



GAO
Accountability Integrity Reliability

Highlights

Highlights of [GAO-07-26](#), a report to the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

GAO previously testified that federal contractors abused the tax system with little consequence. While performing those audits, GAO noted that the Internal Revenue Service (IRS) records sometimes contained inaccurate or outdated tax information that prevented IRS from taking appropriate collection actions against those contractors, including submitting their tax debt to the Federal Payment Levy Program (FPLP) for collection.

As a result, GAO was asked to review IRS's coding of tax debt excluded from the FPLP to determine whether (1) IRS tax records contain inaccurate status or transaction codes that exclude tax debt from the FPLP, (2) IRS's monitoring could be strengthened to ensure the accuracy of its status and transaction codes, and (3) other opportunities exist to increase the amount of tax debt included in the FPLP.

What GAO Recommends

GAO makes four recommendations to IRS to increase the amount of tax debt eligible for the FPLP and six recommendations to evaluate the appropriateness and ongoing validity of IRS's hardship designations. IRS agreed with five of our recommendations and partially agreed with two others. IRS disagreed with three recommendations due to workload, cost, or taxpayer rights considerations. GAO reiterated its support for its recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-07-26.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Steven J. Sebastian at (202) 512-3406 or sebastians@gao.gov.

INTERNAL REVENUE SERVICE

Procedural Changes Could Enhance Tax Collections

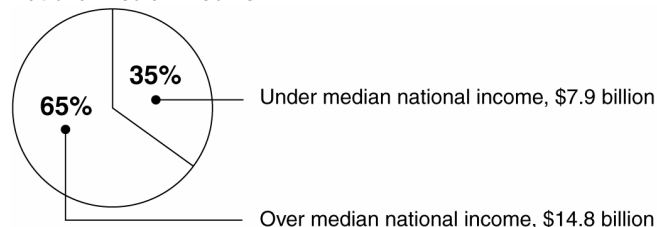
What GAO Found

IRS tax records had inaccurate information that resulted in it erroneously excluding cases from the FPLP and other tax collection actions. The FPLP is a cost-effective automated system used to collect unpaid taxes from certain federal payments. GAO estimates that as of September 30, 2005, over 500,000 tax records—equating to about \$2.4 billion in tax debt—contained inaccurate codes that IRS systems used to exclude tax debts from the FPLP. Inaccuracies included tax debts coded as having active installment agreements even though the tax debtor had stopped making payments.

IRS's monitoring of cases was insufficient to identify and correct the coding errors GAO identified. Additionally, IRS's monitoring of financial hardship cases is not sufficient to ensure their ongoing accuracy. IRS grants tax debtors experiencing financial difficulty a hardship designation that excludes them from the FPLP and other tax collection activities until their income increases. To measure this, IRS solely uses the income reported on the tax debtor's annual tax returns. However, IRS does not monitor those tax debtors to ensure they are filing and paying current taxes. For 31 financial hardship cases GAO examined, 24 had ceased to file tax returns.

Although IRS has increased the amount of tax debt it submits to the FPLP, additional policy changes could further improve the program's effectiveness. Since 1992, IRS has almost tripled the maximum income it allows tax debtors in financial hardship to earn; raising it to \$84,000 in 2004—almost double the national median income. As a result, whereas in 1992 no one earning above the median income was considered to be in financial hardship (and therefore excluded from the FPLP), in 2005 almost two-thirds of the tax debt in financial hardship was owed by individuals earning over the median income. Although a financial hardship designation may be appropriate in many situations, allowing relatively high-income tax debtors to avoid tax collection action, including the FPLP, calls into question the fair application of the tax system and may contribute to noncompliance.

Tax Debt Associated With Debtors in Financial Hardship Who Can Earn Over the 2004 National Median Income



Source: GAO analysis of IRS data.

IRS policy also limits the amount of tax debt in the FPLP by excluding \$5 billion in tax debt from the program while IRS is pursuing levies from other assets or income sources. Additionally, during notification IRS excludes individuals' tax debt from the FPLP about twice as long as legally necessary.