

**Monitoring of Accepted Offers in Compromise
Is Generally Effective, but Some Improvement
Is Needed**

January 2004

Reference Number: 2004-30-043

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

January 29, 2004

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Monitoring of Accepted Offers in
Compromise Is Generally Effective, but Some Improvement Is
Needed (Audit # 200330008)

This report presents the results of our review of the Internal Revenue Service's (IRS) monitoring of accepted Offers in Compromise (OIC). The overall objective of this review was to determine the effectiveness of the IRS' monitoring of accepted OICs to ensure the taxpayers comply with the terms of the agreements and future filing and paying compliance terms.

In summary, the IRS is generally effective in monitoring accepted OICs to ensure compliance with the OIC terms and was resuming collection action on taxpayers' accounts when their OICs were defaulted. Our review of 84 OICs that were accepted in Fiscal Year (FY) 1999 determined that 81 taxpayers were in compliance with all the terms of the OICs at the time of our review.

Although the monitoring of accepted OICs is generally effective, better use of the available program tools will further improve the monitoring. The Automated Offer In Compromise (AOIC)¹ System's follow-up and journal (payments) screens and OIC default transcripts were not always used to help monitor the cases for compliance with OIC payment terms or the future filing of returns and payment of taxes. The IRS had not resumed collection activity on the accounts of 26 taxpayers with approximately \$1.9 million in liabilities when the taxpayers had defaulted on their OICs. We recognize

¹ The AOIC System is the IRS database used to monitor OIC case processing; it was designed to control, track, and monitor OICs.

that not all of the balance due amounts will be collected because it is likely that some of the taxpayers are unable to fully pay.

In addition, controls needed to be improved over newly accepted OICs to ensure they were received in the campuses² and over OICs that were returned to the originating offices for additional information to ensure they were timely returned to the campuses for further monitoring.

Finally, Federal Tax Liens are not always timely released when the offer amount has been fully paid. Our review of 84 OICs determined that after the OIC amount had been fully paid, Federal Tax Liens were not released within the required 30 calendar days for 37 taxpayers and had not been released at all for 9 taxpayers at the time of our review.

We recommended that the Director, Filing and Campus Compliance, Small Business/ Self-Employed (SE/SE) Division, require use of the follow-up screen and the generation and review of follow-up screen due dates reports. The Director should also reemphasize the requirements to use the payment due dates on the journal (payments) screen and to generate and review journal payment due reports. In addition, the Director should require OIC files to include documentation of the results of review of OIC default transcripts.

The Director should require the campuses to periodically generate a list of newly accepted OICs, to validate the receipt of the case files, and to follow up with the originating offices if the files have not been received. The Director should also create a new status code on the AOIC System for newly accepted OICs that are returned to the originating offices for additional information and establish criteria and timeliness guidelines for working and returning the OICs to the campuses. Campuses should be required to follow up with those offices to ensure the files are timely returned for monitoring.

The Director should direct campuses to generate a list of overdue OIs for forwarding to the SB/SE Division Territory Offices or Centralized Offer in Compromise (COIC) site³ Directors. The Director should also require campuses to periodically generate reports of OICs that have been in certain statuses (such as potential default, new, or Other Investigation (OI)⁴) on the AOIC System for 1 year or longer and require a review to determine if they are in the correct status and if timely and effective action is being taken. In addition, the Director, Payment Compliance, SB/SE Division, should direct Territory Offices or COIC sites to timely work and respond to OIs received from the campus OIC units.

² An IRS campus is the data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the computing centers for analysis and posting to taxpayer accounts.

³ The COIC sites operate at two IRS campuses. They are responsible for making the initial processability determination for all OICs received and for completing the perfection process, case building, and initial investigation for individual wage earners, self-employed individuals without employees, or taxpayers that operate a sole proprietorship without employees.

⁴ An OI is the AOIC status that an OIC is put into when it is returned to the originating office for additional information.

Finally, the Director, Filing and Campus Compliance, SB/SE Division, should ensure timely implementation of the process allowing OIC examiners access to the Automated Lien System (ALS)⁵ to release liens and review the process to ensure liens are being correctly released.

Management's Response: The Commissioner, SB/SE Division, agreed with the recommendations in the report and agreed that there is a potential for increased revenue. However, since all the balance due amounts may not be collected, the SB/SE Division did not agree with the entire \$1.9 million figure. SE/SE Division management advised that they have made numerous revisions to the Internal Revenue Manual (IRM) to address our recommendations and that the revisions are in a pending publication of the IRM. In addition, they have created two new subcodes (missing case and incomplete case) under the AOIC System's status code New Work. They stated they have established a 15-day response time for originating offices to submit or perfect incomplete work, and have revised the IRM to ensure the files are returned timely. SB/SE Division management will also review existing IRM guidelines to determine situations in which the use of an OI to resolve back-end OIC issues is necessary to ensure OI requests are appropriate to maximize field resources. Once this review is complete, the IRM will be updated with procedural guidance for campus OIC units and direction will be issued to the field regarding the need to process this work timely.

SB/SE Division management also advised that an ALS train-the-trainer session was provided to the Wage and Investment Division and SB/SE Division management and lead examiners. Campus examiners can now access the ALS database and request release of Federal Tax Liens following full payment of the offer amount. This process will be reviewed during scheduled visits to the campuses during the second quarter of FY 2004. Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment: Although SB/SE Division management agreed with the recommendations and plans to take appropriate corrective actions, they did not agree with the total amount of the potential for increased revenue since all the balance due amounts may not be collected. While we recognize that not all of the balance due amounts will be collected because it is likely that some of the taxpayers will be unable to fully pay, no collection activity was taking place on these accounts at the time of our review. Therefore, we did not adjust the potential outcome measures in this report.

Copies of this report are also being sent to IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Richard Dagliolo, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs), at (631) 654-6028.

⁵ The ALS is the IRS database that prints Notices of Federal Tax Liens, stores taxpayer information, and documents all lien activity.

**Monitoring of Accepted Offers in Compromise Is Generally Effective,
but Some Improvement Is Needed**

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Background

An Offer in Compromise (OIC) is an agreement between the Internal Revenue Service (IRS) and a taxpayer that settles a tax liability for payment of less than the full amount owed. The IRS is granted authority to compromise tax liabilities in Internal Revenue Code (I.R.C.) § 7122.¹

When the IRS receives an OIC, it is entered on the Automated Offer in Compromise (AOIC) System. The AOIC System tracks and controls OICs and generates forms, letters, and managerial reports. After an OIC is filed, an OIC examiner will evaluate the offer to determine if it should be accepted or rejected. The decision to accept an OIC is based on analysis of the taxpayer's facts, circumstances, and financial situation. One of the conditions of an accepted OIC is that the taxpayer agrees to comply with all the provisions of the I.R.C. regarding the filing of returns and paying of taxes for 5 years or until the offer amount is paid in full, whichever is longer.

Once an OIC is accepted, the AOIC System automatically transfers control of the OIC from a field office or a Centralized Offer in Compromise (COIC) site² to an OIC unit at an IRS campus.³ The OIC units are responsible for monitoring accepted OICs to ensure taxpayers comply with the OIC payment terms and the 5-year compliance requirements. The AOIC System assigns status codes at various points in OIC case processing to monitor the status of the OIC. The AOIC System can be used to help monitor the OIC terms and to manage inventory and ensure any necessary actions are timely taken.

If a taxpayer fails to meet any of the terms of the accepted OIC, the OIC may be defaulted and all liabilities previously eliminated as a result of the OIC should be reinstated. A

¹ I.R.C. § 7122 (2002).

² The COIC sites operate at two IRS campuses. They are responsible for making the initial processability determination for all OICs received and for completing the perfection process, case building, and initial investigation for individual wage earners, self-employed individuals without employees, or taxpayers that operate a sole proprietorship without employees.

³ An IRS campus is the data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the computing centers for analysis and posting to taxpayer accounts.

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default may occur because a taxpayer fails to remit any OIC payment due, does not return overpayments erroneously refunded, or fails to timely file subsequent returns and pay all taxes due during the 5-year compliance period.

This review was performed at the Austin, Texas, and Philadelphia, Pennsylvania, Campuses from January through August 2003. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Monitoring of Accepted Offers and Resuming Collection Action Upon Default Are Generally Effective

Review of a statistical sample of 84 of 28,018 “doubt as to collectibility” OICs accepted in Fiscal Year (FY) 1999 showed virtually all of the taxpayers were in compliance with all the terms of the OIC at the time of review. Only 3 (4 percent) taxpayers were not in compliance with the OIC payment terms or the 5-year compliance requirements at the time of our review, and their OICs should have been defaulted.

Our review of the remaining 81 OICs determined:

- In 48 OICs, the taxpayers voluntarily complied with the payment terms and the 5-year compliance requirement.
- In 33 OICs, while the taxpayers did not timely comply with 1 or more of the offer terms, the IRS identified the noncompliance and took appropriate action to resolve it.
 - In 15 OICs, the noncompliance was resolved after the taxpayer received 1 or more of the normal collection notices issued by the IRS.
 - In 12 OICs, the noncompliance was resolved after contact with the OIC units.
 - In 6 OICs, the noncompliance was resolved after a combination of IRS notices and contacts with the OIC units.

In addition, the IRS is generally resuming collection action on taxpayers’ accounts when their OICs have been defaulted. Analysis of the 28,018 OICs accepted in

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FY 1999 determined that 2,119 had been defaulted at the time of our review. Review of a judgmental sample of 75 of these defaulted OICs and their 322 related tax periods showed:

- Collection action was timely resumed on 209 tax periods after the OICs were defaulted.
- Collection action was not needed on 78 periods, mostly because the liabilities had been fully paid prior to the default or the periods were placed back into the Currently Not Collectible status they were in prior to the OICs being filed.
- While the remaining 35 periods were not immediately placed in active collection status, 13 had been fully paid and 18 had been subsequently placed in an active collection status at the time of our review. A new OIC was filed on one period, and the remaining three periods are below the tolerance level for collection activity.

Better Use of Available Program Tools Will Further Improve the Monitoring of Accepted Offers

While the monitoring of accepted OICs is generally effective, better use of the available program tools will further improve the monitoring. Analysis of the inventory of accepted OICs in 2 campuses determined that, at the time of our review, there were 1,788 OICs in potential default status for noncompliance with either the 5-year requirement (1,203) or the OIC payment terms (585).

The IRS identified the potential default more than 1 year prior to our review in 424 (24 percent) of these 1,788 OICs; however, it did not always take timely or effective actions to address the noncompliance. Review of 40 of the 424 OICs determined the campuses should have defaulted 26 of the OICs from 1 to 45 months (an average of 25 months) prior to our review.

Analysis of the accepted OIC inventory at the other 6 campuses that monitor accepted OICs found 3,967 additional OICs that the IRS had identified as being in potential default status for noncompliance with either the 5-year requirement or the payment terms.

In 585 (15 percent) of the 3,967 OICs, the IRS identified the potential default more than 1 year prior to our review.

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While we cannot statistically project how many of these 585 OICs should have been defaulted, we estimate about 380 should have been.

The AOIC System has several tools designed to help in the monitoring of accepted OICs to ensure noncompliance is timely identified and action is timely taken. However, the campuses visited were not always using several of these tools.

The AOIC System's follow-up screen is not always being used

When future actions are required on OICs either by IRS tax examiners who monitor the cases or by taxpayers, the actions and due dates may be entered on the AOIC System's follow-up screen. A follow-up list report may then be generated to alert examiners of cases needing specific actions.

According to the AOIC User Guide, examiners should use the follow-up screen as a reminder when future actions are required. Management at one campus advised us that the examiners are required to use the follow-up screen, while management at another campus said it was not required.

In 27 of the 40 OICs reviewed, examiners either did not enter the necessary follow-up actions and due dates on the follow-up screens (10 OICs) or entered follow-up actions but did not take them (17 OICs). The taxpayers were not in compliance with the payment terms or future compliance requirements in 23 of these 27 OICs, so the OICs should have been defaulted.

Proper use of the follow-up screen would help ensure that taxpayers take the actions promised or that tax examiners identify those cases in which the taxpayers have not responded to requests for actions made to them.

The AOIC System's payment due date on the journal (payments) screen is not always being used

After receipt of an accepted OIC, the OIC examiner is required to set up a payment journal on the AOIC System to post payments and establish the next payment due date and amount. The next payment due date must be updated after receipt of each payment. OIC examiners should review

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OICs weekly for missing payments. The AOIC System's journal payment due report can be generated to alert examiners of all payments due for a specified time period.

According to management at the two campuses visited, OIC examiners are required to use the journal screen, but only one campus requires the generation of the journal payment due report.

In 13 of the 40 OICs reviewed, the OIC examiners either did not enter the OIC payment due date in the journal screen (8 OICs) or entered the due date but did not take timely action when the due date was missed (5 OICs).

In 4 of the 13 OICs, taxpayers timely paid the OIC without this control. In 1 additional case, while the OIC payment was made, it was paid 6 months past the due date. In the remaining 8 OICs, the IRS identified the missed payment but not until 2 to 16 months (an average of 8 months) past the due date. These eight taxpayers had still not made the OIC payments at the time of our review, and seven of the OICs should have been defaulted. In the remaining case, the taxpayer is in bankruptcy.

Proper use of the journal screen would help examiners identify any missed payments to take appropriate actions.

OIC default transcripts are not always being used

When an OIC has been accepted, the taxpayer agrees to timely file all tax returns and pay all taxes during a 5-year compliance period. To systemically monitor this, an indicator code is input on the taxpayer's Master File⁴ account. During the next 5 years, if any tax period after the acceptance date goes into a return delinquency status or 1 of several balance due statuses, a default transcript is generated to the OIC unit alerting it to the potential default condition. The OIC examiner is required to research the account to determine if the noncompliance still exists and, if it does, to contact the taxpayer to resolve it.

⁴ The Master File is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

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For the 40 OICs reviewed, there were 158 tax periods subsequent to the date the OICs were accepted requiring the timely filing and paying of Federal taxes. In 66 of these 158 tax periods, the periods either went into a return delinquency status or 1 of several balance due statuses, so default transcripts should have been issued. Review of the OIC case files determined the receipt of the default transcripts and the results of their reviews are not always documented. Reviews of the transcripts could have helped identify the potential default to take appropriate action.

Our review of the case files specifically determined:

- The receipt of the transcript was documented for five tax periods. For one other period, documentation was not applicable, since the transcript was generated prior to the OIC being assigned to an examiner.
- While the receipt of the transcript was not documented, the noncompliance was notated for 39 periods or subsequently corrected by the taxpayer for 2 periods.
- The returns were filed or the liabilities were paid for eight tax periods shortly after the transcripts should have been generated; therefore, they would not have helped in identifying the noncompliance.
- One OIC with four tax periods had recently been defaulted.
- The taxpayers were still in noncompliance at the time of our review for seven tax periods involving six OICs, so the OICs should be defaulted.

While both campuses visited require the review of default transcripts, neither requires documentation of the receipt or results of review. This documentation would ensure management that the program to generate the transcripts is working correctly and that the transcripts are being properly reviewed and action is being taken on noncompliance.

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Recommendations

The Director, Filing and Campus Compliance, Small Business/Self-Employed (SB/SE) Division, should:

1. Require use of the follow-up screen and the generation and review of the follow-up screen due dates report.

Management's Response: SB/SE Division management has revised the Internal Revenue Manual (IRM) to include instructions requiring the use of the follow-up screen. The IRM has also been updated instructing management to conduct bimonthly reviews of the follow-up listing. These revisions are in a pending publication of the IRM.

Office of Audit Comment: Although SB/SE Division management agreed with the recommendations and plans to take appropriate corrective actions, they do not agree with the total amount of the potential for increased revenue since all the balance due amounts may not be collected. While we recognize that not all of the balance due amounts will be collected because it is likely that some of the taxpayers will be unable to fully pay, no collection activity was taking place on these accounts at the time of our review. Therefore, we did not adjust the potential outcome measures in this report.

2. Reemphasize the requirements to use the payment due dates on the journal (payments) screen and to generate and review journal payment due reports.

Management's Response: SB/SE Division management has revised the IRM to instruct OIC tax examiners to generate the monthly Journal Payment Due report and to instruct management to generate and review the report monthly. These revisions are in a pending publication of the IRM.

3. Require documentation of the results of review of default transcripts in the OIC files.

Management's Response: SB/SE Division management has revised the IRM by adding instructions to document the OIC case history with the receipt date and results of all transcripts. These revisions are in a pending publication of the IRM.

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Controls Need to Be Improved Over Newly Accepted Offers and Offers That Are Returned to the Field for Other Investigation

Newly accepted offers are not timely received at the campuses

When an OIC is accepted by a field office or COIC site, a record is created for the OIC on the campus portion of the AOIC System with a “New” status. The OIC is kept in a queue until the OIC unit at the campus accepts the transfer. An OIC unit does not accept an OIC into inventory until it receives the associated paper case file with all required information. If any required information is missing, the OIC unit should contact the originating office and request the missing information. If the missing information is not received within 5 days, the OIC unit should return the case to the originator.

At the time of our review, there were 1,745 OICs in New status at the 2 campuses we visited, 78 of which had been in the New status for over 1 year. Based on a review of 10 of these 78 OICs, controls need to be improved to ensure New OICs are actually received at the campuses and are returned to the campuses if they had been sent back to the originating offices. Our review specifically determined that:

- The campuses could not locate the case files for five of the OICs and could not determine if the files were ever received or if they were received and had been returned to the originating offices. These OICs were in New status from 17 to 30 months (an average of 23 months) prior to our review. In 2 of the 5 OICs, the taxpayers were not current in their 5-year filing and/or payment requirements, so the OICs should have been defaulted.
- The campuses received the case files for three OICs but had to return them to the originating offices. These OICs were not timely returned to the campuses. For 1 OIC, the case file was returned to the campus after approximately 32 months in the field. According to the campuses, the field offices had not yet returned the other 2 OICs. These cases had been sent back to the originating offices 19 and 30 months prior to our review.
- The campus received the file for one OIC; however, it was never accepted into inventory on the AOIC

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System for monitoring. A copy of the taxpayer's check dated March 2001 for the OIC amount was in the case file, but the payment had not been processed or posted to the taxpayer's account.

- The case file for 1 OIC had been controlled on the AOIC System but not until approximately 27 months after the OIC was accepted. We cannot determine if the OIC had been timely received at the campus.

At the remaining 6 campuses that monitor accepted OICs, there were an additional 1,681 OICs in New status, 153 (9 percent) of which had been in that status for more than 1 year.

Campuses are not required to verify receipt of case files from the originating offices or follow up on New OICs that are returned to the field. Since the OICs have not been accepted for monitoring, the AOIC System cannot be updated to reflect cases that have been returned to the field. Thus, the campuses cannot identify those cases in New status that have never been received or were sent back to the originating office and not returned to the campuses.

Without adequate controls to ensure newly accepted OICs are received in the campuses or returned to the campuses if sent back to the originating offices, monitoring of the acceptance terms cannot be initiated.

OICs sent back to the field for other investigation are not timely returned to the campuses

After an OIC has been accepted into inventory by an OIC unit at a campus, additional fieldwork may be necessary, such as if the taxpayer requests an extension to pay of more than 6 months. Campus OIC examiners use a Courtesy Investigation (Form 2209) for this purpose. When a Form 2209 is issued, the OIC is placed in Other Investigation (OI) status on the AOIC System.

Responses to Forms 2209 are due 90 calendar days from the date of issuance. If a response is not received by the due date, the campus OIC unit should send a list of overdue OIs to the SB/SE Division Territory Office or COIC site Director requesting a status update. If there is no response

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to this request, the campus OIC unit should send the OIC to the SB/SE Division Territory Office or COIC site.

At the time of our review, there were 272 OICs at the 2 campuses we visited that had been returned to the field for additional work, 68 of which had been in the field for over 1 year. Based on a review of 10 of the 68 OICs, controls need to be improved to ensure that OIs are timely worked by field offices, campuses follow up when OIs are not timely worked, and campuses take appropriate actions when the OIs are closed.

Our review of the 10 cases determined:

- In 1 case, an OI had never been issued, and the OIC was incorrectly placed in OI status for 18 months.
- In one case, the OI was timely completed, but the AOIC System had not been updated from OI status.
- In eight cases, the OIs were not completed by the original or extended due dates, and there was no follow-up with the field offices as required. At the time of our review, 6 of these 8 OIs had been and were still open in the field from 11 to 46 months (an average of 24 months) from the original or extended due dates of the OIs. All 6 of these OICs should have been defaulted for either nonpayment of the OIC or noncompliance with the 5-year requirement.

According to personnel at both campuses, they were aware of the requirement to follow up on overdue OIs but did not follow the requirement.

At the remaining 6 campuses that monitor accepted OICs, there were 599 OICs in OI status, 267 (45 percent) of which had been in that status for more than 1 year.

The monitoring of OICs can be interrupted while the OIC has been returned for additional action. If OICs are not timely returned to the campuses, potential noncompliance may not be identified and corrected.

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Recommendations

The Director, Filing and Campus Compliance, SB/SE Division, should:

4. Require campuses to periodically generate AOIC System reports of New cases and validate receipt of case files. If the files are not received, campuses should be required to follow up with the originating offices.

Management's Response: SB/SE Division management has revised the IRM instructing management to generate and review a New Work listing every 30 days for cases that have not been accepted into the campus inventory. Management must validate receipt of the case files and required documentation. Case files not received as listed, and those received with incomplete or missing required documentation, should be resolved within 15 days. Those not resolved in the 15-day period will be returned to the originator. These revisions are in a pending publication of the IRM.

5. Create a new status on the AOIC System for newly accepted OICs that are returned to the originating offices before the OICs are accepted for monitoring, establish criteria and timeliness guidelines for the originating offices to work returned OICs, and require the campuses to periodically generate AOIC System reports on the new status code and follow up with the originating offices to ensure the files are timely returned.

Management's Response: SB/SE Division management has created two new subcodes (missing case and incomplete case) under the AOIC System's status code New Work. They have established a 15-day response time for originating offices to submit or perfect incomplete work. The IRM has been revised to ensure the files are returned timely. These revisions are in a pending publication of the IRM.

6. Direct campuses to generate a list of overdue OIs for forwarding to the SB/SE Division Territory Offices or COIC site Directors requiring they provide a status update.

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Management's Response: SB/SE Division management has revised the IRM to ensure the campuses receive a response from the originating offices by adding instructions for management to generate a quarterly report on OIs. The beginning date for the report will be 90 days before the run date to identify overdue responses and will alert the tax examiners to follow up with the Territory Offices or COIC sites. These revisions are in a pending publication of the IRM.

7. Require the campuses to periodically generate reports of OICs in certain statuses (such as potential default) on the AOIC System for 1 year or longer and require review of these OICs to determine if they are in the correct status and if timely and effective action is being taken. This recommendation pertains to both Finding Number 2 and Finding Number 3.

Management's Response: SB/SE Division management has revised the IRM instructing management to generate a quarterly report on current open OICs on the AOIC System for all statuses, except for payment monitoring and 5-year monitoring, to determine if they are in the correct status and if timely and effective action is being taken. These revisions are in a pending publication of the IRM.

The Director, Payment Compliance, SB/SE Division, should:

8. Direct Territory Offices or COIC sites to timely work and respond to OIs received from campus OIC units.

Management's Response: SB/SE Division management will review existing IRM guidance in this area and determine situations in which the use of OIs to resolve back-end OIC issues is necessary. They will ensure OI requests are appropriately made by campuses to maximize field resources. Once the review is complete, IRM procedural guidance will be updated and distributed to the campus OIC units. In addition, direction will be issued to the field regarding the need to process this work timely.

**Federal Tax Liens Are Not
Always Released When the Offer
Amount Has Been Fully Paid**

After a taxpayer fulfills the OIC payment terms, any liens filed on the accounts covered by the OIC must be released. I.R.C. § 6325 requires the issuance of a release of Federal

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Tax Lien within 30 calendar days of the date on which a liability is satisfied.⁵

Federal Tax Liens were not always released or timely released when OIC payment terms were fulfilled. The 84 OICs reviewed were filed for 428 tax periods. Federal Tax Liens had been filed on 254 of these tax periods. Our review showed that the Federal Tax Liens were:

- Properly released on 79 of the 254 tax periods.
- Not released at the time of our review for 9 taxpayers involving 16 tax periods. These 9 taxpayers had fully paid their OIC amounts from 387 to 1,616 days (an average of 1,023 days) prior to our review.
- Released, but not within the required 30 calendar days after the OIC was fully paid, for 37 taxpayers involving 159 tax periods. The liens were released from 32 to 1,410 days (an average of 227 days) beyond the OIC terms' fulfillment dates.

Procedures require the campuses to notify field offices to release liens when the offer amount has been fully paid. However, there are no controls to ensure this is done or done timely. The IRS recently completed a study to determine whether allowing the OIC examiners to have direct access to the Automated Lien System (ALS)⁶ would streamline the release process by saving time to prepare and ship paper forms via mail or fax to the Area ALS Units and would, most importantly, reduce delays that cause unnecessary burden on taxpayers. We were advised that the process would be implemented nationwide on November 1, 2003.

Taxpayers' rights are violated and their burden is increased if the IRS does not timely release Federal Tax Liens when the OIC terms are fully paid. In addition, taxpayers can file suit against the IRS if any IRS employee knowingly or negligently fails to release a lien as required.

⁵ I.R.C. § 6325 (2003).

⁶ The ALS is the IRS database that prints Notices of Federal Tax Liens, stores taxpayer information, and documents all lien activity.

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Recommendation

The Director, Filing and Campus Compliance, SB/SE Division, should:

9. Ensure timely implementation of the process allowing OIC examiners access to the ALS to release liens and review the process to ensure liens are being correctly released.

Management's Response: SB/SE Division management has provided an ALS train-the-trainer session to the Wage and Investment Division and SB/SE Division management and lead tax examiners. Campus examiners can now access the ALS database and request release of liens following full payment of the offer amount. The Director, Filing and Campus Compliance, SB/SE Division, will review the process during scheduled visits in the second quarter of FY 2004.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine the effectiveness of the Internal Revenue Service's (IRS) monitoring of accepted Offers in Compromise (OIC) to ensure the taxpayers comply with the terms of the agreement and future filing and paying compliance terms. To accomplish this objective, we:

- I. Determined if defaulted OICs were timely identified by the IRS.
 - A. Held discussions with OIC Small Business/Self-Employed and Wage and Investment Division program analysts and OIC unit managers at the Austin, Texas, and Philadelphia, Pennsylvania, Campuses¹ to determine procedures for monitoring accepted OICs. We selected the Austin and Philadelphia Campuses as being representative of the IRS' operations in processing accepted OICs.
 - B. Obtained a computer extract from the Automated Offer in Compromise (AOIC) System² of all 30,439 accepted OICs with a legal disposition date of Fiscal Year (FY) 1999.
 - C. Reviewed a statistical sample of 84 of the 28,018 "doubt as to collectibility" OICs identified from step B that were still open in acceptance status at the time of the computer extract. The sample was based on a 95 percent confidence level, a precision level of ± 4 percent, and an expected error rate of 3.57 percent.
 - D. From the Austin and Philadelphia Campuses, obtained reports of all 1,788 OICs open on the AOIC System in a potential default status, all 1,745 OICs closed by the field as accepted but not yet controlled by the campuses, and all 272 OICs that had been returned and were currently open in the field for additional action. We queried the AOIC System for the same reports for the other six campuses that monitor accepted OICs.
 - E. Analyzed the reports obtained in Step D to determine the age of the OICs.
 - F. Reviewed a judgmental sample of 40 of 424 OICs accepted by the Austin and Philadelphia Campuses that had been in potential default status for the nonpayment of OIC amounts or noncompliance with the 5-year compliance requirements for more than 1 year at the time of our review. We selected a judgmental sample since we did not want to project the results.

¹ An IRS campus is the data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the computing centers for analysis and posting to taxpayer accounts.

² The AOIC System is the IRS database used to monitor OIC case processing; it was designed to control, track, and monitor OICs.

**Monitoring of Accepted Offers in Compromise Is Generally Effective,
but Some Improvement Is Needed**

- G. Reviewed a judgmental sample of 10 of 78 accepted OICs that had not been accepted into the OIC units' inventories for monitoring in the Austin and Philadelphia Campuses for more than 1 year after acceptance. We selected a judgmental sample since we did not want to project the results.
 - H. Reviewed a judgmental sample of 10 of 68 accepted OICs that had been returned to the Territory Offices for some type of action and had not been returned to the Austin or Philadelphia Campus for more than 1 year according to the AOIC System. We selected a judgmental sample since we did not want to project the results.
 - I. Reviewed taxpayer accounts for the 428 tax periods relating to the statistical sample of 84 OICs identified in Step C to determine if Federal Tax Liens had been released as required when the OIC terms were fully paid.
- II. Determined what action the IRS took when it identified cases in which the taxpayers had defaulted on their OICs.
- A. Selected a statistical sample of 280 of the 2,119 "doubt as to collectibility" OICs accepted in FY 1999 that were identified in Step I.B above, and which were closed as defaulted, to determine what collection action was taken on the accounts subsequent to the default action. The sample was based on a 95 percent confidence level, a precision level of ± 5 percent, and an expected error rate of 30 percent. Since the review did not disclose any issues, we stopped the review at 75 cases.

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but Some Improvement Is Needed**

Appendix II

Major Contributors to This Report

Richard J. Dagliolo, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs)

Parker F. Pearson, Director

Preston B. Benoit, Acting Director

Amy L. Coleman, Audit Manager

James D. Dorrell, Senior Auditor

Lynn A. Rudolph, Auditor

Rashme Sawhney, Auditor

**Monitoring of Accepted Offers in Compromise Is Generally Effective,
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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Acting Deputy Commissioner, Small Business/Self-Employed Division SE:S
Acting Director, Compliance, Small Business/Self-Employed Division SE:S:C
Director, Filing and Campus Compliance, Small Business/Self-Employed Division
SE:S:C:CP:FCC
Director, Payment Compliance, Small Business/Self-Employed Division SE:S:C:CP:PC
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Management Controls OS:CFO:AR:M
Audit Liaison: Commissioner, Small Business/Self-Employed Division SE:S

Monitoring of Accepted Offers in Compromise Is Generally Effective, but Some Improvement Is Needed

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 the Congress.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$1,865,916 for 26 taxpayers whose Offers in Compromise (OIC) should have been defaulted and the taxpayer accounts placed back into active collection status. While we recognize that not all of the balance due amounts will be collected because it is likely that some of the taxpayers will be unable to fully pay, no collection activity was taking place on these accounts at the time of our review (see page 3).

Methodology Used to Measure the Reported Benefit:

We selected a judgmental sample of 40 OICs from a population of 424 OICs that were in potential default status for more than 1 year at the time of our review on the Automated Offer in Compromise System for either noncompliance with the OIC payment terms or the 5-year compliance requirement. We selected a judgmental sample since we did not want to project the results.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; nine taxpayers whose Federal Tax Liens had not yet been released by the Internal Revenue Service (IRS) (see page 12).
- Taxpayer Rights and Entitlements – Potential; an additional 37 taxpayers whose Federal Tax Liens were not timely released by the IRS (see page 12).

Methodology Used to Measure the Reported Benefit:

We originally selected a statistical sample of 319 OICs from the population of 28,018 “doubt as to collectibility” OICs that were accepted in Fiscal Year 1999, based on a 95 percent confidence level, a precision level of ± 5 percent, and an expected error rate of 30 percent. We used a statistical sample to project how many of the 28,018 OICs were not in compliance with all the OIC terms (thus, the OICs should have been defaulted). After our review of 69 OICs, we recalculated the error rate to be 5.8 percent. Based on the new “expected” error rate, our sample size was decreased to 84 OICs. After reviewing the 84 OICs in our sample, we determined the actual error rate was 3.57 percent, which changed the precision level to ± 4 percent. We cannot project the number of taxpayers whose Federal Tax Liens were not released or not timely released because the original sample was not taken based on lien filing.

**Monitoring of Accepted Offers in Compromise Is Generally Effective,
but Some Improvement Is Needed**

Appendix V

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

RECEIVED
JAN 20 2004

JAN 20 2004

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION

FROM: Dale F. Hart *Dale F. Hart*
Commissioner Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Monitoring of Accepted Offers in
Compromise Is Generally Effective, but Some Improvement Is
Needed (Audit # 200330008)

I reviewed your report and appreciate your recognition that our monitoring of accepted Offers in Compromise (OIC) is effective. I agree with your recommendations. We have completed many actions required to implement the recommendations. We will continue to look for new ways to improve OIC monitoring and have several initiatives underway which are coordinated with our overall Campus reengineering efforts.

We monitor accepted OIC's to ensure that taxpayers comply with requirements to file returns and pay taxes, as provided in the Internal Revenue Code. We recognize the impact of this monitoring on compliance and are taking action to better utilize our resources. In order to enhance resource use, we are prioritizing two objectives: consistent and efficient program delivery and reduction of paper intensive processes. To address these two areas we are:

- Improving position management, which will save resources by directing appropriate work to lower-graded employees and technical issues to higher-graded employees.
- Automating monitoring of five year compliance cases currently reviewed and updated manually.
- Modifying and expanding the Automated Offer in Compromise System (AOIC) to eliminate manual tasks and provide other systemic enhancements.

We agree there is a potential for increased revenue of \$1,865,916. However, as you point out in your report, it is not likely that the entire amount could be collected. Therefore, we can not agree with the amount stated. These cases will be worked as they are delivered from our Inventory Delivery System (IDS), but will not be tracked due to the extensive resource requirement.

Monitoring of Accepted Offers in Compromise Is Generally Effective, but Some Improvement Is Needed

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Our comments on your recommendations follow:

RECOMMENDATION 1

The Director, Filing and Campus Compliance, Small Business/Self-Employed (SB/SE) Division should require use of the follow-up screen and the generation and review of the follow-up screen due dates report.

CORRECTIVE ACTION

Internal Revenue Manual (IRM) 5.19.7.3 has been revised to include instructions requiring use of the follow-up screen. Internal Revenue Manual 1.4.17, Compliance Managers Guide, has been updated instructing management to conduct bi-monthly reviews of the follow-up listing. This corrective action is complete pending publication of the IRM.

IMPLEMENTATION DATE

July 15, 2004

RESPONSIBLE OFFICIAL

Director, Filing and Campus Compliance, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Office of Return Delinquency will advise the Director, Filing and Campus Compliance of any delays.

RECOMMENDATION 2

The Director, Filing and Campus Compliance, SB/SE Division should reemphasize the requirement to use the due date on the journal (payments) screen and to generate and review journal payment due reports.

CORRECTIVE ACTION

Internal Revenue Manual 5.19.7.3.12.3, Liability Collection, has been revised to instruct OIC tax examiners to generate the monthly Journal Payment Due report. Wording was changed from "should" to "must," and a monthly timeframe was established. We also revised IRM 1.4.17, Compliance Managers Guide, instructing management to generate and review the report monthly. This corrective action is complete pending publication of the IRM.

Monitoring of Accepted Offers in Compromise Is Generally Effective, but Some Improvement Is Needed

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IMPLEMENTATION DATE

July 15, 2004

RESPONSIBLE OFFICIAL

Director, Filing and Campus Compliance, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Return Delinquency will advise the Director, Filing and Campus Compliance of any delays.

RECOMMENDATION 3

The Director, Filing and Campus Compliance, SB/SE Division should require documentation of the results of review of default transcripts in the OIC files.

CORRECTIVE ACTION

Internal Revenue Manual 5.19.7.3.24, Transcripts, has been revised adding instructions to document OIC case history with receipt date and results of all transcripts. This corrective action is complete pending publication of the IRM.

IMPLEMENTATION DATE

July 15, 2004

RESPONSIBLE OFFICIAL

Director, Filing and Campus Compliance, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Return Delinquency will advise the Director, Filing and Campus Compliance of any delays.

RECOMMENDATION 4

The Director, Filing and Campus Compliance SB/SE Division should require campuses to periodically generate AOIC System reports of new cases and validate receipt of case files. If the files are not received, campuses should be required to follow up with the originating offices.

Monitoring of Accepted Offers in Compromise Is Generally Effective, but Some Improvement Is Needed

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CORRECTIVE ACTION

Internal Revenue Manual 1.4.17, Compliance Managers Guide, has been revised, instructing management to generate and review a New Work (NW) Listing every 30 days for cases that have not been accepted into the campus inventory. Management must validate receipt of case files and required documentation. Case files not received as listed, and those received incomplete or missing required documentation, should be resolved within 15 days. These cases will be assigned an NW sub-code: MC for missing case or IC for incomplete case. Those not resolved in the 15-day timeframe will be returned to the originator with an AOIC history note. This corrective action is complete pending publication of the IRM.

IMPLEMENTATION DATE

July 15, 2004

RESPONSIBLE OFFICIAL

Director, Filing and Campus Compliance, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Return Delinquency will advise the Director, Filing and Campus Compliance of any delays.

RECOMMENDATION 5

The Director, Filing and Campus Compliance, SB/SE Division should create a new status on the AOIC System for newly accepted OICs that are returned to the origination offices before the OICs are accepted for monitoring, establish criteria and timeliness guidelines for the originating offices to work returned OICs, and require the campuses to periodically generate AOIC system reports on the new status code and follow up with the originating office to ensure the files are timely returned.

CORRECTIVE ACTION

We have created and implemented two new sub-codes under the AOIC status code New Work (NW). The new codes are MC (missing case), and IC (incomplete case). We have provided a 15-day response time for originating offices to submit or perfect incomplete new work. Revisions to both IRM 5.19.7.3, Offer in Compromise, and IRM 1.4.17, Compliance Managers Guide, have been made to ensure the files are returned timely. This corrective action is complete pending publication of the IRM.

**Monitoring of Accepted Offers in Compromise Is Generally Effective,
but Some Improvement Is Needed**

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IMPLEMENTATION DATE

July 15, 2004

RESPONSIBLE OFFICIAL

Director, Filing and Campus Compliance, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Return Delinquency will advise the Director, Filing and Campus Compliance of any delays.

RECOMMENDATION 6

The Director, Filing and Payment Compliance, SB/SE Division, should direct campuses to generate a list of overdue investigations for forwarding to the SB/SE Division Territory Office or Centralized Offer in Compromise (COIC) site Directors requiring they provide a status update.

CORRECTIVE ACTION

Internal Revenue Manual 5.19.7.3, Transcripts, has been revised to instruct OIC units to generate and send a list of overdue Other Investigations (OI) from District Office Directors to Territory Offices and COIC sites. To ensure the campus receives a response from the originating offices, we have added instructions to IRM 1.4.17, Compliance Managers Guide, for management to generate a quarterly report on Form 2209, Other Investigations. The beginning date for the report will be 90 days before the run date. This will identify overdue responses and will alert tax examiners to follow up with the Territory or COIC. This corrective action is complete pending publication of the IRM.

IMPLEMENTATION DATE

July 15, 2004

RESPONSIBLE OFFICIAL(S)

Director, Filing and Campus Compliance, SB/SE Division

Monitoring of Accepted Offers in Compromise Is Generally Effective, but Some Improvement Is Needed

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CORRECTIVE ACTION MONITORING PLAN

The Director, Return Delinquency will advise the Director, Filing and Campus Compliance of any delays.

RECOMMENDATION 7

The Director, Filing and Campus Compliance, SB/SE Division should require the campuses to periodically generate reports of OICs in certain statuses (such as potential default) on the AOIC System for 1 year or longer, and require review of these OICs to determine if they are in the correct status and if timely and effective action is being taken.

CORRECTIVE ACTION

We agree and have determined the recommended actions should be managerial responsibilities. Internal Revenue Manual 1.4.17, Compliance Managers Guide, has been revised instructing management to generate a quarterly report on current open offers on AOIC for all statuses, except for Journal Payment and 5M to determine if they are in the correct status, and that timely and effective action is being taken. This corrective action is complete pending publication of the IRM.

IMPLEMENTATION DATE

July 15, 2004

RESPONSIBLE OFFICIAL

Director, Filing and Campus Compliance, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Return Delinquency will advise the Director, Filing and Campus Compliance of any delays.

RECOMMENDATION 8

The Director, Payment Compliance, SB/SE Division, should direct Territory Offices or COIC sites to timely work and respond to OIs received from campus OIC units.

CORRECTIVE ACTION

We agree that OI's issued to the field offices from campus OIC units should be worked in a timely manner. The Director, Filing and Campus Compliance and the Director,

Monitoring of Accepted Offers in Compromise Is Generally Effective, but Some Improvement Is Needed

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Payment Compliance will review existing IRM guidance in this area, and determine situations in which the use of OI's to resolve back-end OIC issues is necessary. We will also ensure OI requests are appropriately made by campuses to maximize field resources. Once this review is complete, the Director, Filing and Campus Compliance will update IRM procedural guidance and ensure it is distributed to the campus OIC units. The Director, Payment Compliance will also issue direction to the field regarding the need to process this work in a timely manner.

IMPLEMENTATION DATE

January 15, 2005

RESPONSIBLE OFFICIALS

Director, Payment Compliance, SB/SE Division
Director, Filing and Campus Compliance, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Program Managers, Office of Return Delinquency and Offer In Compromise will advise the Director, Filing and Campus Compliance and Director, Payment Compliance of any corrective action delays.

RECOMMENDATION 9

The Director, Filing and Campus Compliance, SB/SE Division should ensure timely implementation of the process allowing OIC examiners to access the Automated Lien System (ALS) to release liens and review the process to ensure liens are being correctly released.

CORRECTIVE ACTION

An ALS train-the-trainer session was delivered to the Wage & Investment (W&I) and SB/SE management and lead tax examiners on November 13, 2003, at the Memphis campus. Campus examiners can now access the ALS database on a given taxpayer; research for all liens filed, and request release following full payment of the offer amount. An approval queue has been set up allowing OIC managers to approve the release of the lien. Filing and Campus Compliance will review the process during scheduled visits during the second quarter of FY 2004.

IMPLEMENTATION DATE

Completed

**Monitoring of Accepted Offers in Compromise Is Generally Effective,
but Some Improvement Is Needed**

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RESPONSIBLE OFFICIAL(S)

Director, Filing and Campus Compliance, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

N/A

If you have any questions, please call me at (202) 622-0600 or Cheryl Gramalia, Director, Filing Compliance, Small Business/Self-Employed Division, at (202) 283-0712.