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TAX ADMINISTRATION

Periodic Evaluation Needed If IRS Uses Levies to Collect Deferred Accounts

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The Honorable Dan Rostenkowski
Chairman, Joint Committee on Taxation

The Honorable Lloyd Bentsen
Vice Chairman, Joint Committee on Taxation
Congress of the United States

This report, one of a series in response to your Committee's request, discusses the results of our evaluation of the Internal Revenue Service's (IRS) planned use of levies[1] to collect taxes on one type of delinquency—deferred accounts. Deferred accounts by definition fall below an IRS determined dollar level[2] and IRS' current collection process for such accounts stops just short of using levies. According to IRS, deferred accounts do not justify the resources needed to mount its full range of active collection efforts.

During fiscal year 1987, IRS deferred collection action on $240 million of delinquent taxes. As of May 31, 1988, its inventory of deferred accounts totaled $473 million, an increase of 120 percent from May 1985 when the dollar levels used as the basis for deferral were substantially increased. Taxes not collected within the 6-year statutory period for collection are written-off. During fiscal year 1987, $19.6 million of deferred taxes were written-off because of the expiration of the statutory period.

Results in Brief

During the past several years, IRS considered, and in 1988 developed, a plan for taking a more active collection approach to resolve deferred individual taxpayer accounts. Rather than continuing to rely on periodic reminder notices, IRS decided to annually levy taxpayer assets in an attempt to satisfy these accounts. Although IRS' past studies and our analysis suggested that using levies to collect deferred accounts had merit, there was insufficient information available to adequately evaluate the cost-effectiveness of such a program or whether it would adversely affect other program operations.

[1]Levy is the seizure of a taxpayer's assets to satisfy a tax delinquency. IRS differentiates between the levy of physical assets in the possession of the taxpayer, referred to as "seizure," and the levy of taxpayers' liquid assets (e.g., bank accounts, wages) that are in the possession of third parties (e.g., financial institutions and employers), referred to as "levy." This report deals with the latter enforcement tool—the levy of liquid assets in the possession of third parties.

[2]Specific dollar criteria used by IRS are not shown in this report. Disclosure of these dollar amounts could have an adverse effect on IRS' collection activities.

IRS also did not consider business deferred accounts in its initial studies or plans because no national program existed for identifying business assets that could be levied, whereas IRS did have a program to identify individual taxpayers' assets. IRS now has a national program for businesses and our analysis showed that levy source information is available for business accounts, although to a lesser extent than for individual accounts.

IRS has decided to make additional analysis and evaluation of the program, including the issue of business levies, rather than proceed with nationwide implementation at this time. Given the past studies on this issue and the potential benefits, we think IRS should make a final decision on implementation by no later than the end of fiscal year 1989. Should IRS eventually implement a nationwide levy program, we recommend that the program be periodically evaluated to assess its effectiveness.

Background

IRS has numerous options for dealing with delinquent taxpayers who cannot or will not fully pay their taxes. It can suspend collection action because the taxpayer is unable to pay or the taxpayer cannot be located or contacted. IRS can also allow taxpayers to pay their delinquencies in installments or pursue collection through its more powerful tools such as liens, seizures, and levies.

During 1987, IRS collected $22.9 billion in delinquent taxes, an increase of $3.3 billion over the previous year. Of that sum, $9.9 billion resulted from initial computer-generated notices to the delinquent taxpayers. Subsequent computer notices resulted in collections of $5.6 billion while additional actions including the use of levies recovered $7.4 billion. The actual amount collected solely as a result of levies, however, is unknown.

In most cases, IRS affords taxpayers several opportunities to satisfy their tax obligations before levying taxpayer assets. First, service centers attempt to collect delinquent taxes by sending businesses and individuals a series of balance due notices. These notices are computer-generated demands for payment which IRS sends to taxpayers at predetermined intervals. The final notice is sent by certified mail alerting the taxpayer that failure to pay can result in levy action. Generally, if the delinquency is not resolved during this stage, it is forwarded to the second stage of the collection process, the Automated Collection System (ACS).

ACS is a computerized inventory system designed to promote efficient case management and improved taxpayer contact. ACS staff collect outstanding taxes through stronger enforcement measures such as the use of levies. Generally, when an account is transferred to ACS, IRS' first action is to use computer-generated levies for those taxpayers on whom IRS has available levy source information. If this initial levy does not satisfy the delinquency or the taxpayer does not contact IRS, ACS staff, using existing or newly identified levy sources, can use additional levies to resolve outstanding delinquencies. ACS staff also initiate and receive taxpayer and third party telephone contacts.

Accounts not resolved at ACS often proceed to the third stage of collection—the collection field function in one of IRS' 63 district offices. Here, revenue officers attempt to collect delinquent taxes through more direct means, such as face-to-face contact with taxpayers. In settling accounts, revenue officers can, among other things, levy taxpayers' assets and/or seize taxpayers' property.

Deferred accounts, unlike other delinquencies, do not go through the complete collection process. Instead, IRS places deferred accounts in an inactive status if the final notice fails to resolve the account. After assigning these accounts to the deferred inventory, IRS attempts to collect the delinquent taxes by mailing periodic, usually annual, reminder notices and offsetting a taxpayer's delinquency with any refunds due. In addition, IRS may reactivate the account and initiate normal collection procedures whenever additional taxes and/or accrued penalties and interest raise the aggregate delinquency over the predetermined deferral level.

Objectives, Scope, and Methodology

Our initial objective was to assess the potential for using levies to collect deferred delinquencies. Although IRS had proposed such a program in 1985 and 1986, it was not initiated because of higher priority collection work. In April 1987, we judgmentally selected 2 of IRS' 10 service centers to do our analysis. IRS agreed that the results obtained at these locations would be indicative of all service centers for the purposes of this review.

We then determined the existence of potential levy sources by matching the tapes of all individual and business deferred accounts as of January 1987 at the two service centers to the various IRS files containing levy sources as of August 1987. To assist us in determining the merits of using levies to satisfy deferred accounts, IRS had agreed to levy taxpayer assets on a random sample of these accounts and capture data on the results of the levies and the resources required to deal with any taxpayer or third party inquiries prompted by the levies.

In the fall of 1987, we proposed that IRS proceed with the study on its own. IRS officials told us in December 1987 that they preferred to go forward with full implementation of a levy program for individual taxpayer accounts without any further study. As a result, as agreed with your Committee, we revised our objectives to evaluating IRS' plan for implementing a deferred account levy program and determining whether business accounts should be included.

Under our revised objectives, we used the computer tapes already obtained to analyze the availability of levy sources for all deferred accounts at the two service centers. However, we did not do reliability studies of IRS' computer-generated information. We interviewed IRS officials and reviewed IRS policies and procedures on the use of levies in the collection process. We also reviewed past IRS studies of the potential for levying deferred accounts and examined IRS' plan for implementing its levy program for individual deferred accounts.

We did our audit work at IRS headquarters in Washington, D.C.; service centers in Austin, Texas, and Kansas City, Missouri; and the regional and district offices in Chicago, Illinois.

We did our work from April 1987 through May 1988 and in accordance with generally accepted government auditing standards.

IRS' Plan to Levy Deferred Accounts

IRS' plan to levy individual deferred accounts would have carried the collection process one step further than the current approach. In doing so, IRS would annually research its files for levy source information on deferred accounts as part of the regular program of identifying levy sources for other delinquencies. If levy sources were found, those taxpayers would receive a legally required notice informing them of IRS' intention to levy their assets if the delinquency was not paid. This notice would be sent in lieu of the annual reminder notice. If the accounts were not resolved through the notice, levies would be used and information would be maintained on the active file should IRS employees need to respond to any taxpayer or third party inquiries.

Unlike other active cases, IRS would take no other collection action after this one levy. Accounts not satisfied by this levy would revert to deferred status until the next annual research for levy sources. Taxpayers for whom IRS had no levy source information would receive the usual reminder notice and their accounts would remain in the deferred inventory.

IRS had not yet decided how to use its resources to monitor deferred accounts and handle subsequent inquiries about the levy or delinquency itself. One alternative IRS considered was to monitor the accounts on ACS and use ACS staff to answer questions from taxpayers or third parties whom IRS records showed as potential levy sources. IRS experience showed that levies do result in questions from taxpayers and third parties on the levy or delinquency itself. The effect this would have on ACS resources, however, was not clear. According to IRS, a number of ACS call sites have experienced computer capacity problems and monitoring additional cases could further strain computer capacity. In addition, depending upon the volume of deferred account inquiries, the collection of other delinquencies could be adversely affected.

Because of potential ACS computer capacity problems, IRS also considered using its Integrated Data Retrieval System (IDRS) in lieu of ACS. IDRS, a separate computer system, contains information on all active delinquent accounts. IDRS terminals are available at most IRS locations and used by service center, ACS, and district office personnel. Thus, under the IDRS alternative, inquiries could be handled by ACS or other IRS personnel. However, unlike ACS, IDRS was not designed specifically for responding to taxpayers or third parties and individual terminals are not available to each IRS employee who might receive an account-related call. IDRS terminals are used for numerous other activities, including posting payments and other information to taxpayer accounts and updating those taxpayer accounts which are also on ACS. As a result, IDRS terminals may be less accessible than ACS for responding to taxpayer and third party inquiries and may therefore require more staff time to respond to inquiries.

The idea of using levies to collect deferred delinquencies is not new. In a study made in 1984 at the Kansas City Service Center, IRS found that 14 percent of 6,105 levy notices issued to collect individual deferred delinquencies resulted in full payments while 4 percent resulted in partial payments of the outstanding delinquencies. Based on this study, IRS estimated that about $3 million a year could be collected nationwide through the use of levies on individual deferred accounts.

In a 1985 study, Collection's Office of Evaluation and Research addressed the potential for using levies in an attempt to satisfy individual deferred accounts. Although IRS did not actually levy any taxpayers' assets, the study estimated that levies would generate an additional $13.6 million nationwide over a 1-year period or $38 in revenue for every dollar spent. IRS concluded that using levies on individual deferred accounts would be cost-effective, would enhance cash flow and cash management, and could foster voluntary compliance. However, neither of these studies in our view fully explored all the costs necessary to carry out the program or the effects the program could have on other IRS operations.

Based in part on the results of the two studies, Collection considered implementing a levy program for individual deferred accounts in August 1985 and again in September 1986. However, because higher priority collection work was being done by IRS' Computer Services function, the programming changes needed to implement the levy program were not made. In December 1987, Collection again developed a plan for using levies to collect individual deferred taxes and began making the necessary arrangements to initiate the program.

According to IRS officials, the planned levy program did not include businesses because past studies did not evaluate the potential for using levies on business accounts. Those studies did not address using levies on business accounts because a national program for identifying business levy source information was not fully operational until March 1987.

Our Evaluation of IRS' Planned Levy Program

At the time of our review, IRS planned to implement a nationwide program to use levies on deferred individual accounts. On the basis of our evaluation of the planned program, we concluded that IRS would not be in the best position to determine if the program, after implementation, was cost-effective and whether other program operations were adversely affected. We also concluded there was no compelling reason for IRS to exclude business accounts from the program. Accordingly, we proposed in a draft of this report that before implementing a program to use levies on deferred accounts, IRS revise its plan by including businesses in the program and by providing procedures for fully evaluating the program's costs, benefits, and effect on other operations. IRS could then better decide on the program's future, that is, if it should continue as implemented or if modifications should be made to ensure the most efficient and effective use of IRS' collection resources.

In commenting on a draft of this report, IRS agreed with our proposal concerning its planned nationwide levy program. However, IRS said after further consideration of the issues involved it would not be implementing a nationwide program at this time. Rather, before deciding whether to implement the program nationwide, it will evaluate the program's costs and benefits, the impact on computer capacity, and whether levies actually make a difference in collecting deferred accounts. The study will include both individual and business deferred accounts and, as described by IRS, address the issues we raised concerning its plan to implement a nationwide program.

Need to Evaluate Program Results

The need for evaluation we identified in the context of IRS' previous planned nationwide levy program applies as well to IRS' current plan for further study and any future program IRS may decide to implement. That is, during the study and any subsequent implementation, IRS needs to evaluate program operations to ensure efficient and effective use of its collection resources.

To do these evaluations, IRS needs to capture and analyze information on collections realized and the full costs and operational impacts of identifying levy sources, issuing final notices, imposing levies, processing payments, monitoring accounts, and responding to taxpayer or third party inquiries. Specifically, IRS needs to analyze the impact on both computer and personnel resources, including the effect on meeting other program demands. If the analysis demonstrates that excessive costs, workload slowdowns, and/or computer capacity problems result from using levies on deferred accounts, IRS would be in a better position to decide whether to continue the levy program or limit it to accounts with certain characteristics that would maximize the benefits while limiting adverse effects. In this respect, we believe that IRS should, at a minimum, gather data on the dollar amount of the taxes owed and the length of time the accounts were in deferred status so it is available for analysis.

IRS does not plan to levy all deferred accounts, only those with balances between the existing deferral level and a minimum delinquency amount. After gathering program cost information as discussed previously, IRS can evaluate if it is cost-effective to levy accounts at that dollar amount or if the amount should be changed. IRS should also analyze levy collections by the age of the account to determine whether there is a point in time after which levies are not usually cost-effective. IRS statistical information and past studies indicate that about 50 percent of all deferred taxes are fully paid through voluntary payments or refund offsets within the first 2 years after the account is deferred. After 2 years, however, the percentage of full-paid accounts decreases. Information on the extent to which this historical pattern remains the same or changes would be useful to IRS in determining whether the timing of levies to collect deferred delinquencies makes a difference.

In evaluating the overall effect of a levy program, IRS needs to consider two types of benefits. First, IRS should compare the revenues generated by levies with an estimate, based on historical data, of what would have been otherwise collected. Second, to the extent that levies speed up the collection process, IRS should determine the benefits, in terms of the time value of money, from such collections.

Basis for Including Business Accounts

Third party levy source information is a necessary ingredient for operating a levy program. Our analysis of deferred accounts at 2 of IRS' 10 service centers showed that levy source information is available for some individual and business accounts.

In IRS' Austin and Kansas City Service Centers, we found levy source information for about 44 percent of the combined 516,625 individual and business deferred accounts. These accounts represented $34.3 million, or 47.7 percent, of the total $71.9 million in deferred delinquencies at the two service centers. Financial institution and/or employer information was available on 65.8 percent of the individual taxpayers whose delinquencies totaled $30.1 million. Levy source information was available for 18.8 percent of the businesses with delinquencies totaling $4.2 million. For both individual and business deferred accounts, these delinquency balances are understated because accrued interest and penalties are not included. Moreover, these delinquency balances do not include approximately 18.1 percent of the accounts we analyzed. These accounts were carried at a zero balance even though accrued interest and penalties were owed.

Clearly, levy sources were available for a lower percentage of business than individual accounts and the dollar amount of business delinquencies was lower than individual delinquencies. An important issue for both individual and business accounts is whether additional revenues, not otherwise collectible, would be collected or whether revenues would be collected faster. Thus, the percentage of accounts with levy sources should not be the governing factor in deciding whether levies should be used on business accounts. The fact that a potential levy source has been identified does not guarantee collection. For example, deposits in financial institutions may have been withdrawn or transferred elsewhere after the financial institution was identified as a levy source. Neither we nor IRS know whether levies against individual taxpayers are any more productive than levies against businesses. Also, IRS levies both individual and business delinquent accounts above the deferred dollar level, but no comparable data exist on the relative percentages of levy sources for the two types of accounts above the deferral level. However, IRS does capture data on certain levy sources available for accounts over the deferral level. Although this information is not comparable to the data used in our analysis, it does show that the availability of levy sources for businesses is likewise lower than for individuals.

Levying deferred business accounts could also yield revenues that would otherwise be lost due to expiration of the 6-year statutory collection period. At the end of fiscal year 1987, businesses represented about 34 percent of deferred delinquencies but $10.9 million, or about 56 percent, of the $19.6 million of the deferred taxes written-off.

Conclusion

We agree with IRS' decision to defer implementing a nationwide deferred account levy program until its cost-effectiveness and impact on other operations are further evaluated. Should IRS decide to go forward with a nationwide levy program, we believe that IRS should evaluate program operations and results to determine whether the program is achieving its intended objectives or if modifications should be made to ensure the most efficient and effective use of IRS' collection resources.

Recommendation

We recommend that, if a nationwide levy program is implemented for deferred accounts, the Commissioner of Internal Revenue should establish procedures for periodically evaluating the program's effectiveness.

Agency Comments and Our Evaluation

IRS comments on a draft of this report are included in appendix I. IRS now plans to further study the issue of using levies to collect individual and business deferred accounts and has postponed nationwide implementation of its planned levy program. Accordingly, we revised our draft report and incorporated IRS' comments where appropriate in the final report. We recognize the difficulty of the issues involved in making a final decision in this area. However, given the information available from other studies and the potential benefits that might accrue, we think IRS should make a final decision on whether to implement a nationwide program as soon as possible, but no later than the end of fiscal year 1989.

As arranged with the Committee, we are sending copies of this report to the Commissioner of Internal Revenue and other interested parties. We will make copies available to others upon request. This report was prepared under the direction of Jennie S. Stathis, Associate Director. Other major contributors are listed in appendix II.

Richard L. Fogel

Richard L. Fogel
Assistant Comptroller General

Comments From the Internal Revenue Service

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

COMMISSIONER

NOV 14 1988

Mr. Richard L. Fogel
Assistant Comptroller General
United States General Accounting Office
Washington, DC 20548

Dear Mr. Fogel:

We have reviewed your recent draft report entitled "Tax Administration: IRS Can Improve Its Planned Deferred Account Levy Program". We agree with the report's conclusions and its recommendation.

The draft report recommended that, before implementing a program to use levies on deferred collection accounts, IRS revise its current plans by including businesses in the program and by providing procedures for fully evaluating the program's costs, benefits, and effect on other operations.

As stated in the report, Collection had planned to implement a program to levy on deferred individual accounts. However, after further consideration of the issues involved, we believe that additional analysis and evaluation of the program is necessary before we decide to implement it nationwide. Therefore, the Service will conduct a new study beginning in December 1988. This study will allow us to evaluate the program's costs and benefits, the impact on computer capacity, and whether levies actually make a difference in collecting deferred accounts. The study will include both individual and business accounts. If the study shows that levy on deferred accounts is cost-effective and its impact on other operations is acceptable, we will initiate nationwide implementation.

We hope you find these comments useful.

With kind regards,

Sincerely,

Larry Gibbs

Major Contributors to This Report

General Government Division, Washington, D.C.

Jennie S. Stathis, Director, Tax Policy and Administration Issues, (202) 275-6407
Larry H. Endy, Assistant Director
Michael M. Yacura, Evaluator

Chicago Regional Office

Thomas D. Venezia, Assignment Manager
Mark H. Egger, Evaluator-in-Charge
Paul J. Schmidt, Evaluator

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