



*Actions Are Needed to Protect Taxpayers'
Rights During the Lien Due Process*

July 9, 2010

Reference Number: 2010-30-072

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



HIGHLIGHTS

ACTIONS ARE NEEDED TO PROTECT TAXPAYERS' RIGHTS DURING THE LIEN DUE PROCESS

Highlights

Final Report issued on July 9, 2010

Highlights of Reference Number: 2010-30-072 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

After filing Notices of Federal Tax Lien, the Internal Revenue Service (IRS) must notify the affected taxpayers in writing, at their last known address, within 5 business days of the lien filings. However, as noted in previous audits, the IRS has not always complied with this statutory requirement and did not always follow its own internal guidelines for notifying taxpayer representatives of the filing of lien notices. Therefore, some taxpayers' rights to appeal the lien filings may have been jeopardized, and others may have had their rights violated when the IRS did not notify their representatives of the lien filings.

WHY TIGTA DID THE AUDIT

TIGTA is required by law to determine annually whether lien notices sent by the IRS comply with the legal guidelines in Internal Revenue Code Section 6320.

WHAT TIGTA FOUND

TIGTA reviewed a statistically valid sample of 125 Federal Tax Liens filed for the 12-month period ending June 30, 2009, and determined that the IRS mailed substantially all of the 125 lien notices in a timely manner, as required by Internal Revenue Code Section 6320. These errors could result in violations of taxpayers' rights. TIGTA estimated that 15,169 lien notices filed during the same period could have been mailed late.

In addition, the IRS did not always follow its own regulations for notifying taxpayers' representatives of the filing of lien notices. IRS regulations require taxpayer representatives be

given copies of all correspondence issued to the taxpayer. For 8 of the 31 cases in the statistically valid sample where the taxpayer had an authorized representative, the IRS did not notify the taxpayer's representative of the lien filing. The IRS does not have an automated process that updates taxpayer representative information directly to the system that generates the lien notices. TIGTA estimated that 60,675 taxpayer representatives may not have been provided lien notices, resulting in potential violations of taxpayers' right to have their representative notified.

When an initial lien notice is returned because it could not be delivered and a different address is available for the taxpayer, the IRS does not always meet its statutory requirement to send the lien notice to the taxpayer's last known address. TIGTA identified three cases for which a new lien notice should have been sent to the taxpayer at the updated address because IRS systems listed the address prior to the lien filing. The three cases could involve legal violations because the IRS did not meet its statutory requirement to send lien notices to the taxpayer's last known address.

WHAT TIGTA RECOMMENDED

TIGTA recommended that 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 taxpayer violations for the untimely lien notices. In addition, the Director, Campus Filing and Payment Compliance, Small Business/Self-Employed Division, should ensure compliance with undelivered lien notices procedures.

IRS officials agreed with the recommendations and are planning corrective actions. ***1*****

*****1*****

TIGTA maintains that the outcome measure in the report is reasonable. *****1*****

*****1*****



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 9, 2010

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process (Audit # 201030001)

This report presents the results of our review to determine whether liens issued by the Internal Revenue Service (IRS) comply with legal guidelines set forth in Internal Revenue Code (I.R.C.) Section (§) 6320 (a)¹ and related guidance in the Federal Tax Lien Handbook. 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. § 6320.² The audit was included in our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Taxpayer Protection and Rights.

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 Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.

¹ I.R.C. § 6320 (Supp. V 1999).

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



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

Table of Contents

BackgroundPage 1

Results of ReviewPage 4

 Lien Notices Were Not Mailed TimelyPage 4

Recommendation 1:.....Page 4

 The Internal Revenue Service Did Not Comply With Regulations
 for Notifying Taxpayer RepresentativesPage 5

 Ineffective Working of Undelivered Lien Notices Resulted in
 Potential Violations of Taxpayers' RightsPage 7

Recommendation 2:.....Page 10

Appendices

 Appendix I – Detailed Objective, Scope, and MethodologyPage 11

 Appendix II – Major Contributors to This ReportPage 14

 Appendix III – Report Distribution ListPage 15

 Appendix IV – Outcome Measures.....Page 16

 Appendix V – Synopsis of the Internal Revenue Service Collection
 and Lien Filing ProcessesPage 18

 Appendix VI – Internal Revenue Service Computer Systems Used
 in the Filing of Notices of Federal Tax Lien.....Page 20

 Appendix VII – Management's Response to the Draft Report.....Page 21



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

Abbreviations

| | |
|--------|----------------------------------|
| ACS | Automated Collection System |
| ALS | Automated Lien System |
| CAF | Centralized Authorization File |
| FY | Fiscal Year |
| ICS | Integrated Collection System |
| IDRS | Integrated Data Retrieval System |
| I.R.C. | Internal Revenue Code |
| IRS | Internal Revenue Service |
| SB/SE | Small Business/Self-Employed |



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

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. The IRS has the authority to attach a claim to the taxpayer's assets for the amount of unpaid tax when the taxpayer neglects or refuses to pay.¹ This claim is referred to as a Federal Tax Lien. The IRS files in appropriate local government offices a Notice of Federal Tax Lien² (lien notice), which notifies interested parties that a lien exists.

Since January 19, 1999, Internal Revenue Code Section (I.R.C. §) 6320³ 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 lien notice, Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320⁴ (Letter 3172), 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.⁵

Most lien notices are mailed to taxpayers by certified or registered mail rather than being delivered in person. The IRS Automated Lien System (ALS) generates a certified mail list 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 Postal Service employee ensures that all notices are accounted for and 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

¹ Internal Revenue Code Section 6321 (1994).

² Notice of Federal Tax Lien (Form 668(Y) (c); (Rev. 10-1999)), Cat. No. 60025X.

³ I.R.C. § 6320 (Supp. V 1999).

⁴ Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320 (Letter 3172 (Rev. 9-2006)), Cat. No. 26767I.

⁵ The last known address is that one shown on the most recently filed and properly processed tax return, unless the IRS received notification of a different address.



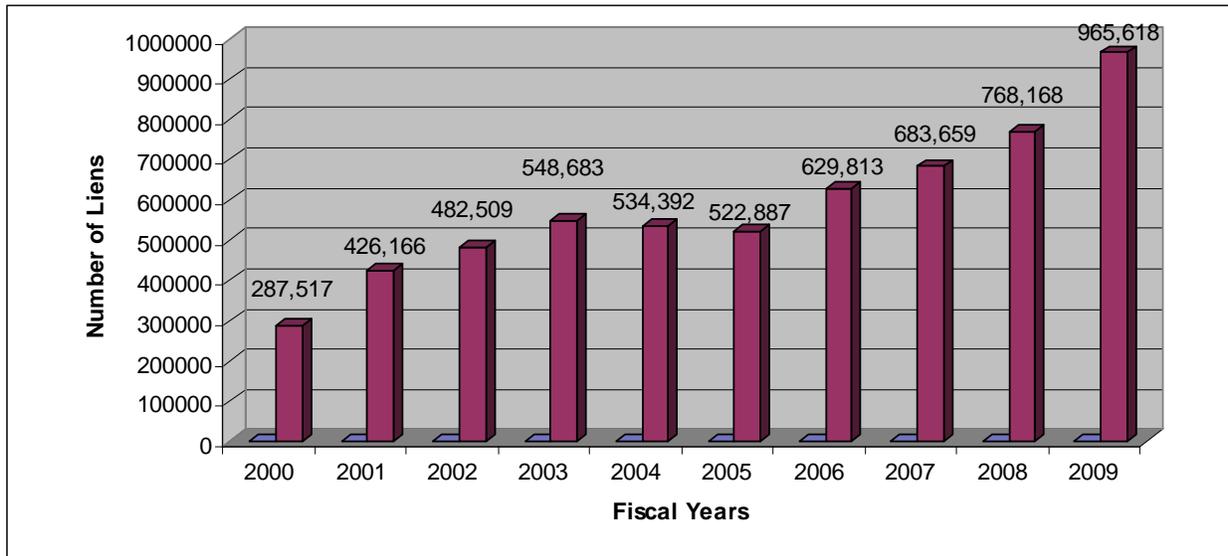
*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

notices were mailed. A synopsis of the IRS collection and lien filing processes is included in Appendix V.

Depending on employee access, lien requests can be generated using one of three IRS systems: 1) the Integrated Collection System (ICS), 2) the Automated Collection System (ACS), or 3) the ALS. A description of IRS computer systems used in the filing of lien notices is included in Appendix VI.

The IRS has increased the number of Federal Tax Liens it has filed to protect the Federal Government's interest. As shown in Figure 1, the number of Federal Tax Liens has increased by 236 percent since Fiscal Year (FY) 2000.

Figure 1: Number of Liens Filed From FYs 2000–2009



Source: IRS Data Books published in FY 2003 (for FYs 2000 to 2003), FY 2007 (for FYs 2004 to 2007), and FY 2009 (for FY 2009).⁶

The Treasury Inspector General for Tax Administration is required to determine annually whether, when filing lien notices, the IRS complied with the law regarding the notifications of affected taxpayers and their representatives.⁷ This is our twelfth annual audit to determine whether the IRS complied with the legal requirements of I.R.C. § 6320 and its own related internal guidelines for filing lien notices. In prior years, we reported that the IRS had not yet achieved full compliance with the law and its own internal guidelines. FY 2009 was the first year our statistically valid sample did not identify any lien notices that were not mailed in a

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

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

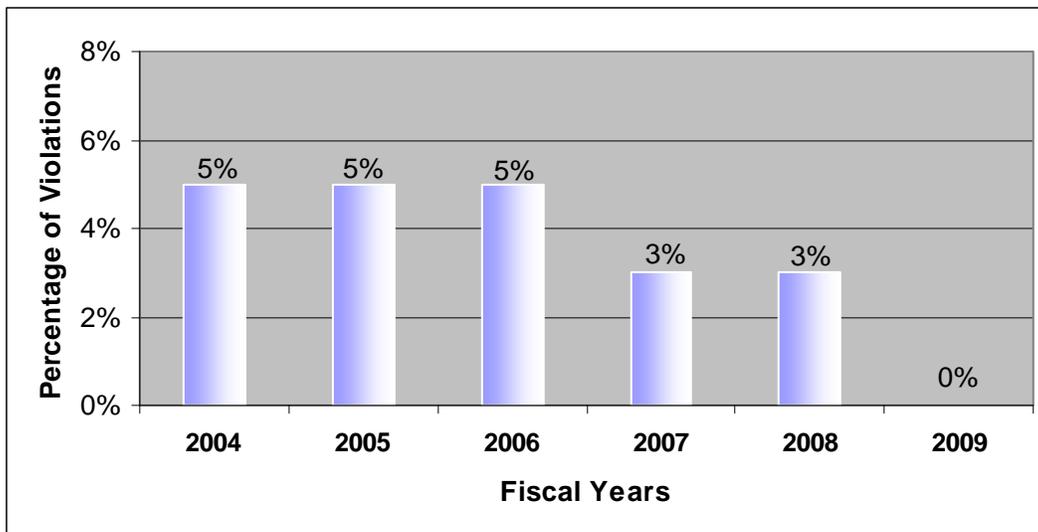


*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

timely manner. However, this year again, we identified potential violations of taxpayer rights because the IRS did not timely notify taxpayers or their representatives. In addition, our review of a judgmental sample of undelivered lien notices found potential violations of taxpayer rights when the IRS did not use the taxpayer's last known address.

Figure 2 shows the percentages of potential violations of I.R.C. § 6320, by not notifying taxpayers timely, that were identified during our prior annual audits.

Figure 2: Potential Violations of Taxpayer Rights Based on I.R.C. § 6320 Timely Notification Requirement



Source: Treasury Inspector General for Tax Administration mandatory lien reports issued during FYs 2004–2009.

This review was performed at the Small Business/Self-Employed (SB/SE) Division Office of Collection Policy in Washington, D.C., and the Centralized Lien Unit in Covington, Kentucky, during the period September 2009 through March 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



Actions Are Needed to Protect Taxpayers' Rights During the Lien Due Process

Results of Review

Lien Notices Were Not Mailed Timely

I.R.C. § 6320 requires the IRS to notify taxpayers in writing, at their last known address, within 5 business days of the filing of a Notice of Federal Tax Lien. We statistically sampled 125 lien notices from the 948,051 lien notices filed between July 1, 2008, and June 30, 2009. The IRS timely and correctly mailed the taxpayers' notices of a lien filing and appeal rights as required by I.R.C. § 6320. The majority of lien notices are sent to taxpayers via certified mail. In order to support the timely notification of taxpayers, IRS procedures require retention of the date-stamped copy of the certified mail lists for 10 years after the end of the processing year.

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 if they appeal the filing of the lien notices and the IRS denies the requests for appeal. We estimate that 15,169 lien notices filed between July 1, 2008, and June 30, 2009,

Recommendation

Recommendation 1: The Director, Collection, SB/SE Division, should consult with the IRS Office of Chief Counsel to identify any actions necessary to correct the potential legal violations for the two untimely notices.

Management's Response: they believe our outcome measure is overstated. They believe the number of taxpayers potentially impacted should be reduced from 15,169, as noted in our report, to 7,584, which is less than 1 percent of the total.



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

Office of Audit Comment: We maintain that the outcome measures in the report are reasonable. *****1*****

The Internal Revenue Service Did Not Comply With Regulations for Notifying Taxpayer Representatives

Taxpayer representative information is contained on the Centralized Authorization File (CAF)⁸ that is located on the Integrated Data Retrieval System (IDRS).⁹ Using the IDRS, employees can research the CAF to identify the types of authorization given to taxpayer representatives.

Department of the Treasury regulations (§ 601.506)¹⁰ require that once a taxpayer representative has been recognized as such, he or she must be given copies of all correspondence issued to the taxpayer. This applies to all computer or manually generated notices or other written communications. Employees responsible for making lien filing determinations are to ensure that 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 taxpayer¹¹ when a Notice of Federal Tax Lien is filed.

Our review of the statistically valid sample of 125 liens included 31 taxpayers with representatives authorized to receive notifications at the time the liens were filed. For 8 (26 percent) of the 31 taxpayers, ALS records did not indicate that the IRS had sent copies of the lien notices to their representatives. Specifically:

- *****1*****

⁸ The CAF contains information about the type of authorizations taxpayers have given their representatives for their tax returns.

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

¹⁰ 26 Code of Federal Regulations § 601.506.

¹¹ Failure to give notice or other written communication to the recognized representative of a taxpayer will not affect the validity of any notice or other written communication delivered to a taxpayer.



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

***** 1 *****

- ***** 1 ***** revenue officers.¹² For three liens, the revenue officer obtained taxpayer representative information from the taxpayer but did not ensure that the CAF was updated. For the other three liens, the revenue officer did not request the representative information on the ICS be sent to the ALS.

Taxpayers might be adversely affected if the IRS does not follow requirements to notify both the taxpayers and their representatives of the taxpayers' rights related to liens. We estimate that 60,675 taxpayer representatives may not have been provided lien notices, resulting in potential violations of the taxpayers' right to have their representatives notified of the filing of a lien notice.

In addition to this year's results, Figure 3 shows the error rates reported on the notification of taxpayer representatives in our last four reports.

Figure 3: Error Rates Reported on Notification of Taxpayer Representatives

| Report FY | Sampled Lien Cases Requiring Representative Notification | Sampled Lien Cases Not Receiving Representative Notification | Error Rate |
|------------------|---|---|-------------------|
| 2006 | 45 | 34 | 76% |
| 2007 | 25 | 15 | 60% |
| 2008 | 30 | 12 | 40% |
| 2009 | 27 | 8 | 30% |
| 2010 | 31 | 8 | 26% |

Source: Prior and current year results of Treasury Inspector General for Tax Administration tests of taxpayer representative notification.

While the error rate has been reduced from 76 percent in our FY 2006 report to 26 percent in our FY 2010 report, the potential for violations still exist in approximately one quarter of all cases requiring taxpayer representative notification.

In last year's report,¹³ we identified similar conditions and made a recommendation to implement computer programming enhancements for an automated upload of CAF data to the ALS. The corrective actions for this recommendation are scheduled to be implemented in August 2010. Because this change is scheduled to occur after FY 2011's sample selection, this process will be evaluated during our FY 2012 statutory review of lien due process procedures.

¹² Employees in the Collection Field function who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by the IRS campuses or the ACS.

¹³ *Additional Actions Are Needed to Protect Taxpayers' Rights During the Lien Due Process* (Reference Number 2009-30-089, dated June 16, 2009).



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

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

IRS procedures require that employees send another lien notice to a new address if 1) the originally mailed notice is returned as undelivered mail, 2) research confirms the original lien notice was not sent to the last known address, 3) a different address is available for the taxpayer, and 4) the address was effective prior to the lien notice filing. SB/SE Division Collection employees are responsible for certain actions when notices are returned as undeliverable. For example, they should research the IRS computer system within 5 business days to ensure that the address on the original lien notice is correct. If the employee cannot find a new address on the computer system, the undelivered lien notice will be destroyed and a new notice is not issued.

If the address on the notice is not the last known address and a different address was in effect prior to issuance of the original lien notice, employees should issue a new notice to the better address. A new notice may be created by using an option in the ALS.

We selected a judgmental sample of 300 undelivered lien notices returned to the Cincinnati Campus¹⁴ for the period October 20 through October 26, 2009. The sample included only returned mail identified as undelivered and did not include returned mail identified as refused or unclaimed. For these 300 notices, we reviewed computer system audit trails to determine whether IRS employees performed timely research to determine whether the addresses were correct on the originally mailed notices. Our results showed that the 300 returned notices were handled by employees as follows:

- In 48 (16 percent) of the 300 notices, employees performed the required research within 5 business days of receipt of the returned notice.
- In 252 (84 percent) of the 300 notices, employees did not perform required research of the IRS computer system for a different address within 5 business days of receipt of the returned notice.

Our test of undelivered lien notices identified 23 of 300 notices in which the address on the IRS computer system and the original lien notice did not agree. For 20 of the 23 notices, the address on the IRS computer system was updated after the original lien notice was sent to the taxpayer. Therefore, no additional action was required. However, for 3 notices (13 percent), the address was updated prior to the issuance of the original lien notice and, according to IRS procedures, a new lien notice should have been sent to the taxpayer at the updated address. These cases could involve potential violations of taxpayer rights because the IRS did not meet its statutory

¹⁴ 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. We selected the Cincinnati Campus because the lien notices issued by the SB/SE Division ACS sites returned as undeliverable are sent there, which provided a sufficient volume of notices from which to select our sample.



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

requirement of sending each lien notice to the taxpayer's last known address. For example, in March 2010, the United States Tax Court¹⁵ dismissed an individual's petition for review of an IRS collection action for lack of jurisdiction, finding that the IRS' lien notice was invalid because it was not mailed to the individual's last known address.

Lien notices are not sent to the most current addresses because, in part, user guides and procedures for the systems that generate lien requests are inconsistent about address verification. In addition, employees are not always following established procedures for verifying the current address of the taxpayer prior to preparing a lien request. Specifically, ACS procedures do not require the user to verify the taxpayer's name and address prior to preparing a lien. Further, the ALS does not perform an automated verification of the taxpayer's last known address prior to printing the lien notice.

Management advised us that the procedures for requiring the research and resolution of undelivered lien notices within 5 business days of being received do not pertain to the ACS. However, there is no exception for the ACS. The procedures provide that all undelivered mail will be returned to the requesting employee or the office designated the responsibility of processing undelivered lien notices to be researched and resolved within 5 business days of receipt. The ACS Support function has been designated by the SB/SE Division to receive all undelivered lien notices filed by SB/SE Division ACS since the process (address verification of undelivered lien notices) was decentralized in August 2007. Management also indicated that the routing of the undelivered lien notices could have contributed to the untimely research of the undelivered mail. Specifically, all returned mail is received at the Cincinnati Campus where it is extracted and sorted by mail type. The returned lien notices are routed to ACS Support that is located in a different building where 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.

In last year's report, we identified similar conditions and made a recommendation to implement computer programming enhancements to include an automated check of a taxpayers' last known address prior to the printing of lien notices. The corrective actions pertaining to this recommendation are scheduled to be implemented in August 2010. Because this change is scheduled to occur after FY 2011's sample selection, this process will be evaluated during the FY 2012 statutory review of the lien due process procedures.

¹⁵ United States Tax Court, filed March 1, 2010, found that the lien notice issued with respect to a taxpayer's 2002 tax return was not mailed to the taxpayer's last known address, nor was it received and, therefore, it is invalid. Consequently, the IRS is required, under the provisions of § 6320 and the accompanying regulations, to issue to the taxpayer a substitute lien notice and provide him or her with an opportunity to request a lien hearing.



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

Employees are not following new procedures designed to monitor undeliverable lien notices

In August 2007, SB/SE Division Collection procedures for handling undelivered lien notices were revised to return the undelivered lien notice directly to the requesting employee or function. Employees handling undelivered lien notices were also required to input a specific IDRS transaction code with an appropriate action code. The transaction code signifies that the lien notice was returned and the action code indicates the reason (i.e., undelivered, unclaimed, or refused). These codes are required to be entered into the IDRS after appropriate research of the returned lien notice is performed.

In August 2009, the ALS was enhanced to perform a weekly systemic extract to send the appropriate undeliverable status (transaction code and action code) of lien notices to the IDRS using a specific command. When this command is used to update the status of the lien notice, no additional input is necessary to update the IDRS. When a lien notice is returned undelivered and research has been completed regarding an updated address, the employee must go to the lien notice screen on the ALS and indicate undelivered status.

Our test of undelivered lien notices determined that the IRS is not complying with this procedure. None of the 300 undelivered lien notices that we sampled had a transaction code or associated action code input into the IDRS. For our sample, the ALS was not updated with the status of the undelivered lien notices and, therefore, the upload to the IDRS (via the ALS) did not occur. As a result, there is no record of the mail status of these lien notices. Management advised us that the requirements to enter these codes do not apply to the ACS. However, as we reported previously, the ACS Support function has been designated by the SB/SE Division to receive all undelivered lien notices that were filed by SB/SE Division ACS since the process (address verification of undelivered lien notices) was decentralized in August 2007. Accordingly, the requirement provides that the person designated the responsibility of processing undelivered lien notices will also check the IDRS for a last known address and request the input of the transaction code with the appropriate action code or the command code enhancement via the ALS.

Compliance with these procedures is important because it allows management to review the handling of undelivered lien notices. Undelivered lien notices are being sent back to more than 450 Collection function groups throughout the country where the employees or functions that requested the liens are located. The combination of decentralizing the handling of undelivered lien notices and the failure of employees to update taxpayers' data in the IDRS resulted in management's inability to ensure and enforce the timely resolution of undelivered lien notices. This situation contributed to the number of undelivered lien notices that were not researched timely increasing from 33 percent in our FY 2008 report to nearly 83 percent in our FY 2009 report and 84 percent in our FY 2010 report.



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

Further, because employees are not following the procedures to enter the information into the IDRS, information about undelivered mail is limited to the employees working the undelivered mail. IRS management, including Accounts Management organization¹⁶ employees and even Centralized Lien Unit employees who have access to the ALS, do not have access to information on undelivered lien notices. As a result, Taxpayer Assistance Center¹⁷ employees would not be able to answer taxpayer questions about their Federal Tax Liens.

This is the second consecutive year that we reported 100 percent noncompliance with this procedure. Management was aware of this condition and is currently evaluating the necessity of the procedure.

Recommendation

Recommendation 2: The Director, Campus Filing and Payment Compliance, SB/SE Division, should ensure the ACS Support function complies with the procedures for timely address verification and mail status updates of undelivered lien notices.

Management's Response: IRS management agreed with this recommendation. The Director, Collection Policy, and the Director, Campus Filing and Payment Compliance, will re-evaluate Internal Revenue Manual procedures to ensure they are consistent across the functions and support the timely resolution of undeliverable notices. In addition, the Director, Collection Policy, will consider the necessity of IDRS status indicators for undelivered lien notices and take appropriate action to improve their usage or discontinue the procedure.

¹⁶ The Accounts Management organization is responsible for providing taxpayers with information on the status of their returns, refunds, and for resolving the majority of issues and questions to settle their accounts.

¹⁷ IRS offices with employees who answer questions, provide assistance, and resolve account-related issues for taxpayers face to face.



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether liens issued by the IRS comply with legal guidelines set forth in I.R.C. § 6320 (a)¹ and related guidance in the Federal Tax Lien Handbook. To accomplish the objective, we:

- I. Determined whether taxpayer lien notices related to 125 Federal Tax Liens 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 125 Federal Tax Lien cases from the ALS² extract of the 948,051 liens filed by the IRS nationwide between July 1, 2008, and June 30, 2009. 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),³ which we rounded to 125:

| | |
|----------------------------------|---------------------------------|
| $n = (Z^2 p(1-p))/(A^2)$ | 948,051 |
| Z = Confidence Level: | 95 percent |
| p = Expected Rate of Occurrence: | 3 percent (last two reports 3%) |
| A = Precision Rate: | ±3 percent |
 - B. Validated the ALS extract by comparing the sampled records to online data from the ALS and by reviewing management system evaluations that covered 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, or business partners by reviewing data from the ALS, ICS, ACS, IDRS, and the certified mail list.
 - D. Evaluated the controls and procedures established for transferring, storing, and safeguarding certified mail lists at the Centralized Case Processing function.
 - E. Determined whether taxpayers' representatives were provided a copy of the lien due process notice by reviewing data from the ALS, IDRS, ICS, and ACS.

¹ I.R.C. Section 6320 (Supp. V 1999).

² See Appendix VI for descriptions of IRS computer systems used in the filing of Notices of Federal Tax Lien.

³ 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.



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

1. Reviewed IDRS screens for CAF indicators (Transaction Code 960) for all sampled cases.
 2. Reviewed ALS history screens for accounts with CAF indicators to see if lien notices were mailed to taxpayers' representatives within 5 business days of mailing the taxpayer's notice.
- F. Validated data from the ACS and the ICS by relying on the Treasury Inspector General for Tax Administration Data Center Warehouse⁴ site procedures that ensure that data received from the IRS are valid. The Data Center Warehouse performs various procedures to ensure that it receives all the records in the ACS, ICS, and IRS databases. In addition, we scanned the data for reasonableness and are satisfied that the data are sufficient, complete, and relevant to the review. All the liens identified are in the appropriate period, and the data appear to be logical.
- G. Provided all exception cases to the Office of Collection Policy, SB/SE Division, for agreement to potential violations and corrective actions if appropriate.
- II. Evaluated the procedures for processing lien notices⁵ that are returned as undelivered.
- A. Selected a judgmental sample of 300 unprocessed mail items containing undelivered lien notices received during the period October 20 through October 26, 2009, and recorded the taxpayer's name, address, Social Security Number, and serial lien identification number. The judgmental sample included only returned mail identified as undelivered. The population of returned mail identified as undelivered is unknown because the IRS does not record the receipt of undelivered mail. A judgmental sample was used for this reason and the test was conducted to show weaknesses for which management needed to take corrective action.
 - B. Researched the IDRS using command code INOLES and determined whether the address on the Master File⁶ matched the address on the undelivered lien notice for each sampled case.
 - C. Reviewed IDRS audit trails and determined whether IRS employees timely performed the required IDRS research for resolution of undelivered status for each sampled case.
 - D. Reviewed the IDRS and verified whether the Transaction Code 971 and corresponding action codes were entered into the IDRS for each sampled case.

⁴ A centralized storage and administration of files that provide data and data access services to IRS data.

⁵ Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320 (Letter 3172 (Rev. 9-2006)), Cat. No. 26767I.

⁶ The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

- III. Determined whether internal guidelines had been implemented or modified since our last review by discussing procedures and controls with appropriate IRS personnel in the National Headquarters.
- IV. Determined the status of ICS and ACS system enhancements and any problems encountered.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the SB/SE Division Collection function's policies, procedures, and practices for timely notifying taxpayers of lien filings and timely verifying addresses of undelivered lien notices. We evaluated these controls by interviewing management and reviewing samples of lien notices sent to taxpayers and lien notices returned to the IRS as undelivered.



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

Appendix II

Major Contributors to This Report

Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Carl Aley, Director
Timothy Greiner, Audit Manager
Richard Viscusi, Lead Auditor
Curtis Kirschner, Senior Auditor
Meaghan Tocco, Senior Auditor
Janis Zuika, Senior Auditor
Stephen Elix, Auditor
Frank Maletta, Auditor
Charles Nall, Auditor
Niurka Thomas, Auditor
Kevin O'Gallagher, Information Technology Specialist



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Chief Counsel CC
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Director, Collection, Small Business/Self-Employed Division SE:S:C
Director, Collection Policy, Small Business/Self-Employed Division SE:S:C:CP
National Taxpayer Advocate
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



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our 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; 15,169 taxpayers may not have been provided Notices of Federal Tax Lien and Your Right to a Hearing Under I.R.C. Section 6320 (Letter 3172),¹ resulting in potential violations of taxpayers' rights (see page 4).

Methodology Used to Measure the Reported Benefit:

From a statistically valid sample of 125 Federal Tax Lien cases, *****1*****

***** The sample was selected based on a confidence level of 95 percent, a precision rate of ± 3 percent, and an expected rate of occurrence of 3 percent. We projected the findings to the total population provided by the IRS of 948,051 Notices of Federal Tax Lien generated by the ALS between July 1, 2008, and June 30, 2009.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 60,675 taxpayer representatives may not have been provided Notices of Federal Tax Lien and Your Right to a Hearing Under I.R.C. Section 6320 (Letter 3172), resulting in potential violations of taxpayers' rights (see page 5).

Methodology Used to Measure the Reported Benefit:

From a statistically valid sample of 125 Federal Tax Lien cases, we identified 8 (6.4 percent) of 125 cases for which IRS employees did not provide notice to taxpayer representatives, resulting in potential violations of taxpayers' rights. In the eight cases, the ALS record did not indicate that the IRS had sent copies of the lien notices to the representatives. The sample was selected based on a confidence level of 95 percent, a precision rate of ± 3 percent, and an expected rate of occurrence of 3 percent. We projected the findings to the total population provided by the IRS of

¹ Notice of Federal Tax Lien Filing and Your Right to a Hearing Under I.R.C. 6320 (Letter 3172 (Rev. 9-2006)), Cat. No. 26767I.



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

948,051 Notices of Federal Tax Lien generated by the ALS between July 1, 2008, and June 30, 2009.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; three taxpayers were not provided Letters 3172, resulting in potential legal violations of taxpayers' rights (see page 7).

Methodology Used to Measure the Reported Benefit:

In a judgmental sample of 300 undelivered lien notices, we determined that the IRS did not send notices to the updated addresses of 3 taxpayers. Taxpayer rights could be affected because a taxpayer not receiving a notice or receiving a late notice might be unaware of the right to appeal or might receive less than the 30-calendar day period allowed by the law to request a hearing. In addition, taxpayer rights could be further affected when the taxpayer appeals the filing of the lien and the IRS denies the request for the appeal.



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

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. 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 locations. The ICS¹ is used in most of these locations to track collection actions taken on taxpayer accounts.
- IRS employees who make only telephone contact with taxpayers work in call sites in Customer Service offices. The ACS is used in the call sites to track collection actions taken on taxpayer accounts.

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 Lien² 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, 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 notices³ to notify responsible parties of the lien filings and of their appeal rights. The ALS maintains an

¹ See Appendix VI for detailed descriptions of IRS computer systems used in the filing of Notices of Federal Tax Lien.

² Notice of Federal Tax Lien (Form 668(Y) (c); (Rev. 10-1999)), Cat. No. 60025X.

³ Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320 (Letter 3172 (Rev. 9-2006)), Cat. No. 26767I.



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

electronic database of all open Notices of Federal Tax Lien and updates the IRS' primary computer records to indicate that a Notice of Federal Tax Lien has been filed.

Most lien notices are mailed to taxpayers by certified or registered mail, rather than 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 that all notices are accounted for, 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.



*Actions Are Needed to Protect Taxpayers' Rights
During the Lien Due Process*

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 Lien¹ 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 ACS and ICS cases are controlled on the ALS by Technical Support or Case Processing functions at the Cincinnati, Ohio, Campus.² 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. It 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 File³ for the IRS to maintain accurate records of activity on taxpayers' accounts.

¹ Notice of Federal Tax Lien (Form 668(Y) (c); (Rev. 10-1999)), Cat. No. 60025X.

² 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.

³ 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.



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
JUN 14 2010
BY: *DAS*

June 14, 2010

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Christopher Wagner
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Actions Are Needed to Protect Taxpayers' Rights during the Lien Due Process (Audit No. 201030001)

Thank you for the opportunity to respond to the draft report entitled "Actions Are Needed to Protect Taxpayers' Rights During the Lien Due Process." We appreciate your review of the program. The notice of lien process is an important, high-volume component of our collection strategy to protect the government's interest on unpaid taxes.

We continue to improve our processes to protect taxpayer rights. We are enhancing our automation process to always use the most current address on lien due process notices. In addition, a recent update to the Automated Lien System allows for an upload to the Integrated Data Retrieval System to post transaction codes to indicate notice issuance as well as a notice returned undeliverable.

We agree it is imperative for both legal and taxpayer rights purposes to timely issue lien notices.

1

We agree with your recommendation to consult Counsel on late notices and will take action as necessary.

Regarding undeliverable lien notices, the Automated Collection System (ACS) employees generally follow IRM 5.19 procedures and do not utilize the field operations procedures in IRM 5.12. The procedural guidance in IRM 5.12 regarding the tracking of the mail status for undeliverable notices is not a legal requirement and its usefulness to the IRS is being reconsidered. Whereas we concur with your recommendation that ACS Support function and Collection field function timely address undeliverable notices, and agree consistent procedures for handling these notices should be established for all



2

functions, we are considering which procedures are more appropriate. This includes considering whether to discontinue the practice of inputting status updates for the undeliverable notices if it adds no value.

1 we believe your outcome measure is overstated. The number of taxpayers potentially impacted should be reduced from 15,169, as noted in your report, to 7,584, which is less than one percent of the total.

Attached is a detailed response outlining our corrective actions. If you have any questions, please contact me, or a member of your staff may contact David Alito at (202) 283-7660.

Attachment



Attachment

RECOMMENDATION 1:

Consult with the IRS Office of Chief Counsel to identify any actions necessary to correct the potential legal violations for the two untimely notices.

CORRECTIVE ACTION:

We agree with the recommendation. We will consult with the Office of Chief Counsel to determine what, if any, corrective actions are necessary.

IMPLEMENTATION DATE:

December 15, 2010

RESPONSIBLE OFFICIAL:

Director, Collection Policy, SB/SE Division

CORRECTIVE ACTION(S) MONITORING PLAN:

The Director, Collection Policy will monitor the status and advise the Director, Collection of any delays in implementation.

RECOMMENDATION 2:

Ensure the ACS Support function complies with the procedures for timely address verification and mail status updates of undelivered lien notices.

CORRECTIVE ACTION:

We agree with the recommendation. 1) Collection Policy and Campus Filing and Payment Compliance will re-evaluate IRM 5.12 and IRM 5.19 procedures to ensure they are consistent across the functions and support the timely resolution of undeliverable notices. 2) Collection Policy will consider the necessity of IDRS status indicators for undelivered lien notices and take appropriate action to improve their usage or discontinue the procedure.

IMPLEMENTATION DATE:

March 15, 2011

RESPONSIBLE OFFICIAL:

Director, Collection Policy, SB/SE Division
Director, Campus Filing and Payment Compliance, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN:

The Director, Collection will monitor the status and will coordinate with the Director, Campus Filing and Payment Compliance for implementation.