TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Business Taxpayers Were Effectively Transitioned to Electronic Payments; However, They Were Not Always Timely Contacted When Payments Were Missed

August 17, 2012

Reference Number: 2012-30-092

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BUSINESS TAXPAYERS WERE EFFECTIVELY TRANSITIONED TO ELECTRONIC PAYMENTS; HOWEVER, THEY WERE NOT ALWAYS TIMELY CONTACTED WHEN PAYMENTS WERE MISSED

Highlights

Final Report Issued on August 17, 2012

Highlights of Reference Number: 2012-30-092 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed Division and the Wage and Investment Division.

IMPACT ON TAXPAYERS

The Electronic Federal Tax Payment System (EFTPS) is a tax payment system that allows business and individual taxpayers to pay their Federal taxes electronically via the Internet or telephone 24 hours a day, seven days a week. The IRS effectively communicated the electronic deposit regulation to business taxpayers, but it did not always timely contact business taxpayers when payments were missed. Business taxpayers who are not contacted timely accrue more interest and penalties and are not treated equitably with business taxpayers who are promptly contacted.

WHY TIGTA DID THE AUDIT

Effective January 1, 2011, businesses not already required to use the EFTPS must now make their Federal Tax Deposit (FTD) payments electronically. The FTD Alert Program identifies at an early stage, *i.e.*, before the return is due, business taxpayers who have fallen behind in their deposits. This audit was initiated to assess whether the IRS is effectively managing the EFTPS and FTD Alert Programs.

WHAT TIGTA FOUND

The IRS took positive steps to communicate and educate business taxpayers about the electronic deposit regulation that took effect on January 1, 2011. Additionally, the IRS developed and implemented communication plans to educate business taxpayers about the electronic deposit requirements. For example, it publicly released Program details on the IRS.gov website, through trade publications and webinars, and at presentations at the IRS Nationwide Tax Forums.

In November 2010, prior to the proposed regulation taking effect, the IRS issued an *Intention Letter* to 3.8 million business taxpayers who would be affected by the proposed regulation change. In December 2010, a *Mandate Letter* was issued to 1.4 million business taxpayers who still had not activated their enrollment in the EFTPS or who continued to make deposits with an FTD coupon. The Letters informed the business taxpayers about the electronic deposit regulation and possible penalties if they failed to comply.

However, revenue officers (RO) did not always contact business taxpayers in a timely manner after receiving FTD Alert assignments. TIGTA reviewed a statistically valid sample of 96 high priority FTD Alert cases and found that the FTD Alerts were not always promptly assigned to the ROs and/or the ROs did not make timely contact with business taxpayers after the FTD Alert was assigned. Also, the case documentation did not include explanations for the delays. Business taxpayers paid less penalties and interest when an FTD Alert was immediately assigned to an RO and the business taxpayer was contacted within 15 calendar days of the FTD Alert being assigned.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS establish criteria for timely group manager assignment of FTD Alerts to ROs and emphasize to group managers that they should ensure ROs contact business taxpayers within 15 calendar days of FTD Alert assignment.

In their response to the report, IRS officials agreed with the recommendations and plan to take appropriate corrective actions. The IRS plans to establish specific criteria and update the appropriate Internal Revenue Manual sections to ensure timely group manager assignment of FTD Alerts to ROs. The IRS also plans to issue guidance to ROs to emphasize the importance of timely assignment and contact of FTD Alerts.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

August 17, 2012

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION
COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Business Taxpayers Were Effectively Transitioned to Electronic Payments; However, They Were Not Always Timely Contacted When Payments Were Missed (Audit # 201130013)

This report presents the results of our review to determine whether the Internal Revenue Service effectively managed the Electronic Federal Tax Payment System[1] and Federal Tax Deposit Alert Programs. This audit was part of our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included in Appendix VI.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations.

Please contact me at (202) 622-6510 if you have questions or Frank Dunleavy, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (213) 894-4470 (Ext. 128).

[1] See Appendix V for a glossary of terms.

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Abbreviations

EFTPS	Electronic Federal Tax Payment System
FTD	Federal Tax Deposit
FY	Fiscal Year
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
RO	Revenue Officer
SB/SE	Small Business/Self-Employed

Background

The Electronic Federal Tax Payment System (EFTPS)[1] is a tax payment system provided free by the U.S. Department of the Treasury. Using the EFTPS to make Federal tax deposits provides substantial benefits to both taxpayers and the Federal Government. The EFTPS allows business and individual taxpayers to pay their Federal taxes electronically via the Internet or telephone 24 hours a day, seven days a week. The System helps taxpayers schedule dates to make payments due even when they are out of town or on vacation. Business users can use the EFTPS to schedule payments up to 120 calendar days in advance of the desired payment date. In addition, compared to manual processing, the EFTPS significantly reduces payment-related errors that could result in a penalty.

The EFTPS allows business and individual taxpayers to pay their Federal taxes electronically via the Internet or telephone 24 hours a day, seven days a week.

Prior to January 1, 2011, business taxpayers were mandated to make Federal Tax Deposits (FTD) electronically only if their aggregate annual deposits exceeded $200,000; however, any business taxpayer could voluntarily use the EFTPS. Business taxpayers who exceeded the $200,000 threshold had an initial one-year grace period after which they were required to use the EFTPS in all subsequent years, even if their FTDs fell below the threshold. Effective January 1, 2011, businesses that have a deposit requirement (such as employment tax, excise tax, and corporate income tax) can no longer use Forms 8109 and 8109-B, *Federal Tax Deposit Coupon*, and are required to make their FTD payments electronically.[2]

To help alleviate any potential burden on small businesses, the regulations did not change the existing *de minimis* deposit rules allowing business taxpayers with tax liabilities under certain thresholds to make a payment with a return. For example, under the *de minimis* deposit rules for employment taxes, an employer with a deposit liability of less than $2,500 for a tax period may remit employment taxes with their quarterly or annual tax return, voluntarily make deposits using the EFTPS, or use other methods of payment as provided by the instructions relating to the return.

Business taxpayers who fail to make the electronic payments, when required, are subject to an FTD penalty of 10 percent for each nonelectronic payment. However, the Internal Revenue Service (IRS) established penalty relief plans to allow business taxpayers a limited period of time to convert to the EFTPS without being penalized if they had problems with the conversion. This

[1] See Appendix V for a glossary of terms.
[2] Treasury Decision 9507 (REG-153340-09), (Dec. 7, 2010).

effort included business taxpayers who mailed or improperly paid their liability with their return, and business taxpayers who made late deposits via the EFTPS (up to three calendar days).

Since the implementation of the EFTPS in Calendar Year 1996, there have been more than 1.7 billion electronic payments made, totaling more than $25.13 trillion. Daily EFTPS transactions average $6 billion, while peak days can total $40 billion. Annually, the EFTPS processes more than $1.9 trillion in funds to the U.S. Government account. In addition, the number of taxpayers using electronic methods to make payments has steadily increased. Figure 1 shows that electronic payments increased from 43 percent of all payments in Fiscal Year (FY) 2008 to 60 percent in FY 2011.

Figure 1: Percentage of Electronic Payments Compared to All Sources of Revenue for FYs 2008 Through 2011

	FY 2008	FY 2009	FY 2010	FY 2011
Total Number of Payments: All Sources	227,484,559	212,100,185	212,767,563	217,097,697
Electronic Payments	98,397,976	100,811,301	108,848,929	129,835,107
Percentage	43%	48%	51%	60%

Source: *IRS EFTPS reports for FYs 2008 through 2011.*

The IRS has an FTD Alert Program to identify, at an early stage, business taxpayers[3] who have fallen behind in their tax deposits. The Program verifies the employer's compliance with employment tax filing requirements and directly sends an FTD Alert from the Master File to the Integrated Collection System for direct assignment to the field. Once a group manager assigns an FTD Alert to a revenue officer (RO), the RO is required to contact the business taxpayer within 15 calendar days. FTD Alerts provide an early opportunity for the IRS to assist and educate business taxpayers before their liability pyramids and the growing debt becomes more difficult to resolve.

In Calendar Year 2011, the IRS conducted two studies to evaluate the effectiveness of the FTD Alert Program. One study[4] focused on using a letter to notify business taxpayers of the FTD Alert to determine if letters would be an effective preventive tool to improve Form 941, *Employer's Quarterly Federal Tax Return*, filing and payment compliance. The IRS found that for high-priority FTD Alerts, live contact by an RO was more effective in obtaining business taxpayer compliance than a letter. The results for low-priority FTD Alerts were inconclusive. The overall results of this study prompted a pilot program, which started in March 2012.

[3] There is no similar program for individual or estate and trust taxpayers.
[4] Small Business/Self-Employed Division Denver Research Office, *FTD Soft Letter Project*, (Jul. 2011).

The results of the other study[5] found that business taxpayers were assessed, on average, fewer Failure to Pay and Failure to File penalties when the FTD Alerts were worked by an RO in comparison to FTD Alerts that were not assigned. The study also showed that 40 percent of the high-priority FTD Alerts that were worked by an RO resulted in business taxpayer compliance compared with a 28 percent compliance rate when the FTD Alerts went unassigned.

This review was performed at the Small Business/Self-Employed (SB/SE) Division Campus Compliance Services Office in New Carrollton, Maryland, and campuses in Memphis, Tennessee, and Ogden, Utah, during the period May 2011 through March 2012. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

[5] Small Business/Self-Employed Division Laguna Niguel Research Office, *The Impact of FTD Alerts on Compliance*, (Jul. 2011).

Results of Review

Our review results showed that the IRS took positive steps to communicate and educate business taxpayers about the electronic deposit regulation that took effect on January 1, 2011. We found that business taxpayers were effectively transitioned to the EFTPS. However, the FTD Alert Program can be improved to reduce business taxpayer burden if business taxpayers are timely contacted when payments are missed.

Business Taxpayers Were Effectively Transitioned From Federal Tax Coupons to Electronic Payments

The IRS developed and implemented formal communication plans to educate business taxpayers about the new electronic deposit requirements. For example, IRS publicity provided program details via the IRS.gov website, trade publications, webinars, IRS Nationwide Tax Forums, and practitioner meetings. Briefings were also conducted with the International Communication and Liaison Office which, in turn, provided information to the State Department in order to notify impacted foreign business taxpayers.

In November 2010, prior to the implementation of the regulation change, the IRS issued Letter 4631, *Intention Letter*, to 3.8 million business taxpayers who would be affected. Letter 4631 informed the business taxpayers that they had been automatically pre-enrolled in the EFTPS and provided a personal identification number to activate their enrollment. Letter 4631 also indicated that business taxpayers may be required to make electronic deposits and may be penalized if they failed to make their deposits electronically.

In December 2010, Computer Paragraph 247 notice, *Mandate Letter*, was issued to 1.4 million business taxpayers (of the initial 3.8 million) who still had not activated their enrollment in the EFTPS, or who continued to make deposits with an FTD coupon in the 18 months prior to the approved regulation. The *Mandate Letter* informed the business taxpayers that, effective January 1, 2011, they could no longer use an FTD coupon to make their deposits and must make their deposits electronically. The *Mandate Letter* again advised the business taxpayers that a penalty for each nonelectronic deposit would be assessed.

In April 2011, reminder postcards were sent to business taxpayers who continued to mail FTD coupons after the regulation took effect. The postcard reminded business taxpayers that they were pre-enrolled in the EFTPS and were required to make their deposits electronically.

Servicewide Electronic Research Program alerts were prepared to notify IRS telephone assistors regarding the implementation of the electronic payment regulation so they could answer questions from business taxpayers. In addition, staffing at the EFTPS call sites was increased to address additional volumes of depositors and provide assistance to business taxpayers.

As a result of the mandate to require business taxpayers to use the EFTPS for all Federal tax deposits, the number of business taxpayers enrolled in the EFTPS increased by 92 percent by the end of FY 2011. However, despite the IRS's efforts to communicate and educate business taxpayers about the electronic deposit requirements, some business taxpayers continued to make their payments with FTD coupons. During our review, the IRS informed us that some business taxpayers were continuing to submit FTD coupon payments to an IRS-designated post office box[6] that was scheduled to close on July 1, 2011. As of June 30, 2011, approximately 42,000 business taxpayers were still mailing their FTD coupon payments to the IRS-designated post office box. The IRS was not tracking these business taxpayers individually or sending follow-up notifications informing them of the planned closure of the post office box.

Management Action: During our review, IRS management delayed the closure of the post office box to December 31, 2011, and began identifying the business taxpayers making the FTD coupon payments. In October 2011, the IRS began sending these business taxpayers letters reminding them of the electronic tax deposit requirements and informing them that the post office box would be closing and any subsequent payments would be returned. Between July 1 and September 30, 2011, 5,245 business taxpayers had submitted FTD coupon payments totaling $15.2 million to the IRS-designated post office box. IRS management informed us the payments were processed and letters were sent to any business taxpayer who mailed in these payments.

In December 2011, the IRS identified the largest depositors from the 5,245 business taxpayers who submitted FTD coupon payments to the IRS-designated post office box. IRS management informed us that they attempted to make direct telephone contact with 100 business taxpayers who made deposits of $5,000 or more to determine if there were problems preventing them from using the EFTPS. Most of the business taxpayers contacted had started using the EFTPS after receiving a notice. The remaining business taxpayers indicated they would begin using the EFTPS.

Improvements Can Be Made to Promptly Contact Business Taxpayers When Payments Are Missed

The IRS established the FTD Alert Program to proactively assist business taxpayers to remain compliant with their FTD payment requirements. The FTD Alert process identifies at an early stage, *i.e.*, before the return is due, business taxpayers who have fallen behind in their deposits. FTD Alerts are used to determine an employer's compliance with current employment tax deposit requirements and for subsequent quarters until the business taxpayer becomes compliant.

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[6] The SB/SE Division uses post office boxes for the public to send general and revenue-bearing mail, including the FTDs.

The Master File computer program identifies an employer's quarterly compliance with employment tax deposit requirements and categorizes the noncompliance under three types of classifications – an FTD Alert priority code A, B, or C. The type of FTD Alert issued is based on whether the business taxpayer has had compliance issues in prior tax periods and whether the outstanding balances exceed $5,000. For example, FTD Alert:

- Priority codes A and B are sent directly from the Master File to the Integrated Collection System for direct assignment to the field.
- Priority code C is low priority and not worked or assigned to IRS field offices because the IRS expects the business taxpayer to voluntarily comply without any IRS intervention.

For the FTD Alert Program to be effective, group managers must assign FTD Alerts expeditiously, and ROs must promptly make contact with the business taxpayer. Once a Collection Field function group manager assigns the FTD Alert to an RO, the RO should contact the business taxpayer within 15 calendar days.

We reviewed a sample of 96 FTD Alert priority code A and B cases issued between January 1, 2009, and December 31, 2010.[7] Our review showed that FTD Alerts were not always timely assigned to ROs. Specifically, 17 (17.7 percent) of the 96 cases took 11 to 34 calendar days from FTD Alert issuance to RO assignment.[8] These 17 cases accrued penalties, interest, and fees totaling $139,587, which is an average of $8,211 per business taxpayer. This assessment compares with an average of $3,663 in accrued penalties, interest, and fees paid by business taxpayers whose FTD Alerts were timely assigned and who were timely contacted. Immediate assignment of an FTD Alert to an RO for business taxpayer contact can reduce the amount of penalties and interest the business taxpayer pays. Based on our statistically valid sample, we project that 3,954 cases were not assigned in a timely manner, and we are 95 percent confident that the range of potential cases is between 2,244 and 5,664.[9]

Additionally, we determined that the ROs did not always contact business taxpayers in a timely manner after receiving FTD Alert priority code A and B assignments. We identified eight cases (8.3 percent) in which the business taxpayer was not contacted until 16 to 56 calendar days after the FTD Alert was assigned. The documentation for each of these cases did not offer explanations for the delays. The business taxpayers, after being contacted by the ROs, paid accrued penalties, interest, and fees totaling $47,671, which is an average of $5,959 per business taxpayer (compared with $3,663 for business taxpayers whose FTD Alerts were timely assigned

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[7] A valid statistical sample of 96 FTD Alert priority code A and B cases was selected from a population of 22,327 FTD Alerts issued between January 1, 2009, and December 31, 2010, and based on a confidence level of 95 percent, a percent precision level of ± 10 percent, and an expected error rate of 50 percent.
[8] We considered FTD Alerts assigned up to 10 calendar days after FTD Alert issuance to have been assigned timely.
[9] To project the results of our statistical sample, we used a 95 percent confidence level, a 17.7 percent error rate, and a 7.66 percent precision factor.

and who were timely contacted). Based on our statistically valid sample, we project that 1,861 business taxpayers were not contacted within the required 15-calendar-day period, and we are 95 percent confident that the range of potential business taxpayers is between 622 and 3,099.[10] Figure 2 shows the comparative results between timely and untimely FTD Alert assignment and business taxpayer contact.

Figure 2: Comparison of Timely and Untimely FTD Alert Assignment and Business Taxpayer Contact

	Untimely Assignment Cases	Untimely Contact Cases	Timely Assigned and Contacted Cases[11]
Number of Cases	17	8	38
Accrued Penalties, Interest, & Fees	$139,587	$47,671	$139,198
Average Penalties, Interest, & Fees	$8,211	$5,959	$3,663
Average Days From FTD Alert Generation to Business Taxpayer Contact	29	37	13

Source: Analysis based on review of IRS-provided FTD Alerts, Integrated Collection System case history, and Integrated Data Retrieval System research.

Internal Revenue Manual (IRM)[12] guidance is specific about how much time an RO has to contact a business taxpayer after he or she receives an FTD Alert (15 calendar days after assignment). However, group managers did not always ensure business taxpayers were being timely contacted by the RO or that the case histories reflected reasons for delays. The IRM does not provide specific timeliness criteria for when a group manager should assign the FTD Alert to an RO.

The IRS Office of Research conducted a study[13] and concluded that as more time elapses before an individual makes at least one payment, it becomes less likely that they will do so at any

[10] To project the results of our statistical sample, we used a 95 percent confidence level, an 8.3 percent error rate, and a 5.55 percent precision factor.
[11] The remaining 33 FTD Alert cases were either not assigned, already assigned to an RO due to an existing balance due condition, the business taxpayer was no longer liable, or the business taxpayer made payments before contact was attempted.
[12] IRM 5.7.1.4 (Nov. 19, 2010).
[13] U.S. Department of the Treasury, IRS, Publication 1500, *The IRS Research Bulletin*, (Rev. 11-99).

subsequent time. Furthermore, the IRS studies we cited[14] earlier in this report found that business taxpayers were assessed fewer penalties when the FTD Alerts were worked by an RO in comparison to FTD Alerts that were not assigned. The longer the IRS delays business taxpayer contact, the higher the possibility the business taxpayer will not make the required payment, and the greater the amount of penalties and interest the business taxpayer will accrue. Penalties and interest continue to accrue until the delinquency is resolved.

Management Action: On March 12, 2012, the IRS initiated a Soft Letter Notice Pilot Process. This initiative will measure the effectiveness of sending written correspondence as a means to contact FTD Alert priority code B and C business taxpayers in an attempt to educate and resolve the identified issues, prior to the account becoming a FTD Alert priority code A.

Recommendations

The Director, Collection Policy, SB/SE Division, should:

Recommendation 1: Establish criteria for timely group manager assignment of FTD Alerts to the ROs.

> ***Management's Response:*** IRS management agreed with this recommendation. The IRS will establish specific criteria and update the appropriate IRM sections to ensure timely group manager assignment of FTD Alerts to ROs.

Recommendation 2: Emphasize to group managers that they should ensure the ROs contact business taxpayers within 15 calendar days of FTD Alert assignment.

> ***Management's Response:*** IRS management agreed with this recommendation. The IRS will issue guidance to the field ROs to emphasize the importance of timely assignment and contact of FTD Alerts as directed by the IRM.

[14] See page 2 of the Background section of this report.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the IRS is effectively managing the EFTPS[1] and FTD Alert Programs. To accomplish the objective, we:

I. Determined whether the EFTPS Program is effectively transitioning business taxpayers from Federal tax coupons to electronic payments.

   A. Identified and reviewed the new requirement for business taxpayers to deposit taxes electronically effective January 1, 2011.

   B. Interviewed SB/SE Division analysts to determine the actions taken by the IRS to notify business taxpayers of the requirement to deposit taxes electronically that was to take effect on January 1, 2011, and obtained the 3.8 million population of business taxpayers affected by the electronic payment requirements.

   C. Obtained the population of 1.4 million business taxpayers who still had not activated their enrollment in the EFTPS, or who continued to make deposits with an FTD coupon in the 18 months prior to the approved regulation.

   D. Obtained a list of 5,245 business taxpayers who submitted FTD coupon payments totaling $15.2 million to an IRS-designated post office box between July 1 and September 30, 2011, that was scheduled to close on December 31, 2011. We determined the actions taken by the IRS to notify those business taxpayers who continued mailing their FTD coupon payments to the post office box that was being closed.

II. Determined whether the FTD Alert Program resulted in the timely assignment of cases to the field and effectively brought the delinquent business taxpayers back into compliance.

   A. Identified and reviewed the applicable FTD Alert IRM[2] and interim guidance.

   B. Interviewed IRS management about the purpose and objective of the FTD Alert Program for business taxpayers, studies performed to improve the FTD Alert Program and ensure that business taxpayers remain in tax compliance, and whether the FTD Alert Program should be expanded.

   C. Reviewed a valid statistical sample of 96 FTD Alert priority code A and B cases, and 96 FTD Alert priority code C cases issued from January 1, 2009, to

[1] See Appendix V for a glossary of terms.
[2] IRM 5.7.1 (Nov. 19, 2010).

December 31, 2010. We reviewed each case to determine if FTD Alert policies and procedures were consistently followed, business taxpayers were contacted in a timely manner, overall processing time (from receipt to closure) was appropriate, and business taxpayers remained in compliance.

The sample selected was based on random sampling techniques using random case selection from a population of 22,327 FTD Alert priority code A and B cases, and 134,192 FTD Alert priority code C cases. The sample selection of 96 FTD Alert priority code A and B cases, and 96 FTD Alert priority code C cases was each based on a confidence level of 95 percent, a ±10 percent precision level, and an expected error rate of 50 percent. The Treasury Inspector General for Tax Administration contract statistician was consulted throughout the development and selection of this sample.

***Validity and reliability of data from computer-based systems*:** We obtained IRS business taxpayer FTD Alert data and data on business taxpayers affected by the electronic payment requirements. We matched these data to data processed by the IRS and stored on the Treasury Inspector General for Tax Administration Data Center Warehouse. We compared the data to information processed and stored in the Business Master File. We used the Business Taxpayer Identification Number as the control to validate the accuracy of the matching of the tax return information stored on the Business Master File and the Integrated Data Retrieval System. These data were sufficiently reliable to perform our audit analyses.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: SB/SE Division policies, procedures, and practices for processing and working FTD Alerts. We evaluated these controls by reviewing source materials, interviewing management, reviewing a sample of FTD Alerts and related Integrated Collection System case files, and researching business taxpayer accounts.

Appendix II

Major Contributors to This Report

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Carl Aley, Director
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Michael A. Garcia, Lead Auditor
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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Wage and Investment Division SE:W
Director, Campus Compliance Services, Small Business/Self-Employed Division SE:S:CCS
Director, Collection, Small Business/Self-Employed Division SE:S:C
Director, Filing and Payment Compliance, Wage and Investment Division SE:W:CP:FPC
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP
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 Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
    Commissioner, Small Business/Self-Employed Division SE:S
    Commissioner, Wage and Investment Division SE:W

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 Burden – Potential; 1,861 business taxpayers affected (see page 5).

Methodology Used to Measure the Reported Benefit:

We selected a random statistical sample of 96 FTD Alert priority code A and B cases from the total population of 22,327 cases issued between January 1, 2009, and December 31, 2010. We selected this type of sample so that we could project our results to the population of FTD Alerts for this time period. In eight (8.3 percent) of the 96 FTD Alert priority code A and B cases, the business taxpayer was not contacted within 15 calendar days of the FTD Alert being assigned to an RO.

To project the results of our statistical sample, we used a 95 percent confidence level, an 8.3 percent error rate, and a 5.55 percent precision factor. Based on these parameters, 1,861 business taxpayers with FTD Alert priority codes A and B issued between January 1, 2009, and December 31, 2010, may not have been contacted by the IRS within 15 calendar days of being assigned to an RO (the projected range is from 622 to 3,099 business taxpayers).

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 3,954 business taxpayers affected (see page 5).

Methodology Used to Measure the Reported Benefit:

We selected a random statistical sample of 96 FTD Alert priority code A and B cases from the total population of 22,327 cases issued between January 1, 2009, and December 31, 2010. We selected this type of sample so that we could project our results to the population of FTD Alerts for this time period. In 17 (17.7 percent) of the 96 FTD Alert priority code A and B cases, the FTD Alert was assigned to an RO an average of 29 calendar days (ranged from 11 to 34 calendar days) after the FTD Alert was issued.

To project the results of our statistical sample, we used a 95 percent confidence level, a 17.7 percent error rate, and a 7.66 percent precision factor. Based on these parameters, 3,954 business taxpayers with FTD Alert priority codes A and B issued between January 1, 2009, and December 31, 2010, may not have been contacted by the IRS within 15 calendar days of being assigned to an RO (the projected range is from 2,244 to 5,664 business taxpayers).

Appendix V

Glossary of Terms

Business Master File – The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

Campus – 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.

Collection Field Function – The unit in the Area Offices consisting of the ROs who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.

De Minimus – A Latin phrase meaning "concerning minimal things." It usually refers to a difference being so small or minimal that the law does not take it into consideration.

Electronic Federal Tax Payment System – The system designed to process Federal tax deposits and other types of business and individual payments.

Employment Tax Returns – Various Form 940 return series (primarily Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*, and Form 941, *Employer's QUARTERLY Federal Tax Return*) filed by businesses to report things such as employer's Federal unemployment taxes and Federal taxes withheld.

Federal Tax Deposit – Tax payment deposits made up of taxes withheld from employees' salaries (trust fund) and the employer's share (Federal Insurance Contributions Act taxes - Social Security and Medicare), along with taxes paid by the employer to provide for unemployment compensation to workers who have lost their jobs. These taxes need to be paid as they become due in order to avoid penalties.

Federal Tax Deposit Alert – A process that identifies at an early stage, *i.e.*, before the return is due, business taxpayers who have fallen behind in their tax payment deposits.

Fiscal Year – A 12-consecutive-month period ending on the last day of any month, except December. The Federal Government's fiscal year begins on October 1 and ends on September 30.

Integrated Collection System – An information management system designed to improve revenue collections by providing the ROs access to the most current taxpayer information, while in the field, using laptop computers for quicker case resolution and improved customer service.

Integrated Data Retrieval System – An IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

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

Revenue Officer – Employees in the Collection Field function who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by the IRS campuses or the Automated Collection System.

Soft Letter Notice – Soft Letter (or Soft Notice) is a written notice from the IRS that requires no action on the taxpayer's part but encourages the taxpayer to check his or her return for errors, serving as an educational tool and improving voluntary compliance.

Tax Period – Refers to each tax return filed by the taxpayer for a specific period (year or quarter) during a calendar year for each type of tax.

Telephone Assistors – A group of assistors who have received specialized training to assist taxpayers with specific tax issues. Telephone assistors answer taxpayer questions involving tax law and tax account conditions such as refunds, balance due billing activity, and changes to the amount of tax owed.

Appendix VI

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

RECEIVED JUL 26 2012

JUL 26 2012

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Faris R. Fink
Commissioner, Small Business/Self-Employed Division

SUBJECT: TIGTA Draft Report – Business Taxpayers Were Effectively Transitioned From Federal Tax Coupons to Electronic Payments, They Were Not Always Timely Contacted When Payments Were Missed
(Audit # 201130013)

Thank you for the opportunity to review your draft report titled: "Business Taxpayers Were Effectively Transitioned From Federal Tax Coupons to Electronic Payments, They were Not Always Timely Contacted When Payments Were Missed." The IRS appreciates TIGTA's recognition of our efforts to effectively implement Regulation 153340-09 which became effective on December 31, 2011. It impacted approximately 3.8 million taxpayers by eliminating the rules for making federal tax deposits by paper coupons.

The IRS worked diligently to ensure all impacted taxpayers were notified in advance of the change and assisted in efforts to enroll those taxpayers in the Electronic Federal Tax Payment System. As the effective date of December 31, 2011 was approaching, we continued to monitor the receipt of paper coupons and made adjustments to allow taxpayers to transition to electronic payments. For example, we extended the period the lock box was available to make paper coupon deposits; added staff to our call sites; sent additional notifications to those who mailed deposits; adjusted penalties when appropriate; and, in some instances, contacted the business directly to offer assistance.

Beyond this effort, the IRS recognizes the importance and benefits that result from the FTD (Federal Tax Deposit) Alert Program which attempts to identify, at an early stage, business taxpayers who have fallen behind in their tax deposits. The IRS has made significant efforts to expand and enhance the program to more effectively identify taxpayers that have decreased tax deposits and to increase the number of taxpayers that are contacted on a quarterly basis. Recently, IRS Research completed four FTD

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Alert Program studies which resulted in several recommendations to improve the program.

Additionally, the IRS has made improvements to ensure FTD Alerts are generated and assigned for contact as early as possible in the quarter to help ensure taxpayers have an opportunity to resolve the potential shortfall in deposits prior to the due date of the return. With timely contact of these taxpayers as our mutual goal, the IRS welcomes the two recommendations contained here within and we have crafted corrective actions that will address your concerns.

Attached is a detailed response outlining our corrective actions.

If you have any questions, please contact me, or a member of your staff may contact Michael Julianelle, Director, Enterprise Collection Strategy at (202) 622-3480.

Attachment

Attachment

RECOMMENDATION 1:
The Director, Collection Policy, SB/SE Division, should establish criteria for timely group manager assignment of FTD Alerts to revenue officers.

CORRECTIVE ACTION:
The IRS will establish specific criteria and update the appropriate Internal Revenue Manual sections to ensure timely group manager assignment of FTD (Federal Tax Deposit) Alerts to revenue officers.

IMPLEMENTATION DATE:
January 15, 2013

RESPONSIBLE OFFICIAL(S)
Director, Collection Policy

RECOMMENDATION 2:
The Director, Collection Policy, SB/SE Division, should emphasize to group managers to ensure ROs contact business taxpayers within 15 calendar days of FTD Alert assignment.

CORRECTIVE ACTION:
The IRS will issue guidance to the field revenue officers to emphasize the importance of timely assignment and contact of FTD Alerts as directed by the Internal Revenue Manual.

IMPLEMENTATION DATE:
January 15, 2013

RESPONSIBLE OFFICIAL(S)
Director, Collection Policy