Reducing the Processing Time Between Balance Due Notices Could Increase Collections

September 26, 2011

Reference Number: 2011-30-112

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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REDUCING THE PROCESSING TIME BETWEEN BALANCE DUE NOTICES COULD INCREASE COLLECTIONS

Highlights

Final Report issued on September 26, 2011

Highlights of Reference Number: 2011-30-112 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed Division and the Wage and Investment Division.

IMPACT ON TAXPAYERS

The notice stream is the least costly of the Internal Revenue Service's (IRS) three-phase approach to collecting unpaid taxes. While the notice stream collects billions of dollars in delinquent taxes annually, reducing the time between notices could result in millions more being collected annually. If the IRS does not effectively pursue collection of unpaid tax through the notice stream, it could create an unfair burden on the majority of taxpayers who fully pay their taxes on time.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether the IRS balance due notice stream is effectively collecting taxes owed and providing timely service to taxpayers. The audit was included in our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

WHAT TIGTA FOUND

During Fiscal Year 2010, the IRS sent approximately 21.9 million balance due notices to individuals to try to collect approximately $67.9 billion in 11.6 million balance due modules. More than one-half of the 11.6 million balance due modules that entered the notice stream were closed as fully paid or an installment agreement was established, but only 16.5 percent of the total assessment amount was collected. By a wide margin, the first notice (the Master File notice) closed the most modules, collected the most money, and generated the most taxpayer responses.

Balance due modules not resolved after the Master File notice continue in the notice stream, and the taxpayers receive various sequences of notices. While the statutory requirement to provide notice of a balance due is met with the Master File notice, the IRS may send up to three reminder notices. The IRS allows 35 days between notices for the taxpayer to respond, but our analysis shows that the time between notices can be reduced to reflect taxpayer response times. As these balance due modules progress within the notice stream, the probability of collection diminishes. TIGTA estimates that by reducing the time between each notice by seven days, the notice stream could potentially collect an additional $363 million each year. However, a study analyzing the impact of reducing the time would be needed to quantify the benefits. In addition, taxpayers could potentially save $1.8 million each year in interest payments.

Our analysis of the 11.6 million balance due modules that entered the notice stream in Fiscal Year 2010 also showed the notice stream does not always treat taxpayers with more than one delinquency the same. As a result, the IRS may not use collection resources most effectively.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS consider reducing the time between each notice by seven days and consider establishing a business rule to address taxpayers with more than one balance due module entering the notice stream at the same time. The IRS agreed with TIGTA's recommendations and plans to take corrective actions. However, the IRS stated 35 days between notices was necessary to process taxpayer inquiries and correspondence. In addition, the IRS disagreed with the outcome measures, stating it has enforcement tools not available to private industry. It is unclear why the IRS refers to its enforcement tools because collection rates in private industry are higher than in the IRS. Further, the IRS Office of Research has reported that the probability of collection diminishes as taxpayers' balance due accounts age.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 26, 2011

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

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Reducing the Processing Time Between Balance Due Notices Could Increase Collections (Audit # 201030020)

This report presents the results of our review to determine the effectiveness of the Internal Revenue Service's (IRS) balance due notice stream in collecting taxes owed and providing timely service to taxpayers. This review was included in our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included as Appendix VIII.

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.

Table of Contents

Abbreviations

ACS	Automated Collection System
CFf	Collection Field function
CP	Computer Paragraph
FY	Fiscal Year
GAO	Government Accountability Office
IDRS	Integrated Data Retrieval System
IRS	Internal Revenue Service
TDA	Taxpayer Delinquent Account

Background

The Internal Revenue Service (IRS) identifies unpaid tax liabilities by using a variety of techniques, including (1) identifying taxpayers who file tax returns without fully paying the tax reported to be owed, (2) checking for obvious errors when processing returns, (3) finding additional tax liabilities by auditing a filed tax return, (4) assessing a penalty for some taxpayer action or inaction, and (5) sending a bill to a taxpayer who did not file a required tax return. These liabilities move through the IRS's three phases for collecting unpaid tax liabilities until they are determined to be uncollectible, collected, or otherwise resolved:

The notice stream is one of the IRS's three phases for collecting unpaid taxes.

- Notice Stream: The IRS sends a series of balance due notices to the taxpayer to prompt a reply or payment by the taxpayer.
- Telephone Contact (Automated Collection System (ACS)[1]): IRS employees attempt telephone contact with the taxpayer to prompt a payment or take enforcement action that may include levying financial assets or filing a lien against property.
- In-person contact (Collection Field function (CFf)): Revenue officers contact the taxpayer to prompt a payment or take enforcement action, including levies, liens, and seizures of property.

The IRS uses an "assembly line" approach for its collection cases, starting with a preset number of automatically generated balance due notices (notice stream), followed by assignment to the ACS, followed by placement in a queue for assignment to revenue officers. Statutory[2] requirements provide that the IRS send one notice of deficiency for each assessment to the taxpayer. Accordingly, the notice stream begins with the issuance of the statutory notice, which is generated by the Master File, followed by reminder notices, which are generated by the Integrated Data Retrieval System (IDRS). During the notice stream for individual taxpayers, the IRS's general practice is to send up to four[3] notices at 5-week intervals to collect the balances due (the IRS provides 6 weeks from the Computer Paragraph (CP) 504 notice[4] before issuing a Taxpayer Delinquent Account (TDA)). Figure 1 illustrates the notice stream for a taxpayer who files an individual tax return with a balance due.

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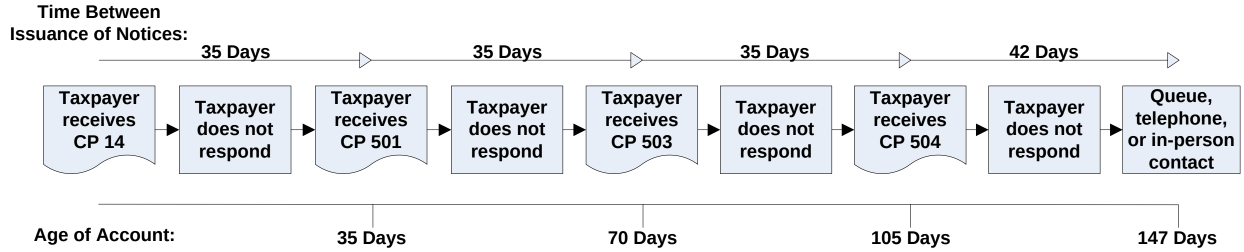
[1] See Appendix VII for a glossary of terms.
[2] 26 U.S.C. § 6303(a).
[3] Business taxpayers receive up to two notices. Business taxpayers are outside the scope of this review.
[4] See Appendix V for a list of CP notices.

Figure 1: IRS Balance Due Notice Stream Process for Individuals



Source: Our analysis of the notice stream.

The Master File generates a CP 14 notice (Balance Due of $5 or More, No Math Error) and sends it to the taxpayer. If the taxpayer does not respond to this notice, the IDRS will generate a CP 501 notice (1st Notice – Individual Master File Balance Due) as the first reminder notice. If the taxpayer does not respond to this notice, then the CP 503 notice (2nd Notice – Individual Master File Balance Due) is issued as the second reminder notice. If the taxpayer still has not responded, the IDRS generates the CP 504 notice (Final Notice – Individual Master File Balance Due), which is sent as an urgent notice to remind a taxpayer of a balance due. The CP 504 notice is the final balance due notice and includes information on the IRS's right to levy the taxpayer's State income tax refund[5] and on how the taxpayer can prevent collection action. If the taxpayer does not respond to the CP 504 notice, a TDA is issued for the taxpayer's module. Depending on the specific circumstances of the taxpayer (such as a prior period liability), the IRS may skip one or more of the reminder notices.

In November 2008, the IRS Taxpayer Communication Task Force initiated a review of all notices sent to taxpayers. The task force's objectives included simplifying and clarifying notice language; instituting effective measures; streamlining and improving business processes; and eliminating unnecessary or duplicative notices, letters, reminders, and inserts. In May 2010, the IRS issued Notice Effectiveness Reports for each of the three reminder notices (CP 501, CP 503, and CP 504). These reports presented the redesigned notices, which consisted of wording and format changes to make the notices easier to read and understand. The revised versions of these notices were implemented on February 1, 2011.

In September 2009, the Government Accountability Office (GAO) reported[6] the IRS lacks reasonable assurance that collection notices achieve desired results and lacks documentation on the notice stream business rules and whether the notices work as intended. The GAO concluded the notice stream may be operating well, but given the lack of objectives and performance measures for the process, its efficiency and effectiveness are not assured and opportunities for improving performance may be missed.

[5] 26 U.S.C. § 6330(f).
[6] *Tax Debt Collection: IRS Needs to Better Manage the Collection Notices Sent to Individuals* (GAO-09-976, dated September 2009).

This review was performed at the Headquarters Offices of the Small Business/Self-Employed Division in New Carrollton, Maryland, and the Wage and Investment Division in Atlanta, Georgia, during the period December 2010 through April 2011. 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. Rounding impacted the percentage amounts shown throughout this report. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

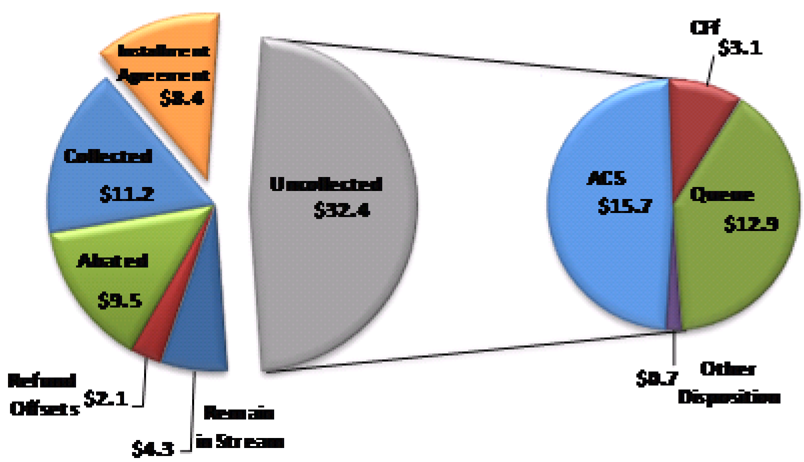
Results of Review

The Notice Stream Collects Billions of Dollars, but Significant Dollars Remain Uncollected at the End of the Stream

The balance due notice stream allows the IRS to maximize collections while minimizing costs in pursuing individual taxpayer balance due modules. Because notices are computer generated and mailed to taxpayers, there is little direct involvement by IRS employees. To the extent that taxpayers then take action to pay or otherwise resolve their balance due modules, collections can occur with relatively little additional IRS investment. When taxpayers do not respond during the notice stream, the module pertaining to the balance due is issued a TDA. The IRS sends these TDAs to the Collection Queue or takes immediate enforcement action through the other two phases (telephone contact or in-person contact) to collect the balance due modules. Such enforcement action is more labor-intensive and expensive.

During Fiscal Year (FY) 2010, the IRS sent approximately 21.9 million balance due notices to individuals to try to collect approximately $67.9 billion in 11.6 million balance due modules. Figure 2 shows the disposition of these modules while in the stream.

Figure 2: FY 2010 Balance Due Notice Stream Activity (in billions)



Source: Our analysis of the IRS Collection Database of individual modules entering the balance due notice stream in FY 2010.

Through the use of the notice stream, the IRS obtained more than $11.2 billion (16.5 percent) of the $67.9 billion in full or partial payments. In addition, balance due modules with assessments of nearly $9.5 billion were abated and $2.1 billion were offset via taxpayer refunds by overpayments in a subsequent module. Also $8.4 billion left the notice stream because the taxpayer entered into an installment agreement.[7] Another $32.4 billion (48 percent) of the $67.9 billion exited the notice stream uncollected, of which $18.8 billion was moved to more costly collection phases (the ACS and the CFf).

Extra Processing Time Between Reminder Notices Postpones Collection Action and Reduces Potential Revenue

Our analysis of the 11.6 million individual taxpayer modules in the notice stream showed the majority of collections and taxpayer responses were the result of the statutory Master File notice. The balance due modules not resolved after the Master File notice spend up to 76 percent of the time in the notice stream collecting 35 percent of the dollars received during the notice stream process. Specifically, our results showed:

- The Master File notice meets the statutory notification requirement.
- The Master File notice is the most effective notice.
- The processing time between notices can be reduced to reflect taxpayer response time.
- The time between the notices can be reduced to increase revenue and reduce taxpayer costs.

The Master File notice meets the statutory notification requirement

After a balance due is established for a taxpayer, the IRS has a statutory requirement to send one notice of deficiency to the taxpayer. Specifically, the Internal Revenue Code[8] requires the IRS to, as soon as practicable and within 60 days after the making of an assessment pursuant to Section 6203,[9] give notice to the taxpayer liable for the unpaid tax, stating the amount and demanding payment thereof. This notice should be mailed to the taxpayer's last known address.[10] This statutory requirement is met by providing taxpayers with the Master File notice. The CP 501 and CP 503 notices are discretionary, not mandatory. The IRS sends the CP 501 and CP 503 notices to the taxpayer as a reminder that the taxpayer's balance due is still unpaid.

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[7] The $8.4 billion associated with the modules exiting the notice stream due to an installment agreement is not yet collected. An installment agreement allows a taxpayer who does not have the funds to make a full payment to instead make installment payments over a prescribed period of time. In some instances, the taxpayer defaults on the agreement and the money is never collected.
[8] 26 U.S.C. § 6303(a), Notice and Demand for Tax.
[9] 26 U.S.C. § 6203, Method of Assessment.
[10] The last known address is that shown on the most recently filed and properly processed tax return, unless the IRS received notification of a different address.

The CP 504 notice is sent as a final notice to remind taxpayers of a balance due and of the IRS's intent to levy a State tax refund as part of the State Income Tax Levy Program.[11] The CP 504 notice is also mandatory for this reason. However, only 34 States (including the District of Columbia) participate in the State Income Tax Levy Program. Accordingly, the notice of intent to levy a State refund would not apply to all taxpayers because it would not be mandatory for taxpayers living in States that do not participate in the program.

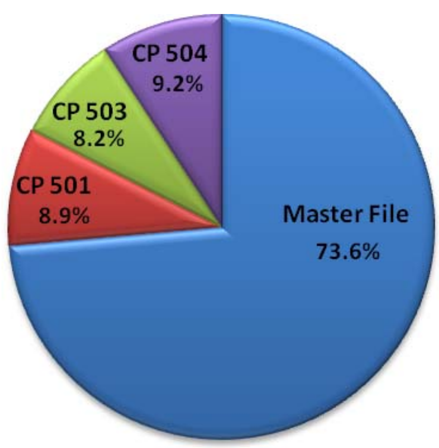
The Master File notice is the most effective notice

The statutory Master File notice is the first notice sent to the taxpayer. By a wide margin, the Master File notice was the most effective notice in all measures of success.[12] Specifically, the Master File notices:

- Resulted in 2.79 times more closures than all other notices combined.
- Collected 1.84 times more dollars than all other notices combined.
- Generated 2.02 times more taxpayer responses than all other notices combined.

Modules closed: 6.9 million (59 percent) of the 11.6 million balance due modules that entered the notice stream in FY 2010 were closed as fully paid or the taxpayer entered into an installment agreement. Figure 3 shows that more than 73 percent (more than 5 million) of the 6.9 million closures were a result of the Master File notice.

Figure 3: Modules Closed by Notice Type



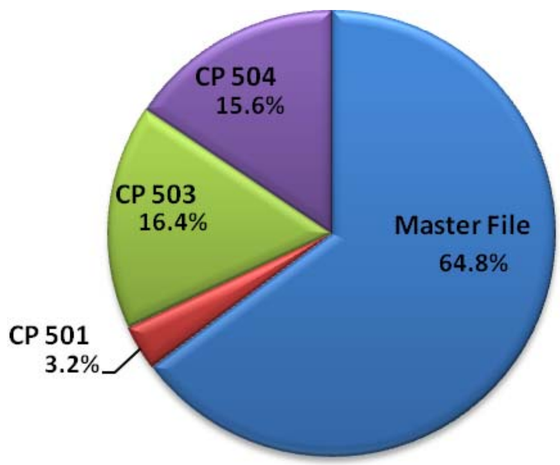
Source: Our analysis of the IRS Collection Database of individual modules entering the balance due notice stream in FY 2010.

[11] Each State with income tax requirements can sign an agreement with the IRS to permit the State tax refund to be applied to a Federal tax liability.
[12] See Appendix VI for the results of each notice.

More than 2.6 million (52 percent) of the 5 million closures by the Master File notice were due to full payment; the other 48 percent were because the taxpayer entered into an installment agreement.

Dollars Collected: $11.2 billion (16.5 percent) of the nearly $68 billion of assessed taxes that entered the notice stream were collected while still in the stream. Figure 4 shows approximately 65 percent ($7.2 billion) of the $11.2 billion was collected as a result of the Master File notice.

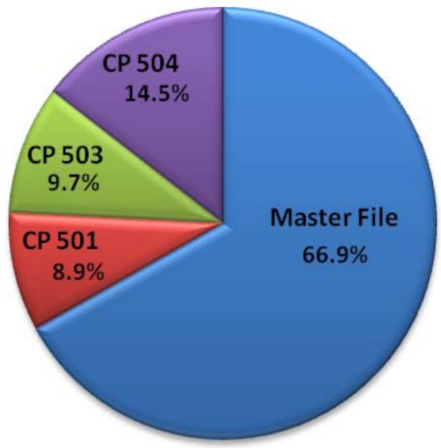
Figure 4: Dollars Collected by Notice Type



Source: Our analysis of the IRS Collection Database of individual modules entering the balance due notice stream in FY 2010.

Taxpayer Responses: An important goal of the notice stream is making contact with taxpayers so the IRS can assist them in resolving delinquencies. The notice stream generated taxpayer responses from 8.3 million (71 percent) of the 11.6 million modules. Figure 5 shows that about 67 percent (5.6 million) of the 8.3 million taxpayer responses came as a result of the Master File notice.

Figure 5: Taxpayer Responses by Notice Type



Source: Our analysis of the IRS Collection Database of individual modules entering the balance due notice stream in FY 2010.

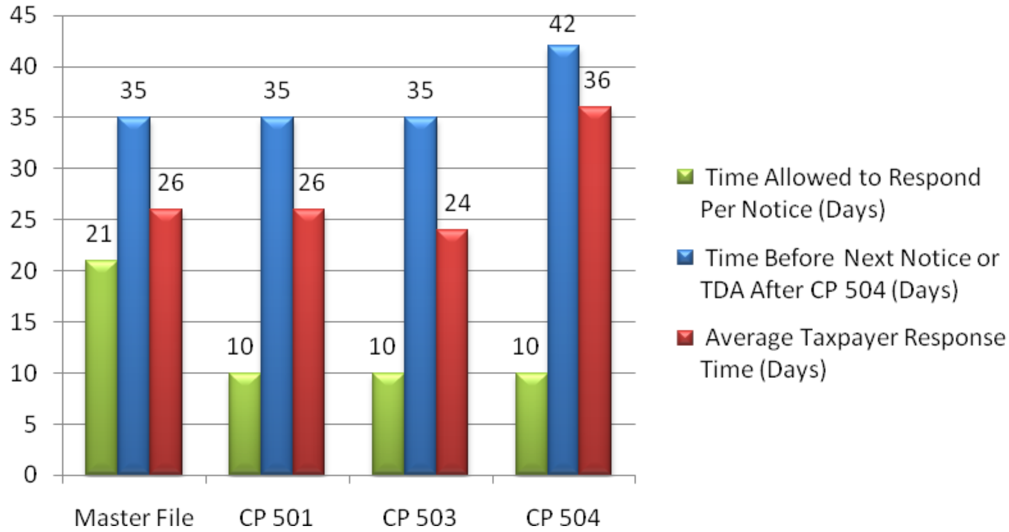
Our results show that by a wide margin, the Master File notice closes the most modules, collects the most money, and generates the most taxpayer responses. Accordingly, if only the statutory notices were sent to the taxpayers, the majority of tax delinquencies that are now collected would still be collected.

The processing time between notices can be reduced to reflect taxpayer response time

For each notice sent, the IRS allows 5 weeks (35 days) for the taxpayer to resolve the balance due before sending the next notice. According to the IRS, this is to provide sufficient time for the taxpayer to submit his or her payment and the IRS to process the payment and avoid unnecessary notices sent to the taxpayer.

Figure 6 compares the average taxpayer response time (which includes the time it takes the IRS to process the payment) for each notice based on our analysis of the 11.6 million balance due modules that entered the notice stream in FY 2010. This comparison also includes the number of days the IRS allows for a response per the notices and IRS procedures.

Figure 6: Time Allowed Compared to Actual Response Time



Source: CP 14, CP 501, CP 503, and CP 504 notice processing times, IRS procedures, and our analysis of the 11.6 million balance due notices in FY 2010.

The IRS advises taxpayers they have 21 days to respond to the Master File notice, but allows 35 days before sending the next notice. However, the subsequent reminder notices (CP 501, CP 503, and CP 504) advise the taxpayers they have just 10 days to respond, but the IRS still allows 35 days before sending the next notice (the IRS provides 6 weeks from the CP 504 notice before issuing a TDA). Based on discussions with IRS officials, it is unclear why it is necessary for the IRS to allow the additional time for each reminder notice, compared with the Master File notice. Further, our analysis showed that approximately 67 percent of taxpayers who respond during the notice stream did so after the Master File notice (and responded within 26 days on average).

Taxpayers may respond to a notice by submitting correspondence inquiring about their balance due module or providing information for the IRS to consider in regards to their inability to pay. This correspondence will be routed to the IRS area[13] that processes taxpayer correspondence regarding balance due modules. While their correspondence is processed, the IRS will prevent the next notice from being sent to the taxpayer for another 8 weeks (56 days).

In addition, while IRS procedures allow 5 weeks (35 days) between the issuance of notices if the taxpayer does not respond, we found that, on average, the time between notices is consistently longer. For example, Figure 7 shows that it took the IRS 44 days (compared to 35 days) to send

[13] Compliance Services Collection Operations located at each IRS campus.

a taxpayer the CP 504 notice, and it took the IRS 39 days (compared to 35 days) to send the taxpayer a CP 503 notice.

Figure 7: Actual IRS Processing Times Between Notices

		To		
		CP501	CP503	CP504
From	MF	38	39	44
From	CP501		37	40
From	CP503			38

Source: Our analysis of the IRS Collection Database of individual modules entering the balance due notice stream in FY 2010. MF = Master File.

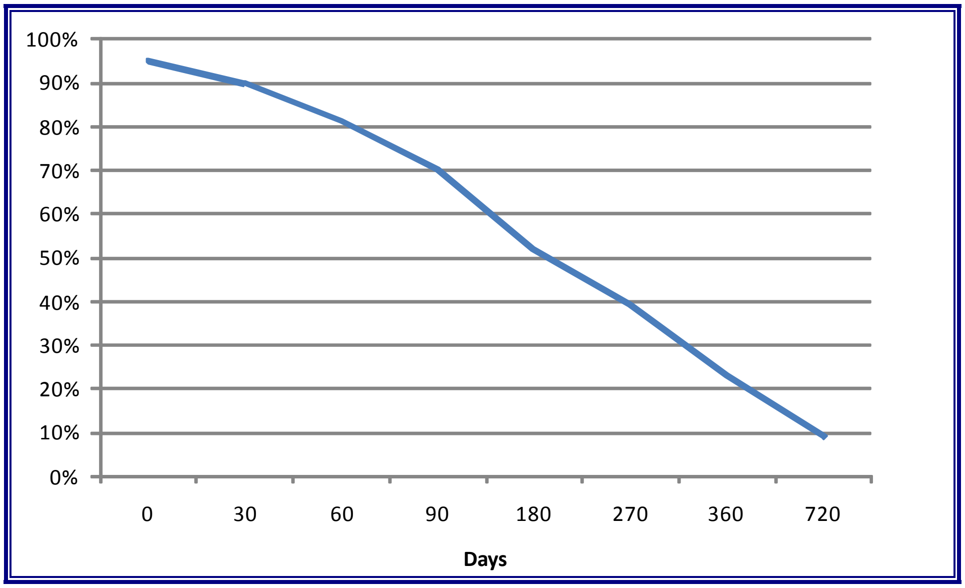
Our analysis of the 11.6 million FY 2010 notice stream modules showed that the processing time allowed between the notices was longer than necessary. We were advised the IRS has not made changes to the time intervals between the notices in more than 15 years. Since that time, the IRS has made many improvements to its mail and payment sorting capabilities and notice stream processing. As a result, the IRS is more efficient at processing taxpayer payments than it was in years past. The IRS can realize additional benefits from this increased efficiency by reducing the time intervals between notices to improve revenue.

The time between the notices can be reduced to increase revenue and reduce taxpayer costs

There is a widely accepted principle in the collection industry referred to as the collectability curve, which measures the probability of collecting funds over time. Figure 8 is a generally accepted industry collectability curve[14] which shows that the probability of collecting funds diminishes over time.

[14] Collectability statistics were based on a survey conducted by the Commercial Collection Agency Association of the Commercial Law League of America among its members, who collectively handle about 80 percent of all commercial debt claims placed for collection in the United States.

Figure 8: Generally Accepted Industry Collectability Curve



Source: Commercial Collection Agency Association.

In the collection industry, the probability of settling unpaid accounts falls dramatically over time, as follows:

- After 3 months, collectability falls to 70 percent.
- After 6 months, collectability falls to 52 percent.
- After 12 months, collectability falls to 23 percent.

Similar to the industry collectability principle, the IRS has recognized its collections also diminish as accounts age. Specifically, the IRS Office of Research conducted a study[15] and concluded that as more time elapses before an individual makes at least one payment, it becomes less likely that they will do so at any subsequent time. However, the IRS does not compare collectability with the milestones during the notice stream. For example, the IRS does not know the specific reduction in collectability when a module moves from a CP 501 notice to a CP 503 notice or the specific impact of each additional day that passes when no collection action is taken. Therefore, we estimated the impact of reducing the time between notices by using the percentage point decreases of the collectability curve.

Specifically, our analysis showed that a 7-day reduction in the time between notices corresponded to a 1-percent increase on the collectability curve (see Figure 8). For example, the collectability curve suggests the likelihood of collection is 1 percent higher if the CP 501 notice

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[15] United States Department of the Treasury, IRS – The IRS Research Bulletin, Publication 1500 (Rev. 11-99).

is sent to the taxpayer after 28 days instead of 35 days. Figure 9 shows the potential impact of reducing the time between notices.

Figure 9: Impact of Reducing the Time Between Notices

Notice Stream Path	Number of Modules	Assessment Less Collections	Percentage Increase on Collectability Curve	Potential Increase in Collections
MF	5,858,502	$ 10,914,711,673	0%	$ -
MF plus one or more notices	5,767,196	$ 36,343,485,312	1%	$ 363,434,853
	11,625,698	$ 47,258,196,985		$ 363,434,853

Source: Our analysis of the IRS Collection Database of individual modules entering the balance due notice stream in FY 2010. MF = Master File.

The notice stream could potentially collect an additional $363.4 million, based on the 11.6 million balance due modules that entered the notice stream during FY 2010. However, it would be necessary to collect more information, such as a pilot study, to validate the benefits.

In addition to increasing collection within the notice stream, accelerating the notices through the notice stream will also reduce the interest paid by taxpayers whose delinquent accounts exit the notice stream and are subsequently paid by the taxpayers when the delinquent accounts are assigned to the ACS or the CFf. Specifically, because taxpayers' delinquent accounts will be assigned to these other 2 collection phases 7 to 21 days earlier, the interest they will have incurred will be less. Overall, the delinquent accounts for 466,544 taxpayers exited the notice stream and then more than $1.4 billion was paid by the taxpayers after their delinquent accounts were assigned to either the ACS or the CFf. By reducing the time between each notice by 7 days, we estimate that these taxpayers would pay about $1.8 million less in interest.

Also, accelerating the notice stream would allow the IRS to assign the remaining uncollected modules to the more aggressive collection processes in the ACS and the CFf earlier in the process, which should allow those functions to improve collection rates. We analyzed a statistical sample[16] of modules that were issued a CP 504 notice and determined that collectability of balance due modules that exit the notice stream is low. Of the 296 modules we reviewed, the CP 504 notice resulted in full or partial payments on only 12 modules (4 percent). Of the remaining 284 balance due modules, 29 exited the notice stream and were placed into the status indicating the balance was below the IRS tolerance for assignment, while 255 exited the notice stream and the modules were issued TDAs. The ACS was assigned 209 (82 percent) of these TDAs and 46 (18 percent) were assigned to the queue. Overall, 222 (78 percent) of the 284 balance due modules did not receive any payments after exiting the notice stream.

[16] Sample results were not projected to the population. Our sampling methodology is included in Appendix I.

The IRS's success with Master File notices supports the concept that collection potential is greater earlier in the notice stream. We were advised that as long as the notices collect some money, IRS management is satisfied with performance. While we agree there is a benefit in providing taxpayers with reminder notices, we believe the IRS can improve the success of the notice stream by reducing the time between the notices to take advantage of improvements the IRS has made to its sorting and processing of payments and to be more consistent with taxpayer behavior.

Recommendation

Recommendation 1: The Director, Office of Taxpayer Correspondence, Wage and Investment Division, should consider reducing the time between each notice by 7 days.

> ***Management's Response:*** IRS management agreed with this recommendation and is open to modifying the time between each notice subject to budget constraints and programming issues. The Director, Collection Policy, Small Business/Self-Employed Division, will consider this recommendation along with other options, including earlier phone intervention, to improve the notice process.
>
> ***Office of Audit Comment:*** In their response, the IRS stated 5 weeks between notices was necessary to process taxpayer inquiries and correspondence. However, our report noted the IRS has controls in place to prevent the next notice from being sent when the IRS is processing taxpayers' correspondence. During our audit, the IRS was unable to provide any data supporting the need for 35 days to accomplish this task; however, our analysis of the 11.6 million taxpayer modules that entered the notice stream in FY 2010 showed it does not take 35 days to process payments or installment agreement requests. The IRS also disagreed with the outcome measures in the report, stating that while it may be appropriate to consider private collection curves when reviewing the IRS collection process, the IRS has enforcement tools not available to private industry. It is unclear why the IRS refers to its enforcement tools because collection rates in private industry are higher than in the IRS. Further, the IRS Office of Research has recognized the probability of collection diminishes as taxpayers' balance due accounts age.

Processing Varies for Taxpayers With Multiple Balance Due Modules

The IRS has developed variations on the practice of sending taxpayers four notices before deciding whether to send any uncollected balance due modules to the next collection phase. For example, the IRS may take such actions as skipping the discretionary reminder notices to accelerate a debt to the next collection phase. The IRS established business rules that are embedded in the IRS's computer system that determine the number and types of notices. These business rules also determine whether collection action should be deferred or the modules should be sent to other phases for further collection action. The business rules were created in an attempt to make the most effective use of collection resources.

Our analysis of the 11.6 million balance due modules that entered the notice stream in FY 2010 showed the notice stream does not always treat taxpayers the same when there is more than one balance due module. Modules with other open balance due modules in a TDA status and assigned to either the ACS, the CFf, or the Queue, skip the discretionary reminder notices and accelerate a debt to the next collection phase. These modules should proceed from the Master File notice to the CP 504 notice and then TDA issuance. However, we identified taxpayers who had more than one balance due module enter the notice stream at the same time. Specifically, more than 263,000 taxpayers had 670,761 balance due modules enter the notice stream on the same day. Approximately 75 percent of these modules were not accelerated by receiving the CP 504 notice after the Master File notice.

Taxpayers who have existing open balance due modules when a new balance due module enters the notice stream are in a similar situation as taxpayers who have more than one module entering the stream on the same day. When this occurs, the taxpayer has two open modules in the notice stream at the same time. However, IRS management explained that there are no business rules that address the situation of taxpayers who have more than one module entering the stream on the same day. The IRS added that the taxpayers with more than one module entering the notice stream is not as much of a collection risk as those taxpayers with an existing open balance due module.

In its report on the IRS notice stream, the GAO[17] determined the IRS lacks documentation on the notice phase business rules and whether the business rules work as intended. The GAO also stated the IRS could not provide documentation on the rationales, such as the factors considered or reasons for adopting the rule, for any of the rules reviewed. Accordingly, the IRS may not have considered the collection risk of taxpayers who have more than one balance due module enter the notice stream at the same time.

When the notice stream business rules do not address taxpayers with more than one module entering the notice stream at the same time, the IRS may not be making the most effective use of collection resources.

Recommendation

Recommendation 2: The Director, Collection Policy, Small Business/Self-Employed Division, should consider establishing a business rule to address taxpayers with multiple balance due modules entering the notice stream at the same time.

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[17] *Tax Debt Collection: IRS Needs to Better Manage the Collection Notices Sent to Individuals* (GAO-09-976, dated September 2009).

Management's Response: IRS management agreed with this recommendation. The Director, Collection Policy, Small Business/Self-Employed Division, will reexamine the business rules and consider establishing a rule to address taxpayers with multiple balance due modules entering the notice stream at the same time.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine the effectiveness of the IRS's balance due notice stream in collecting taxes owed and providing timely service to taxpayers. To accomplish this objective, we:

I. Reviewed collection procedures in the IRS's Internal Revenue Manual and interviewed IRS employees to determine current collection processes used and compliance with statutory regulations.

II. Obtained from the IRS Collection Database[1] a computer extract of the COLL_IMF_MODULE_BALDUE, a Collection file that contains records of individual taxpayer modules that entered the notice stream as status 19/21 (initial Master File notice) and tracks the related collection activity on each module.

   A. Analyzed 11,625,698 individual taxpayer modules that received the initial Master File notice during FY 2010 and captured any collection activity on those modules from issuance of the initial notice through December 31, 2010.

   B. Assessed the validity of the extract by comparing the data contained in 30 records to information from the IRS Individual Master File.

III. Selected a random sample of 296 balance due modules from a population of 222,509 balance due modules that received CP 504 notice (final notice) during the 5-week period ending as of July 31, 2010. We selected a random sample using a confidence level of 90 percent, a precision rate ±5 percent, and an expected rate of occurrence of 50 percent (unknown) in order to project our results to the population.

   A. For each module in our sample, researched the IDRS using various command codes to gather relevant information for each module.

   B. Analyzed the information to determine 1) the change in delinquency balance due amount resulting from partial payments, refund offsets, abatements, etc.; 2) the interest incurred on the balance due amount; and 3) the current status of the balance due account.

IV. Used a generally accepted industry collectability curve to determine the potential impact of reducing the time between each notice.

[1] See Appendix VII for a glossary of terms.

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 IRS business rules for sending balance due modules through the notice stream. We evaluated these controls by interviewing management, reviewing a sample of balance due modules that exited the notice stream, and analyzing approximately 11.6 million balance due modules that entered the notice stream during FY 2010.

Appendix II

Major Contributors to This Report

Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
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Timothy Greiner, Audit Manager
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Michael Garcia, Senior Auditor
Frank Maletta, Auditor
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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Wage and Investment Division SE:W
Director, Campus Compliance Services, Small Business/Self-Employed Divsion SE:S:CCS
Director, Collection-Field, Small Business/Self-Employed Division SE:S:C
Director, Filing and Payment Compliance, Wage and Investment Division SE:W:CP:FPC
Director, Office of Taxpayer Correspondence, Wage and Investment Division SE:W:OTC
Chief Counsel CC
Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
    Commissioner, Small Business/Self-Employed Division SE:S
    Commissioner, Wage and Investment Division SE:W

Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $1.8 billion for a 5-year period by reducing the time between each balance due notice by 7 days (see page 5).

Methodology Used to Measure the Reported Benefit:

During FY 2010, approximately 11.6 million balance due modules with assessments totaling $67.9 billion entered the balance due notice stream. We identified the specific paths (number of notices) that these modules took while in the notice stream. Using a generally accepted industry collectability curve, we matched the timeline of the various balance due notice paths and estimated the potential collection rates of each notice based on the curve. We then decreased the notice stream timeline by 7 days for each notice and identified the percentage points increase in collections the notice stream could potentially realize. The difference between the two estimated collection rates from the Master File notice to the first reminder notice sent was 1 percentage point, which we multiplied by the assessment amounts (less amounts collected and abated while in the notice stream) to determine the amount of additional revenue the notice stream could collect.

- 5,767,196 modules with assessments of $36,343,485,312 with the notice stream timeline reduced 7 or more days results in an additional 1 percent collection rate.
    - $36,343,485,312 × 1 percent = $363,434,853.

This resulted in total additional revenue collected of $363,434,853. The additional revenue for FY 2010 was multiplied by 5 to obtain a 5-year projection of $1,817,174,265.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 466,544 taxpayers could reduce the interest they pay on their delinquent tax by $9.1 million for a 5-year period by reducing the time between each balance due notice by 7 days (see page 5).

Methodology Used to Measure the Reported Benefit:

During FY 2010, approximately 11.6 million balance due modules with assessments totaling $67.9 billion entered the balance due notice stream. We identified the specific paths (number of notices) that these modules took while in the notice stream before exiting and being assigned to the ACS or the CFf. Overall, 466,544 taxpayers made payments on their delinquent accounts after being assigned to the ACS or the CFf. By reducing the time between each notice by 7 days, we calculated the potential reduction in interest charges that taxpayers would have to pay because their delinquent accounts would be assigned to the ACS or the CFf 7 to 21 days earlier (depending on how many notices were received in the notice stream). The current rate of interest the IRS charges on delinquent taxes is 4 percent.

Taxpayers who received two notices in the notice stream:

- 149,031 taxpayers paid $522,254,832 after their delinquent accounts were assigned to the ACS or the CFf.
    - ($522,254,832 × 4 percent / 365) × 7 days = $400,634.

Taxpayers who received three notices in the notice stream:

- 254,799 taxpayers paid $830,119,057 after their delinquent accounts were assigned to the ACS or the CFf.
    - ($830,119,057 × 4 percent / 365) × 14 days = $1,273,607.

Taxpayers who received four notices in the notice stream:

- 67,684 taxpayers paid $59,264,259 after their delinquent accounts were assigned to the ACS or the CFf.
    - ($59,264,259 × 4 percent / 365) × 21 days = $136,389.

The number of taxpayers affected was 466,544, as there were 4,970 taxpayers who had multiple modules. The total interest savings is $1,810,630. The interest savings for FY 2010 was multiplied by 5 to obtain a 5-year projection of $9,053,150.

Appendix V

Computer Paragraph Notices

CP #	Name	Explanation
14	Balance Due of $5.00 or More, No Math Error	Issued as a first notice to inform a taxpayer of a balance due when there is no math error.
501	1st Notice – Individual Master File Balance Due	First reminder notice issued to taxpayers reminding them of a balance due on one of their tax accounts.
503	2nd Notice – Individual Master File Balance Due	Second reminder notice issued to taxpayers reminding them of a balance due on one of their tax modules.
504	Final Notice – Individual Master File Balance Due	Final notice issued to taxpayers informing them that the IRS intends to issue a levy against the taxpayer's State tax refund because there is still a balance due on one of their tax accounts. Also, it informs the taxpayers that the IRS will begin searching for other assets on which to issue a levy and that the IRS may also file a Federal Tax Lien.

Source: IRS Document 6209 (IRS Processing Codes and Information).

Appendix VI

Notice Results

Modules Closed by Notice Type[1]

FY 2010 Balance Due	MF Notice	CP 501	CP 503	CP 504	Total Dispositions
Notices Issued	11,625,698	2,521,824	3,571,082	4,176,674	
Disposition Types					
Full Paid	2,633,230	485,000	295,388	279,391	3,693,009
Installment Agreement	2,431,131	129,343	271,130	356,745	3,188,349
Dispositions	5,064,361	614,343	566,518	636,136	6,881,358
Dispositions/Total Dispositions	73.6%	8.9%	8.2%	9.2%	
Total Dispositions/Notices	59.2%				

Source: Our analysis of the IRS Collection Database of individual modules entering the balance due notice stream in FY 2010. MF = Master File.

Dollars Collected by Notice Type[2]

FY 2010 Balance Due	MF Notice	CP 501	CP 503	CP 504	Overall
Notices Issued	11,625,698	2,521,824	3,571,082	4,176,674	
Amount Assessed	$67,958,271,184	$6,217,541,371	$21,629,498,037	$36,743,016,687	
Payments (Collected)	($7,264,611,093)	($363,699,761)	($1,834,210,095)	($1,747,311,775)	($11,209,832,724)
Collected/Assessment	10.7%	5.8%	8.5%	4.8%	16.5%
Collected/Overall	64.8%	3.2%	16.4%	15.6%	

Source: Our analysis of the IRS Collection Database of individual modules entering the balance due notice stream in FY 2010. MF = Master File.

[1] The number of CP 501, CP 503, and CP 504 notices does not represent new modules but the number of modules that received these notices after receiving the Master File notice. Accordingly, the amount assessed on the Master File notices is the total amount of assessments that entered the notice stream while the amount assessed on subsequent notices is the amount of assessments that pertain to those specific notices.
[2] The overall Collected/Assessment percentage (16.5 percent) represents the overall amount collected ($11,209,832,724) as a percentage of the overall amount assessed ($67,958,271,184).

Appendix VII

Glossary of Terms

Abated – The amount of tax liability (tax assessment) on a taxpayer's module that has been reversed.

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

Assessment – The determination of a taxpayer's liability, including applicable interest and penalties.

Automated Collection System – A telephone contact system through which telephone assistors collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.

Balance Due Module – A balance due account occurs when the taxpayer has an outstanding liability for taxes, penalties, or interest.

Campus – 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.

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

Compliance Services Collection Operation – Units of tax examiners that work Balance Due Notice Program cases in the campuses.

Individual Master File – The IRS database that maintains transactions or records of individual taxpayer accounts.

Integrated Data Retrieval System – The IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.

Internal Revenue Service Collection Database – The IRS database that tracks activity on individual balance due modules from the initial balance due notice to ultimate resolution. The IRS Collection database uses information from the Individual Master File.

Levy – A method used by the IRS to collect outstanding taxes from sources such as bank accounts and wages.

Lien – An encumbrance on property or rights to property as security for outstanding taxes.

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

Module – Refers to one specific tax return filed by the taxpayer for one specific tax period (year or quarter) and type of tax.

Queue – An automated holding file for unassigned inventory of delinquent cases for which the Collection function does not have enough resources to immediately assign for contact.

Revenue Officers – Employees in the Collection field offices who attempt to contact taxpayers and resolve collection matters that have not been resolved by the notice stream or the ACS.

Seizure – The taking of a taxpayer's property to satisfy his or her outstanding tax liability.

Taxpayer Delinquent Account – A balance due account of a taxpayer. A separate Taxpayer Delinquent Account exists for each tax period.

Appendix VIII

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

RECEIVED
SEP 12 2011

SEP 12 2011

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Faris R. Fink *Faris R. Fink*
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Reducing the Processing Time Between Balance Due Notices Could Increase Collections (Audit # 201030020)

Thank you for the opportunity to review your draft report titled, "Reducing the Processing Time Between Balance Due Notices Could Increase Collections." The IRS appreciates TIGTA's acknowledgement that the collection notice process for individual taxpayers allows the Service to maximize collections while minimizing costs. As you noted, the notice process is the first of the three primary phases of the collection process. Accounts not closed in the notice process become Taxpayer Delinquent Accounts (TDAs) and move on to the more costly phases of collection, the Automated Collection System (ACS) and/or Field Collection.

The TIGTA defined a response to a balance due notice as receipt and processing of payments; however, during our discussions with TIGTA, the Service emphasized that while a taxpayer may respond by simply making a payment, quite often taxpayers respond to balance due notices via telephone, correspondence or on-line to address other issues. In these instances, it may take additional time to respond dependent upon the issue and how the account is being resolved. The timeframe between notices needs to reflect all types of issues and responses, and allow the Service to respond appropriately before the next notice is issued to avoid causing undue burden on the taxpayer or the Service.

The primary reason the Service allows five weeks between notices is to ensure that the taxpayer has sufficient time to respond to a notice (by phone, correspondence or on-line) and that the Service has sufficient time to process that response before sending the next notice or beginning enforcement actions (levies, liens, seizures, etc.). In FY 2010, the Service processed over 2.5 million pieces of balance due correspondence. Five weeks provides sufficient time for a notice to be mailed, the taxpayer to receive the mail, the taxpayer to prepare a response, and for the Service to receive, route and process the response. The Service is concerned that shortening the time between notices would jeopardize our ability to process the taxpayer responses in time to prevent subsequent notices or enforcement actions from occurring.

While reducing the time between notices would get cases into ACS inventory faster, we do not have any data indicating that reducing the notice phase by two or three weeks would (or would not) lead to increased collections downstream. Additionally, while getting accounts into TDA status more quickly may seem logical, the Service does not have adequate resources to pursue immediate collection actions on all accounts that reach TDA status. In fact, the Service is looking at a variety of additional treatments in the notice phase to increase case resolution and reduce the volume of accounts reaching TDA status.

We do not agree with the outcome measures in your report. While it may be appropriate to consider private industry collection curves when reviewing the IRS collection process, the Service has enforcement tools at our disposal that are not available to private industry

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 Michael Julianelle, Director, Enterprise Collection Strategy at (202) 622-3480.

Attachment

Attachment

RECOMMENDATION 1:
The Director, Office of Taxpayer Correspondence, Wage and Investment Division, should consider reducing the time between each notice by seven days.

CORRECTIVE ACTION:
The IRS is open to modifying the time between each notice subject to budget constraints and programming issues. The Director, Collection Policy, Small Business/Self Employed Division will consider this recommendation along with other options, including earlier phone intervention, to improve the notice process.

IMPLEMENTATION DATE:
January 15, 2013

RESPONSIBLE OFFICIAL(S):
The Director, Collection Policy, Small Business/Self Employed Division

CORRECTIVE ACTION MONITORING PLAN:
The IRS will monitor this corrective action as part of its internal management system of controls.

RECOMMENDATION 2:
The Director, Collection Policy, Small Business/Self-Employed Division, should consider establishing a business rule to address taxpayers with multiple balance due modules entering the notice stream at the same time.

CORRECTIVE ACTION:
The Director, Collection Policy, Small Business/Self-Employed Division will reexamine the business rules and consider establishing a rule to address taxpayers with multiple balance due modules entering the notice stream at the same time.

IMPLEMENTATION DATE:
January 15, 2013

RESPONSIBLE OFFICIAL(S):
The Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:
The IRS will monitor this corrective action as part of its internal management system of controls.