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TAX ADMINISTRATION

Collecting Delinquent Taxes and Communicating With Taxpayers

Statement of Jennie S. Stathis, Director
Tax Policy and Administration Issues
General Government Division

GAO/T-GGD-94-50

COLLECTING DELINQUENT TAXES
AND COMMUNICATING WITH TAXPAYERS

SUMMARY STATEMENT OF
JENNIE S. STATHIS
DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES
GENERAL GOVERNMENT DIVISION
U.S. GENERAL ACCOUNTING OFFICE

GAO recently completed reviews for the Subcommittee on Oversight on the way IRS collects tax debts, processes tax returns, and communicates with taxpayers. GAO identified opportunities to increase revenues, treat taxpayers more evenly, reduce taxpayer frustration, and cut down the need for repetitive contacts to resolve tax questions. If IRS implements GAO's recommendations, major improvements should result in the collection of back taxes and in taxpayer relations.

For the third consecutive year, IRS' collection of delinquent taxes declined in 1993. GAO believes that increased collections may be achieved from delinquent tax accounts that IRS has deemed "currently not collectible." Questionable work and faulty monitoring systems have allowed taxpayers earning more than $70,000 to pay nothing towards their tax debts. IRS' uneven staffing and antiquated collection process don't help the situation. With staffing imbalances, the extent of collection action may vary depending on where a taxpayer lives. Thus, the amount of revenues collected per staff year varies considerably among IRS districts. More fundamental changes are needed in the collection process, with more emphasis on earlier telephone contact, tailoring actions to the taxpayer's situation, and evaluating Collection staff performance.

GAO found that the 1993 tax filing season, while generally successful, was clouded by a few problems. About 2 million fewer returns were filed in 1993 than 1992. The main reason for this appears to be the revised 1992 withholding tables which resulted in more taxpayers owing taxes at the end of the year. Also, electronic filing fraud grew in 1993. In the first 8 months of 1993, IRS identified 100 percent more fraudulent electronically-filed returns than in 1992. One reason may be IRS' improved detection; however, no one knows how much fraud is not being detected. Also, taxpayers continued to have problems calling IRS. In 1993 taxpayers had a 1 in 4 chance of getting through to an IRS assistor--even worse than the 1 in 3 chance the year before.

Written communication is another continuing problem. Inaccurate, incomplete, confusing, and late responses to taxpayers continue to be problems for IRS. Forms, notices, and publications are also of concern and GAO suggested 59 changes to 19 of the commonly-used ones. IRS has made many of the suggested changes in forms and publications but will not be able to clarify the notices before 1995 because of computer constraints.

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to be here today to highlight our work for the Subcommittee this year on Internal Revenue Service (IRS) programs.[1] My statement has two sections. The first focuses on what IRS can do to collect more tax debts and at the same time treat similarly situated taxpayers the same. The second shows some of the difficulties taxpayers have in filing returns and communicating with the IRS--areas also in need of improvement.

COLLECTING TAX DEBTS

The federal government has the opportunity to realize substantial revenue from taxes already owed if IRS can more effectively and efficiently carry out the process of collecting those debts. Again this year, collection results were disappointing. For the third fiscal year in a row, IRS' collections of delinquent taxes declined--from $24.2 billion in 1992 to $22.8 billion in 1993.

At the end of fiscal year 1992, IRS' records showed gross accounts receivable totaling $131 billion. Of that amount, IRS estimated that $22 billion was collectible. The larger number reflects IRS' collection workload--accounts that must be resolved one way or another, either by attempting collection or correcting the records. But, because of errors and deliberate overstatements, as much 35 to 40 percent of the recorded balance is invalid. Other accounts constitute real taxpayer debts but are uncollectible because IRS cannot find the delinquent taxpayers or believes they cannot pay. Thus, the smaller number is IRS' estimate of the amount the government could realize.

But IRS needs to revisit some of the accounts for which it has decided the taxpayers cannot pay.

Some "Currently Not Collectible" Accounts May Be Collectible

The single largest segment of the accounts receivable inventory--and one of its fastest growing portions--is $52 billion in accounts IRS deems "currently not collectible." District office staff now declare more tax debt "currently not collectible" than they collect. Our report[2] to you on IRS' management of these accounts will be released today. In that report, we said that IRS is forgoing the potential to collect hundreds of millions of dollars because of poor work and poor procedures.

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[1]Appendix I lists GAO tax-related work recently completed for this Subcommittee.

[2]Tax Administration: IRS Can Do More to Collect Taxes Labelled "Currently Not Collectible" (GAO/GGD-94-2, Oct. 8, 1993).

We reviewed a sample of 107 individual taxpayer accounts that five IRS district offices classified "currently not collectible" in August and September 1991. We concluded the collection actions taken by IRS were inadequate or at least questionable 55 percent of the time. The more serious problem--in 12 percent of the cases--involved IRS' failure to question taxpayers' living expenses and fully consider their income. The outcome is that some taxpayers who reported incomes of more than $70,000 pay nothing towards their tax debts. The following examples illustrate these cases.

-- Married taxpayers with no dependents, who earned nearly $80,000 a year, owed $123,000 in back taxes. Their financial statement showed expenses that exceeded income by almost $275 a month. IRS allowed as necessary living expenses monthly life insurance payments of $450 and over $900 in monthly payments on debts to credit card companies and other creditors.

-- Married taxpayers with four dependents, earning almost $80,000 a year, owed $75,000 in taxes for 1984 through 1990. IRS allowed a monthly mortgage expense of $1,800 and payments for two cars totaling $950 as necessary and reasonable living expenses.

Collection employees are to obtain financial information from the taxpayer's current tax return, and third parties, such as employers and financial institutions, to determine the taxpayer's ability to pay taxes owed. Collection staff are also to consider what the taxpayer's reasonable and necessary living expenses should be. But the Collection staff have fairly vague guidance to help make these decisions and their supervisors did not identify and correct problems. As a result, IRS permitted taxpayers who reported substantial incomes to pay nothing towards their tax debts when installment payments may have been more appropriate. Allowing some taxpayers to avoid paying back taxes by choosing a more comfortable lifestyle is unfair to all those taxpayers who live within their means and pay their taxes.

The remainder of the "currently not collectible" decisions we questioned were based on inadequate work, were questionable given the available information, or did not fully provide for future collection potential. Examples follow.

-- IRS was unable to locate the delinquent taxpayer. However, the file indicated that the taxpayer had accounts at one time with a number of banks. These banks could have served as leads to locate the taxpayer. However, the banks were not contacted for that purpose; and the case was closed as "currently not collectible."

-- A taxpayer owed $130,000 in back taxes assessed against profits from criminal activities. His current income exceeded expenses by $115 a month. Instead of making an installment agreement, the revenue officer closed the case as "currently not collectible."

-- A self-employed single taxpayer claimed living expenses that exceeded income by $670 a month. The file did not explain how this could continue; but the case was closed as "currently not collectible."

We also believe that IRS waits too long to follow up on some cases. IRS puts a 65-week hold on reactivating accounts. During this period, IRS does not review subsequent tax returns for increased income. We analyzed over 300,000 such accounts and found that in almost 36,000, totaling $250 million in delinquent taxes, the taxpayer had filed a new tax return showing substantial income. Yet the hold period precluded timely followup.

We made a number of recommendations in the report. IRS has agreed, at least in principle, with most of them. IRS promised action to address the issue of lifestyle choices involved in reasonable living expenses and committed to long-term improvements in the management of "currently not collectible" accounts. IRS did not agree to eliminate the 65-week reactivation hold because it precluded the premature reactivation of some cases.

Congress, too, may be able to influence the number of cases closed as "currently not collectible." Private firms measure their collection success in terms of dollars collected, and a key premise is that incentives based on individual collection performance motivate collectors.[3] Tax law prohibits IRS from using performance statistics to evaluate, compensate, or reward employees. Under IRS' staff evaluation system, accounts classified "currently not collectible" are given the same weight as dollars collected. This could have contributed to the growth in accounts being closed as "currently not collectible."

Congress, long concerned that collection performance might be interpreted as quotas that might induce IRS staff to mistreat taxpayers, added this provision in 1988 to protect taxpayers from such actions. We said then, and continue to believe now, that taxes collected is a reasonable basis on which to judge the performance of employees whose job it is to collect taxes, as long as other criteria, such as fair and courteous treatment of taxpayers, are also evaluated. The provision might be changed to specify prohibited behaviors that would be grounds for employee

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[3]Tax Administration: New Delinquent Tax Collection Methods for IRS (GAO/GGD-93-67, May 11, 1993).

dismissal or other forms of discipline, rather than prohibiting the use of performance statistics as a management tool.

Taxpayers who owe back taxes can also receive disparate treatment just by the way IRS assigns its staff.

Uneven Staffing

In May 1993[4] we reported to you that IRS has not allocated its staff to maximize revenues and ensure that taxpayers in all parts of the country are treated the same. Revenue officer staffing varies dramatically among district offices, not always in proportion to the workload. As a consequence, wide variations exist in tax debts "worked" versus those kept in a queue--accounts waiting to be assigned to revenue officers. The range in fiscal year 1991 was from one district that worked all delinquent tax cases to another that worked just 27 percent. In two districts, the dollar amounts of delinquencies that triggered collection actions were more than 10 times higher than amounts in seven others.

While we cannot disclose exact dollar thresholds, we can say that taxpayers who owe substantial debts will not hear from a revenue officer in some districts; but in other districts IRS has the staff to follow up debts that are much smaller. Thus, delinquent taxpayers' treatment depends on where they live. Taxpayers who reside in places like Wyoming may feel the full force of IRS' collection enforcement efforts while taxpayers living in New York may not. Such imbalances affect productivity. Collections per staff year in fiscal year 1991 ranged from a low of $175,000 in one district to a high of $775,000 in another.

IRS needs to quit relying on overall staff growth and attrition as the primary means of eliminating district staffing imbalances. Instead, the agency needs to develop a plan to maximize the collection of tax debts, using staff productivity measures in determining the most appropriate allocation of staff. To be most efficient, the increase in productivity achieved by adding the next staff person should be the same for each location.

Antiquated Process

But, more fundamentally, IRS relies too heavily on visits by revenue officers to collect tax debts. In reporting to the Subcommittee on alternative collection strategies, we said that IRS needs to revamp its collection process. It needs to place more emphasis on collection activities early in the process at

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[4] Tax Administration: Improved Staffing of IRS' Collection Function Would Increase Productivity (GAO/GGD-93-97, May 5, 1993).

the service centers and call sites and less emphasis on district office collection activities.[5]

Good business practice dictates that after a debt arises, efforts be made to secure some type of payment agreement as quickly as possible. IRS' decades-old collection process, however, is not based on this premise. The IRS collection process involves three steps. In step one, IRS service centers mail the taxpayer a series of three to five computer-generated bills, at 30-day intervals. If the taxpayer has not responded to the final notice, IRS levies any known bank accounts. In step two, IRS call sites telephone the taxpayer to collect the money or otherwise resolve the debt. In step three, revenue officers visit the taxpayer.

The process is outdated, costly, and inefficient. A comparison with private debt collectors shows three ways it could be improved. First, the process takes too long. Delinquencies in the private sector are usually closed after 180 days. By that time, IRS has probably not even tried to telephone the taxpayer, a tactic private sector companies employ very early in their collection process.

Second, the process is too rigid. IRS follows the same three-step process for virtually all types of accounts, regardless of the taxpayer's compliance history.

Third, the process relies too heavily on step three, visits by revenue officers. IRS has allocated almost two-thirds of its Collection staff to this step. Private sector companies avoid personal contact because of the cost and potential dangers involved. IRS' own data show that on average, call site collectors are more productive than the revenue officers. In fiscal year 1991, each call site collector averaged $1.5 million in collections while each revenue officer averaged $331,000 in collections.

In addition to improving the collection of back taxes, IRS needs to better communicate with taxpayers who are trying to file and pay their taxes.

TAXPAYERS ENCOUNTER PROBLEMS IN COMMUNICATING WITH IRS

Other work for the Subcommittee focused upon a variety of problems taxpayers face when trying to file and pay taxes. Taxpayers' chances of reaching the IRS by telephone during the filing season worsened. The growth of electronically-filed returns led to a related increase in fraudulent returns. IRS correspondence with taxpayers continues to be a troublesome area. IRS letters to taxpayers are often inappropriate, unclear, and

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[5]GAO/GGD-93-67.

late. Tax forms, publications, and notices, while accurate, often need to be made more understandable to the taxpayer.

Now I would like to discuss each of these problems in greater detail.

Filing Tax Returns

At the Subcommittee's request, we assessed IRS' performance during the 1993 filing season. As discussed more fully in a report to be issued next month, 1993 was an unusual year. By April 30, about 2 million fewer taxpayers filed returns than the year before. Considering that the number of returns usually grows each year, the number of filers was about 3.7 million fewer than IRS expected. The main reason for fewer filers appears to be the change to the 1992 withholding tables; this change caused more taxpayers to owe taxes and fewer to receive refunds. According to IRS' current analysis, about 1.2 million taxpayers so affected did not file their returns, even though IRS made it much easier to pay by installments. IRS expects to complete its study of this problem in December 1993.

Telephone Accessibility

IRS data indicate that taxpayers who call IRS have a good chance of getting a correct answer to their tax law questions; but their chances of getting through to ask those questions are poor. People who called during the 1993 filing season, for example, had a 1 in 4 chance of getting through--even worse than the 1 in 3 chance we reported for 1992.

Efforts to answer more calls, by upgrading telephone equipment, have been offset by reductions in staff and a larger number of calls--the net effect being a continuing erosion of telephone service. To counter this trend, IRS plans to merge various telephone operations, shift calls to locations where assistors are available, and automate answers to routine inquiries.

These changes will not be fully implemented before 1996. Meanwhile, demand for telephone service will likely grow in response to recent tax law changes, especially those affecting the Earned Income Credit. This credit has been a traditional source of taxpayer confusion, and with more taxpayers now eligible, IRS can expect more calls for help.

Electronic Filing Fraud

Electronic filing fraud is another problem that grew in 1993. Although the number of identified fraudulent returns is small in absolute terms, the rate of growth is not. Through the first 8 months of 1993, IRS had identified more than 23,000 fraudulent electronic returns--100 percent more than during the same period last year. Conversely, the number of returns filed electronically grew by only 14 percent. At least some of the growth in identified fraud may be due to the fact that IRS took various steps in 1993 to improve its detection of fraud. It seems clear that the harder IRS looks for fraud, the more it finds. And no one knows how much is not being found.

What makes electronic filing such an appealing target for fraud is the speed with which perpetrators can get their money--about 2 weeks under normal procedures and even faster if the filer gets a Refund Anticipation Loan. And, because of this timing, IRS is less likely to stop the refund. Of the $48.9 million claimed in the 23,000 fraudulent returns, IRS was able to stop only $28.3 million.

With electronic fraud, as with telephone access, changes in the Earned Income Credit may increase IRS' problems. IRS' analysis of the 23,413 fraudulent electronic returns showed that all but 344 involved the Earned Income Credit.

Our comments here and earlier are not intended to question the appropriateness of expanding the credit. Our intent is to show that IRS needs to continue dealing with telephone service and fraud problems. Our report will make several recommendations that should assist IRS with regard to the fraud issue.

IRS Correspondence With Taxpayers

One of the main ways taxpayers communicate with IRS is through the mail. Each year, IRS receives upwards of 20 million pieces of correspondence from taxpayers. They write to respond to a notice or letter from IRS about a balance due, failure to file a return, or discrepancy in reported income. They also write to inquire about refunds, ask for an installment agreement, or request a penalty abatement.

Over the last 6 years, IRS has been criticized for sending delayed, inaccurate, incomplete, and confusing responses to taxpayers. At the Subcommittee's request, we assessed IRS' efforts to improve its correspondence.

Our assessment indicates that IRS' correspondence has improved. Nonetheless, problems still exist. Our analysis of almost 1,900 IRS letters showed that 15 percent were incorrect, unclear, incomplete, or nonresponsive; and 11 percent came from taxpayers trying to resolve something left unresolved during earlier contacts with IRS. Another sample of 261 "interim" letters--letters IRS sent to advise taxpayers it needed more time to respond--showed that half were unclear or not responsive to the taxpayers' reason for writing. Problems such as these increase IRS' costs, frustrate taxpayers, and ultimately hinder compliance with the tax laws.

-- A Spanish speaking taxpayer corresponded with IRS using Spanish language forms from IRS. IRS appropriately sent the taxpayer an interim response in Spanish explaining that more time was needed to address the taxpayer's questions. Unfortunately, when IRS completed its work, it responded in English. IRS officials speculated that the English response was sent because different IRS offices handled the interim and final responses and the last office to respond made an error.

-- A divorced taxpayer asked for copies of joint returns filed while she was still married. Instead of sending the returns to the taxpayer making the request, IRS sent copies of the return to the divorced spouse. This occurred because the ex-spouse had the primary social security number on the account and IRS sent the returns to the address of record.

-- A taxpayer wrote IRS inquiring if he could combine monthly payments for three tax periods into one. IRS responded with an interim letter that thanked the taxpayer for the information submitted. We believe this response was potentially confusing because the taxpayer was not submitting information, but in fact was making an inquiry about his existing payment plan.

One IRS objective is to resolve more taxpayer issues over the phone. Although not all matters can be resolved by phone, IRS believes that it is usually to the taxpayer's and IRS' benefit to use the phone when possible. Our results support the potential for greater phone usage. About 38 percent of the 1,900 taxpayers in our sample wrote IRS when they could have called and gotten an answer over the phone, in part because IRS does not tell taxpayers when a phone call will suffice. Before telling taxpayers to call instead of write, however, IRS must make it easier for taxpayers to get through by phone.

Our report will recommend a number of steps IRS can take to improve these and other correspondence problems.

Forms, Publications, and Notices

At the Subcommittee's request, we recently examined 17 commonly-used forms and publications and suggested more than 50 ways to make these documents easier for taxpayers to understand and use. Generally, we suggested more specific language, consistent terminology, and more references to other forms and publications. IRS agreed with most of our suggestions and is making the changes.

We also looked at 21 computer-generated notices IRS sends to taxpayers. We suggested changes to make five of these notices easier for taxpayers to understand. The most significant of these changes concerns the way taxpayer account information is displayed on many notices. This information often appears as a section called "Your Tax Statement." The format we suggested would more clearly compare data reported on the taxpayer's return with IRS' proposed adjustment. Information would be extracted from a taxpayer's return and shown alongside IRS' proposed adjustment. While agreeing to clarify the notices, IRS said that most changes could not be made until 1995 at the earliest because of limitations in IRS' current computer programming and printing capabilities.

We are continuing to study this aspect of the agency's communications with taxpayers at the Subcommittee's request. We are analyzing another group of notices for clarity and evaluating IRS' process for developing forms, publications, and notices.

CONCLUSIONS

In requesting this series of GAO reviews, the Subcommittee has focused on two of IRS' more vital roles--collecting back taxes and communicating with taxpayers who are trying to fulfill their tax obligations. As the results of our work clearly point out, it is essential that IRS make fundamental changes to collect more back taxes. IRS needs to emphasize earlier contacts with taxpayers, tailor its actions to the taxpayers' compliance history, and more effectively allocate collection staff. In addition, IRS needs to develop better guidance for making "currently not collectible" determinations and improve its monitoring of these accounts. We also believe Congress should reconsider present constraints in evaluating collection staff performance.

A successful filing season is dependent on IRS' ability to effectively help taxpayers meet their filing obligations. One way for IRS to do this is to be more responsive to taxpayers' correspondence and make its many forms, publications, and notices easier to understand. The 1993 filing season was marked by one surprising development--a reduction in the number of returns filed. It also saw the continuation of two disturbing trends--more fraudulent electronic refund claims and less access to IRS by telephone. The challenge for IRS is to reverse these trends in the next filing season.

This concludes my statement. We welcome any questions that you may have.

GAO TAX-RELATED WORK RECENTLY COMPLETED FOR THE SUBCOMMITTEE ON OVERSIGHT, HOUSE COMMITTEE ON WAYS AND MEANS

IRS Seized Assets (GAO/GGD-93-7R, Nov. 18, 1992)

Tax Administration: Implementation of IRS Employee Suggestions (GAO/GGD-93-22, Nov. 24, 1992)

Government Management: Status of Progress in Correcting Selected High-Risk Areas (GAO/T-AFMD-93-1, Feb. 3, 1993)

Tax Administration: Delayed Tax Deposits Continue to Cause Lost Interest for the Government (GAO/GGD-93-64, Mar. 22, 1993)

IRS-Customs Data Systems Exchange (GAO/GGD-93-33R, Apr. 6, 1993)

Tax Administration: Information on Tax Counseling for the Elderly Program (GAO/GGD-93-90BR, Apr. 8, 1993)

Tax Administration: Examples of Waste and Inefficiency in IRS (GAO/GGD-93-100FS, Apr. 27, 1993)

IRS Correspondence (GAO/GGD-93-38R, Apr. 27, 1993)

Tax Administration: IRS' Budget Request For Fiscal Year 1994 (GAO/T-GGD-93-23, Apr. 28, 1993)

Tax Administration: Selected IRS Forms, Publications, and Notices Could Be Improved (GAO/GGD-93-72, Apr. 30, 1993)

Tax Administration: Recurring Tax Issues Tracked by IRS' Office of Appeals (GAO/GGD-93-101, May 4, 1993)

Tax Administration: Improved Staffing of IRS' Collection Function Would Increase Productivity (GAO/GGD-93-97, May 5, 1993)

Tax Administration: New Delinquent Tax Collection Methods for IRS (GAO/GGD-93-67, May 11, 1993)

IRS' ADP Organization (GAO/GGD-93-37R, May 25, 1993)

Corporate Taxes: Many Benefits and Few Costs to Reporting Net Operating Loss Carryover (GAO/GGD-93-131, Sep. 23, 1993)

Tax Administration: IRS Can Do More to Collect Taxes Labelled "Currently Not Collectible" (GAO/GGD-94-2, Oct. 8, 1993)

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