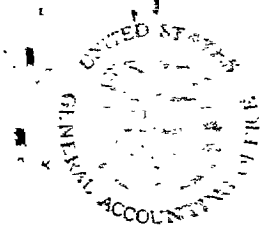

REPORT TO
THE JOINT COMMITTEE
ON INTERNAL REVENUE TAXATION
CONGRESS OF THE UNITED STATES

Collection Of Taxpayers' Delinquent Accounts By The Internal Revenue Service

B-137762

Department of the Treasury

BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-137762

To the Chairman and Vice Chairman
Joint Committee on Internal Revenue
Taxation
Congress of the United States

In response to the request of the Joint Committee on Internal Revenue Taxation, we are reporting on the Internal Revenue Service's collection of taxpayers' delinquent accounts

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of the Treasury; and the Commissioner of Internal Revenue.

Elmer B. Staats

Comptroller General
of the United States

Contents

ABBREVIATIONS

GAO	General Accounting Office
IRS	Internal Revenue Service

COMPTROLLER GENERAL'S REPORT TO THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

COLLECTION OF TAXPAYERS' DELINQUENT ACCOUNTS BY THE INTERNAL REVENUE SERVICE
Department of the Treasury
B-137762

D I G E S T

WHY THE REVIEW WAS MADE

The Joint Committee on Internal Revenue Taxation asked GAO to review the Internal Revenue Service's (IRS's) policies and procedures in handling and collecting taxpayers' delinquent accounts. (See app. I.)

FINDINGS AND CONCLUSIONS

Interest on deferred payment of estate taxes

Payment of estate taxes is generally required 9 months after a decedent's death unless IRS grants the estate an extension. As of March 31, 1972, estates that had been granted extensions owed taxes of about $347 million. The Internal Revenue Code requires that annual interest of 4 percent be charged on these taxes. This rate is 2 percent lower than the 6 percent charged on underpayments, nonpayments, or extensions of time for payment of other Federal taxes.

Since this 4-percent interest rate was established in 1938, the Government's cost of borrowing funds has increased so that it now exceeds the interest rate on estate taxes. This change results in the Government's incurring additional interest costs which the Congress may not have anticipated when it established the 4-percent rate.

Because the 4-percent interest rate on deferred estate tax payments is significantly below the rate of interest estates can earn on investments, the estates have no incentive to promptly pay their taxes if they can obtain extensions. Therefore GAO believes the interest rate on deferred estate tax payments should be closer to the Government's cost of borrowing funds. (See p. 21.)

Discharge of taxes through bankruptcy

The Bankruptcy Act provides for the discharge in bankruptcy of debts for taxes which became legally due and owing more than 3 years preceding bankruptcy. Taxpayers with high incomes and large tax liabilities have avoided paying taxes through bankruptcy.

The House Judiciary Committee has noted that the discharge of unsecured taxes legally due and owing more than 3 years preceding bankruptcy would not impose an unrealistic or unfair burden on tax authorities in auditing returns and assessing deficiencies.

However, IRS does not try to collect taxes from a taxpayer until taxes are assessed. Thus, in some cases, the delays inherent in auditing returns, assessing deficiencies, and legal processing do not permit IRS enough time to collect the taxes before they are discharged through bankruptcy.

GAO believes IRS should have 3 years from the date of assessment in which to collect taxes before such taxes can be discharged through bankruptcy. (See p. 25.)

Social security credits allowed for unpaid self-employment taxes

IRS reports to the Social Security Administration the amount self-employed persons designate on their income tax returns as self-employment income even though they may not have paid the applicable self-employment social security tax. The self-employed person thus receives credit toward social security benefits even though he has not made the required contribution.

Although IRS does not maintain statistics on the amount of self-employment social security taxes not collected, GAO believes it is a significant problem. A random sample of individual taxpayers whose accounts IRS had classified as uncollectible disclosed that about 13.6 percent of the taxpayers were self-employed and liable for paying the self-employment social security tax.

The statutes are silent on whether a person should receive social security benefit credits on self-employment income if he does not pay his social security taxes.

GAO believes the structure of the social security system--whereby funds for payment of benefits are obtained from the collection of the social security taxes--indicates the Congress did not intend a person to receive credit toward social security benefits if he does not pay the social security tax.

Giving credit for social security benefits in such cases tends to violate one of the system's fundamental premises that a self-employed person draws benefits as a result of payments he made during his working years. (See p. 30.)

Effectiveness and equity of collection procedures

After reviewing 1,096 accounts of randomly selected delinquent taxpayers--670 accounts for which IRS was actively pursuing collection and 426 accounts that IRS had classified as uncollectible--GAO believes that:

--IRS has effectively collected taxpayers' delinquent accounts.

--Taxpayers are treated equitably.

--Procedural safeguards in classifying a taxpayer's delinquent account as uncollectible insure that collection action on delinquent accounts is not prematurely suspended. (See p. 33.)

Collection of taxes withheld from employees' wages

Although IRS has recognized that collecting employee withholding taxes is a major problem, it has rarely used the penalty provisions of Public Law 85-321 which was enacted specifically to enforce collection of these taxes.

Before this law was enacted in 1958, criminal provisions of the Internal Revenue Code were of limited usefulness. IRS needed to prove that the employer willfully failed to collect or truthfully account for and pay the taxes withheld from employees' wages; that is, IRS must show that the defendant acted willfully with evil motive, bad purpose, or corrupt design of tax evasion.

Public Law 85-321 provides that IRS can require an employer who fails to collect, account for, and pay income and social security taxes withheld from an employee's wages to collect and deposit the tax in a separate bank account as a special fund in trust for the United States. Failure to comply with these special procedures is a misdemeanor which does not require proof of willfulness for conviction.

As of December 1971, delinquent employee withholding taxes totaled about $691 million and accounted for about one-third of the total delinquent taxes being actively pursued for collection by IRS. In addition, IRS considered about $379 million in withheld taxes to be uncollectible.

IRS officials advised GAO that they have not been using the special provisions of Public Law 85-321 because they considered them ineffective. GAO believes the small number of cases prosecuted under this law has not been a valid test of whether such prosecutions can effectively alleviate this problem. (See p. 37.)

Other delinquent accounts collection activities

IRS accumulates statistics on taxpayer delinquent accounts, such as the number of delinquent accounts issued and closed and the dollar amount of the delinquent accounts inventory. These statistics are included in annual budget justifications presented to the Congress.

GAO observed that the statistics

--were inflated by multiple assessments,

--included assessments for marihuana taxes although these assessments are traditionally uncollectible, and

--were inflated by invalid delinquent accounts. (See p. 42.)

An offer in compromise is a proposal by a taxpayer to settle his tax liability for less than the amount assessed. IRS regulations provide that a taxpayer's tax liability may be settled for less than the amount assessed when the liability or the collectibility of the full amount is in doubt.

During fiscal year 1972, IRS accepted 1,170 offers in compromise involving doubt as to collectibility. These offers provided for payments totaling about $5 million on liabilities totaling about $16.7 million.

GAO reviewed 61 offers in compromise involving doubt as to collectibility and concluded that taxpayers were treated equitably and that the facts and circumstances in each case justified the decision to accept or reject the offers. (See p. 48.)

This report also contains information on IRS actions to more effectively collect delinquent excise taxes on telephone services. (See p. 51.)

RECOMMENDATIONS

GAO recommends that the Joint Committee on Internal Revenue Taxation initiate legislation to:

--Amend section 6601(b) of the Internal Revenue Code of 1954 to require that the Secretary of the Treasury set the interest rate on estate taxes during extended

payment periods on the basis of the Government's borrowing cost subject to adjustment for material changes in such cost. (See p. 24.)

--Amend the Bankruptcy Act to exclude, from discharge through bankruptcy, taxes assessed within 3 years before a bankruptcy petition is filed. (See p. 29.)

--Amend section 205(c) of the Social Security Act to prohibit a person from receiving credits toward social security benefits if he has not paid the required tax on self-employment income. (See p. 32.)

GAO recommends that IRS:

--Increase the number of cases selected for prosecution under Public Law 85-321 to test whether such prosecutions can effectively alleviate the problem of withholding tax delinquencies. (See p. 41.)

--Revise its instructions for accumulating statistics to insure that inventories of taxpayer delinquent accounts represent valid receivables to the Federal Government. (See p. 46.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Acting Commissioner of Internal Revenue, by letter dated April 30, 1973, said IRS generally concurs in GAO's findings and conclusions and in most instances agrees with the recommendations. The Acting Commissioner's specific comments are included in the applicable sections of this report. (See pp. 24, 29, 32, 41, and 46, and app. II.)

MATTERS FOR CONSIDERATION BY THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

This report contains recommendations for legislative action by the Joint Committee on Internal Revenue Taxation.

CHAPTER 1

INTRODUCTION

By letter dated January 13, 1971, to the Comptroller General and the Commissioner of Internal Revenue, the Joint Committee on Internal Revenue Taxation requested that GAO act as the agent of the Joint Committee in performing certain reviews of the operations, policies, and procedures of the Internal Revenue Service (IRS). These reviews are to assist the Joint Committee in carrying out its duty under section 8022 of the Internal Revenue Code to investigate the operation, effects, and administration of the Federal tax system.

Enclosed with the joint letter to the Comptroller General and the Commissioner was another letter, also dated January 13, 1971, to the Comptroller General in which GAO was requested and authorized to undertake a study concerning the policies and procedures established by IRS to handle and collect taxpayers' delinquent accounts. (See app. I.) The letter suggested that GAO examine:

--The effectiveness of IRS programs to collect past due accounts. (See ch. 4.)

--The equities of collection procedures as applied to all taxpayers. (See ch. 4.)

--The policies and practices pertaining to taxpayers' delinquent accounts considered currently uncollectible. (See chs. 2 and 4.)

--The policies and practices pertaining to offers in compromise. (See ch. 7.)

--What changes, if any, in policies or practices need to be considered to reduce the number of taxpayers' delinquent accounts. (See chs. 6 and 8.)

--The adequacy of the resources devoted to collecting taxpayers' delinquent accounts.

In considering the adequacy of resources, we did not evaluate manpower utilization in depth. We assumed that, if IRS was effective in collecting delinquent accounts, the manpower devoted to this activity would be adequate. And since we concluded in chapter 4 that IRS has effectively collected delinquent accounts, we believe that IRS is devoting adequate resources to that activity. Also, on the basis of our analysis of the caseloads of collection personnel, it does not appear that IRS is devoting excessive resources to collecting delinquent accounts.

ORGANIZATION OF INTERNAL REVENUE SERVICE

IRS is part of the Department of the Treasury and its mission is to encourage and achieve the highest possible degree of voluntary compliance with the tax laws and regulations and to maintain the highest degree of public confidence in its integrity and efficiency. IRS encourages voluntary compliance by communicating the requirements of the internal revenue laws to the public, determining the extent of compliance and causes of noncompliance, and doing all things needed to properly enforce the law. IRS has a national office in Washington, D.C., 7 regional offices, 58 district offices, 10 service centers, a data processing center, and a national computer center.

Most of the accounts for individual income and business taxes are kept in automatic data processing master files at the national computer center in Martinsburg, West Virginia. Tax accounts which are not automated are maintained at the service centers, which also process all tax returns and related documents, maintain accountability records for taxes collected within a specified region, and forward and receive tax information to and from the national computer center and district offices.

During fiscal year 1972, IRS processed about 112 million tax returns and collected $209.9 billion in taxes. It examined about 1.7 million returns and recommended additional taxes of about $5.4 billion. IRS had about 74,000 employees and its operating costs were about $1.1 billion. About 12,300 employees were assigned to collection and taxpayer service activities.

BACKGROUND ON DELINQUENT ACCOUNTS

IRS had an inventory of 659,227 taxpayers' delinquent accounts representing assessments of about $1.9 billion as of June 30, 1972. IRS records indicated that about 45 percent of the delinquent accounts were for miscellaneous taxes (e.g., wagering, estate, and gift taxes), transferee assessments,[1] and 100-percent penalty assessments.[2] These accounts were manually maintained at the service centers. The remaining delinquent accounts were for individual and various business taxes and were maintained on magnetic tapes at the national computer center.

Information provided by IRS shows the following disposition of delinquent accounts during fiscal year 1972.

Type of disposition	Amount
	(000 omitted)
Collected	$2,232,953
Classified as uncollectible	518,787
Abated	323,268
Payment tracer or adjustment	168,309
Total	$3,243,317

Further details on each type of disposition are included in chapter 2.

---

[1]An assessment which may be made against second parties (transferees) to whom the transferor (generally the taxpayer) has transferred assets without full, fair, and adequate consideration. In general, the assessment against a transferee is the amount of the transferor's tax liability or the value of the property received by the transferee, whichever is less.

[2]An assessment which provides that any person required to withhold tax and who willfully fails to collect or truthfully account for and pay the tax is liable for a civil penalty equal to the total amount of such tax.

IRS bases its policy for collecting delinquent accounts on the taxpayer's ability to pay. A taxpayer's ability to pay is determined by (1) whether his income exceeds his expenses, (2) whether his expenses are reasonable, (3) whether he has any assets against which levy or seizure action could be taken, and (4) whether enforced collection would create undue hardship or simply inconvenience the taxpayer.

IRS collection personnel have broad discretionary powers. They must decide whether to levy against, seize, or file a lien against the taxpayer's property; accept an installment payment agreement or demand immediate payment in full; classify an account as uncollectible; or take some other action. IRS, through training programs, supervisory reviews of collection actions, and internal audits, attempts to guard against the intentional or unintentional misuse of these broad discretionary powers.

IRS training programs combine classroom and on-the-job training during the first year of a revenue officer's career. The training includes case studies, classroom simulation of actual situations, and observations of experienced revenue officers. The training emphasizes the need for the revenue officer to exercise judgment in various situations. Courses involving classroom training are also provided to revenue officer group supervisors.

Supervisors review each revenue officer's caseload at least once a year and sometimes more frequently in the case of inexperienced or less competent revenue officers. The objectives of the review are to (1) determine how well revenue officers are carrying out their responsibilities, (2) determine whether IRS policies and procedures are being followed, and (3) provide guidance.

IRS internal audit activities, carried out by about 360 technical staff members, independently review and appraise all IRS operations and determine whether the policies, practices, procedures, and controls at all levels of management are efficiently and effectively carried out. Those activities which are most directly related to collecting tax revenues and enforcing tax laws are emphasized.

SCOPE OF REVIEW

We reviewed pertinent sections of the Internal Revenue Code, its legislative history, and the IRS policies, regulations, and procedures applicable to collecting taxpayers' delinquent accounts. We also reviewed the delinquent accounts of 832 taxpayers maintained by 4 district offices consisting of (1) 437 taxpayers' accounts on which collection action was being taken--active inventory, (2) 221 taxpayers' accounts classified as uncollectible, (3) 48 taxpayers' accounts classified as uncollectible but subject to reactivation if the taxpayer's adjusted gross income increased so that further collection effort would be warranted, (4) accounts of 61 taxpayers who offered to compromise their taxes, and (5) 65 taxpayers' accounts that involved miscellaneous taxes, such as the Federal excise tax on telephone services.

We interviewed IRS supervisory and staff personnel who had collection responsibilities. We did not contact or solicit the views of any taxpayers concerning IRS operations.

We made our review at IRS' (1) national office in Washington, D.C., (2) district offices in Dallas, Manhattan, Chicago, and Reno, and (3) service centers in Austin, Texas; Ogden, Utah; Kansas City, Missouri; and Andover, Massachusetts.

CHAPTER 2

PROCEDURES RELATING TO DELINQUENT ACCOUNTS

A tax delinquency results when a taxpayer (1) files a correct return but does not pay the required tax, (2) does not file a return, or (3) files an incorrect return which understates his tax liability. However, IRS cannot initiate action to collect the delinquent tax until the tax is assessed. Therefore, the first step in collecting taxes is to establish an account against a taxpayer by assessing the amount due.

The Internal Revenue Code and the regulations established thereunder provide that IRS shall assess all taxes disclosed on a return. If a taxpayer has not filed a return, IRS--for the purpose of determining the deficiency--considers the tax disclosed by the taxpayer on a return as zero.

When IRS determines that a taxpayer has understated his tax liability on his return with respect to taxes imposed by the Internal Revenue Code on income, estates, gifts, and private foundations, IRS is required to notify the taxpayer of the deficiency (also referred to as proposed assessment) before assessing the tax. IRS assesses the amount of the understated tax liability 90 days from the date of the notice of deficiency, or 150 days if the notice of deficiency is mailed to a person outside the United States. However, if the taxpayer contests the proposed assessment by filing a petition with the U.S. Tax Court, IRS cannot assess the tax until the court's decision is final. IRS procedures provide that collection action will be withheld for 10 days after the assessment.

The date of the assessment is particularly important in collecting taxes because it is the beginning of the 6-year statute of limitation period for collection. It is also the date of the statutory lien in favor of the United States on all property and rights to property belonging to any person who has neglected or refused to pay any assessed tax.

SERVICE CENTER COLLECTION PROCEDURES

After an account has been established, the regional service center mails computer-generated notices to the

taxpayer requesting full payment of the tax liability. At this time, the unpaid account is considered to be in "notice status" and is not considered delinquent. If the taxpayer does not pay the account when in notice status, the account becomes delinquent and, depending on the amount involved, is normally sent to a district office for collection. As shown below, the type of tax determines the types and number of notices that the taxpayer will receive from the service center.

Notices on business assessments

A notice of tax due is mailed to a business taxpayer showing a due date for payment which is the date the return was due or 10 days from the date of the notice, whichever is later. If payment in full is not received in 9 weeks, the account becomes delinquent and is normally sent to the district office having collection responsibility.

The regional service centers mailed about 2,947,000 notices of past due business taxes during calendar year 1971. About 1,662,000 business accounts were closed during the year, primarily on the basis of taxpayers' response to the notices. Of the remaining accounts, those above the minimum dollar amount for issuance were sent to district offices for collection.

An accelerated issuance delinquent account, which pertains to such items as employment taxes or excise taxes of a material amount, is an exception to the above procedures. The service center sends these delinquent accounts to the district offices without mailing the usual notices to the taxpayer.

Notices on individual income assessments

The first notice mailed to an individual taxpayer has a due date for payment which is the date the return was due or 10 days from the date of the notice, whichever is later. If full payment is not received in 7 weeks, a second notice is mailed. If full payment is not received within 7 weeks after the second notice (14 weeks from the mailing of the first notice), the account is classified as delinquent and is normally sent to a district office for collection action.

The regional service centers mailed about 4.9 million first notices and 2.3 million second notices on past due individual income taxes during calendar year 1971. About 3.8 million of these taxpayers' accounts were closed, of which about three-fourths were closed on the basis of taxpayers' responses to the notices. The remaining accounts above the minimum dollar amount for issuance were sent to district offices for collection.

DISTRICT OFFICE COLLECTION PROCEDURES

The collection division at the district office collects delinquent accounts through seizure, levy, or other means. The collection division is comprised of an office branch, a field branch, and a special procedures staff. The office branch makes the initial collection effort at the district office on most accounts; however, after screening the accounts, the office branch may assign some directly to revenue officers in the field branch.

Office branch

The office branch is generally comprised of taxpayer service representatives and interviewers. Office branch personnel demand payment of delinquent taxes by correspondence, telephone, or office interview. They can file liens, issue levies, classify an account as uncollectible, or accept an installment payment agreement.

The office branch mails the taxpayer a form letter to advise him that his account has not been paid and that the law authorizes filing of tax liens and seizure of property to satisfy tax liabilities. This form letter is usually the second notice to business taxpayers and the third notice to individual taxpayers.

If the taxpayer, in response to the letter, comes to the district office, he will be interviewed by an office branch interviewer. The office branch interviewer generally will demand full payment, but, based on his judgment, can accept an installment payment agreement or classify the account as uncollectible.

If the taxpayer does not respond to the first letter, he is sent a second form letter stating that his wages, commissions, or other income will be seized if he does not

pay the tax within 10 days. The letter also states that the taxpayer's bank accounts, receivables, or other property or rights to property may also be seized.

If satisfactory disposition of the delinquent tax is not reached and there is no known source on which to levy, the account is transferred to the field branch for further collection effort.

Field branch

The field branch is comprised of revenue officers who generally handle cases in which the office branch was unsuccessful in obtaining collection and special cases which are screened by the office branch and forwarded directly to the field branch after they are received in the district office from the service center.

Revenue officers attempt to contact the taxpayer and collect the delinquent taxes. They are authorized to file tax liens; serve levies on wages, salaries, or other moneys due the taxpayer; seize and sell real and personal property; accept an installment payment agreement; or classify an account as uncollectible. Revenue officers also investigate offers in compromise[1] when the collectibility of the taxes is in doubt.

Special procedures staff

The special procedures staff advises the division and branch chiefs on technical matters involving the collection of delinquent taxes. The staff's other responsibilities include postreviewing certain accounts classified as uncollectible and processing offers in compromise when collectibility is in doubt.

---

[1]A proposal by a taxpayer to settle his tax liability for less than the amount assessed.

COLLECTION OF DELINQUENT ACCOUNTS

Some delinquent taxpayers respond to the initial collection efforts by the district offices and pay the full amount owed at that time. However, some cases require collection through installment payments, offsets, levy action, or the seizure and sale of property.

Installment payments

IRS permits those taxpayers who cannot immediately pay their full tax liability to pay in installments. Also, IRS can arrange with the taxpayer and his employer for the employer to withhold and regularly pay to IRS amounts deducted from the taxpayer's wages. Any such arrangement is left to the judgment of the office branch interviewer or the revenue officer after analyzing the taxpayer's financial condition and his ability to pay.

Collection action will be resumed and may be enforced by levy or seizure if a taxpayer defaults on the installment agreement and does not immediately notify the collection division of extenuating or unusual circumstances which have made it impossible to comply. About 48,000 delinquent accounts were being liquidated in installments as of June 30, 1972.

Offsets

A delinquent account may be paid by offset against funds due a taxpayer from the Federal Government. An offset of tax refunds due the taxpayer against a prior tax liability is a common form of offset.

Levies against taxpayers' assets

The Internal Revenue Code provides that IRS may initiate levy action against a taxpayer when he neglects or refuses to pay a delinquent tax within 10 days after notice and demand. It is IRS policy, however, to send several notices to the taxpayer over a period that may cover 18 weeks or longer before taking levy action.

A revenue officer has wide latitude as to when he will use a levy; however, it is IRS policy to initiate levy action

only after a taxpayer has been given every reasonable opportunity to satisfactorily dispose of the tax assessment.

The Internal Revenue Code lists certain items that are exempt from levy, including clothes and school books; books and tools of a trade, profession, or business worth up to $250; unemployment benefits; and workmen's compensation. IRS has established several additional exemptions, such as welfare payments, allowances for Government training and skill development programs, salaries and wages in hardship cases, income from social security, and Veterans Administration pensions and benefits.

If more than one levy is necessary to fully satisfy a tax liability, IRS times the levies to avoid undue hardship that might occur, for example, from serving successive levies on wages. A levy served to the employer attaches only the taxpayer's "take home" pay; that is, his pay after deductions for such things as taxes, hospitalization, savings bonds, and union dues. A levy may be released when the taxpayer agrees to a payment plan acceptable to IRS to liquidate the tax liability.

Sale of seized property

IRS may seize and sell a taxpayer's home and other property to liquidate Federal income taxes. Before seizing the property, however, IRS considers several factors, such as the taxpayer's equity in the property, the sale value of the property, and whether the seizure and sale of the property would cause the taxpayer undue hardship.

IRS must issue a notice of sale to the taxpayer as soon as practicable after his property is seized and after all the necessary arrangements for the sale have been completed. IRS also must publish the notice in a newspaper circulated within the county in which the property was seized.

IRS regulations also state that it is advisable to post the notice of sale in public places. Radio or television spot announcements and display advertising also may be used if necessary. IRS regulations require that the district director personally sign all advertising orders unless he has delegated this authority.

The taxpayer's name is mentioned in the advertising because IRS is offering only the taxpayer's right, title, and interest in the property seized. The taxpayer's interest is subject to any prior outstanding mortgages, encumbrances, or other liens in favor of third parties which are valid against the taxpayer and are superior to the lien of the United States.

- - - -

During fiscal year 1972, IRS issued 914,413 levies, filed 349,359 liens, and made 23,331 seizures of property and collected $2.2 billion from 2,163,749 delinquent accounts.

CLASSIFYING AN ACCOUNT AS UNCOLLECTIBLE

IRS classified about 362,000 delinquent accounts as uncollectible during fiscal year 1972. The accounts totaled about $519 million and consisted of automated and manually maintained accounts of $337 million and $182 million, respectively.

An account is classified as uncollectible when the likelihood of collection is so remote that IRS considers it unwise to devote further manpower to it or when the cost of collection does not justify the effort. Accounts are considered uncollectible if (1) the balance owed is small, (2) the taxpayer has no assets, (3) the taxpayer cannot be located, or (4) collection would cause the taxpayer undue hardship.

Classifying an account as uncollectible does not necessarily mean that the potential revenue is irrevocably lost to the Government. The account is removed from the active inventory until there is an indication that it may be collectible, at which time IRS resumes collection efforts.

In most cases, if the taxpayer can be located, IRS must obtain a statement of financial condition before it classifies an account as uncollectible. If a taxpayer refuses to furnish a financial statement, however, IRS procedures provide that the account may be classified as uncollectible if the taxpayer's ability to pay and standard of living show that the account should be so classified. The extent to which financial information is verified is commensurate with the type and amount of tax due.

Unless IRS files a lien at a public office designated by State or Federal law, the statutory lien established by the Internal Revenue Code against the property of any person who has not paid his assessed tax is not valid against certain creditors of the taxpayer. Accordingly, IRS requires that a lien against the taxpayer be filed before classifying an account as uncollectible if the aggregate outstanding liability is a material amount, unless (1) the taxpayer is deceased, (2) the tax is owed by a corporation that has gone bankrupt, or (3) the statutory period of collection has expired. A lien may be filed on any delinquent account if such action is deemed necessary.

An account may be classified as uncollectible with a stipulation that a mandatory followup be made at some future date if

--the taxpayer's ability to pay is expected to improve at some specific future date,

--a specific lead is to be checked at a certain future time to locate the taxpayer,

--subsequent payments are to be made on accounts classified as uncollectible,

--the statutory collection period needs to be extended by waiver or suit, or

--a notice of lien needs to be refiled.

Cases where taxpayer cannot be located

Some delinquent accounts are classified as uncollectible because the taxpayer cannot be located. Criteria for classifying an account as uncollectible for this reason vary according to the amount of liability and whether the delinquency involves individual income or business taxes. Delinquent accounts on individual income taxes with a low initial unpaid balance, other than accounts of repeaters or taxpayers with other active accounts, can be classified as uncollectible by the office branch if the notices mailed to the taxpayers have been returned as undeliverable. The only sources that must be checked to try to locate the taxpayer are street, city, and telephone directories and the taxpayer's former employer, if known.

Revenue officers investigate delinquent accounts on business taxes and all other accounts where the taxpayer cannot be located before the accounts are classified as uncollectible. Based on the circumstances in each of these cases, the revenue officer decides what attempts to take to locate the taxpayers.

Undue hardship cases

IRS' policy for collecting delinquent accounts is based on the taxpayer's ability to pay. IRS generally does not classify an account as uncollectible if the taxpayer has any assets or income which are by law subject to levy. IRS may classify an account as uncollectible, however, if in its judgment, a levy or other collection action would cause undue hardship. IRS training guidelines state that undue hardship requires evidence that (1) the taxpayer does not have enough cash over and above necessary working capital or other assets convertible to cash at current market prices to pay the tax, although he may have assets that could be sold at a sacrifice and (2) the taxpayer is unable to borrow the money to pay the tax except on terms that would inflict severe hardship.

Reactivating uncollectible accounts

IRS reactivates an account if it receives additional information about the taxpayer which, in its judgment, indicates that the chances of collection have improved.

When a delinquent account on individual income taxes is classified as uncollectible because collection would cause the taxpayer undue hardship, the IRS employee making this determination selects an adjusted gross income level that, in his judgment, would represent a large enough increase in the taxpayer's income to warrant additional collection effort. The income level selected may range from $4,000 to $14,000.

IRS computers are programed to automatically reactivate an account for further consideration of its collectibility if an income tax return filed by the taxpayer in subsequent years shows an adjusted gross income equal to or greater than the amount previously selected. An account classified as uncollectible because the taxpayer could not be located will also be automatically reactivated if the taxpayer files an income tax return in a subsequent year.

An uncollectible business tax delinquency will be automatically reactivated only when a taxpayer who previously could not be located subsequently files another business tax return using the same employer identification number.

- - - -

All accounts classified as uncollectible are reviewed by the supervisor of the employee who first determined that the account was uncollectible. The district office special procedures staff reviews all uncollectible accounts for which the liability is $1,000 or more and a small percentage of those for which the liability is less than $1,000.

ABATEMENTS

During fiscal year 1972, about 48,000 delinquent accounts, amounting to approximately $323 million, were abated (canceled or reduced in amount). As a general rule, the Internal Revenue Code authorizes IRS to abate that portion of any tax liability which was (1) excessive, (2) assessed after the expiration of the statute of limitation, or (3) erroneously or illegally assessed. Delinquent accounts normally are abated when the tax liability is discharged through bankruptcy proceedings, when a jeopardy assessment[1] is set aside, or when a 100-percent penalty assessment or transferee assessment has been paid by one of the parties against whom the tax had been assessed.

PAYMENT TRACERS AND ADJUSTMENTS

IRS disposed of about 136,000 delinquent accounts amounting to $168 million through payment tracers and adjustments in fiscal year 1972.

A payment is traced normally after a taxpayer complains or inquires about receiving a bill or notice from IRS after

---

[1]An assessment made when the taxpayer is, or appears to be, designing to place his property beyond the reach of the Government, either by removing it from the United States, by concealing it, by transferring it to other persons, or by dissipating it. When a jeopardy assessment is made, the 10-day period during which collection action must be withheld after an assessment is made does not apply.

he has paid his taxes. This occurs when the payment is (1) inadvertently separated from the return during processing, (2) applied to other liabilities, (3) not mailed at the time the return was filed, or (4) not properly identified by the taxpayer for application to the appropriate tax account.

Request for adjustments may stem from duplicate assessments, omitted exemptions, errors in dividend retirement credits, errors in computing the tax, processing joint returns as separate returns, invalid assessments, or errors in processing.

SPECIAL COLLECTION PROCEDURES

Section 6672 of the Internal Revenue Code provides that any person who is required to withhold tax and who willfully fails to collect or truthfully account for and pay the tax is liable for a civil penalty equal to the total amount of such tax. Before classifying withholding taxes outstanding against a corporation as uncollectible, IRS considers whether responsible officers or employees of the corporation should be assessed the 100-percent penalty. Revenue officers and their supervisors determine who is a responsible officer or employee and recommend such an assessment.

Section 6901 of the Internal Revenue Code provides that, under certain circumstances, assessments may be made against second parties to whom assets have been transferred without full, fair, and adequate consideration.

Thus, the 100-percent penalty assessment and the transferee assessment are additional means by which IRS may collect taxes considered uncollectible from the taxpayer who is primarily liable.

CHAPTER 3

MATTERS FOR CONSIDERATION BY THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

This chapter includes our findings, conclusions, and recommendations for changes in legislation on the following subjects.

--Need to change interest rate charged on estate taxes during extended payment periods.

--Tax liabilities of high income individuals discharged through bankruptcy.

--Self-employment income reported for credit toward social security benefits although tax was not paid.

NEED TO CHANGE INTEREST RATE CHARGED ON ESTATE TAXES DURING EXTENDED PAYMENT PERIODS

Payment of estate taxes is generally required 9 months after a decedent's death unless, in accordance with authority contained in the Internal Revenue Code, IRS grants the estate an extension. IRS may grant extensions of up to 1 year for reasonable cause and extensions not to exceed 10 years in cases of undue hardship or when an estate consists largely of interest in a closely held business. IRS may also grant extensions up to 3-1/2 years after termination of a precedent interest where reversionary or remainder interest in property is involved. As of March 31, 1972, estates that had been granted extensions owed taxes of about $347 million. Section 6601(b) of the Internal Revenue Code requires that an annual 4-percent interest rate be charged on these taxes during the extended payment period.

During the last 6 years, the annual average rate of interest on the public debt has exceeded the 4-percent interest rate charged on estate taxes. Also, the effective interest rate on bonds with maturities of 10 or more years and notes with maturities from 5 to 7 years issued by the

Department of the Treasury in 1971 and 1972 have all exceeded 6 percent. The Federal Government has therefore incurred interest costs in recent years which we believe the estates should bear because, during the extension period, the Federal Government forgoes the availability of the taxes which could have been used to reduce current borrowings to finance the public debt or to repay previous borrowings.

IRS does not accumulate national statistics on the amount of estate taxes for which payment requirements have been extended. At our request, however, IRS obtained the amount of such estate taxes from each of its service centers as of March 31, 1972, and advised us that the national total was about $347 million. We do not know whether the $347 million is representative of the amount of such estate taxes that are outstanding. However, it indicates that additional interest costs to the Government during recent years because of such extensions could have exceeded $6 million a year, because (1) the effective interest on long-term Government borrowings has exceeded 6 percent in recent years and (2) 6 percent is a reasonable annual interest rate because it is the rate authorized to be charged on underpayments, nonpayments, or extensions of time for payment of other Federal taxes. (See section 6601(a) of the Internal Revenue Code.)

The Government apparently established a 4-percent interest rate on estate taxes being paid on an extended payment basis--rather than a 6-percent interest rate--to alleviate some of the hardships that result from imposing the tax on large estates. However, it was apparently not intended that the relief from the lower interest rate would result in an interest cost to the Government, because it was stated during the Senate hearings on the revenue bill of 1938 that the rate should be greater than the interest rate at which the Government was borrowing. The 4-percent interest rate imposed by the Revenue Act of 1938 was, in fact, about 1.4 percent above the average interest on public indebtedness during fiscal year 1938. (See p. 454 of the March 1938 hearings before the Senate Committee on Finance.)

During fiscal years 1938 through 1966, the annual interest rate on the public debt averaged about 2.6 percent and ranged from 1.929 percent to 3.988 percent. Thus, the average interest rate on the public debt during these 29 years did not exceed the 4-percent interest rate imposed on estate taxes.

However, as shown below, the average rate of interest on the public debt for fiscal years 1967 through 1972 exceeded 4 percent.

Fiscal year	Average interest rate
1967	4.039
1968	4.499
1969	4.891
1970	5.557
1971	5.141
1972	5.093

The public debt is composed of bills, notes, and bonds with maturities ranging at the time of issuance from 91 days to greater than 25 years. The average interest rate during a fiscal year, as cited above, is based on interest rates on securities of varying maturities, some of which were issued many years ago, and therefore is not a good gauge of the current cost to the Government of borrowing funds. Among the public debt obligations, the interest rate on Treasury notes, which have maturities ranging from 1 to 7 years, most nearly approximates the rate for borrowing funds for the periods covered by extensions for payment of estate taxes because such extensions range up to 10 years.

From February through August 1972, the Treasury issued five notes. Four of the notes had maturities ranging from about 3 to 7 years with interest rates ranging from 5-3/4 to 6-1/4 percent, and the remaining note had a 1-year maturity with a 4-3/4 percent interest rate. As of September 29, 1972, the market yield--that is the effective interest that will be earned by a purchaser in the open market--exceeded 6 percent on the four notes and was 5.27 percent on the note with a 1-year maturity.

Conclusion

Since the establishment in 1938 of the 4-percent interest rate on estate taxes for which extended payment periods are granted, the Government's cost of borrowing funds had increased so that it now exceeds the interest rate on estate taxes. Thus the Government incurs additional interest costs which the Congress may not have anticipated when it

established the 4-percent rate. Also, because the 4-percent interest rate on deferred estate tax payments is significantly below the rate of interest that estates can earn on investments, the estates have no incentive to promptly pay their taxes if they are granted extended payment periods. We therefore believe that the Joint Committee should consider revising section 6601(b) of the Internal Revenue Code.

We believe that the interest rate on deferred estate tax payments should be closer to the Government's cost of borrowing funds and that the Secretary of the Treasury should establish the rate on the basis of market yields on Treasury notes or some other appropriate measure of the Government's borrowing cost. For simplicity of administration, we believe also that the interest rate established for deferred estate tax payments should not be adjusted for minor fluctuations but should remain in effect until the Secretary determines that the rate is substantially out of line with the Government's borrowing cost.

Recommendations to the Joint Committee on Internal Revenue Taxation

We recommend that the Joint Committee on Internal Revenue Taxation initiate legislation to amend section 6601(b) of the Internal Revenue Code to require that the Secretary of the Treasury set the interest rate on estate taxes during extended payment periods. We recommend also that the rate be based on the Government's borrowing cost and be subject to adjustment for material changes in such cost.

Internal Revenue Service comments

By letter dated April 30, 1973 (see app. II), the Acting Commissioner of Internal Revenue stated that the recommendation raises a matter of policy. He explained that in the past the Congress has held that a disparity should exist between the interest rates applicable to underpayments of estate taxes for which extensions have been granted and other Internal Revenue taxes to mitigate, at least to some extent, the hardship on certain estates. He concluded, however, that consideration might well be given to increasing the interest rate to the present 6-percent charge on underpayments or delayed payments.

TAX LIABILITIES OF HIGH INCOME INDIVIDUALS DISCHARGED THROUGH BANKRUPTCY

Taxpayers with high incomes have avoided paying taxes by taking advantage of the Bankruptcy Act (11 U.S.C. 1). Further, because of delays inherent in auditing returns, in assessing deficiencies, and in going through legal processes, IRS in all cases is not permitted sufficient time to collect the taxes before they are discharged through bankruptcy. Although the number of such cases does not appear to be large, the dollar amounts in the individual cases are material.

Section 17 of the Bankruptcy Act (11 U.S.C. 35), as amended by Public Law 89-496, approved July 5, 1966, provides for the discharge in bankruptcy of debts for taxes which became legally due and owing more than 3 years preceding bankruptcy. Taxes withheld from employees' wages, taxes based on a false or fraudulent return, and taxes that the bankrupt willfully attempted to evade or defeat cannot be discharged in bankruptcy.

In the House Judiciary Committee report on the bill enacted as Public Law 89-496 (H. Rept. No. 687, 89th Cong., 1st sess.), it was stated that the fundamental policy of the Bankruptcy Act is to provide means for (1) effectively rehabilitating the bankrupt and (2) equitably distributing his assets among his creditors.

The Committee report noted that (1) under the then existing law, debts for taxes could not be discharged and taxes had to be paid before other general creditors were paid, (2) an honest but financially unfortunate debtor might be prevented from making a fresh start by an overwhelming liability for accumulated taxes, and (3) the act discriminated against the individual or unincorporated small businessman in that a corporate bankrupt normally ceases to exist after bankruptcy and tax claims against it go unsatisfied without further recourse.

The report also noted that wage and tax claims were superior to general creditors' claims. Because tax claims could not be discharged, tax collectors had allowed uncollected tax claims to accumulate until little if anything was left to general creditors. The report also stated that,

under the proposed change to the act, only unsecured taxes legally due and owing more than 3 years before bankruptcy would be discharged and that such a period would not impose an unrealistic or unfair burden on tax authorities in auditing returns and assessing deficiencies.

IRS and the courts have interpreted the phrase "legally due and owing" to mean the due date for filing a return, for example, April 15 of the succeeding year for individual income taxes. Thus, the 3-year period starts on the date the tax was due rather than the date the tax was assessed. Because IRS does not take collection action until after taxes are assessed, in certain cases it does not have 3 years in which to collect the tax. Delays in auditing returns and assessing deficiencies consume part of the 3 years because IRS is generally auditing tax returns that are at least 1 year old. This reduces the 3-year period to 2 years or less when an assessment is proposed as a result of an audit.

A taxpayer can create additional delays by taking advantage of various appeal rights. A taxpayer can appeal a proposed assessment at various levels within IRS, which may consume several months. He then may choose to make an offer in compromise or appeal his case to the U.S. Tax Court. Cases appealed to the U.S. Tax Court may be tied up several years before a final judgment is rendered and the taxes assessed. Thus, a taxpayer can keep his case held up in various appeals for more than 3 years so as to put his tax liabilities beyond the 3-year period.

The following cases illustrate how IRS had less than 3 years to collect tax liabilities before bankruptcy proceedings were instituted.

Case 1

On August 26, 1966, a physician filed tax returns for 1953 through 1965. In November 1966 IRS assessed the taxpayer for the taxes owed for these years and started its normal collection action, after which the taxpayer submitted an offer in compromise. The revenue officer elected to suspend collection action pending an IRS review of the offer in compromise.

The taxpayer later withdrew the offer in compromise and on February 29, 1968, filed a petition in bankruptcy to discharge his indebtedness. In June 1968, taxes and accrued interest totaling $45,283 for the years 1956 through 1960 and for 1963 were discharged in bankruptcy. All other Federal taxes had been paid by the taxpayer.

In a sworn statement dated February 26, 1968, the taxpayer stated that he had an income of approximately $60,000 in 1966 and $71,000 in 1967.

From the time the taxpayer filed his delinquent returns until he filed the petition in bankruptcy, IRS had only about 18 months to collect the taxes or locate assets which it could seize. If the taxpayer had filed a petition in bankruptcy sooner, IRS would have had less than 18 months to attempt to collect the major part of the taxes, because at the time the tax returns were filed, taxes for 1956 through 1960 had been legally due and owing for over 3 years and could have been discharged in bankruptcy.

Case 2

This taxpayer is an entertainer who had a personal service contract with a hotel which paid him $15,000 a week whenever he performed. On August 13, 1969, IRS advised the taxpayer of proposed tax assessments for the years 1961 through 1964 resulting from an audit. (This proposed assessment was within the statute of limitation because for each of the 4 years the taxpayer agreed to extend the statute of limitation.) IRS advised him also that he had 90 days in which to initiate an appeal action against the proposed assessments. The taxpayer protested the proposed assessments by petition to the U.S. Tax Court on November 10, 1969.

IRS subsequently learned that the taxpayer intended to agree to the assessment of the taxes and then file a bankruptcy petition under section 17 of the Bankruptcy Act. Because of this, IRS initiated a jeopardy assessment against the taxpayer on Friday, June 25, 1971, and 3 days later seized a $7,000 boat owned by the taxpayer. On Friday, July 9, 1971, the U.S. Tax Court issued two decisions--establishing the taxpayer's tax deficiencies for 1961 through 1964--in which it was stated that the findings of the Court incorporated the facts agreed to by the taxpayer and IRS. Three days later on Monday, July 12, 1971, the taxpayer filed

a petition in bankruptcy listing Federal tax liabilities of $277,797.

The taxpayer also owed State and local taxes of $21,045, secured claims of $435,743, and unsecured claims of $49,553. His secured creditors held securities valued between $175,000 and $210,000.

Because the taxes were legally due and owing more than 3 years before the jeopardy assessment, IRS had only 10 working days between the date of the jeopardy assessment and the date of filing the bankruptcy petition to collect the taxes or to locate assets against which seizure action could have been taken. However, one of the taxpayer's creditors objected to the discharge of the taxpayer's indebtedness and, as of December 31, 1972, final action on the bankruptcy petition was still pending.

It is difficult for IRS personnel to decide how aggressively to pursue collection efforts against delinquent taxpayers whose financial condition makes them eligible to have their debts discharged through bankruptcy. If they forgo enforcing collection in hopes that the taxpayer's financial situation may improve in the future, they risk allowing the taxes to become more than 3 years old and subject to discharge through bankruptcy. However, if they take collection action immediately, they may cause undue hardship or precipitate the taxpayer's bankruptcy.

Under various provisions of the Bankruptcy Act, IRS and other creditors can request the U.S. district courts to bar the discharge of a bankrupt's debts for such reasons as filing a false or fraudulent return or attempting to conceal assets. IRS has occasionally been successful in having the U.S. district courts bar taxpayers from having their debts discharged. However, an IRS official stated that this places an undue burden on its legal staff.

- - - -

In a July 14, 1961, letter to the Chairman, House Committee on the Judiciary, the Assistant Secretary of the Treasury commented on a bill to amend the Bankruptcy Act which was not enacted. He questioned whether the proposed 3-year period to be used in determining the dischargeability of taxes would run from the due date of the return or from

the date of assessment. He stated that, if the 3-year period ran from the due date of the return, IRS often would have little or no opportunity to collect the tax before the liability would be discharged through bankruptcy. The Assistant Secretary's letter was included in House Report No. 687.

Conclusion

The Bankruptcy Act, as amended in 1966, gives certain preferences to the Federal, State, and local governments not given other creditors by providing that taxes must be "due and owing" more than 3 years before they are eligible for discharge through bankruptcy. However, the determinations by IRS and the courts that the 3-year period starts on the due date for filing a return rather than from the date of assessment substantially reduces the time that IRS has to collect the taxes. This time is further reduced if the taxpayer takes advantage of various appeal rights within IRS and the courts. As a result, IRS in some cases has little or no time to collect the tax before the taxpayer files a petition in bankruptcy. To make the preference given the Federal, State, and local governments more meaningful, we believe that IRS and other taxing authorities should have 3 years from the date of assessment in which to collect the taxes before the taxes can be discharged through bankruptcy.

Recommendation to the Joint Committee on Internal Revenue Taxation

We recommend that the Joint Committee on Internal Revenue Taxation initiate legislation to amend the Bankruptcy Act to exclude, from discharge through bankruptcy, taxes assessed within 3 years before a bankruptcy petition is filed.

Internal Revenue Service comments

The Acting Commissioner stated that the recommendation raises a matter of legislative policy. He explained that, although the provisions of the Bankruptcy Act are intended to help rehabilitate the bankrupt, some taxpayers have used them to defraud creditors, particularly IRS. He concluded that, if the assessment date became the controlling date for discharge, the problem of a taxpayer filing delinquent returns for prior periods and then following up with a petition in bankruptcy would be virtually eliminated.

SELF-EMPLOYMENT INCOME REPORTED FOR CREDIT TOWARD SOCIAL SECURITY BENEFITS ALTHOUGH TAX NOT PAID

IRS reports to the Social Security Administration the amount self-employed persons designate on their income tax returns as self-employment income even though such persons may not have paid the applicable self-employment social security tax. The self-employed person thus receives credit toward social security benefits even if he has not made the required contribution. Although IRS does not maintain any statistics on the amount of self-employment social security taxes that are not collected, we believe that it is a significant problem. Our random sample of individual taxpayers whose accounts IRS had classified as uncollectible disclosed that about 13.6 percent of the individuals were self-employed and were liable for paying the self-employment social security tax.

Under the present procedure, a self-employed person reports his self-employment income and computes the income and social security tax due on his return. IRS reports the self-employment income subject to social security taxes as shown on the return to the Social Security Administration without noting whether the tax was paid. The Social Security Administration therefore credits the self-employment income whether or not the tax was paid. The income recorded by the Social Security Administration for an individual during his working or productive years is the basis on which subsequent social security benefits are computed and paid to the individual.

Both IRS and the Social Security Administration are aware that (1) self-employed persons receive benefit credits even though they do not pay their social security taxes and (2) the statutes do not provide for adjusting a person's social security records for nonpayment of social security taxes and are silent on whether a person should receive benefit credits if he has not paid his social security taxes. Neither agency, however, has proposed legislation to clarify the matter.

We randomly selected and examined the accounts of 125 individual taxpayers that IRS had classified as uncollectible. Seventeen of the taxpayers were self-employed. Summaries of two of the self-employed taxpayers' accounts follow.

Case 1

In June 1967, a self-employed architect, age 70, voluntarily disclosed that he failed to file tax returns for 1943 through 1966. The delinquent returns were filed in June 1968. In October 1968, IRS classified $31,747 of the taxes owed, including the amount for social security taxes, as uncollectible due to hardship. IRS records showed that the taxpayer was enrolled in the hospital insurance program administered by the Social Security Administration and funded from social security tax collections.

Case 2

During August 1969, IRS issued a $602 delinquency against a self-employed salesman for his 1968 individual taxes. IRS visits to his residence revealed that he was in his late twenties, single, unemployed, and being supported by his parents. A financial statement obtained from the taxpayer on May 25, 1970, showed that he had equity of $1,000 in an automobile and debts of $4,800 consisting of credit card charges of $1,000 and loans of $3,800, including an automobile loan of $2,400. IRS did not find any assets which warranted collection action and thus, on July 15, 1970, classified the delinquent account as uncollectible because of hardship.

Although the taxpayer is a young man, his earnings during calendar year 1968 may be used eventually in computing his social security benefits even though he did not pay social security taxes on such earnings.

Conclusion

The statutes are silent on whether a person should receive social security benefit credits on self-employment income if he does not pay his social security taxes. But we believe that the structure of the social security system, whereby funds for the payment of benefits are obtained from the collection of the social security taxes, indicates that the Congress did not intend a person to receive credit toward social security benefits if he does not pay the social security tax. We also believe that giving credit for social security benefits in such cases tends to violate one of the fundamental premises on which the system is based, that a

self-employed person draws benefits as a result of payments made by him during his working years.

Recommendation to the Joint Committee on Internal Revenue Taxation

Because it is inequitable for a person to receive benefits from a fund to which he had not made his legally required contribution, we recommend that the Joint Committee on Internal Revenue Taxation initiate legislation to amend section 205(c) of the Social Security Act (42 U.S.C. 405(c)) to prohibit a person from receiving credits toward social security benefits if he has not paid the required tax on self-employment income.

Internal Revenue Service comments

The Acting Commissioner stated that IRS agrees with the finding and recommendation.

CHAPTER 4

EFFECTIVENESS AND EQUITY OF PROCEDURES FOR COLLECTING DELINQUENT ACCOUNTS

We reviewed randomly selected taxpayers' delinquent accounts actively pursued for collection and accounts classified as uncollectible and concluded that:

--IRS has been effective in collecting taxpayers' delinquent accounts.

--Taxpayers are treated equitably.

--Procedural safeguards involved in classifying a taxpayer's delinquent account as uncollectible provide assurance that collection action on delinquent accounts is not prematurely suspended.

We did not contact or solicit the views of any taxpayers concerning IRS operations. Rather, our conclusions are based solely on information obtained by interviewing IRS personnel and reviewing IRS records and internal operating policies and procedures. Thus, this report does not contain any taxpayers' views on how effectively or equitably IRS is administering the delinquent accounts collection program.

SAMPLE OF DELINQUENT ACCOUNTS

To ascertain the effectiveness and equitableness of IRS collection activities, we examined 670 delinquent accounts of 437 taxpayers randomly selected from the automated records of individual and business delinquent accounts. We also reviewed some manually maintained accounts, including accounts for wagering, estate, and gift taxes.

The 670 delinquent accounts involved assessed taxes of about $1,068,000. At the conclusion of our fieldwork, the status of collection efforts on the delinquent accounts was as follows:

	Delinquent taxes	
	Amount	Percentage
Accounts closed:		
Collected	$ 721,608	67.6
Classified as uncollectible	58,597	5.5
Abated	23,757	2.2
Collection action pending	264,192	24.7
Total	$1,068,154	100.0

IRS personnel generally followed the prescribed procedures for collecting taxpayers' delinquent accounts and used the various legal means authorized by the Internal Revenue Code to effect collection. The initial collection action at a district office on delinquent accounts was usually made by clerical-type personnel who demanded payment by correspondence, telephone, or office interview. The more difficult cases were transferred to revenue officers for additional collection action.

In efforts to collect the taxes due from the 437 taxpayers, IRS filed liens against the property of 61 taxpayers, issued levies against the assets of 118 taxpayers, and seized cash and other property from 6 taxpayers. In some cases, more than one levy was issued against the same taxpayer at different times in an effort to collect the entire tax.

The 437 taxpayers were given adequate notice and reasonable opportunity to pay their tax delinquencies before liens were filed or levies were issued and IRS procedures for collecting delinquent taxes, as summarized in chapter 2, were consistently applied.

Conclusions

The results of our sample--67.6 percent of the delinquent accounts collected and collection action pending on another 24.7 percent at the conclusion of our fieldwork--shows that IRS is collecting the major portion of delinquent accounts. We also believe that the 5.5 percent of delinquent accounts shown by our sample as being classified as uncollectible is reasonable from a management standpoint.

Because these taxpayers were given adequate notice and reasonable opportunity to pay their tax delinquencies before liens were filed or levies were issued and because collection procedures were consistently applied, we believe that the taxpayers were treated equitably.

SAMPLE OF UNCOLLECTIBLE ACCOUNTS

Taxpayers' delinquent accounts are classified as uncollectible if (1) the balance owed is small, (2) the taxpayer has no assets or cannot be located, or (3) collection would cause undue hardship to the taxpayer. Classifying an account as uncollectible removes it from the inventory of accounts on which collection efforts are being taken. This action, however, does not necessarily mean that the potential revenue is irrevocably lost. Collection efforts may be resumed within the 6-year statute of limitation period of the Internal Revenue Code if there is an indication that the tax is collectible. For example, a taxpayer's uncollectible account will be reactivated for further collection action if the taxpayer later files an income tax return which indicates that he can pay his delinquent tax.

At the 4 district offices where we conducted our review, we examined the 426 delinquent accounts of 221 taxpayers randomly selected from the automated records of individual and business accounts classified as uncollectible. The reasons for classifying the accounts as uncollectible and the amounts involved follow.

Reason classified as uncollectible	Number of accounts	Tax liability	
		Amount	Percentage
Defunct corporations	144	$352,673	75.0
Collection would cause undue hardship	123	83,890	17.8
Unable to locate taxpayer	103	26,213	5.6
Responsible persons deceased	10	7,102	1.5
Low dollar amounts--uneconomical to pursue collection	46	404	.1
Total	426	$470,282	100.0

Conclusion

The procedures for administering uncollectible accounts provide for equitable treatment of the taxpayers and adequate safeguards to insure that IRS does not prematurely suspend collection action on delinquent accounts. Our review of the above 426 accounts also indicated that the prescribed procedures were generally being followed.

CHAPTER 5

NEED TO STRENGTHEN COLLECTION PROCEDURES FOR TAXES WITHHELD FROM EMPLOYEES' WAGES

IRS recognizes that collecting social security and income taxes withheld from employees' wages is a major problem in collecting delinquent taxes. As of December 1971, such deliquent taxes totaled about $691 million and accounted for about one-third of the total delinquent taxes being actively pursued for collection by IRS. In addition, IRS considered about $379 million in withheld taxes to be uncollectible.

Although IRS recognizes the problems involved in collecting delinquent withholding taxes and the significant amounts involved, it is not using to any significant extent the penalty provisions of Public Law 85-321 (72 Stat. 5), approved on February 11, 1958, to aid in collecting these taxes.

Public Law 85-321 was designed to eliminate withholding tax delinquencies to the fullest extent possible. This law was enacted after the House Committee on Ways and Means and the Senate Committee on Finance recognized that to permit withholding tax delinquencies to continue places an unfair burden on law-abiding employers and the taxpaying public. The committee reports noted that delinquent withholding taxes were a relatively small portion of the total taxes withheld from employees' wages.

The committee reports also recognized that the criminal provisions of section 7202 of the Internal Revenue Code, which make it a felony to willfully fail to collect or truthfully account for and pay the taxes, were of limited usefulness because it was difficult to prove such willfulness. Proof of willfulness in a felony prosecution requires a showing that the defendant acted willfully with evil motive, bad purpose, or corrupt design of tax evasion.

Because of this difficulty, the Congress enacted Public Law 85-321 which amended the Internal Revenue Code by adding sections 7215 and 7512. Section 7512 provides, in part, that an employer who is required to collect, account for, and pay income and social security taxes withheld from an employee but fails to do so can be required, by notice from IRS, to collect and deposit the tax in a separate bank account as a

special fund in trust for the United States until the tax is paid to the Government. Section 7215 makes failure to comply with section 7512 a misdemeanor, and any person convicted thereof can be fined up to $5,000 and imprisoned up to 1 year. Proof of willfulness is not required.

The penalty does not apply to persons who can show reasonable doubt that the law required collection of the tax. For example, the penalty does not apply to a person showing reasonable doubt as to whether he was an employer. Neither does the penalty apply to a person who can show that the failure to collect or deposit the taxes in a separate account "was due to circumstances beyond his control." Lack of funds immediately after the payment of wages because the employer had only enough funds on hand to pay net wages or because he paid other creditors is not considered a circumstance beyond his control.

At the four district offices where we made our review, we found that the penalty provision of Public Law 85-321 was used rarely. Collection officials generally stated that Public Law 85-321 is seldom used as an enforcement tool because (1) the cases rarely go to the Justice Department for prosecution and (2) collection action such as levying on bank accounts or seizing property has to be suspended. They advised us that they preferred to pursue the regular collection procedures rather than attempt to use the Public Law 85-321 penalty procedures which are generally ineffective.

Nationwide prosecutions under Public Law 85-321 have been very limited. From 1959 through 1969, 84 cases were referred to the Department of Justice for prosecution. Information provided by an IRS official during July 1972 showed the following disposition of the 84 cases.

--22 returned to IRS without prosecution,
--54 convictions obtained,
--3 cases pending,
--3 defendants died,
--1 defendant acquitted, and
--1 indictment dismissed.

Jail sentences averaging 4.5 months were imposed in 11 of the 54 convictions; fines only, or fines and probated sentences were imposed in 16 cases; probated sentences were imposed in 26 cases; and sentence was pending on the remaining case.

ACTION PROPOSED TO EXPEDITE PROSECUTIONS

On June 7, 1971, the Chief Counsel of IRS transmitted a 49-page memorandum to the IRS Assistant Commissioner (Compliance) and the Assistant Attorney General (Tax Division) of the Department of Justice in which he outlined the development of criminal sanctions imposed on employers for withholding tax delinquencies under Public Law 85-321. The Chief Counsel included the following recommendations in the memorandum which were designed to secure greater compliance with the statutory requirement that employers pay taxes withheld from their employees' salaries and wages.

--IRS policies on selecting cases for potential prosecutions under Public Law 85-321 should be liberalized.

--The number of prosecutions under Public Law 85-321 should be increased and attempts should be made to speed up processing of these cases by IRS regional counsels, U.S. attorneys, and the courts.

--IRS should determine whether the district and regional review procedures of potential Public Law 85-321 cases are satisfactory or can be expedited.

The operating procedures of the Office of the Chief Counsel were later revised to provide that the IRS regional counsels would process within 15 days any Public Law 85-321 cases that did not involve unusual circumstances and which were referred to them with recommendations for prosecution. The revised procedures also reemphasized that proof of willfulness was not a prerequisite for prosecution under Public Law 85-321 and that only lack of responsibility and impossibility of performance due to circumstances beyond the employer's control constituted defenses against prosecution.

In response to the Chief Counsel's memorandum, an official of the IRS intelligence division reviewed the division's policies relating to prosecuting withholding tax cases and advised the Assistant Commissioner (Compliance) on July 27, 1971, that the policies were liberal enough to provide an adequate flow of cases. He stated that the division selected and recommended for prosecution those cases involving a continued disregard of the employers' obligation to withhold or collect and pay taxes. He stated also that the regional

counsels and the Department of Justice have interpreted an employer's payment of, or his attempt to pay, a substantial part of the withheld taxes for the period under investigation as being prejudicial to the successful prosecution of the case. The official concluded that whenever an employer makes a payment during an investigation he has usually been able to frustrate the prosecution of a tax case against him and that this situation should not continue to exist.

The Acting Assistant Attorney General (Tax Division) of the Department of Justice, in responding to the Chief Counsel's memorandum, advised him that many districts had a backlog of criminal and civil cases and that the courts are instructed to give priority to trials of serious felony offenses and those in which defendants are incarcerated. He stated, however, that if a procedure is agreed on, the U.S. attorneys will be notified that such priority as is feasible will be given to Public Law 85-321 cases so that prosecutions will be effective deterrents. He stated also that the U.S. attorneys would be advised that partial payments of withheld taxes after an investigation is underway does not constitute a reason for nonprosecution and that the Department of Justice will cooperate in implementing whatever procedures IRS decides to adopt to more effectively enforce Public Law 85-321 cases.

- - - -

The Office of the Assistant Commissioner (Compliance) told us that collection personnel have not been notified of the actions the Office of the Chief Counsel and the Department of Justice are taking to expedite the processing of Public Law 85-321 cases. Collection personnel also have not been instructed that the policies for selecting cases for potential prosecutions under Public Law 85-321 should be liberalized and that an increased number of such cases should be prosecuted. Without such instructions, there is no reason to believe that the number of cases initiated for prosecution under Public Law 85-321 will increase.

CONCLUSIONS

Considering the large number of withholding tax delinquencies, we believe that the small number of cases that have been prosecuted under Public Law 85-321 is not a valid test of whether such prosecutions can effectively alleviate the problem of withholding tax delinquencies. However, the results

of the few cases that have been prosecuted under Public Law 85-321--convictions obtained in about 65 percent of the cases referred to the Department of Justice for prosecution--indicate that an increase in the prosecution of such cases may alleviate the problem of withholding tax delinquencies.

Accordingly, to carry out the Congress's intent as expressed in Public Law 85-321, we believe that the recommendations of the Chief Counsel as set forth in his June 7, 1971, memorandum to increase the number of cases selected for prosecution under Public Law 85-321 should be fully implemented.

RECOMMENDATION TO THE COMMISSIONER OF INTERNAL REVENUE

We recommend that IRS increase the number of cases selected for prosecution under Public Law 85-321 to adequately test whether such prosecutions can effectively help alleviate the problem of withholding tax delinquencies.

INTERNAL REVENUE SERVICE COMMENTS

The Acting Commissioner stated that this tax area has been one of major IRS interest and action over the past decade and that procedures governing the collection of employment taxes have provided for accelerated attention at the initial delinquency stage. He also stated that, in recognizing the problems indicated in our report, implementation of Public Law 85-321 has been revitalized. He explained that IRS has eliminated time lags that existed in the past which made the use of the sanctions provided by this law impractical and ineffective. On March 1, 1973, the revitalized program was instituted as a national program.

CHAPTER 6

OBSERVATIONS ON THE ACCURACY OF STATISTICS ON TAXPAYER DELINQUENT ACCOUNTS

IRS accumulates statistics on taxpayer delinquent accounts, such as the number of delinquent accounts issued and closed and the dollar amount of the delinquent accounts inventory. These statistics are included in annual budget justifications presented to the Congress. We observed that the statistics

--were inflated by multiple assessments,

--included assessments for marihuana taxes although these assessments are traditionally uncollectible, and

--were inflated by invalid delinquent accounts.

USE OF STATISTICS IN BUDGET SUBMISSIONS

In recent budget submissions to the Congress, IRS has referred to the delinquent accounts inventory in terms of the workload and uncollected revenue that it represented. For example, in hearings before a Subcommittee of the House Committee on Appropriations on the fiscal year 1973 budget, IRS stated that during fiscal year 1971, 2,821,000 delinquent accounts were issued and 2,847,000 accounts were closed resulting in the collection of $2.6 billion in delinquent taxes. IRS also stated:

> "* * * The accumulation of delinquent accounts is expected to number 800 thousand at the start of FY 1973, tying up over $2.0 billion in uncollected revenue. With additional manpower we are now requesting, the Service will be able to get abreast of the growing delinquent accounts workload and thus prevent still more revenue from going uncollected."

STATISTICS INFLATED BY MULTIPLE ASSESSMENTS

We analyzed the types of assessments included in the inventory of nonautomated delinquent accounts as reported by IRS' Southwest, Midwest, and Western regions, and by the Manhattan, Augusta, and Burlington district offices in the North Atlantic region. Our analysis covered the nonautomated inventories of 32 of IRS' 58 districts.

The above regions and district offices reported a combined delinquent account inventory of about $966 million at the time of our review. About $131 million, or about 14 percent of the combined inventory, was comprised of multiple assessments; that is, assessments that had been made against two or more taxpayers for the same tax. These multiple assessments were primarily transferee assessments and 100-percent penalty assessments. (See p. 7.)

Although a transferee or 100-percent penalty assessment is made against one or more second parties, IRS' objective is to collect only an amount equal to the original assessment. If an amount equal to the original assessment is collected from one of the parties, the other assessments for the same tax liability remain in the inventory until the statutory period for a refund claim has elapsed, usually 2 or 3 years. Because IRS can collect only the amount of tax owed, multiple assessments do not represent collectible revenue to the extent that they are duplicated in the inventory.

Our analysis of the Dallas district office's total inventory of delinquent accounts revealed that about $52 million, or 56 percent, of the $93 million in the inventory did not represent collectible revenue. For example, about $36 million resulted from assessments of $12 million each against three companies for a single tax liability of $12 million. Originally, four companies were each assessed about $12 million but one of the companies paid IRS which satisfied the total $12 million liability. The assessments against the other three companies were still in the inventory and will remain there until the expiration of the statutory period in which the paying company may file a claim for refund. Thus, the inventory contained $36 million in multiple assessments although the full amount of the tax had already been paid.

The extent to which multiple assessments can inflate statistics is illustrated further by a case revealed during our analysis of the New Orleans and Little Rock district offices' inventories of nonautomated delinquent accounts. In this case a business failed to pay employment taxes of $4,731.80. In addition to the tax assessed against the business, 100-percent penalties were assessed against each of 30 responsible officers of the business. Accounts totaling $141,954 were established for these 100-percent penalties and were included in the delinquent accounts inventories.

UNCOLLECTIBLE MARIHUANA EXCISE TAX ASSESSMENTS INCLUDED IN INVENTORY

The excise tax on transfers of marihuana was repealed effective May 1, 1971. However, taxes assessed before then are included in the inventory of delinquent accounts. One of the primary objectives in imposing this tax was to control illicit drug traffic. The tax--$1 per ounce of marihuana, or fraction thereof--was imposed on any person to whom marihuana was transferred and who had paid a special marihuana occupational tax and had registered his name and place of business with the IRS district office. It was unlawful, with certain exceptions, for any person to transfer marihuana to another who had not secured a written order form from an IRS district office on which IRS employees recorded information of the marihuana transfer.

In most cases, individuals dealing in illicit marihuana traffic did not comply with the marihuana excise tax laws. When marihuana was transferred to a person who had not secured the required form, had not paid the marihuana occupational tax, or had not registered his name and place of business, the rate of tax imposed on the person receiving the marihuana was $100 per ounce or fraction of an ounce. If the transfer violated the Internal Revenue Code without an order form and without payment of the transfer tax, the person transferring the marihuana was also liable for a tax of $100 per ounce.

Marihuana excise tax assessments included in the inventory of delinquent accounts are traditionally uncollectible. During fiscal year 1971, IRS assessed about $68 million in delinquent marihuana excise taxes, but only $138,000 was collected. Data we obtained from service center records on

the San Francisco and the Augusta, Maine, district offices illustrates how the marihuana excise tax can significantly distort the delinquent accounts inventory. As of October 31, 1971, the San Francisco district office had an inventory of delinquent accounts totaling $68.3 million, of which $11.8 million (17 percent) was for marihuana excise tax assessments. As of January 31, 1972, the Augusta district office had an inventory of delinquent accounts totaling $4.8 million, of which $1.4 million (30 percent) was for one marihuana assessment.

INVENTORY INFLATED BY INVALID DELINQUENT ACCOUNTS

Our review of 411 randomly selected business accounts that were classified as uncollectible at 4 IRS district offices showed that 37, or 9 percent, of the accounts were not valid receivables. These accounts, however, were included in the statistical reports showing the number of delinquent business accounts issued and closed. We considered an account to be invalid if the payment had been received by IRS or other action had been taken which satisfied the tax liability 1 week or more before issuance of the delinquent account.

IRS has recognized in its Internal Revenue Manual that questionable delinquent accounts may be issued. They consider questionable accounts to be those where payment was received or action was pending at least 4 weeks before issuance of the delinquent account which should have precluded its issuance. IRS cited the following as some of the conditions most frequently resulting in questionable delinquent accounts.

--A taxpayer's tax deposits are not associated with his account.

--Deposits are applied to the wrong class of tax or tax period.

--Adjustments which will eliminate the tax liability are in process but have not been applied to the taxpayer's account.

The Internal Revenue Manual states that, although it is impracticable to make adjustments for all such items, it is desirable to obtain minimum inflation or distortion in statistical data with the least amount of recordkeeping. The manual outlines procedures for accumulating the number of questionable delinquent accounts and the assessed dollar amounts and provides that adjustments for these accounts be made to statistical reports. Two of the four district offices covered by our review were not adjusting their reports for questionable delinquent accounts. The other two offices were adjusting the reports only for delinquent accounts of $100,000 or more. An official at one of these two district offices advised us that only one account had been adjusted under this criterion during the prior 18 months.

CONCLUSION

For internal management purposes and in order to correctly report statistical information to the Congress, we believe that IRS should revise its instructions for accumulating statistical information to insure that inventories of taxpayer delinquent accounts represent valid receivables to the Federal Government. Such revision should require that multiple assessments exceeding the amount due are excluded from statistical reports and stress the need for adjusting the reports for such accounts. Statistical reports should also include information on the number and dollar amount of marihuana taxes included and an evaluation of their collectibility. In addition, invalid delinquent accounts should be excluded from statistical reports.

RECOMMENDATION TO THE COMMISSIONER OF INTERNAL REVENUE

We recommend that IRS revise its instructions for accumulating statistics to insure that inventories of taxpayer delinquent accounts represent valid receivables to the Federal Government.

INTERNAL REVENUE SERVICE COMMENTS AND OUR EVALUATION

In a letter dated April 30, 1973, the Acting Commissioner stated that IRS statistics may be considered inflated

to the extent multiple assessments are involved but that this does not necessarily pose a problem nor is it misleading. He explained that it is IRS' view that our findings in the Dallas district where a sizable portion of the inventory represented multiple assessments was the exception and not the rule. He also explained that, in making its budgetary request to the Congress, collection manpower is predicted on the number of delinquent accounts issued because all issuances require attention and manpower must be expended on each of the multiple assessments to protect the Government's interest. He further explained that it is this total manpower requirement that dictates budgetary needs.

Subsequently, on May 22, 1973, the Assistant Commissioner (Accounts, Collection, and Taxpayer Service) advised us that IRS will footnote appropriate statistical reports to disclose a reasonable estimate of the amounts of multiple assessments included in the inventory.

The Acting Commissioner also stated that (1) instructions have been issued to provide the capability of extracting uncollectible marihuana assessments as a separate report item and (2) the problem of an inflated inventory due to invalid delinquent accounts will be considerably mitigated by total implementation of the integrated data retrieval system.[1]

We believe that the actions being taken by IRS to (1) footnote statistical reports showing reasonable estimates of the amounts of multiple assessments included in the taxpayer delinquent accounts inventory and (2) report marihuana excise tax assessments as a separate uncollectible item in the statistical reports should result in accumulating statistical information that will fairly disclose the amount of delinquent accounts. We did not evaluate the integrated data retrieval system to determine what effect it might have on the deflated inventory.

---

[1]A nationwide communications network that consists essentially of a series of video display-inquiry stations in IRS offices which are linked to large random-access computers located at the IRS service centers. The objective of the system is to improve taxpayer service, reduce paperwork, and expedite internal operations. Nationwide installation of the system was completed during fiscal year 1973.

CHAPTER 7

OBSERVATIONS ON OFFERS IN COMPROMISE

An offer in compromise is a taxpayer's proposal to settle his tax liability for less than the amount assessed. IRS regulations provide that the amount of tax owed by a taxpayer may be compromised when the liability or the collectibility of the full amount is in doubt. Because we were requested to review IRS handling and collection of delinquent accounts, our review was limited to offers in compromise involving doubt as to the collectibility of the full amount of the tax owed.

During fiscal year 1972, IRS accepted 1,170 offers in compromise involving doubt as to collectibility for payments of about $5 million on liabilities totaling about $16.7 million. IRS also rejected 2,439 offers providing for payments of about $11.1 million on liabilities totaling about $69.8 million.[1]

An offer in compromise usually originates during a revenue officer's effort to collect a delinquent account. IRS policy, however, is to not consider an offer until all other avenues of collection have been explored. Generally, a taxpayer is not asked to submit an offer but rather is advised of the tax compromise provisions and procedures.

IRS procedures provide that an offer in compromise must be accompanied by a financial statement showing the taxpayer's assets, liabilities, earnings, and other personal information. The investigating revenue officer is required to completely analyze the taxpayer's present financial condition and his past, present, and future earning ability and obtain information on his physical condition and other factors. The revenue officer then determines what the taxpayer can

---

[1]Offers in compromise relating to specific penalties are not included because the amount of liability was not available. Specific penalties are those wherein a specific amount is assessed for failure to perform a duty required by law, such as obtaining a tax stamp when required.

afford to pay on the basis of this information and the taxpayer's standard of living and decides whether the taxpayer's offer is reasonable. He then recommends that the offer be accepted or rejected.

After various levels of review, including the national office when large tax liabilities are involved, IRS notifies the taxpayer in writing of its decision to accept or reject the offer. IRS procedures provide that, if the offer is rejected, the amount submitted by the taxpayer will be returned unless he requests that it be applied to his tax liability.

IRS permits taxpayers to pay accepted offers in installments, but in no case can the installment period exceed 6 years. If the taxpayer defaults on the terms of an accepted offer, the original tax liability may be reinstated.

When IRS accepts an offer in compromise, the taxpayer may be required to sign a collateral agreement. The most frequent type of collateral agreement is the future income agreement under which the taxpayer agrees, contingent on stipulated increases in future income, to pay additional sums on his tax liability. The collateral agreements generally provide for additional payments ranging from 20 to 50 percent of the annual income available to the taxpayer which exceeds his basic needs. The investigating revenue officer, on the basis of his judgment and the taxpayer's standard of living, determines the taxpayer's available income which exceeds basic needs. Other types of collateral agreements require the taxpayer to give up present or potential tax benefits, such as a bad debt loss or net operating loss carryback or carryover, which have the effect of increasing the amount of the offer.

Each of the four district offices included in our review took the following actions on offers in compromise involving doubt as to collectibility during a 12-month period:

District	Offers accepted	Offers rejected by IRS or withdrawn by taxpayer
Dallas	10	43
Reno	17	22
Manhattan	33	130
Chicago	3	18
Total	63	213

We reviewed 27 of the 63 offers in compromise that were accepted by the 4 regions. Sixteen of the offers were for various business taxes, 10 were for income taxes, and 1 was for a 100-percent penalty assessment. The 27 offers totaled about $133,300, compared with a tax liability of about $796,200. Collateral agreements were obtained on 16 of the offers and 18 of the offers provided for installment payments.

We also reviewed 34 of the 213 offers in compromise rejected by IRS or withdrawn by the taxpayers in the 4 regions. The 34 offers totaled $113,350, compared with a tax liability of about $914,800. Ten of the offers were for various business taxes, 19 were for income taxes, 3 were for wagering taxes, 1 was for a 100-percent penalty assessment, and 1 was a combination of income and employment taxes.

For the 61 offers in compromise that we reviewed, IRS collection personnel complied with the prescribed policies and procedures for processing offers in compromise. For each of the offers accepted, the revenue officer obtained adequate information to support a conclusion that the offer represented the maximum amount that the Government would be able to collect. IRS rejected offers for various reasons, including (1) IRS believed the taxpayers had the ability to pay their tax in full, (2) the taxpayers had assets exceeding the amount of the offer in compromise, and (3) IRS deemed it detrimental to the Government's interest to compromise wagering taxes. Also, IRS records showed that most offers withdrawn by the taxpayers were withdrawn after IRS had informed the taxpayer that his offer would not be approved.

Conclusion

Based on our review of 61 offers in compromise, we believe that the taxpayers were treated equitably and that acceptance or rejection of the offers was justified based on the facts and circumstances in each case.

CHAPTER 8

PROPOSED CHANGES IN COLLECTION OF FEDERAL EXCISE TAX ON TELEPHONE SERVICES

Since 1967 certain nationwide campaigns have urged taxpayers to omit the Federal excise tax when paying their telephone bills as a protest against U.S. military involvement in Vietnam. From January 1971 through March 1972, IRS issued about 56,000 delinquent accounts for nonpayment of the telephone excise tax. This protest movement has tied up a great deal of IRS manpower, considering the relatively small amount of taxes involved.

The excise tax on telephone services is imposed on the person paying for the service. Telephone companies are liable for the tax only to the extent that they must pay to the Treasury the tax that is voluntarily paid by telephone customers. Telephone companies are not liable for the tax unless it is paid by their customers; therefore, IRS does not look to the telephone companies for payment. Rather, IRS attempts to collect the tax from the persons who refused to pay it to the telephone companies.

The Federal Communications Commission in a ruling issued May 4, 1972 (FCC 72D-29), noted that it had previously advised the respondent (telephone company) in the case being heard that telephone companies are not required to force collection of the Federal excise tax because the IRS procedural rules do not require telephone companies to attempt to enforce payment of the tax but merely to report refusal to IRS.

Experience has shown that generally persons involved in telephone excise tax cases have repeatedly refused to pay the tax but have not attempted to place their assets beyond IRS' reach. Recognizing this, the IRS national office issued instructions on August 9, 1971, to the service centers informing them that these delinquent accounts were to be accumulated and issued to the district office once a year for collection action.

IRS assesses the tax if the amount owed is $1 or more. The district offices send notice and demand letters to the taxpayers and if payment is not received within 10 days,

they use normal collection procedures to collect the delinquent account.

Delinquent accounts resulting from nonpayment of the Federal excise tax on telephone services involve relatively small amounts, averaging less than $10. Ordinarily, collection action would not be taken on such small amounts because it would be uneconomical to do so. An IRS official told us, however, that IRS pursues collection of these delinquent accounts, notwithstanding the relatively small amounts, because it considers the attitude manifested by the protestors as an organized movement against, and a deliberate threat to, voluntary compliance with the tax laws. This position is somewhat supported by the fact that protest leaders have stated that protestors initially refuse to pay the telephone excise tax because it is the easiest to resist and then, if they are bold, they begin resisting the payment of income taxes.

We could not determine the precise amount of collection effort devoted to these tax delinquencies because IRS does not distinguish between these and other delinquencies in its collection statistics. The number of man-hours required to close an account averaged about 2 hours in fiscal year 1972. Because about 56,000 delinquent accounts were issued during one 15-month period, it is apparent that considerable man-hours have been devoted to collecting these accounts.

On July 28, 1972, a proposed IRS procedural change for collecting the telephone excise tax was published in the Federal Register. This change will make the telephone companies directly liable for the tax if the companies willfully fail to collect. Under the proposed change, willful failure to collect the tax is presumed if the telephone company does not discontinue rendering communication services to a taxpayer not later than 60 days after the company could have discontinued service under local law for failure to pay for services. On November 13, 1972, a public hearing was held on this proposed change.

- - - -

IRS studies indicated that about 70 percent of the taxpayers who are delinquent in paying Federal excise taxes on telephone service would have an overpayment of their individual taxes which could be offset to satisfy the delinquent

telephone excise tax. As a result, on December 11, 1972, procedures were issued to effect such an offset.

Conclusion

IRS' action to offset a taxpayer's delinquent telephone excise taxes against tax refunds due the taxpayer will reduce IRS manpower requirements. Further, if IRS' proposed procedure for collecting the telephone excise tax is implemented, telephone companies will be authorized, and in effect, required to discontinue service to taxpayers who refuse to pay the tax. In our opinion, this will eliminate the need for IRS to devote manpower to collect delinquent Federal excise taxes on telephone services.

Congress of the United States
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION
1011 LONGWORTH HOUSE OFFICE BUILDING
Washington, D.C. 20515

January 13, 1971

Honorable Elmer B. Staats
Comptroller General
General Accounting Office
Washington, D. C.

Dear Mr. Staats:

The Joint Committee hereby requests and authorizes the General Accounting Office to undertake a study concerning the policies and procedures established by the Internal Revenue Service in connection with the handling and collection of taxpayers' delinquent accounts. This study is to be conducted in accordance with the understandings set forth in my letter dated January 13, 1971, to you and the Commissioner of Internal Revenue. In order to achieve the objectives of this study, it is contemplated that the General Accounting Office will examine into:

(1) The effectiveness of Internal Revenue Service programs to collect past due accounts.

(2) The equities of collection procedures as applied to all taxpayers.

(3) The policies and practices in regard to delinquent accounts considered currently uncollectible.

(4) The policies and practices in regard to offers in compromise.

(5) What changes, if any, in policies or practices need be considered to reduce the number of delinquent accounts.

APPENDIX I

Congress of the United States
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION
Washington, D.C. 20515

Honorable Elmer B. Staats
Page two

(6) The adequacy of the resources devoted to carrying out the Internal Revenue Service's responsibilities in regard to the collection of delinquent accounts.

I would appreciate it if you would arrange a meeting in the near future between representatives of the General Accounting Office, the Internal Revenue Service, and the staff of the Joint Committee, to discuss the manner in which this study of delinquent account policies and procedures will be carried out. The Joint Committee also has requested that your office submit reports from time to time of the probable cost of the investigation contemplated together with the potential benefit therefrom.

Sincerely yours,

Laurence N. Woodworth

cc: Commissioner of Internal Revenue

Department of the Treasury

Internal Revenue Service
Washington, DC 20224

Date. APR 30 1973 | In reply refer to: ACTS:C

Honorable Elmer B. Staats
Comptroller General
General Accounting Office
Washington, D. C. 20548

Dear Mr. Staats:

We have completed our review of the GAO Report to the Joint Committee on Internal Revenue Taxation on the collection of taxpayer delinquent accounts by the Internal Revenue Service. First, we are pleased that the in-depth examination of randomly selected accounts revealed that taxpayers are treated equitably and that the IRS has been effective in collecting taxpayer delinquent accounts.

We generally concur with the findings and conclusions contained in this Report and in most instances agree with the recommendations offered.

On a more specific basis, the Report addressed itself to seven major areas, each of which is discussed below under its own separate heading:

1. Interest on Deferred Payment of Estate Taxes

We agree with the findings of the Report. The recommendation raises a matter of policy. Congress, in the past, has held that a disparity should exist in the interest rates applicable to underpayments of estate taxes for which extensions have been granted and other Internal Revenue taxes. The reason was to mitigate, at least to some extent, the hardship on certain estates. With the addition of "reasonable cause" as a factor for extending the time to pay estate taxes, consideration might well be given to increasing the rate of interest to the present 6 percent charge on underpayments or delayed payments.

Honorable Elmer B. Staats

2. Discharge of Taxes Through Bankruptcy

We agree with the findings of the Report. The recommendation raises a matter of legislative policy of the Bankruptcy Act. Although the provisions of the Bankruptcy Act (Section 17) are intended to provide for the rehabilitation of the bankrupt, they have become a vehicle used by some to defraud creditors, particularly the Internal Revenue Service. If the assessment date became the controlling date for discharge, the problem of a taxpayer filing delinquent returns for prior periods and then following up with a petition in bankruptcy would be virtually eliminated.

3. Collection of Taxes Withheld from Employees' Wages (Public Law 85-321)

We agree with the findings of the Report. In fact, this tax area has been one of major IRS interest and action over the past decade. For example, during this entire period, procedures governing the collection of these employment taxes have provided for accelerated attention at the initial delinquency stage. Further, the IRS has established programs to contact all business taxpayers before they become liable for the filing of any returns so that they can be advised of their tax filing and paying obligations. Recognizing the problems indicated in the Report, implementation of Public Law 85-321 has been revitalized. We have eliminated time lags that existed in the past which made the utilization of the sanctions provided by this law impractical and ineffective. On March 1, 1973, this revitalized program was instituted as a national program.

4. Social Security Credits Allowed for Unpaid Self-Employment Taxes

We agree with the findings and recommendations of the Report. However, we believe the legislative initiative lies with Social Security, since the situation described in the GAO Report occurs at that point in time when an individual applies for Social Security credit.

Honorable Elmer B. Staats

[See GAO note.]

6. Accuracy of Statistics on Taxpayer Delinquent Accounts Statistics Inflated by Multiple Assessments

While it is readily conceded that our statistics may be considered inflated to the extent multiple assessments are involved, we do not believe that this necessarily poses a problem or is misleading. In the first place, notwithstanding the GAO findings in the Dallas District where a sizeable proportion of the inventory represented multiple assessments, it is our view that this represented the exception and certainly not the rule. We base this statement on our on-going experience which shows a high proportion of our nationwide workload to be collectible, as well as on our past experience when we manually did monitor multiple assessments. This latter point is extremely important. After a period of time of monitoring and adjusting for multiple assessments, a conscious management decision was made to discontinue this effort because of the excessive cost in terms of resources required equated against the relatively small dollars involved.

Further, it is important to understand that, in terms of collections, no amounts are ever included in taxpayer delinquent accounts yield that were not actually collected by the Internal Revenue Service. And the amount Internal Revenue Service declares as collected does actually represent yield. It is equally important to understand that in making its budgetary request to the Congress, Collection manpower is not predicted on dollar yield but rather on the number of delinquent accounts issued. This is because Internal Revenue Service can never say what portion of the accounts issued or subsequently in inventory will wind up as yield, but the fact remains that all issuances and all accounts in inventory require attention. Manpower must be expended on each of the multiple assessments to protect the Government's interest, and it is this manpower requirement, in its totality, that dictates budgetary needs.

The Report also deals with two other areas involving statistical accuracy: (a) uncollectible marihuana excise tax assessments and (b) invalid delinquent accounts. Our comments on these follow:

a. Uncollectible Marihuana Excise Tax Assessments Included in Active Inventory Statistics

We agree with the findings and recommendations of the Report. Instructions have been issued to provide the capability of extracting uncollectible marihuana assessments as a separate report item.

b. Inventory Statistics Inflated by Invalid Delinquent Accounts

We agree with the findings and recommendations of the Report. For the purpose of this Report, an account was considered to be invalid if the payment had been received by Internal Revenue Service, or other action had been taken which otherwise satisfied the liability, one week or more prior to the issuance of the delinquent account. This problem will be considerably mitigated by the total implementation of IDRS. However, the problem of payments posting prior to TDA issuance will remain until the "pipeline" time can be effectively reduced.

Honorable Elmer B. Staats

7. Offers in Compromise

No specific comment required. The Report found that taxpayers were being treated equitably and that Internal Revenue Service's actions on the offers were justified.

We appreciate the opportunity afforded to comment on the Report's observations and recommendations. We also appreciate the careful and fully responsible manner in which the GAO team went about its investigation. As requested, we are returning the draft copies sent us.

With warm regards,

Sincerely,

R. F. Harless

Acting Commissioner

Enclosures

GAO note: The deleted comments relate to matters discussed in the draft report but omitted from this final report.

APPENDIX III

PRINCIPAL OFFICIALS RESPONSIBLE

FOR ADMINISTRATION OF ACTIVITIES

DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
SECRETARY OF THE TREASURY:		
George P. Shultz	June 1972	Present
John B. Connally	Feb. 1971	June 1972
David M. Kennedy	Jan. 1969	Feb. 1971
COMMISSIONER OF INTERNAL REVENUE:		
Donald C. Alexander	May 1973	Present
Raymond F. Harless (acting)	May 1973	May 1973
Johnnie M. Walters	Aug. 1971	Apr. 1973
Harold T. Swartz (acting)	June 1971	Aug. 1971
Randolph W. Thrower	Apr. 1969	June 1971
ASSISTANT COMMISSIONER (ACCOUNTS COLLECTION AND TAXPAYER SERVICE) (note a):		
Dean J. Barron	July 1971	Present
ASSISTANT COMMISSIONER (DATA PROCESSING):		
Dean J. Barron	Sept. 1970	June 1971
Erwin B. Osborn (acting)	May 1970	Sept. 1970
Robert L. Jack	Sept. 1961	Apr. 1970
ASSISTANT COMMISSIONER (COMPLIANCE):		
John F. Hanlon	Jan. 1972	Present
John F. Hanlon (acting)	Nov. 1971	Jan. 1972
Donald W. Bacon	Sept. 1962	Nov. 1971
DIRECTOR, COLLECTION DIVISION:		
Harold E. Snyder	Mar. 1961	Present

[a]Effective July 1, 1971, the Office of Assistant Commissioner (Data Processing) was redesignated the Office of Assistant Commissioner (Accounts, Collection, and Taxpayer Service) and the Collection Division was transferred from the Office of Assistant Commissioner (Compliance) to the Office of Assistant Commissioner (Accounts, Collection, and Taxpayer Service).

AN EQUAL OPPORTUNITY EMPLOYER

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE $300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE

SPECIAL FOURTH-CLASS RATE
BOOK