



*Fiscal Year 2007 Statutory Review of  
Compliance With Lien Due Process  
Procedures*

**March 20, 2007**

**Reference Number: 2007-30-051**

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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TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

March 20, 2007

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

*Michael R. Phillips*

**FROM:**

Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Fiscal Year 2007 Statutory Review of Compliance  
With Lien Due Process Procedures (Audit # 200630032)

This report presents the results of our review of the Internal Revenue Service's (IRS) Lien Due Process Procedures. The overall objective of this review was to determine whether IRS Notice of Federal Tax Lien filings and notices of taxpayers' appeal rights complied with legal guidelines set forth in Internal Revenue Code Section (I.R.C. §) 6320.<sup>1</sup> The Treasury Inspector General for Tax Administration is required by law to determine annually whether lien notices sent by the IRS comply with the legal guidelines in I.R.C. § 6320.<sup>2</sup> This is our ninth annual audit to determine the IRS' compliance with the law and with its own related internal guidelines when sending lien notices.

*Impact on the Taxpayer*

After filing Notices of Federal Tax Lien, the IRS must notify the affected taxpayers in writing within 5 business days of the lien filings. The IRS has not always complied with this statutory requirement. Therefore, the taxpayers' rights to appeal the lien filings may be jeopardized.

*Synopsis*

The IRS attempts to collect Federal taxes due from taxpayers by sending letters, making telephone calls, and meeting face to face with taxpayers. When initial contacts by the IRS do not result in the successful collection of unpaid tax, the IRS has the authority to attach a claim

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<sup>1</sup> I.R.C. § 6320 (Supp. V 1999).

<sup>2</sup> I.R.C. § 7803(d)(1)(A)(iii) (Supp. V 1999).



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(called a Federal Tax Lien) to the taxpayer's assets for the amount of the unpaid tax.<sup>3</sup> The IRS files a Notice of Federal Tax Lien, which notifies interested parties that a lien exists. Since January 19, 1999, I.R.C. § 6320 has required the IRS to notify taxpayers in writing within 5 business days of the filing of a Notice of Federal Tax Lien.

The IRS did not comply with the law in all cases. Our review of a statistically valid sample of 150 Federal Tax Lien cases identified 142 cases (95 percent) for which the IRS did mail lien notices timely and correctly as required by I.R.C. § 6320 and internal procedures. Four lien notices (about 3 percent) were not sent timely; for another 4 lien notices (about 3 percent), we could not determine if the IRS complied with the law because the IRS could not provide proof of mailing. When an initial lien notice is returned because it could not be delivered and a different address is available for the taxpayer, the IRS is not always meeting its statutory requirement to send the lien notice to the taxpayer's last known address.

***The IRS did not comply with the legal guidelines in all cases. In 4 of 150 Federal Tax Lien cases, the IRS issued lien notices after the required period.***

Also, the IRS did not always follow its own internal guidelines for notifying taxpayer representatives of the filing of lien notices. For 15 (60 percent) of the 25 cases in which the taxpayer had a representative at the time of the IRS lien actions, the IRS did not notify the taxpayer's representative of the lien filing.

### *Recommendations*

We recommended the Director, Collection, Small Business/Self-Employed Division, consult with the IRS Office of Chief Counsel to identify any actions necessary to correct the potential legal violations we identified in this audit. We also recommended the Director, Collection, Small Business/Self-Employed Division, reestablish procedures for (1) controlling and processing returned mail as undelivered, refused, or unclaimed and (2) returning undelivered lien notices to the initiators of the Notices of Federal Tax Lien. In addition, management should change the procedures for routing undelivered mail among three offices.

### *Response*

IRS management agreed with our findings and recommendations. The IRS will issue new lien notices to the eight taxpayers we had identified and will review procedures for mailing notices and maintaining certified mailing lists. Management has revised procedures requiring employees to conduct research for last known addresses so immediate appropriate actions can be taken on undelivered mail. In addition, management will initiate discussions to determine whether

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<sup>3</sup> I.R.C. § 6321 (1994).



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returning notices to originators provides a benefit to taxpayers and the IRS. Management's complete response to the draft report is included as Appendix VII.

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 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
ALS	Automated Lien System
CLU	Centralized Lien Unit
FY	Fiscal Year
ICS	Integrated Collection System
IDRS	Integrated Data Retrieval System
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration



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## *Background*

The Internal Revenue Service (IRS) attempts to collect Federal taxes due from taxpayers by sending letters, making telephone calls, and meeting face to face with taxpayers. When initial contacts by the IRS do not result in the successful collection of an unpaid tax, the IRS has the authority to attach a claim to the taxpayer's assets for the amount of unpaid tax.<sup>1</sup> This claim is referred to as a Federal Tax Lien. The IRS files in appropriate local government offices a Notice of Federal Tax Lien,<sup>2</sup> which notifies interested parties that a lien exists.

Since January 19, 1999, Internal Revenue Code Section (I.R.C. §) 6320<sup>3</sup> has required the IRS to notify taxpayers in writing within 5 business days of the filing of a Notice of Federal Tax Lien. The IRS is required to notify taxpayers the first time a Notice of Federal Tax Lien is filed for each tax period. The Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320<sup>4</sup> (lien notice) is used for this purpose and advises taxpayers that they have 30 calendar days, after that 5-day period, to request a hearing with the IRS Appeals office. The lien notice indicates the date on which this 30-day period expires.

***The IRS must notify taxpayers in writing of the filing of a Federal Tax Lien within 5 business days of the filing.***

The law also requires that the lien notice explain, in simple terms, the amount of unpaid tax, administrative appeals available to the taxpayer, and provisions of the law and procedures relating to the release of liens on property. The lien notice must be given in person, left at the taxpayer's home or business, or sent by certified or registered mail to the taxpayer's last known address.

The lien processing operation has been centralized at the Cincinnati, Ohio, Campus,<sup>5</sup> except for the printing and mailing of taxpayer lien notices. The centralization took most of Fiscal Year (FY) 2005 to be implemented. The National Print Sites in Detroit, Michigan, and Ogden, Utah, are responsible for the printing and mailing of taxpayer lien notices. They have a goal to reduce the number of untimely issued lien notices by using mail facilities located at their sites. IRS personnel take the mail lists and lien notices to the Mail unit, where they are metered

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<sup>1</sup> Internal Revenue Code Section 6321 (1994).

<sup>2</sup> Notice of Federal Tax Lien (Form 668(Y) (C); (Rev. 10-1999)), Cat. No. 60025X.

<sup>3</sup> I.R.C. § 6320 (Supp. V 1999).

<sup>4</sup> Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320 (Letter 3172 (Rev. 11-2004)), Cat. No. 26767I.

<sup>5</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.

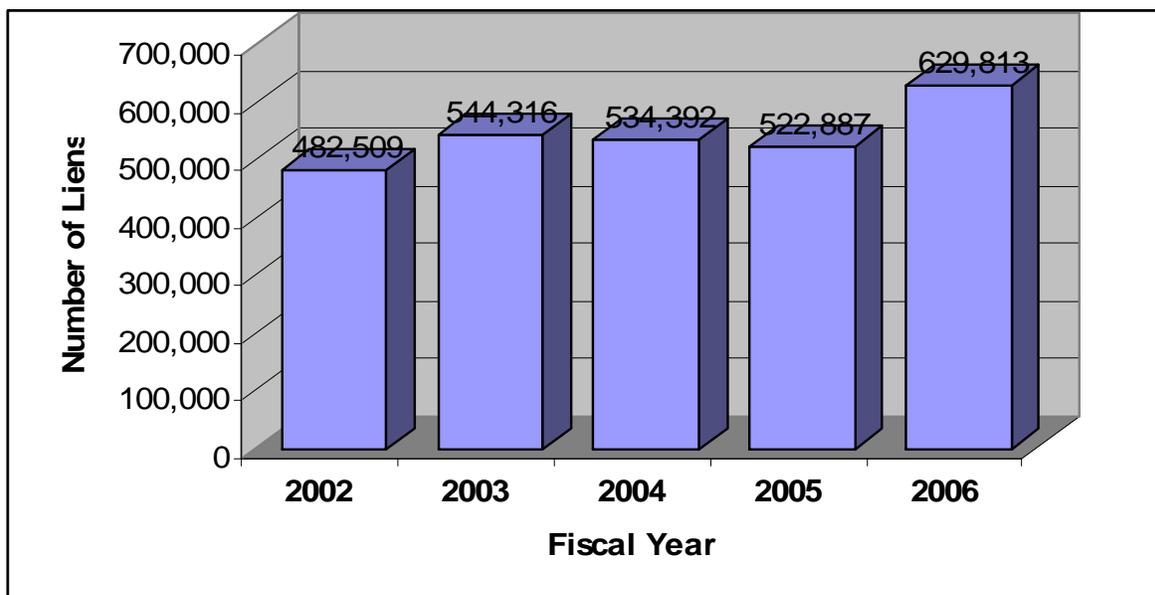


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and prepared daily for shipment to the main post office. In the in-house mail facility, a United States Postal Service employee is responsible for date stamping the certified mail lists. After these mail lists are stamped, an IRS employee sends them to the Centralized Lien Unit (CLU) via overnight mail. A synopsis of the IRS collection and lien filing processes is included in Appendix V. A description of IRS computer systems used in the filing of liens is included in Appendix VI.

The IRS has been relatively consistent in the number of Federal Tax Liens it has filed to protect the Federal Government's interest. The number of Notices of Federal Tax Lien filed increased from FY 2002 to FY 2003, decreased slightly in FYs 2004 and 2005, then increased in FY 2006. Figure 1 shows the number of Notices of Federal Tax Lien filed in the last 5 fiscal years.

**Figure 1: Liens Filed**



Source: *IRS Data Book 2005* and IRS personnel.<sup>6</sup>

The Treasury Inspector General for Tax Administration (TIGTA) is required annually to determine whether, when filing Notices of Federal Tax Lien, the IRS complied with the law regarding the notifications of affected taxpayers and their representatives.<sup>7</sup> We performed our audit work in the Small Business/Self-Employed Division Office of Collection Policy during the period August through December 2006. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and

<sup>6</sup> The IRS Data Book is published annually by the IRS and contains statistical tables and organizational information on a fiscal year basis.

<sup>7</sup> I.R.C. § 7803(d)(1)(A)(iii) (Supp. V 1999).



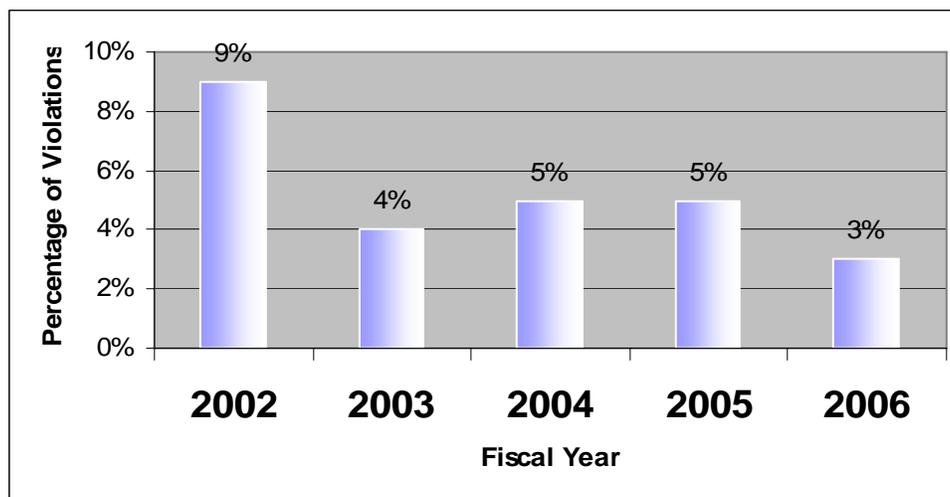
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methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

### **Results of prior TIGTA reviews**

This is our ninth annual audit to determine if the IRS complied with the legal requirements of I.R.C. § 6320, and its own related internal guidelines, when filing Notices of Federal Tax Lien. In prior years, we reported the IRS had not yet achieved full compliance with the law and its own internal guidelines. Figure 2 shows the percentages of potential violations of taxpayer rights.

**Figure 2: Potential Violations of Taxpayer Rights**



Source: TIGTA mandatory lien reviews in FYs 2002 through 2006.



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*Results of Review*

***Lien Notices Were Not Always Mailed Timely, and Proof of Mailing Could Not Always Be Located***

A review of a statistically valid sample of 150 Federal Tax Lien cases identified 142 cases (95 percent) for which the IRS did mail timely and correctly the taxpayers' notices of a lien filing and appeal rights as required by I.R.C. § 6320 and internal procedures. However, the IRS did not comply with internal procedures for 4 taxpayer notices (about 3 percent) that were not sent timely. We estimate that 15,847 lien notices filed between July 1, 2005, and June 30, 2006, could have been mailed late based upon IRS procedures. This year's review showed an improvement in the timeliness of mailing lien notices since completion of our prior audit, which had shown 4.67 percent of the lien notices were sent late (projected to a potential 23,825 late notices).

I.R.C. § 6320 requires the IRS to notify taxpayers in writing within 5 business days of the filing of a Notice of Federal Tax Lien. Because of difficulties in obtaining and controlling the filing dates from numerous courthouses across the country, IRS procedures require that notices be mailed within 5 business days of when the liens are printed for mailing to the courthouses. Management could not provide an explanation as to why the lien notices were not mailed timely. Delays in mailing the lien notices can reduce the time taxpayers have to request a hearing to less than the 30 calendar-day period allowed by the law. These errors could result in violations of taxpayers' rights should they appeal the filing of the lien notices and the IRS deny the requests for appeal.

For another 4 lien notices (about 3 percent), we could not determine if the IRS complied with the law because the IRS could not provide proof of mailing. This is an increase over the 2 lien notices (1.33 percent) we had identified in our prior audit, but it is an improvement from the previous years when the missing certified mail lists averaged 9.9 percent. IRS procedures require retention of the date-stamped copy of the certified mail lists for 10 years after the end of the processing year. Management could not provide an explanation as to why the mail listings were not available. Without the dated proof of mailing, the IRS may be unable to protect itself against a taxpayer's claim that he or she did not receive timely notice of the lien and was unaware a Federal Tax Lien existed against his or her assets.



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## **Recommendation**

**Recommendation 1:** The Director, Collection, Small Business/Self-Employed Division, should consult with the IRS Office of Chief Counsel to identify any actions necessary to correct the potential legal violations we identified in this audit.

**Management's Response:** IRS management agreed with the recommendation. Management has consulted with the IRS Office of Chief Counsel and will issue new lien notices to the eight taxpayers we had identified and will review procedures for mailing notices and maintaining certified mailing lists.

## ***Ineffective Working of Undelivered Lien Notices Resulted in Violations of Taxpayers' Rights***

IRS procedures require that it send a lien notice to a new address if the originally mailed notice is returned because it could not be delivered and a different address is available for the taxpayer. CLU employees are responsible for certain actions when notices are returned as undeliverable. They are required to research the IRS computer system to ensure the address on the original lien notice is correct. If the address on the notice is not the last known address<sup>8</sup> and a different address was in effect prior to issuance of the original lien notice, then they should issue a new notice to the better address within 5 business days of receipt. When a new address is found, the CLU employee should update the Automated Lien System (ALS) to document the undelivered mail and to ensure the new notice is created. If the CLU employee cannot find a new address on the IRS computer system, the undelivered lien notice will be destroyed and the case will be closed.

For the period of June 14 through June 26, 2006, we selected a judgmental sample of 400 undelivered lien notices. The judgmental sample included only returned mail identified as undelivered; it did not include returned mail identified as refused or unclaimed. For these 400 cases, we reviewed computer system audit trails to determine whether CLU employees performed any research on IRS computer systems to determine whether the addresses were correct on the originally mailed notices. Our research showed that CLU employees were not always researching IRS computer systems to determine whether taxpayer addresses on undelivered lien notices were correct. The 400 cases noted above were handled by CLU employees as follows:

- For 60 cases, CLU employees did not research IRS computer systems for different addresses.

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<sup>8</sup> The last known address is that shown on the most recently filed and properly processed tax return, unless the IRS received notification of a different address.



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- For 74 cases, CLU employees performed the required research but not within 5 business days of receipt of the returned notice (average was 7.4 business days, ranging from 6 business days to 8 business days).
- For 266 cases, CLU employees performed the required research within 5 business days of receipt of the returned notice.

Our research also identified 42 cases for which the address on IRS computer systems and the original lien notice did not agree and the CLU employees were not properly updating the ALS to document the undelivered mail. Only 32 of the 42 cases we identified were documented in the ALS as being undelivered. Without properly updating the ALS, the IRS cannot verify the status of the lien notices. [REDACTED]

[REDACTED] however, new lien notices should have been sent in eight additional cases.

Because our review showed CLU employees did not always research the IRS computer systems for last known addresses, the IRS did not meet its statutory requirement of sending each lien notice to the taxpayer's last known address. These cases could involve legal violations.

This condition occurred because procedures are not adequate to ensure returned lien notices are properly controlled and accounted for. In July 2005, IRS management implemented interim guidelines that eliminated the procedures for (1) tracking returned mail as undelivered, refused, or unclaimed on the ALS and (2) returning the undelivered mail to the lien initiator, such as a revenue officer. These temporary procedures were implemented during the centralization of the lien processing operation so the IRS could complete the backlog of returned mail. However, these procedures became permanent in December 2005.

In addition, undelivered lien notices are routed to three locations before they are researched by CLU employees to determine whether the addresses on the original notices are correct. Currently, the mail is received at the Cincinnati Campus in Covington, Kentucky, where it is extracted and sorted by mail type. The returned lien notices are routed to a part of the CLU that is located in a different building; here, the undelivered notices are date stamped, batched, and routed to another city, where CLU employees actually perform the research on IRS computer systems to identify the last known addresses. This routing can delay the processing of the mail, which could have caused the undelivered mail not to be researched within the required 5 business days of receipt of the returned notice.

### ***The IRS National Headquarters conducted a notice compliance review***

In June 2006, the IRS performed a review of CLU activities to ensure procedures are being followed and taxpayers' rights are being protected. This was the first review performed since the lien operation was centralized at the Cincinnati Campus. The review was conducted jointly by Headquarters Operations and the Collection Policy function. The scope of the review was expanded to provide a status update of the lien operation. Normally, the review includes



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analyses to determine if the IRS timely notified taxpayers, business partners, spouses, and taxpayer representatives of the filing of a Notice of Federal Tax Lien and timely processed undelivered mail. The draft report of the IRS review shows results similar to those in our review.

During the IRS compliance review of the CLU operations, personnel randomly selected 100 Automated Collection System (ACS) cases to evaluate compliance with the lien notification requirement. For the sampled cases, 17 lien notices were issued late. Eight of those notices were affected by the printing stoppage that resulted from the landfall of Hurricane Katrina. In addition, the IRS review found that copies of lien notices were appropriately issued to all powers of attorney.

IRS personnel selected another sample of 100 lien cases to evaluate the processing of undelivered lien notices; they determined only 9 undelivered lien notices were appropriately reissued and the remaining 91 cases showed various procedures were not followed. The IRS review team concluded that the I.R.C. legal requirement to issue the lien notice within 5 business days was not met.

### ***Recommendation***

***Recommendation 2:*** The Director, Collection, Small Business/Self-Employed Division, should reestablish procedures for (1) controlling returned lien notice mail on the ALS as undelivered, refused, or unclaimed and (2) returning undelivered lien notices to the initiators of the Notices of Federal Tax Lien. In addition, the Director, Collection, Small Business/Self-Employed Division, should change the procedures for routing undelivered mail among three offices.

***Management's Response:*** IRS management agreed with the recommendation. Management has revised the Internal Revenue Manual requiring employees to conduct research for last known addresses so immediate appropriate actions can be taken on undelivered mail. Management will amend the programming request for the Inbound Return Receipt Notice Delivery System to include lien notice processing. This change will systematically upload mail information to the ALS, thus eliminating the need for retention, date stamping, and filing of certified/registered mail lists. Management will initiate discussions to determine whether returning notices to originators provides a benefit to taxpayers and the IRS.



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***Internal Guidelines for Notifying Taxpayer Representatives Were Not Always Followed***

Taxpayer representative information is contained on the Centralized Authorization File that is located on the Integrated Data Retrieval System (IDRS), a system that enables IRS employees to access taxpayer accounts. Using the IDRS, employees can research the Centralized Authorization File to identify the types of authorization given to taxpayers' representatives.

IRS employees responsible for making the lien filing determination are to ensure all appropriate persons, such as those with a taxpayer's power of attorney, receive a notice of the lien filing and the taxpayer's appeal rights. Specifically, IRS procedures require that a copy of the notice be sent to the taxpayer's representative no later than 5 business days after the notice is sent to the taxpayer when a Notice of Federal Tax Lien is filed.

From review of 150 liens filed between July 1, 2005, and June 30, 2006, we determined 25 had representatives listed on the Centralized Authorization File at the time the ALS generated the liens. In 15 (60 percent) of the 25 cases, the ALS records did not indicate the IRS had sent copies of the lien notices to the representatives. In 12 of the 15 cases, revenue officers did not document that they had requested lien notices be sent to the taxpayers' representatives. In the other 3 cases, ACS function employees did not electronically forward the taxpayers' representatives' information so the ALS would send copies of the lien notices.

Revenue officers are required to document in the case history when they request a lien filing and a lien notice for a taxpayer's representative. Revenue officers' managers are required to examine case files for this documentation during their regular review process.

In a previous report,<sup>9</sup> we had identified similar conditions and made recommendations to implement computer programming enhancements. In August 2006, these programming changes were implemented. Because these systemic changes occurred after our sample selection, this process will be evaluated during our next statutory review of the lien due process procedures, scheduled for FY 2008.

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<sup>9</sup> *Fiscal Year 2006 Statutory Review of Compliance with Lien Due Process Procedures* (Reference Number 2006-30-094, dated June 2006).



## Appendix I

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

The overall objective of this review was to determine whether IRS Notice of Federal Tax Lien filings and notices of taxpayers' appeal rights complied with legal guidelines set forth in I.R.C. § 6320.<sup>1</sup> Specifically, we:

- I. Determined whether taxpayer lien notices related to 150 Notices of Federal Tax Lien filed by the IRS complied with legal requirements set forth in I.R.C. § 6320 (a) and related internal guidelines.
  - A. Selected a statistically valid sample of 150 Notices of Federal Tax Lien cases from an ALS<sup>2</sup> extract of the 594,270 liens filed by the IRS nationwide between July 1, 2005, and June 30, 2006. We used a statistical sample because we wanted to project the number of cases with errors. We used attribute sampling to calculate the minimum sample size (n),<sup>3</sup> which we rounded to 150:  
$$n = (Z^2 p(1-p))/(A^2)$$

Z = Confidence Level: 90 percent (expressed as 1.65 standard deviation)  
p = Expected Rate of Occurrence: 5 percent<sup>4</sup>  
A = Precision Rate: ±3 percent
  - B. Validated the ALS extract by comparing the sampled records to online data from the Integrated Collection System (ICS) and the ACS because Small Business/Self-Employed Division management stated that they had no data checks ensuring reliability, completeness, and accuracy.
  - C. Determined whether the sampled liens adhered to legal guidelines regarding timely notifications of lien filings to the taxpayer, the taxpayer's spouse, and/or business partners by reviewing data from the ALS, ICS, ACS, IDRS, and certified mail lists.
  - D. Assessed the controls and procedures established for transferring, storing, and safeguarding certified mail lists at the CLU to determine whether enhancements had been implemented since completion of our prior audit.

<sup>1</sup> I.R.C. § 6320 (Supp. V 1999).

<sup>2</sup> See Appendix VI for descriptions of IRS computer systems mentioned in Appendix I.

<sup>3</sup> The formula  $n = (Z^2 p(1-p))/(A^2)$  is from *Sawyer's Internal Auditing - The Practice of Modern Internal Auditing*, 4th Edition, pp. 462-464.

<sup>4</sup> The actual error rate in our prior report was 4.67 percent.



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- E. Determined whether the taxpayers' representatives were provided a copy of the lien notices by reviewing data from the ALS, ICS, ACS, and IDRS.
  - 1. Reviewed IDRS screens and Master File<sup>5</sup> extracts for Centralized Authorization File<sup>6</sup> indicators (Transaction Code 960) for the sampled cases.
  - 2. Reviewed the ALS history screens for all sampled accounts to determine whether notices were mailed to taxpayers' representatives.
  - 3. Reviewed ICS case histories for documentation that taxpayers' representatives' name/address information was sent to the CLU or that the revenue officers had mailed the notices directly to the taxpayers' representatives for the sampled cases that did not have taxpayers' representatives notifications on the ALS histories.
  - 4. Reviewed the ACS case history for documentation that taxpayers' representatives' name/address information was electronically transmitted to the CLU.
- F. Provided all exception cases to Small Business/Self-Employed Division Office of Collection Policy for agreement to potential violations and corrective actions if appropriate.
- II. Determined whether internal guidelines had been implemented or modified since completion of our last audit by discussing procedures and controls with appropriate personnel in the Small Business/Self-Employed Division Office of Collection Policy.
- III. Determined the status of the ICS and ACS system enhancements as planned and any problems encountered.
- IV. Evaluated the procedures for processing lien notices that are returned as undelivered.
  - A. Selected a judgmental sample of 400 undelivered lien notices from the period of June 14 through June 26, 2006. The judgmental sample included only returned mail identified as undelivered; it did not include returned mail identified as refused or unclaimed. A judgmental sample was used because IRS did not control the receipt of undelivered mail; therefore, the auditors were unable to determine the population because time was limited. Also, the test was conducted to show control weaknesses for which management needed to take corrective action.

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<sup>5</sup> The Master File is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

<sup>6</sup> The Centralized Authorization File contains information regarding the type of authorization that taxpayers have given representatives for various modules within their accounts.



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- B. Researched the Master File using IDRS command code INOLES and determined whether the address on the Master File matched the address on the undelivered lien notice for each sampled case.
- C. Researched the ALS database and determined whether the lien notice was mailed to the updated address and was identified as undelivered on the ALS and whether a new lien notice was sent to the taxpayer's updated address for all sampled cases.
  - 1. Reviewed taxpayer audit trails for all of the address mismatch cases and determined whether CLU employees performed the required IDRS address research using command code INOLES.
  - 2. Determined whether the lien notice was returned to the initiator and documented on the ICS for each sampled case for which the lien notice was not re-sent to the taxpayer.
- D. Determined whether management requested and received approval from the IRS Office of Chief Counsel prior to revising the Internal Revenue Manual procedures allowing employees to discard and stop tracking returned mail that is undeliverable, unclaimed, or refused. We also requested an opinion from the TIGTA Office of Chief Counsel to determine whether the revised procedures are compliant with the I.R.C.



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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  
Edward Gorman, Audit Manager  
Lawrence R. Smith, Senior Auditor  
Janis Zuika, Senior Auditor  
Denise Gladson, Auditor  
Stephen Elix, Student Trainee



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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  
Director, Campus Compliance Services, Small Business/Self-Employed Division SE:S:CCS  
Director, Collection, Small Business/Self-Employed Division SE:S:C  
Director, Collection Policy, Small Business/Self-Employed Division SE:S:C:CP  
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 Liaison: Commissioner, Small Business/Self-Employed Division SE:S



## **Appendix IV**

### *Outcome Measures*

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

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

- Taxpayer Rights and Entitlements – Potential; 15,847 Notices of Federal Tax Lien and Your Right to a Hearing Under IRC 6320 (Letter 3172)<sup>1</sup> were mailed late, causing potential legal violations of taxpayers' rights (see page 4).

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

From a nationwide statistically valid sample of 150 Federal Tax Lien cases,<sup>2</sup> we identified 4 lien notices (about 3 percent) with potential legal violations of taxpayers' rights. The sample was selected based on a confidence level of 90 percent, a precision rate of  $\pm 3$  percent, and an expected rate of occurrence of 5 percent. We projected the findings to the total population provided by the IRS of 594,270 Notices of Federal Tax Lien generated by the ALS between July 1, 2005, and June 30, 2006. We estimated that similar taxpayer rights could have been affected in 15,847 lien notices ( $4/150 \times 594,270$  population). We are 90 percent confident that the range of notices with similar errors is between 15,372 and 16,322.

Taxpayer rights could be affected because a taxpayer not receiving a notice or receiving a late notice might not be aware of the right to appeal or have less than the 30 calendar-day period allowed by the law to request a hearing. In addition, taxpayer rights could be affected when the taxpayer appeals the filing of the lien and the IRS denies the request for the appeal.

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

- Taxpayer Rights and Entitlements – Potential; 60 taxpayers were not provided Letters 3172, causing potential legal violations of taxpayers' rights (see page 5).

<sup>1</sup> Rev. 11-2004, Cat. No. 26767I.

<sup>2</sup> One Notice of Federal Tax Lien (Form 668(Y) (C), Rev. 10-1999, Cat. No. 60025X) may require multiple Letters 3172 because the IRS is required to separately notify taxpayers' spouses and business partners.



*Fiscal Year 2007 Statutory Review of Compliance With Lien Due  
Process Procedures*

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

From a judgmental sample of 400 undelivered lien notices, we identified 60 cases for which CLU employees did not research IRS computer systems for different addresses.

Taxpayer rights could be affected because a taxpayer not receiving a notice or receiving a late notice might not be aware of the right to appeal or have less than the 30 calendar-day period allowed by the law to request a hearing. In addition, taxpayer rights could be affected when the taxpayer appeals the filing of the lien and the IRS denies the request for the appeal.



## **Appendix V**

### *Synopsis of the Internal Revenue Service Collection and Lien Filing Processes*

The collection of unpaid tax begins with a series of letters (notices) sent to the taxpayer advising of the debt and asking for payment of the delinquent tax. The IRS computer systems are programmed to mail these notices when certain criteria are met. If the taxpayer does not respond to these notices, the account is transferred for either personal or telephone contact.

- IRS employees who make personal (face-to-face) contact with taxpayers are called revenue officers and work in various IRS locations. The computer system used in most of these locations to track collection actions taken on taxpayer accounts is called the ICS.<sup>1</sup>
- IRS employees who make only telephone contact with taxpayers work in call sites in IRS Customer Service offices. The computer system used in the call sites to track collection actions taken on taxpayer accounts is called the ACS.

When these efforts have been taken and the taxpayer has not paid the tax liability, designated IRS employees are authorized to file a lien by sending a Notice of Federal Tax Lien<sup>2</sup> to appropriate local government offices. Liens protect the Federal Government's interest by attaching a claim to the taxpayer's assets for the amount of unpaid tax. The right to file a Notice of Federal Tax Lien is created by I.R.C. § 6321 (1994) when:

- The IRS has made an assessment and given the taxpayer notice of the assessment, stating the amount of the tax liability and demanding payment.
- The taxpayer has neglected or refused to pay the amount within 10 calendar days after the notice and demand for payment.

When designated employees request the filing of a Notice of Federal Tax Lien using either the ICS or the ACS, the ALS processes the lien filing requests from both Systems. In an expedited situation, IRS employees can manually prepare the Notice of Federal Tax Lien. Even for manually prepared liens, the ALS controls and tracks the liens and initiates subsequent lien notices<sup>3</sup> to notify responsible parties of the lien filings and of their appeal rights. The ALS maintains an electronic database of all open Notices of Federal Tax Lien and updates the IRS' primary computer records to indicate a Notice of Federal Tax Lien has been filed.

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<sup>1</sup> See Appendix VI for detailed descriptions of IRS computer systems mentioned in Appendix V.

<sup>2</sup> Notice of Federal Tax Lien (Form 668(Y) (C); (Rev. 10-1999)), Cat. No. 60025X.

<sup>3</sup> Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320 (Letter 3172 (Rev. 11-2004)), Cat. No. 26767I.



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Most lien notices are mailed to taxpayers by certified or registered mail rather than being delivered in person. To maintain a record of the notices, the IRS prepares a certified mail list (United States Postal Service Form 3877), which identifies each notice that is to be mailed. The notices and a copy of the certified mail list are delivered to the United States Postal Service. A United States Postal Service employee ensures all notices are accounted for, then date stamps the list and returns a copy to the IRS. The stamped certified mail list is the only documentation the IRS has that certifies the date on which the notices were mailed. IRS guidelines require that the stamped certified mail list be retained for 10 years after the end of the processing year.



## **Appendix VI**

### *Internal Revenue Service Computer Systems Used in the Filing of Notices of Federal Tax Lien*

**The Automated Collection System (ACS)** is a computerized call site inventory system that maintains balance-due accounts and return delinquency investigations. ACS function employees enter all of their case file information (online) on the ACS. Lien notices requested using the ACS are uploaded to the ALS, which generates the Notices of Federal Tax Lien and related lien notices and updates the IRS' primary computer files to indicate that Notices of Federal Tax Lien have been filed.

**The Automated Lien System (ALS)** is a comprehensive database that prints Notices of Federal Tax Lien and lien notices, stores taxpayer information, and documents all lien activity. Lien activities on both the ACS and the ICS cases are controlled on the ALS by Technical Support or Case Processing functions at the Cincinnati, Ohio, Campus.<sup>1</sup> Employees at the Cincinnati Campus process Notices of Federal Tax Lien and lien notices and respond to taxpayer inquiries using the ALS.

**The Integrated Collection System (ICS)** is an IRS computer system with applications designed around each of the main collection tasks such as opening a case, assigning a case, building a case, performing collection activity, and closing a case. The ICS is designed to provide management information, create and maintain case histories, generate documents, and allow online approval of case actions. Lien requests made using the ICS are uploaded to the ALS. The ALS generates the Notices of Federal Tax Lien and related lien notices and updates the IRS' primary computer files to indicate Notices of Federal Tax Lien have been filed.

**The Integrated Data Retrieval System (IDRS)** is an online data retrieval and data entry system that processes transactions entered from terminals located in campuses and other IRS locations. The IDRS enables employees to perform such tasks as researching account information, requesting tax returns, entering collection information, and generating collection documents. The IDRS serves as a link from campuses and other IRS locations to the Master File<sup>2</sup> for the IRS to maintain accurate records of activity on taxpayers' accounts.

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<sup>1</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.

<sup>2</sup> The Master File is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



*Fiscal Year 2007 Statutory Review of Compliance With Lien Due Process Procedures*

**Appendix VII**

*Management's Response to the Draft Report*



COMMISSIONER  
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

**RECEIVED**  
**FEB 20 2007**

February 20, 2007

MEMORANDUM FOR ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Fiscal Year 2007 Statutory Review of  
Compliance with Lien Due Process Procedures  
(Audit No. 200630032)

We have reviewed the draft report titled, "Fiscal Year 2007 Statutory Review of Compliance with Lien Due Process Procedures." We are pleased the report recognizes that potential violations of taxpayer rights have decreased significantly over the past five years, from 9 percent in 2002 to 3 percent in 2006.

The report addresses findings and recommendations regarding IRS processes for mailing Collection Due Process (CDP) notices and copies of federal tax liens to taxpayers. As stated in the report, issuing copies of CDP notices to the Powers of Attorney (POAs) continues to pose concerns. When we discovered our initial enhancements did not eliminate errors, we identified additional programming needs and implemented further enhancements in August 2006. We will complete an internal review to determine the effectiveness of these programming changes later this month.

We agree with the findings and recommendations and concur with your calculation and presentation methodology of the benefits to tax administration described in Appendix IV of your report.

Attached is a detailed response outlining our planned corrective actions. If you have any questions, please call me at (202) 622-0600 or Fred Schindler, Director Collection Policy, Small Business/Self-Employed Division, at (202) 283-7650.

Attachment



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*Fiscal Year 2007 Statutory Review of Compliance With Lien Due Process Procedures*

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Attachment

**RECOMMENDATION 1:**

The Director, Collection, Small Business/Self-Employed Division, should consult with the IRS Office of Chief Counsel to identify actions necessary to correct potential legal violations identified in this audit.

**CORRECTIVE ACTIONS:**

The report stated that, in a sample of 150 cases, four CDP notices (3%) were not sent timely; and four CDP notices (3%) had no proof of mailing. We consulted with IRS Office of Chief Counsel and were advised to:

- (1) Send new Collection Due Process notices to the eight taxpayers identified in the report.
- (2) Review and, if necessary, change the procedures for:
  - a) Mailing lien CDP notices within 5 business days of the date liens are printed for mailing to courthouses; and
  - b) Retaining and controlling certified mailing lists.

**IMPLEMENTATION DATES:**

- (1) By February 8, 2007, we will issue new CDP notices to the eight taxpayers identified in the report.
- (2) By December 31, 2007, we will initiate a review of lien CDP notices and certified mailing lists.

**RESPONSIBLE OFFICIAL(S)**

Director, Campus Compliance Services, SB/SE Division

**CORRECTIVE ACTION MONITORING PLAN:**

We will monitor the corrective actions as part of our internal management control system.

**RECOMMENDATION 2:**

The Director, Collection, Small Business/Self-Employed Division, should reestablish procedures for (1) controlling returned lien notice mail on the ALS as undelivered, refused, or unclaimed and (2) returning undelivered lien notices to the initiators of the Notices of Federal Tax Lien. In addition, the Director, Collection, Small Business/Self-Employed Division needs to change the procedures for routing undelivered mail among three offices.

**CORRECTIVE ACTION:**

- (1) (a) The Internal Revenue Manual was revised to require employees in the Centralized Lien Unit (CLU) to conduct research for last known addresses upon receipt of mail that is returned undelivered and take immediate appropriate action.



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*Fiscal Year 2007 Statutory Review of Compliance With Lien Due Process Procedures*

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(b) We will amend the programming request for the Inbound Return Receipt Notice Delivery System (IRRNDS) implemented by Agency Wide Shared Services (AWSS) to include lien notice processing. When completed, IRRNDS will systemically upload mail information into ALS, eliminating the need for retention, date stamping and filing of certified/registered mail registers.

- (2) The Director, Collection, SB/SE Division will initiate discussions with the impacted functions to determine whether returning notices to originators provides benefit to taxpayers and the IRS.
- (3) Procedures will be established and, if necessary, system changes considered, to ensure returned lien notices are sent directly to the Lien Unit where research is performed to identify the last known address of the taxpayer.

**IMPLEMENTATION DATES**

- (1) (a) On January 25, 2007 the IRM was revised.  
(b) By December 31, 2010, the IRRNDS will include lien notice processing.
- (2) By December 31, 2007, we will initiate discussions with the impacted functions.
- (3) By December 31, 2008, we will establish procedures and consider system changes.

**RESPONSIBLE OFFICIAL(S)**

Director, Collection, SB/SE Division and Director, Campus Compliance Services, SB/SE Division

**CORRECTIVE ACTION MONITORING PLAN**

The Director, Collection will advise the SB/SE Commissioner of any delays in implementing the corrective actions.