A Significantly Reduced Automated Substitute for Return Program Negatively Affected Collection and Filing Compliance

September 29, 2017

Reference Number: 2017-30-078

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Redaction Legend:
1 = Tax Return/Return Information
2 = Law Enforcement Techniques/Procedures and Guidelines for Law Enforcement Investigations or Prosecutions

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A SIGNIFICANTLY REDUCED AUTOMATED SUBSTITUTE FOR RETURN PROGRAM NEGATIVELY AFFECTED COLLECTION AND FILING COMPLIANCE

Highlights

Final Report issued on September 29, 2017

Highlights of Reference Number: 2017-30-078 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

The IRS is authorized under Internal Revenue Code Section 6020(b) to use third-party information to determine and assess a tax liability for taxpayers who have a filing requirement but fail to file a tax return. These cases are primarily worked in the Automated Substitute for Return (ASFR) Program. The IRS attempts to bring noncompliant taxpayers into compliance to ensure fairness and reduce the burden on the vast majority of taxpayers who fully pay their taxes on time.

WHY TIGTA DID THE AUDIT

ASFR inventory receipts and 30-day letter issuances decreased by 89 and 98 percent, respectively, between Fiscal Years 2009 and 2016. This audit was initiated to evaluate the effect of the ASFR Program on enforcement yield and nonfiler compliance and to determine whether it effectively processed its workload.

WHAT TIGTA FOUND

The Internal Revenue Manual describes the ASFR Program as a key compliance program, but due to significant resource reductions, it has been cut back substantially. Normal attrition and the inability to hire, reduced nonfiler case creation, reallocation of staff to other collection work, and changes to ASFR inventory selection/work priorities have all contributed to the reduction of ASFR inventory receipts and 30-day letter issuances.

Management prioritized ASFR cases involving Refund Holds over cases with potential high–net tax due ($100,000 or more) even though the average dollars collected per case is five times higher than all other cases. TIGTA estimates that the IRS could collect $843 million over the next five years if it replaced 9 percent of Refund Hold inventory with high–net tax due cases.

Our analysis of 21,533 Refund Hold cases worked in the ASFR Program between June 2011 and November 2016 identified 12,872 (60 percent) cases that were not resolved within six months, and a refund was released to the taxpayer in 8,115 cases. If the IRS held these refunds until the ASFR process was completed, it could have potentially applied $45 million to the taxpayers’ accounts.

Our analysis of 103 randomly sampled ASFR cases determined that 9 percent of ASFR inventory could be eliminated if previously filed tax return and other information was considered during the inventory selection process.

Finally, ASFR Program performance measures are generally limited to employee direct time percentages, types and numbers of closures, and closure rates. Additional comparative measures such as the abatement rates and collection dollars for cases would provide management with information to make informed strategic decisions.

WHAT TIGTA RECOMMENDED

TIGTA made several recommendations to improve the ASFR Program, including: revising the ASFR case selection strategy to prioritize more high–net tax due cases; extending the six-month refund hold deadline for cases worked in the ASFR Program; and incorporating prior filing information, including allowable exemptions, deductions, and credits, into the nonfiler case creation process.

In response to the report, IRS management plans to take corrective actions relating to five of our recommendations. Management disagreed with two recommendations, in one instance, due to limited resources, and in the other, due to its view that the refund hold period is sufficient when the ASFR Program is operating as intended.
MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – A Significantly Reduced Automated Substitute for Return Program Negatively Affected Collection and Filing Compliance (Audit # 201630012)

This report presents the results of our review to evaluate the effect of the Automated Substitute for Return (ASFR) Program on enforcement yield and nonfiler compliance and to determine whether it effectively processed its workload. This audit is included in our Fiscal Year 2017 Annual Audit Plan and addresses the major management challenge of Improving Tax Compliance.

Management’s complete response to the draft report is included as Appendix VII.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).
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### Abbreviations

<table>
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<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACS</td>
<td>Automated Collection System</td>
</tr>
<tr>
<td>ASFR</td>
<td>Automated Substitute for Return</td>
</tr>
<tr>
<td>CSCO</td>
<td>Compliance Services Collection Operation</td>
</tr>
<tr>
<td>FTE</td>
<td>Full-Time Equivalent</td>
</tr>
<tr>
<td>FY</td>
<td>Fiscal Year</td>
</tr>
<tr>
<td>IA</td>
<td>Installment Agreement</td>
</tr>
<tr>
<td>I.R.C.</td>
<td>Internal Revenue Code</td>
</tr>
<tr>
<td>IRM</td>
<td>Internal Revenue Manual</td>
</tr>
<tr>
<td>IRS</td>
<td>Internal Revenue Service</td>
</tr>
<tr>
<td>SB/SE</td>
<td>Small Business/Self-Employed</td>
</tr>
<tr>
<td>TDI</td>
<td>Taxpayer Delinquency Investigation</td>
</tr>
<tr>
<td>TFRP</td>
<td>Trust Fund Recovery Penalty</td>
</tr>
<tr>
<td>TIGTA</td>
<td>Treasury Inspector General for Tax Administration</td>
</tr>
</tbody>
</table>
When a taxpayer who has a filing requirement fails to file a tax return, the Internal Revenue Service (IRS) is authorized under Internal Revenue Code (I.R.C.) Section (§) 6020(b) to use third-party information to determine and assess a tax liability. These cases are primarily worked through the Automated Substitute for Return (ASFR) Program, which enforces filing compliance on taxpayers who have not filed individual income tax returns but appear to owe a significant tax liability.

Through the ASFR Program, the IRS secures a valid income tax return or prepares a Substitute for Return for taxpayers with a proposed tax assessment based on third-party information returns reported to the IRS combined with other internal data (Information Returns Processing information).

Before a nonfiler case moves to ASFR inventory, an automated process (Case Creation Nonfiler Identification Process) applies specific criteria to delinquent returns, including Information Returns Processing information, which is used to calculate the potential tax due. The annual Information Returns Processing information is usually reported on Forms W-2, Wage and Tax Statement, and the series of Forms 1099, U.S. Information Returns, by employers, banks, and other third parties to report wages, interest, and dividends as well as some payments for services rendered to self-employed individuals. If the IRS determines that a nonfiler case meets ASFR criteria, it is moved into ASFR inventory.

The ASFR system assigns priority codes to cases received into inventory based on certain conditions, such as a taxpayer’s withheld refunds (Refund Hold cases), the amount of the taxpayer’s potential net tax due, the age of the taxpayer’s delinquent tax return, and the number of delinquent tax years a taxpayer has. Refund Hold cases are considered the highest priority work for the ASFR Program. No other priority cases are started by the ASFR Program until all Refund Hold cases in available inventory have been started. All other cases in inventory are first prioritized by the most current delinquent tax year followed by two additional criteria: the amount of the taxpayer’s potential net tax due (cases of more than $100,000 are highest priority) and the number of delinquent tax years the taxpayer has outstanding (the more delinquent tax years the higher the priority).

1 There is no Assessment Statute Expiration Date for unfiled tax returns.
2 See Appendix VI for a glossary of terms.
3 If a taxpayer files a tax return requesting an income tax refund, the IRS delays issuing the refund for up to six months while it investigates any delinquent returns within five years prior to the current filing year.
4 Priority codes are 0 (highest priority) through 6 (lowest priority). See Appendix V for more details on ASFR priority codes.
years a taxpayer has, the higher the priority).\(^5\) In addition, for Refund Hold cases, the ASFR Program works all tax years for taxpayers with multiple delinquent returns. For all other cases (i.e., cases for which no refund is being held), the ASFR Program works only the most current tax year for taxpayers with multiple delinquent returns. \(^6\)

After the IRS uses Information Returns Processing information to estimate the taxpayer net tax due, the ASFR system issues a Letter 2566, 30-Day Letter, to the taxpayer. The letter informs the taxpayer that the IRS has not received a tax return for the tax year shown and includes a proposed tax assessment for the taxpayer. The letter advises taxpayers that within 30 days they must do one of the following: send their signed tax return; consent to the proposed tax assessment; or explain why they believe they are not required to file. If the IRS does not receive a response, the taxpayer is issued a notice CP 3219N, Statutory Notice of Deficiency – 90-Day Letter.\(^6\) The taxpayer is given another 90 days to respond or to seek judicial review before the proposed tax is assessed. The proposed tax computed by the IRS may be higher than what would actually be owed because the IRS cannot make an assessment that includes some exemptions, deductions, or credits the taxpayer must claim on a filed return. Therefore, it is usually in the taxpayer’s best interest to file his or her own tax return.

Taxpayer responses to ASFR notices can be in the form of inbound telephone calls, written correspondence, or taxpayer-filed individual tax returns. These responses are worked by tax examiners in the Small Business/Self-Employed (SB/SE) Division’s Campus Collection function in the Fresno, California; Brookhaven, New York; and Austin, Texas, campuses. The Brookhaven Campus has its own independent ASFR operation and works only paper and return correspondence.\(^7\) Tax examiners in the Compliance Services Collection Operation (CSCO) in the Austin and Fresno Campuses also work ASFR paper and return correspondence. In addition, these two campuses have call sites to handle inbound ASFR telephone calls.

The IRS’s Fiscal Year (FY) 2016 President’s Budget request stated that reduced staffing levels have resulted in current ASFR inventory levels not being addressed, and pursuant to the IRS’s inventory policy, more than 150,000 cases became too old to be worked by the ASFR Program. In its 2015 Annual Report to Congress, the Taxpayer Advocate Service reported that the ASFR Program has poor collection results and a high abatement rate. The report stated that from FY 2011 through FY 2014, the IRS assessed nearly $34 billion through its ASFR authority, but it

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\(^5\) The potential tax due is derived from the ASFR potential tax assessment less any withholding credits or any other credits (such as estimated tax payments) on the account.

\(^6\) The ASFR Program issues a Statutory Notice of Deficiency (90-day letter) as authorized by I.R.C. § 6212.

\(^7\) As of June 25, 2017, the Brookhaven ASFR operation will be under the direction of Brookhaven Compliance Services Collection Operation but will not handle inbound ASFR telephone calls.
collected less than one-third of this amount, approximately $11 billion. The IRS abated about $10 billion (29 percent) of the ASFR assessments. However, it is not unusual for ASFR cases to have a high abatement rate because the IRS cannot make an assessment that includes exemptions, deductions, and credits that must be claimed on a tax return.

The Taxpayer Advocate Service also questioned the usefulness of the ASFR Program due to a low return on investment reported by the IRS Office of the Chief Financial Officer as $2.25 for every $1 spent. However, the ASFR Program serves an important purpose for balanced tax administration by addressing both filing compliance and payment compliance. For example, the cited ASFR return on investment was based only on dollars collected while the case was worked within the ASFR Program (up to the point the tax is assessed via a secured return or a default ASFR assessment); it does not include the subsequent revenue collected from balance due notices or by other Collection functions. In addition, without a taxpayer return or an ASFR Substitute for Return filed, the law prevents the issuance of a refund (i.e., for the year of the unfiled return) and the application of any taxpayer credits, including overpayments of estimated or withholding taxes to the taxpayer.

Abatements of ASFR cases are resource intensive because they require work by IRS employees and many times result in no revenue to the Government. With current resource and budget constraints, it is important that cases selected to be worked in the ASFR Program are those with the highest potential of increasing filing compliance and generating revenue.

The Treasury Inspector General for Tax Administration (TIGTA) previously reported problems with how the IRS identifies and processes cases for taxpayers who had not filed tax returns. That report identified significant decreases in the number of nonfiler cases identified for the IRS’s inventory, particularly those involving taxpayers with expired extensions. There is a relationship between the Nonfiler Program and the ASFR Program because some nonfiler cases eventually become candidates for ASFR inventory. However, the processing of ASFR cases is entirely different and separate from the processing of nonfiler inventory that gets assigned to other Collection functions. This current review focused on ASFR inventory and processes.

This review was performed at the Fresno, California; Brookhaven, New York; and Austin, Texas, IRS Campus Collection offices and with information obtained from the SB/SE Division Headquarters in Lanham, Maryland, during the period May 2016 through June 2017. We conducted this performance audit in accordance with generally accepted government auditing standards.

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8 The $11 billion collected includes all credits and payments on the account, including tax withholding, credit transfers, and all dollars collected upon or after tax assessment (i.e., if tax is still owed after the assessment, it may be collected after the taxpayer receives a balance due notice or after it is assigned to be worked in the Appeals, Exam, and Collection functions).

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.
Results of Review

The IRS Has Significantly Reduced the Automated Substitute for Return Program As a Tool for Addressing Tax Noncompliance

The IRS periodically estimates the Tax Gap, which gives a broad view of the Nation’s compliance with Federal tax laws. The gross Tax Gap is defined as the difference between the true tax liability in any year and the amount of tax that is paid voluntarily and on time. The IRS’s most recent gross Tax Gap estimate was $458 billion per year for Tax Years 2008 through 2010. The nonfiler portion of the gross Tax Gap is defined as the amount of true tax liability that is not paid on time by taxpayers who do not file a required return on time (or not at all). The IRS estimates the nonfiler portion (based on Tax Years 2008 through 2010) of the gross Tax Gap is $32 billion (7 percent of the total Tax Gap) each year. The IRS Collection function’s strategic objectives include promoting filing compliance and reducing the Tax Gap. By resolving delinquent tax return accounts, the ASFR Program supports those objectives.

The Internal Revenue Manual (IRM) states that the ASFR Program is a key compliance program. However, due to significant resource reductions, it is now used mainly as a supporting program for other key compliance programs. Figure 1 shows that the numbers of ASFR inventory receipts and issuances of 30-day letters have decreased significantly in recent years.

Figure 1: FYs 2009–2016 ASFR Program Receipts and Issuances

ASFR inventory receipts and 30-day letter issuances decreased by 89 and 98 percent, respectively, between FYs 2009 and 2016. Put another way, in FY 2016 the ASFR Program issued just two 30-day letters for every 100 letters that it issued in FY 2009. In addition, the
percentage of the inventory that was worked dropped from 66 percent (1,061,129 issuances/1,598,763 receipts) in FY 2009 to just 14 percent (25,105/179,878) in FY 2016. IRS management stated that the ASFR Program is considered discretionary, meaning the volume of ASFR issuances can be increased or decreased depending on available resources. In recent years, normal attrition and the inability to hire new staff have left the ASFR Program with 78 percent fewer employees to work cases.

Before a nonfiler case moves to ASFR inventory, the Taxpayer Delinquency Investigation (TDI) module has to be created. Nonfiler cases identified by the IRS generally first go through a notice phase during which one or two notices are sent to taxpayers to remind them to file or explain why they are not required to file a tax return. When the taxpayer fails to resolve the nonfiler case during this notice process, the TDI case creation process generates the TDI module. The TDI module is also assigned a case selection code that determines into which Collection treatment stream it will be assigned. Those TDI modules that meet ASFR criteria are moved directly into ASFR inventory twice per year. However, due to resource constraints and the reallocation of employees to handle other types of work, Collection management has been reducing the number of nonfiler TDI modules generated in recent years, which in turn has reduced the number of ASFR TDI inventory receipts. Figure 2 shows the declining trend of TDI modules created in recent years.

Figure 2: FYs 2011–2016 TDI Module Receipts

Source: TIGTA analysis of Collection Activity Reports from FYs 2011 through 2016.

10 TDI modules are not always created for nonfiler cases. For example, those with an expected balance due under a certain dollar amount are eliminated in nonfiler case creation.
11 TDI modules are also referred to the ASFR Program by other Collection functions, such as Field Collection.
12 The number of TDI modules created and worked is determined by the annual Enterprise Collection Work Plan process and is generally based on the historical work volumes and the allocation of available resources among Collection programs.
Since FY 2011, TDI module receipts decreased by 56 percent. However, IRS management stated that the reduction of TDIs has not affected ASFR productivity because even with the precipitous drop in the number of TDIs generated and subsequent ASFR inventory receipts, the ASFR Program has still been able to issue 30-day letters to only a fraction of its inventory. Specifically, during FY 2016, the ASFR Program worked just 14 percent of its inventory. Increasing the size of the inventory would not have resulted in more ASFR issuances.

With fewer cases entering inventory and ultimately being worked, the cases that are worked should be the highest priority cases. However, our analysis showed that the cases which have been worked have not resulted in more revenue per case. Figure 3 shows that total dollars has significantly decreased, and, with the exception of the period from July 2013 through June 2014, the dollars collected per case has remained close to $5,000 since July 2010.

**Figure 3: Dollars Collected From ASFR Closures as of January 2016**

<table>
<thead>
<tr>
<th>Period</th>
<th>Closed Cases</th>
<th>Tax Dollars Collected</th>
<th>Dollars Collected Per Case</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2011 – June 2012</td>
<td>442,266</td>
<td>$2,142,919,864</td>
<td>$4,845</td>
</tr>
<tr>
<td>July 2012 – June 2013</td>
<td>227,456</td>
<td>$1,219,718,025</td>
<td>$5,362</td>
</tr>
<tr>
<td>July 2013 – June 2014</td>
<td>233,550</td>
<td>$1,420,878,346</td>
<td>$6,084</td>
</tr>
<tr>
<td>July 2014 – June 2015</td>
<td>216,533</td>
<td>$1,141,555,091</td>
<td>$5,272</td>
</tr>
</tbody>
</table>

Source: TIGTA analysis of ASFR closed cases obtained from the Individual Master File.

As these data illustrate, IRS collections from closed ASFR cases were approximately $2.9 billion (87 percent) less in the 2015–2016 period than in 2010–2011 period and 85 percent fewer ASFR cases were closed. The decrease in tax dollars collected is significant and can be directly attributed to the decline in cases started and worked by the ASFR Program.

As ASFR work declines, subsequent voluntary filing compliance also decreases. A study in April 2016 by the Collection function’s Strategic Analysis and Modeling group estimated the subsequent filing compliance impact of working 100,000 additional cases in the ASFR Program.

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13 IRS management stated that they do not know what caused the anomaly for this period.
14 We are not including the 13 percent drop in the last period because this number will likely increase as more dollars are collected for any remaining balances due on cases closed during this most recent period.
15 Tax dollars collected includes all credits and payments on the tax module, including any prepayments such as tax withholding and estimated tax payments and any tax dollars collected on balances due after assessment.
16 More revenue may be collected for closed cases over time; for example, closed cases may involve installment agreements.
The study estimated that approximately 73,198 (73 percent) additional voluntarily filed returns would be filed by ASFR taxpayers over the next three years after ASFR treatment of Tax Year 2009 returns. Figure 4 shows the estimated number of returns that were potentially not voluntarily filed in each of the last eight years using this formula.

**Figure 4: Estimated Returns Not Voluntarily Filed (FYs 2009–2016)**

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>ASFR Receipts</th>
<th>ASFR Issuances</th>
<th>ASFR Receipts Not Started</th>
<th>Returns Not Voluntarily Filed Three Tax Years After the ASFR Delinquent Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>1,598,763</td>
<td>1,061,129</td>
<td>537,634</td>
<td>392,473</td>
</tr>
<tr>
<td>2010</td>
<td>1,565,895</td>
<td>1,090,515</td>
<td>475,380</td>
<td>347,027</td>
</tr>
<tr>
<td>2011</td>
<td>764,324</td>
<td>558,509</td>
<td>205,815</td>
<td>150,245</td>
</tr>
<tr>
<td>2012</td>
<td>748,721</td>
<td>329,030</td>
<td>419,691</td>
<td>306,374</td>
</tr>
<tr>
<td>2013</td>
<td>249,466</td>
<td>260,078</td>
<td>(10,612)</td>
<td>(7,747)</td>
</tr>
<tr>
<td>2014</td>
<td>434,038</td>
<td>191,670</td>
<td>242,368</td>
<td>176,929</td>
</tr>
<tr>
<td>2015</td>
<td>233,890</td>
<td>155,145</td>
<td>78,745</td>
<td>57,484</td>
</tr>
<tr>
<td>2016</td>
<td>179,878</td>
<td>25,105</td>
<td>154,773</td>
<td>112,984</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>5,774,975</strong></td>
<td><strong>3,671,181</strong></td>
<td><strong>2,103,794</strong></td>
<td><strong>1,535,770</strong></td>
</tr>
</tbody>
</table>

Source: TIGTA analysis/calculation using the IRS Strategic Analysis and Modeling group’s formula.

We estimate that since FY 2009, a total of 1,535,770\(^{17}\) returns were potentially not voluntarily filed by taxpayers in the three years following the ASFR delinquent tax year.\(^{18}\) It is important to note that the number of cases in inventory has dropped because of management’s decision to reduce TDI receipts, therefore reducing ASFR receipts. If receipts had not been deliberately reduced since FY 2009 and all cases were worked in the ASFR Program each year, we estimate approximately 9.3 million returns would have potentially been voluntarily filed in the three years following the ASFR delinquent tax year.\(^{19}\)

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\(^{17}\) The total was rounded up to 1,535,770 from 1,535,769.62.

\(^{18}\) We subtracted the ASFR issuances from the ASFR receipts to get the number of receipts not started each year. Then we multiplied the ASFR receipts not started by 73 percent to get the number of returns not voluntarily filed three years after ASFR treatment. Because the calculation for this estimate is based on the IRS study results for Tax Year 2009 returns treated in the ASFR, the estimate assumes, among other considerations, that taxpayer behavior to voluntarily file tax returns after ASFR treatment remains the same each year.

\(^{19}\) This estimate assumes that all receipts in FY 2009 are worked and the number remains the same for FYs 2010 through 2016. Calculation is 1,598,763 multiplied by 73 percent to get the number of returns subsequently voluntarily filed over the next three years = 1,167,097 multiplied by eight fiscal years = 9,336,776.
Data also show that more modules are being purged from the ASFR Program every year due to age. The IRS’s FY 2016 President’s Budget request stated that reduced staffing levels have resulted in current ASFR inventory levels not being addressed, and more than 150,000 cases became too old to be worked by the ASFR Program.  

When older modules are closed without being worked, the IRS will likely never assess the taxes that may be owed. From FY 2014 to FY 2016, ASFR old-year closures increased from 185,886 (32 percent) of 572,378 modules to 233,680 (60 percent) of 387,610 modules.  

**Collection management reallocated some ASFR Program resources and stopped issuances in recent years**

At the beginning of each fiscal year, Collection management develops inventory goals and workload projections for each of the Collection programs resulting in an overall Enterprise Collection Work Plan. In FY 2015, Collection management decided to shift some ASFR staff to work other types of CSCO inventory in the middle of the year. In addition, management halted ASFR issuances completely from September 2015 through May 2016. These decisions were documented in a revised FY 2015 CSCO work plan to address two situations that affected the ASFR Program.

1. ASFR staff (in Brookhaven) would be realigned to address Trust Fund Recovery Penalty (TFRP) transcript processing.
2. Delinquent Return Notice issuances (including ASFR TDI notice issuances) would be decreased due to an increase in volume and age of Balance Due Notice correspondence (mostly Installment Agreement (IA) requests) in the CSCO.

Nationally, TFRP transcript work volumes in the CSCO doubled from FY 2012 (306,821) to FY 2013 (614,364) and has remained about the same since then. The decision to shift work to TFRP transcripts only affected the Brookhaven ASFR staff because the other two sites do not perform this work. TFRP transcript closures at Brookhaven have more than doubled from FY 2012 (103,223) to FY 2016 (291,596). Most (52 percent) of that increase occurred during FYs 2015 and 2016, which substantiates that ASFR resources were shifted to TFRP processing. In addition, the Brookhaven full-time equivalent (FTE) work plan for FY 2015 showed that 36 tax examiners and two managers in the ASFR Program were detailed to the CSCO to work TFRP inventory.

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20 IRS Policy Statement P-5-133 states that enforcement of delinquency procedures would normally be for modules less than six years old and that enforcement beyond this period will not be undertaken without prior managerial approval.
21 Old-year closures were not tracked in the ASFR Program prior to FY 2014.
22 TFRP transcript processing involves processing TFRP payments or other adjustment requests.
23 An FTE is equal to one full-time employee.
The decision to shift resources from the ASFR Program to IA processing affected all three ASFR Program locations, not just Brookhaven. Nationally, the IA work volumes in the CSCO operation increased by 114 percent since FY 2011. Figure 5 shows the IA work volumes more specifically for the three ASFR sites during the period FY 2011 through FY 2016.

**Figure 5: Austin, Brookhaven, and Fresno CSCO IA Work Volumes**

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Austin Closures</th>
<th>Brookhaven Closures</th>
<th>Fresno Closures</th>
<th>Total Closures</th>
<th>Percent Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>0</td>
<td>21,988</td>
<td>0</td>
<td>21,988</td>
<td>–</td>
</tr>
<tr>
<td>2012</td>
<td>0</td>
<td>16,846</td>
<td>0</td>
<td>16,846</td>
<td>-23%</td>
</tr>
<tr>
<td>2013</td>
<td>0</td>
<td>48,735</td>
<td>0</td>
<td>48,735</td>
<td>189%</td>
</tr>
<tr>
<td>2014</td>
<td>113,606</td>
<td>65,760</td>
<td>202,690</td>
<td>382,056</td>
<td>684%</td>
</tr>
<tr>
<td>2015</td>
<td>119,897</td>
<td>85,376</td>
<td>153,548</td>
<td>358,821</td>
<td>-6%</td>
</tr>
<tr>
<td>2016</td>
<td>120,498</td>
<td>114,494</td>
<td>252,716</td>
<td>487,708</td>
<td>36%</td>
</tr>
</tbody>
</table>

Source: TIGTA analyses of Austin, Brookhaven, and Fresno CSCOs IA work volumes.

FYs 2014 through 2016 data further confirm the shift in ASFR resources to process IA requests (Balance Due Correspondence). The Austin and Fresno sites did not have any IA volume prior to FY 2014. Starting in FY 2014, the Austin, Brookhaven, and Fresno IA volumes increased by a factor of more than 14 times, which required CSCO resources that would normally work ASFR inventory.\(^{24}\)

The annual Collection Enterprise Work Plan process focuses mainly on setting work goals for each Collection program based on historical work volumes and available resources. The Collection function was realigned in November 2014 to combine the Wage and Investment Division and SB/SE Division compliance programs, which reduced the number of Collection function resources available to the CSCO by approximately 5 percent. However, within the CSCO, the ASFR Program has experienced a 78 percent FTE reduction between FYs 2009 and 2016, dropping from 485 to 108 FTE.

Collection function management stated that budgetary constraints led to reducing discretionary programs in order to deal with the receipts of significant volumes of taxpayer requests, most notably for IAs. IA requests are customer-driven inventory that must be worked, compared to discretionary delinquent return and ASFR TDI notices, which management can control by reducing the number of notice issuances. In prior years, management used overtime funding to process the Balance Due Correspondence (mostly IA requests) received. Without overtime funding, discretionary programs such as the issuance of ASFR TDI notices were halted in the

\(^{24}\) The increase in IA correspondence in FY 2013 may be related to the FY 2012 redesigned balance due notices that now include information regarding how to request installment agreements.
middle of FY 2015 to enable the CSCO to stay somewhat current with the receipts of customer-driven inventory.

The IRS has not conducted any major studies to assess the compliance impact of the decision to reassign resources away from ASFR inventory. However, this decision has led to an imbalanced approach to managing work streams in the Collection function programs. Nonfiler inventory represents $32 billion of the overall Tax Gap, and the IRS is not fully using its enforcement tools to ensure taxpayer filing compliance. It is important for Collection management to study the risks and impacts on compliance before making policy decisions to ensure that the benefits outweigh any negative impacts.

As of March 30, 2017, the CSCO FY 2017 work plan had not been finalized. Collection function management stated that they were currently evaluating opportunities to adjust staff going forward, using the historical inventory volumes, in an effort to balance enforcement within the Collection program. However, in January 2017, Collection management once again suspended nonfiler TDI case creation, this time to allow the temporary reassignment of employees to the Automated Collection System (ACS) because management wanted to improve the level of customer service in that function. Management expects that permanent reassignments and promotions of ASFR staff to positions within the ACS will further reduce ASFR staff, which it now projects will be fewer than 100 FTEs by the end of FY 2017.

Most ASFR cases involve taxpayers whose refunds are being withheld

If a taxpayer files a tax return requesting an income tax refund, the IRS delays issuing the refund for up to six months while it investigates any delinquent returns within five years prior to the current filing year.25 The refund can be used to offset any potential balance due on a taxpayer’s delinquent return. Many of the refunds that are withheld are worked in conjunction with the ASFR Program. Such cases are top priority issuances for the ASFR Program because the IRS’s policy is that the cases must be resolved within six months, and there is a funding source readily available to pay towards any delinquent taxes that may arise from the missing returns (the pending refund).26 However, as is subsequently discussed, if the delinquent tax return investigation cannot be completed in six months, the refund is released. Figure 6 shows that as the total volume of ASFR issuances has decreased, the portion of the issuances involving refunds held has increased.

25 IRM 25.12.1.2 (2) (07-17-2015) – The refund must meet a certain dollar threshold to be held in the Refund Hold Program.
26 IRS management created the six-month holding policy for refunds based on I.R.C. § 6532 (a)(1), which allows taxpayers to file suit for a refund after six months. There is no law that prohibits the IRS from holding the refund longer than six months. However, the IRS is required to pay interest to the taxpayer on the held refund starting 45 days after the Refund Hold date.
Since FY 2009, the percentage of ASFR issuances (30-day letters) involving a held refund increased from 8 percent to 97 percent in FY 2016. Predictably, although the percentage of ASFR issuances involving held refund cases increased significantly from FY 2009 to FY 2016, the ASFR Program worked fewer cases from the total Refund Hold Program inventory. Figure 7 shows that the percentage of Refund Hold Program inventory worked by the ASFR Program has dropped from a high of 79 percent during FY 2010 to just 22 percent during FY 2016.

Since FY 2009, the percentage of ASFR issuances (30-day letters) involving a held refund increased from 8 percent to 97 percent in FY 2016. Predictably, although the percentage of ASFR issuances involving held refund cases increased significantly from FY 2009 to FY 2016, the ASFR Program worked fewer cases from the total Refund Hold Program inventory. Figure 7 shows that the percentage of Refund Hold Program inventory worked by the ASFR Program has dropped from a high of 79 percent during FY 2010 to just 22 percent during FY 2016.

Figure 7: Held Refunds Compared to ASFR Refund Hold Issuances

Source: TIGTA analysis of ASFR Management Information Reports from FYs 2009 through 2016 and Refund Hold Management Information Reports from Calendar Years 2009 through 2016.

27 Held refunds are reported by Calendar Year (January through December), and ASFR issuances are reported by fiscal year (October through September). While slightly different, they are both one-year time periods.
High–net tax due cases are lower priority than Refund Hold cases in the ASFR Program, but dollars collected on high–net tax due cases are five times higher

The ASFR Program works cases based on priorities set by management. The highest priority cases are those with held refunds because of the IRS’s six-month refund hold policy. This policy can lead to counterintuitive results to the IRS’s goal of having the most impact on tax noncompliance. For example, under IRS policy, a Refund Hold case with a $5,000 refund being held to secure a return with a net tax due of $1,000 would have a higher priority than a non-Refund Hold ASFR case with $100,000 net tax due. After Refund Hold cases, cases not involving a refund hold are prioritized first by the most current tax year followed by additional criteria for the potential net tax due and the number of delinquent returns outstanding for the taxpayer. As a result, current year low–tax due cases have a higher priority than prior year high–net tax due cases, which are those cases with potential net tax due of $100,000 or more. This policy can also lead to counterintuitive results if the IRS’s goal is to address the highest risks to tax compliance. For example, under IRS policy, a current tax year case with $5,000 net tax due would have higher priority than an ASFR case that was two years old with a $100,000 net tax due. Similarly, taxpayers with multiple delinquent returns may have priority over taxpayers with only a single delinquent return. As described below, this policy also can lead to counterintuitive results.

In FY 2012, IRS management ended the practice of working all delinquent tax years for non–Refund Hold cases to working only the most current tax year. However, the ASFR Program continues to work all delinquent tax years for Refund Hold cases. For example, under IRS policy, a taxpayer with multiple years of unfiled tax returns each with $5,000 net tax due may have a greater priority than a taxpayer with a single year’s unfiled return with over $100,000 net tax due. Additionally, a taxpayer with multiple years of unfiled returns with net tax due of $5,000 on each year and a refund hold on the current year will have greater priority than a taxpayer with multiple years of unfiled returns with over $100,000 net tax due without a refund hold—the IRS will work each of the unfiled years of the cases with $5,000 net tax due because there is a refund hold, while it would work only one year of the unfiled returns of the taxpayer with unfiled returns with over $100,000 due. Additionally, while management has reduced the volume of ASFR issuances as resources declined, they have not proportionally reduced it based on case priority. Specifically, during FY 2016, 97 percent of ASFR cases were Refund Hold cases, compared with 8 percent in FY 2009.

Our analysis suggests that a more effective tax compliance strategy for ASFR casework would be to prioritize high–net tax due cases first. Figure 8 compares the dollars assessed and collected...
for the closed high–net tax due cases with all other closed cases in the ASFR Program over the last five periods.

**Figure 8: High–Net Tax Due Closures Compared to All Other ASFR Closures**

<table>
<thead>
<tr>
<th>Period</th>
<th>High–Net Tax Due Closures</th>
<th>Dollars Assessed</th>
<th>Dollars Assessed Per Case</th>
<th>Dollars Collected</th>
<th>Dollars Collected Per Case</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2010 – June 2011</td>
<td>9,360</td>
<td>$2,457,458,852</td>
<td>$262,549</td>
<td>$250,906,307</td>
<td>$26,806</td>
</tr>
<tr>
<td>July 2011 – June 2012</td>
<td>4,990</td>
<td>$1,244,436,238</td>
<td>$249,386</td>
<td>$112,984,716</td>
<td>$22,642</td>
</tr>
<tr>
<td>July 2012 – June 2013</td>
<td>3,328</td>
<td>$856,875,199</td>
<td>$257,475</td>
<td>$90,964,745</td>
<td>$27,333</td>
</tr>
<tr>
<td>July 2013 – June 2014</td>
<td>1,567</td>
<td>$383,304,471</td>
<td>$244,610</td>
<td>$48,151,203</td>
<td>$30,728</td>
</tr>
<tr>
<td>July 2015 – June 2016</td>
<td>551</td>
<td>$180,213,084</td>
<td>$327,065</td>
<td>$6,957,064</td>
<td>$12,626</td>
</tr>
<tr>
<td><strong>Averages</strong></td>
<td><strong>3,522</strong></td>
<td><strong>$909,313,727</strong></td>
<td><strong>$265,099</strong></td>
<td><strong>$90,413,675</strong></td>
<td><strong>$24,076</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Period</th>
<th>All Other Closures</th>
<th>Dollars Assessed</th>
<th>Dollars Assessed Per Case</th>
<th>Dollars Collected</th>
<th>Dollars Collected Per Case</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2011 – June 2012</td>
<td>437,276</td>
<td>$5,001,187,815</td>
<td>$11,437</td>
<td>$2,029,935,148</td>
<td>$4,642</td>
</tr>
<tr>
<td>July 2012 – June 2013</td>
<td>224,128</td>
<td>$2,409,915,970</td>
<td>$10,752</td>
<td>$1,128,753,280</td>
<td>$5,036</td>
</tr>
<tr>
<td>July 2013 – June 2014</td>
<td>231,983</td>
<td>$2,843,648,924</td>
<td>$12,258</td>
<td>$1,372,727,143</td>
<td>$5,917</td>
</tr>
<tr>
<td>July 2014 – June 2015</td>
<td>215,196</td>
<td>$2,301,173,959</td>
<td>$10,693</td>
<td>$1,109,037,075</td>
<td>$5,154</td>
</tr>
<tr>
<td>July 2015 – June 2016</td>
<td>99,645</td>
<td>$1,029,174,228</td>
<td>$10,328</td>
<td>$427,747,249</td>
<td>$4,293</td>
</tr>
<tr>
<td><strong>Averages</strong></td>
<td><strong>311,784</strong></td>
<td><strong>$3,541,810,210</strong></td>
<td><strong>$11,173</strong></td>
<td><strong>$1,518,418,837</strong></td>
<td><strong>$4,939</strong></td>
</tr>
</tbody>
</table>

*Source: TIGTA analysis of ASFR closed cases obtained from the Individual Master File.*

The six-year average for dollars assessed per case ($265,099) on high–net tax due closures was 24 times higher than average dollars assessed per case for all other ASFR closures ($11,173). Similarly, the six-year average for dollars collected per case ($24,076) for high–net tax due closures was five times higher than dollars collected per case ($4,939) for all other ASFR closures. We estimate, based on these data, that if the IRS had worked the same number of high–net tax due cases it closed in the period July 2010 through June 2011 (9,360) in the most current period, July 2015 through June 2016 (551), it would have potentially increased revenue.

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30 Dollars collected in our analysis includes all credits and payments on the module, including withholding and estimated tax payments.
by about $169 million dollars, which is approximately $843 million over the next five years.\textsuperscript{31} During FY 2016, the IRS closed 99,645 cases that were not high–net tax due cases, so the opportunity exists to replace inventory with high–net tax due cases. Specifically, replacing 9 percent of the Refund Hold cases closed during FY 2016 with high-dollar cases would achieve these results.

This is a conservative estimate because it limits the increase in high–net tax due cases to the number that the IRS has worked in the past. If the IRS were to expand beyond historical trends and focus more on high–net tax due cases, a significantly higher percentage of ASFR assessments could involve them. TIGTA previously reported that in Tax Year 2010, there were 305,843 high-income nonfilers in the Case Creation Nonfiler Identification Process inventory, which is significantly more than the 9,360 cases that we used for our estimate.\textsuperscript{32} Many of these nonfiler cases could become ASFR high–net tax due cases if the IRS elected to work them.

At different times in the past, IRS officials have stated both publicly and in internal program letters to employees that high-income nonfilers\textsuperscript{33} and repeat nonfilers were the top priorities.\textsuperscript{34} Our audit reflects that high–net tax due cases are generally a second priority behind Refund Hold cases, and even though repeat nonfilers (those with multiple delinquent returns) are given higher priority, only the most current tax year is worked in the ASFR Program.

Our analysis of the declining statistics for the ASFR Program, in addition to the declines in TDIs created through the Case Creation Nonfiler Identification Process, provide compelling evidence the IRS is not adequately addressing the nonfiler portion of the Tax Gap. The automated ability of the ASFR Program to reach a large portion of unresponsive delinquent filers cannot be simulated in other, more costly, Collection programs such as the Automated Collection System or Field Collection. Therefore, it is important for management to develop a more effective case selection and work priority strategy for the ASFR Program that will increase revenue and improve filing compliance.

\textsuperscript{31} Calculation is 9,360 high net tax due case closures – 551 high net tax due case closures x $19,137 (six-year average additional dollars collected per high–net tax due case) = $168,577,833. $168,577,833 x five years = $842,889,165. See Appendix IV. The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.


\textsuperscript{33} The IRS defines a high-income nonfiler as a taxpayer with total income of more than $100,000. IRM 5.19.2.8(1) (Nov. 6, 2015).

\textsuperscript{34} At a 2009 meeting of the American Institute of Certified Public Accountants, the SB/SE Division Deputy Commissioner stated that high-income nonfilers were a top IRS priority. Tax Enforcement: IRS Official Says High-Income, High Wealth Individuals Top Enforcement Priority for 2010, BNA Daily Tax Report, October 27, 2009. In the 2009 SB/SE Division program letter to employees, nonfiler priorities were stated as follows: “This Strategy will ensure a consistent, coordinated approach that addresses nonfiling with emphasis on high-income and repeat nonfilers that are particularly egregious to our tax system.”
Recommendations

The Director, Collection, SB/SE Division, should:

Recommendation 1: Reassess the decisions to suspend the ASFR Program, including the reduction of TDI inventory and the reassignment of ASFR staff. The reassessment should weigh the benefits of processing other types of correspondence against the negative consequences to tax compliance, such as not pursuing high–net tax due nonfilers and the significant reduction in subsequent voluntarily filed returns.

Management’s Response: IRS management stated that, while it is reviewing its overall nonfiler program, resource constraints resulted in their decision to suspend the ASFR Program. The IRS did not commit to taking corrective action on this recommendation unless resources become available in the future.

Office of Audit Comment: TIGTA believes that the ASFR Program is critically important and should not be taken offline and, at a minimum, should always remain in place for certain classifications of nonfilers, such as high-income nonfilers, who present a significant risk to efficient and effective tax administration.

Recommendation 2: Revise the ASFR case selection strategy to prioritize more high–net tax due and repeat nonfiler cases, both of which constitute a significant tax compliance risk.

Management’s Response: IRS management agreed with this recommendation. IRS management will revise the case selection strategy, as needed, to prioritize high–net tax due and repeat nonfiler cases in the ASFR case selection mix.

Recommendation 3: Reverse the policy of working only the most current tax year for high–net tax due cases to working all delinquent tax years.

Management’s Response: IRS management agreed with this recommendation. IRS management will reevaluate the policy of working only the most current tax years for high–net tax due cases as part of their work to determine the appropriate blend of cases in response to Recommendation 2.

Millions of Dollars Were Paid to Potentially Delinquent Taxpayers Because Held Refunds Were Released

When we asked IRS officials the basis for prioritizing Refund Hold cases as the top priority, we were told that Refund Hold cases are time sensitive because the law provides that taxpayers can
file a suit for refund after six months.\textsuperscript{35} In addition, taxpayers are entitled to receive interest on held refunds after 45 days. The IRS also explained that holding refunds for longer than six months would subject the IRS to needless and wasteful administrative, interest, and litigation costs and take resources away from other taxpayer services. The IRS also stated that it would have no defense to a refund suit filed by taxpayers whose refunds would have been paid already but for unfiled returns. However, there are compelling reasons not to issue refunds to some taxpayers who have unfiled returns, especially in egregious cases of high-income taxpayers who willfully fail to file and pay tax that is due. The IRS has a statutory right to offset amounts owed by taxpayers from refunds that would otherwise be issued to those taxpayers.\textsuperscript{36} It is also crime for taxpayers who are required to file returns and pay taxes to willfully fail to do so.\textsuperscript{37}

For Refund Hold Program cases worked in the ASFR Program, the IRS’s policy is that the taxpayer’s delinquent return(s) must be resolved or the Notice of Deficiency (CP 3219N) must be sent to the taxpayer prior to the expiration of the six-month refund hold period; otherwise, the refund will be released to the taxpayer.\textsuperscript{38}

When taxpayers with a held refund do not resolve their delinquent returns in treated ASFR cases, the refund credit can be transferred to the delinquent return module as soon as a Notice of Deficiency letter is sent to the taxpayer. If the taxpayer does not respond to the Notice of Deficiency after 90 days, the ASFR system will assess the tax on the delinquent return by default and the transferred refund credit can then be applied to any balance due. However, if the Notice of Deficiency is not sent before the end of the six-month refund hold period, the IRS will systemically release the withheld refund.

Our analysis of 21,533 Refund Hold cases worked in the ASFR Program between June 2011 and November 2016 identified 12,872 (60 percent) cases that were not resolved before expiration of the six-month holding period. In addition, for 8,115 of these cases the refund was released to the taxpayer.\textsuperscript{39} Based on the ASFR potential balance due calculation for the 8,115 cases, these taxpayers would still owe a total of $68.5 million after the default assessment was made. If the IRS continued to suppress the refund while the ASFR process was being completed, refunds in the amount of $45 million could have potentially been applied to the balances due.

\textsuperscript{35} I.R.C. § 6532 (a)(1) provides “No suit or proceeding under section 7422(a) for the recovery of any internal revenue tax, penalty, or other sum, shall be begun before the expiration of 6 months from the date of filing required under such section unless the Secretary renders a decision thereon within that time, nor after the expiration of 2 years from the date of mailing by certified mail or registered mail by the Secretary of a notice of the disallowance of the part of the claim to which the suit or proceeding relates.”

\textsuperscript{36} I.R.C. § 6402(a).

\textsuperscript{37} I.R.C. § 7203.

\textsuperscript{38} See Footnote 2 in this sentence.

\textsuperscript{39} This population comes from an October 2016 data extract of the ASFR cases for which the refund hold indicator was released, the tax module with the held refund was identified, and a 30-day letter was issued.
Even though the refund is released to the taxpayer, the ASFR process continues. For cases in which the taxpayer does not respond, the IRS still assesses the ASFR default taxes due for the missing return after the refund is paid to the taxpayer. Because the ASFR is working the case anyway, management could extend the refund hold time period on these cases and still secure the refund. Extending the holding period could also motivate the taxpayer to make an effort to file the missing tax return themselves. Releasing the refund before completing the ASFR process eliminates an obvious and easily accessible funding source from which the IRS could collect the delinquent revenue.

The six-month refund hold policy for taxpayers with delinquent returns is a self-imposed timeline by IRS management. There is nothing that legally prohibits the IRS from holding the refund longer than six months, although the IRS would need to continue paying interest on any balance that is ultimately owed to the taxpayer.\(^{40}\) Our analysis of Refund Hold cases worked in the ASFR Program showed the average time from starting an ASFR case (30-day letter) to issuing the Notice of Deficiency is 89 days. Extension of the six-month hold deadline an additional three months for cases that are started in the ASFR Program would allow the IRS to resolve many of the delinquent returns before releasing taxpayers’ refund claims. In addition, as previously discussed, the work priority for Refund Hold cases could be lowered to allow more high-dollar value cases to be worked.

**Recommendation**

**Recommendation 4:** The Director, Collection, SB/SE Division, should extend the six-month Refund Hold deadline for started cases in the ASFR Program by an adequate period of time that would ensure that refunds are held until the delinquency is resolved.

**Management’s Response:** IRS management does not agree with this recommendation. IRS management believes that the six-month Refund Hold period provides sufficient time for the IRS to resolve cases when the ASFR Program is operating as intended. However, if the current suspension of the ASFR Program is not reversed in FY 2018, management will consult with Chief Counsel and reassess the six-month hold period for ASFR cases.

**Office of Audit Comment:** TIGTA was not provided with documentation or data to support the claim that the six-month Refund Hold period provides sufficient time for the IRS to resolve the cases when the ASFR Program is operating as intended. Furthermore, we believe the corrective action should not be dependent on whether suspension of the ASFR Program is reversed in FY 2018. The failure to take even temporary mitigating

\(^{40}\) Interest payable begins to accumulate after the refund has been held for 45 days beyond the tax return due date for that period.
corrective action while the ASFR Program is suspended allows for continuing release of refunds to taxpayers with delinquent returns.

**Using Historical Filing Information During Case Creation Would Eliminate Some Less Productive Inventory**

For calculation of ASFR tax assessments, the IRS made a policy decision to 1) treat taxpayers as single or married filing separately even when there is evidence the taxpayer is married and 2) allow one exemption and only a standard deduction even when there is third-party reporting evidence, such as Form 1098, *Mortgage Interest Statement*, that the taxpayer itemizes deductions. The IRS has legal limitations for using certain types of information when making an ASFR assessment. For example, per I.R.C. § 63(e), taxpayers must elect whether to itemize deductions on their tax return. Therefore, the IRS cannot make an assessment based on allowing itemized deductions even if information is available supporting deductions that could be used.

This practice makes many ASFR default assessments higher than if taxpayers file their own tax returns and results in a high abatement rate for the ASFR Program. For example, the Taxpayer Advocate Service reported that from FY 2011 to FY 2014, the IRS assessed nearly $34 billion through its ASFR authority but abated about $10 billion (29 percent) of the ASFR assessments. Figure 9 shows our analysis of abatement rates for ASFR default closures over the past seven years.

**Figure 9: Dollars Assessed and Abated for ASFR Default Closures**

*Trends show that abatement rates decreased from 48 percent of default assessment dollars for the period July 2009 through June 2010 to 20 percent for the period July 2015 through June 2016.*
However, abatement rates in the last few years will likely increase as more taxpayers file their own returns with allowable exemptions and deductions that were not allowed to be used for the ASFR default assessment. In addition, abatement rates are declining, in part, due to the larger percentage of Refund Hold cases worked in the ASFR Program. The IRS Strategic Analysis and Modeling group stated that Refund Hold cases produce a higher percentage of taxpayers who file their returns before the ASFR default assessment (45 percent versus 21 percent for other cases). As the ASFR default assessment closure rate decreases, abatements also decrease.

Unlike assessment criteria, the IRS may use available taxpayer information and any prior filing information when determining which cases are candidates for the ASFR Program. The use of such information could eliminate the selection of cases that are less likely to produce revenue and potentially create taxpayer burden.

Our review of a statistical sample of 103 closed ASFR taxpayer cases identified nine taxpayer cases (9 percent) that would not have met the ASFR criteria for inventory selection when the tax assessment was recalculated using previously filed tax return and other information documents on file with the IRS. In all nine cases, the recomputed tax would have resulted in a potential refund to the taxpayer. In four of the nine cases, taxpayers still have a balance due and are assigned to the ACS function. We recomputed the taxpayers’ balance due for the nine cases by allowing additional deductions and credits that are not normally considered by the IRS. We also used the taxpayer’s prior filing status and the number of exemptions previously claimed. In addition, the itemized deductions for mortgage interest and state sales tax as well as qualifying Child Tax Credits and other considerations were made in some cases. The average difference between the ASFR and TIGTA balance due computations for all nine cases was $5,688.

IRS strategic goals include reducing taxpayer burden and encouraging voluntary compliance. While ASFR default assessments encourage subsequent voluntary compliance, these taxpayers can also be unnecessarily burdened. For example, four of the nine exception cases resulted in ASFR balances due that are currently assigned to the ACS function. These taxpayers will receive IRS notices and possible enforcement actions for taxes they potentially do not owe. In the nine exception cases, payments made on the ASFR balance due were deducted from the taxpayers’ held refunds and paid on assessed taxes they potentially do not owe.

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41 The total population of closed ASFR cases was 115,515 taxpayers, obtained from the IRS Individual Master File and closed from July 1, 2015, through June 30, 2016.
42 A case is below tolerance when the balance due is less than a certain dollar amount.
43 For example, spousal income and Federal tax prepayments were also used, if they were applicable.
IRS operations are supposed to be geared to produce the greatest revenue yield with current tax collections being given priority. The ASFR Program uses a balanced approach to prioritize non–Refund Hold inventory by working the most current delinquent tax year with additional criteria for the amount of net tax due and the number of delinquent modules outstanding; however, some cases selected by the ASFR Program are not generating the greatest revenue yield. For example, ASFR default cases that result in a full abatement of tax are producing zero revenue yield and cases that result in a refund are producing a negative revenue yield. Of the 103 cases in our sample, 17 (17 percent) had a full abatement of the ASFR default assessment after the taxpayers filed their own tax return, and in 10 of these 17 cases, a refund was also issued.

During nonfiler case creation, a mathematical formula called the Collection Optimum Potential Yield Score is automatically assigned to all cases. The Collection Optimum Potential Yield Score formula assigns weights to miscellaneous prior year income tax return and current year income variables in a nonfiler case and computes a score based on these weights. The higher the score, the greater the likelihood that a taxable return is due. Although this score is a major part of the nonfiler inventory selection process, additional exemptions from prior returns, credits, and itemized deductions are not used in the formula. Because the IRS is not considering all information available during nonfiler case creation, many cases are being selected and assigned to the ASFR Program which ultimately generate a zero or negative collection yield and create taxpayer burden.

Our analysis demonstrates that using the additional taxpayer information the IRS has available during case creation could help eliminate some of the inventory from the ASFR Program that produces little or no revenue and creates taxpayer burden. Based on the nine cases in our sample, we estimate from our population of 115,515 cases that 10,187 taxpayer cases would not have been assigned to be worked by the ASFR Program if prior filing status and exemptions, itemized deductions, and credits were considered during the nonfiler case creation process.

IRS management informed us that they have developed two predictive models to improve case selection and prioritization for the ASFR Program. The Expected Balance Due Model will use different variables to compute the expected balance due of a nonfiler case to be more accurate than just summarizing income documents and allowing a single exemption. The Secured Return Model will use different variables to identify cases that will most likely secure a return prior to ASFR default assessment. Management plans to pilot these two models as soon as resources allow. Once the pilots are complete and the data are analyzed, the IRS will be able to determine how prior filing information could be incorporated into the nonfiler case creation process for ASFR inventory selection purpose.

44 IRM 1.2.14.1.19(1) (07-09-1959), Policy Statement 5-134 (Formerly P-1-167).
45 The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 3,828 and 16,546.
Recommendations

**Recommendation 5:** The Director, Collection, SB/SE Division, should incorporate prior filing information, including allowable exemptions, deductions, and credits, into the nonfiler case creation process for ASFR inventory selection purposes.

**Management’s Response:** IRS management agreed with this recommendation. IRS management will review and test existing analytics and develop new filters and models to identify and prioritize case selection.

**Recommendation 6:** The Director, Collection, SB/SE Division, should monitor abatement and refund cases regularly to determine if any additional criteria can be added to the case creation process to eliminate these cases for ASFR inventory selection purposes.

**Management’s Response:** IRS management agreed with this recommendation. IRS management will review and test existing analytics and develop new filters and models to identify and prioritize case selection.

**Program Effectiveness Is Not Fully Measured**

The IRS Collection function’s strategic objectives include promoting filing compliance and reducing the Tax Gap. The objective of the ASFR Program is to secure delinquent tax returns from taxpayers who have not filed but who owe a significant income tax liability with the end goal of improving or increasing filing compliance. By resolving delinquent tax return accounts, the ASFR Program supports those objectives. However, performance measures for the ASFR Program used by IRS management to set program goals are generally limited to employee direct time percentages, types and numbers of closures, and closure rates. In addition, casework quality and timeliness of ASFR staff are also considered. However, important measures for the ASFR Program such as abatement rates, refund rates, high-dollar closures, subsequent compliance, and dollars collected are not tracked or measured. Without these types of measures, IRS management does not have complete information needed to help make informed strategic decisions, such as inventory prioritization, for the ASFR Program.

The Government Performance and Results Act of 1993 establishes that Federal Government agencies are expected to identify performance measures for program activities and compare results of activities with measures identified. Performance measures, as well as methods of performance assessment, provide management with information on how resources should be allocated to ensure program effectiveness. They help support development and justification of budget proposals by indicating how taxpayers and others benefit. Determining the best method

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46 ASFR closure rates are calculated by dividing the number of closed cases by the number of hours employees spent working the cases.

of performance assessment, including the establishment of performance measures, helps managers to focus on the key goals of the program. In addition, they help provide management with the information necessary to make strategic decisions regarding the best ways to address delinquent filers and nonfilers.

IRS management stated that the ASFR system is limited in the type of data it can track. Because the system is a stand-alone flat file program, it cannot access closed ASFR case data from the Integrated Data Retrieval System for tracking purposes; therefore, ad hoc studies have to be completed to measure these results. An upgrade of the ASFR system has been requested by IRS management several times to allow for improved workload targeting, easier query ability, and tracking of downstream collection information, but due to budget limitations, requests have been rejected. Without an updated system, the IRS must rely on ad hoc studies to measure the filing and payment compliance performance of the ASFR Program.

A first attempt ad hoc study to evaluate the impact of the ASFR Program on tax compliance was completed in FY 2015 by the Collection function’s Strategic Analysis and Modeling group. The study measured subsequent filing compliance and dollars collected on TDIs treated by the ASFR Program compared with TDIs that were not treated by the ASFR Program or were assigned to the Queue. The study found that for 39 percent of ASFR treated cases, a voluntarily filed return was filed within four years after ASFR treatment. For revenue collected, ASFR treated cases had a higher collection rate than TDIs that were not treated by the ASFR Program or were assigned to the Queue. IRS management stated that they have no plans to regularly assess these measures or to use this information to develop further goals or performance measures for the ASFR Program.

**Recommendation**

**Recommendation 7:** The Director, Collection, SB/SE Division, should track and measure the ASFR closure results for abatement rates, refund rates, and collection rates and should categorize the results by types of closures, including Refund Hold and high–net tax due, to better measure ASFR productivity.

**Management’s Response:** IRS management agreed with this recommendation. IRS management will review and assess case characteristics to improve current methods of allocating nonfiler cases across potential treatment streams, including the ASFR Program.

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Appendix I

Detailed Objectives, Scope, and Methodology

Our overall objective was to evaluate the effect of the ASFR Program on enforcement yield and nonfiler\(^1\) compliance and to determine whether it effectively processed its workload. To accomplish our objective, we:

I. Identified current ASFR procedures and guidelines to gain an understanding of the ASFR inventory identification and selection process, operational ASFR work processes, and June 2012 policy revisions for ASFR inventory selection and work priorities.
   A. Reviewed the IRM and any interim guidance memos related to the ASFR Program.
   B. Interviewed IRS management in the ASFR Program and other responsible Collection functions to discuss ASFR procedures, including the impact of the June 2012 policy revisions for inventory selection and work priorities.
   C. Conducted a walkthrough with IRS management and staff in three ASFR locations (Fresno, California; Brookhaven, New York; and Austin, Texas), to develop an understanding of the workflow of the ASFR operation and the case processing procedures.

II. Determined how IRS management monitors and measures ASFR Program goals, including the June 2012 policy revisions for ASFR inventory selection and work priorities.
   A. Identified the current mission and goals of the ASFR Program.
   B. Determined the process ASFR Program management uses to establish and revise ASFR goals and measures.
   C. Reviewed ASFR Program management reports and other available data to determine if they are sufficient to measure the goals of the ASFR Program.
   D. Analyzed the CSCO historical program work results for FYs 2011 through 2016 and related information to determine the impact of management decisions to shift ASFR resources to other work priorities.

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\(^1\) See Appendix VI for a glossary of terms.
III. Evaluated the effects of the June 2012 policy revisions for inventory selection and case priorities by comparing ASFR Program data results before and after the changes.

A. Compared the ASFR inventory receipt and issuance data before and after the June 2012 policy revisions to determine the impact on the ASFR Program. We used the ASFR Management Information Reports for FYs 2009 through 2016.

B. Compared the inventory of TDI case receipts before and after the June 2012 policy revisions to evaluate the impact on ASFR inventory receipts. We used the IRS Collection Activity Reports for FYs 2011 through 2016.

C. Compared the dollars assessed, abated, and collected on ASFR closed cases before and after the June 2012 policy revisions to determine the enforcement yield impact on the ASFR Program.\(^2\) We used the Data Center Warehouse and IRS Compliance Data Warehouse to identify the population of closed ASFR cases.

1. Identified ASFR cases closed between the period July 1, 2010, and June 30, 2016 using the Data Center Warehouse Individual Master File tables. We used the following criteria to obtain the data:

   a) Tax modules with an ASFR default assessment closure.

   b) Tax modules with a Return Secured by ASFR and no prior default assessment within the July 1, 2010, through June 30, 2016, time period.

   c) Tax modules in which an ASFR 30-day letter was issued.

   d) Validated each data extract by selecting random samples of 15 default cases and 15 return secured cases and verifying selected data fields (such as Taxpayer Identification Number, Master File Tax Account Code, tax period, taxpayer name, etc.) on the Integrated Data Retrieval System for accuracy. We determined the data were reasonable, complete, and accurate and therefore, sufficiently reliable for the audit purpose.

2. Obtained data from the IRS Compliance Data Warehouse by matching the Taxpayer Identification Number and tax period of the closed cases identified in Step III.C.I. to the IRS Enforcement Revenue Information System table.

   a) Selected only those records that indicated an ASFR tax assessment. We identified a total of 1,891,837 records.

   b) Validated the data extract by selecting a random sample of 10 default cases and 10 return secured cases and verified certain data fields to the Integrated Data Retrieval System for accuracy. We determined that the data were

\(^2\) Tax dollars collected includes all credits and payments on the tax module including any prepayments, such as tax withholding and estimated tax payments, and any tax dollars collected on balances due after assessment.
A Significantly Reduced Automated Substitute for Return Program Negatively Affected Collection and Filing Compliance

reasonable, complete, and accurate and, therefore, sufficiently reliable for the audit purpose.

D. Identified the ASFR high–net tax due cases from the cases identified in Step III.C.2.
   1. Calculated the potential tax due for each case by subtracting the tax withholding amount from the Enforcement Revenue Information System data field Tax Assessment Amount.3
   2. Identified high–net tax due cases as those for which the estimated potential tax due amount was greater than or equal to $100,000.

IV. Determined the number of ASFR Refund Hold cases that were not resolved before the release date of the taxpayer’s held refund.
   A. Obtained an ASFR data extract of tax modules worked in the ASFR Program between June 2011 and November 2016 for which refund hold indicators were released. We used an IRS data extract request.
   B. Validated the ASFR data extract by selecting a random sample of 10 cases to verify the accuracy of the data fields needed for our review. We determined that the data were reasonable, complete, and accurate and, therefore, sufficiently reliable for the audit purpose.
   C. Identified 21,533 tax modules with the following characteristics:
      1. Tax modules for which an ASFR 30-day letter was issued.
      2. Tax modules with a related Refund Hold module. We obtained these data by matching the Taxpayer Identification Numbers from the records in Step IV.C.1 to the Data Center Warehouse Individual Master File table to find related tax modules with a Refund Hold indicator.
      3. Calculated the end of the six-month refund hold time period4 and eliminated those cases with release dates after December 31, 2016.5

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3 We used the difference between the data fields “E_Tax_Collection Amount” and “Tax Dollars Applied” to calculate the tax withholding; therefore, the tax withholding is an estimated amount.
4 ************************************************************************************************************************************************************************************************************************************************************************************************
5 We were unable to analyze any actions taken during Calendar Year 2017 because the data extracted from the Data Center Warehouse Individual Master File tables only included actions as of December 31, 2016.
D. Analyzed these cases to determine if the ASFR case was resolved prior to the refund hold release date. 6

V. Determined if considering certain deductions and credits will help reduce the inventory that meets ASFR criteria and make more accurate assessments.

A. Identified a population of 115,515 closed ASFR cases between the one-year period of July 1, 2015, and June 30, 2016, from data identified in Step III.C.

B. Selected a statistical sample of 103 cases based on a confidence level of 95 percent, an expected rate of occurrence of 50 percent, and a precision rate of 10 percent. We discussed population size and other characteristics with the TIGTA contract statistician to obtain our sampling plan. 7

C. Reviewed each case to capture:

1. The filing status of the taxpayer’s most recent filed tax return before the ASFR case was created.

2. The number of exemptions on the taxpayer’s most recent filed tax return that could still be legally claimed for the ASFR case.

3. Income and withholding information reported to the IRS for the ASFR case tax year. For married filing jointly filing status cases, the spouse’s income and withholding information was captured.

4. Form 1098, Mortgage Interest Statement, that was reported to the IRS for the ASFR case tax year. For married filing jointly filing status cases, the spouse’s Form 1098 interest was captured.

5. Whether the case was a Federal Employee/Retiree Delinquency Investigation. 8

D. Recalculated the proposed tax due for each sample case by using the determined:

1. Filing status. 9

2. Number of exemptions.

3. Income and withholding.

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6 We considered a case was resolved if 1) there was an ASFR 90-day letter issued to the taxpayer prior to the refund hold release date, 2) the delinquent return was secured from the taxpayer or there was some other closure such as the taxpayer was not liable to file, or 3) the case had a credit transferred from the Refund Hold module.

7 Our sampling plan was a stratified sample categorized by dollars assessed; however, we did not project dollars to population strata, just the number of error cases to the entire population.

8 Federal Employee/Retiree Delinquency Investigation cases have a lower criteria threshold for meeting ASFR criteria.

9 For joint filers, we used married filing jointly status for the calculation.
4. Standard or itemized deduction, based on any applicable mortgage interest or sales tax.

5. Applicable child tax credits.

E. Compared the recalculated potential tax due to the applicable ASFR inventory criteria threshold to determine if the case could have been eliminated from ASFR inventory selection.

F. Projected the number of exception cases to the population to determine the impact on ASFR Program inventory selection.

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 that the following internal controls were relevant to our audit objective: the IRS procedures for issuing ASFR 30-day and 90-day letters and IRS policies, procedures, and practices for monitoring and measuring the effectiveness of the ASFR Program, including evaluation of the June 2012 inventory selection case priority changes. We evaluated these controls by interviewing management and reviewing IRM procedures.
Appendix II

**Major Contributors to This Report**

Matthew Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Carl Aley, Director
Phyllis Heald London, Audit Manager
Heath Sollak, Lead Auditor
Doris Cervantes, Senior Auditor
Lynn Wofchuck, Senior Auditor
Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Services and Enforcement
Director, Campus Collection, Small Business/Self-Employed Division
Director, Collection, Small Business/Self-Employed Division
Director, Collection Inventory Delivery and Selection, Small Business/Self-Employed Division
Director, Collection Policy, Small Business/Self-Employed Division
Director, Headquarters Collection, Small Business/Self-Employed Division
Director, Office of Audit Coordination
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: $168,577,833 in total dollars that could have been collected if more high–net tax due cases\(^1\) were worked by the ASFR Program;\(^2\) $842,889,165 forecast over five years (see page 5).\(^3\)

Methodology Used to Measure the Reported Benefit:

From a population of 1,891,837 ASFR cases closed between July 1, 2010, and June 30, 2016, we estimated which cases were high–net tax due by subtracting any tax withholding amounts from the actual tax assessment on each module. Resulting modules with a net tax due of $100,000 or more were high–net tax due cases. The six-year average dollars collected per case for these high–net tax due closures was $24,076 versus $4,939 dollars collected per case for all other ASFR closures (a difference of $19,137). We estimate, based on these data, that if the IRS had worked the same number of high–net tax due cases it closed in the period July 2010 through June 2011 (9,360) in the most current period July 2015 through June 2016 (551), it would have potentially increased revenue by about $169 million dollars, which is approximately $843 million over the next five years. The calculation is 9,360 high–net tax due case closures minus 551 high–net tax due case closures multiplied by $19,137 (six-year average additional dollars collected per high–net tax due case) = $168,577,833. The five-year forecast calculation is $168,577,833 x five years = $842,889,165.

Type and Value of Outcome Measure:

Increased Revenue – Potential: $45,004,720 in held refunds could have been applied to ASFR balances due if the refund had been held until the ASFR process was completed (see page 16).

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\(^1\) The ASFR Program defines high–net tax due cases as those with a potential net tax due of $100,000 or more.

\(^2\) See Appendix VI for a glossary of terms.

\(^3\) The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.
Methodology Used to Measure the Reported Benefit:

From a population of 21,533 Refund Hold cases worked in the ASFR Program between June 2011 and November 2016, we identified 12,872 (60 percent) cases that were not resolved before expiration of the six-month holding period; for 8,115 of these cases, the refund was released. Based on the ASFR potential balance due calculation for these cases, these taxpayers would still owe a total of $68,489,398 after the default assessment was made. If the IRS continued to suppress the refund while the ASFR process was being completed, refunds in the amount of $45,004,720 could have potentially been applied to the balances due.
Appendix V

ASFR Prioritization

The manner in which the ASFR prioritizes inventory changed in June 2012. The ASFR database will reflect all programming changes in FY 2012.

ASFR inventory is now prioritized by Refund Hold (priority 0) and the number of weeks (one through six) since the Refund Hold indicator was set. The weeks are called “buckets.” The remaining priorities are by tax year, with various categories for Net Tax Due (which are also called “buckets”).

The ASFR Program will issue Priority 0 first. Priority 1 is issued second. Priority 2 will not be issued until all Priority 1 have been started. Priority 3 will not be issued until all of Priority 2 have been started. The ASFR Program will work only one module per taxpayer. ¹ All related modules will be suspended pending resolution of the one started year.

The Priority Charts below outline Refund Hold and non–Refund Hold prioritization.

<table>
<thead>
<tr>
<th>Refund Hold Priority Chart</th>
<th>Bucket - Weeks since RH Indicator</th>
</tr>
</thead>
<tbody>
<tr>
<td>Priority 0</td>
<td>Any Year</td>
</tr>
<tr>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>3</td>
<td>4</td>
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<td>4</td>
<td>5</td>
</tr>
<tr>
<td>5</td>
<td>6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Non-Refund Hold Priority Chart</th>
<th>Bucket - Net Tax Due</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Tax Due Over 100K</td>
<td>Net Tax Due $50,000 - $99,999</td>
</tr>
<tr>
<td>Net Tax Due Less than $50K</td>
<td></td>
</tr>
<tr>
<td>Priority</td>
<td>Multiple Module Single Module Multiple Module Single Module Multiple Module Single Module</td>
</tr>
<tr>
<td>1 TY 2012</td>
<td></td>
</tr>
<tr>
<td>2 TY 2011</td>
<td></td>
</tr>
<tr>
<td>3 TY 2010</td>
<td></td>
</tr>
<tr>
<td>4 TY 2009</td>
<td></td>
</tr>
<tr>
<td>5 TY 2008</td>
<td></td>
</tr>
<tr>
<td>6 TY 2007</td>
<td></td>
</tr>
</tbody>
</table>

¹ All of the taxpayer’s delinquent return modules are worked for Refund Hold cases.
## Glossary of Terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Automated Collection System</td>
<td>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.</td>
</tr>
<tr>
<td>Automated Substitute for Return System</td>
<td>The ASFR system is an assessment tool used by ASFR Program employees to systemically perform some liability calculations, issue ASFR notices, and input transactions to the Integrated Data Retrieval System.</td>
</tr>
<tr>
<td>Balance Due</td>
<td>Occurs when a taxpayer has an outstanding (unpaid) liability for taxes, penalties, and/or interest.</td>
</tr>
<tr>
<td>Campus</td>
<td>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.</td>
</tr>
<tr>
<td>Compliance Data Warehouse</td>
<td>Offers a broad range of databases to research analysts that can be easily accessed through a variety of third-party tools. For example: Collection and Enforcement Revenue Information.</td>
</tr>
<tr>
<td>Compliance Services Collection Operation</td>
<td>An IRS function that mails the balance due and return delinquency notices to taxpayers and analyzes and responds to taxpayer correspondence.</td>
</tr>
<tr>
<td>Data Center Warehouse</td>
<td>An online database maintained by TIGTA. The Data Center Warehouse pulls data from IRS system resources, such as IRS Collection files and IRS Examination files, for TIGTA access.</td>
</tr>
<tr>
<td>Delinquent Return</td>
<td>A tax return that a taxpayer does not file with the IRS by the due date (including extensions) for any year in which a filing requirement exists.</td>
</tr>
<tr>
<td>Term</td>
<td>Definition</td>
</tr>
<tr>
<td>-------------------------------------------</td>
<td>----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Enforcement Revenue Information System</td>
<td>An IRS Compliance Data Warehouse database that contains enforcement activity on Appeals, Exam, and Collection cases since FY 1992; Information Returns Processing and Automated Underreporter closures since FY 1994; penalty amounts by I.R.C. and Reference Number since FY 1996; and Earned Income Tax Credit math error information (added to existing enforcement cases) since Calendar Year 1999.</td>
</tr>
<tr>
<td>Field Collection</td>
<td>The unit in the Area Offices consisting of revenue officers who handle face-to-face contacts with taxpayers to collect delinquent accounts or secure unfiled returns.</td>
</tr>
<tr>
<td>Fiscal Year</td>
<td>Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government’s fiscal year begins on October 1 and ends on September 30.</td>
</tr>
<tr>
<td>Form W-2, Wage and Tax Statement</td>
<td>Used to report wages earned and taxes withheld</td>
</tr>
<tr>
<td>Full-Time Equivalent</td>
<td>The total number of regular straight-time hours (i.e., not including overtime or holiday hours) worked by employees divided by the number of compensable hours applicable to each fiscal year. Annual leave, sick leave, compensatory time off, and other approved leave categories are considered to be “hours worked” for purposes of defining FTE employment. One FTE is equal to eight hours multiplied by the compensable days in the particular fiscal year; therefore, one FTE can be equal to 2080, 2088, or 2096 hours depending on the fiscal year.</td>
</tr>
<tr>
<td>Individual Master File</td>
<td>The IRS database that maintains transactions or records of individual tax accounts.</td>
</tr>
<tr>
<td>Installment Agreement</td>
<td>Arrangement in which a taxpayer agrees to pay his or her tax liability over time in smaller, more manageable payments.</td>
</tr>
<tr>
<td>Term</td>
<td>Definition</td>
</tr>
<tr>
<td>-------------------------------------------</td>
<td>----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Integrated Data Retrieval System</td>
<td>An IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer’s account records.</td>
</tr>
<tr>
<td>Internal Revenue Manual</td>
<td>The operations manual for employees of the IRS. It contains the policies, procedures, instructions, guidelines, and delegations of authority which direct the operation for all divisions and functions of the IRS. Topics include tax administration, personnel and office management, and others.</td>
</tr>
<tr>
<td>Nonfilers</td>
<td>Individual and business taxpayers who have been identified as liable to file a tax return but who have not filed a tax return by the return due date or extended due date.</td>
</tr>
<tr>
<td>Queue</td>
<td>An automated holding file for unassigned inventory of delinquent cases for which employees in the Collection Field function are unable to be immediately assigned for contact due to limited resources.</td>
</tr>
<tr>
<td>Taxpayer Advocate Service</td>
<td>An independent organization within the IRS whose employees assist taxpayers who are experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe that an IRS system or procedure is not working as it should.</td>
</tr>
</tbody>
</table>
A Significantly Reduced Automated Substitute for Return Program Negatively Affected Collection and Filing Compliance

Appendix VII

Management's Response to the Draft Report

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

September 7, 2017

MEMORANDUM FOR MICHAEL E. McKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – A Significantly Reduced Automated Substitute for Return Program Negatively Affected Collection and Filing Compliance (Audit # 201630012)

Thank you for the opportunity to review the above subject draft report. The Automated Substitute for Return (ASFR) Program is a component of our collection strategy to promote filing compliance. Attempting to bring noncompliant taxpayers into compliance ensures fairness and reduces the burden on the taxpayers who fully pay their taxes on time.

Resource constraints have forced us to make difficult decisions with respect to some of our programs, even those that provide clear benefits to tax administration. Because a nonfiler strategy is important to our mission, we are currently working to develop one that fits within the current and future IRS operating environment, requiring fewer human resources, while providing an opportunity for us to achieve our desired outcomes:

- Identifying productive nonfiler work that maximizes secured returns and dollars collected while minimizing labor impact to the Service;
- Promoting continued filing compliance through programs built to encourage voluntary taxpayer filing and payment;
- Increasing operational efficiencies across existing nonfiler programs by treating the right taxpayer via the right channel.

In the Spring of 2017, we initiated a proactive review of the nonfiler program (including ASFR). We are engaging our Collection, Examination and Research functions in this effort. We are seeking to improve efficiencies, develop new models, and allocate resources effectively to ensure nonfiler is an integral part of our overall compliance efforts. These themes align closely with the spirit of TIGTA's recommendations in the ASFR audit, which are similarly focused on improving the efficiency and effectiveness of that portion of the IRS's larger nonfiler program.
The Collection program continues to fulfill its mission to collect delinquent taxes and secure delinquent tax returns through the fair and equitable application of the tax laws. We appreciate your continued support and insight in this regard. Attached is a detailed response outlining our corrective actions to address your recommendations.

If you have any questions, please contact me, or a member of your staff may contact Scott Prentky, Director Collection at (954) 991-4326.

Attachment
RECOMMENDATION 1:
The Director, Collection, Small Business/Self-Employed Division, should reassess the decisions to suspend the ASFR Program, including the reduction of TDI inventory and the reassignment of ASFR staff. The reassessment should weigh the benefits of processing other types of correspondence against the negative consequences to tax compliance; such as not pursuing high net tax due nonfilers and the significant reduction in subsequent voluntarily-filed returns.

CORRECTIVE ACTION:
Resource constraints resulted in our decision to suspend the ASFR program. If resources are available in the future, we will reassess this decision.

IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A

RECOMMENDATION 2:
The Director, Collection, Small Business/Self-Employed Division, should revise the ASFR case selection strategy to prioritize more high net tax due and repeat nonfiler cases, both of which constitute a significant tax compliance risk.

CORRECTIVE ACTION:
We will revise our case selection strategy, as needed, to prioritize high net tax due and repeat nonfiler cases in the ASFR case selection mix.

IMPLEMENTATION DATE:
June 15, 2018

RESPONSIBLE OFFICIAL:
Director, Collection Inventory Delivery & Selection, SB/SE

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.
RECOMMENDATION 3:
The Director, Collection, Small Business/Self-Employed Division, should reverse the policy of working only the most current tax year for high net tax due cases to working all delinquent tax years.

CORRECTIVE ACTION:
As part of our work to determine the appropriate blend of cases in response to recommendation 2, we will re-evaluate the policy of working only the most current tax years for high net tax due cases.

IMPLEMENTATION DATE:
June 15, 2018

RESPONSIBLE OFFICIAL:
Director, Collection Inventory Delivery & Selection, SB/SE

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

RECOMMENDATION 4:
The Commissioner, SB/SE Division, should extend the six-month Refund Hold deadline for started cases in the ASFR Program by an adequate period of time that would ensure that refunds are held until the delinquency is resolved.

CORRECTIVE ACTION:
We disagree. The six-month Refund Hold provides sufficient time for us to resolve cases when the ASFR Program is operating as intended. However, if the current suspension of the ASFR Program is not reversed in FY 2018, see recommendation #1, we will consult with Chief Counsel and reassess the six-month hold period for ASFR cases.

IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A
RECOMMENDATION 5:
The Director, Collection, Small Business/Self-Employed Division, should incorporate prior filing information, including allowable exemptions, deductions, and credits into the nonfiler case creation process for ASFR inventory selection purposes.

CORRECTIVE ACTION:
We will review and test existing analytics and develop new filters and models to identify and prioritize case selection.

IMPLEMENTATION DATE:
October 15, 2018

RESPONSIBLE OFFICIAL:
Director, Collection Inventory Delivery & Selection, SB/SE

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

RECOMMENDATION 6:
The Director, Collection, SB/SE Division, should monitor abatement and refund cases regularly to determine if any additional criteria can be added to the case creation process to eliminate these cases for ASFR inventory selection purposes.

CORRECTIVE ACTION:
We will review and test existing analytics and develop new filters and models to identify and prioritize case selection.

IMPLEMENTATION DATE:
October 15, 2018

RESPONSIBLE OFFICIAL:
Director, Collection Inventory Delivery & Selection, SB/SE

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

RECOMMENDATION 7:
The Director, Collection, Small Business/Self-Employed Division, should track and measure the ASFR closure results for abatement rates, refund rates, and collection
rates and should categorize the results by types of closures, including Refund Hold and high net tax due, to better measure ASFR productivity.

**CORRECTIVE ACTION:**
We will review and assess case characteristics to improve current methods of allocating nonfiler cases across potential treatment streams, including ASFR.

**IMPLEMENTATION DATE:**
October 15, 2018

**RESPONSIBLE OFFICIAL:**
Director, Collection Inventory Delivery & Selection, SB/SE

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