



*Most Compliance Actions Were Prevented;  
However, Some Letters Were Sent  
Inappropriately to Taxpayers Affected by  
Hurricanes Katrina and Rita*

**December 15, 2006**

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This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

**Redaction Legend:**

1 = Tax Return/Return Information

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Phone Number | 202-927-7037

Email Address | [Bonnie.Heald@tigta.treas.gov](mailto:Bonnie.Heald@tigta.treas.gov)

Web Site | <http://www.tigta.gov>



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

December 15, 2006

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

*Michael R. Phillips*

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

**SUBJECT:** Final Audit Report – Most Compliance Actions Were Prevented;  
However, Some Letters Were Sent Inappropriately to Taxpayers  
Affected by Hurricanes Katrina and Rita (Audit # 200630006)

This report presents the results of our review of the Internal Revenue Service's (IRS) potential compliance actions related to taxpayers affected by Hurricanes Katrina and Rita. The overall objective of this review was to determine whether the Examination and Collection functions were taking compliance actions on cases for taxpayers that were in designated Hurricane Tax Relief areas.

This review was conducted in conjunction with the President's Council on Integrity and Efficiency as part of its examination of relief efforts provided by the Federal Government in the aftermath of Hurricanes Katrina and Rita. As such, a copy of the final audit report will be forwarded to the President's Council on Integrity and Efficiency Homeland Security Working Group, which is coordinating Inspectors' General reviews of this important subject.

### *Impact on the Taxpayer*

In 2005, Hurricanes Katrina and Rita directly affected unprecedented numbers of taxpayers in the States of Alabama, Florida, Louisiana, Mississippi, and Texas. In response to six separate Federal disaster declarations made by the President for these Hurricanes, the IRS used its administrative authority to reduce taxpayer burden by granting broad tax relief for affected taxpayers. The IRS suspended most compliance activities on affected taxpayers; however, some letters were sent inappropriately to taxpayers.



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Synopsis

Historically, after various disasters occur, the IRS has provided affected taxpayers with tax relief. For Hurricanes Katrina and Rita, the IRS automatically granted tax relief for taxpayers who resided or had businesses in the hardest hit areas, generally those designated by the Federal Emergency Management Agency (FEMA)<sup>1</sup> for “individual” relief. Various types of tax relief were granted by the IRS to affected taxpayers such as extensions of filing and payment deadlines, abatements of late filing and payment penalties and interest, and other time-sensitive acts. The IRS Collection and Examination functions were instructed to suspend compliance activities for these taxpayers through February 28, 2006.

Overall, the IRS prevented most collection and examination compliance activities from occurring by programming disaster indicators on the Master File<sup>2</sup> accounts with zip codes in the FEMA designated “individual” disaster relief areas. Management responded quickly by issuing disaster guidelines and instructions to employees and establishing a Hurricane Katrina/Rita web site for IRS employees with easy access to up-to-date instruction memos, IRS news releases, and FEMA disaster relief zip code lists. Also, the IRS established on its web site instructions and guidelines on the tax relief provisions granted to affected taxpayers. The IRS published *Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma* (Publication 4492) in January 2006.

The Collection Field function<sup>3</sup> successfully prevented most compliance activities from occurring. Some inappropriate actions were taken against some taxpayers with accounts in the Automated Collection System (ACS)<sup>4</sup> and Examination functions. However, the number of actions taken was small in relation to the number of affected taxpayers in the areas. In the first weeks after the Hurricanes, the inappropriate actions were due mainly to systemic timing issues.<sup>5</sup> Subsequently, employee errors caused most of the inappropriate actions.

We identified 80,300 taxpayers in the ACS and 30,210 taxpayers in the Examination function open inventory system, as of December 31, 2005, with zip codes in the FEMA designated “individual” disaster areas for Hurricanes Katrina and Rita. Inappropriate actions potentially may have occurred on as many as 3,494 taxpayers with accounts in the ACS and 2,239 taxpayers with returns being examined. We categorized these instances as potential actions because management informed us, and we later found, that some actions may have been canceled or may

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<sup>1</sup> The FEMA manages Federal response and recovery efforts following any national incident.

<sup>2</sup> The Master File is the IRS database that stores various types of taxpayer account information.

<sup>3</sup> The Collection Field function is the unit in the Area Offices consisting of revenue officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.

<sup>4</sup> The ACS is a telephone contact system through which telephone assistants collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.

<sup>5</sup> A systemic timing issue is the delay that occurs from the date IRS employees initially program disaster indicators on the Master File until the date the indicators actually appear on the various Examination and Collection inventory systems, ranging from 1 week to 3 weeks.



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have been appropriate due to exigent circumstances such as protecting the IRS' interest on expiring collection and assessment statutes or if the taxpayer requested to continue the activity.

To determine whether compliance actions were taken inappropriately, we reviewed judgmental samples of the various actions. Our review showed that 70 percent of the ACS actions (230 of 327) and 82 percent of the Examination function actions (135 of 165) were inappropriate. Of the inappropriate actions, 77 percent (282 of 365) were due to a systemic timing issue. Most of these problems occurred in the first few weeks after the disasters and in some instances the actions had already been initiated.

While ACS and Examination function letters should not have been sent to taxpayers based on the tax relief guidelines, these actions did not result in an immediate adverse action to the taxpayers. Examples include letters to the taxpayers explaining that they had a balance due or a proposed examination tax adjustment and the taxpayers should contact the IRS. The IRS included another notice with these letters informing taxpayers they could contact the IRS if they lived in an area affected by the Hurricanes.

As of July 2006, programming changes have been made to the ACS to address the systemic timing delays, and managerial approval with case documentation is now required for any compliance actions on affected taxpayer accounts. We believe this change to the system and requiring managerial approval will minimize the risk of inappropriate actions. However, the effectiveness will be known only after the next disaster of this magnitude occurs.

### *Recommendations*

We recommended the Commissioner, Small Business/Self-Employed Division, and the Commissioner, Wage and Investment Division, coordinate to establish a monitoring process to test the effectiveness of the ACS programming change to ensure inappropriate letters and levies are not sent during future disasters.

### *Response*

The Commissioner, Small Business/Self-Employed Division, agreed with our recommendation and has taken corrective action. In July 2006, the Small Business/Self-Employed Division submitted a Request for Information Services through the ACS Semi-Annual Maintenance to establish a disaster table allowing them to restrict any enforcement action in designated disaster areas. Also, they immediately implemented corrective programming as a result of a review conducted by the Small Business/Self-Employed Collection Policy function in November 2005 of all systemic actions taken on ACS accounts containing a Disaster ("DST") alert.<sup>6</sup> The

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<sup>6</sup> The term DST alert is used for the ACS disaster freeze code that was placed on ACS accounts.



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effectiveness of the programming changes was recently tested when the IRS decided to continue the suspension of compliance and enforcement activities in designated disaster areas. Queries of the ACS database showed no systemic or manual actions on accounts containing a DST alert. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to IRS officials affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-5894.



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## *Abbreviations*

ACS	Automated Collection System
AIMS	Audit Information Management System
CFf	Collection Field function
DST alert	Disaster alert
FEMA	Federal Emergency Management Agency
ICS	Integrated Collection System
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
TIGTA	Treasury Inspector General for Tax Administration



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## *Background*

Historically, after various disasters occur, the Internal Revenue Service (IRS) has provided affected taxpayers with tax relief. The IRS has procedures in place to address these types of situations and reacts as quickly as possible to implement the tax relief. In 2005, Hurricanes Katrina and Rita directly affected unprecedented numbers of taxpayers in the States of Alabama, Florida, Louisiana, Mississippi, and Texas. In

***The IRS tried to reduce taxpayer burden after Hurricanes Katrina and Rita by granting broad tax relief for affected taxpayers. This included suspending compliance activities.***

response to six separate Federal disaster declarations made by the President for these Hurricanes, the IRS used its administrative authority to reduce taxpayer burden by granting broad tax relief for affected taxpayers. This relief was automatically granted for taxpayers who resided or had businesses in the hardest hit areas, generally those designated by the Federal Emergency Management Agency (FEMA)<sup>1</sup> for “individual” relief. Additionally, relief was granted to taxpayers in counties and parishes designated by the FEMA for “public” relief; however, these taxpayers had to self identify and indicate to the IRS they had been affected.

Various types of tax relief were granted by the IRS to affected taxpayers such as extensions of filing and payment deadlines, abatements of late filing and payment penalties and interest, and other time-sensitive acts. In addition, the IRS Collection and Examination functions were instructed to suspend compliance activities (the words “activities” and “actions” are used interchangeably throughout the report) for affected taxpayers through February 28, 2006. Examples of these compliance activities include:

- Contacting the taxpayer by telephone and/or by sending letters.
- Filing Federal tax liens.
- Issuing levies.<sup>2</sup>
- Conducting audits.

The Collection function includes the Automated Collection System (ACS) and the Collection Field function (CFf). The ACS is a telephone contact system through which telephone assistants attempt to collect unpaid taxes and secure tax returns from delinquent taxpayers who have not

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<sup>1</sup> The FEMA manages Federal response and recovery efforts following any national incident.

<sup>2</sup> Federal tax liens and levies are enforcement tools. A lien attaches to a taxpayer’s property and rights to property for the amount of liability when an assessment and demand for payment have been made and the taxpayer has not paid within 10 calendar days. A levy is where the IRS has the authority to work with financial institutions and other third parties to seize a taxpayer’s assets if the taxpayer does not pay taxes owed after receiving demand for payment.



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complied with previous written notices. ACS employees attempt to resolve delinquent taxes and returns with the taxpayers over the telephone. Sometimes it is necessary to send letters to the taxpayers to remind them of the amount owed or returns due. Sometimes it is necessary to take enforcement actions such as liens and levies. If telephone contact cannot resolve the account, certain cases are assigned to the Cff, where a revenue officer attempts face-to-face contact with the taxpayer. Once a delinquent account is assigned, the revenue officer conducts an investigation to determine which collection procedures should be used to bring the taxpayer into compliance and this can include taking enforcement actions, such as liens and levies.

The Examination function selects and examines Federal tax returns to determine taxpayers' correct tax liabilities. Examinations are conducted at the field, office, and correspondence levels. Field examinations involve individuals, partnerships, and corporations and generally occur at the taxpayer's place of business. Office examinations usually involve individuals and are conducted through interviews at an IRS office. Correspondence examinations are conducted primarily through the mail by the campuses.<sup>3</sup>

This review was performed at the IRS National Headquarters in Washington, D.C., in the Small Business/Self-Employed (SB/SE) and Wage and Investment Divisions during the period January through August 2006. The audit was conducted in accordance with *Government Auditing Standards*. This review was conducted in conjunction with the President's Council on Integrity and Efficiency as part of its examination of relief efforts provided by the Federal Government in the aftermath of Hurricanes Katrina and Rita. As such, a copy of the report will be forwarded to the President's Council on Integrity and Efficiency Homeland Security Working Group, which is coordinating the Inspectors' General reviews of this important subject. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>3</sup> A 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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## *Results of Review*

### ***The Internal Revenue Service Responded Immediately to Prevent Compliance Activities***

The IRS took many actions to provide tax relief to affected taxpayers immediately after the President declared Federal disaster areas. Overall, our review showed that these actions helped prevent most compliance actions from occurring.

#### **The IRS took various effective actions**

To prevent collection and examination compliance actions from occurring, the IRS programmed disaster indicators on the Master File<sup>4</sup> accounts with zip codes in the FEMA designated “individual” disaster relief areas. Inventory systems used by the Collection and Examination functions were then updated with the disaster indicators through the Integrated Data Retrieval System<sup>5</sup> within a range of 1 week to 3 weeks, depending on how the systems interacted. Once disaster indicators were in place, they were supposed to prevent most compliance activities from occurring and/or warn Collection and Examination function employees that taxpayer accounts should have no compliance actions taken. The inventory systems included:

- The Integrated Collection System (ICS), which is an automated inventory system used to control and monitor delinquent cases assigned to revenue officers in the CFf.
- The ACS, which is a telephone contact system through which telephone assistants collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.
- The Audit Information Management System (AIMS), which is a computer system designed to give the Examination function information about returns in inventory and closed.

The compliance activities to be suspended included, but were not limited to, initiating contact with the taxpayer; filing a notice of Federal tax lien; serving a notice of levy; conducting a seizure or sale activity; issuing a summons of the taxpayer or a third party; mailing letters

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<sup>4</sup> The Master File is the IRS database that stores various types of taxpayer account information.

<sup>5</sup> The Integrated Data Retrieval System is the IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer’s account records.



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proposing the Trust Fund Recovery Penalty<sup>6</sup> assessment; mailing letters proposing assessment under Internal Revenue Code Section 6020(b) or Substitute for Return;<sup>7</sup> denying penalty appeals; enforcing summons proceedings; initiating suit proceedings; rejecting offers in compromise;<sup>8</sup> issuing Letter 1058, Final Notice of Intent to Levy;<sup>9</sup> and making third-party contacts regarding any of these actions. In cases where notices or letters had to be sent to taxpayers located in a disaster area, the IRS inserted Notice 1155 – Disaster Relief from IRS, which advised them where to call the IRS for help if they were affected by the Hurricanes.

Also, the IRS established on its web site instructions and guidelines on the tax relief provisions granted to affected taxpayers. The IRS published *Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma* (Publication 4492) in January 2006.

The SB/SE and Wage and Investment Divisions' Collection and Examination functions management responded quickly to the disasters by issuing disaster guidelines and instructions to employees within a few days after the disaster declarations were made by the President. Shortly thereafter, a Hurricane Katrina/Rita web site was established for IRS employees with easy access to up-to-date instruction memos, IRS news releases, and FEMA disaster relief zip code lists.

Although the IRS took many effective actions including programming the Master File to place an indicator on the accounts which would suspend actions, IRS systems did not always provide for real-time actions including the freezing of accounts. In some instances there could be a delay ranging from 1 week to 3 weeks from the date IRS employees initially program disaster indicators on the Master File until the date the freeze actually appeared on the various inventory systems to freeze the accounts. Throughout the audit report, we refer to this as a “systemic timing delay or issue.”

***The IRS successfully prevented most compliance activities in the CFf and generally prevented liens from being issued***

We identified 10,830 taxpayers on the ICS as of December 31, 2005, with zip codes in the FEMA designated “individual” disaster relief areas for Hurricanes Katrina and Rita. These were CFf delinquent accounts in inventory as of December 31, 2005, and CFf accounts closed

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<sup>6</sup> The Trust Fund Recovery Penalty is a penalty that may be assessed against any person who is responsible for collecting or paying withheld income and employment taxes, or for paying collected excise taxes, and willfully fails to collect or pay them.

<sup>7</sup> Internal Revenue Code Section 6020(b) gives the IRS authority to prepare and execute a return for a taxpayer if the taxpayer willfully fails to prepare and execute a legally required return (also known as Substitute for Return).

<sup>8</sup> An Offer in Compromise is an agreement between a taxpayer and the Federal Government that settles a tax liability for payment of less than the full amount owed. The IRS has the authority to settle or compromise Federal tax liabilities by accepting less than full payment under certain circumstances. This is accomplished through an Offer in Compromise (Form 656).

<sup>9</sup> Letter 1058 is a final notice of intent to levy and notice of taxpayer's right to a hearing.



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between the disaster declaration dates of both Hurricanes and December 31, 2005. As of September 22, 2006, the remaining taxes owed were approximately \$429 million.

Our review of a judgmental sample of 90 ICS cases with history action dates on or after the disaster declaration dates showed the CFf successfully prevented compliance activities. We did not identify any indication in the case narratives of compliance activities taking place.

***The CFf successfully prevented most compliance activities from occurring.***

Effective suspension of actions was accomplished for several reasons. First, CFf revenue officers lived in the same general locations as affected taxpayers and would be aware of the disaster situation in which taxpayers were affected. Second, the ICS has some enhanced capabilities to warn CFf employees about affected taxpayers and to prevent compliance actions. For example, the ICS:

- Provides a “notification” to CFf employees anytime a change takes place on a taxpayer’s account, including the placement of a disaster indicator.
- Warns CFf employees of the disaster indicator by displaying “disaster alert” on the initial case screen of a taxpayer.
- Prevents new collection cases with disaster indicators from being assigned to CFf manager queues.

Finally, CFf management instructed employees not to take compliance actions for affected taxpayers without managerial approval. If an employee took action and the manager approved the action, it needed to be documented in the case file.

Our review of potential levies initiated by the CFf showed that 12 taxpayers had levies issued. This number is very minor when compared to the 10,830 taxpayers in inventory at the time. Three taxpayers had levies issued correctly due to exigent circumstances. Seven taxpayers had levies issued due to the systemic timing delay when disaster indicators had not yet updated the ICS. In the remaining two instances, the levies were issued due to employee errors.

The IRS SB/SE Division also successfully prevented liens from being issued. Our review showed that in the first few days after Hurricane Rita, the IRS filed 11 liens. These liens were already in process and had been printed prior to the disaster indicators being placed. Since then no inappropriate liens have been issued.



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**A Limited Number of Compliance Actions Occurred in the Automated Collection System and the Examination Function**

Some inappropriate actions were taken against taxpayers with accounts in the ACS and the Examination function; however, the number of actions taken was small in relation to the number of affected taxpayers in the areas. In the first weeks after the Hurricanes, the inappropriate actions were due mainly to the systemic timing issue. Subsequently, the primary reason was that employees took inappropriate actions that were contrary to existing procedures.

We identified 80,300 ACS taxpayers as of December 31, 2005, with addresses in the FEMA designated “individual” disaster relief areas for Hurricanes Katrina and Rita. As of August 25, 2006, the remaining taxes owed were approximately \$433 million. Also, using the AIMS, we identified 30,210 Examination taxpayers in inventory based on the same criteria.

***While most compliance activities were prevented, some inappropriate actions occurred related to the ACS and Examination function taxpayers.***

Overall, the IRS prevented most compliance actions from being taken on these taxpayers. Approximately 96 percent of the ACS taxpayers and 93 percent of the Examination function taxpayers had no indications of compliance actions. Figure 1 shows the results of our analysis of the ACS and AIMS for specific compliance actions and the population of taxpayers with potential actions taken.

**Figure 1: Potential ACS and Examination Function Actions**

ACS Actions	Taxpayers With Potential Actions Taken
Collection letters/notices	2,889
Levies	605
<b>TOTAL</b>	<b>3,494</b>
Examination Function Actions	Taxpayers With Potential Actions Taken
30 day letters	752
90 day letters	1,206
"No Response" assessments	250
"Undeliverable" assessments	31
<b>TOTAL</b>	<b>2,239</b>

*Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of ACS and AIMS system data extracts.*



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ACS taxpayers (3,494) with potential actions taken represented approximately 4 percent and Examination taxpayers (2,239) with potential actions taken represented approximately 7 percent of the overall populations. Also, the majority of these potential actions were taken in Collection and Examination functions' campuses or offices located remote to the disaster areas. We categorized these instances as potential actions because management informed us, and we later found, that some actions may have been canceled or may have been appropriate due to exigent circumstances such as protecting the IRS' interest on expiring collection and assessment statutes or if the taxpayer requested to continue the activity.

To determine whether compliance actions were inappropriately taken, we reviewed judgmental samples of the various actions. Our review showed that 70 percent of the ACS actions (230 of 327) were inappropriate and 82 percent of the Examination actions (135 of 165) were inappropriate. Seventy-seven percent (282 of 365) of the inappropriate actions were due to systemic timing issues caused by the 1-week to 3-week delay between the IRS' initial programming of disaster indicators on the Master File until they were updated on the ACS and AIMS. Most of these problems occurred in the first few weeks after the disasters and in some instances the actions had already been initiated. While the actions were inappropriate, correspondence to the taxpayers included a notice informing taxpayers they could contact the IRS if they lived in an area affected by the Hurricanes. Only 23 percent (83 of 365) of the inappropriate actions were due to employee errors, which occurred mostly at later dates in November and December 2005. It is likely a small number of inappropriate actions due to employee errors continued to occur throughout the disaster relief period.

**Some ACS letters and levies were issued throughout the disaster relief period**

As part of its actions related to disaster relief for Hurricanes Rita and Katrina, the IRS established procedures to suspend most compliance activities including sending letters and issuing levies. In addition, ACS management placed their own freeze code (known as a "DST alert") on ACS accounts at the same time the IRS was placing disaster indicators on all affected taxpayer accounts through the Master File. This was done to mitigate compliance actions from taking place during any potential delay involving programming the computer systems. This allowed ACS employees to see the disaster indicator on the ACS within a few days, rather than a few weeks. After Hurricane Katrina, ACS management searched for any letter and levy actions taken within those few days and canceled them.

Figure 2 shows the results of our review of 110 ACS taxpayers with letter actions. Ninety-six of the 110 letters (87 percent) were inappropriately sent. In 57 instances, the letters were sent due to timing issues and in 39 instances because of employee errors. The letters sent prior to October 2005 were due mostly to systemic timing issues. The letters sent after those dates were due mostly to employees not following the disaster procedures. In addition, letters had been initiated or sent on 14 taxpayers but the IRS appropriately canceled 7 of the letters prior to sending them out. The remaining seven were sent appropriately because the taxpayers did not live in the declared disaster areas at the time of the Hurricanes.



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**Figure 2: Review of ACS Letter Actions**

Compliance Action Reviewed	Number of Taxpayer Cases Reviewed	Exigent Circumstances	Canceled, No Action or Taxpayer Lived Outside Disaster Area	Inappropriate Actions	
				Timing Issues	Employee Errors
Letters sent prior to 10/1/05	60	0	5	50	5
Letters sent after 9/30/05	50	0	9	7	34
<b>Total</b>	<b>110</b>	<b>0</b>	<b>14</b>	<b>57</b>	<b>39</b>

*Source: TIGTA judgmental sample review of an ACS data extract of taxpayers with letter collection actions.*

While these letters should not have been sent based on the tax relief guidelines, these actions did not result in an immediate adverse action to the taxpayer. Examples include letters to the taxpayers explaining that they had a balance due or intent to levy and they should contact the IRS. The IRS included another notice with these letters informing taxpayers they could contact the IRS if they lived in an area affected by the Hurricanes.

Figure 3 shows the results of our review of 217 ACS taxpayers with levy actions. Specifically, 134 of 217 levies were inappropriately issued. In 114 instances, the levies were issued due to systemic timing issues and in 20 instances because of employee errors. Similar to the sent letters, the levies issued prior to October 2005 were mostly due to timing issues and levies issued after that date mostly were due to employees not following the disaster procedures. Although levies had been initiated on 82 taxpayers, the IRS appropriately canceled most of these levies prior to or released them shortly after issuance. In some instances, the IRS appropriately issued the levies because the taxpayers did not live in the declared disaster areas at the time of the Hurricanes, or there was an exigent circumstance where the taxpayer contacted the IRS to resolve the account.



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**Figure 3: Review of ACS Levy Actions**

	Levies issued prior to 10/1/05	Levies issued after 9/30/05	Total
Levies issued prior to 10/1/05	60	101	5
Levies issued after 9/30/05	22	13	15
<b>Total</b>			<b>20</b>

Source: TIGTA judgmental sample review of an ACS data extract of taxpayers with levy actions.

Although ACS management tried to mitigate the systemic timing issue by placing their own freeze codes on affected taxpayer accounts to avoid the timing delay, the following problems sometimes occurred causing the letters or levies to be issued.

- Follow-up action dates could be manually changed on accounts which caused the letters and levies to continue.
- Employees were not blocked from taking ACS manual actions to issue letters, liens, or levies even if the account was in disaster status and could use their judgment to take actions.
- Some ACS campus employees did not receive the proper instructions for canceling all letter and levy actions that took place in the few days before the DST alerts were placed.
- Some Hurricane Rita actions did not get canceled because the DST alerts were not placed on the accounts until at least October 1, 2005, which was 9 calendar days after the disaster declaration date.

In the weeks following the Hurricanes, there were fewer systemic timing issues and more employee errors. Of the 59 letter and levy actions that were caused by employee errors, 49 occurred after September 30, 2005. Employee errors were the main cause of any errors that occurred in November and December 2005.



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SB/SE Collection Policy management submitted a Request for Information Services to the IRS Modernization, Information and Technology Services organization<sup>10</sup> in January 2006 to fix the systemic problems. As of July 2006, programming changes had been made and all systemic and real-time (manual) ACS letter, levy, and lien actions are expected to be suppressed by the DST alert until the actual disaster indicators update on the ACS. Also, managerial approval with case documentation is now required for these compliance actions on all taxpayer accounts with the ACS DST alerts and updated disaster indicators. We believe this change to the system and requiring managerial approval will minimize the risk of inappropriate actions. However, the effectiveness will be known only after the next disaster of this magnitude occurs.

### ***Recommendation***

***Recommendation 1:*** The Commissioner, SB/SE Division, and the Commissioner, Wage and Investment Division, should coordinate to establish a monitoring process to test the effectiveness of the ACS programming change to ensure inappropriate letters and levies are not sent during future disasters.

***Management's Response:*** The Commissioner, SB/SE Division, agreed with our recommendation and has taken corrective action. In July 2006, the SB/SE Division submitted a Request for Information Services through the ACS Semi-Annual Maintenance to establish a disaster table allowing them to restrict any enforcement action in designated disaster areas. Additionally, they immediately implemented corrective programming as a result of a review conducted by the SB/SE Collection Policy function in November 2005 of all systemic actions taken on ACS accounts containing a DST alert.

The recent decision to continue the suspension of compliance and enforcement activities in designated disaster areas provided ACS the opportunity to test the effectiveness of the programming changes implemented in July 2006. Queries of the ACS database showed no systemic or manual actions on accounts containing a DST alert.

### ***Some examination letters were issued throughout the disaster relief period***

During a tax examination, examiners may determine the taxpayer's tax liability is not correct and propose additional assessments. If the taxpayer does not agree, letters are sent to notify the taxpayer of changes in the tax liabilities and his or her appeal rights. Examples of these letters are the Letter to Transmit Examination Report, Letter 915 (referred to as a 30-Day letter for Office Examination); the 30-Day Letter, Letter 950-A (referred to as a 30-Day letter for Field Examination); and the Notice of Deficiency, Letter 531 (referred to as a 90-Day letter).

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<sup>10</sup> The Modernization, Information and Technology Services organization provides information technology solutions, services, and support to IRS employees enterprise-wide.



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Figure 4 shows the results of our review of 135 Examination function taxpayers who were sent 30-Day and 90-Day letters. Employees inappropriately issued letters due to the systemic timing delay in 97 cases and due to not properly following guidelines in 12 (30-Day letter) cases. In 21 instances, the action was not taken or canceled, and in 5 instances exigent circumstances existed such as Taxpayer Advocate Service<sup>11</sup> involvement, the taxpayer contacted the IRS for resolution, or a refund was issued.

As stated in the ACS section of the audit report, these letters did not have an immediate adverse affect on the taxpayers. These letters were sent to taxpayers who were already in the examination process. In addition, when the letters were sent to taxpayers, an additional note was included informing taxpayers that if they lived in an area affected by the Hurricanes, they should call the IRS.

**Figure 4: Review of Examination Function Letter Actions**

Letter Type	Total	Systemic Timing	Employee Errors	Exigent Circumstances
30 day letters	30	13	12	5
90 day letters	105	84	0	21
<b>Total</b>	<b>135</b>	<b>97</b>	<b>12</b>	<b>21</b>

*Source: TIGTA judgmental sample review of an AIMS data extract of taxpayers with Examination letter actions.*

When taxpayers do not respond to 90-Day letters, the reason could be that the letters were “undeliverable” or the taxpayer simply did not respond. In these situations, the IRS can assess the taxes. Our review showed there were less than 1 percent of taxpayers in inventory that had assessments. Figure 5 shows that 30 Examination function taxpayers had additional taxes assessed due to “no response” and “undeliverable” letters, and 26 of the assessments were inappropriate. Fourteen were due to systemic timing issues with the disaster indicators and 12 were due to employee errors. Four taxpayers had assessments made correctly due to exigent circumstances such as Taxpayer Advocate Service involvement, a refund was issued, or protection of the statute was needed.

<sup>11</sup> The Taxpayer Advocate Service is an IRS program that provides an independent system to assure that tax problems, which have not been resolved through normal channels, are promptly and fairly handled.



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**Figure 5: Review of Examination Function Assessment Actions**

Assessed – No Response	20		11	6
Assessed - Undeliverable	10		3	6
<b>Total</b>	<b>30</b>		<b>14</b>	<b>12</b>

*Source: TIGTA judgmental sample review of an AIMS data extract of taxpayers with Examination function assessment actions.*

The timing issues were due mostly to actions in process prior to disaster indicators being placed on the accounts. There is a delay before the AIMS gets the disaster indicator which can be 1 or 2 weeks, depending on when the Master File program updates the Integrated Data Retrieval System, which then updates the AIMS. Also, it takes up to 11 days from the time letters are initiated on the AIMS to the time they are printed and mailed through centralized print sites. If the disaster indicator is not on the account when letters are initiated they cannot be stopped in a cost-effective manner. Campus compliance management stated that these systemic issues would continue to occur in future disaster relief situations because, generally, it is not feasible to stop letters at the print site once they have been initiated.

The employee errors found in the review were due mainly to employees not properly following disaster relief guidelines. Although there was a small number overall, these assessment actions can cause undue hardship on taxpayers affected by the disasters. For the undeliverable assessments, the taxes may have been assessed without the taxpayer's knowledge.

This audit report does not contain any recommendations related to the examination process because the number of taxpayers affected by inappropriate actions was due primarily to systemic timing issues. Examination function management is limited by what they can do to address the major cause of the problems which was the ability to cost-effectively stop letters that were already in process. Although we are not formally recommending any corrective actions, after any disaster occurs and tax relief is granted, Examination function management should ensure employees and managers are reminded to follow the guidelines.



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## Appendix I

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

The overall objective of this review was to determine whether the Examination and Collection functions were taking compliance actions on cases for taxpayers that were in designated Hurricane Tax Relief areas. For all case reviews described below, we used judgmental sampling to select cases because we did not plan to project the results or conclude anything beyond what was occurring in the Hurricanes Katrina and Rita disaster areas. To accomplish our objective, we:

- I. Determined whether the Examination function took compliance actions after the Hurricanes.
  - A. Identified the population of affected Examination function taxpayers (30,210 taxpayers) with open cases as of December 31, 2005, and cases closed from September 6, 2005, through December 31, 2005, for Hurricane Katrina and September 23, 2005, through December 31, 2005, for Hurricane Rita, by matching the FEMA<sup>1</sup> “individual” disaster relief zip code listings to the AIMS,<sup>2</sup> the Individual Master File,<sup>3</sup> and the Business Master File<sup>4</sup> in the TIGTA Data Center Warehouse.<sup>5</sup>
  - B. Extracted those records (752 taxpayers) that had a Letter to Transmit Examination Report, Letter 915 (referred to as a 30-Day letter for Office Examination); and 30-Day Letter, Letter 950-A (referred to as a 30-Day letter for Field Examination) issued and reviewed a judgmental sample of 30 taxpayers.
  - C. Extracted those records (1,206 taxpayers) that had a Notice of Deficiency, Letter 531 (90-Day letter) issued and reviewed a judgmental sample of 105 taxpayers.
  - D. Extracted those closed records (250 taxpayers) that had assessments made due to no response from the taxpayers to the 90-Day letters and reviewed a judgmental sample of 20 taxpayers.

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<sup>1</sup> The FEMA manages Federal response and recovery efforts following any national incident.

<sup>2</sup> The AIMS is a computer system designed to give the Examination function information about returns in inventory and closed.

<sup>3</sup> The IRS database that maintains transactions or records of individual tax accounts.

<sup>4</sup> 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.

<sup>5</sup> The Data Center Warehouse provides centralized storage, security, and administration of data files. It provides data and data access services enabling auditors to access historical IRS data files.



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- E. Extracted those closed records (31 taxpayers) that had assessments made due to undeliverable 90-Day letters and reviewed a judgmental sample of 10 taxpayers.
- F. Reviewed taxpayer cases from Steps I.B, C, D, and E for the following:
  - 1. Determined whether disaster indicators were on taxpayer accounts and if the disaster indicator date was before or after the compliance action transaction date.
  - 2. Determined whether those taxpayers without disaster indicators on their accounts were living in the disaster areas at the time of the Hurricanes.
  - 3. Obtained evidence and explanations for cases with compliance actions that were canceled prior to or released shortly after issuance, and where compliance actions were taken due to exigent circumstances.
- II. Determined whether the Collection function took compliance actions after the Hurricanes.
  - A. Identified the population of affected Collection function taxpayers (80,300 ACS taxpayers and 10,830 ICS taxpayers) with open cases as of December 31, 2005, and cases closed from September 6, 2005, through December 31, 2005, for Hurricane Katrina, and September 23, 2005, through December 31, 2005, for Hurricane Rita, by matching the FEMA “individual” disaster relief zip code listings to the ICS<sup>6</sup> and ACS<sup>7</sup> files in the TIGTA Data Center Warehouse. We obtained the updated tax balances owed by the ACS taxpayers as of August 25, 2006, and the ICS taxpayers as of September 22, 2006.
  - B. Extracted those records (18 taxpayers) with ICS levy issue dates between the disaster declarations dates and December 31, 2005, and records (605 taxpayers) with ACS LV (levy) action codes for the same period. We reviewed all 18 ICS taxpayer cases with potential levies issued, a judgmental sample of 167 ACS taxpayer cases with levies issued prior to October 1, 2005, and a judgmental sample of 50 ACS taxpayer cases with levies issued after September 30, 2005.
  - C. Identified those ICS records (10,830 taxpayers) with ICS history action dates between the disaster declaration dates and December 31, 2005, (taxpayers with potential compliance activities). We reviewed a judgmental sample of 90 taxpayer case histories with potential compliance activities to determine if employees took compliance actions.
  - D. Extracted those records (2,889 taxpayers) with ACS LT (letter) action codes between the disaster declarations dates and December 31, 2005. We reviewed a judgmental

<sup>6</sup> The ICS is an automated inventory system used to control and monitor delinquent cases assigned to revenue officers.

<sup>7</sup> The ACS is a telephone contact system through which telephone assistants attempt to collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.



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- sample of 60 taxpayer cases with letters sent prior to October 1, 2005, and a judgmental sample of 50 ACS taxpayer cases with letters sent after September 30, 2005, to determine the causes.
- E. Reviewed Collection function cases from Step II.B, C, and D for the following:
1. Determined specific actions from the case history narratives.
  2. Determined whether disaster indicators were on taxpayer accounts and if the disaster indicator date was before or after the compliance action transaction date.
  3. Determined whether those cases without disaster indicators were living in the disaster areas at the time of the Hurricanes.
  4. Obtained evidence and explanations for cases with compliance actions that were canceled prior to or released shortly after issuance, and where compliance actions were taken due to exigent circumstances.
- F. Reviewed all 11 records from the Automated Lien System<sup>8</sup> where liens were both prepared and printed between October 1, 2005, and December 31, 2005, to determine the causes.
- III. Determined the reliability of data by relying on the TIGTA Data Center Warehouse, which has procedures in place to ensure the data it receives from the IRS are valid. We performed various procedures to ensure all the records in the AIMS, ICS, ACS, Automated Lien System, and Master File databases were received. In addition, on judgmentally selected taxpayer accounts, we performed other reliability testing, which included a comparison of one or more of the following fields from the Data Center Warehouse with the IRS Integrated Data Retrieval System<sup>9</sup> (taxpayer identification number/social security number, taxpayer name, and/or Master File tax account codes).<sup>10</sup> We were satisfied that the data are sufficient, complete, and relevant to the review.
- IV. Determined whether IRS controls and processes for responding to Hurricanes Katrina and Rita were effective by evaluating Examination and Collection functions' guidelines to stop actions, the process used to insert mail stuffers, the process to print and mail letters, the process and time periods for updating inventory systems with disaster indicators, the instructions provided to employees to prevent compliance actions, and the process used to stop ACS levies and letters from being mailed out before the disaster indicators were placed on taxpayer accounts.

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<sup>8</sup> The Automated Lien System is a comprehensive database that prints Notices of Federal Tax Lien and lien notices, stores taxpayer information, and documents all lien activity.

<sup>9</sup> The IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

<sup>10</sup> Master File Tax Account Codes help to identify the type of return a taxpayer files.



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## **Appendix II**

### *Major Contributors to This Report*

Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs)

Parker F. Pearson, Director

Lynn Wofchuck, Audit Manager

Phyllis Heald, Lead Auditor

Christina Dreyer, Auditor

Nina Julius, 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, Collection, Small Business/Self-Employed Division SE:S:C  
Director, Examination, Small Business/Self-Employed Division SE:S:E  
Director, Campus Compliance Services, Small Business/Self-Employed Division SE:S:CCS  
Director, Communications, Liaison and Disclosure, Small Business/Self-Employed Division SE:S:CLD  
Director, Compliance, Wage and Investment Division SE:W:CP  
Director, Strategy and Finance, Wage and Investment Division SE:W:S  
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



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## **Appendix IV**

### *Outcome Measure*

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

#### **Type and Value of Outcome Measure:**

- Taxpayer Burden – Actual; 230 taxpayers affected (see page 6).

#### **Methodology Used to Measure the Reported Benefit:**

Our objective was to determine whether any compliance actions were taken on taxpayers living in the Hurricanes Katrina and Rita disaster areas. To accomplish this, we identified 3,494 ACS<sup>1</sup> taxpayers with potential compliance actions taken. We selected judgmental samples of the ACS taxpayers to whom it appeared the IRS sent the letters and issued levies. We reviewed 327 ACS taxpayers with letter and levy actions and determined that 96 taxpayers had letters sent inappropriately and 134 had levies issued inappropriately, for a total of 230 taxpayers.

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<sup>1</sup> The ACS is a telephone contact system through which telephone assistants attempt to collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.



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**Appendix V**

*Management's Response to the Draft Report*



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

RECEIVED  
NOV 28 2006

November 21, 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kevin M. Brown   
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Most Compliance Actions Were Prevented; However, Some Letters Were Sent Inappropriately to Taxpayers Affected by Hurricanes Katrina and Rita (Audit #200630006)

We reviewed your draft report, "Most Compliance Actions Were Prevented; However, Some Letters Were Sent Inappropriately to Taxpayers Affected by Hurricanes Katrina and Rita." We appreciate your acknowledgement that IRS actions prevented the overwhelming majority of compliance activities from occurring. When letters were inappropriately issued, we took appropriate corrective action to ensure no adverse impact on the taxpayer. You recognized that we quickly issued disaster guidelines and instructions to employees within a few days after the Presidential disaster declarations. We also expeditiously established web site instructions and guidelines on tax relief provisions granted to affected taxpayers.

We agree with your recommendation and have successfully tested the effectiveness of the Automated Collection System (ACS) programming changes.

Attached is a detailed response outlining our corrective action.

If you have any questions, please call me at (202) 622-0600 or Beth Tucker, Director, Communications, Liaison and Disclosure, Small Business/Self-Employed Division at (972) 308-1676.

Attachment



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*Most Compliance Actions Were Prevented; However, Some Letters Were Sent Inappropriately to Taxpayers Affected by Hurricanes Katrina and Rita*

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**Attachment**

**RECOMMENDATION**

The Commissioner, Small Business/Self-Employed Division and the Commissioner, Wage and Investment Division should coordinate to establish a monitoring process to test the effectiveness of the ACS programming change to ensure that inappropriate letters and levies are not sent during future disasters.

**CORRECTIVE ACTION**

In July 2006, we submitted a Request for Information Services (RIS) through our ACS Semi-Annual Maintenance to establish a disaster table allowing us to restrict any enforcement action in designated disaster areas. Additionally, we immediately implemented corrective programming as a result of a review conducted by SB/SE Collection Policy in November 2005 of all systemic actions taken on ACS accounts containing a Disaster (DST) Alert.

Our recent decision to continue the suspension of compliance and enforcement activities in designated disaster areas provided ACS the opportunity to test the effectiveness of the programming changes implemented in July 2006. Queries of the ACS database showed no systemic or manual actions on accounts containing a DST Alert.

**IMPLEMENTATION DATE**

Completed October 21, 2006

**RESPONSIBLE OFFICIAL**

Director, Filing and Payment Compliance, Campus Compliance Services, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN**

N/A