TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

The Fresh Start Initiatives Have Benefited Many Taxpayers, but Additional Monitoring and Evaluation Is Needed

December 30, 2014

Reference Number: 2015-30-005

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:
1 = Tax Return/Return Information

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HIGHLIGHTS

THE FRESH START INITIATIVES HAVE BENEFITED MANY TAXPAYERS, BUT ADDITIONAL MONITORING AND EVALUATION IS NEEDED

Highlights

Final Report issued on December 30, 2014

Highlights of Reference Number: 2015-30-005 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

By Calendar Year 2009, the U.S. economy was well into what some economists have described as the worst economic crisis since the Great Depression. In January 2009, the IRS announced some existing and new alternatives available to taxpayers facing financial challenges and having difficulties paying their balance due accounts because of the declining economy. In February 2011, the IRS began implementing the first of several initiatives to assist economically distressed taxpayers by offering viable collection alternatives to help resolve their delinquent balance due accounts. These initiatives are known as the Fresh Start Initiatives.

WHY TIGTA DID THE AUDIT

Although the Fresh Start Initiatives helped many struggling taxpayers resolve their outstanding tax liabilities, if the potential risks are not fully mitigated, revenue collection could be jeopardized. This audit was initiated to determine the impact of the Fresh Start Initiatives in promoting tax compliance.

WHAT TIGTA FOUND

The IRS's implementation of the Fresh Start Initiatives provided several benefits to thousands of struggling taxpayers. For example, the number of Notices of Federal Tax Lien (NFTL) filed on taxpayers with assessed liabilities less than $10,000 decreased 60 percent, from 488,378 in Fiscal Year 2010 to 195,009 in Fiscal Year 2013. Many other taxpayers benefited from streamlined procedures for processing installment agreements and offers in compromise. In addition, penalties were not assessed on certain taxpayers who requested a filing extension.

Although the Fresh Start Initiatives were generally implemented effectively, additional attention should be given in a few areas. For example, 524 taxpayers, who owed approximately $10.5 million, defaulted on their Direct Debit Installment Agreements after the IRS had withdrawn the NFTLs, yet the IRS did not file new NFTLs. In addition, the IRS has not fully assessed the revenue impact of filing fewer NFTLs. Performance measures may have helped identify potential problems and areas for improvement, but they were not established for all of the initiatives.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) ensure new NFTLs are filed for the 524 taxpayers who defaulted on their Direct Debit Installment Agreements after their NFTLs were withdrawn; 2) establish controls to ensure that new NFTLs are filed on taxpayers who default on their Direct Debit Installment Agreements; 3) assess the long-term revenue protection impact of the Fresh Start Initiative that increased the minimum dollar threshold for NFTL determinations in Field Collection; and 4) establish methods to monitor and assess the performance of the Fresh Start Initiatives.

In its response to the report, IRS management generally agreed with our recommendations and plans to review case files and take action when appropriate for the 524 taxpayers, determine the viability of making a systemic enhancement or procedural changes for filing new NFTLs, and initiate a research request to evaluate potential revenue protection impact on NFTL filing determinations. Although IRS management agreed that there should be established methods to assess performance, they have limited information technology resources to commit to a submission or completion of a work request at this time.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

December 30, 2014

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Fresh Start Initiatives Have Benefited Many Taxpayers, but Additional Monitoring and Evaluation Is Needed (Audit # 201330011)

This report presents the results of our review to determine the impact of the Fresh Start Initiatives in promoting tax compliance. This review was included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations.

If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

Table of Contents

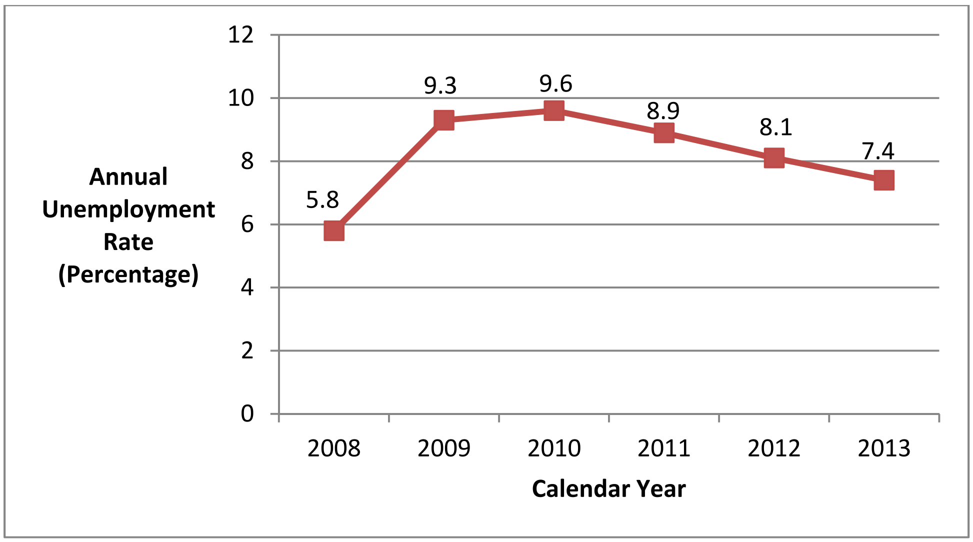
Abbreviations

CPS	Collection Process Study
FY	Fiscal Year
IBTF	In-Business Trust Fund
IRS	Internal Revenue Service
NFTL	Notice of Federal Tax Lien
OIC	Offers in Compromise
TIGTA	Treasury Inspector General for Tax Administration

Background

By Calendar Year[1] 2009, the U.S. economy was well into what some economists have described as the worst economic crisis since the Great Depression. Household net worth fell $11 trillion, or 18 percent, during the course of this crisis. The record number of homeowners falling behind on their mortgage payments and the loss of jobs at an alarming rate resulted in taxpayers facing financial difficulties that affected their ability to meet their tax obligations. Figure 1 shows that from Calendar Years 2008 to 2009, the unemployment rate jumped from 5.8 percent to 9.3 percent. After peaking at 9.6 percent in Calendar Year 2010, the unemployment rate started declining in Calendar Year 2011.

Figure 1: Annual Unemployment Rate



Source: U.S. Bureau of Labor Statistics data.

When the economy started to weaken, the Internal Revenue Service (IRS) implemented or reemphasized provisions that would help economically distressed taxpayers. In January 2009, the IRS announced some existing and new alternatives available to taxpayers facing financial challenges and having difficulties paying their balance due accounts because of the declining economy. Depending on the circumstances, taxpayers in hardship situations were able to adjust payments for back taxes, avoid defaulting on payment agreements, or possibly defer collection action. The IRS notified taxpayers, tax preparers, and its employees of the new and existing collection alternatives. These changes were implemented by February 2009.

[1] See Appendix V for a glossary of terms.

In February 2011, the IRS began implementing the first of several new initiatives to assist economically distressed taxpayers by offering viable collection alternatives to help resolve their delinquent balance due accounts. The IRS established these "Fresh Start Initiatives" anticipating that they would help individuals and small business taxpayers meet their tax obligations by providing taxpayers more payment options, while the IRS would use fewer resources reviewing detailed financial statements. Over the course of 17 months, the IRS made several policy changes that involved the following three collection methods:

The IRS anticipated that the Fresh Start Initiatives would help taxpayers meet their tax obligations without adding unnecessary burdens.

Installment Agreements:[2]

- In March 2011, the IRS increased the dollar threshold for taxpayers to qualify for streamlined In-Business Trust Fund (IBTF) Express Installment Agreements so that more struggling small business taxpayers would qualify. The threshold in unpaid tax liabilities increased from $10,000 to $25,000, and the taxpayer is required to pay off the agreement within 24 months. The taxpayer must also enter into a Direct Debit Installment Agreement. IBTF Express Installment Agreements reduce taxpayer burden because full financial reviews are not required to set up the agreement.
- In January 2012, the IRS increased the dollar threshold for taxpayers to qualify for Streamline Installment Agreements so that more struggling individual taxpayers would qualify. The threshold in unpaid tax liabilities increased from $25,000 to $50,000, and the time to pay the tax debt off also increased from 60 months to 72 months. Streamline Installment Agreements reduce taxpayer burden because they require less documentation from the taxpayer than traditional installment agreements.

Offers in Compromise:[3]

- In February 2011, the IRS expanded the Streamline Offers in Compromise (OIC) program to include taxpayers with less than $50,000 in tax liabilities and less than $100,000 in annual income. Previously, the maximum amounts were $25,000 and $50,000, respectively. Streamline OICs reduce taxpayer burden because less documentation is required from the taxpayer.
- In May 2012, the IRS further expanded the Streamline OIC program to cover all taxpayers requesting an OIC (with no dollar limitations).

[2] I.R.C. § 6159 allows the IRS to enter into installment agreements to allow a taxpayer with a balance due to pay the taxes over time.
[3] I.R.C. § 7122 allows the IRS to accept from a taxpayer with a balance due less than the amount due as settlement of the outstanding debt under certain situations.

Notices of Federal Tax Lien:[4]

- In March 2011, the IRS doubled the dollar threshold of the delinquent tax amount for which a Notice of Federal Tax Lien (NFTL) is generally issued,[5] from $5,000 to $10,000. This change reduced taxpayer burden because many taxpayers with delinquencies in this dollar range were not issued an NFTL, which can adversely affect their credit rating.
- In April 2011, the IRS began withdrawing NFTLs when requested by taxpayers who either entered into a new Direct Debit Installment Agreement or converted a traditional installment agreement to a Direct Debit Installment Agreement. NFTLs were also withdrawn for taxpayers who had existing Direct Debit Installment Agreements with unpaid assessments of $25,000 or less. Unlike an NFTL release, a withdrawal removes the mention of the NFTL from the taxpayer's credit report or the credit agency updates the NFTL status to show that it was withdrawn.
- In June 2011, the IRS began approving taxpayers' NFTL withdrawal requests after taxpayers received an NFTL release (generally for taxpayers who fully paid their delinquent tax).

In addition, the IRS provided relief to unemployed taxpayers who had been assessed a failure to pay penalty. Specifically, from March to October 2012, the IRS did not assess the failure to pay penalty on certain wage earners and self-employed individuals (business taxpayers were not eligible). To qualify, the taxpayer's delinquent balance could not be more than $50,000, and income had to be below specific thresholds ($200,000 for married taxpayers filing jointly, and $100,000 for single and head of household taxpayers). Taxpayers benefited from this relief because they were not required to pay a penalty when they requested a filing extension.

Prior to the Fresh Start Initiatives, the Deputy Commissioner for Services and Enforcement chartered the Collection Process Study (CPS)[6] to conduct a broad-based review of the current IRS Collection processes, identify opportunities for improvement, and recommend specific actions that could be implemented to improve collection potential from delinquent taxpayers. The study examined all areas across the IRS enterprise engaged in, or supporting, collection activities. Each CPS recommendation contained a description of the current situation, its business and financial impacts, a summary of key considerations, associated risks, dependencies and points of integration needed to successfully implement the recommendation, and proposed

[4] I.R.C. § 6323 allows the IRS to file a Notice of Federal Tax Lien to reflect the tax debt owed by taxpayers and protect the Government's interest in collection of the debt.
[5] An NFTL filing determination (decision to file or not to file an NFTL) is required on taxpayers owing $10,000 or more of assessed liabilities. Generally NFTLs will not be filed when the taxpayer owes less than $10,000, but they may be filed if they will protect the Government's interest, such as pending bankruptcy or other urgent circumstances.
[6] *IRS Collection Process Study*, final report dated September 30, 2010.

implementation approach and time frame. Several of the Fresh Start Initiatives were based on CPS recommendations.

This review was performed with information obtained from the Small Business/Self-Employed Division Headquarters in New Carrollton, Maryland, during the period July 2013 through May 2014. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

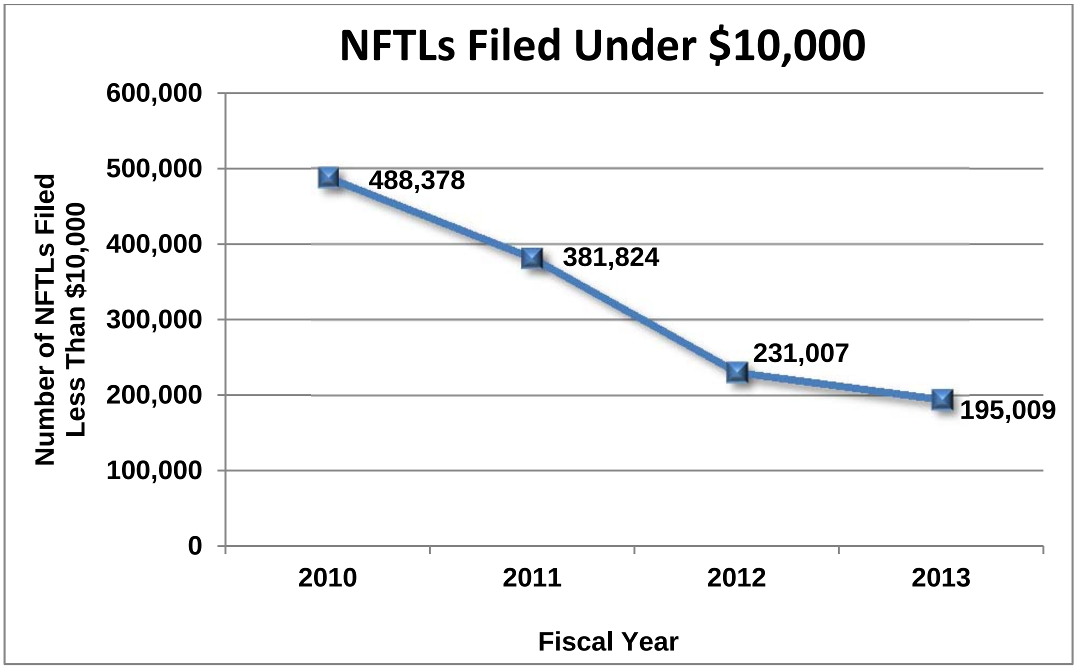
The Fresh Start Initiatives Are Beneficial to Taxpayers

So that taxpayers would be aware of the changes that the IRS made as part of its Fresh Start Initiatives, the IRS initiated several communication efforts to explain how struggling taxpayers could benefit. For example, the former IRS Commissioner issued several press releases announcing the overall goal of the Initiatives. The IRS also promoted the Initiatives through the IRS National Tax Forums, the IRS website, and IRS Open Houses. Additionally, the IRS produced videos accessible from the IRS website as well as through YouTube, a video-sharing website. The Initiatives received additional publicity from tax practitioners who promoted them in their own television and radio advertisements as a way of attracting struggling taxpayers as new clients. To ensure the correct application of each Initiative, IRS employees were provided with interim guidance, and updates were made to the Internal Revenue Manual.

Because of the changes, hundreds of thousands of taxpayers were not subject to NFTLs

After 30 years at $5,000, the IRS increased the dollar threshold for making NFTL determinations to $10,000 in Fiscal Year (FY) 2011. The increase was based on Consumer Price Index data supporting that the $5,000 threshold established in 1984 is approximately $10,000 in today's dollars. Increasing the dollar threshold for filing an NFTL helped to reduce the burden for many taxpayers with delinquencies below the new threshold—not only due to the avoidance of the lien itself, but also because an NFTL can adversely affect a taxpayer's credit rating. Figure 2 shows that the number of NFTLs filed on taxpayers with liabilities less than $10,000 has decreased by 60 percent since FY 2010, the fiscal year before the procedural change to the NFTL filing criteria occurred.

Figure 2: Number of NFTLs Filed Between FYs 2010 and 2013 for Liabilities Less Than $10,000



Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of IRS NFTL filing data.

While the NFTL filing determination is only required on delinquent liabilities of $10,000 or more, a decision to file an NFTL may still be made for balances less than $10,000 if it will help protect the Government's interest, such as those instances in which taxpayers have a pending bankruptcy or other urgent circumstances. Collection reports did not include data on the number of NFTLs filed on taxpayers with liabilities between $5,000 and $10,000 until FY 2012 (after the Initiative was established). The IRS filed 16 percent fewer NFTLs on taxpayers with tax liabilities between $5,000 and $10,000 in FY 2013 when compared with FY 2012.

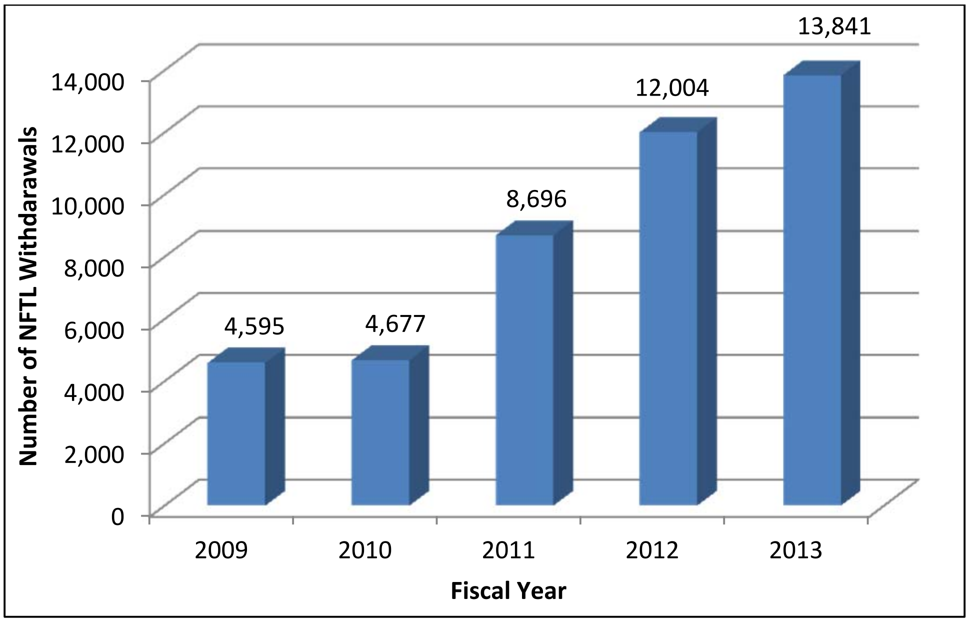
NFTLs were withdrawn for thousands of taxpayers

In FY 2011, the IRS established two Fresh Start Initiatives that made it easier for taxpayers to obtain NFTL withdrawals. Obtaining an NFTL withdrawal can help taxpayers improve their financial condition because the impact of a lien withdrawal under Internal Revenue Code section 6323(j) is as if the NFTL was never filed, and the NFTL is removed from the taxpayer's credit report in many instances.[7] The IRS did not report data on NFTL withdrawals on its Collection reports until FY 2012, after the Initiatives were already established. However, the Taxpayer

[7] IRS management advised us that some credit report companies do not remove the NFTL from the taxpayer's credit report but instead note that the NFTL has been withdrawn.

Advocate Service reported NFTL withdrawal data for FYs 2009 through 2011 in its 2012 report to Congress.[8] Figure 3 shows the significant increase in the number of NFTL withdrawals since FY 2009.

Figure 3: Number of NFTL Withdrawals



Source: Taxpayer Advocate Service 2012 Annual Report to Congress and TIGTA analysis of IRS NFTL withdrawal data for FYs 2012 and 2013.

In FYs 2012 and 2013, over 25,500 NFTLs were withdrawn.

Thousands of taxpayers avoided the failure to pay penalty

The failure to pay penalty is assessed on taxpayers who fail to timely pay the full tax shown on any tax return.[9] The penalty generally accrues at a rate of one-half of 1 percent per month on the unpaid tax and continues to accrue until the penalty reaches a maximum of 25 percent of the balance due. The penalty accrues even when taxpayers request to extend the time to file their tax returns. An extension of time to file does not extend the time to pay. However, this Fresh Start Initiative extended the time to pay along with the time to file. The IRS hoped that by providing penalty relief for qualifying taxpayers, it would allow taxpayers to file their return and fully pay their tax obligations by the extension deadline, *e.g.*, October 15, 2012.

The IRS created Form 1127-A, *Application for Extension of Time for Payment of Income Tax for 2011 Due to Undue Hardship*, specifically for this Initiative. More than 33,000 taxpayers

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[8] *Taxpayer Advocate Service 2012 Annual Report to Congress* (December 31, 2012).
[9] I.R.C. § 6651.

applied for relief under this Initiative, and 10,175 of these taxpayers qualified and were granted an extension to file their return and payment by October 15 without penalty.

Although not all taxpayers filed their return or fully paid their balance due, nearly 7,000 taxpayers were able to satisfy their tax obligations without incurring a late payment penalty.

For wage earners:

- The average balance due was $1,858 and the average penalty avoided was $97.
- Seventy-six percent of the taxpayers resolved their tax debt in one payment.

For self-employed individuals:

- The average balance due was $3,558 and the average penalty avoided was $94.
- Sixty-nine percent of the taxpayers resolved their tax debt in one payment.

More taxpayers were approved for streamlined OICs

The streamlined financial analysis for OICs eliminated the taxpayers' burden of providing comprehensive, detailed financial information. In addition, the streamlined process allowed the IRS to spend less time and resources reviewing OIC applications.

Our analysis of OIC data showed that dispositions increased 13 percent, from 61,084 in FY 2012 to 68,797 in FY 2013. In addition, the number of accepted applications increased 31 percent, from 23,628 in FY 2012 to 30,839 in FY 2013, while the number of rejected applications decreased 12 percent, from 10,516 in FY 2012 to 9,219 in FY 2013.

The IBTF Express Installment Agreement Initiative helped taxpayers meet their tax obligations

The IBTF Express Installment Agreement Initiative enabled small business taxpayers, owing up to $25,000, to qualify for a Streamline Installment Agreement. IBTF taxpayers were required to stay compliant with future tax filing and payment requirements in addition to making the required installment payments as part of the installment agreement. Because the IRS did not specifically track the benefits or results of the IBTF Express Installment Agreement Initiative, we compared a random sample of 25 IBTF taxpayers[10] who established installment agreements before the Initiative with a random sample of 25 IBTF taxpayers[11] who established IBTF Express Installment Agreements after the Initiative. Figure 4 shows that taxpayers who established an IBTF Express Installment Agreements after the Initiative's policy changes were implemented

[10] The sample was taken from IBTF taxpayers with installment agreements between $10,000 and $25,000. The Initiative expanded IBTF Express Installment Agreement eligibility to taxpayers with liabilities in this range.
[11] For consistency, we limited this sample to taxpayers with IBTF Express Installment Agreements between $10,000 and $25,000.

were more likely to file subsequent tax returns and remain compliant with their tax obligations. This was most likely due to the Initiative's requirement for the taxpayer to establish a Direct Debit Installment Agreement.[12] Specifically, sampled taxpayers who established IBTF Express Installment Agreements after the policy changes were implemented were 32 percent[13] more likely to be compliant with their future tax obligations, as compared with the IBTF taxpayers who established installment agreements prior to the policy changes.

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Risks to Tax Administration Were Not Fully Mitigated

The CPS contained recommendations to mitigate risks associated with some of the policy changes that were included in the Fresh Start Initiatives. However, due to time constraints and a desire to take timely action, the IRS did not always follow the recommendations. Specifically, prior to implementing the Fresh Start Initiatives, IRS management did not:

- Implement procedures to mitigate the risk of withdrawing NFTLs from taxpayers entering into a Direct Debit Installment Agreement before their delinquent tax was fully paid.
- Assess the impact on Collection revenue of increasing the NFTL determination threshold from $5,000 to $10,000.

[12] Historically, the default rate for Direct Debit Installment Agreements is less than for traditional installment agreements.
[13] The difference in compliance rates is based on a two-sided 90 percent confidence interval. We are 90 percent confident that the actual percentage of taxpayers more likely to be compliant with their future tax obligations is between 14.6 percent and 49.4 percent.

Withdrawn NFTLs were not addressed after taxpayers defaulted on their Direct Debit Installment Agreements

The CPS recommended that the IRS withdraw NFTLs for taxpayers who stay compliant with the terms of their Direct Debit Installment Agreements. The IRS reasoned that because the default rate was lower for Direct Debit Installment Agreements than traditional installment agreements, encouraging taxpayers to enter into agreements was beneficial to tax administration. In addition, taxpayers benefit because NFTLs are withdrawn. The CPS further recognized that there was a risk that taxpayers for whom the NFTLs were withdrawn could default on their Direct Debit Installment Agreements, which would leave the Government's interest in the taxpayers' assets (in the amount of unpaid tax delinquencies) unprotected against other creditors.

Many taxpayers default on installment agreements during the second year of the agreement. To help mitigate this risk, the CPS recommended withdrawing the NFTL only after the taxpayer remained current on a Direct Debit Installment Agreement for 24 months. Taxpayers would be notified of this opportunity as an incentive to make payments for at least 24 months. In addition, the CPS recommended that these agreements be closely monitored to determine if there was a decrease in payments after the NFTLs were withdrawn.

However, when this CPS recommendation was adopted as a Fresh Start Initiative, the IRS lowered the NFTL withdrawal criterion from 24 payments to three payments. In addition, the IRS did not implement controls to ensure that new NFTLs were filed if the taxpayers defaulted on their agreements.

As of November 2013, there were 4,002 taxpayers whose NFTLs were withdrawn as part of this Initiative. We also identified 670 taxpayers who defaulted on their Direct Debit Installment Agreement after their NFTLs were withdrawn. We determined that 524 of the 670 taxpayers did not reestablish their Direct Debit Installment Agreements nor did the IRS file new NFTLs. As a result, the approximately $10.5 million still owed by these taxpayers is currently unprotected by NFTLs.

Most of the taxpayers who defaulted on their agreements would not have had their NFTLs withdrawn if the CPS recommendation was implemented as intended. Specifically, 379 (72 percent) of the 524 taxpayers with NFTLs withdrawn defaulted before making 24 payments. Further analysis showed that 144 of them defaulted within the first year of establishing a Direct Debit Installment Agreement or within a year of the Fresh Start Initiative date, whichever was later. Separately, 31 defaulted within 30 days of the NFTL withdrawal.

The revenue protection impact of fewer NFTLs has not been fully assessed

The IRS increased the dollar threshold for making an NFTL determination from $5,000 to $10,000. The CPS recognized that because NFTLs protect the Government's interest, there was a risk that fewer NFTLs could have a negative impact on future revenue. However, the full extent of this risk is unknown. Since its implementation, the IRS has not fully assessed the monetary impact of this procedural change on revenue collection. Specifically, although the IRS recently analyzed the short-term impact on revenue, the study was limited to NFTLs generated by the Automated Collection System. The IRS has not studied the long-term revenue impact of fewer NFTLs filed by Field Collection. In FY 2013, Field Collection generated 65 percent of all NFTLs.

This Fresh Start Initiative has the potential to impact a significant number of taxpayers. At the end of FY 2013, the IRS reported that taxpayer delinquent accounts between $2,000 and $10,000[14] accounted for 41 percent of all taxpayer delinquent accounts. Since the procedural change, balance due accounts for 117,961 taxpayers with assessed tax liabilities between $5,000 and $10,000 were transferred to the Collection Queue without an NFTL to protect the Government's interest on more than $843 million in tax liabilities. Although many of the cases in the Collection Queue may be assigned to be worked, a significant number may only be sent an annual reminder notice in an attempt to resolve the delinquency.[15]

Recommendations

The Director, Collection Policy, Small Business/Self-Employed Division, should:

Recommendation 1: Ensure that new NFTLs are filed for the 524 taxpayers who defaulted on their Direct Debit Installment Agreements after their NFTLs were withdrawn.

> ***Management's Response:*** IRS management agreed with this recommendation and will review the case files of these 524 taxpayers and determine whether a new NFTL should be issued. Additionally, IRS management will take action, as appropriate, following these reviews and determinations.
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> ***Office of Audit Comment:*** In its response, IRS management disagreed with our outcome measure by stating that the Government still has a legal claim (lien) when taxpayers fail to pay their tax debt and that withdrawal of the NFTL does not remove the lien. While the IRS is correct that Internal Revenue Code section 6321 imposes a lien against the property of a person liable for tax, section 6323(a) renders that lien unenforceable against any purchaser, holder of a security interest, mechanic's lien creditor, or judgment creditor until an NFTL is filed. Additionally, IRS Revenue Ruling 2003-108 provides that the lien established under Internal Revenue Code section 6321 is unenforceable against those interest holders even when they had prior knowledge of the tax liability before becoming an interest holder. In other words, if no NFTL is filed

[14] This is the best available dollar range per Collection Activity Report 5000-2.

[15] Before taxpayer accounts are assigned to the Collection Queue, the IRS has already sent notices to the taxpayer about the delinquency. After the notice process, some cases go directly to the Collection Queue, while others are worked in the Automated Collection System. Those cases in the Collection Queue that are not assigned may not receive contact aside from annual reminder notices.

against a taxpayer with unpaid tax liabilities, a purchaser can purchase the taxpayer's real estate even if the purchaser was aware of the seller's outstanding tax liability and receive the title free and clear of the tax debt owed to the Government. On the other hand, with an NFTL in place, the purchaser must either ensure that the Government's interest is satisfied from the sale proceeds or else take the property subject to the Government's lien on the property. Therefore, contrary to the IRS's position, we believe an NFTL affords substantial protection to the Government's interest.

Recommendation 2: Establish controls to ensure that new NFTLs are filed on taxpayers who default on their Direct Debit Installment Agreements.

> ***Management's Response:*** IRS management partially agreed with this recommendation. IRS management will review their current processes and the viability of a systemic enhancement to determine whether it is the best use of their limited resources in the current business environment to implement systemic enhancements or procedural changes to ensure that new NFTL filing determinations are made after taxpayers default on Direct Debit Installment Agreements.

Recommendation 3: Assess the long-term revenue protection impact of the Fresh Start Initiative that increased the minimum dollar threshold for NFTL determinations in Field Collection.

> ***Management's Response:*** IRS management agreed with this recommendation and will initiate a research request to evaluate the potential revenue protection impact from Field Collection cases of the Fresh Start Initiative that increased the minimum dollar threshold for NFTL filing determinations.

Performance Measures Were Not Established

Performance measurement involves the ongoing monitoring and reporting of program effectiveness and the progress made towards achieving established goals and objectives. Establishing goals or targets are essential to performance measures because they:

- Allow meaningful evaluation of progress because it is immediately clear whether targets have been met or little progress has been made.
- Facilitate accountability for the level of results achieved.

The Government Accountability Office *Standards for Internal Control in the Federal Government* states that relevant, reliable, and timely information is needed in order to achieve program objectives.

IRS management established performance measures for the Failure to Pay Penalty and the Streamline OIC Initiatives. For the Failure to Pay Penalty Initiative, taxpayers were required to submit a form in order to qualify, and the IRS compiled the data necessary to compare the Initiative's goals with its actual results. Similarly, the Streamline OIC Initiative was established with goals to increase dispositions and productivity. While these goals did not include specific quantifiable targets, Collection information reports capture the data necessary to determine whether dispositions and productivity have increased.

However, the IRS did not establish performance measures for the three Fresh Start Initiatives related to NFTLs. IRS management advised us that establishing measures related to the filing of NFTLs were not considered because NFTLs may not impact a taxpayer immediately and Collection information reports do not capture the relevant NFTL withdrawal information. Although Collection information reports began capturing NFTL withdrawal data after implementation of the Initiatives, the data does not isolate withdrawals made via a Fresh Start Initiative. For example, reports show that for the two-year period ending in FY 2013, over 25,500 taxpayers obtained NFTL withdrawals. However, it is not known how many of those withdrawals were made possible because of the Fresh Start Initiative.

In addition, the CPS recommendations for the Streamline Installment Agreement and IBTF Express Installment Agreement Initiatives included performance measures (increased installment agreements established and increased revenue) and quantifiable projections (number of installment agreements established and dollars collected). The projections for the Streamline Installment Agreement and IBTF Express Installment Agreement measures are:

- 50,000 taxpayers would enter into Streamline Installment Agreements annually and dollars collected would increase by $400 million due to the threshold increase from $25,000 to $50,000.
- 115,000 taxpayers would enter into IBTF Express Installment Agreements annually and dollars collected would increase $524 million due to the threshold increase from $10,000 to $25,000.

However, when implementing these Initiatives, the IRS did not adopt these measures or projections because of current information systems limitations. As a result, IRS management is unable to compare actual results with the projections.

Identifying and understanding variances between projected and actual dollars collected would provide more information for the IRS to assess the effectiveness of these Initiatives. Establishing performance measures and comparing actual results with projections is important to both the IRS and its stakeholders. Given the promotion and stakeholder interest in the Fresh Start Initiatives, the IRS should have put in place the capability to report on the Initiatives' results. Without performance measures, IRS management cannot fully assess the impact that the Initiatives have had on taxpayers or on tax administration.

Recommendation

***Recommendation 4*:** The Director, Collection Policy, Small Business/Self-Employed Division, should establish methods to monitor and assess the performance of the Fresh Start Initiatives.

> ***Management's Response*:** IRS management agreed that there should be established methods for the agency to assess the performance of the Fresh Start Initiative. However, limited information technology resources and the benefits associated with establishing these methods would not make this an information technology priority. Therefore, the IRS will not commit to the submission or completion of a work request at this time.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective was to determine the impact of the Fresh Start Initiatives in promoting tax compliance. To accomplish this objective, we:

I. Reviewed IRS policies, procedures, and external reports pertaining to the Fresh Start Initiatives.

   A. Reviewed Internal Revenue Manual[1] procedures and other guidance used in the Fresh Start Initiatives.

   B. Reviewed portions of the IRS's CPS pertaining to the Fresh Start Initiatives.

   C. Reviewed TIGTA, IRS Office of Program Evaluation and Risk Analysis, and Taxpayer Advocate Service reports pertaining to the Fresh Start Initiatives.

II. Assessed the IRS methods used to develop, monitor, and measure the Fresh Start Initiatives.

   A. Assessed the basis/support used to develop the Fresh Start Initiatives, including the dollar thresholds.

   B. Determined if the IRS established a method to monitor the Fresh Start Initiatives.

   C. Determined if the IRS established a method to measure the effectiveness of the Fresh Start Initiatives.

   D. Determined whether the IRS appropriately assessed the performance of the Fresh Start Initiatives (using the results of Subobjective II.C).

   E. Determined how the IRS promoted the Fresh Start Initiatives.

III. Determined whether the IRS considered certain risks when implementing the Fresh Start Initiatives.

   A. Determined whether the risks identified in the CPS pertaining to the NFTL withdrawal and Streamline Installment Agreement Initiatives were mitigated by the IRS.

   B. Analyzed a Taxpayer Information File extract of taxpayers who had NFTLs withdrawn after establishing a Direct Debit Installment Agreement as part of the

[1] See Appendix V for a glossary of terms.

Fresh Start Initiatives. We determined how many of these taxpayers defaulted on their Direct Debit Installment Agreement.

C. Validated the Taxpayer Information File extract by comparing installment agreement and NFTL withdrawal data with Master File records. The data were found to be sufficient for use in our audit.

IV. Determined the impact of the Fresh Start Initiatives.

A. Analyzed data from the Collection Activity Reports pertaining to OICs, installment agreements, NFTLs filed, and NFTLs withdrawn. We focused on the fiscal years before and after the implementation of the Fresh Start Initiatives.

B. Analyzed IRS data on the results of the Failure to Pay Penalty Initiative.

C. Performed case reviews to determine the impact on future compliance of taxpayers participating in the IBTF Express Installment Agreement Initiative.

1. Obtained a computer extract from the Taxpayer Information File of IBTF Express Installment Agreements.

2. Validated the Taxpayer Information File extract by comparing the installment agreement data with Master File records. The data were found to be sufficient for use in our audit.

3. Due to limited audit resources, selected two random samples from the data extract obtained in Subobjective IV.C.1. We consulted with TIGTA's contract statistician for our sampling methodology.

a) Selected 25 IBTF taxpayers from a population of 52,848 with total liabilities between $10,000 and $25,000 that established an installment agreement before implementation of the IBTF Express Installment Agreement Initiative (prior to April 2011). The installment agreements for the 52,848 taxpayers were still open as of the end of March 2011. Installment agreements for taxpayers with total liabilities between $10,000 and $25,000 that established an installment agreement before implementation of the IBTF Express Installment Agreement Initiative that were closed (fully paid) were not available for sampling. We used a random sample to ensure that each taxpayer had an equal chance of being selected, which enabled us to obtain sufficient evidence to support our results.

b) Selected 25 IBTF taxpayers from a population of 46,681 with total liabilities between $10,000 and $25,000 that established an installment agreement as part of the IBTF Express Installment Agreement Initiative (between April 2011 and January 2013). The installment agreements for the 46,681 taxpayers were still open as of the end of January 2013. Installment agreements for taxpayers with total liabilities between $10,000 and $25,000 that established an installment agreement as part of the IBTF Express Installment Agreement Initiative that were closed (fully paid) were not available for sampling.[2] We used a random sample to ensure that each taxpayer had an equal chance of being selected, which enabled us to obtain sufficient evidence to support our results.

4. Determined the future compliance rates for both samples for the period from the start of the installment agreement to the end of our fieldwork.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the Small Business/Self-Employed Division's collection policies, procedures, and practices for establishing, monitoring, and measuring the Fresh Start Initiatives. We evaluated these controls by performing a review of IBTF Express Installment Agreement cases and performing an analysis of the NFTL withdrawal population.

[2] For the purposes of this review, open installment agreements are those that continue to be active on the Taxpayer Information File. Alternately, closed installment agreements refer to those for which information was archived from the Taxpayer Information File.

Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Director, Collection Policy, Small Business/Self-Employed Division SE:S:CS:CP
Director, Enterprise Collection Strategy, Small Business/Self-Employed Division SE:S:CS
Director, Field Collection, Small Business/Self-Employed Division SE:S:FC
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Commissioner, Small Business/Self-Employed Division SE:S

Appendix IV

Outcome Measure

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; $10,469,857 owed by 524 taxpayers who defaulted on their Direct Debit Installment Agreements[1] after their NFTLs were withdrawn (see page 8).

Methodology Used to Measure the Reported Benefit:

We analyzed a computer extract from the Taxpayer Information File of taxpayer accounts with Direct Debit Installment Agreements who had also received a default notice (Computer Paragraph 523) as of November 2013. We matched the data from this extract with Master File records for taxpayers with an NFTL withdrawn, an NFTL filed, and an installment agreement. We identified 670 taxpayers who were issued a default notice subsequent to their NFTL withdrawal. We determined that 524 of the 670 taxpayers did not reestablish their Direct Debit Installment Agreements nor have NFTLs refiled by the IRS. The 524 taxpayers owed $10,469,857 at the time of their default.

[1] See Appendix V for a glossary of terms.

Appendix V

Glossary of Terms

Term	Definition
Automated Collection System	A telephone contact system through which telephone assistors collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.
Collection Activity Reports	Reports that provide Collection activity information from the beginning of the fiscal year through the end of the current reporting month.
Collection Queue	An automated holding file for unassigned inventory of delinquent cases for which employees in the Collection Field function are unable to be immediately assigned for contact due to limited resources.
Consumer Price Index	A measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.
Direct Debit Installment Agreement	The means by which funds are automatically debited from a taxpayer's bank account for the agreed-upon installment amount.
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
In Business	A business with ongoing business activity.
Installment Agreement	Arrangement in which a taxpayer agrees to pay his/her tax liability over time.
Internal Revenue Manual	The operations manual for employees of the IRS.

Term	Definition
Master File	The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
Notice of Federal Tax Lien	A public notification filed with designated State and local jurisdictions to inform certain third parties, typically a purchaser, holder of a security interest, mechanic's lien, or judgment lien creditor, of the existence of the statutory lien securing the tax debt and establish the Government's right of priority against these same creditors.
Offer in Compromise	An agreement between a taxpayer and the Federal Government that settles a tax liability for payment of less than the full amount owed.
Open House	The IRS opened the doors to dozens of its Taxpayer Assistance Centers across the country on a Saturday to answer taxpayer questions and provide help with tax filing issues.
Tax Forum	IRS-held event with seminars discussing Federal and State tax issues from top IRS subject matter experts and leading industry experts.
Taxpayer Information File	IRS file that contains active taxpayer accounts which include many areas such as installment agreements and current delinquent tax balances. Balance due notices are issued from the Taxpayer Information File.
Trust Fund	Money withheld from an employee's wages (income, Social Security, and Medicare taxes) by an employer and held in trust until paid to the U.S. Department of the Treasury.
YouTube	A video-sharing website on which users can upload, view, and share videos.

Appendix VI

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

NOV 24 2014

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Karen Schiller
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – The Fresh Start Initiatives Have Benefited Many Taxpayers, but Additional Monitoring and Evaluation Is Needed (Audit # 201330011)

Thank you for the opportunity to review your draft report titled "The Fresh Start Initiatives Have Benefited Many Taxpayers, but Additional Monitoring and Evaluation is Needed." We appreciate your acknowledgment that the Fresh Start Initiatives have helped thousands of struggling individuals and small business taxpayers in resolving their tax issues.

The goal of Fresh Start was to help taxpayers who were negatively impacted by a declining economy. Through Fresh Start, taxpayers have a better chance to remain current on their taxes and keep their finances in order. These initiatives primarily changed IRS Collection practices related to Notices of Federal Tax Liens (NFTLs), installment agreements, and offers-in-compromise. As you acknowledge in your report, thousands of taxpayers have benefitted from these changes, and we are proud of these results.

We appreciate your recommendations for improvements, as well as your recommendation that we assess the long-term revenue protection impact of the Fresh Start initiatives. We note, however, that we disagree with your revenue protection outcome measure of $10.469,85, which is the amount owed by the 524 taxpayers who defaulted on their Direct Debit Installment Agreements after their NFTLs were withdrawn. When a taxpayer neglects or fails to pay a tax debt, the government has a legal claim (a lien) against the taxpayer's property. While the NFTL notifies creditors of the government's right to the taxpayer's property and gives the government a higher priority than certain other creditors with respect to the taxpayer's property, the withdrawal of the NFTL does not remove the lien. The lien exists until the tax debt has been paid, regardless of whether the new NFTL is issued. Thus, depending on the taxpayer's assets, the number of creditors who have a higher priority without the NFTL, and the amount owed by the taxpayer to these creditors, the government may be fully or partially protected based solely on the existence of the lien, without regard to the issuance of a new NFTL. Additionally, the issuance of a new NFTL will not give the government a higher priority than certain other creditors. Therefore, if the value of the

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taxpayer's assets does not exceed the amount owed to these creditors, the issuance of the NFTL will not protect any additional revenue.

A detailed response with our corrective actions to your recommendations is attached. If you have any questions, please contact me, or a member of your staff may contact Tom Mathews, Director, Headquarters Collection at (801) 799-7020.

Attachment

Attachment

RECOMMENDATION 1:
The Director, Collection Policy, Small Business/Self-Employed Division, should ensure that new NFTLs are filed for the 524 taxpayers that defaulted on their Direct Debit Installment Agreements after their NFTLs were withdrawn.

CORRECTIVE ACTION:
We will review the case files of these 524 taxpayers and determine whether a new NFTL should be issued. We will take action, as appropriate, following these reviews and determinations.

IMPLEMENTATION DATE:
November 15, 2015

RESPONSIBLE OFFICIAL:
Director, Collection Policy, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:
The Director, Collection Policy, Small Business/Self-Employed Division, should establish controls to ensure that new NFTLs are filed on taxpayers who default on their Direct Debit Installment Agreements.

CORRECTIVE ACTION:
We will review our current processes and the viability of a systemic enhancement to determine whether it is the best use of our limited resources in the current business environment to implement systemic enhancements or procedural changes to ensure that new NFTL filing determinations are made after taxpayers default on DDIAs.

IMPLEMENTATION DATE:
November 15, 2015

RESPONSIBLE OFFICIAL:
Director, Collection Policy, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 3:
The Director, Collection Policy, Small Business/Self-Employed Division, should assess the long-term revenue protection impact of the Fresh Start Initiative that increased the minimum dollar threshold for NFTL determinations in Field Collection.

CORRECTIVE ACTION:
We will initiate a research request to evaluate the potential revenue protection impact from Field Collection cases of the Fresh Start initiative that increased the minimum dollar threshold for NFTL filing determinations.

IMPLEMENTATION DATE:
November 15, 2015

RESPONSIBLE OFFICIAL:
Director, Collection Policy, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 4:
The Director, Collection Policy, Small Business/Self-Employed Division, should establish methods to monitor and assess the performance of the Fresh Start Initiatives.

CORRECTIVE ACTION:
We agree that there should be established methods for the agency to assess the performance of the Fresh Start Initiative. However, we have limited information technology resources and the benefits associated with establishing these methods do not make this an information technology priority. We, therefore, cannot commit to the submission or completion of a work request at this time.

IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A