

GAO

Testimony

For Release  
on Delivery  
Expected at  
9:30 a.m. EST  
Thursday  
October 18, 1990

IRS' Accounts Receivable Inventory

Statement of Paul L. Posner  
Associate Director, Tax Policy  
and Administration Issues  
General Government Division

Before the Subcommittee on Oversight  
Committee on Ways and Means  
House of Representatives



## IRS' ACCOUNTS RECEIVABLE INVENTORY

SUMMARY OF STATEMENT BY  
PAUL L. POSNER  
ASSOCIATE DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES  
GENERAL GOVERNMENT DIVISION  
U.S. GENERAL ACCOUNTING OFFICE

As part of its continuing work on IRS' accounts receivable inventory, GAO examined the composition and disposition of two groups of accounts comprising 10 percent of the first quarter 1990 accounts receivable inventory of \$67.7 billion--the 98 largest accounts and (2) accounts receivable from federal agencies for employment taxes. GAO found that, for both groups of accounts, the amount owed declined substantially from the first quarter of 1990 through August, but very little of this decrease could be attributed to collections from these taxpayers. Rather, nearly all of the decrease was the result of amounts written off by adjusting taxpayers' accounts due to taxpayer or IRS errors. The complex and confusing nature of the federal tax deposit system is at least partly responsible for these errors. This system, as well as IRS' accounting and information processing systems, needs improvement to reduce erroneous receivables in the inventory.

GAO cannot determine how much of the remaining amount due as of August 1990 can be collected. With regard to the 98 largest accounts, the total amount owed declined 44 percent, or \$2.7 billion. While nearly all this amount was written off by IRS through account adjustments, some of the remaining accounts may yield substantially more in actual collections once IRS' pending actions come to fruition. IRS has installment or settlement agreements in process with 15 of these 98 taxpayers, which may yield collections in coming months. In addition, IRS may get further collections from some of the 20 accounts currently in litigation or appeals.

With regard to federal agencies, the total amount owed declined by 79 percent, or \$145.6 million, through August 1990, with only \$4.3 million representing actual collections. GAO expects only a small portion of the remainder to be collectible since most of these receivables are overstated as a result of accounting and tax processing errors by both IRS and the agency taxpayers. Some of these errors occurred because federal agencies filed their tax returns late, while others were due to a payment process requiring federal agencies to issue checks through the Treasury to IRS--a cumbersome system, ill-designed for intragovernmental transfers.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in its continuing inquiry into IRS' accounts receivable inventory. As you requested, Mr. Chairman, our testimony today focuses on IRS' accounts receivable from federal government agencies for employment taxes and IRS' largest accounts receivable--accounts comprising 10 percent of the \$67.7 billion receivables inventory.<sup>1</sup>

In the first quarter of 1990, federal agency receivables accounted for \$185 million while the 98 largest receivables accounted for \$6.2 billion.<sup>2</sup> To help determine how much of this amount was truly owed by taxpayers, we tracked their disposition through August 1990 and found that most of the amounts resolved as of August were erroneously recorded as receivables because of bookkeeping errors, such as misapplying payments, caused by both IRS and taxpayers. IRS resolved these amounts by making adjustments to its records, and the taxpayers did not have to pay additional taxes.

---

<sup>1</sup>These amounts for the first quarter of 1990 exclude interest and penalties. The accounts receivable inventory is \$90 billion when interest and penalties are included.

<sup>2</sup>With regard to the largest receivables, we analyzed the largest 98, rather than the largest 100, as requested by the Subcommittee. We asked IRS for a list of the 100 largest receivables, but the list IRS provided only included 98 taxpayers. In some instances, the same taxpayer is in two IRS databases, and therefore appeared among the 100 largest receivables twice when we combined information from the databases.

Nevertheless, when we looked at the 63 largest federal accounts, we did find that 6 of the accounts resolved so far consisted of late agency payments on employment taxes. For the unresolved accounts, some other agencies may be found to owe additional taxes once IRS finishes its investigation. Not only do federal agencies have an obligation to be model taxpayers, but their failure to make timely tax payments causes the Social Security Trust Fund to lose interest revenue as well.

#### FEDERAL AGENCY ACCOUNTS RECEIVABLE

Currently, federal agencies, like other employers, are required to deposit withheld income and social security taxes as well as their portion of social security taxes through the Federal Tax Deposit (FTD) System, and to file quarterly returns. Many federal agencies pay their taxes by authorizing the Treasury to issue checks. They must also submit an FTD coupon with each payment like other employers. However, federal agencies, unlike other employers, are not liable for paying penalties and interest if they fail to meet deposit and filing requirements because they cannot legally use funds appropriated for other purposes to pay penalties and interest.

IRS records showed that 676 federal entities--more than a quarter of those reporting--owed \$185 million in back taxes as of

February 24, 1990.<sup>3</sup> Every Cabinet department was represented, as were a number of independent agencies, including the General Accounting Office, which was reported as owing \$52,000. Sixty-three federal entities had balances due of \$100,000 or more, totaling about \$178 million, or about 96 percent of the amount due from federal entities. Therefore, we chose to track actions taken on receivables from these 63 entities. The 63 included 49 defense-related entities.

Tracking the disposition of these 63 accounts through August helps reveal how many actually owed additional taxes. As the table in attachment I shows, the vast majority of the resolved amount--\$141 million for 48 of the 63 entities--was not caused by owed taxes but rather was resolved by IRS bookkeeping adjustments such as abatements of tax assessments and corrections of misapplied payments caused by IRS or taxpayer errors. However, 6 of these 63 entities actually paid \$4.3 million in additional tax to resolve their accounts. It would be helpful to discuss each of these cases at this point:

-- The United States Information Agency owed nearly \$1.4 million for one quarter in 1988, representing 16 percent of its liability for that quarter. Officials admitted that the

---

<sup>3</sup>We refer to entity rather than agency because a federal agency may have numerous taxpaying entities, including employee associations, reporting to IRS. Each entity has its own identification number and accounts. IRS' records are maintained by entity, not agency, and, in some instances, information in IRS' records is not descriptive enough to identify which agency the entity belongs to.

underpayment was caused when a payment for nearly \$1.4 million was mistakenly cancelled by Treasury. This underpayment was satisfied by applying a \$1 million overpayment still on IRS' books and a check from the agency for the rest.

- The Portsmouth Naval Shipyard owed \$282,000 for a 1988 quarter (2 percent of its liability) and \$2.2 million dollars for a 1989 quarter (14 percent of its liability). The agency claimed that it had already paid these taxes, but that the payments did not post to its accounts. The agency subsequently issued new checks to cover these delinquencies.
  
- The Defense Logistics Agency sent a late payment for almost \$1 million, 14 percent of its liability for the quarter in which it was due, that resulted from not returning a payment IRS send back in error nearly 15 months earlier.
  
- The Army Communications Command, Ft. Monmouth, New Jersey, made a late tax payment for the first quarter of 1988 that IRS did not receive until the second quarter of that year. IRS recorded the payment in the taxpayer's account for the second quarter. This caused the second quarter's account to be overpaid and, as a result, IRS issued the taxpayer a refund. The taxpayer returned the refunded amount to IRS almost a year later, thereby clearing the delinquency.

-- The Environmental Protection Agency underpaid its taxes by \$283,000 for four quarters between December 1987 and March 1989. The agency ultimately paid the amount due in June 1990 some 2-1/2 years following the first delinquency period. IRS' detection of these insufficient payments was delayed because the agency filed its returns up to 9 months late for these quarters.

-- The State Department owed \$45,000 in taxes because of insufficient deposits for the periods ending December 1985 and December 1987. This amount was paid in June 1990.

Some other agencies may be found to owe additional taxes once IRS and the agencies finish their investigation of the remaining \$32.3 million not yet resolved through either payments or adjustments. For example, IRS collection officials indicate that Walter Reed Army Medical Center may owe \$300,000.

As noted earlier, the great majority of agency accounts examined were erroneously recorded as receivables because of accounting, clerical, and tax processing mistakes caused by both IRS and the agencies. GAO's case is instructive. The agency was incorrectly recorded as owing tax when tax deposits were applied either to the wrong tax period or to the wrong account number (GAO maintained three accounts for three separate entities), partly because of clerical errors on GAO's part. According to IRS officials, GAO's accounts will be resolved with no taxes due.

In fairness, the opportunity for errors in the tax deposit process is great. The Department of Labor alone makes over 200 tax deposits per quarter for payroll and numerous interim payments made to its employees. Even IRS revenue officers have difficulty understanding account activity because of its complexity and volume. In addition, fully one-third of the nation's private employers were penalized for violating the complex rules governing tax deposits in 1988.

However, in addition to clerical and bookkeeping errors, we observed a more disturbing pattern--late filing of tax returns. More than two-thirds of the 63 federal entities filed tax returns late. IRS' detection of late and insufficient payments is delayed when returns are not filed on time.

We believe changes in the payment requirements for federal agencies would help to avoid unnecessary administrative problems for IRS and the agencies. Currently, problems stem from applying the same deposit and collection process designed for private taxpayers to federal agencies. This results in such anomalies as federal agencies issuing checks through the Department of the Treasury to pay another federal agency--IRS--for taxes. In one case, the State Department said that checks for over \$2 million have been lost twice, causing a delay of over 2 years in resolving discrepancies in this agency's account and costing many staff hours.



Recognizing the unique nature of federal agency tax payments as intragovernmental transfers, the Treasury should administratively streamline its payment and filing process by adopting simpler procedures for processing federal payments and return information such as using bookkeeping adjustment or electronic funds transfer.

#### LARGEST DOLLAR ACCOUNTS RECEIVABLE

Let me now briefly describe the results IRS has obtained from its focus on the largest receivables. As shown in the table in attachment II, the total amount due from the 98 largest receivables decreased by \$2.7 billion (44 percent) between March and August 1990. Nearly all of the decrease was due to abatements and adjustments of amounts resulting from erroneous assessments and misapplied payments, with only \$40 million due to collections.

As of the end of August, over \$3.5 billion was still owed by 74 of the original 98 taxpayers. IRS has already made progress in collecting some of these receivables by establishing installment or settlement agreements. For example, the table in attachment III showing the status of these remaining largest receivables indicates that agreements have been reached with 15 taxpayers for at least partial payment on assessed taxes of \$1.8 billion. As a result of a recent bankruptcy case, a taxpayer with one of the

largest accounts has agreed to pay about 30 percent of the amount owed. Thus, we believe that it is reasonable to expect that substantial amounts eventually will be collected.

IRS faces considerable difficulties in collecting from other taxpayers who have no assets or cannot be located. One example is a drug dealer whom IRS assessed \$29 million in back taxes for 1981 through 1983 based on his court testimony. IRS seized his known assets--including luxury cars, vessels, aircraft, and a minesweeper--and sold them for \$360,000. IRS' prospects of collecting the remaining taxes are slight because the taxpayer is now deceased and no other assets have been located. The table in attachment IV lists the types of taxpayers comprising the 98 largest accounts receivable.

Even for those accounts with potential collections, 89 percent are over 5 years old, so IRS may not be able to realize the revenue potential unless extensions to the 6-year statutory collection period are obtained.

#### OBSERVATIONS

Our study of these two groups of receivables again points to the importance of IRS' taking action to determine the real value of the accounts receivable inventory, including federal agency and largest dollar receivables. We believe that IRS needs to adjust its inventory to account for those cases that do not represent

real receivables. Further, IRS should focus its collection efforts on receivables that have the greatest potential to result in additional revenue.

Such actions as simplifying the federal tax deposit system for federal agencies and all taxpayers and enhancing efforts to reduce the number of erroneous assessments and misapplied payments will go a long way toward the prevention of overstated receivables. For example, in a July 1990 report, we recommended a broad reform of federal tax deposit requirements that could help reduce errors and delinquencies caused by the complexity of the current process.<sup>4</sup> However, until other alternatives are available, it is our view that agencies must meet their responsibility to file tax returns on time and make prompt tax deposits.

This concludes my prepared statement. I would be pleased to answer any questions you may have.

---

<sup>4</sup>Tax Policy: Federal Tax Deposit Requirements Should Be Simplified (GAO/GGD-90-102, July 31, 1990).

FEDERAL AGENCY RECEIVABLES OVER \$100,000  
ANALYSIS OF CHANGE IN BALANCE DUE PER IRS' RECORDS BETWEEN  
FEBRUARY 24, 1990, AND AUGUST 21, 1990

(Dollars in millions)

|                                  |                             |                                |
|----------------------------------|-----------------------------|--------------------------------|
| Balance due on February 24, 1990 | \$177.9                     | 63 entities total <sup>a</sup> |
| Less payments                    | ( <u>4.3</u> )              | 6 entities involved            |
| Subtotal                         | \$173.6                     |                                |
| Less abatements & adjustments    | ( <u>141.3</u> )            | 48 entities involved           |
| Balance due on August 21, 1990   | \$ <u>32.3</u> <sup>b</sup> | 36 entities involved           |

<sup>a</sup>Some entities made payments and also had amounts abated or adjusted. Further, some entities that had amounts abated or adjusted still had balances due as of August 21, 1990. Therefore, the number of entities in this column do not add to 63.

<sup>b</sup>\$13 million dollars of this balance is currently expected to be written-off through adjustments and abatements.

THE 98 LARGEST ACCOUNTS RECEIVABLE  
ANALYSIS OF CHANGE IN BALANCE DUE PER IRS' RECORDS  
BETWEEN MARCH 31, 1990, AND AUGUST 21, 1990

(Dollars in billions)

|                               |               |
|-------------------------------|---------------|
| Balance due March 31, 1990    | \$6.22        |
| Less payments                 | (0.04)        |
| Less statutes expired         | (0.17)        |
| Less abatements & adjustments | <u>(2.51)</u> |
| Balance due August 21, 1990   | <u>\$3.50</u> |

STATUS OF THE 98 LARGEST ACCOUNTS  
RECEIVABLE PER IRS' RECORDS AS OF AUGUST 21, 1990

(Dollars in billions)

| <u>Status</u>   | <u>Number of taxpayers</u> | <u>Balance</u> |
|---|----------------------------|----------------|
| Installment or settlement<br>agreements pending/reached | 15                         | \$1.78         |
| Insolvent, unable to locate<br>or incarcerated          | 18                         | .60            |
| Litigation or IRS appeals                               | 20                         | .50            |
| Collection being pursued by<br>revenue officers         | 6                          | .36            |
| IRS expects soon to clear<br>balance due                | 10                         | .21            |
| Under review by IRS exam or<br>criminal divisions       | 5                          | .07            |
| No balance due  | <u>24</u>                  | ( <u>.02</u> ) |
| Total   | <u>98</u>                  | <u>\$3.50</u>  |

THE 98 LARGEST ACCOUNTS RECEIVABLE  
BALANCES DUE AND NUMBER OF ACCOUNTS PER IRS' RECORDS  
AS OF MARCH 31, 1990, AND AUGUST 21, 1990,  
BY TYPE OF TAXPAYER

(Dollars in billions)

|                                   | <u>March 1990</u> |                  | <u>August 1990</u> |                        |
|-----------------------------------|-------------------|------------------|--------------------|------------------------|
|                                   | <u>Number</u>     | <u>Balance</u>   | <u>Number</u>      | <u>Balance</u>         |
| <u>Business</u>                   |                   |                  |                    |                        |
| Petroleum                         | 10                | \$0.9            | 7                  | \$0.4                  |
| Energy-related                    | 3                 | 0.3              | 3                  | 0.3                    |
| Financial                         | 5                 | 0.1              | 4                  | 0.1                    |
| Investment companies              | 5                 | 0.2              | 2                  | 0.1                    |
| Transportation                    | 6                 | 0.4              | 5                  | 0.4                    |
| Other                             | <u>24</u>         | <u>1.0</u>       | <u>16</u>          | <u>0.3</u>             |
| Subtotal                          | <u>53</u>         | <u>2.9</u>       | <u>37</u>          | <u>1.6</u>             |
| <u>Individual</u>                 |                   |                  |                    |                        |
| Drug dealing/<br>money laundering | 4                 | 0.2              | 3                  | 0.1                    |
| Incarcerated                      | 4                 | 0.1              | 4                  | 0.1                    |
| Deceased                          | 3                 | 0.1              | 3                  | 0.0 <sup>a</sup>       |
| Other                             | <u>19</u>         | <u>1.5</u>       | <u>18</u>          | <u>1.5</u>             |
| Subtotal                          | <u>30</u>         | <u>2.0</u>       | <u>28</u>          | <u>1.7</u>             |
| <u>Government</u>                 |                   |                  |                    |                        |
| Foreign                           | 1                 | 0.0 <sup>a</sup> | 0                  | 0.0                    |
| Federal                           | 4                 | 1.0              | 0                  | 0.0                    |
| State & local                     | <u>2</u>          | <u>0.1</u>       | <u>1</u>           | <u>0.0<sup>a</sup></u> |
| Subtotal                          | <u>7</u>          | <u>1.1</u>       | <u>1</u>           | <u>0.0</u>             |
| Estates                           | <u>8</u>          | <u>0.2</u>       | <u>8</u>           | <u>0.2</u>             |
| Total                             | <u>98</u>         | <u>\$6.2</u>     | <u>74</u>          | <u>\$3.5</u>           |

<sup>a</sup>Less than \$50 million.

Note: Totals may not add because of rounding.