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Report to the Joint Committee on Taxation
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TAX ADMINISTRATION

Protecting Tax Revenue When Businesses File for Bankruptcy

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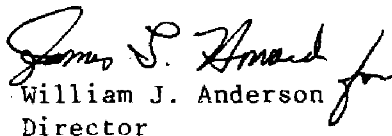
The Honorable Bob Packwood
Chairman, Joint Committee on
Taxation

The Honorable Daniel Rostenkowski
Vice Chairman, Joint Committee
on Taxation
Congress of the United States

This report, which concludes our work in response to your Committee's request, discusses the Internal Revenue Service's (IRS) efforts to protect the government's interest when businesses file for bankruptcy. The report points out that while IRS has made some improvements in dealing with businesses in bankruptcy, it can further improve its efforts in this area.

The report recommends that IRS take additional actions to deal with businesses that do not pay their employment taxes--primarily income and social security taxes withheld from their employees' wages--during bankruptcy. Also, the report recommends that IRS change its procedures to better ensure the accuracy of claims it files with the bankruptcy courts. IRS agrees with the report and plans to implement the report's recommendations.

As agreed with your office, we are sending copies of this report to other congressional committees and subcommittees and to other interested parties.



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Executive Summary

More than 56,000 businesses filed for bankruptcy during fiscal year 1984 and a large number of them were delinquent in paying their federal taxes. Most of these delinquent taxes were withheld from employee wages for income and social security taxes but not paid to the government as required. In addition, many businesses became delinquent in paying their employment taxes after bankruptcy proceedings began.

At the request of the Joint Committee on Taxation, GAO evaluated the effectiveness of IRS' procedures and practices for

- detecting and minimizing the accumulation of employment tax delinquencies, and
- filing claims for delinquent taxes with the bankruptcy court.

Background

The United States Bankruptcy Code provides financially troubled businesses two basic ways to deal with their financial obligations: liquidation or reorganization. In a liquidation bankruptcy, a business' assets are sold and the proceeds are used to pay creditors all or some of the amounts they are owed. In a reorganization bankruptcy, the business attempts to continue operating while it develops a plan to pay all or a part of its debts.

After a business files for liquidation or reorganization with a bankruptcy court, its creditors file claims with the court for payment. As the principal federal creditor in most bankruptcies, IRS files claims for payment of taxes owed by both liquidating and reorganizing businesses, monitors the progress of reorganizing businesses, keeps track of actual tax payments, and reviews proposed tax payment plans. In fiscal year 1984, claims filed by IRS totaled $298 million while collections totaled about $53 million.

It is especially important for IRS to monitor business reorganizations because such businesses usually retain employees and continue to withhold taxes from employees' wages. If a reorganizing business accumulates delinquent taxes after it initiates bankruptcy proceedings, IRS can file a motion with the bankruptcy court requesting that the court either require that the business pay the delinquency, or convert the bankruptcy to a liquidation. However, IRS needs to be aware of this situation before it can initiate corrective action. (See pp. 9 to 15.)

Results in Brief

IRS has taken recent actions in response to GAO's findings that IRS could more effectively monitor businesses as they reorganize and more aggressively refer cases to the courts when these businesses are delinquent in the payment of their taxes. However, additional corrective action could be taken.

In addition, although IRS files claims in most liquidation bankruptcies in which the businesses owe delinquent taxes, it needs to take further action to improve the accuracy of these claims.

Principal Findings

Need for More Effective Monitoring

In the three bankruptcy court districts GAO reviewed, an estimated 254 of the 583 businesses that filed for reorganization in 1981 accumulated a total of about $6.6 million in delinquent taxes after bankruptcy proceedings began. Of these delinquencies, $5.5 million were still outstanding at the time of GAO's fieldwork in early 1984. GAO believes that IRS could reduce the accumulation of such delinquencies by more closely monitoring those businesses that had the greatest potential for accumulating additional taxes—businesses with past delinquencies or large payrolls. Also, once IRS detects a problem, it could require businesses to file monthly instead of quarterly tax returns. (See pp. 16 to 18.)

Need for Improved Court Referral Procedures

Court referrals should be made quickly so as to minimize the accumulation of additional tax delinquencies. In the three IRS districts GAO reviewed, 10 businesses in its sample that accumulated delinquent employment taxes were referred to court. These cases took an average of 15 months to come to court after the first delinquent tax return was due. IRS' bankruptcy manual has only limited guidance on referrals and contains inconsistent information. (See pp. 18 to 20.)

Need to Improve the Accuracy of Claims

In GAO's three sample districts, IRS filed claims for more than 95 percent of the liquidation bankruptcies filed in 1982. However, 77 percent of these cases contained errors totaling an estimated $1.7 million in overclaims, underclaims, and misclassified priorities. Overclaims and underclaims resulted because IRS incorrectly applied bankruptcy rules for penalties, inadequately followed up on estimated claims, and made mathematical errors in computing claim amounts. These errors, along

with errors in classifying priorities, occurred because IRS district personnel lacked guidance in computing interest and penalties for bankruptcies. (See ch. 3.)

IRS Has Made Improvements

Since GAO performed its review, IRS has made improvements in its procedures for dealing with delinquent taxes during bankruptcy. It now provides additional guidance on monitoring reorganizing businesses and computing claim amounts, and it is working to improve its referral criteria and speed up the referral process. GAO believes IRS' actions will have a positive effect on reducing the accumulation of delinquent taxes. GAO also believes IRS could further improve its monitoring and referral efforts and the guidance it provides. (See pp. 20 and 26.)

Recommendations

Among other things, GAO recommends that the Commissioner of the Internal Revenue Service

- develop additional indicators for IRS personnel to use in deciding how frequently a case should be monitored, such as a firm's prior delinquency history;
- establish minimum criteria for the referral of delinquent cases to the bankruptcy courts; and
- require that supervisory or quality control reviews of claim computations be made to ensure that claims filed with the court are accurately prepared. (See pp. 21 and 29.)

Agency Comments

IRS agrees with the general thrust of the report and is taking actions to implement GAO's recommendations. (See pp. 21 and 29.)

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Abbreviations

GAO	General Accounting Office
IRS	Internal Revenue Service

Introduction

At the request of the Joint Committee on Taxation, we reviewed the actions taken by the Internal Revenue Service (IRS) to protect the government's interest when taxpayers go through bankruptcy proceedings. This report, the second issued under the Joint Committee's request, deals with IRS' procedures for identifying and collecting taxes owed by businesses involved in bankruptcy.[1]

Many bankrupt businesses owe delinquent federal taxes, the majority of which are employment taxes that have been withheld from employees' wages but not paid to IRS. Available IRS statistics show that during fiscal year 1984, IRS filed claims with the bankruptcy courts for about $298 million in delinquent business taxes. Since IRS does not file claims for delinquent taxes when bankrupt businesses have no assets available for distribution, the actual amount of tax delinquencies owed by bankrupt businesses could have been substantially greater.

Business Bankruptcy Process

Bankruptcy provides a judicial means for financially troubled businesses to deal with their financial obligations. The Bankruptcy Code provides for two basic business bankruptcy approaches. One is a liquidation bankruptcy. In a liquidation, the business elects to sell its assets and the proceeds are used to pay all or some of the creditors' claims. The other is a reorganization bankruptcy. In a reorganization, the business decides to keep operating while it sets up a plan to pay all or part of its debts. Either approach precludes creditors from pursuing their normal collection actions.

Liquidation of a Business

Chapter 7 of the Bankruptcy Code provides for the liquidation of a business. Statistics provided by the Administrative Office of the United States Courts show that during fiscal year 1984, 38,649 business bankruptcies were filed under Chapter 7 of the Code.

The process for a liquidation bankruptcy starts when the debtor, or possibly a creditor, files a petition with the bankruptcy court. Regardless of who files the bankruptcy petition, the Bankruptcy Code requires all liquidating businesses to file schedules of their assets and liabilities with the court. These schedules are to include the names and addresses of all

[1]Our first report, entitled Legislative Change Needed To Enable IRS To Assess Taxes Voluntarily Reported By Taxpayers In Bankruptcy (GAO/GGD-83-47, June 20, 1983), dealt with the impact that the 1978 Bankruptcy Reform Act's restriction on tax assessments was having on IRS and bankrupt taxpayers.

creditors and the amounts owed to them. A trustee is then appointed to take control of any business assets.

At this point the bankruptcy courts send notices to the creditors, including IRS, informing them of the bankruptcy. If assets are available for distribution, creditors must generally file claims with the court within 90 days of a date prescribed in the notice in order to be considered for payment. After the claims are filed, the trustee arranges for the disposition of the assets and distributes the proceeds based on criteria established in the Bankruptcy Code.

The payment priority in a business liquidation is complex and has numerous exceptions. Generally, however, secured creditors—those to whom specific assets of the business have been pledged as collateral for the amount that is owed—are paid first. The remaining funds are used to pay IRS as well as the businesses' other creditors. Payments to IRS are made in the following order. The first payment IRS receives is for those taxes incurred by the business after the date it filed a bankruptcy petition. Tax delinquencies for which IRS filed a tax lien are in the next category of payments, followed by employment tax and other tax delinquencies less than 3 years old for which a tax lien was not filed. Next, tax delinquencies over 3 years old are paid, along with other general unsecured creditors and creditors who filed late claims regardless of their actual priority. After this, tax penalties are paid. Finally, any remaining proceeds from assets are used to pay interest that was incurred on the delinquent taxes after the business filed for bankruptcy.

Businesses generally remain legally liable for delinquent taxes not paid during bankruptcy proceedings. However, corporate businesses are usually dissolved during bankruptcy, leaving IRS with no corporate entity from which to collect. In such cases, however, IRS can assess a penalty against the responsible corporate officer(s) or employee(s) who failed to pay IRS the employment taxes withheld from employees' wages. The amount of the penalty can be equal to the amount of withheld income and social security taxes that were not paid to IRS. (This procedure—referred to as the 100-percent penalty—is discussed further on page 13.)

Reorganization of a Business

Chapter 11 of the Bankruptcy Code authorizes businesses who choose this approach to continue operating while they attempt to pay creditors all or some portion of their liabilities. Available statistics show that

17,396 businesses filed for bankruptcy under Chapter 11 of the Code during fiscal year 1984.

As with liquidation bankruptcies, reorganization bankruptcies start when the business files a petition with the bankruptcy court, including schedules of all assets, liabilities, and creditors. The court then notifies all creditors of the bankruptcy. (Because businesses in reorganization continue to incur tax liabilities, the court notifies IRS of all reorganization bankruptcies even when it is not listed as a creditor.)

Unlike liquidation bankruptcies, the courts generally do not appoint trustees in reorganization bankruptcies. Instead, the businesses are usually allowed to maintain possession of their assets as they attempt to reorganize and continue to operate. The Bankruptcy Code requires a business filing for reorganization to prepare reorganization plans that show how it intends to pay its creditors and what portion of its debts it intends to pay.

The priority for payment of debts in a reorganization bankruptcy is the same as in a liquidation bankruptcy. Usually, as long as a creditor is listed in the bankruptcy petition, the creditor does not have to file a claim with the court. However, it is IRS' policy to file claims in all reorganization bankruptcies if delinquent taxes are due.

Bankruptcy Administration

Before the Bankruptcy Reform Act of 1978, the "courts of bankruptcy" were the district courts. However, nearly all bankruptcy cases were administered by referees appointed and supervised by U.S. district court judges. The 1978 act as amended by the bankruptcy amendments of 1984 established federal bankruptcy courts in the judicial districts as adjuncts of the U.S. district courts.

The 1978 act also attempted to separate the bankruptcy judges from the administrative aspects of case processing in an effort to eliminate the potential impropriety that could arise by having the judges responsible for both the judicial and administrative functions of a case. As a test to determine an effective way of administering bankruptcy cases, the 1978 act created the U.S. Trustee Program, within the Department of Justice, as a pilot program scheduled to continue through September 30, 1986. The Trustee program is operating in 18 of the 94 bankruptcy court districts. In the remaining 76 court districts the responsibility for case administration falls primarily on the Clerks of the Court and the Deputy

Clerks of Court for Estate Administration, also known as estate administrators. The U.S. trustee is an independent party in the bankruptcy; the estate administrator is an employee of the bankruptcy court.

The U.S. trustee or the estate administrator is responsible for monitoring a business as it attempts to reorganize. Ensuring that a business is current with its financial obligations and is progressing toward a successful reorganization is a major part of the administration of a reorganization bankruptcy. Businesses are generally required to submit monthly financial reports to the bankruptcy courts or U.S. trustees. U.S. trustees, in turn, hold periodic meetings with the business debtors.

If the U.S. trustee determines that a business may not succeed or that the business is not complying with bankruptcy rules and regulations, the U.S. trustee can petition the court to dismiss the bankruptcy case or convert it to a liquidation bankruptcy. The dismissal of a bankruptcy case reverts the status of the business to where it was before it filed the bankruptcy petition, and creditors are free to pursue normal collection actions against the business.

The estate administrator does not have this same power to petition the court. While some bankruptcy courts have taken independent actions based on information supplied by estate administrators, at least one federal appellate court has ruled that the bankruptcy court cannot act without a request from a party in interest. The court also ruled that the estate administrator is not considered to be a party in interest.

We did not evaluate how well the estate administrator and U.S. trustee performed their roles in the administration of bankruptcies. We note, however, that while the U.S. trustee and the estate administrator may be responsible for the administration of a bankruptcy case, the creditors are also responsible for monitoring the business' payment of its current obligations and bringing any delinquencies to the attention of the court.

IRS' Role in Business Bankruptcies

IRS is the principal federal creditor in bankruptcy cases. In liquidation bankruptcies IRS accomplishes its responsibility primarily by filing claims; however, in reorganization bankruptcies, IRS' activities are greatly expanded. Not only does IRS file claims, it also monitors the business to ensure that current taxes are paid. In addition, IRS attempts to ensure that reorganization plans provide for the payment of delinquent taxes and that payments under approved plans are made as required.

This responsibility is placed within the special procedures function of IRS' Collection Division.

Once IRS receives notification of a bankruptcy, it researches its files to determine whether the business owes any delinquent taxes. IRS then files claims for any delinquencies, including estimated claims for unfiled returns. For reorganization bankruptcies, IRS sets up files to use in monitoring the business as it attempts to reorganize. This monitoring includes reviewing the status of current tax liabilities and proposed plans to ensure that they provide for the payment of delinquent taxes in accordance with the Bankruptcy Code.

Because businesses are protected from creditor actions during bankruptcy, IRS is generally restricted from following its normal collection procedures. When a business involved in a reorganization bankruptcy fails to pay its current taxes, IRS contacts the business to determine why payment was not made and informs the business that the nonpayment of these taxes can result in a court motion to dismiss the bankruptcy case or have it converted to a liquidation.

If a reorganizing business does not pay its current taxes after this contact, IRS can bring the case to the attention of the bankruptcy court. IRS does this through intermediaries, such as the U.S. trustee, or by petitioning the court directly through U.S. attorneys. The approach used by IRS varies among district offices and depends primarily on the relationship established with U.S. trustees and estate administrators. In those cases in which IRS petitions the court directly, the case is first referred to IRS' district counsel, who prepares the case for court, then to the U.S. attorney for actual presentation to the court. In 13 IRS districts, IRS district counsel attorneys have been designated special assistant U.S. attorneys and are able to present the cases directly to the bankruptcy courts. In those instances where IRS refers delinquent cases to the U.S. trustee or the estate administrator, these officials either attempt to obtain compliance directly or notify the court of the delinquency. If no action is taken by the U.S. trustee or estate administrator, IRS will petition the court directly.

Most Taxes Owed by Bankrupt Businesses Have Been Withheld From Employees' Wages

Most of the taxes bankrupt businesses owe are employment taxes. These taxes are primarily income and social security taxes that a business withheld from its employees' wages in trust for the government. Since employees receive full social security and withholding income tax credit for these taxes regardless of whether the business pays them, the government has a vested interest in making sure it receives all employment taxes that are due.

Employment taxes comprise withheld income taxes, social security taxes (both the employers' and the employees' share), and unemployment taxes. Because these taxes are held in trust for the government, IRS has the authority to assess a 100-percent penalty against responsible individuals, including officials of bankrupt businesses, who fail to collect and/or pay them. The penalty is equal to the amount of taxes that should have been withheld from employees and paid to the government. It does not include the employer's share of the employment taxes or penalties and interest on the unpaid withheld taxes.

In effect, the 100-percent penalty transfers the tax liability from the business to the responsible individuals; however, IRS' ability to collect the 100 percent penalty may be impaired if the responsible individual's finances are closely tied to those of the bankrupt business.

Objectives, Scope, and Methodology

Our review dealt with IRS' efforts to detect and collect delinquent taxes during business bankruptcies. We concentrated on businesses rather than individuals because businesses attempting to reorganize can accumulate substantial employment tax delinquencies. The Joint Committee staff concurred with our focus.

Our objectives were to evaluate IRS' procedures and practices for monitoring the payment of employment taxes during business reorganizations and for filing claims for delinquent taxes with the bankruptcy courts during liquidation bankruptcies. Our work took place at

- the headquarters offices of the IRS, the Department of Justice, the Administrative Office of the Courts, and the Executive Office of the U.S. Trustee in Washington, D.C.;
- IRS regional offices in Chicago, Philadelphia, and Dallas;
- IRS district and district counsel offices and U.S. attorney offices in Chicago, Newark, and New Orleans;
- U.S. trustee offices in Chicago and Newark; and

- the Illinois-Northern, New Jersey, and Louisiana-Eastern bankruptcy court districts.

We obtained general information on bankruptcy-related procedures for filing claims and monitoring tax payments from all IRS district offices and all bankruptcy courts and court subdivisions. We interviewed officials of IRS, the Administrative Office of the U.S. Courts, bankruptcy courts, and the Department of Justice. We reviewed IRS' bankruptcy policies and procedures, relevant internal audit reports, and bankruptcy case records and computer-generated data at IRS district collection and counsel offices, bankruptcy courts, and U.S. trustee offices. We relied on the accuracy of agencies' computer-generated data and did not test its validity.

We judgmentally selected the three bankruptcy court districts and the corresponding IRS district offices where we performed our detailed analysis. These locations provided a mix of geographic locations and district sizes and included the operations of both an estate administrator and a U.S. trustee. We discussed our location selections with IRS, court, and U.S. trustee officials and changed one of our initial locations because IRS officials felt that the district we selected would not provide a typical representation of IRS bankruptcy operations. IRS officials agreed that our final selection provided a fair cross section of districts upon which to evaluate IRS bankruptcy procedures.

Using a stratified random sample design, we randomly selected 563 of the 694 reorganization bankruptcies filed in 1981 and 1,933 of the 2,684 liquidation bankruptcies filed in 1982 in the three bankruptcy court districts selected for review. These three locations accounted for about 8 percent of the reorganization and 6 percent of the liquidation bankruptcies filed nationwide. Recognizing that bankruptcy proceedings often cover long periods of time, we selected reorganization cases filed in 1981 and liquidation bankruptcies filed in 1982 thinking that these bankruptcies would have progressed far enough for us to evaluate IRS' procedures and analyze the final disposition of the cases. Even using these time frames, however, we were unable to fully analyze all the final dispositions because most of the sampled cases were still open at the time of our review work. We did follow up on cases in one district in January 1985 to obtain some disposition information.

New bankruptcy court rules which became effective August 1, 1983, reduced the extent to which IRS is notified of liquidation bankruptcies. Prior to the new rules, IRS was notified of all liquidation bankruptcies.

Instead the courts will now notify IRS only if it is listed as a creditor on the bankruptcy petition. We reviewed all business liquidation bankruptcies filed in August and September 1983 in the locations we visited to determine the effect of this change.

Appendix II describes our sampling methodology in greater detail and presents the statistical results of our review. Our review was conducted during the period October 1983 through January 1985, and work was performed in accordance with generally accepted government auditing standards.

IRS Can Further Improve Its Procedures for Preventing Businesses From Accumulating Employment Tax Delinquencies

A business attempting to reorganize is required by both the Internal Revenue and the Bankruptcy codes to pay employment taxes the same as any other business. However, in the three bankruptcy court districts we reviewed, an estimated 254 of the 583 businesses that filed for reorganization in 1981 had not been paying all of their employment taxes. These businesses accumulated an estimated $6.6 million in tax delinquencies, of which $5.5 million remained unpaid in early 1984.

IRS could more effectively monitor the payment of employment taxes during reorganization bankruptcies and more aggressively pursue court action to minimize the accumulation of employment tax delinquencies. Businesses are required to file quarterly returns with IRS showing the amount of taxes that have been withheld from employees' salaries and paid to the government. In the three districts we reviewed, all businesses were monitored quarterly regardless of the size of the business or its tax delinquency history. The frequency with which businesses are required to pay taxes is based on the size of their tax liability and can be as often as 8 times a month. Thus, a significant liability could accrue before quarterly monitoring would detect the existence of a problem. With regard to pursuing court action, we found that the districts had either established no criteria for court referral or had based their criteria on perceptions of local court requirements.

Before we completed our work, IRS took action to improve its procedures for dealing with businesses that accumulate employment tax delinquencies during reorganization bankruptcy. However, additional actions could further improve IRS' ability to deal with this problem.

More Frequent Monitoring Would Enable IRS to More Quickly Identify Employment Tax Delinquencies During Reorganization Bankruptcies

It is important for IRS to keep apprised of the status of businesses in reorganization because these businesses can accumulate additional tax delinquencies and have a high potential for failure. An estimated 312, or 54 percent, of the 583 business reorganization bankruptcies filed in 1981 in the three districts we reviewed were either dismissed or converted to liquidation bankruptcies. Moreover, information from the Administrative Office of the U.S. Courts shows that, nationwide, 74 percent of the business reorganization bankruptcies that were converted to liquidations made no payments to creditors. Since IRS could lose any delinquencies that might be owed by reorganizing businesses, monitoring represents the first step in helping to keep such losses to a minimum.

IRS has provided its district offices with only limited guidance on monitoring business reorganization cases for employment tax compliance.

The bankruptcy manual required only that business reorganizations be monitored and left it to the IRS district offices to establish procedures on how and when monitoring should be done. An IRS headquarters official explained that this was because local bankruptcy courts had differing requirements on the extent of tax delinquency necessary before they would be willing to take action. He said that because of these differing requirements, each district would have to develop its own monitoring criteria.

We found that a need existed for national guidance that could be used to supplement IRS' locally developed criteria. For example, each of the districts we visited told us that all business reorganizations were monitored quarterly. The districts did not take the size of the companies into consideration in determining how often monitoring should be done. The size of the business needs to be considered because businesses with large numbers of employees have the potential to accumulate large employment tax delinquencies in a short period of time. For example, we found that one of the businesses in our sample accumulated about $76,000 in employment tax delinquencies in one quarter. More frequent monitoring would facilitate the detection of problems in large businesses before a more significant liability has been incurred.

The districts also did not take into consideration the fact that some companies are more likely to accumulate tax delinquencies than others. The need to do this is shown by our analysis of tax delinquencies in the three districts we visited. We estimated that $5 million, or about 90 percent, of the $5.5 million in unpaid tax delinquencies were accumulated by 105, or 18 percent, of the districts' 583 business reorganizations. Each of these 105 businesses had accumulated over $10,000 in tax delinquencies. (See table 2.1.)

Table 2.1: Businesses Accumulating Over $10,000 in Tax Delinquencies in the Three Districts Visited by GAO

Dollars in thousands

	Businesses	
Bankruptcy court district	**Number**	**Amount**
Illinois-Northern	57	$2,719
New Jersey	39	1,760
Louisiana-Eastern	9	550
Total	**105**	**$5,029**

One factor that could be considered in determining whether a business might be likely to incur a tax liability is that businesses that owed taxes at the time of bankruptcy seemed to be more prone to accumulate tax

delinquencies than those that did not. Of the 327 businesses that owed taxes at the time they filed for bankruptcy, 186, or 57 percent, accumulated additional tax delinquencies. Only 17, or 12 percent, of the 140 businesses that owed no taxes at the start of bankruptcy became delinquent later.

IRS receives information that would enable it to more frequently monitor businesses. For example, IRS district offices receive litigation transcripts and proofs of deposit. Litigation transcripts are sent to the district offices weekly and include a listing of all deposits made and all returns filed by the business. Proofs of deposits are bank-certified statements that are sent to IRS whenever deposits of withheld taxes are made.

IRS could further improve its monitoring capability by working more closely with U.S. trustees and estate administrators. Because U.S. trustees and estate administrators receive businesses' operating reports and participate in bankruptcy conferences, they can provide IRS with valuable information on the status of a business. Our review showed that IRS made only limited use of these sources.

Once a problem has been identified, there are even more stringent measures IRS could take. Under Treasury regulations, IRS can require businesses to file monthly rather than quarterly returns. Despite the potential increased monitoring capability provided by monthly filings, we found that only 1 of the 62 IRS districts we contacted had used monthly filing of returns as a monitoring technique.

Better Referral Criteria Can Improve IRS' Efforts to Bring Delinquent Reorganization Businesses to the Courts

IRS must use the bankruptcy courts to pursue action against businesses that accumulate employment tax delinquencies during bankruptcy. Therefore, identification of a delinquency is not enough. IRS must also quickly bring these cases to the court's attention.

Of the 472 reorganizing businesses in our sample, 203 had accumulated employment tax delinquencies. Of these 203, 53 had been referred to IRS district counsel or the U.S. trustee, which is the first step in the court referral process. Of the 150 cases not referred, 92 had been delinquent for at least 2 quarters and had accumulated over $1,000 in employment tax delinquencies. Our analysis of the referred cases also showed that it took an average of 7.4 months from the businesses' first delinquency to refer a case to IRS district counsel or the U.S. Trustee.

Of the 53 cases referred to IRS district counsel or the U.S. trustee, 10 were referred to court. These cases took an average of 15 months to come to court after the first delinquent tax return was due. According to IRS headquarters and district officials, bankruptcy judges were not always receptive to IRS' motions dealing with businesses that accumulated tax delinquencies during bankruptcy. IRS officials believed that bankruptcy courts required from one to three delinquent tax periods before acting upon an IRS motion. However, IRS did not have historical information to support this belief. In fact, because so few cases came to each court's attention, it is questionable whether IRS could make any determination about the requirements of the local bankruptcy courts. Four of the 7 bankruptcy judges we interviewed told us that any delinquency that would affect the potential success of the bankruptcy would be acted upon. Six stated they were not even aware that businesses were accumulating employment tax delinquencies during reorganization bankruptcies and said that the matter had never been brought to their attention.

IRS' bankruptcy manual provided only limited guidance on referrals and we noted inconsistent information in what had been provided. One section of the manual stated that cases should be referred to district counsel immediately after a business fails to pay current taxes. However, another section of the manual stated that before referring a case to district counsel, IRS should request the payment of delinquent taxes. The manual did not set any specific time frames or dollar amounts for referrals. We found that this lack of specific criteria contributed to major inconsistencies between and within districts. Within one district, for example, eight employees cited four different criteria to use in determining when to refer a case to counsel. The criteria described ranged from $1,000 in taxes delinquent for at least one quarter to $10,000 in delinquent taxes for at least two quarters. Officials in another district told us that it had established no referral criteria at all. Instead, it was left up to each employee monitoring business reorganizations to determine if and when a case should be referred.

The IRS bankruptcy manual also lacked adequate guidance concerning what information should be obtained and provided to counsel for each referral. Although IRS national office officials told us that such guidance should be developed locally, we believe the problems we noted could best be addressed by IRS headquarters. For example, the bankruptcy manual does not require that a determination be made as to whether a business is still operating, nor does it require that information be provided on the number of a business' employees or the size of its payroll.

According to one district counsel, this information is vital to determining whether court action is necessary. District counsel explained that even a minor tax liability would be considered for court action if the possibility existed that the business would accumulate a more significant delinquency.

District counsel attorneys informed us that many referrals in our sample were made without adequate support and that, as a result, they either had to request the additional information from IRS' special procedures function or obtain it themselves. Since tax delinquencies are being accumulated during this period, delays should not be incurred to locate missing information.

IRS Is Taking Actions to Improve Its Monitoring and Referral Procedures

We kept IRS apprised of our preliminary findings, and before we completed our work IRS took actions to improve its monitoring and referral procedures for reorganization bankruptcy businesses that do not pay their employment taxes. An October 1, 1984, joint memo from the Assistant Commissioner for Collections and the Director of the General Litigation Division in IRS' Office of Chief Counsel to all regional collection and counsel personnel discusses the need for better coordination between IRS' district counsel and collection officials to develop both referral criteria and criteria concerning required referral information. In February 1985, IRS revised its bankruptcy manual to require more frequent monitoring of reorganizing businesses with large payrolls. The revised manual also incorporates the requirement that local collection and district counsel personnel work together to develop referral criteria, including requirements for evidence of nonpayment to be provided with each referral.

Also, the IRS national office has recently made efforts to emphasize to its district offices the importance and potential benefits of local coordination and cooperation with the U.S. trustees in dealing with delinquent debtors, and IRS' chief counsel is working to expand a program whereby IRS district counsel attorneys are designated as special assistant U.S. attorneys. This program, which allows IRS to motion the bankruptcy court directly, is currently in effect in 13 district offices.

Conclusions

IRS has taken recent actions that should improve its efforts to minimize the accumulation of employment tax delinquencies during reorganization bankruptcies. We believe actions could be taken to further enhance IRS' ability to deal with this matter. With regard to monitoring, IRS has

revised its bankruptcy manual to require more frequent monitoring of businesses with large payrolls. We believe that factors such as the business' past delinquency history should also be considered. Additionally, IRS should make greater use of its authority to require businesses to file monthly rather than quarterly returns once a tax delinquency problem has been identified through its monitoring efforts.

Responsibility for establishing monitoring and referral criteria is still left up to the local district offices based on local bankruptcy court requirements. We believe IRS could assist in this effort by establishing minimum nationwide criteria for the monitoring and referral of cases. It could then allow districts to supplement these criteria when locally documented requirements show the need to do so. In addition, IRS needs to continue its efforts to make better use of information and resources available from U.S. trustees and estate administrators in dealing with businesses that do not pay their employment tax delinquencies during reorganization bankruptcies.

Recommendations

We recommend that the Commissioner of Internal Revenue:

- Develop and include in the bankruptcy manual additional indicators for IRS personnel to use in deciding how often to monitor bankrupt businesses. One indicator that has been incorporated into the manual is the size of the businesses' payroll; another could be the businesses' prior delinquency history.
- Make greater use of the authority to require businesses with employment tax liabilities to file monthly rather than quarterly returns.
- Develop and include in the bankruptcy manual minimum criteria for referral of cases to district counsel and the bankruptcy courts. The manual should also state that each referral include information on the business' operating status and the size of its employment tax liability.

Agency Comments and Our Evaluation

The Acting Commissioner of Internal Revenue commented on a draft of this report by letter dated December 11, 1985. He stated that IRS generally agreed with the thrust of our report and plans to take actions to implement the report's recommendations.

Specifically, IRS intends to revise its Internal Revenue Manual to:

- Require its employees to consider past delinquency history in determining how frequently to monitor a business.

- Provide that monthly filing of tax returns be considered for those businesses whose past payment history warrants such action.
- Include minimum criteria for referral of cases for bankruptcy court action.

IRS also plans to automate the monitoring of tax payments during bankruptcy. IRS believes that this action will enable its districts to more consistently manage the bankruptcy caseload.

In commenting on our recommendation that IRS make greater use of its authority to require businesses with employment tax liabilities to file monthly rather than quarterly tax returns, IRS stated that our report suggests that IRS resort to requiring monthly filing after the business fails to pay a tax liability during bankruptcy. IRS stated that this would unnecessarily delay bringing the matter before the court since, if the problem were significant enough to require monthly filing, it would also warrant referral for legal action. IRS stated that it preferred to make this determination based on the business' prior delinquency history so that it could take preventive action at the outset of the business' operation under bankruptcy status.

We agree with the preventive approach described by IRS in its comments. However, not all businesses that accumulate tax delinquencies during bankruptcy have a history of tax delinquency. Therefore, there also will be instances where IRS can use monthly filings to more frequently monitor businesses that develop problems in paying their tax liabilities during bankruptcy.

IRS also offered additional comments on our recommendation that it develop and include in the bankruptcy manual minimum criteria for the referral of cases to the district counsel and the bankruptcy courts. While agreeing to implement the recommendation, IRS commented that our report appears to imply that the bankruptcy court will automatically convert or dismiss a reorganization bankruptcy based on a motion that the business is accumulating tax delinquencies. We did not intend to imply that the court would, or should, automatically convert or dismiss a reorganization bankruptcy based on the nonpayment of taxes during bankruptcy. Our point is that since IRS is restricted from taking any collection action during bankruptcy, it must seek court action. If the court can get the business to pay its current taxes, there will be no need to convert or dismiss the case. Also, if the court rules in favor of continued reorganization, IRS can quickly make additional motions if there is continued noncompliance.

IRS Can Further Improve Its Procedures for Preparing and Filing Liquidation Bankruptcy Claims

In a business liquidation bankruptcy, failure to file a claim could eliminate any chance a creditor might have to collect whatever amount is owed. Also, because the bankruptcy distribution is based on the amounts and the priority of the delinquencies shown on the claims that are filed, an inaccurate claim can result in the inequitable distribution of payments that are made.

In the three districts reviewed, an estimated 384 of the 597 businesses with assets available for distribution that filed for liquidation bankruptcies during 1982 owed delinquent taxes. These delinquencies totaled an estimated $13 million. We found that IRS did not file claims against some of these businesses and filed inaccurate claims against some others. For example, IRS did not file claims for an estimated $480,000 owed by 21 businesses. Conversely, IRS filed inaccurate claims totaling an estimated $1.7 million in an estimated 77 percent of the bankruptcy cases. IRS classified $118,000 in tax delinquencies under the wrong priority, overclaimed $1,072,000, and underclaimed $527,000. Not all of the money owed by liquidation bankruptcies is collected; however, available information shows that bankruptcy payments are made in many cases and that the type of errors we found would affect the distribution of such payments.

Our analysis of the cases where claims were either not filed or filed inaccurately showed that IRS could improve its claims procedures if it provided better overall guidance on the technical treatment of taxes, penalties, and interest and established supervisory and quality assurance reviews for tax claims. After our review work was completed, IRS revised its manual to provide more specific instructions on tax, penalty, and interest computations, and it initiated national reviews of district bankruptcy operations. These are positive steps that could be supplemented by further improvements.

Some Delinquent Taxes Are Paid During Liquidation Bankruptcy Proceedings

Reliable statistics are not available to show the total amount of taxes owed by businesses that file for bankruptcy or how much of the delinquencies are collected. However, available information does show that some amount of delinquent taxes is often paid during bankruptcy proceedings.

Statistical information developed by IRS shows that during fiscal year 1984, IRS filed claims for $298 million in business tax delinquencies and collected about $53 million. Since bankruptcies are not normally settled in the year in which they are filed, most of the $53 million would relate

to claims that were filed in previous fiscal years. Also, an internal audit study in nine IRS districts covering the first three quarters of 1983 showed that IRS collected $167,000 of $1.2 million in business tax delinquencies owed by 100 businesses in liquidation bankruptcy.[1] Using these figures, IRS' internal audit group estimated that IRS received about 14 percent of total tax delinquencies through bankruptcy payments.

Our review of a sample of business liquidation bankruptcies filed in 1982 showed that by the early months of 1984, 7 percent of the bankruptcy proceedings had been completed. In January 1985, we followed up on the status in one district and found that 12, or 11 percent, of the 105 bankruptcies in that district had been completed with final distributions. In 11 of these 12 cases IRS received payments amounting to $28,574, or 12 percent of the total tax delinquencies owed by the 12 businesses. In 1 of 11 cases, IRS received full payment.

The above information shows it is important for IRS to file accurate claims with the bankruptcy courts so that it can receive its fair share of whatever proceeds are available.

IRS Files Claims for Delinquent Taxes in Most Liquidation Bankruptcies

In the three districts we reviewed, IRS filed claims for an estimated 95 percent of the 384 tax-delinquent businesses with assets available for distribution that filed for liquidation bankruptcy in 1982. In one of the three districts, IRS filed claims for all business liquidation bankruptcies. The other two districts did not file claims for an estimated 10 percent of their 204 cases. These missed claims totaled an estimated $480,000 in delinquent taxes. Based on information we provided IRS on 14 of our sample cases, it filed 10 additional claims for $324,000.

We found that many of the missed claims resulted from isolated problems and were not attributable to procedural deficiencies. However, in one district we found that inadequate follow-up of involuntary bankruptcy motions was the main reason for missed claims. An involuntary bankruptcy motion is filed by one or more of the business' creditors and no asset information becomes available until the bankruptcy court accepts the case and the debtor files the required schedules of assets and liabilities. As a result, IRS does not require that districts file a claim until the court approves the bankruptcy and a determination that assets are available for distribution is made. We found that this IRS district did

[1]Our review of these 100 cases showed that IRS was paid in full in 19 and received partial payment in 35 others.

not follow up to determine whether the court accepted the case and whether assets were available for distribution. Arrangements have since been worked out with the the local bankruptcy court whereby it provides notification on all involuntary bankruptcies it accepts. This should correct the procedural problem we identified.

The Effect of Recent Revisions to the Bankruptcy Court Rules Needs to Be Assessed

Under revised bankruptcy court rules that became effective in August 1983, the courts are required to notify IRS of liquidation bankruptcies only when it is listed as a creditor on the bankruptcy petition. Work we did in one district office before the new rule became effective showed that some of the businesses that owed taxes had not listed IRS as a creditor. Under the new procedures, IRS would not have been notified of these bankruptcies.

IRS sought the new rule, hoping that it would eliminate the task of processing cases when the businesses did not owe taxes. IRS officials told us that they believed the money IRS saves by not working all bankruptcy cases far outweighs any revenue it might lose by not filing claims, but the officials stated that IRS had no factual data to support this conclusion.

We attempted to evaluate the effect of this change in notification requirements by reviewing all 260 business liquidations filed in the three bankruptcy court districts during August and September 1983. Although our analysis did not show that the new rule was causing any major problems, we are concerned that due to the timing of our analysis, it might not fully reflect the effects of this change on the notification process. Our analysis covered the first 2 months that the rules were in effect, and many court districts continued to notify IRS of all bankruptcies after the August implementation date. At the time we completed our field work in one IRS district in June 1984, IRS officials told us that they were beginning to experience greater problems with businesses incorrectly failing to list IRS as a creditor.

IRS Has Taken Actions to Improve Accuracy of Bankruptcy Claims

Bankruptcy payments are based on the priority of the debts and the amounts of tax delinquencies shown on the claims filed with the bankruptcy courts. Therefore, it is important that claims be accurate. In the three districts reviewed, IRS filed inaccurate claims in an estimated 281, or 77 percent, of the estimated 363 business liquidation claims filed in

1982. Based on our sample cases, we estimate that IRS misclassified priorities worth $118,000, understated $527,000, and overstated an estimated $1,072,000 in tax delinquencies.

Our analysis of the sample cases is shown in table 3.1.

Table 3.1: Inaccuracies Disclosed in GAO's Sample of Claims Filed by IRS

Type of inaccuracy	Number of occurrences[a]	Amount of error
Misclassified claims		
claimed higher priority	4	$ 2,514
claimed lower priority	21	59,533
Inaccurate tax and interest		
overstated	125	744,847[b]
understated	119	204,588
Inaccurate penalties		
overstated	214	67,183
understated	550	177,203

[a]The number of times the errors occurred according to this table does not equal the number of bankruptcies with inaccurate claims because many bankruptcies contained more than one error. For example, one error in the amount of tax could cause a number of additional errors, since interest and penalties could be calculated on the tax amount.

[b]One case accounted for $596,871 in overstated tax on an estimated claim.

Inaccuracies in claims stemmed mainly from the fact that IRS' bankruptcy manual did not contain adequate guidance on the computation of interest and penalties in bankruptcy situations. Table 3.2 shows the types of errors that caused the inaccuracies.

Table 3.2: Types of Errors That Caused Inaccuracies Identified in GAO's Sample of Claims Filed by IRS

Type of errors	Number of errors	Percent of total errors
Incorrect application of bankruptcy rules	350	34
Inadequate controls and follow-up for estimated claims	172	17
Calculation and omission errors	435	42
Other	76	7
Total	**1,033**	**100**

In two of the three IRS districts we visited, the policy the district established for claiming penalties was incorrect. The Bankruptcy Code provides that penalties can be claimed only up to the date of the bankruptcy petition. One district was not claiming penalties incurred before the petition date if the tax was not assessed at the time of the petition, an error accounting for about 30 percent of the total number of

errors in that district. IRS district officials stated that since a July 1983 district counsel policy statement, the district has been claiming these penalties. In another district IRS was claiming the failure-to-file penalty after the petition date, basing this procedure on the erroneous assumption that the penalty was a one-time penalty applicable on the due date of the return. This error accounted for 38 percent of the total number of errors in that district. IRS' revised bankruptcy manual clarifies the fact that this penalty should stop accumulating at the date of the petition.

We also found that IRS was not adequately following up on estimated claims in one district reviewed. To protect the government's interest, IRS files estimated claims when tax returns are due but not filed. IRS procedures require that amended claims be filed once the actual liability is known. One district did not adequately follow up to ensure that amended claims were filed. We discussed this with local IRS officials who informed us that instructions would be issued to require that when tax returns are received in the district, claims should be reviewed to determine whether an estimated claim was filed and whether amended claims should be prepared.

We also found that IRS' bankruptcy manual did not clearly state how delinquent tax claims should be computed, and IRS employees did not always receive specific training on how to compute claims. In addition, the manual did not require that supervisory reviews be made to detect errors that had been made on such claims. With regard to computing interest and penalties, the bankruptcy manual did not provide the specific technical instructions needed to prepare accurate bankruptcy claims. In the three districts visited we found that IRS employees preparing claims had received some general training on claim preparation but had received little or no training on specific penalty or interest computations. Also, only one district's bankruptcy files were adequately documented to ensure that a supervisory review could identify problems.

IRS revised its manual in February 1985 to provide more detailed instructions on claim preparation and interest and penalty computations in bankruptcy cases. However, IRS has not addressed the problem of inadequate documentation and supervisory reviews.

Conclusions

It is important that IRS file accurate claims to ensure the equitable distribution of bankruptcy payments. While IRS improved its claim preparation and filing procedures after our review, it could further improve its

performance in this area by requiring that case files contain adequate documentation for claim computations and that supervisory reviews of prepared claims be made. Such reviews will enable IRS to assess the adequacy of the actions it has taken and identify other areas in need of improvement.

We did not identify any increase in missed claims that could be directly related to the new bankruptcy court rule which changed notification requirements; however, we believe that the potential problem of IRS not being notified of business liquidation bankruptcies because it has not been listed as a creditor needs to be monitored.

Recommendations

We recommend that the Commissioner of Internal Revenue

- revise the bankruptcy manual to require that bankruptcy case files contain adequate documentation of claim computations and that supervisory or quality control reviews of these computations be made to ensure that claims are accurately prepared; and
- periodically test the effects of the revised bankruptcy court rules' notification requirements to (1) determine the extent to which liquidating businesses are not listing IRS as a creditor on bankruptcy petitions and (2) provide the basis for developing corrective action if needed.

Agency Comments and Our Evaluation

IRS generally agreed with our findings and stated that it plans to take actions to implement our recommendations. In this regard, IRS plans to revise the Internal Revenue manual to require that bankruptcy case files contain adequate documentation of claim computations to facilitate more thorough reviews. Also, IRS plans to conduct a study to determine the effect of the revised bankruptcy court rule that requires the courts to notify IRS of liquidation bankruptcies only when IRS is listed as a creditor on the bankruptcy petition.

Letter Dated December 11, 1985, From the Acting Commissioner of Internal Revenue

COMMISSIONER OF INTERNAL REVENUE
Washington, DC 20224

DEC 11 1985

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Anderson:

Thank you for the opportunity to review your draft report entitled "IRS Can Further Improve Its Procedures for Protecting the Government's Interest When Businesses File for Bankruptcy".

We agree with general thrust of your report and are planning actions to implement the report recommendations as described in the enclosed.

With kind regards,

Sincerely,

Enclosure

Department of the Treasury Internal Revenue Service

IRS COMMENTS ON GAO DRAFT REPORT
"IRS CAN FURTHER IMPROVE ITS PROCEDURES FOR
PROTECTING THE GOVERNMENT'S INTERESTS WHEN
BUSINESSES FILE FOR BANKRUPTCY"

Recommendation

Develop and include in the bankruptcy manual additional indicators for IRS personnel to use in deciding how often to monitor bankrupt businesses. An indicator that has already been incorporated into the manual is the size of a business' payroll. Another could be the business' prior delinquency history.

Response

We generally agree with the recommendation for improvement of our procedures to limit post-petition accrual of unpaid employment taxes. We will add to the Internal Revenue Manual (IRM) the statement that the Special Procedures function in Collection should consider the debtor's pre-petition compliance record in determining how frequently post-petition compliance should be monitored. Due to the wide variety of monitoring methods, workload, and staffing, we believe that classifying the bankruptcy inventory as to frequency of monitoring is best done locally, using the factors provided in the IRM. However, we are working toward an automated system for monitoring post-petition employment tax compliance. Once operational, this system will promote consistency among the districts.

Recommendation

Make greater use of the authority to require businesses with employment tax liabilities to file monthly rather than quarterly returns.

Response

We intend to change the IRM to provide that Collection should consider delivering Form 2481, Notice to Make Special Deposits of Taxes, to debtors whose pre-petition delinquencies and current employment tax liability indicate a significant risk of pyramiding post-petition tax liabilities. Delivery of Form 2481 requires the recipient to open a separate bank account and deposit all withheld taxes into it within three days of withholding, as well as to file and pay returns monthly. Violation of the special deposit requirements after delivery of the notice is a misdemeanor under I.R.C. Section 7215, "Offenses with Respect to Collected Taxes." IRS policy has recently been changed to provide for use of these

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requirements for compliance purposes whether or not criminal prosecution is contemplated. We think that this procedure has the potential of increasing compliance in high risk cases, as well as enhancing our ability to quickly detect noncompliance.

We read GAO's recommendation for greater use of monthly filing as a suggestion that we resort to monthly filing after the debtor fails to pay a post-petition liability. We think that if the problem is significant enough to warrant monthly filing, it would also warrant a referral for legal action in the bankruptcy court and that the intermediate step of monthly filing would unnecessarily delay bringing the matter before the court. For this reason, we prefer to identify high risk cases based on pre-petition noncompliance and take preventive action at the outset.

Recommendation

Develop and include in the bankruptcy manual minimum criteria for referral of cases to district counsel and the bankruptcy courts. The manual should also state that each referral include information on whether the business is still operating and the size of its employment tax liability.

Response

We will add to the IRM, as GAO recommends, minimum criteria for referral of cases for bankruptcy court action.

We agree that referrals to Counsel for action on post-petition liabilities should include a statement of whether the business is still operating and, if so, Collection's best estimate of the debtor's current employment tax liability. We will add this to the IRM. We will discuss with the General Litigation Division what further information, if any, should be required for all referrals.

In addition, we should point out that the report appears to leave an impression that a bankruptcy court will automatically convert or dismiss a chapter 11 case under 11 U.S.C. Section 1112 whenever there is a showing of pyramiding of post-petition tax liabilities. This is not so. Failure to pay post-petition debts is not even one of the nine enumerated causes warranting conversion or dismissal. The dismissal also must be in the best interest of creditors and the estate. Granting dismissal rests with the discretion of the bankruptcy court. There is often a presumption in favor of continued reorganization rather than conversion or dismissal.

Recommendation

Revise the bankruptcy manual to require that bankruptcy case files contain adequate documentation of claim computations and that supervisory or quality control reviews of these computations be made to ensure that claims are accurately prepared.

Response

We agree that the percentage of proofs of claim in GAO's sample that contained one or more errors is cause for concern. As recommended, we will add a requirement to the IRM that the bankruptcy case file contain adequate documentation of the proof of claim computations. This should facilitate a more thorough review and decrease the error rate.

Recommendation

Periodically test the effects of the revised bankruptcy court rules notification requirements to (1) determine the extent to which liquidating businesses are not listing IRS as a creditor on bankruptcy petitions and (2) provide the basis for developing corrective action if needed.

Response

We intend to test the effect of Bankruptcy Rule 2002 as GAO recommends. We have not yet determined the form that our test will take. While we currently have no hard data, we think that the vast majority of significant tax liabilities are scheduled because of the self-interest of the debtor or, in the case of corporations, controlling officers. Most taxes, unlike most other debts, are not discharged in the bankruptcy. Withheld taxes not paid by a corporate debtor can be assessed against the responsible officers as a 100-percent penalty. We think that these considerations should cause well-counseled debtors to be especially careful about including all Federal tax debts in the schedules that they file with the bankruptcy court. Nonetheless, since GAO's study indicated that some businesses did not schedule Federal tax debts, we agree that a study of the effect of the rule is warranted.

Data Analysis Methodology

Because we reviewed a statistical sample of bankruptcies, each estimate developed from the sample has a measurable precision, or sampling error. The sampling error is the maximum amount by which the estimate obtained from a statistical sample can be expected to differ from the true universe value we are estimating. Sampling errors are usually stated at a certain confidence level—in this case 95 percent. This means the chances are 19 out of 20 that if we reviewed all the 1981 reorganization and 1982 liquidation bankruptcies in the three court districts, the results of such a review would differ from the estimates obtained from our samples by less than the sampling errors of such estimates.

Using listings of bankruptcies filed provided by the Administrative Office of the U.S. Courts for the three bankruptcy court districts selected for review, we randomly selected sample cases for review. Because of the small number of 1981 reorganization bankruptcies in the New Jersey district and the eastern district of Louisiana, we reviewed a 100-percent sample of these cases. For the northern district of Illinois, we selected a stratified sample of Chicago cases in order to use information we developed in our survey and reviewed 100 percent of the Rockford, Illinois, cases. We reviewed all 1982 liquidation bankruptcies in the eastern district of Louisiana and selected random samples in the other two districts.

In statistical surveys, the implementation of a sampling design does not always proceed exactly as planned because one does not have complete control of the sample. In this review, the lists of bankruptcies provided by the Administrative Office contained both personal and business bankruptcies. Thus, we adjusted our universe to reflect only the business bankruptcies and projected our findings to the adjusted universe. This is a common statistical procedure used to provide conservative estimates, since no statement is made about the values of the unknown segment of the universe. Tables II.1 and II.2 show the adjusted sample and universe sizes of business bankruptcies in the three districts reviewed.

Table II.1: Adjusted Sample Design for 1982 Liquidation Bankruptcies

Bankruptcy court district	Initial universe	Initial sample	Cases not in sample category	Adjusted sample size	Adjusted universe
Illinois-Northern[a]	1,344	854	684	170	264
Louisiana-Eastern	279	279	222	57	57
New Jersey	1,061	800	592	208	276
Total	**2,684**	**1,933**	**1,498**	**435**	**597**

[a]The northern district of Illinois sample is also stratified.

Table II.2: Adjusted Sample Design for 1981 Reorganization Bankruptcies

Bankruptcy court district	Initial universe	Initial sample	Cases not in sample category	Adjusted sample size	Adjusted universe
Illinois-Northern[a]	345	214	31	183	294
Louisiana-Eastern	61	61	17	44	44
New Jersey	288	288	43	245	245
Total	**694**	**563**	**91**	**472**	**583**

[a]The northern district of Illinois sample is also stratified.

Since we had data from three bankruptcy court districts, we used a stratified random sample design for our analysis. The northern district of Illinois sample of 1981 liquidation bankruptcies was also stratified in order to use data obtained in the survey. The estimates shown in this report are weighted for the three court districts and are shown at the 95 percent confidence level. The totals for the three districts do not always equal the sum of the individual districts because we used weighted totals. The differences are much greater in those cases in which more than one district's figures are projected.

For a number of the statistical projections, the estimated lower limit is less than the value actually found in the sample. Whenever this occurred, we used the value actually found in the sample.

Tables II.3 through II.7 show the actual sampling errors for some of the estimates used in this report. The lower limits marked with an asterisk (*) are actual sample values.

Table II.3: Total Number of 1981 Reorganization Bankruptcies That Accumulated an Employment Tax Delinquency During Bankruptcy

Bankruptcy court district	Estimate	Sampling error	95% confidence limits	
			lower	upper
Illinois-Northern	136	14	122	150
Louisiana-Eastern	21	0	21	21
New Jersey	97	0	97	97
Weighted Total	**254**	**14**	**240**	**268**

Table II.4: Total Accumulated Employment Tax Delinquencies for the 1981 Reorganization Bankruptcies

Bankruptcy court district	Estimate	Sampling error	95% confidence limits	
			lower	upper
Illinois-Northern	$3,578,044	$839,073	$2,738,971	$4,417,117
Louisiana-Eastern	771,108	0	771,108	771,108
New Jersey	2,291,921	0	2,291,921	2,291,921
Weighted Total	**$6,641,073**	**$839,073**	**$5,802,000**	**$7,480,146**

Table II.5: Total Collections of Accumulated Tax Delinquencies for the 1981 Reorganization Bankruptcies

Bankruptcy court district	Estimate	Sampling error	95% confidence limits	
			lower	upper
Illinois-Northern	$605,368	$282,081	$366,237*	$887,449
Louisiana-Eastern	203,774	0	203,774	203,774
New Jersey	376,259	0	376,259	376,259
Weighted Total	**$1,185,401**	**$282,081**	**$946,270***	**$1,467,482**

Table II.6: Total Number of 1982 Liquidation Bankruptcies With Errors on the Claims

Bankruptcy court district	Estimates	Sampling error	95% confidence limits	
			lower	upper
Illinois-Northern	120	14	106	134
Louisiana-Eastern	21	0	21	21
New Jersey	141	10	131	151
Weighted Total	**281**	**17**	**264**	**298**

Table II.7: Total Dollar Amount of Errors on the Claims of 1982 Liquidation Bankruptcies

Bankruptcy court district	Estimate	Sampling error	95% confidence limits	
			lower	upper
Illinois-Northern	$1,529,338	$968,064	$1,109,283*	$2,497,402
Louisiana-Eastern	23,488	0	23,488	23,488
New Jersey	163,338	36,560	126,778	199,897
Weighted Total	**$1,716,163**	**$968,754**	**$1,255,867***	**$2,684,917**

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