



*The Estate Tax Collection Process Has  
Improved, but Opportunities Exist to Better  
Ensure Taxpayers Are Treated Equitably*

**September 24, 2007**

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

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TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 24, 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 – The Estate Tax Collection Process Has Improved,  
but Opportunities Exist to Better Ensure Taxpayers Are Treated  
Equitably (Audit #200630037)

This report presents the results of our review to evaluate the effectiveness of the corrective actions taken in response to the recommendations in a prior Treasury Inspector General for Tax Administration report<sup>1</sup> and to determine whether the Small Business/Self-Employed Division is ensuring that correct and necessary actions are taken to protect the Federal Government's interest when collecting estate taxes.

*Impact on the Taxpayer*

The estate tax is imposed on the assets of a deceased person and is generally based on the value of the gross estate at the date of death. The Internal Revenue Service (IRS) is not consistently securing and recording special extended estate tax liens on certain estate tax installment election cases. Therefore, the Federal Government's interest is not always adequately protected to ensure the taxes owed will be collected. In addition, the IRS does not always advise estate taxpayers of the status of payment extension requests. This results in additional taxpayer burden since taxpayers must initiate contact with the IRS to determine whether their payment extensions were granted.

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<sup>1</sup> *The Internal Revenue Service Can Improve the Estate Tax Collection Process* (Reference Number 2000-30-059, dated March 2000).



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Synopsis

Estate tax returns are required for only about 2 percent of all decedents and even fewer actually pay a tax because of exclusions allowed from the value of the estate.<sup>2</sup> In 2002, the IRS centralized the processing of estate tax returns to the Cincinnati Compliance Center. We found that management had taken corrective actions to address our previously reported conditions. For example, a database system was implemented to improve controls for handling and monitoring estate tax cases. In addition, programming changes were implemented to improve the timeliness of billing estate taxpayers and to automatically update the Collection Statute Expiration Date<sup>3</sup> on estate tax cases.

However, some additional concerns exist. IRS processes are generally designed for a maximum 10-year payment period. Under Internal Revenue Code (I.R.C.) Section (§) 6166, qualifying estates may elect to pay their estate tax liability over 14 years, which exceeds the 10-year period during which the general Federal estate tax lien attaches to the assets of the estate. The IRS is not consistently securing and recording I.R.C. § 6324A special extended tax liens on estate tax cases to secure the Federal Government's interest after the 10-year general estate tax lien expires.<sup>4</sup> Therefore, additional processes and controls for the 4-year period that extends beyond the 10-year general estate tax lien period are required. There are two specific activities requiring improvements. First, special lien monitoring controls require enhancements to ensure the Federal Government's interest is protected for estate tax cases in which installment payment periods extend past the normal 10-year general estate tax lien period. Second, requests for payment extension cases may be evaluated more effectively by the technical experts in the Collection Advisory Office than by the less technical Cincinnati Campus Compliance Operations staff. These payment extension requests should be reassessed to determine whether the cases are being worked by employees with proper technical expertise. The current process allows similarly situated taxpayers to be treated differently. In addition, from a customer service

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<sup>2</sup> This exclusion amount varies depending on the year of death. For Tax Years 2004 and 2005, the exclusion amount was \$1.5 million. The threshold is scheduled to increase annually through Tax Year 2009, when it will reach \$3.5 million. The estate tax is eliminated in tax year 2010 and is reinstated in tax year 2011. For Tax Year 2011, the exclusion amount will be \$1 million. Estates required to file a Form 706 may owe no estate tax because of allowed deductions.

<sup>3</sup> The Collection Statute Expiration Date is a time period established by law to collect taxes. The time allowed to collect the deferred estate tax in an Internal Revenue Code Section (I.R.C. §) 6166 case is suspended during the entire installment payment period, and begins to run again if the I.R.C. § 6166 election is terminated (e.g., for failure to make one or more required installment payments).

<sup>4</sup> As a result of the Treasury Inspector General for Tax Administration's prior report, the IRS began instituting procedures to require a bond or an I.R.C. § 6324A lien from all estates making I.R.C. § 6166 elections. However, in *Estate of Roski v. Commissioner*, 128 T.C. No. 10 (April 12, 2007), the Tax Court held that the IRS may not require a bond or I.R.C. § 6324A special estate tax lien in every case but may determine on a case-by-case basis whether credit risks justify requiring security to protect the Federal Government's interest in the deferred estate tax. Accordingly, a bond or special lien may no longer be required in every case.



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perspective, estate taxpayers are not being provided proper followup when their requests for a payment extension have been granted. This can cause unnecessary taxpayer burden because the taxpayer may have to contact the IRS to determine whether the extension was granted.

### *Recommendations*

We recommended the Director, Collection, take steps to enhance the internal controls on the lien tracking system currently in place for I.R.C. § 6324A special estate tax liens. Procedures and guidelines should be provided to all employees advising them of the entering and monitoring of liens on this system. Guidelines should be updated to reflect the use of this system and interim guidelines should be issued immediately. Additionally, periodic reconciliations should be performed to ensure all I.R.C. § 6324A special estate tax liens are being timely recorded and released. The Directors, Collection and Specialty Programs, should reassess whether estate cases requesting payment extensions are being worked by employees with the proper technical expertise to ensure estate taxpayers receive equitable tax treatment and estate taxes are collected. The Director, Specialty Programs, needs to update controls on I.R.C. § 6166 installment payment cases to ensure that lien packages are sent to the Collection Advisory Office to determine whether a bond or an I.R.C. § 6324A special estate tax lien should be secured. Additionally, the Director, Specialty Programs, should notify the taxpayer when their payment extension has been granted. Procedures should be developed to ensure estates requesting payment extensions are sent a copy of the Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes (Form 4768) notating its approval and a letter explaining the terms of the extension. In addition, *Your Rights as a Taxpayer* (Publication 1) should be sent explaining the taxpayer's rights.

### *Response*

IRS management agreed with three of our recommendations and partially agreed with one recommendation. They agreed to enhance internal controls on the lien tracking system for I.R.C. § 6324A special estate tax liens and on the I.R.C. § 6166 installment payment cases to ensure that lien packages are sent to the Collection Advisory Office. Management also will review the process by which requests for payment extensions on estate tax returns are evaluated and will resume notification of taxpayers when the requests for payment extensions are granted. However, management concluded that a form letter indicating the approval date and terms of an extension will suffice and require fewer resources than providing the taxpayer with a copy of Form 4768. Management's complete response to the draft report is included as Appendix IV.



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*Office of Audit Comment*

Although IRS management did not fully agree with our recommendation to send a copy of Form 4768 notating its approval to estate taxpayers, we considered their alternative corrective action and found it to be satisfactory.

Copies of this report are also being sent to 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*

ICS	Integrated Collection System
I.R.C.	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service



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## *Background*

The Federal estate tax is imposed on the transfer of the property of a decedent at death. A United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706) must be filed when the value of the gross estate at the date of death exceeds the estate tax exclusion amount in effect under the Internal Revenue Code (I.R.C.) Section (§) 2011. This exclusion

***In Tax Year 2006, there were approximately 58,500 Forms 706 filed with a total balance due of over \$13.2 billion.***

amount varies depending on the year of death,<sup>1</sup> and acts as a threshold for filing an estate tax return and for estate tax liability. Estates with property valued at less than the exclusion amount are not required to file an estate tax return and owe no estate tax. Accordingly, estate tax returns are required for only about 2 percent of all decedents and even fewer estates actually are required to pay estate tax.<sup>2</sup> Unless an extension of time to file is granted, Form 706 is due 9 months after the date of death and is filed and processed at the Cincinnati Compliance Center. Under I.R.C. § 6324(a), a 10-year Federal tax lien on all of the property in the gross estate automatically arises upon the date of death. No recorded notice is required for this general 10-year estate tax lien to become effective, and it generally secures any estate tax that may be determined to be due.

In Tax Year 2006, there were approximately 58,500 Forms 706 filed with a total balance due of more than \$13.2 billion. Estate taxes should be collectible in these cases since taxpayers must have assets more than \$2 million before an estate tax return is even required to be filed. Under I.R.C. § 6166,<sup>3</sup> if the value of the decedent's interest in a closely held business,<sup>4</sup> is more than 35 percent of the value of the adjusted gross estate and other requirements are met, the estate may elect to pay the portion of the estate tax attributable to the closely held business in installments over a period of up to 14 years from the date payment of the estate tax otherwise

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<sup>1</sup> For Tax Years 2004 and 2005, the exclusion amount was \$1.5 million. For Tax Years 2006 through 2008, the exclusion amount is \$2 million. The threshold is scheduled to increase to \$3.5 million in tax year 2009. The estate tax is eliminated in tax year 2010 and is reinstated in tax year 2011. For Tax Year 2011, the exclusion amount will be \$1 million.

<sup>2</sup> Estates required to file a Form 706 may owe no estate tax because of allowed deductions.

<sup>3</sup> Pub. L. 107-16, Title V, §§ 571(a), 572 (a), 573 (a), 115 Stat. 92, 93.

<sup>4</sup> Interest in closely held business is defined as: (a) a proprietorship that carries on a trade or business; (b) an interest in a partnership that carries on a trade or business. A deceased partner's interest must be 20 percent or more of the total capital interest in the partnership or the partnership has 15 or fewer partners; and (c) stock in a corporation carrying on a trade or business if 20 percent or more of the value of voting stock of the corporation is included in the gross estate, or the corporation has 45 or fewer shareholders. An I.R.C. § 6166 election also must be made on a timely filed estate tax return and the decedent must have been a citizen or resident of the United States.



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would be due (usually 9 months after the date of death). Generally, the estate will pay annual installments of only the interest on the deferred tax for the first 5 years,<sup>5</sup> and then will pay interest and principal in 2 or more, but not to exceed 10, equal annual installments. The interest rate during the deferral period is less than the interest normally charged when other types of extensions to pay tax are granted.

This review is a followup to a prior Treasury Inspector General for Tax Administration audit.<sup>6</sup> The review was performed at the Cincinnati Compliance Center, Estate and Gift Tax Campus<sup>7</sup> Operations in Covington, Kentucky, the Collection Advisory Office in Cincinnati, Ohio, and the Specialty Programs Office, Estate and Gift Tax Program, Small Business/Self-Employed Division in New Carrollton, Maryland, during the period February through May 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.

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<sup>5</sup> Four payments of interest on the deferred estate tax are due during the initial 5-year period, no later than at the end of the first, second, third, and fourth years, respectively, from the original due date for payment of estate tax. The first installment payment of deferred estate tax, plus interest, is due no later than 5 years from the original payment due date (i.e., at the end of the fifth year).

<sup>6</sup> *The Internal Revenue Service Can Improve the Estate Tax Collection Process* (Reference Number 2000-30-059, dated March 2000).

<sup>7</sup> The data processing arm of the Internal Revenue Service (IRS). The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



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## *Results of Review*

### ***The Estate and Gift Tax Program Has Implemented Corrective Actions to Address Prior Areas of Concern***

In the prior Treasury Inspector General for Tax Administration audit, we reported that the Internal Revenue Service (IRS) process for collecting estate taxes was not effective in protecting the Government's interest and in protecting taxpayers' rights. IRS employees were neither properly billing interest on payment extensions nor providing taxpayers who elect to pay estate tax in installments under I.R.C. § 6166 the publication that explained their rights. In addition, the IRS computer system did not calculate the Collection Statute Expiration Date<sup>8</sup> correctly in cases that had section I.R.C. § 6166 installment elections in place, causing tax amounts owed to be abated prematurely or late. In Calendar Year 2002, the IRS consolidated its Estate and Gift Tax Campus Operations at the Cincinnati Compliance Center.

In Calendar Year 2003, operations were improved when a centralized system was implemented to control, monitor, and bill all I.R.C. § 6166 installment payment cases and extensions to file and/or pay in other estate tax cases. The system is continually updated to provide management with an internal control system that allows employees to monitor their own work and managers to monitor the work of their employees. The system provides employees information on when to send bills, notices, and letters and for other monitoring and informational purposes. In February 2007, procedures were implemented to mail out *Your Rights as a Taxpayer* (Publication 1) to estate taxpayers electing under I.R.C. § 6166 to pay a portion of their estate tax in installments.

Other improvements to the program operations include eliminating a manual billing process for requests for payment extensions and replacing it with an annual automated billing routine. Another program change allows the Collection Statute Expiration Date in I.R.C. § 6166 installment payment cases to update automatically, so tax amounts due are no longer prematurely abated or late. As a result of these changes, there has been a reduction in incorrect and late billing.

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<sup>8</sup> The Collection Statute Expiration Date is a time period established by law to collect taxes. The time allowed to collect the deferred estate tax in an I.R.C. § 6166 case is suspended during the entire installment payment period, and begins to run again if the I.R.C. § 6166 election is terminated, e.g., for failure to make one or more required installment payments.



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***The System for Recording and Monitoring I.R.C. § 6324A Special Estate Tax Liens Could Be Enhanced to Ensure the Federal Government's Interests Are Protected***

Under I.R.C. § 6166, a qualifying estate with closely held business interests may elect to pay the estate tax liability attributable to the business in low-interest annual installments for a period of up to 14 years. I.R.C. § 6165 permits the IRS to require that an estate post a bond to secure the deferred estate tax in appropriate cases. In lieu of a bond, an estate may consent to provide a special extended estate tax lien under I.R.C. § 6324A that lasts for the entire installment payment period and any further time that the IRS may have to collect tax that may still be due after the installment period. Securing an I.R.C. § 6324A special lien for the full term of the I.R.C. § 6166 installment payment period helps to ensure that assets are not sold or encumbered by other creditors that might be able to obtain priority over the Federal Government's tax claims during the life of the installment payment period.

***The Centralized Lien Unit's system for recording liens could be enhanced***

A limitation of the general estate tax lien provided in I.R.C. § 6324(a) is that it has an absolute life of 10 years and cannot be extended. Where an estate has elected to pay the estate tax attributable to its interest in a closely held business in installments over a period of up to 14 years under I.R.C. § 6166, the IRS could be left without lien protection for 4 years or more if a bond or an I.R.C. § 6324A special lien is not obtained and recorded with the appropriate local government office before the 10-year period of the general estate tax lien has expired. The filing and recording of an I.R.C. § 6324A special lien<sup>9</sup> will secure the deferred estate tax for the entire I.R.C. § 6166 installment payment period.

Estates make I.R.C. § 6166 elections to pay a portion of their estate tax in installments with their Form 706 estate return that is timely filed with the Cincinnati Processing Center and directed to Estate and Gift Campus Operations at the Cincinnati Campus for handling. A bond or an I.R.C. § 6324A special lien may be required from estates making I.R.C. § 6166 elections where it is determined that security is needed to protect the Federal Government's interest in the deferred estate tax.<sup>10</sup> The Collection Advisory Office, which consists of a staff of technical experts on estate tax collections, will send all information necessary to file and record I.R.C. § 6324A lien

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<sup>9</sup> Notice Of Federal Estate Tax Lien Under Internal Revenue Laws (Form 668-J) will attach only to the property specified on the recorded lien. Any property listed on the Form 668-J is automatically released from the general estate tax lien.

<sup>10</sup> As a result of the Treasury Inspector General for Tax Administration's prior report, the IRS began instituting procedures to require a bond or an I.R.C. § 6324A lien from all estates making I.R.C. § 6166 elections. However, in *Estate of Roski v. Commissioner*, 128 T.C. No. 10 (April 12, 2007), the Tax Court held that the IRS may not require a bond or I.R.C. § 6324A special lien in every case but may determine on a case-by-case basis whether credit risks justify requiring security to protect the Federal Government's interest in the deferred estate tax. Accordingly, a bond or special lien may no longer be required in every case.



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to the Centralized Lien Unit to be processed. Within 7 days of receipt, the Centralized Lien Unit mails Notices of Federal Estate Tax Lien to the County and/or State recording offices for filing and recording. The Collection Advisory Office is responsible for followup after 30 days to ensure the lien has been properly recorded and that a copy of the recorded lien has been secured.

IRS processes are designed to track the 10-year general estate tax lien (I.R.C. § 6324(a)) that attaches to the assets of the estate on the Automated Lien System<sup>11</sup> by entry of the date the lien arises (date of death). After 10 years, the Automated Lien System is programmed to show that the lien has automatically expired. The Automated Lien System cannot be used to automatically monitor the filing, recording, and release of I.R.C. § 6324A special liens. The system used by the Centralized Lien Unit at the Cincinnati Campus to control and monitor I.R.C. § 6324A special liens obtained in estate tax cases does not include information prior to September 2006. In September 2006, the Centralized Lien Unit started tracking the special liens on an Excel spreadsheet. However, management has not developed procedures or guidelines, nor can they determine whether or not all I.R.C. § 6324A special liens obtained have been entered onto this spreadsheet database. The Collection Advisory Office maintains an Integrated Collection System (ICS)<sup>12</sup> case in the name of the estate for which an I.R.C. § 6324A special lien was recorded in a local governmental office until the special lien is released.

The accurate and timely recording of events is an important control activity. The Government Accountability Office *Standards for Internal Control in the Federal Government*<sup>13</sup> state internal control should provide reasonable assurance that the objectives of the agency are being achieved in the following categories:

- Effectiveness and efficiency of operations including the use of the entity's resources.
- Reliability of financial reporting, including reports on budget execution, financial statements, and other reports for internal and external use.
- Compliance with applicable laws and regulations.

Internal control activities help ensure management's directives are carried out. The control activities should be effective and efficient in accomplishing the agency's control objectives.

The IRS needs to enhance its current process to ensure a bond or an I.R.C. § 6324A special lien is obtained and filed in all I.R.C. § 6166 installment cases in which the IRS determines that there is a credit risk to the Federal Government and all special liens are appropriately monitored and tracked. Where an estate has elected to pay the estate tax attributable to its interest in a closely held business in installments over a period of up to 14 years under I.R.C. § 6166, the IRS could

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<sup>11</sup> A comprehensive database that prints Notices of Federal Tax Lien and lien notices, stores taxpayer information, and documents all lien activity.

<sup>12</sup> An automated inventory system used by Collection Office employees designed to provide management information, create and maintain case histories, generate documents, and allow online approval of case actions.

<sup>13</sup> GAO/AIMD-00-21.3.1 (November 1999).



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be left without lien protection for 4 years or more if a bond or an I.R.C. § 6324A special lien is not obtained and recorded with the appropriate local government office before the 10-year period of the general estate tax lien expires.

**Special extended estate tax liens may not be secured in all I.R.C. § 6166 installment payment cases**

An Estate and Gift Tax Program or Estate and Gift Campus Operations supervisory attorney or estate tax attorney determines whether an estate meets the eligibility requirements for installment payments under I.R.C. § 6166. Prior to the April 2007 decision in the Estate of Roski case, IRS procedures required the attorney in an examined I.R.C. § 6166 case to secure a bond or an I.R.C. § 6324A special lien. In I.R.C. § 6166 cases that were accepted as filed or surveyed, the attorney was required to send case information to the Collection Advisory Office to secure a bond or an I.R.C. § 6324A special lien agreement and ensure the special lien was filed and recorded. The estate tax attorney could not close the case until notified by the Collection Advisory Office whether the bond or special lien had been secured. IRS procedures required notification to the estate tax group if the bond or special lien could not be secured within 60 days of receipt of the case by the Collection Advisory Office. The IRS has informed us that, in light of the Estate of Roski case, they are revising procedures to provide that all eligible I.R.C. § 6166 installment payment cases will be forwarded to the Collection Advisory Office to determine if a bond or a special lien should be required and, if so, to obtain the bond or special lien agreement with the estate and ensure any special lien obtained is filed and recorded.

We reviewed a judgmental sample of 245 open I.R.C. § 6166 installment payment cases<sup>14</sup> and found 92 (37.5 percent) cases in which an ICS case history had not been established. The current balance due on the 92 cases is more than \$79 million. Based on this information, we concluded the Estate and Gift Tax Program field attorneys may not always be providing lien information to the Collection Advisory Office requesting that an I.R.C. § 6324A special lien or bond be secured. If lien packages are not sent to the Collection Advisory Office, then special liens<sup>15</sup> may not be obtained. In such cases, the Federal Government's interests may not be protected for the years of the I.R.C. § 6166 installment payment period that extend beyond the 10-year period of the general estate tax lien.

During discussions with IRS management, we were informed that other processing events may have resulted in the absence of an open ICS file on the installment payment cases we reviewed. These events include cases with I.R.C. § 6166 elections that were fully paid prior to the completion of the lien package, cases in which a final tax determination had not been made and the lien was not yet filed, cases in which liens were filed by Estate and Gift Tax personnel in

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<sup>14</sup> These cases were selected based on the closing date of the examination so that the interim guidance dated January 2003 on handling I.R.C. § 6166 elections had already been issued.

<sup>15</sup> We did not confirm whether the special liens were recorded at the appropriate county and/or State recording offices.



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field offices and not recorded on the ICS, and cases that may have been sent to the Collection Advisory Office but not input into the ICS at the time of our review. We were also advised that in January 2007, the Director, Specialty Programs, reissued interim procedures to reinforce the control, handling, and disposition of I.R.C. § 6166 election estate tax cases.

## **Recommendations**

**Recommendation 1:** The Director, Collection, should take steps to enhance the internal controls on the lien tracking system currently in place for I.R.C. § 6324A special estate tax liens. Procedures and guidelines on entering and monitoring of liens on this system should be provided to all employees. Guidelines should be updated to reflect the use of this system and interim guidelines should be issued immediately. Additionally, periodic reconciliations should be performed to ensure that all I.R.C. § 6324A special liens are being timely recorded in the relevant local government office and timely released.

**Management's Response:** IRS management agreed with the recommendation. They plan to a) distribute a memorandum providing interim procedures for lien tracking, entry and monitoring, and explaining system enhancements; b) issue procedures and guidelines in IRM Sections 5.12.2 and 5.12.6 for lien tracking, entry and monitoring, and explaining system enhancements; and c) incorporate reviews during annual estate tax lien reviews at the Cincinnati Campus to ensure that all I.R.C. § 6324A special liens are properly recorded and released.

**Recommendation 2:** The Director, Specialty Programs, needs to update controls on I.R.C. § 6166 installment payment cases to ensure that lien packages are sent to the Collection Advisory Office to determine whether a bond or an I.R.C. § 6324A special lien should be secured.

**Management's Response:** IRS management agreed with the recommendation. They plan to implement the following actions to ensure compliance with established procedures: a) distribute a memorandum establishing interim procedures for technical staff in the campus and field Estate and Gift Tax operations to follow in order to solicit acknowledgement from the Collection Advisory Office that lien packages have been received and to ensure case files contain evidence of receipt in the Collection Advisory Office, b) issue procedures and guidelines in IRM Sections 4.25.1 and 4.25.2 to verify receipt of lien packages by the Collection Advisory Office, and c) evaluate the feasibility of matching Estate and Gift systemic data with Collection systemic data to confirm that all estate tax returns having a balance due and qualifying for I.R.C. § 6166 installment payments are referred to the Collection Advisory Office.



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## ***Requests for Extensions of Time to Pay on Estate Tax Cases Could Be More Responsive to Estate Taxpayers***

Estate taxpayers may extend the time of payment of estate taxes under I.R.C. § 6161. To qualify, the estate must complete the Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes (Form 4768) and attach a statement of reasonable cause. The statement must establish why it is not possible or practical for the executor to pay the full amount of the estate tax by the due date. If an extension is granted, the I.R.C. provides that the estate must pay interest on the account but no penalty is charged for failure to timely pay the tax due.

### **Requests for extensions of time to pay the estate tax were not properly evaluated**

All requests for payment extension are received by the Estate and Gift Tax Program for processing. Requests for extensions to pay will be transferred to the Collection Advisory Office, if:

1. The amount of tax due is \$500,000 or more, and it is the initial request.
2. The amount of tax due is \$100,000 or more, and it is the second request.
3. The amount of tax due is \$25,000 or more, and it is the third request.
4. It is the fourth or subsequent request, regardless of dollar amount.

Requests for payment extension cases may be evaluated more effectively by the technical experts in the Collection Advisory Office than by the less technical Cincinnati Campus Compliance Operations staff. The current process allows similarly situated taxpayers to be treated differently. The Collection Advisory Office's procedures provide that additional reviews are to be conducted, taxpayers are to be contacted, and asset valuations are to be completed prior to approving an extension. The same procedures used by the Collection Advisory Office are not required procedures in the Estate and Gift Tax Campus Operations, Cincinnati Compliance Center guidelines. Essentially, the Estate and Gift Tax Program's tax examiners approve the extensions to pay for 12 months if a reasonable cause is given. Rarely is a case disapproved, unless it is not timely filed or is extended more than 12 months. The Estate and Gift Tax Program's tax examiners do not have sufficient guidelines to properly evaluate whether reasonable cause has been established to explain the need for an extension.

To verify our observation, we reviewed a judgmental sample of 67 payment extension cases<sup>16</sup> from Fiscal Years 2002 through 2007. These cases were selected from the Estate and Gift Tax Campus Operations, Cincinnati Compliance Center and the Collection Advisory Office in Cincinnati. We found 6 (9 percent) discrepancies made in processing the payment extensions.

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<sup>16</sup> A judgmental sample was used because statistical projections were considered to be unnecessary.



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These discrepancies included 4 cases that were not forwarded to the Collection Advisory Office when meeting the referral criteria and 2 cases that were sent to the Collection Advisory Office between 3 and 6 months from the date of receipt in the Estate and Gift Tax Campus Operations, Cincinnati Compliance Center.

Sound tax policy and practice requires treating similar taxpayers in a similar and equitable way. There is an inequity in the treatment of estate taxpayers depending on where the payment extension is processed within the IRS. Estate taxpayers with payment extensions processed by the Estate and Gift Tax Campus Operations, Cincinnati Compliance Center are granted payment extensions more readily than estate taxpayers with payment extensions processed in the Collection Advisory Office.

The Collection Advisory Office criteria for granting an installment agreement requires additional taxpayer information and evidence. In addition to establishing reasonable cause, cases referred to the Collection Advisory Office require an analysis of the progress of efforts being made to borrow or liquidate assets or to otherwise pay the amounts to be extended. Some additional information required in this analysis may include balance sheets listing all assets, disbursements, liabilities, and earnings for the estate and relating to the prior extension period; an accounting of the actions taken during the past extension period to resolve the indebtedness; and information on the executor's proposal to make partial payments during the extension period being requested. The Collection Advisory Office also solicits and receives payments from some taxpayers during the payment extension process, which was not evident in the cases processed by the Estate and Gift Tax Program. Assigning all payment extension cases to the Collection Advisory Office would better ensure estate taxpayers are treated equitably.

The complexity of estate taxes adds to the importance of assigning all payment extension cases to the Collection Advisory Office. Estate taxpayers requesting extensions to pay would benefit from a more thorough review by technical experts in the Collection Advisory Office due to the complexity of estate tax returns. The IRS states on its web site that by the time most estates reach \$1 million there is usually some complexity involved. Only total taxable estates that exceeded \$1.5 million in Tax Years 2004 and 2005 will actually file and pay tax. For Tax Years 2006 through 2008, the amount increased to \$2 million. In order to determine the tax due, includable property may consist of cash and securities, real estate, insurance, trusts, annuities, business interests, and other assets. The Collection Advisory Office would be in a better position to conduct this review.

**Estates with extensions to pay were not properly advised of their taxpayer rights**

The Cincinnati Compliance Center, Estate and Gift Tax Campus Operations, could improve its service to estate taxpayers by sending out notification that their extensions to pay are granted. Estate taxpayers are not aware if their payment extensions have been granted and are generating additional correspondence with the IRS to request notification of whether their payment



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extensions have been granted. Also, *Your Rights as a Taxpayer* (Publication 1) is not being sent to estate taxpayers who request an extension to pay.

Prior to Tax Year 2006, the Estate and Gift Tax Program sent out letters to taxpayers advising them that their extension had been approved, while also providing Publication 1. However, beginning in Tax Year 2006, the IRS discontinued notifying taxpayers of whether the extensions to pay had been granted. Providing a timely response to taxpayers' requests for payment extensions promotes good taxpayer relations. In addition, improving customer service continues to be a focus of the IRS Strategic Plan for Fiscal Years 2005 - 2009 and was listed as a priority of the Small Business/Self-Employed Division in its Fiscal Year 2006-2007 Business Plan.

According to IRS management, the decision not to notify estate taxpayers of the granting of extensions to pay resulted from a Calendar Year 2005 cross-functional task force.<sup>17</sup> The task force was formed to review Form 4768 and simplify the Form and extension process and make the Form consistent with other extension forms. The IRS does not notify non-estate taxpayers of the granting of the extension to file. However, estate taxpayers may request an extension to pay along with an extension to file on the Form 4768.

## **Recommendations**

**Recommendation 3:** The Directors, Collection and Specialty Programs, should reassess whether estate cases requesting payment extensions are being worked by employees with proper technical expertise to ensure estate taxpayers receive equitable tax treatment and estate taxes are collected.

**Management's Response:** IRS management agreed with the recommendation. They plan to a) assemble a team, including representatives of Small Business/Self-Employed Division Directors for Collection, Specialty Programs, and Campus Compliance Services, to evaluate the criteria for referring payment extension requests to the Collection Advisory Office and the adequacy of guidance provided to campus personnel making decisions about granting extensions to pay; b) consider the technical expertise needed to evaluate the requests and decide on changes which may be needed to ensure proper consideration is given to all requests for extensions to pay; c) distribute a memorandum establishing interim procedures, if appropriate, for referring payment extension requests to the Collection Advisory Office; d) revise technical guidance, if appropriate; and e) issue procedures and guidelines in IRMs 5.5.5 and 4.25.2, if appropriate, for referring payment extension requests to the Collection Advisory Office.

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<sup>17</sup> The task force members included personnel from the Office of Taxpayer Burden Reduction; Media and Publications, Tax Forms and Publications, and Submission Processing, Individual Master File Policy from the Wage and Investment Division; and the Estate and Gift Tax Program, and Chief Counsel from the Small Business/Self-Employed Division.



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**Recommendation 4:** The Director, Specialty Programs, should notify the taxpayer when his or her payment extension has been granted. Procedures should be developed to ensure that estates requesting payment extensions are sent a copy of the Form 4768 notating its approval and a letter explaining the terms of the extension. In addition, Publication 1 should be sent explaining the taxpayer's rights.

**Management's Response:** IRS management partially agreed with the recommendation. They conclude that a form letter indicating the approval date and terms of the extension will suffice and will require fewer resources than providing the taxpayer with a copy of the Form 4768. IRS management plans to a) draft an extension to pay approval notification letter for review/approval, b) distribute a memorandum establishing interim procedures, and c) issue procedures in IRM 4.25.2 for the processing of the notification letter along with Publication 1.

**Office of Audit Comment:** Although IRS management did not fully agree with our recommendation to send a copy of the Form 4768 notating its approval and a letter explaining the terms of the extension to estate taxpayers, we considered their alternative corrective action and found it to be satisfactory.



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## Appendix I

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

The overall objective of this review was to evaluate the effectiveness of the corrective actions taken in response to the recommendations in a prior Treasury Inspector General for Tax Administration report.<sup>1</sup> Also, we determined whether the Small Business/Self-Employed Division is ensuring that correct and necessary actions are taken to protect the Government's interest when collecting estate taxes. To accomplish the objective, we:

- I. Determined whether corrective measures were taken by the IRS to ensure the proper collection of estate taxes and whether taxpayers' rights were protected during this process.
  - A. Reviewed corrective actions taken to resolve the IRS' process for collecting estate taxes as a result of the previous audit's findings and recommendations.
    1. Identified how and when corrective actions were implemented in response to the findings requiring a corrective action from the original report.
    2. Evaluated the adequacy and effectiveness of corrective measures taken.
    3. Reviewed the adequacy of the compensating controls for the reconciliation of liens for estate tax cases. Also, we determined whether liens had been filed for estates with a status indicator for an I.R.C. § 6166 installment payment election. We judgmentally selected a sample of 245 installment elections,<sup>2</sup> from a population of approximately 3,500 open installment cases that were being monitored by the Estate and Gift Tax Campus Operations, Cincinnati Compliance Center.<sup>3</sup> We performed research on these cases on the Integrated Data Retrieval System<sup>4</sup> to select cases based on a closed examination date. This data were then used to select our sample and review these cases with histories maintained by the Collection Advisory Office.
  - B. Interviewed management in the Estate and Gift Tax Campus Operations, Cincinnati Compliance Center, Specialty Tax Program, Small Business/Self-Employed Division,

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<sup>1</sup> *The Internal Revenue Service Can Improve the Estate Tax Collection Process* (Reference Number 2000-30-059, dated March 2000).

<sup>2</sup> The original sample contained 250 installment elections; however, 5 cases did not have any available data on the Integrated Data Retrieval System so we removed these cases from our sample.

<sup>3</sup> A judgmental sample was used because no projections were being made.

<sup>4</sup> IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.



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- and Collection Advisory Office to determine whether procedures and guidelines had been implemented to ensure proper processing of installment agreements and payment extensions of estate taxes, proper recording and timely release of estate tax liens, and proper review of tax abatements to ensure these abatements do not occur prematurely or late.
- C. Determined whether the applicable Requests for Information Services<sup>5</sup> had been submitted and computer programs had been changed and were in place to ensure that Collection Statute Expiration Dates<sup>6</sup> were computed accurately.
- II. Tested the adequacy of corrective controls by reviewing a judgmental sample of cases selected from the Open and Closed extension listing dated October 2006 provided by the Estate and Gift Tax Campus Operations, Cincinnati Compliance Center. We selected 65 payment extension cases and received 40 cases due to cases no longer being available for review.<sup>7</sup> Additionally, we judgmentally selected 27 payment extension cases from the inventory on hand at the Collection Advisory Office in Cincinnati to bring our total to 67 cases. We could not determine the total population of payment extension cases based on available IRS reports. We judgmentally selected cases due to time constraints. We reviewed these cases to determine whether:
- A. Payment extension cases had a reasonable cause statement attached.
- B. Internal Revenue Manual and interim internal control procedures were being followed in the processing of payment extension cases.
- C. Balance-due notices and explanation of rights had been issued and interest had been assessed on payment extension cases.

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<sup>5</sup> A formal memorandum requesting Business Systems Development organization support for changes to current or planned programming, corporate hardware, software applications, system testing, and other organization activities used in processing tax information.

<sup>6</sup> The Collection Statute Expiration Date is a time period established by law to collect taxes. The time allowed to collect the deferred estate tax in an I.R.C. § 6166 case is suspended during the entire installment payment period, and begins to run again if the I.R.C. § 6166 election is terminated (e.g., for failure to make one or more required installment payments).

<sup>7</sup> A judgmental sample was used because the audit universe could not be determined and we could not project our results.



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## **Appendix II**

### *Major Contributors to This Report*

Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs)  
Philip Shropshire, Director  
Lisa Stoy, Audit Manager  
Donna Saranchak, Lead Auditor  
Frank Maletta, Auditor



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## **Appendix III**

### *Report Distribution List*

Acting Commissioner C  
Office of the Commissioner – Attn: Acting Chief of Staff C  
Assistant 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, Examination, Small Business/Self-Employed Division SE:S:E  
Director, Specialty Programs, Small Business/Self-Employed Division SE:S:SP  
Director, Campus Compliance Operations, Cincinnati, Small Business/Self-Employed Division  
SE:S:CCS:CCO:CIN  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Director, Office of Legislative Affairs CL:LA  
Audit Liaison: Small Business/Self-Employed Division SE:S:CLD



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**Appendix IV**

*Management's Response to the Draft Report*



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

**RECEIVED**

**AUG 31 2007**

August 30, 2007

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – The Estate Tax Collection Process Has  
Improved; However, Opportunities Exist to Better Ensure  
Taxpayers Are Treated Equitably (Audit #200630037)

We have reviewed your draft report, "The Estate Tax Collection Process Has Improved; However, Opportunities Exist to Better Ensure Taxpayers Are Treated Equitably." We agree with your recommendations to enhance internal controls on the lien tracking system for Internal Revenue Code (IRC) Section 6324A special estate tax liens and on the IRC Section 6166 installment payment cases to ensure that lien packages are sent to the Collection Advisory function. Although consolidation and automation efforts have improved the collection process since the prior audit was completed in 2000, more can be done to improve current procedures.

We also agree to review the process by which requests for payment extensions on estate tax returns are evaluated and will resume notification of taxpayers when the requests are granted. The appropriate IRM sections will be revised to reflect procedural changes as needed.

Attached is a detailed response outlining our corrective actions.

If you have any questions, please contact me or call Bill Conlon, Director, Specialty Programs, Small Business/Self-Employed Division, at (202) 283-6874.

Attachment



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**Attachment**

**RECOMMENDATION 1:**

The Director, Collection, should take steps to enhance the internal controls on the lien tracking system currently in place for IRC Section 6324A special estate tax liens. Procedures and guidelines on entering and monitoring of liens on this system should be provided to all employees. Guidelines should be updated to reflect the use of this system and interim guidelines should be issued immediately. Additionally, periodic reconciliations should be performed to ensure that all IRC Section 6324A special liens are being timely recorded in the relevant local government office and timely released.

**CORRECTIVE ACTIONS:**

We agree with the recommendation and will take the following corrective actions:

- a) Distribute a memorandum providing interim procedures for lien tracking, entry and monitoring, and explaining system enhancements.
- b) Issue procedures and guidelines in IRM Sections 5.12.2 and 5.12.6 for lien tracking, entry and monitoring, and explaining system enhancements.
- c) Incorporate reviews during annual estate tax lien reviews at the Cincinnati Campus to ensure that all IRC Section 6324A special liens are properly recorded and released.

**IMPLEMENTATION DATE:**

- a) January 15, 2008
- b) May 15, 2008
- c) March 15, 2008

**RESPONSIBLE OFFICIAL:**

- a) Director, Collection Policy, Small Business/Self-Employed Division
- b) Director, Collection Policy, Small Business/Self-Employed Division
- c) Director, Collection Policy, Small Business/Self-Employed Division

**CORRECTIVE ACTION(S) MONITORING PLAN:**

The Director, Collection, Small Business/Self-Employed Division, will advise the Commissioner, Small Business/Self-Employed Division, of any delays in implementing these corrective actions.

**RECOMMENDATION 2:**

The Director, Specialty Programs, needs to update controls on IRC Section 6166 installment payment cases to ensure that lien packages are sent to Collection Advisory to determine whether a bond or an IRC Section 6324A special lien should be secured.



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**CORRECTIVE ACTIONS:**

We agree to implement the following actions to ensure compliance with established procedures:

- a) Distribute a memorandum establishing interim procedures for technical staff in the campus and field Estate and Gift tax operations to follow in order to solicit acknowledgement from the Collection Advisory function that lien packages have been received and to ensure case files contain evidence of receipt in the Collection Advisory function.
- b) Issue procedures and guidelines in IRM Sections 4.25.1 and 4.25.2 to verify receipt of lien packages by the Collection Advisory function.
- c) Evaluate the feasibility of matching Estate and Gift systemic data with Collection systemic data to confirm that all estate tax returns having a balance due and qualifying for IRC Section 6166 installment payments are referred to the Collection Advisory function.

**IMPLEMENTATION DATE:**

- a) October 15, 2007
- b) May 15, 2008
- c) March 15, 2008

**RESPONSIBLE OFFICIAL:**

- a) Chief, Estate and Gift Tax, Specialty Programs, Small Business/Self-Employed Division
- b) Chief, Estate and Gift Tax, Specialty Programs, Small Business/Self-Employed Division
- c) Chief, Estate and Gift Tax, Specialty Programs, Small Business/Self-Employed Division

**CORRECTIVE ACTION(S) MONITORING PLAN:**

Director, Specialty Programs, Small Business/Self-Employed Division, will advise the Commissioner, Small Business/Self-Employed Division, of any delays in implementing these corrective actions.

**RECOMMENDATION 3:**

The Directors, Collection and Specialty Programs, should reassess whether estate cases requesting payment extensions are being worked by employees with proper technical expertise to ensure estate taxpayers receive equitable tax treatment and estate taxes are collected.

**CORRECTIVE ACTIONS:**

We agree with the recommendation and will take the following corrective actions:

- a) Assemble a team, including representatives of Small Business/Self-Employed Division Directors for Collection, Specialty Programs, and Campus Compliance



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Services, to evaluate the criteria for referring payment extension requests to the Collection Advisory function and the adequacy of guidance provided to campus personnel making decisions about granting extensions to pay.

- b) Consider the technical expertise needed to evaluate the requests and decide on changes which may be needed to ensure proper consideration is given to all requests for extensions to pay.
- c) Distribute a memorandum establishing interim procedures, if appropriate, for referring payment extension requests to the Collection Advisory function.
- d) Revise technical guidance, if appropriate, to campus staff.
- e) Issue procedures and guidelines in IRMs 5.5.5 and 4.25.2, if appropriate, for referring payment extension requests to the Collection Advisory function.

**IMPLEMENTATION DATE:**

- a) November 15, 2007
- b) February 15, 2008
- c) February 15, 2008
- d) March 15, 2008
- e) May 15, 2008

**RESPONSIBLE OFFICIAL:**

- a) Director, Collection Policy, Small Business/Self-Employed Division
- b) Director, Collection Policy, Small Business/Self-Employed Division
- c) Director, Campus Compliance Services, Small Business/Self-Employed Division
- d) Director, Campus Compliance Services, Small Business/Self-Employed Division
- e) Director, Specialty Programs, Small Business/Self-Employed Division

**CORRECTIVE ACTION(S) MONITORING PLAN:**

- a) Director, Collection, Small Business/Self-Employed Division, will advise the Commissioner, Small Business/Self-Employed Division, of any delays in implementing this corrective action.
- b) Director, Collection, Small Business/Self-Employed Division, will advise the Commissioner, Small Business/Self-Employed Division, of any delays in implementing this corrective action.
- c) Director, Campus Compliance Services, Small Business/Self-Employed Division, will advise the Commissioner, Small Business/Self-Employed Division, of any delays in implementing this corrective action.
- d) Director, Campus Compliance Services, Small Business/Self-Employed Division, will advise the Commissioner, Small Business/Self-Employed Division, of any delays in implementing this corrective action.
- e) Director, Specialty Programs, Small Business/Self-Employed Division, will advise the Commissioner, Small Business/Self-Employed Division, of any delays in implementing this corrective action.



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**RECOMMENDATION 4:**

The Director, Specialty Programs, should notify the taxpayer when their payment extension has been granted. Procedures should be developed to ensure that estates requesting payment extensions are sent a copy of the extension request (Form 4768) notating its approval and a letter explaining the terms of the extension. In addition, Publication 1 should be sent explaining the taxpayer's rights.

**CORRECTIVE ACTIONS:**

We partially agree with the recommendation. We conclude that a form letter indicating approval date and terms of the extension will suffice and will require fewer resources than providing the taxpayer with a copy of the extension request Form 4768. We will take the following corrective actions:

- a) Draft an extension to pay approval notification letter for review/approval.
- b) Distribute a memorandum establishing interim procedures.
- c) Issue procedures in IRM 4.25.2 for the processing of the notification letter along with Publication 1.

**IMPLEMENTATION DATE:**

- a) March 15, 2008
- b) March 15, 2008
- c) July 15, 2008

**RESPONSIBLE OFFICIAL:**

- a) Director, Campus Compliance Services, Small Business/Self-Employed Division
- b) Director, Campus Compliance Services, Small Business/Self-Employed Division
- c) Director, Specialty Programs, Small Business/Self-Employed Division

**CORRECTIVE ACTION(S) MONITORING PLAN:**

- a) The Director, Campus Compliance Services, Small Business/Self-Employed Division, will advise the Commissioner, Small Business/Self-Employed Division, of any delays in implementing this corrective action.
- b) The Director, Campus Compliance Services, Small Business/Self-Employed Division, will advise the Commissioner, Small Business/Self-Employed Division, of any delays in implementing this corrective action.
- c) The Director, Specialty Programs, Small Business/Self-Employed Division, will advise the Commissioner, Small Business/Self-Employed Division, of any delays in implementing this corrective action.