TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Required Actions Were Not Always Completed Prior to Closing Defunct Corporation Cases As Currently Not Collectible

April 17, 2015

Reference Number: 2015-30-028

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
2 = Risk Circumvention of Agency Regulation or Statute

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REQUIRED ACTIONS WERE NOT ALWAYS COMPLETED PRIOR TO CLOSING DEFUNCT CORPORATION CASES AS CURRENTLY NOT COLLECTIBLE

Highlights

Final Report issued on April 17, 2015

Highlights of Reference Number: 2015-30-028 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Accounts may be reported as currently not collectible (CNC) for a variety of reasons, one of which is that the entity is defunct. This can apply to corporations, partnerships, and exempt organizations. The Internal Revenue Manual requires that certain case actions be completed on delinquent corporate accounts prior to closing them as CNC-defunct. Consistent application of these actions helps protect the Government's interest and ensures that taxpayers are treated equitably.

WHY TIGTA DID THE AUDIT

In Fiscal Year 2013, the IRS closed 264,840 tax modules, involving approximately $4 billion, as CNC-defunct. This audit was initiated to determine if the Field Collection function is performing all required collection actions before closing delinquent corporate accounts as CNC-defunct and if all tax periods for defunct corporate taxpayers are properly closed.

WHAT TIGTA FOUND

IRS employees did not complete required case actions in approximately 15 percent of a stratified sample of 162 corporation cases closed as CNC-defunct. Specifically, employees did not always complete required research or obtain necessary financial information, and the cases with missing actions were approved by their managers. TIGTA identified 39 instances involving 30 cases in which required case actions were not taken.

These actions are required to ensure that, before a case is closed as uncollectible, due diligence is exercised to determine whether collection potential exists.

TIGTA also determined that 30 of 162 sampled cases were closed after 65 weeks, which is considered over-age. In December 2011, IRS management removed the requirement for managers to specifically monitor and discuss over-age cases.

In addition, 66 percent of sampled corporations were already out of business when the case was assigned to the revenue officer. Out-of-business taxpayers are an unlikely source of revenue, raising the question of whether the IRS is choosing the most productive cases for its revenue officers. On the other hand, for employment tax cases, the IRS can assess the Trust Fund Recovery Penalty against individual employees of the defunct business. However, 15 percent of these cases did not include delinquent employment taxes, so there was no possibility of this penalty. Trust Fund Recovery Penalties were assessed on only 21 percent of the out-of-business cases.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) ensure that Field Collection employees and managers are properly trained on the actions they need to take prior to closing cases as CNC-defunct and 2) ensure that case actions are taken timely, including properly documenting the reasons for any delays.

In their response to the report, IRS officials agreed with the recommendations and stated that they provided training to improve CNC closures. IRS management plans to augment this training by issuing a memorandum reminding Field Collection employees to follow the procedures in the Internal Revenue Manual when closing cases as CNC. Additionally, management plans to issue a memorandum reminding Field Collection managers and revenue officers that the Internal Revenue Manual requires revenue officers to document delays in taking timely actions and managers to review cases for timely actions.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

April 17, 2015

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Required Actions Were Not Always Completed Prior to Closing Defunct Corporation Cases As Currently Not Collectible (Audit #201330018)

This report presents the results of our review to determine if the Field Collection function is performing all required collection actions before closing delinquent corporate accounts as currently not collectible-defunct and if all tax periods for defunct corporate taxpayers are properly closed. This audit is included in our Fiscal Year 2015 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 V.

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 Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

Table of Contents

Abbreviations

CNC	Currently Not Collectible
FY	Fiscal Year
IDRS	Integrated Data Retrieval System
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
TDA	Taxpayer Delinquent Account
TDI	Taxpayer Delinquency Investigation

Background

Internal Revenue Service (IRS) Policy Statement 5-1 states that enforcement action is a necessary component of a voluntary tax system and should be taken promptly in cases for which taxpayers have not shown a good faith effort to comply. Taking all of the steps in the collection process may require the use of enforcement tools such as liens,[1] levies, seizures, and Trust Fund Recovery Penalty assessments. In addition, IRS Policy Statement 5-71 states that if, after taking all steps in the collection process, it is determined that an account receivable is currently not collectible (CNC), it should be so reported in order to remove it from active inventory.

Accounts may be reported as CNC for a variety of reasons including hardship (when the taxpayer is unable to pay reasonable basic living expenses), decedent and decedent estates, bankruptcy, unable to contact or unable to locate the taxpayer, and defunct. The following types of cases can be closed as CNC-defunct:

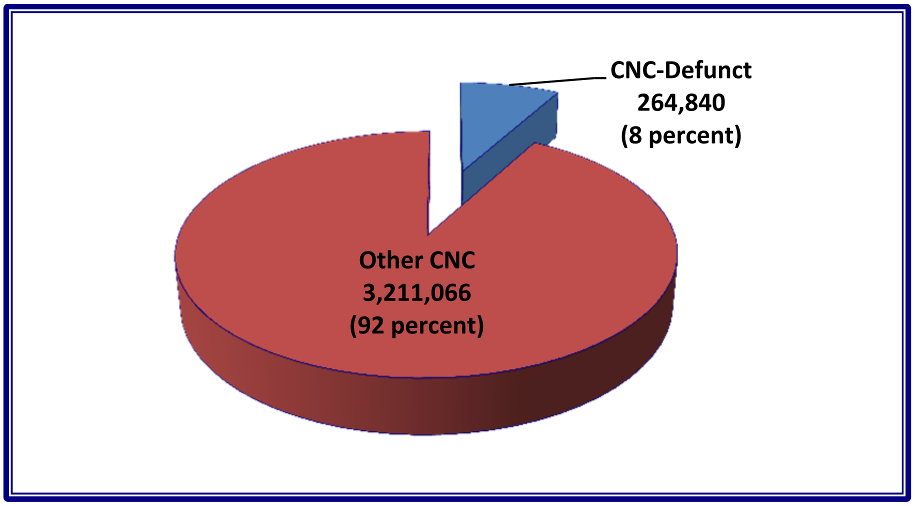
- Any corporation or exempt organization that is no longer operating and from which all assets have been dispersed.
- Corporations dissolved under state receivership proceedings or other State dissolution proceedings.
- Limited partnerships (when the partnership agreement limits the liability of the partners under local law) that are no longer operating and from which all assets have been dispersed.
- Limited liability corporations (when identified as the liable taxpayer) that are no longer operating and from which all assets have been dispersed.

The investigation required to close a case as CNC-defunct varies with the dollar amount and type of case. These cases are normally closed by employees working in the Automated Collection System, IRS campuses, or Field Collection function (hereafter referred to as the Field). The decision to place an account in CNC-defunct status requires the review and approval of a manager to help ensure the thoroughness of the investigation.

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

Figure 1 shows that 264,840 tax modules were closed as CNC-defunct in Fiscal Year (FY) 2013, which accounted for 8 percent of the total number of tax modules closed as CNC.

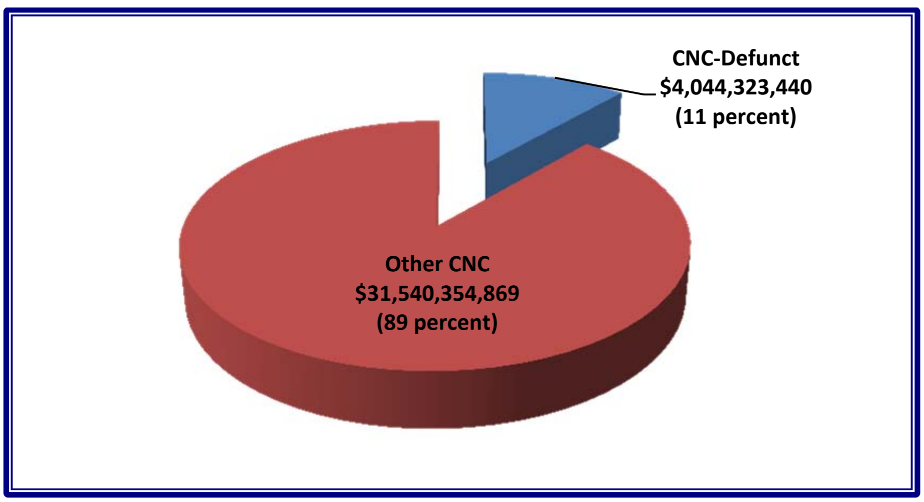
Figure 1: Number of Tax Modules Closed As CNC in FY 2013



Source: FY 2013 IRS Collection Activity Report, Recap of Accounts Currently Not Collectible, Report Symbol NO-5000-149.

Figure 2 shows that these closures amounted to $4 billion, which represented 11 percent of the total dollar amount of tax modules closed as CNC in FY 2013.

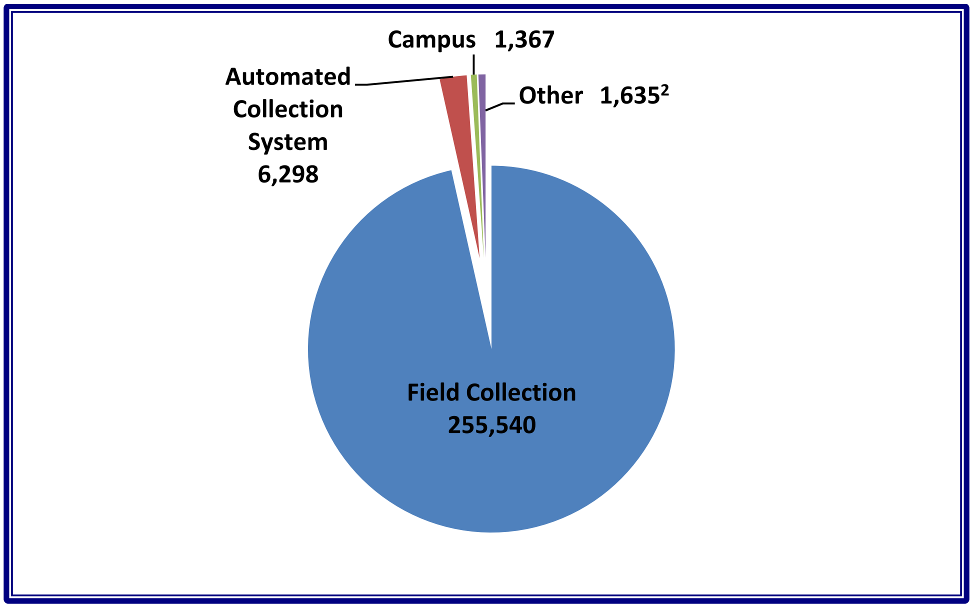
Figure 2: Amount of Unpaid Assessed Balances of Tax Modules Closed As CNC in FY 2013



Source: FY 2013 IRS Collection Activity Report, Recap of Accounts Currently Not Collectible, Report Symbol NO-5000-149.

Figure 3 shows a breakout by Collection function of the 264,840 total tax modules closed as CNC-defunct during FY 2013.

Figure 3: FY 2013 Tax Modules Closed CNC-Defunct by Collection Function



Source: FY 2013 IRS Collection Activity Report, Recap of Accounts Currently Not Collectible, Report Symbol NO-5000-149.

The Field closed 96 percent of the CNC-defunct modules during FY 2013. The types of cases closed as CNC-defunct include corporations, partnerships, and exempt organizations. This review focused on corporation cases closed by the Field as CNC-defunct.

This review was performed at the IRS field office in Lanham, Maryland, along with information obtained from the Small Business/Self-Employed Division Headquarters in New Carrollton, Maryland, during the period September 2013 through October 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

[2] The IRS Collection Activity Report, *Recap of Accounts Currently Not Collectible*, Report Symbol NO-5000-149, includes the number of CNC-defunct closures for the functions listed (Field Collection, Automated Collection System, and Campus). However, the total number of CNC-defunct closures on the report includes 1,635 closures not included in the break-out by function.

methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

The Internal Revenue Manual (IRM) requires that certain case actions be completed on delinquent corporate accounts prior to closing them as CNC-defunct. Further actions are required on cases when the ******************2************************ and again when the *********************2********************. For example, ****2***** ********2***********, research is required to determine information about previously filed returns. ***************2********************, the revenue officer must review the examination case file and research is required to determine if there is an open examination on the taxpayer and if any portion of the assessment resulted from an examination and/or a fraud penalty. However, all required actions were not always completed on the cases we reviewed. Following the required procedures for closing cases as CNC-defunct helps protect the Government's interest and ensures that taxpayers are treated equitably. Omitting required case actions and closing a case as CNC-defunct for some taxpayers while properly scrutinizing others may result in inequitable treatment.

Additionally, the Field uses an over-age indicator to show when a case has been in inventory for 65 weeks or more. Of the 162 cases we reviewed, 30 cases exceeded this criterion. If these over-age cases remain in a revenue officer's inventory without oversight to ensure that timely actions are taken, the assignment of more productive cases with higher collection potential could be delayed.

With the significant growth in delinquent accounts and reduction in the number of employees, it is essential that the Field inventory selection process identifies the cases that have the highest risk and potential for collection. This requires IRS officials to make decisions about how to ensure that the cases in the Collection Queue (hereafter referred to as the Queue) with the best collection potential are identified, selected, and assigned to be worked. However, the IRS has not considered the limited revenue potential when assigning out-of-business taxpayer cases to revenue officers that are ultimately closed as CNC-defunct.

Required Case Actions Were Not Always Completed

The required case actions depend on the aggregate unpaid balance of assessments prior to closing a case as CNC-defunct. Additional case actions are required as the amount of unpaid balances increases. The required case actions that should be completed prior to closing a case as CNC-defunct may include:

- Securing a collection information statement to conduct a financial analysis.
- Making a Trust Fund Recovery Penalty decision.

- Confirming that a business is no longer operating by checking bank records, State employment records, real and personal property records, and all known levy sources when unable to locate a corporation/limited liability corporation or its officers/members and third-party sources indicate that the business is no longer operating.
- Requesting information on the latest filed return (if within the last two years) using the Integrated Data Retrieval System (IDRS) *******************2*************** *****************2*********************.
- Checking for an open examination using the IDRS ************2*************** *********************2******************************.

In addition, the IRM requires documentation of all actions to support a CNC determination, and managers must approve the decision to close a case as CNC-defunct.

We reviewed a stratified random sample of 162 corporation cases closed as CNC-defunct between July 1, 2012, and June 30, 2013. Our case review showed that not all of the required case actions had been completed for approximately 15 percent of the 162 cases prior to their closing.[3] These consisted of

were not taken before closing the case as CNC-defunct. The missing case actions included incomplete IDRS research and not securing a collection information statement when required.

Specifically, 27 of the 39 missing actions involved incomplete IDRS research, and a collection information statement was not obtained when required in seven instances.[4] These required actions may help locate additional taxpayer assets and assess the taxpayer's ability to pay, which directly affects the IRS's ability to collect revenue. IRS management advised us that revenue officers sometimes take alternate actions when conducting IDRS research, and they recently revised the IRM to permit such actions. However, none of these alternate actions were taken in the exception cases. IRS management could not explain why not all required actions were taken on CNC-defunct cases. However, management believes that recent revisions to the IRM and requested changes to the Integrated Collection System checklist will help improve procedural compliance.

Field managers reviewed and approved all of the cases with missing case actions. If managers had ensured that all required actions were completed prior to closing these cases, some additional assets may have been identified. This potentially could have resulted in the collection of additional revenue from some of the approximately $350 million in delinquent taxpayer accounts.[5] However, we did not determine if any of the cases with missing case actions had any

[3] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the percentage is between 7.93 percent and 21.27 percent.
[4] The IRM was revised on August 25, 2014, to further clarify the requirements for when revenue officers should obtain collection information statements. However, this did not affect the results of our case reviews.
[5] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the total dollar amount is between $146 million and $554 million.

assets that would have been available for collection actions at the time the case was being worked. It is important to note that the amount actually collectible from these cases might only be a small portion of the total amount of delinquent taxpayer accounts. For example, IRS management advised that it subsequently researched 19 of the 30 taxpayer cases in which the revenue officers did not conduct the required IDRS research and determined that, in 17 cases, the research did not reveal additional assets. However, completing all case actions helps ensure that before a case is closed as uncollectible, due diligence is exercised to determine whether collection potential exists. This helps protect the Government's interest and ensures that taxpayers are treated equitably. Additionally, omitting required case actions and closing a case as CNC-defunct for some taxpayers while properly scrutinizing others may result in inequitable treatment.

Management Action: During our review, management revised some sections of the IRM involving the processing and closing of CNC-defunct cases. The changes included a new checklist that employees can use to ensure that all required actions are taken prior to closing the case. Additionally, in May 2014, management submitted a request for Integrated Collection System improvements, which will add required case actions for CNC closures to a list in the system that is already used by revenue officers when working cases. The system updates are planned to be completed by January 2016.

Recommendation

Recommendation 1: The Director, Collection Policy, and the Director, Field Collection, should ensure that Field employees and managers are properly trained to complete the required actions prior to closing cases as CNC-defunct.

> ***Management's Response:*** Management agreed with this recommendation. Management stated that in October 2014, Field Collection delivered its FY 2014 Leadership Continuing Professional Education "Collection Management Fundamentals" course, which included training segments and tools to improve CNC closures and timely follow-up actions. Management plans to augment this training by issuing a memorandum reminding Field Collection employees to follow the procedures in the IRM when closing cases as CNC.

Some Corporation Cases Closed As Currently Not Collectible–Defunct Were Over-Age When Closed

The aging of a case begins when the case is assigned to a revenue officer and usually continues until the case is closed. According to IRS management, a case is considered over-age after it has been in the revenue officer's inventory for 65 weeks or more. In December 2011, the IRS removed the following requirements from the IRM:

- Managers should monitor over-age cases and address any negative trends identified with the revenue officer.
- Over-age cases are a business priority to be considered as part of the consultation process between managers and revenue officers.

The IRM still requires that managers, as part of the periodic consultation process, discuss with their revenue officers business priority cases not being actively reviewed for performance evaluation purposes. Each manager may select and consult on a subset of cases that have been deemed a business priority. However, because the IRM revision removed the requirement for managers to monitor over-age cases and removed over-age cases as a business priority, managers are no longer specifically required to monitor and discuss over-age cases with revenue officers.

IRS management advised us that the requirements to monitor over-age cases were eliminated for all Collection cases to allow an emphasis on working the entire inventory instead of focusing on only a subset of cases. They believed that cases which were not designated as over-age were being treated with less priority, thus delaying resolution. IRS management believes that consultations now allow the manager to access the full inventory to identify performance trends, emerging issues, training needs, and systemic issues.

In our sample of 162 cases, it took an average of approximately 37 weeks from the date the case was assigned to a revenue officer to the date the case was closed as CNC-defunct.[6] The range of time it took to work the 162 cases was between one and 197 weeks. However, 30 of the 162 cases were closed after 65 weeks, which is considered over-age. Based on our sample results, we estimate that 969 CNC-defunct cases were over-age when closed.[7] In discussions with IRS management, they indicated that the extended time needed to close some of the corporate cases may have been because of the complexity of the case (involving multiple entities and questionable sales or transfers of assets).

Of our 30 sample cases considered over-age when closed, 20 cases continued to have consultations by managers to ensure that timely actions were being taken even though they were no longer required. The remaining 10 cases did not include consultations after the December 2011 guidance change. Of these cases:

- Five cases were in-business taxpayers when assigned and went out of business shortly before they were closed as CNC-defunct.
- Four cases were complex and required extensive work prior to closing.

[6] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the average length of time is between 31 weeks and 44 weeks.
[7] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the number of cases is between 485 and 1,453.

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Based on our case review, we could not determine the impact of the removal of the requirement to monitor and discuss over-age cases. However, because the IRM no longer specifically includes the need to monitor and discuss over-age cases, there is a risk that over-age cases may not be subjected to the same high level of management scrutiny and oversight. To mitigate the risks associated with over-age cases in revenue officers' inventories, the over-age indicator should continue to be monitored by managers and there should be ongoing communication between the revenue officers and their managers. In addition, any issues that cause a delay in the closure of an over-age case should be documented in the Integrated Collection System history. Without communication and documentation specifically about over-age cases, there is a risk that managers may not be involved in decisions about the benefits of continuing to work cases that have been in inventory for 65 weeks or more. If these cases are closed sooner from the revenue officer's inventory, more productive cases with higher collection potential than an out-of-business taxpayer case could be assigned and worked by the revenue officer.

Recommendation

Recommendation 2: The Director, Collection Policy, and the Director, Field Collection, should ensure that actions in CNC-defunct cases are taken timely. This should include requiring employees to document the reasons for any delays in taking timely actions to work cases toward closure.

> ***Management's Response:*** Management agreed with this recommendation and plans to issue a memorandum reminding Field Collection managers and revenue officers that the IRM requires revenue officers to document delays in taking timely actions and managers to review cases for timely actions.

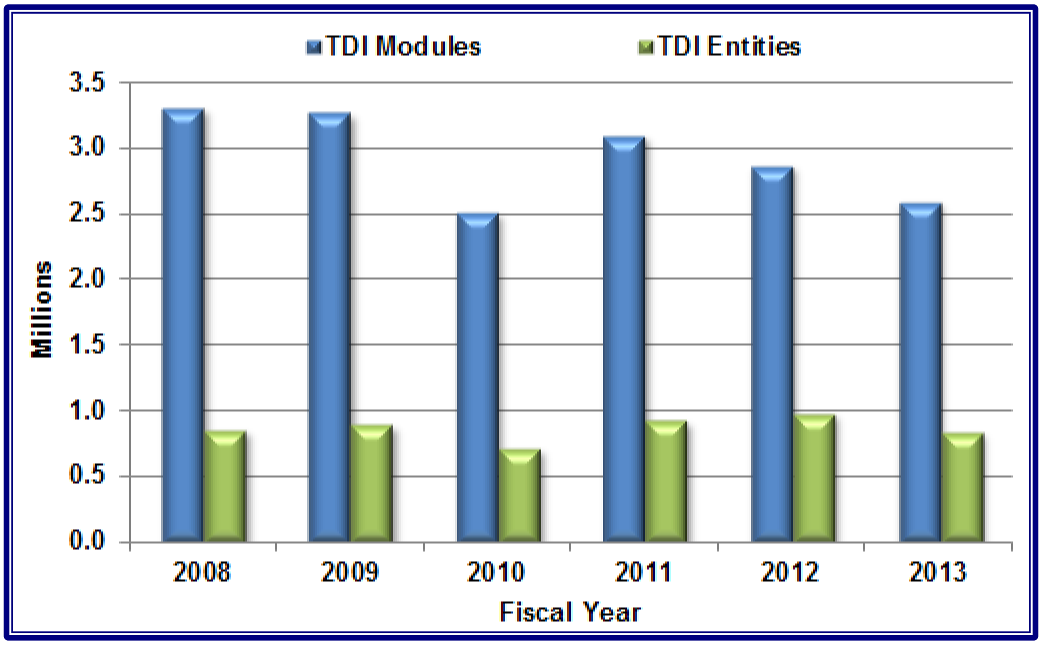
Cases Assigned Had Limited Revenue Collection Potential

We previously reported that the IRS does not consider the likelihood that revenue will be collected when assigning cases to be worked by revenue officers.[8] Case selection criteria are important because the Field is the most expensive collection operation, and the IRS has a limited number of resources within the Field to work all of the delinquent inventory. The Collection function maintains an inventory of unassigned Taxpayer Delinquency Investigations (TDI) and

[8] Treasury Inspector General for Tax Administration, Ref. No. 2014-30-068, *Field Collection Could Work Cases With Better Collection Potential* (Sept. 2014).

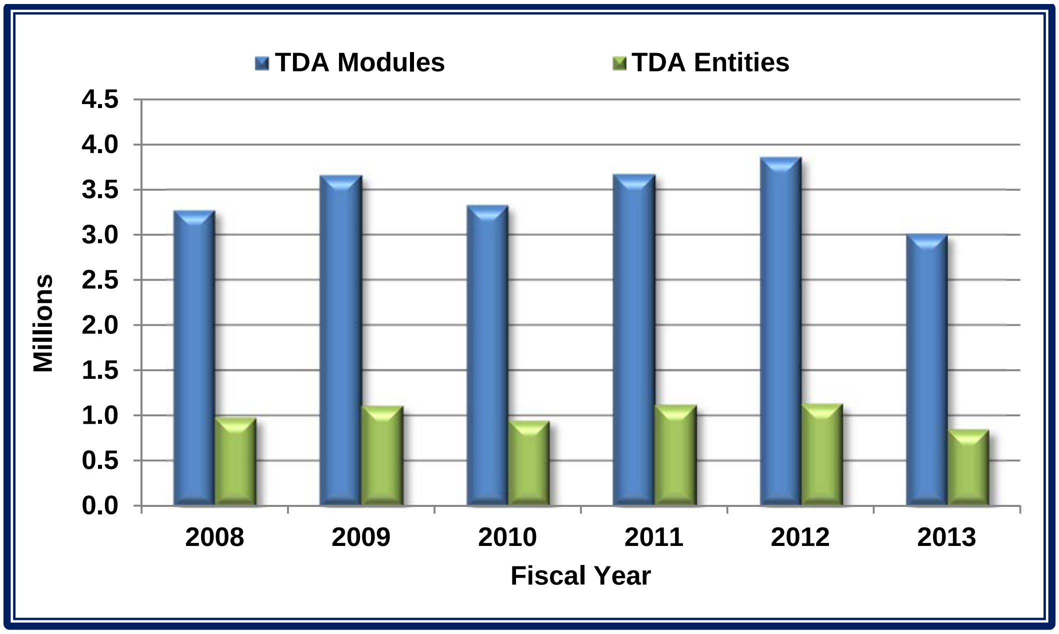
Taxpayer Delinquent Accounts (TDA) in the Queue. Figures 4 and 5 show the number of TDI and TDA cases awaiting assignment in the Queue over the past six FYs.

Figure 4: TDIs in the Queue at the End of FYs 2008 Through 2013



Source: Our analysis of IRS Collection Activity Reports for FYs 2008 through 2013.

Figure 5: TDAs in the Queue at the End of FYs 2008 Through 2013



Source: Our analysis of IRS Collection Activity Reports for FYs 2008 through 2013.

Many of these cases will not be worked. When cases are not worked, the IRS eventually removes them from active inventory. For example, in FY 2013 the IRS removed approximately 2.4 million TDA and TDI tax modules involving $12.6 billion in delinquent accounts from active inventory.

During FY 2013, the IRS closed 264,840 tax modules, involving more than $4 billion in delinquencies, as CNC-defunct. For our stratified random sample of 162 cases closed as CNC-defunct between July 1, 2012, and June 30, 2013, analysis showed that approximately 66 percent of the 162 corporations were already out of business when the case was assigned to the revenue officer. Out-of-business taxpayers are an unlikely source of revenue, raising the question of whether the IRS is choosing the most productive cases for its revenue officers. On the other hand, for employment tax cases, the IRS can access the Trust Fund Recovery Penalty[9] against individual employees of the defunct business. However, 15 percent[10] of these cases did not include delinquent employment taxes, so there was no possibility of a Trust Fund Recovery

[9] Internal Revenue Code Section (§) 6672 imposes personal liability on persons responsible for willfully failing to collect and remit taxes.
[10] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the percentage is between 8.35 percent and 22.11 percent.

Penalty assessment. Ultimately, of the 92 cases that were already out of business when assigned to a revenue officer, only 21 percent[11] had Trust Fund Recovery Penalty assessments.

IRS studies have shown that the likelihood of collection diminishes considerably as cases become older. For example, the IRS Office of Research conducted a study[12] and concluded that as more time elapses before a taxpayer makes at least one payment, it becomes less likely that the taxpayer will do so at any subsequent time. Thus, the collection potential for these cases diminishes as they age. The average time to work the 92 cases involving corporations that were already out of business when assigned was 26 weeks,[13] and the average time to work the 54 corporation cases that were in business when assigned was 61 weeks.[14]

The IRS should consider the types of cases that are being assigned to the Field and include the potential revenue to be collected. During FY 2013, 40 percent of the TDAs closed by the Field were written off as CNC and were no longer being actively worked. The dollar value of the tax liabilities on these cases was $16.1 billion, which was more than five times as much as the amount collected ($3.1 billion). Notably, $4 billion (25 percent) of the $16.1 billion that the Field Collection function wrote off as CNC involved defunct corporations.

IRS officials should ensure that the delinquent accounts in the Queue with the most collection potential are identified, selected, and assigned to the Field while balancing the need to protect taxpayers' rights and minimize taxpayer burden. Our prior report recommended that the IRS reexamine the Field workload selection criteria and strategy to determine whether they ensure that the Field prioritizes collecting revenue as well as making the best use of its limited resources. The findings in this report further support that recommendation. As part of its corrective action and overall strategy, we believe the IRS should consider the revenue potential of defunct corporations, particularly those with no employment taxes, before assigning them to be worked by the Field.

[11] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the percentage is between 12.88 percent and 29.91 percent.
[12] U.S. Department of the Treasury, IRS – The IRS Research Bulletin, Publication 1500 (Rev. 11-99).
[13] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the average length of time is between 20.64 weeks and 31.21 weeks.
[14] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the average length of time is between 45.46 weeks and 75.54 weeks. For the 162 cases we reviewed in our sample, we identified 92 that were out of business when assigned, 54 that were in business when assigned, and 16 for which we could not determine the date that they went out of business.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine if the Field Collection function[1] is performing all required collection actions before closing delinquent corporate accounts as CNC-defunct and if all tax periods for defunct corporate taxpayers are properly closed.

I. Identified IRS procedures and guidelines required for use by Small Business/ Self-Employed Division employees for closing delinquent corporation accounts as CNC-defunct.

II. Determined whether the Field performed all required collection actions before closing delinquent corporation accounts as CNC-defunct.

   A. Selected a statistically valid sample of delinquent corporation accounts closed as CNC-defunct between July 2012 and June 2013. See below for our sampling methodology.

   B. Reviewed the closed case files, including Integrated Collection System histories, to determine whether required enforcement procedures were taken and statutes considered prior to closing the delinquent corporation accounts as CNC-defunct.

      1. Determined whether sampled cases were timely and properly closed as CNC-defunct.

      2. Identified the amount of time each case was in open inventory.

      3. For cases of corporations that were in business when the cases were assigned, determined if all appropriate collection actions were taken in an effort to collect the liabilities before the business ceased operations.

      4. Determined whether required management oversight, direction, and review were followed prior to classification as CNC-defunct.

Data validation methodology

During this review, we evaluated the reasonableness of the FY 2012 CNC-defunct population by comparing the Data Center Warehouse totals with the FY 2012 IRS Collection Activity Report, *Recap of Accounts Currently Not Collectible*, Report Symbol NO-5000-149, totals. The comparison supported that the data were sufficiently reliable and could be used to meet the objective of this audit.

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

Sampling methodology

We obtained a statistically valid random sample from cases closed CNC-defunct between July 1, 2012, and June 30, 2013. The population of cases was 8,155, and we selected a sample of 162 cases based on strata that were defined to improve the projection of overall error dollars. The stratified sample consisted of 67 cases with aggregate assessed module balance of -$15,000 to $99,999, 45 cases from $100,000 to $999,999, 45 cases from $1 million to $30 million, and five cases of more than $30 million. The Treasury Inspector General for Tax Administration's contracted statistician reviewed and assisted in developing the sampling plans and projections.

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 that the following internal controls were relevant to our audit objective: IRM guidance for CNC-defunct case actions to ensure that required research is conducted before cases are closed as CNC. We evaluated these controls by reviewing statistical samples of CNC-defunct cases and interviewing Collection function personnel.

Appendix II

Major Contributors to This Report

Matthew Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
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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, Headquarters Collection, Small Business/Self-Employed Division SE:S:C:HQ
Director, Field Collection, Small Business/Self-Employed Division SE:S:FC
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Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Commissioner, Small Business/Self-Employed Division SE:S

Appendix IV

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.
Campus	The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
Collection Activity Reports	Reports that provide collection activity information from the beginning of the FY through the end of the current reporting month.
Collection Information Statement	Forms used to obtain current financial information necessary for determining how a wage earner, self-employed individual, or business can satisfy an outstanding tax liability.
Currently Not Collectible	Accounts can be declared CNC for numerous reasons including bankruptcy, defunct, hardship, unable to locate, unable to contact, decedent, *etc*.
Data Center Warehouse	Treasury Inspector General for Tax Administration function that obtains and stores numerous IRS data files and makes them available to auditors and investigators.
Field Collection	The unit in the Area Offices consisting of revenue officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.

Term	Definition
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's FY begins on October 1 and ends on September 30.
Integrated Collection System	Provides workload management, case assignment/tracking, inventory control, case analysis tools, and management information system capabilities to support Small Business/ Self-Employed Division Collection fieldwork.
Integrated Data Retrieval System	The IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.
Internal Revenue Manual	The primary official source of instructions to staff relating to the organization, administration, and operation of the IRS.
Levy	A method used by the IRS to collect outstanding taxes from sources such as bank accounts and wages.
Lien	A legal claim against current and future property, such as a house or car, and rights to property, such as wages and bank accounts. The lien automatically comes into existence if a taxpayer does not pay an amount due after receiving the first bill.
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.
Revenue Officer	Employees in the Field who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by the IRS campuses (formerly known as service centers) or the Automated Collection System.
Seizure	The taking of a taxpayer's property to satisfy an outstanding tax liability.

Term	Definition
Tax Module	Refers to each tax return filed by the taxpayer for a specific period (year and quarter) during a calendar year for each type of tax.
Taxpayer Delinquency Investigation	An unfiled tax return for a taxpayer. One TDI is issued for each delinquent tax period for a taxpayer.
Taxpayer Delinquent Account	A balance due account of a taxpayer. One TDA exists for all delinquent tax periods for a taxpayer.
Trust Fund Recovery Penalty	The penalty is assessed personally against the individual or individuals who are responsible for paying the trust fund taxes but willfully did not do so. The amount of the penalty is equal to the amount of the unpaid trust fund taxes.

Appendix V

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

MAR 26 2015

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Required Actions Were Not Always Completed Prior to Closing Defunct Corporation Cases as Currently Not Collectible (Audit # 201330018)

Thank you for the opportunity to review the subject draft report, which examined delinquent corporate accounts that are ultimately closed as currently not collectible-defunct (CNC-defunct). A case is closed as CNC-defunct when, for example, the corporation is no longer operating and all assets have been dispersed. In general, we remove a case from active inventory when we have taken all the steps in the collection process and determined that an account receivable is currently not collectible (CNC). We do this to focus our limited resources on cases where we will collect more dollars and thereby protect the government's interest. Although closing a case as CNC removes it from active inventory, the IRS can collect on the tax modules, and does collect, primarily through offsets, provided the collection statute of limitations remains open.

We appreciate your acknowledgment of the steps we took during your review to improve our procedures for processing and closing CNC-defunct cases. As you noted, we created a checklist that employees can use to ensure all required actions are taken before a case is closed, and we updated the CNC models in the Collection Inventory Delivery System that will allow us to identify cases that are CNC quicker and remove them from inventory earlier. Also, as noted in your report, the 30 cases where our revenue officers did not complete all required action were likely to have a relatively small collection potential. In fact, our research did not yield additional assets from which we could collect in 17 of the 19 cases we subsequently reviewed.

Unless a delinquent account involves employment taxes, which at least allows the government the possibility of pursuing personal liability under the Trust Fund Recovery Penalty, the likelihood of collecting revenue from defunct corporations is remote. We currently have an initiative underway with respect to employment taxes, whereby revenue officers are alerted when an employment tax deposit is missed and then the revenue officer makes timely contact with the taxpayer to pursue collection of these missed amounts in closer proximity to when these amounts were first due. Utilizing this approach will allow us to protect the government's interest in these amounts, generally before the corporation has entered the fully delinquent and then defunct stage.

We also agree with your statement that our field workload selection criteria with respect to CNC cases should ensure that we are prioritizing cases with potential collection revenue. We are taking your findings into account as we refine our overall case selection strategy in way that ensures that we are making strategic and risk-based decisions and efficiently using our limited resources.

Attached is a detailed response outlining our corrective actions. If you have any questions, please contact me, or a member of your staff may contact Scott Prentky, Director, Collection at 954-423-7318.

Attachment

Attachment

RECOMMENDATION 1:
The Director, Collection Policy and the Director, Field Collection should ensure that field employees and managers are properly trained to complete the required actions prior to closing cases as CNC-defunct.

CORRECTIVE ACTION:
In October 2014, Field Collection delivered its FY14 Leadership Continuing Professional Education "Collection Management Fundamentals" course, which included training segments and tools to improve currently not collectible closures and timely follow up actions. We will augment this training, by issuing a memorandum reminding Field Collection employees to follow the procedures in the IRM when closing cases as currently not collectible.

IMPLEMENTATION DATE:
September 15, 2015

RESPONSIBLE OFFICIAL:
Director, Field Collection, Small Business/Self Employed Division

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

RECOMMENDATION 2:
The Director, Collection Policy, and the Director, Field Collection, should ensure that actions in CNC-defunct cases are taken timely. This should include requiring employees to document the reasons for any delays in taking timely actions to work cases toward closure.

CORRECTIVE ACTION:
We believe that our Field Collection employees overwhelmingly complete their actions timely and that our managers ensure that actions are taken timely. We will, however, issue a memorandum reminding our Field Collection managers and revenue officers that the internal revenue manual requires revenue officers to document delays in taking timely actions and managers to review cases for timely actions.

IMPLEMENTATION DATE:
September 15, 2015

RESPONSIBLE OFFICIAL:
Director, Field Collection, Small Business/Self-Employed Division

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