



*Efforts to Collect Delinquent Employment
Taxes Owed by Government Entities
Could Be Improved*

August 27, 2007

Reference Number: 2007-10-166

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.

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 27, 2007

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION
COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES
DIVISION

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

SUBJECT: Final Audit Report – Efforts to Collect Delinquent Employment Taxes
Owed by Government Entities Could Be Improved
(Audit # 200610034)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) has implemented an effective process to collect delinquent employment taxes and secure delinquent returns owed by Federal, State, and local government entities. This audit was requested by the IRS Chief Financial Officer.

Impact on the Taxpayer

Government entities, including those in the Federal Government, are not exempt from meeting employment tax deposit and reporting requirements. As of December 2006, Federal Government entities owed approximately \$45 million in delinquent employment taxes. Additional emphasis is needed in three key areas related to the IRS' efforts to resolve these types of delinquencies. It is critical to the image of the United States that Federal Government entities be held to the same standards as private employers. In addition, the delivery of essential services by State and local government entities, such as school districts, could be adversely affected if employment tax delinquencies by these entities are not addressed timely.

Synopsis

The IRS has enhanced its efforts to address delinquent employment taxes owed by government entities in multiple areas. For example, three different IRS functional offices (the Tax Exempt



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and Government Entities (TE/GE) Division, the Small Business/Self-Employed (SB/SE) Division, and the Office of the Chief Financial Officer) formed a working group to discuss ways to address Federal Government entity employment tax delinquencies. In addition, beginning in June 2005, the SB/SE Division, which is responsible for seeking repayment and securing past due tax returns from delinquent entities including government entities, established a special unit at the Brookhaven Campus¹ in Holtsville, New York, to address Federal Government entity tax delinquency cases. This unit was established to work directly with delinquent Federal Government agencies to reduce the taxes due through payments, filing of tax returns, and corrections to accounts, as necessary. For State and local government entity delinquencies, the SB/SE Division uses standard collection processes and enforcement tools to collect the delinquencies. As of January 2007, delinquent State and local government entity accounts totaling \$254 million were assigned to the SB/SE Division Collection Field function² for resolution. These collection services are provided pursuant to a Memorandum of Understanding between the SB/SE and TE/GE Divisions.

In our opinion, this coordinated approach represents a marked increase in emphasis since the last time we reviewed this area. Specifically, in 2002, we reported³ that the TE/GE Division did not have an effective agreement with the SB/SE Division to provide for allocation of the resources necessary to help ensure government entities complied with Federal tax requirements for the submission of tax returns and related payments.

Despite these efforts, the IRS needs to take additional actions in three key areas to effectively address government entity employment tax delinquencies. First, efforts to identify and address the causes of government entity tax delinquencies need to be expanded. For example, the special unit established at the Brookhaven Campus does not routinely track information regarding how these cases are resolved (e.g., was the money collected or the account adjusted) or gather data during the collection process on the causes of the delinquencies.

Second, controls over case processing and the administration of enforcement actions on government entity delinquency cases need to be strengthened. At the time of our review, the Brookhaven Campus lacked comprehensive guidelines and procedures to guide the assignment, control, and resolution of Federal Government entity cases. As a result, the Brookhaven Campus could not determine the exact receipt/assignment date or current status of balance-due and delinquent-return cases in its inventory. Information gathering on State and local government entity delinquency trends is similarly minimal despite an IRS procedure requiring that, prior to

¹ The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

² The unit in the Area Offices consisting of revenue officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns. An Area Office is a geographic organizational level used by IRS business units and offices to help their specific types of taxpayers understand and comply with tax laws and issues.

³ *Additional Management Actions Should Be Taken to Ensure That Government Entities' Customers Meet Their Federal Tax Obligations* (Reference Number 2002-10-123, dated September 2002).



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pursuing collection actions against government entities, revenue officers and/or their managers contact the Federal, State, and Local Governments (FSLG) office Specialist designated for their respective offices. Our review of 133 State and local government entity delinquency cases assigned to revenue officers indicated this procedure was followed in only 7 cases.

Finally, the IRS needs to develop alternative strategies to address delinquent Federal Government entity accounts that the Brookhaven Campus could not readily resolve. In general, Federal Government agencies cannot use current year funding to satisfy prior year debts, and prior year funding is often limited at the start of a new fiscal year.

Our review of the inventory of Federal Government entity delinquent tax cases located at the Brookhaven Campus as of December 2006 indicated 99 entities owing \$5.8 million had been assigned for resolution for more than 1 year. The IRS informed us it plans to perform an onsite review of a sample of aged delinquencies to gain a better understanding of the reasons why these entities are unable to timely resolve their outstanding tax debts.

Recommendations

We recommended the Director, Collection, SB/SE Division, in coordination with the Director, FSLG, TE/GE Division, develop a methodology for recording and sharing information regarding case resolution actions and causes of all Federal Government entity delinquencies; reinforce IRS procedures requiring revenue officers or their managers to contact FSLG office Specialists prior to pursuing collection actions against government entities and explore the feasibility of preparing a quarterly report of new State and local government entities assigned to the Collection Field function; ensure comprehensive guidelines and procedures are developed to guide the assignment, control, and resolution of Federal Government entity cases; reinforce existing IRS procedures regarding issuance of a final notice of the intent to levy⁴ to a State or local government entity; and continue ongoing efforts to develop a process for resolving aged delinquent Federal entity accounts.

Response

IRS management agreed with our recommendations. A new database has been developed to capture the causes and case resolutions for all open and closed Federal Government delinquency cases worked by the Brookhaven Campus special unit and a process will be created to share this information with the FSLG office. The SB/SE Division will also work with the TE/GE Division to create a single point of contact within the FSLG office for revenue officers and determine the content, creation, delivery, and use of a quarterly report of new State and local government

⁴ A levy is a means to take property by legal authority to satisfy a tax debt. The IRS uses a levy as a tool to collect on balance-due accounts that are not being voluntarily paid.



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entities assigned to the Collection Field function. Additionally, the development of the new database allows for complete inventory management, in-process case monitoring, and the inclusion of a current compliance indicator. The SB/SE Division will also issue a memorandum to remind and inform revenue officers of their notification requirements regarding issuing a final notice of the intent to levy to a State or local government entity. Finally, SB/SE Division analysts continue to review current procedures, identify obstacles, explore alternative procedures and case processes, and identify opportunities for improvement to resolve these cases. Once this analysis is completed, the team will create a report and present its findings and recommendations to IRS executives for consideration. Management's complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Nancy Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.



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Abbreviations

CFO	Chief Financial Officer
FSLG	Federal, State, and Local Governments
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
TE/GE	Tax Exempt and Government Entities



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Background

Government entities, including those in the Federal Government, are not exempt from meeting employment tax deposit and reporting requirements. According to the Internal Revenue Service (IRS), 86,000 Federal, State, and local government entities in the United States are involved, as employers, in Federal employment tax withholding and wage reporting. Although this segment comprises a relatively small portion of the almost 6 million total employment tax filers, Federal, State and Local Governments (FSLG) office customers file and pay employment taxes for their more than 23 million employees (20 percent of the United States workforce). FSLG office customers pay wages in excess of \$760 billion and employment taxes in excess of \$200 billion annually.

The Tax Exempt and Government Entities (TE/GE) Division has primary responsibility for employment tax returns filed by TE/GE Division taxpayers. The FSLG office within the TE/GE Division has primary responsibility for ensuring employment tax returns are accurately filed and paid by Federal Government entities, United States possessions, State and local government entities, and quasi-governmental entities. The FSLG office focuses on assisting government entities in understanding their tax obligations, identifying compliance issues, and correcting noncompliance through its compliance program and customer education and outreach programs. The FSLG office is also responsible for conducting compliance checks¹ and examinations² of government entity tax returns. If government entities do not timely file or pay employment tax obligations, the Small Business/Self-Employed (SB/SE) Division is responsible for seeking repayment and securing past due tax returns.

In a previous audit report,³ we identified that the TE/GE Division did not have an effective agreement with the SB/SE Division to ensure government entities complied with Federal tax requirements for the submission of tax returns and related payments. That report identified more than 12,000 Federal, State, and local government entities as delinquent in Calendar Years 1999, 2000, and 2001. Additional analysis of these entities showed 2,697 entities had not submitted their required tax payments and 1,604 entities had not submitted their required tax returns.

¹ A compliance check is a voluntary contact with a government entity that involves a review of its filed information and tax returns; this check does not relate to determining a tax liability for any particular period. The compliance check is a tool to help educate government entities about their reporting requirements and increase voluntary compliance.

² An examination is an inspection of an individual's or an entity's books and records. In addition, an examination involves the questioning of witnesses to determine the individual's or entity's correct tax liability.

³ *Additional Management Actions Should Be Taken to Ensure That Government Entities' Customers Meet Their Federal Tax Obligations* (Reference Number 2002-10-123, dated September 2002).



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Currently, the SB/SE Division provides collection services to the TE/GE Division under a 5-year Memorandum of Understanding effective through Fiscal Year 2011. Under this Memorandum, the SB/SE Division is responsible for providing services for the resolution of government entity collection cases and calculation of the performance measures used to evaluate the effectiveness of the collection program. Such measures include the number of TE/GE Division taxpayer records entering the SB/SE Division Collection Field function⁴ and the number of TE/GE Division taxpayer records resolved.

This review was performed at the Detroit, Michigan; New York, New York; and Nashville, Tennessee, SB/SE Division Area Offices; the Brookhaven Campus⁵ in Holtsville, New York; the IRS National Headquarters in the SB/SE Division, in New Carrollton, Maryland; and the Office of the Chief Financial Officer (CFO) in Washington, D.C., during the period July 2006 through March 2007. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁴ The unit in the Area Offices consisting of revenue officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns. An Area Office is a geographic organizational level used by IRS business units and offices to help their specific types of taxpayers understand and comply with tax laws and issues.

⁵ 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

***Efforts to Collect Delinquent Employment Taxes Owed by
Government Entities Have Been Enhanced***

The IRS has enhanced its efforts to address delinquent employment taxes owed by government entities in several areas. For example, three different IRS functional offices (the TE/GE Division, the SB/SE Division, and the CFO) formed a working group to discuss ways to address Federal Government agency employment tax delinquencies. Additionally, in June 2005, the CFO issued letters to the CFOs of each Federal Government agency that owed employment taxes in an attempt to inform senior-level management of the taxes owed and resolve the delinquencies at the agency level. Finally, beginning in June 2005, the SB/SE Division established a special unit in the Brookhaven Campus to address Federal Government entity tax delinquency cases. This unit was established to work directly with delinquent Federal Government agencies to reduce the tax due through payments, filing of tax returns, and corrections to accounts, as necessary. As of December 2006, approximately \$45 million in delinquent employment taxes related to Federal Government entities was assigned to the Brookhaven Campus for resolution. It is critical to the image of the United States that Federal Government entities be held to the same standards as private employers.

Delinquent employment taxes owed by State and local government entities are addressed by the SB/SE Division using standard collection processes. As of January 2007, delinquent State and local government entity accounts totaling \$254 million were assigned to the SB/SE Division Collection Field function for resolution. The IRS informed us that, in comparison, almost \$6 billion in delinquent business employment taxes was assigned to the Collection Field function as of January 2007. Collection services are provided pursuant to a Memorandum of Understanding between the SB/SE and TE/GE Divisions.

In our opinion, this approach represents a marked increase in emphasis since the last time we reviewed this area. Specifically, in 2002, we reported that the TE/GE Division did not have an effective agreement with the SB/SE Division to provide for allocation of the resources necessary to help ensure government entities complied with Federal tax requirements for the submission of tax returns and related payments.

Despite these efforts, the IRS needs to take additional actions in three key areas to effectively address government entity employment tax delinquencies. Specifically, the IRS needs to:



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1. Expand efforts to identify and address the causes of government entity employment tax delinquencies.
2. Strengthen controls over case processing and administration of enforcement actions on government entity cases.
3. Develop alternative strategies to address delinquent Federal Government entity accounts that the Brookhaven Campus cannot readily resolve.

Efforts to Identify and Address the Causes of Government Entity Tax Delinquencies Need to Be Expanded

Although the IRS has expanded its efforts to collect delinquent employment taxes owed by government entities, progress in identifying and addressing the causes of these delinquencies has been limited. For example, the special unit established at the Brookhaven Campus to address Federal Government entity delinquencies does not routinely track information regarding how these cases are resolved or gather data during the collection process on the causes of the delinquencies. Without this type of information, the IRS cannot effectively identify taxpayer knowledge gaps and direct its outreach and education efforts. Federal Government entity tax delinquencies represent an ongoing problem for the IRS and, in our opinion, cannot be effectively addressed without reliable trend information regarding the causes of these delinquencies. During the first quarter of Fiscal Year 2007, approximately \$8.5 million in new delinquencies from 51 Federal Government entities were assigned to the Brookhaven Campus. However, we were unable to readily determine the amount collected by the Brookhaven Campus from resolved Federal Government entity cases during this period because the IRS does not routinely track this type of information.

Information gathered regarding State and local government entity delinquency trends is similarly minimal despite an IRS procedure requiring that, prior to pursuing collection actions against government entities, revenue officers and/or their managers contact the FSLG office Specialist designated for their respective offices. Our review of 133 State and local delinquency cases assigned to revenue officers indicated this procedure was followed in only 7 cases. FSLG office Specialists serve as a point of contact for their customers and work with government entities to help bring those entities into compliance. Without these contacts by the SB/SE Division, FSLG office Specialists have no way of readily determining which State and local government entities in their geographic areas of responsibility are assigned to the Collection Field function for resolution of outstanding tax delinquencies. As discussed previously, delinquent State and local government entity accounts totaling \$254 million were assigned to the SB/SE Collection Field function for resolution as of January 2007.

The primary cause for the lack of useful trend information regarding government entity delinquencies is a lack of recording and sharing of information between the SB/SE Division and the TE/GE Division. We also found that not all SB/SE Division field-level collection managers



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were aware of the requirement to contact the FSLG office Specialists when working State and local government entity delinquencies. The collection and analysis of reliable trend data related to government entity delinquencies would help both Divisions in their efforts to address noncompliance of this taxpayer segment through sound planning, management, and oversight.

Recommendations

Recommendation 1: The Director, Collection, SB/SE Division, in coordination with the Director, FSLG, TE/GE Division, should develop a methodology for recording and sharing information regarding case resolution actions and causes of all Federal Government entity delinquencies processed by the Brookhaven Campus, to allow the FSLG office to better focus outreach and education efforts for this taxpayer segment.

Management's Response: IRS management agreed with this recommendation. A new database has been developed that captures the causes and case resolutions for all open and closed Federal Government delinquency cases worked by the Brookhaven Campus special unit. Also, SB/SE Division Collection Policy and Campus analysts will create a process to share this information with the FSLG office for the purpose of enabling the FSLG office to focus outreach and educational efforts for this taxpayer segment.

Recommendation 2: The Director, Collection, SB/SE Division, should 1) reinforce IRS procedures requiring that revenue officers and/or their managers contact FSLG office Specialists designated for their respective offices prior to pursuing collection actions against government entities and 2) work with the FSLG office to explore the feasibility of preparing a quarterly report of new State and local government entities assigned to the Collection Field function. The report would help ensure FSLG office Specialists are aware of new State and local government entity delinquencies and provide useful nationwide trend information regarding these types of cases. This report could also serve as a supplemental notice if revenue officers do not always contact the FSLG office Specialists.

Management's Response: IRS management agreed with this recommendation. The SB/SE Division will work with the TE/GE Division to simplify the notification process by creating a single point of contact in the FSLG office for revenue officers. Additionally, the SB/SE Division and the TE/GE Division FSLG office will meet to determine the content, creation, delivery, and use of a quarterly report of new State and local government entities assigned to the Collection Field function.



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**Controls Over Case Processing and the Administration of
Enforcement Actions on Government Entity Delinquency Cases Need
to Be Strengthened**

Our review of a random sample of 133 State and local government and 42 Federal Government entity delinquency cases identified 3 areas in which controls over the processing of these types of cases needs to be improved. Specifically, we found:

- In 22 (52 percent) of the 42 Federal Government entity delinquency cases, the Brookhaven Campus focused only on assigned delinquencies and did not evaluate the taxpayers' current compliance with their tax obligations as part of its research or correspondence/contacts with taxpayers. In 3 (14 percent) of the 22 cases, the taxpayers had not filed 1 or more required returns and/or made required Federal tax deposits.
- In 42 (89 percent) of the 47 State and local government entity cases for which a final notification letter informing the taxpayer of the IRS' intention to levy⁶ was issued, the revenue officer did not notify the Territory manager,⁷ as required, before issuing the final notification letter. In eight of these cases, a levy was subsequently filed against the taxpayer.
- In 19 (14 percent) of the 133 State and local government entity cases and 7 (17 percent) of the 42 Federal Government entity delinquency cases, we identified periods of significant inactivity after the cases had been assigned. The periods of inactivity ranged from 84 days to more than 1 year.

The Brookhaven Campus, which assumed responsibility for addressing Federal Government entity tax delinquency cases in June 2005, did not consistently address unfiled employment tax returns (including both current and prior year returns) until after June 2006. Prior to June 2006, cases in which a Federal Government entity was under investigation for not filing one or more required tax returns were not assigned for resolution. As of December 2006, 143 Federal Government entities still had not filed 750 required tax returns. Over 95 percent of the 750 tax returns not filed related to employment taxes.

Finally, management information regarding Federal Government entity cases assigned to the Brookhaven Campus special unit is not sufficiently comprehensive to allow for effective oversight of this critical process. For example, at the time of our review, it was difficult to readily determine from available management information the exact receipt/assignment date or current status of the Federal Government entity balance-due and delinquent-return cases assigned to the special unit at the Brookhaven Campus.

⁶ A levy is a means to take property by legal authority to satisfy a tax debt. The IRS uses a levy as a tool to collect on balance-due accounts that are not being voluntarily paid.

⁷ A Territory Manager is a second-level manager who oversees groups in a geographic area.



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In general, the conditions we identified are attributable to a lack of comprehensive guidelines and procedures to guide the assignment, control, and resolution of Federal Government entity cases. In addition, not all Collection Field function managers we interviewed were aware that revenue officers on their staff were required to notify the SB/SE Division Territory manager before issuing the Final Notice letter to a government entity. This notification requirement ensures Collection Field function management is timely informed of planned collection actions involving government entities, including potentially sensitive entities such as school districts or rescue worker retirement funds.

The maintenance of accurate data regarding case assignment and actions is essential to the effective management of work-in-process at the Brookhaven Campus. In addition, addressing the filing of current returns as part of the processing of Federal Government entity delinquencies will assist these Federal Government entities in avoiding future delinquencies.

Recommendations

Recommendation 3: The Director, Collection, SB/SE Division, should ensure comprehensive guidelines and procedures are developed to guide the assignment, control, and resolution of Federal Government entity delinquency cases. These procedures should at a minimum: 1) establish a reliable methodology for controlling assigned cases and monitoring the status of in-process work and 2) include a requirement that a determination of current compliance with tax obligations be made on all assigned cases.

Management's Response: IRS management agreed with this recommendation. A new database has been developed which allows for complete inventory management, monitoring of in-process cases, and the inclusion of a current compliance indicator.

Recommendation 4: The Director, Collection, SB/SE Division, should reinforce existing IRS procedures requiring that revenue officers notify the appropriate SB/SE Division Territory manager before issuing a final notice of the intent to levy to a State or local government entity.

Management's Response: IRS management agreed with this recommendation. The SB/SE Division will review this notification procedure and determine if any changes are needed prior to reinforcing the existing procedures. A memorandum will be issued to remind revenue officers of the notification requirement and/or to inform them of any changes.

Alternative Strategies Need to Be Developed to Address Delinquent Federal Government Entity Accounts That the Brookhaven Campus Could Not Readily Resolve

The collection of aged debts from Federal Government entities represents a unique challenge to the IRS because, in general, Federal Government agencies cannot use current funding to satisfy



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debts properly chargeable to a prior year. In addition, prior year funding is often limited and generally remains open for only 5 years.

Our review of the inventory of Federal Government entity delinquent tax cases located at the Brookhaven Campus as of December 2006 indicated 99 entities owing \$5.8 million had been assigned for resolution for more than 1 year. More than \$1 million of the \$5.8 million related to tax years 2001 and earlier. As discussed previously, as of December 2006, 143 Federal Government entities still had not filed 750 required tax returns. Further, 466 (62 percent) of the 750 unfiled returns related to tax periods at least 3 years old. The continued existence of significantly aged delinquent Federal Government entity accounts, despite the IRS' repeated attempts to secure repayment, raises the possibility that these entities may simply not have the funding available to satisfy these delinquencies.

At the time of our review, the IRS lacked a viable methodology for addressing aged Federal Government entity delinquencies that the Brookhaven Campus cannot readily resolve. Further, IRS policy prohibits the use of enforcement actions, such as the filing of liens or levies, against Federal entities. Thus, the ability of the IRS to enforce collection of delinquent taxes from Federal Government entities is limited. The IRS informed us it plans to perform an onsite review of a sample of aged delinquencies, to gain a better understanding of the reasons why these entities are unable to timely resolve their outstanding tax debts. This onsite review is tentatively scheduled for late in Fiscal Year 2007.

Recommendation

Recommendation 5: The Director, Collection, SB/SE Division, should continue ongoing efforts to develop a process for resolving aged delinquent Federal Government entity accounts.

Management's Response: IRS management agreed with this recommendation. SB/SE Division analysts continue to review current procedures, identify obstacles, explore alternative procedures and case processes, and identify opportunities for improvement to resolve these cases. Once this analysis is completed, the team will create a report and present its findings and recommendations to IRS executives for consideration.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether the IRS has implemented an effective process to collect delinquent employment taxes and secure delinquent returns owed by Federal, State, and local government entities. To accomplish this objective, we:

- I. Determined whether the IRS has developed a coordinated national strategy for addressing government entity employment tax delinquencies.
 - A. Interviewed appropriate TE/GE Division, SB/SE Division, and CFO personnel to obtain their perspectives regarding barriers to the timely collection of delinquent employment taxes owed by Federal, State, and local government entities.
 - B. Ascertained whether the roles and responsibilities of the TE/GE and SB/SE Divisions and Office of the CFO in collecting delinquent employment taxes owed by Federal, State, and local government entities are clearly identified in a current Memorandum of Understanding and are adequate for ensuring effective oversight.
- II. Ascertained whether field-level controls are effective to ensure government entity employment tax delinquencies are resolved timely and effectively.
 - A. Identified and selected random samples of in-process cases from three randomly selected SB/SE Division Collection Area Offices¹ and the Brookhaven Campus² in Holtsville, New York. Seven SB/SE Division Area Offices maintain responsibility for domestic taxpayers. To reduce the possibility of introducing bias factors into our sample, in July 2006 we chose a random sample of 133 State and local government entity cases from the population of 873 cases in the SB/SE Division Collection Field function offices.³ These cases were residing in the Integrated Collection System at the time our sample was selected (the total population of government entity cases at this time was 926). From 2 current inventory lists containing 506 total Federal Government entity cases provided by the Brookhaven Campus special unit, we chose a random sample of 42 cases.

¹ A geographic organizational level used by IRS business units and offices to help their specific types of taxpayers understand and comply with tax laws and issues.

² The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

³ The unit in the Area Offices consisting of revenue officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.



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- B. Reviewed the selected cases to determine whether adequate and effective efforts were taken to resolve the delinquencies and secure any delinquent returns.
 - C. Interviewed selected SB/SE Division Collection Field function managers to obtain their input/concerns regarding the IRS' current approach to collecting delinquent employment taxes from government entities.
 - D. Interviewed selected field office managers from the FSLG office to obtain their input/concerns regarding the FSLG office's efforts within the IRS' current approach to collecting delinquent employment taxes from government entities.
 - E. Identified the total current population of all FSLG office entities with delinquencies and stratified the results by the collection status of the delinquencies. For this analysis, we made a Master File⁴ data request in December 2006. To validate the reliability of the electronic data extracted, we compared it to SB/SE Division Collection Field function inventory contained on the Integrated Collection System and inventory lists maintained by the CFO. We determined the reliability of the electronic data was adequate and valid for use in making analytical conclusions. We relied on information provided by the IRS regarding total employment tax filers, total FSLG entities involved as employers, and total delinquent business employment taxes. We did not verify the accuracy of this information.
- III. Determined the effectiveness of the CFO's efforts to assist in the resolution of government entity employment tax delinquencies.
- A. Interviewed selected CFO personnel to obtain their input/concerns regarding the IRS' current approach to collecting delinquent employment taxes from government entities. We ascertained any barriers encountered when attempting to assist in resolving government entity delinquencies as well as any new initiatives/best practices.
 - B. Reviewed actions taken by the Office of the CFO in Fiscal Years 2005 and 2006 to assist in the resolution of government entity employment tax delinquencies.

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



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Appendix II

Major Contributors to This Report

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Arlene Feskanich, Information Technology Specialist



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Appendix III

Report Distribution List

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Office of the Commissioner – Attn: Acting Chief of Staff C
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Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Campus Compliance Services, Small Business/Self-Employed Division SE:S:CCS
Director, Collection, Small Business/Self-Employed Division SE:S:C
Director, Government Entities, Tax Exempt and Government Entities Division SE:T:GE
Director, Collection Policy, Small Business/Self-Employed Division SE:S:C:CP
Director, Campus Compliance Operations, Brookhaven, Small Business/Self-Employed Division
SE:S:CCS:CCO:BR
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Appendix IV

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

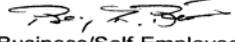
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INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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JUL 30 2007

July 25, 2007

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kathy K. Petronchak 
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report - Efforts to Collect Delinquent Employment
Taxes Owed by Government Entities Could Be Improved
(Audit # 200610034)

We have reviewed your draft report on the collection of delinquent employment taxes owed by government entities and agree with the recommendations.

We appreciate your acknowledgment of our efforts to improve the procedures to collect delinquent employment taxes and secure delinquent returns owed by federal, state and local government entities. Steps taken to improve management of this casework, include the consolidation of federal agency accounts at the Brookhaven Campus and coordinated efforts to address issues with the Tax Exempt & Government Entities (TE/GE) Division and the Office of the Chief Financial Officer. Additionally, during the course of the audit, the Brookhaven Campus implemented a new database to capture the causes and case resolutions for all delinquencies open and closed by the Federal Agency Delinquency (FAD) team.

Assuring governmental agencies comply with employment tax laws is important to us and we appreciate your input on opportunities to further improve this process.

Attached are detailed comments on the recommendations. If you have any questions or concerns, please contact me at (202) 622-0200 or David Alito, Director, Collection, at (202) 283-7660.

Attachment



*Efforts to Collect Delinquent Employment Taxes Owed by
Government Entities Could Be Improved*

Attachment

Recommendation 1:

The Director, Collection, SB/SE Division, in coordination with the Director, FSLG, TE/GE Division, should develop a methodology for recording and sharing information regarding case resolution actions and causes of all Federal Government entity delinquencies processed by the Brookhaven Campus, to allow the FSLG office to better focus outreach and education efforts for this taxpayer segment.

Corrective Action:

The Brookhaven Federal Agency Delinquency (FAD) Team has developed a database that captures the causes and case resolution(s) for all delinquencies open and closed by the team. Collection Policy and Campus analysts, in coordination with TE/GE FSLG and the Brookhaven Compliance Services Collection Operations (CSCO), will create a process to share this information with FSLG for the purpose of enabling FSLG to focus outreach and educational efforts for this taxpayer segment. Tax examiners are also identifying and advising taxpayers of return delinquencies prior to receipt of CFO case listings. This is referred to as Voluntary Compliance Cases.

Implementation Date:

The database was implemented in May 2007. The process to share the information will be implemented by September 30, 2007.

Responsible Official:

Director, Collection, SB/SE Division

Corrective Action Monitoring Plan:

The SB/SE Commissioner will monitor the efforts of the Director, Collection contained in this commitment to corrective actions.

Recommendation 2:

The Director, Collection, SB/SE Division, should 1) reinforce IRS procedures requiring that revenue officers and/or their managers contact FSLG office Specialists designated for their respective offices prior to pursuing collection actions against government entities and 2) work with the FSLG office to explore the feasibility of preparing a quarterly report of new State and local government entities assigned to the Collection Field function. The report would help ensure FSLG office Specialists are aware of new State and local government entity delinquencies and provide useful nationwide trend information regarding these types of cases. This report could also serve as a supplemental notice if revenue officers do not always contact the FSLG office Specialists.



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Corrective Action:

IRS management agrees with this recommendation.

1) SB/SE will work with TE/GE to simplify the notification process by creating a single point of contact in FSLG for revenue officers. A memo detailing the new contact procedure will be issued to the field and changes will be included in the next revision of the IRM.

2) SB/SE and the TE/GE FSLG office will meet to determine the content, creation, delivery, and use of a quarterly report of new state and local government entities assigned to the Collection field function. Elements to be explored are the types of data elements needed for the report, the potential sources of the data elements, the program needed to create the report, the method of delivery and any work request requirements. If warranted, a work request will be submitted to generate the report.

Implementation Date:

Element 1 – The memorandum will be issued by September 30, 2007; changes will be included in the next IRM revision scheduled for August 31, 2008.

Element 2 – Any work request needed to generate this report will be submitted by December 31, 2007, with the report delivery date to be determined by the supplier.

Responsible Official:

Director, Collection, SB/SE

Corrective Action Monitoring Plan:

The SB/SE Commissioner will monitor the efforts of the Director, Collection contained in this commitment to corrective actions.

Recommendation 3:

The Director, Collection, SB/SE Division, should ensure comprehensive guidelines and procedures are developed to guide the assignment, control, and resolution of Federal Government entity delinquency cases. These procedures should at a minimum: 1) establish a reliable methodology for controlling assigned cases and monitoring the status of in-process work and 2) include a requirement that a determination of current compliance with tax obligations be made on all assigned cases.

Corrective Action:

With the development and implementation of the new database, the listings received from CFO are imported into it. This transmission allows for complete inventory management and quick access to all reports and queries. In addition, reports for causes and case resolutions for all TDA and TDI cases are utilized to assist in taxpayer outreach and education. Compliance Policy and Campus Filing and Payment Compliance analysts have completed an onsite visit and are



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currently developing additional case procedures for inclusion in the IRM used by the Brookhaven FAD team.

In-process cases are monitored on the CCA Report and database by the team leader and tax examiners through IDRS.

Current compliance is indicated on the new database. All TDA and TDI issues are addressed by tax examiners. Tax examiners also identify and advise taxpayers of return delinquencies prior to receipt of CFO case listings. These are referred to as Voluntary Compliance Cases.

Implementation Date:

The database was implemented in May 2007. Applicable changes to the IRM for campus procedures are scheduled for publishing by August 31, 2008.

Responsible Official:

Director, Collection, SB/SE Division

Corrective Action Monitoring Plan:

The SB/SE Commissioner will monitor the efforts of Director, Collection, to ensure the Brookhaven FAD Team continues to monitor database reports and the CCA report (Age Listing).

Recommendation 4:

The Director, Collection, SB/SE Division, should reinforce existing IRS procedures requiring that revenue officers notify the appropriate SB/SE Division Territory manager before issuing a final notice of the intent to levy to a State or local government entity.

Corrective Action:

IRS management agrees with this recommendation. SB/SE will review this notification procedure and determine if any changes are needed prior to reinforcing the existing procedures. A memorandum will be issued to remind revenue officers of the notification requirement and/or to inform them of any changes. If procedural changes are warranted, they will be included in the next revision of the IRM.

Implementation Date:

The memorandum to revenue officers will be issued by September 30, 2007. If required, any changes to the notification process will be included in the next revision of the IRM, scheduled for August 31, 2008.



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Responsible Official:

SBSE, Director, Collection

Corrective Action Monitoring Plan:

The SB/SE Commissioner will monitor the efforts of the Director, Collection contained in this commitment to corrective actions.

Recommendation 5:

The Director, Collection, SB/SE Division, should continue ongoing efforts to develop a process for resolving aged delinquent Federal Government entity accounts.

Corrective Action:

During the week of May 21, 2007, Campus and Collection Policy analysts met with the FAD Team to discuss and develop IRM procedures at the Brookhaven Campus. Analysts continue to review current procedures, identify obstacles, explore alternative procedures and case processes, and identify opportunities for improvement to resolve these cases. Once this analysis is completed, the team will create a report and present its findings and recommendations to IRS executives for consideration.

Implementation Date:

Team members will report its recommendations by September 30, 2007.

Responsible Official:

Director, Collection, SB/SE Division

Corrective Action Monitoring Plan:

The SB/SE Commissioner will monitor the efforts of the Director, Collection contained in this commitment to corrective actions.