring/reinstating an installment agreement. The minor differences of $0.12 ($16.85 - $16.73) and $0.06 ($7.77 and $7.71) are attributed to rounding differences between the cumulative recalculation shown at Appendix V and the individual recalculations discussed in Appendix VI. We used the smaller differences for our projected user fee overcharges.

calculated an estimated overcharge of $10,317,859 [616,728 * $16.73] for initiating an installment agreement and $2,498,757 [324,093 * $7.71] for restructuring/reinstating an installment agreement for a total of $12,816,616.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; waived user fees on 33,711 individual taxpayer accounts for a total of $1,087,003. The amount of uncollected installment agreement user fees could be $629,021 as a result of improperly waiving the user fee for initiating an installment agreement. In addition, another $457,982 in waived user fees for restructuring/reinstating an installment agreement is questionable because the justification for waiving the fee was not adequately documented (see page 9).

Methodology Used to Measure the Reported Benefit:

To determine the potential amount of uncollected installment agreement user fees, we obtained a data extract from the Taxpayer Information File of accounts with installment agreement user fees recorded as due, paid, or waived during FY 2006. From this file containing 2,904,348 records (1,426,083 unique taxpayer accounts), we isolated 90,948 records for 44,088 unique taxpayer accounts with a waived user fee identified. From this population, we selected our sample in 3 parts starting with a sample of 30 cases. Based on the tentative results, we reviewed 20 additional cases and later expanded the sample to the predetermined size of 73 using a 95 percent confidence level, a ±5 percent precision rate, and a 5 percent expected error rate for the population of 90,948. Because of the way the data were extracted, each taxpayer account contained one or more account actions making up the 90,948 records. However, each unique taxpayer account contained only one identified waived user fee. By selecting our sample using the 90,948 records, some of the unique taxpayer accounts having higher numbers of account actions had more of a probability of being selected in the sample than others. We believe that the impact on our sample and resulting projections is negligible, because having more recorded account actions would not make one taxpayer account more prone to error than another.

During our review of the 73 sampled accounts, we determined that Continuous Wage Levies were included. Because Continuous Wage Levies are not installment agreements, we removed them from the population of unique taxpayer accounts and from the sample. The 44,088 unique taxpayer accounts included 6,829 Continuous Wage Levies. Deducting the Continuous Wage Levies left 37,259 (44,088 – 6,829) installment agreement accounts with a waived user fee and reduced our sample from 73 to 67. The sample was later reduced to 63 as 4 of the sampled accounts could not be verified because they were dropped from the tracking system once the installment agreement was paid. In 57 (90 percent) of the 63 cases, we determined that 32 fees were improperly waived for initiating an installment agreement and 25 fees were waived without providing adequate documentation for restructuring/reinstating an installment agreement.

Our projections were made using the 37,259 unique taxpayer accounts. Of the 37,259 unique taxpayer accounts, 16,168 were for initiating an installment agreement and 21,091 were for restructuring/reinstating an existing installment agreement. Using the 37,259 unique taxpayer accounts, we projected the reported error rate (37,259 taxpayer accounts * 90.48 percent = 33,711 [±2,701][2]). The projections were calculated using valid statistical formulas to estimate the variable range of taxpayer account errors. We used the 33,711 taxpayer accounts to calculate the amount of additional fees the IRS should have collected including an additional $629,021 [((16,168/37,259) * 33,711) * $43] in initial user fees and $457,982 [((21,091/37,259) * 33,711) * $24] for restructuring/reinstating an installment agreement.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 435 taxpayer accounts with duplicate installment agreement user fee payments that went unaddressed in the second quarter of FY 2006. These accounts were overcharged user fees totaling $18,705 [435 taxpayer accounts * $43] (see page 13).

Methodology Used to Measure the Reported Benefit:

To determine the number of accounts that could have unaddressed duplicate installment agreement user fee payments, we obtained data on taxpayer accounts with multiple installment agreement user fee payments of $43 during the period from October 1, 2000, through June 1, 2006.[3] From this population, we isolated 4,039 records representing 2,920 taxpayer accounts showing multiple user fee payments for initiating an installment agreement during the second quarter of FY 2006 (January through March 2006). We selected a sample of 94 accounts based on a population of 4,039 records (2,920 taxpayer accounts), using a confidence level of 95 percent, a precision level of ±6 percent, and an expected error rate of 10 percent.

We first reviewed a probe sample of 30 accounts and then the remaining 64 accounts sampled. In 14 (15 percent) of the 94 accounts, the duplicate user fee charges were inappropriate and the

---

[2] Calculated as follows: 37,259 taxpayer accounts * +7.25 percent (actual precision) = +2,701. The lower limit of the range is 33,711 – 2,701 = 31,010 taxpayer accounts. The upper limit of the range is 33,711 + 2,701 = 36,412 taxpayer accounts.
[3] Until January 2007, the IRS charged $43 for establishing an installment agreement. At that time, the rate for establishing an installment agreement was increased to $105.

Wage and Investment Division Compliance Services Collection Operation function did not identify or correct the duplicate payments during its normal review process. We projected our results to the 2,920 taxpayer accounts to emphasize the number of taxpayer accounts having potential duplicate user fee payments. Out of the 2,920 taxpayer accounts in the second quarter of FY 2006 with duplicate user fee payments, 435 went uncorrected (2,920 taxpayer accounts * 14.89 percent = 435 [±207]).[4] The projection was calculated using valid statistical formulas to estimate the variable range of total taxpayer error accounts in the population.

[4] Calculated as follows: 2,920 taxpayer accounts * +7.09 percent (actual precision) = +207. The lower limit of the range is 435 - 207 = 228 taxpayer accounts. The upper limit of the range is 435 + 207 = 642 taxpayer accounts.

Appendix V

Cost Estimate of Installment Agreements

Table 1 shows the FY 2004 labor cost estimate used by the IRS for the proposed initial and restructured/reinstated installment agreements. Table 2 shows the non-labor cost estimate, and Table 3 summarizes the labor and non-labor results applying the IRS overhead rate for the overall user fee totals. The information contained in the brackets [ ] identifies the source for the data used to support the calculation. The highlighted lines identify those items of the calculation that were reviewed during this audit.

Table 1 - Labor Cost Estimate

		IRS Calculation	***TIGTA Recalculation***
1	Number of Installment Agreements [FY 2003 Collection Activity Report (CAR)[1] 5000-6 Part 1; 1.1]	**2,859,111**	**2,463,348**
2	Rate per hour [FY 2003 WP&C[2] for Wage and Investment Division Compliance Services Collection Operation[3] 62010 and 62020; estimate for others][4]	-	-
3	Direct hours *(add items in the Direct hours rows for individual functions)*	2,420,232	2,024,469
4	Quality Review - 2.2% Direct [Internal Revenue Manual 3.30.10-3] *(multiply line 3 by 2.2%)*	53,245	44,538
5	Overhead - average 90% direct [Internal Revenue Manual 3.30.10-2] *(multiply line 3 by 90% for IRS and 91% for TIGTA)*	2,178,209	1,842,267
6	Total Staff Hours *(add lines 3, 4 and 5)*	4,651,686	3,911,274

[1] The CAR includes Integrated Data Retrieval System data extracts of installment agreements. The Integrated Data Retrieval System is the IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.
[2] Compliance Work Plans and Control (WP&C) reports use standard work codes to show time expended and volume of work processed. The data are compiled from employees' time reports.
[3] Compliance Service Collections Operation includes the Automated Collection System. The Automated Collection System is a telephone contact system through which telephone assistors collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.
[4] The IRS did not provide an average rate per hour for all functions. Individual rates per hour were applied to the number of installment agreements for each individual function with the sum for all those functions included on line number 3.

	Table 1 - Labor Cost Estimate (Con't)		
	Installment Agreement Account Listing Costs	***IRS Calculation***	***TIGTA Recalculation***
7	Hourly Salary [FY 2004 salary tables, average locality pay, rounded][5]		
8	Labor	$ 94,025,380.64	$ 80,262,177.07
9	Total Labor *(with average 25% benefits)* [Internal Revenue Manual 3.30.10-1]*(multiply line 8 by 1.25 for IRS and 1.26 for TIGTA)*	$ 117,531,725.80	$ 101,130,343.11
10	Inflation rate for FY 2005 (2.23% for IRS and 3.50% for TIGTA) and FY 2006 (2.89% for IRS and 3.10% for TIGTA) *(For IRS multiply line 9 by each of the inflation rates then add the two results to line 9. For TIGTA multiply line 9 by the FY 2005 rate and that result by the FY 2006 rate with the final result on line 10)*	$ 123,549,350.16	$ 107,914,672.17
11	Labor Cost per agreement taken *(divide line 10 by line 1)*	$ 43.21	$ 43.81
12	Allocate 70.3% to the Initial fee [CAR 5000-6 Part 2; 4.2] *(multiply line 11 by 70.3%)*	$ 30.38	$ 30.80
13	Allocate 29.7% to Restructured/Reinstated fee [CAR 5000-6 Part 2; 4.9] *(multiply line 11 by 29.7%)*	$ 12.83	$ 13.01
14	Volume - Installment Agreement Accounts Listing (Installment Agreement Account Listing) [WP&C]	2,064,699	2,064,699
15	Rate per hour [WP&C]	17.5	17.5
16	Direct hours *(divide line14 by line 15)*	117,983	117,983
17	Quality Review (2.2% Direct) [Internal Revenue Manual 3.30.10-3] (*multiply line 16 by 2.2%)*	2,596	2,596
18	Overhead (average 90% direct) [Internal Revenue Manual 3.30.10-2] *(multiply line 16 by 90% for IRS and 91% for TIGTA)*	106,185	107,364
19	Total Staff Hours *(add lines 16 – 18)*	226,763	227,943
20	Hourly Salary [FY 2004 locality salary table, *rounded*]	$ 16.78	$ 16.78
21	Labor *(multiply line 19 by line 20)*	$ 3,805,082.16	$ 3,824,879.67
22	Total Labor (with average 25% benefits) [Internal Revenue Manual 3.30.10-1] *(multiply line 21 by 1.25 for IRS and 1.26 for TIGTA)*	$ 4,756,352.70	$ 4,819,348.39

[5] The IRS did not provide an average hourly salary rate. The salaries were applied to each individual function.

	***Table 1 - Labor Cost Estimate** (Con't)*		
		IRS Calculation	***TIGTA Recalculation***
23	Inflation rate for FY 2005 (3.50%) and FY 2006 (3.10%) (IRS did not apply inflation. *For TIGTA multiply line 22 by the FY 2005 rate and the result by the FY 2006 rate with the final result on line 23)*	$ -	$ 5,142,654.38
24	Cost per Installment Agreement Account Listing case *(divide line 22 for IRS and line 23 for TIGTA by line 14)*	$ 2.20[6]	$ 2.49
25	Allocate 70.3% to the Initial fee [CAR 5000-6 Part 2; 4.2] *(multiply line 24 by 70.3%)*	$ 1.55	$ 1.75
26	Allocate 29.7% to Restructured/Reinstated fee [CAR 5000-6 Part 2; 4.9] *(multiply line 24 by 29.7%)*	$ 0.65	$ 0.74
27	Add Burden to the Initial fee @ 2.3% *(add lines 12 and 25. Multiply by 2.3%)*	$ 0.73	$ -[7]
28	Add Burden Restructured/Reinstated fee @ 2.3% *(add lines 13 and 26. Multiply by 2.3%)*	$ 0 .31	$ -[8]
29	**Labor Costs - Initial Fee** *(add lines 12, 25 and 27 for IRS and lines 12 and 25 for TIGTA)*	**$ 32.66**	$ 32.55
30	**Labor Costs – Restructured/Reinstated Fee** *(add lines 13, 26 and 28 for IRS and lines 13 and 26 for TIGTA, rounded)*	**$ 13.80**	$ 13.75

[6] Calculates to $2.30, but the IRS allocated $2.20 so we are showing this amount.
[7] We eliminated the burden rate because the IRS could not provide support for it.
[8] We eliminated the burden rate because the IRS could not provide support for it.

	Table 2 –Non-Labor Cost Estimate		
		IRS Calculation	TIGTA Recalculation
1	**Number of** Installment Agreements [CAR 5000-6 Part 1; 1.1]	**2,859,111**	**2,463,348**
2	Average # payments per agreement [CAR 5000.6 Part 1; 2.1.1.6]	44.21[9]	31.02[10]
3	**Total Reminder Notices (& payments)** *(multiply lines 1 by 2)*	126,406,432	76,413,055
4	Notices (2 laser pages per notice; 4 per joint account - use average 3) @ $4.54 per 1,000 [Internal Revenue Manual 3.30.10-42] (*divide line 3 by 1,000, multiply by $4.54, then multiply by 3, the average)*	$ 1,721,655.60	$ 1,040,745.81
5	Envelope E178 @ $14.92 per 1,000 [Internal Revenue Manual 3.30.10-42] (*divide line 3 by 1,000 then multiply by $14.92)*	$ 1,885,983.97	$ 1,140,082.78
6	Envelope E205 @ $10.04 per 1,000 [Internal Revenue Manual 3.30.10-42] (*divide line 3 by 1,000 then multiply by $10.04)*	$ 1,269,120.58	$ 767,187.07
7	Postage @ $.352 [Internal Revenue Manual 3.30.10-41] *(multiply line 3 by $.352)*	$ 44,495,064.06	$ 26,897,395.35
8	Total Cost - Reminder Notices *(add lines 4 – 7)*	$ 49,371,824.21	$ 29,845,411.01
9	Inflation rate for FY 2004 (1.4%), FY 2005 (1.5%), FY 2006 (1.6%) *(For IRS multiply line 8 by each of the inflation rates then add the results to line 8. For TIGTA multiply line 8 by the FY04 rate, the result by the FY05 rate, and that result by the FY06 rate with the final product on line 9)*	$ 51,593,556.30	$ 31,208,670.59
10	Cost per Installment Agreement *(divide line 9 by line 1)*	$ 18.05	$ 12.67

[9] The IRS did not provide an average number of payments for all functions. Individual averages were applied to the number of installment agreements for each individual function with the sum for all those functions. The sum of the results for all the functions was included on line 3. Dividing line 3 by line 1 produces the weighted average of 44.21.

[10] Correctly calculating the average number of payments based on data the IRS used in its FY 2004 cost estimate resulted in an adjusted weighted average for the number of payments totaling 10.51 months. Once this error was disclosed, the IRS re-estimated the average number of payments using a new methodology, which resulted in a 31.02 month average. While we did not audit the new estimate, we believed that it was a better estimate of the life of an installment agreement than the 10.51 months computed from data the IRS elected to use in its FY 2004 cost estimate. Therefore, our recalculation is based on using the IRS' adjusted estimate of 31.02 months.

	***Table 2 –Non-Labor Cost Estimate** (Cont.)*		
		IRS Calculation	***TIGTA Recalculation***
11	Allocate 70.3% to Initial fee [CAR 5000-6 Part 2; 4.9] (*multiply line 10 by 70.3%)*	$ 12.69	$ 8.91
12	Allocate 29.7% to Restructured/Reinstated fee [CAR 5000-6 Part 2; 4.9] (*multiply line 10 by 29.7%)*	$ 5.36	$ 3.76
13	Cost to process payment @ $521.16 per 1,000 [Internal Revenue Manual 3.30.10-20] (*divide line 3 by 1,000 then multiply by $521.16)*	$ 65,877,976.10	$ 39,823,427.72
14	Inflation rate for FY 2004 (1.4%), FY 2005 (1.5%), FY 2006 (1.6%) (IRS did not apply inflation. *For TIGTA multiply line 13 by the FY 2004 rate, the result by the FY 2005 rate, and that result by the FY 2006 rate with the final product on line 14)*	$ -	$ 41,642,456.77
15	Cost per Installment Agreement *(divide line 13 for IRS and line 14 for TIGTA by line 1)*	$ 23.04	$ 16.90
16	Allocate 70.3% to Initial fee [CAR 5000-6 Part 2; 4.2] (*multiply line 15 by 70.3%)*	$ 16.20	$ 11.88
17	Allocate 29.7% to Restructured/Reinstated fee [CAR 5000-6 Part 2; 4.9] (*multiply line 15 by 29.7%)*	$ 6.84	$ 5.02
	Costs for Installment Agreement Defaults		
18	Number of Defaults [CAR 5000.6 Part 1; 2.1.2]	976,316	877,103
19	Notices (2 laser pages per notice; 4 per joint account - use average 3) @ $4.54 per 1,000 [Internal Revenue Manual 3.30.10-42] (*divide line 18 by 1,000, multiply by $4.54, then multiply by 3, the average)*	$ 13,297.42	$ 11,946.14
20	Stuffers @ $64 per 1,000 [estimates per Internal Revenue Manual 3.30.10-42] (*divide line 18 by 1,000 then multiply by $64)*	$ 62,484.22	$ 56,134.59
21	Envelope E142 @ $19.20 per 1,000 [Internal Revenue Manual 3.30.10-42] (*divide line 18 by 1,000 then multiply by $19.20)*	$ 18,745.27	$ 16,840.38
22	Envelope E205 @ $10.04 per 1,000 [Internal Revenue Manual 3.30.10-42] (*divide line 18 by 1,000 then multiply by $10.04)*	$ 9,802.21	$ 8,806.11
23	Postage (certified) @ $2.80 [Internal Revenue Manual 3.30.10-41] *(multiply line 18 by $2.80)*	$ 2,733,684.80	$ 2,455,888.40
24	Total Cost - Default Notices (*add lines 19 – 23*)	$ 2,838,013.93	$ 2,549,615.63

	Table 2 –Non-Labor Cost Estimate (Cont.)		
		IRS Calculation	***TIGTA Recalculation***
25	Inflation rate for FY 2004 (1.4%), FY 2005 (1.5%), FY 2006 (1.6%) (IRS did not apply inflation. *For TIGTA multiply line 24 by the FY 2004 rate, the result by the FY 2005 rate, and that result by the FY 2006 rate with the final product on line 25)*	$ -	$ 2,666,075.34
26	Cost per Installment Agreement *(divide line 24 for IRS and line 25 for TIGTA by line 1)*	$ 0.99	$ 1.08
27	Allocate 70.3% to Initial fee [CAR 5000-6 Part 2; 4.2] *(multiply line 26 by 70.3%)*	$ 0.70	$ 0.76
28	Allocate 29.7% to Restructured/Reinstated fee [CAR 5000-6 Part 2; 4.9] (*multiply line 26 by 29.7%)*	$ 0.29	$ 0.32
29	**Non-labor cost - Initial Fee** *(add lines 11, 16, and 27)*	**$ 29.58**	**$ 21.55**
30	**Non-labor cost – Restructured/Reinstated Fee** *(add lines 12, 17, and 28)*	**$ 12.50**	**$ 9.10**

	Table 3 - Summary of Cost Estimates				
1		***Initial Installment Agreement (IRS)***	***Initial Installment Agreement (TIGTA)***	***Restructured/ Reinstated Installment Agreement (IRS)***	***Restructured/ Reinstated Installment Agreement (TIGTA)***
2	Labor costs (*Table 1, lines 29 and 30*)	$ 32.66	$ 32.55	$ 13.80	$ 13.75
3	Non-labor costs (*Table 2, lines 29 and 30*)	$ 29.58	$ 21.55	$ 12.50	$ 9.10
4	**Totals**	$ 62.24	$ 54.10	$ 26.30	$ 22.85
5	Overhead at 62.93% *(multiply line 4 above by 62.93%)*	$ 39.17	$ 34.05	$ 16.55	$ 14.38
6	**Overall User Fee Totals** *(add lines 4 and 5 above)*	$ 101.41	$ 88.15	$ 42.85	$ 37.23

Appendix VI

Effect of Revised Cost Calculations

Our review of the 2004 cost estimate disclosed problems with the cost assumptions used in the actual cost calculation, calculation errors, and unsupported costs. The differences were calculated to show the individual effect each error had on the cumulative overstatement. The overall impact of the problems identified is summarized in the following table.

User Fee Unit Cost Recalculations

Cost Category	Labor Costs	Non-Labor Costs	Indirect Overhead[1]	Total
Initial User Fee – IRS	$32.66	$29.58	$39.17	$101.41
1. Continuous Wage Levies and Extensions to Pay	-	-	-	-
2. Average Number of Payments	-	(8.62)	(5.43)	(14.05)
3. Double Counted Installment Agreements	(.45)	.03	(.26)	(.68)
4. Unsupported Burden Rate	(.74)	-	(.47)	(1.21)
5. Unsupported Inflation Rates	.66	.56	.77	1.99
6. Overhead Rounding Errors	.50	-	.31	.81
Total[2]	$32.63	$21.55	$34.09	$88.27
Rounding Difference				(.12)[3]

---

[1] The calculation for Indirect Overhead is (Labor Costs + Non-Labor Costs) * 62.93 percent.
[2] The actual difference for the individual error estimates would be the difference between the actual $105 user fee charged and the total shown or $16.73 ($105.00 - $88.27).
[3] The calculation for the Rounding Difference is the Total minus the Revised Total. The Revised Total is the number we calculated. This difference is due to the IRS rounding some numbers in its formulas when calculating the line items. Therefore, when we calculated the figures based on the errors individually and collectively, they did not match due to the rounding that occurred in the formulas.

Revised Total				$88.15
Difference				($13.26)
Restructured/Reinstated User Fee - IRS	$13.80	$12.50	$16.55	$42.85
1. Continuous Wage Levies and Extensions to Pay	-	-	-	-
2. Average Number of Payments	-	(3.64)	(2.29)	(5.93)
3. Double Counted Installment Agreements	(.19)	.01	(.11)	(.29)
4. Unsupported Burden Rate	(.31)	-	(.20)	(.51)
5. Unsupported Inflation Rates	.28	.23	.32	.83
6. Overhead Rounding Errors	.21	-	.13	.34
Total[4]	$13.79	$9.10	$14.40	$37.29
Rounding Difference				(.06)[5]
Revised Total				$37.23
Difference				($5.62)

Source: The IRS FY 2004 cost estimate and our review of that estimate.

Note: The Indirect Overhead was recalculated based on the sum of the revised Labor and Non-Labor times 62.93%.

The overall difference between the 2004 cost for establishing an initial installment agreement and for a reinstating/restructuring of an existing installment agreement was estimated at $13.26

[4] The actual difference for the individual error estimates would be the difference between the actual $45 user fee charged and the total shown or $7.71 ($45.00 - $37.29).

[5] The calculation for the Rounding Difference is the Total minus the Revised Total. The Revised Total is the number we calculated. This difference is due to the IRS rounding some numbers in its formulas when calculating the line items. Therefore, when we calculated the figures based on the errors individually and collectively, they did not match due to the rounding that occurred in the formulas.

and $5.62, respectively. The following are the different problems we identified with the cost assumptions used in the actual cost calculation, calculation errors, and unsupported costs resulting in our adjustments (except as noted). In the 2004 cost estimate, the IRS incorrectly:

- Included taxpayers who were subjected to a continuous wage levy and taxpayers given an extension of time to pay their tax debt rather than paying under an installment agreement.[6] The IRS took this data from a line item in the CAR. At that time, IRS management was unaware of a method to separate the continuous wage levies and extensions to pay from the total; therefore, they overstated the number of installment agreements in the calculation. We later determined that continuous wage levies and accounts with extensions could be identified using the Collection Information Locator Number field. While we could not analyze the 2003 data used in the IRS' cost estimate, we made an assessment based on accounts we had obtained from the Taxpayer Information File with an installment agreement status code in FY 2006 and determined that, out of a population of 2,904,348 records, 14,262 records (9,412 unique taxpayer accounts) were related to continuous wage levies and 162,364 records (133,556 unique taxpayer accounts) were related to extensions to pay and not installment agreements.[7] Being subjected to a continuous wage levy and getting an extension to pay does not result in an installment agreement, and a user fee is not charged. While the 10 percent (based on unique taxpayer accounts) does not represent the entire amount of extensions to pay and continuous wage levies that would have been entered into during FY 2006, it shows that those accounts could be identified and should have been eliminated from the CAR data used in the FY 2004 cost estimate.[8]

- Estimated the average number of payments per installment agreement that had a significant impact on the non-labor calculation. The IRS extracted the number from a workload report[9] assuming that the data represented the number of monthly payments.

[6] Accounts with continuous wage levies, extensions of time to pay their taxes, and installment agreements are identified in IRS systems with the same status code. However, the accounts with continuous wage levies and extensions can only be identified through the Agreement Locator Number.
[7] Using available data, the IRS could not readily separate accounts with continuous wage levies and extensions to pay from the actual installment agreement accounts used in the FY 2004 calculation. Therefore, we could not correct the number of installment agreements used in the labor and non-labor calculations. As a result, we were unable to estimate the amount of the resulting error in the FY 2004 cost estimate. Our estimate of extensions to pay accounts in FY 2006 was determined by using the designator in the Collection Information Locator Number (which is the same as the Agreement Locator Number) to identify those types of accounts.
[8] The data pulled from the IRS Taxpayer Information File was a snapshot in time of the accounts with installment agreements established during FY 2006. Because accounts are deleted from this system when paid, those extensions to pay and continuous wage levies granted and paid during FY 2006 would not be included in the data extract. Therefore, while we found a 10 percent rate of occurrence, the actual occurrence for FY 2006 would be higher.
[9] The CAR includes Integrated Data Retrieval System data on installment agreements. The Integrated Data Retrieval System is an IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

However, we determined from the workload documentation for the CAR report that the data actually represented the number of weeks until the installment agreement was paid, not monthly payments. We adjusted the data used to reflect monthly payments, which resulted in the weighted average for the number of installment agreement payments being reduced to 10.51 months from the 44.21 months used by the IRS in the FY 2004 cost estimate (See Appendix V). If the data had been applied correctly in the calculation, it would have been evident to management that the data used were flawed because most installment agreements would last much longer than the 10.51 months computed. When we brought this error to the IRS' attention, it was quickly pointed out that using and correctly adjusting the original data resulted in an average number of payments that was too low. The IRS then took steps to devise an alternate methodology and recalculated the average number of payments using the 2003 data. The revised estimate was 35.6 months.[10] While we did not audit the revised method for calculating the average number of monthly payments, we did note a couple of items for the IRS to consider in its approach, which resulted in another revised estimate of 31.02 months.[11] While this estimate might still not be completely refined, we believe it provides a more realistic estimate of the average number of payments than the results obtained from adjusting the original data used in the FY 2004 cost calculation. Therefore, when calculating the results of the error, we used the 31.02 month estimate. Overstating the estimated number of payments had the effect of overestimating the non-labor cost associated with the user fee for initiating an installment agreement and the user fee for restructuring/reinstating an installment agreement by $(8.62) and $(3.64), respectively. Considering the effect on the indirect overhead calculation, this resulted in a reduction of $(14.05) and $(5.93).

- Double counted 395,763 installment agreements by including the same installment agreements in 2 separate cost categories. This affected the results of both the labor and non-labor cost estimates. Correcting the double counting resulted in reducing the cost of the installment agreement initial user fee by $(0.42) [$(0.45) + $0.03] and the restructuring/reinstating user fee by $(0.18) [$(0.19) + $0.01]. Considering the effect on the indirect overhead calculation, this error resulted in a reduction of $(0.68) and $(0.29) to the initial and restructured/reinstated user fees, respectively.

[10] Instead of using the data depicting the average cycles (weeks) until an installment agreement was paid, the IRS recalculated using data on the projected number of payments when the installment agreement was set up. However, this new method does not consider that installment agreements could be paid early or that installment agreements could default.

[11] The IRS originally proposed a revised estimate of 35.6 as the average monthly payments. However, after discussion, IRS management made further adjustments that reduced the new estimate to 31.02 months. We believe the IRS should further refine this approach and, before using the estimate, clearly explain why using the projected number of payments for an installment agreement would be preferable to using data on the actual number of payments made to settle installment agreements. Using the actual number of installment agreement payments, if the data collected could be determined reliable, would be preferable over using projected numbers.

- Applied a 2.3 percent burden rate to the labor cost. The Chief Financial Officer's office was unable to provide any documentation to support this specific rate but explained that this was the same burden rate used in the original FY 1994 cost estimate and was just carried forward without re-evaluation. Eliminating the unsupported burden rate from the calculation resulted in a reduction of the installment agreement initial user fee by $(0.74) and user fee for restructuring/reinstating by $(0.31). Considering the effect on the indirect overhead calculation this error resulted in a reduction of $(1.21) and $(0.51) to the initial and restructured/reinstated user fees, respectively.
- Applied inflation rates for FY 2004, 2005 and 2006 to some cost categories but not others. The Chief Financial Officer's office could not identify the actual source of all rates and the rates used could not be verified. In addition, the IRS' application of inflation was incorrect. The inflation rates were applied against the same total without considering the cumulative effect of inflation when adjusting for multiple years. Because the IRS elected to adjust for multi-year inflation rather than taking the preferred approach of updating the calculation based on the most current data, we recalculated the cost estimate by applying the inflation rates where they were omitted and corrected the labor inflation rates used where we could using the appropriate application. This resulted in an increase in the installment agreement initial user fee by $1.22 [$0.66 + $0.56] and the user fee for restructuring/reinstating by $0.51 [$0.28 + $0.23]. Considering the effect on the indirect overhead calculation, this error increased the initial and restructured/reinstated user fees by $1.99 and $0.83, respectively.
- Rounded overhead rates for direct labor and employee benefits when applying those rates in the labor cost analysis. For better accuracy, the overhead rates should have been averaged. The overhead rounding errors resulted in increasing the installment agreement initial user fee estimate by $0.50 and user fee for restructuring/reinstating estimate by $0.21. Considering the effect on the indirect overhead calculation, this error increased the initial and restructured/reinstated user fees by $0.81 and $0.34, respectively.

Appendix VII

Management's Response to the Draft Report

COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

APR 04 2008

RECEIVED
APR -4 2008

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Installment Agreement User Fees Were Not Properly Calculated or Always Collected (Audit # 200640006)

I reviewed the subject draft report and thank you for the opportunity to provide feedback. We agree with many of your recommendations for ensuring the installment agreement fees are appropriately administered to affected taxpayers. However, we disagree with several conclusions reached in the report.

We disagree with the conclusion that we overcharged taxpayers for installment agreement user fees. Although certain costs were incorrectly stated during the 2005 calculation process, our fee did not exceed actual costs. In fact, based on a subsequent review conducted by the Small Business/Self-Employed (SB/SE) Division, our initial calculation resulted in implementation of an installment agreement user fee that fell below full cost. As part of our 2007 biennial review, we refined our methodology and developed better cost information. We also addressed weaknesses in the data we used in 2005 to calculate and support the full cost of the installment agreement user fee. Applying this new methodology to the FY 2005 user fee rates, we determined we did not overcharge taxpayers for installment agreements. This review also revealed that the new user fee rate implemented on January 1, 2007, was also considerably lower than full cost. We provided the result of our review to TIGTA during the latter part of this audit.

We also disagree that the user fee for Direct Debit Installment Agreements may have been higher than appropriate. Even after some non-applicable notice and payment processing costs for direct debit installment agreements were excluded from our FY 2005 biennial review, our calculations resulted in a higher cost than was actually proposed.

2

We agree with your findings that some installment agreement user fees were incorrectly waived and others were not collected from the first payment made by the taxpayer. Since you brought these issues to our attention we were able to take immediate corrective action, including issuing an alert to all employees that user fees for initiating installment agreements should never be waived. Additionally, we submitted two Work Requests (WR) that addressed these findings. When the first WR is completed, employees will be systemically prevented from waiving user fees associated with initiating an installment agreement. The second WR, which was requested in response to a recommendation made by the Government Accountability Office (GAO), was completed and operational in January 2008. When taxpayers make payments, the system now automatically transfers the appropriate amount to the taxpayers' user fee account.

Finally, we disagree with your first outcome measure that indicates the IRS may have collected excess amounts in user fees of $10.3 million. As we indicated above, the costing methodology we used in 2005 to establish the user fee rate did not address all costs. Furthermore, your estimated rate did not include appropriate cost adjustments we proposed that would have increased the calculated amount of the user fee. Nor does it include the impact of reducing the fee to $43 for low-income taxpayers, which represent roughly one-third of those who paid the user fee. We also disagree with your second outcome measure. Outside of sample size concerns, we do not agree the full portion of fees waived for restructured/reinstated user fees should be included in the measure. While we agree documentation was lacking to support waiving the fees, it is not correct to assume all of these fees were waived incorrectly. However, we agree with your third outcome measure.

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, Filing and Payment Compliance, at (202) 283-7144.

Attachment

Attachment

RECOMMENDATION 1

The Chief Financial Officer should ensure that the methodology used to support installment agreement user fee rates is properly revised and that the best data available is used to justify the rate increase. The new methodology and the cost estimating process should be adequately supported and designed to be fair and equitable to the affected taxpayers.

CORRECTIVE ACTION

We agree with your recommendation and agree to do the following:

1. The CFO will publish IRM guidance related to calculating the full cost of the services related to user fees. This guidance will include information on the type of direct and indirect costs to be included in calculating user fees. The CFO will provide the overhead rate and the inflation rates to be included in calculations of the user fee rates on an annual basis to affected business units. Business units will remain responsible for assuring the completeness and correctness of the direct and indirect costs.

2. In order to resolve any ongoing discrepancy between the calculations used in your audit and our calculations, SB/SE will validate information contained in the most recent calculation of the user fee rate developed during the FY 2007 biennial review which was completed on September 11, 2007. This validation will be completed in May 2009.

IMPLEMENTATION DATE

1. September 30, 2008
2. May 1, 2009

RESPONSIBLE OFFICIAL

1. Chief Financial Officer
2. Director, SB/SE Collection

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 2

The Commissioner, Wage and Investment Division, should establish a system control to ensure fees for initiating an installment agreement are not waived. Until such a control is in place, revise established procedures to require a periodic review of waived installment agreement user fees through the Installment Agreement Account Listing or another process to ensure fees for initiating installment agreements are not being waived. Also, implement a review process to ensure the justification for waiving restructured/reinstated installment agreements is appropriately documented on the taxpayers' accounts.

CORRECTIVE ACTION
We agree with this recommendation and have already submitted a Work Request to systemically prevent fees for initiating installment agreements from being waived. Until the requested programming is in place, we will periodically request a run of all status code 60 accounts with a user fee code of "2" (indicating waiver). We will review the results and provide feedback to the appropriate functional areas when problems are identified. We will not be implementing a review process to ensure the justification for waiving restructured or reinstated installment agreements is appropriately documented on the taxpayers' accounts. Rather, we will continue to assess adequacy of documentation during Operational, Managerial, and Quality Reviews.

IMPLEMENTATION DATE
February 15, 2009

RESPONSIBLE OFFICIAL
Director, Filing and Payment Compliance, W&I

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control process.

RECOMMENDATION 3
The Commissioner, Wage and Investment Division, should revise the procedures for processing installment agreement tax payments without a coupon. When there is an outstanding user fee due, examiners should be instructed to first deduct the installment agreement user fee from the payment before applying the balance of the payment to taxes due.

CORRECTIVE ACTION
We agree with the intent of this recommendation that any monies received from the taxpayer should first be applied to the user fee before applying the balance of the payment to taxes due. We implemented a process which systemically transfers the appropriate amount into a taxpayers' user fee account, regardless of whether a coupon was submitted. Tax examiners are no longer required to manually deduct installment agreement user fees from payments made by taxpayers.

IMPLEMENTATION DATE
Completed January 20, 2008

RESPONSIBLE OFFICIAL
Director, Filing and Payment Compliance, W&I

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 4
The Commissioner, Wage and Investment Division, should coordinate with the Modernization and Information Technology Services organization to modify the Installment Agreement Account Listing to expand the information currently provided on accounts with duplicate user fees to include information on the number of duplicates that exist, allowing the examiner to prioritize for correction those accounts showing more than one duplicate.

CORRECTIVE ACTION
We agree with this recommendation and will explore options to enhance the Installment Agreement Account Listing (IAAL) with MITS. Additionally, we provided employees with revised requirements for working the IAAL, utilizing a three-tier hierarchy. Accounts identified as Tier 1, including those with duplicate user fees, are required to be worked as a priority.

IMPLEMENTATION DATE
February 15, 2010

RESPONSIBLE OFFICIAL
Director, Filing and Payment Compliance, W&I

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control process.

RECOMMENDATION 5
The Commissioner, Wage and Investment Division, should reinforce with first-line managers the importance of complying with the IRS' internal procedures requiring direct taxpayer contact when it becomes evident the taxpayer may be repeatedly submitting the initial payment coupon. Furthermore, a modification to the coupon and programming should be considered to ensure the fee is charged on the first payment and to eliminate the possibility of double charging the fee.

CORRECTIVE ACTION
We agree we need to reduce or eliminate the possibility of charging erroneous duplicate user fees to taxpayers. We are working with the Submission Processing Lockbox staff to eliminate split payment processing that often results

4

in duplicate fees. Modification of the coupon will not be necessary as the sweep process we addressed in our corrective action to Recommendation 3 will ensure proper payment application.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 6
The Commissioner, Wage and Investment Division, should develop a control/report which ensures that once examiners identify duplicate user fees these duplicates are reversed.

CORRECTIVE ACTION
Due to the corrective actions we have taken already or planned, we expect the volume of duplicate user fees to be greatly reduced. We will be able to confirm this through the results of the periodic run we will be requesting (as outlined in our Corrective Action to Recommendation 2). While we don't believe an additional control or report is necessary, we will continue to monitor this issue during Operational, Managerial, and Quality reviews.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A