



**United States General Accounting Office
Washington, DC 20548**

January 3, 2003

The Honorable Bob Wenzel
Acting Commissioner of Internal Revenue
Internal Revenue Service

Subject: Minimizing Inappropriate Levies in IRS's Federal Payment Levy Program

Dear Mr. Wenzel:

Each year, thousands of taxpayers who owe delinquent federal taxes receive billions of dollars in federal payments. To help the Internal Revenue Service (IRS) collect these delinquent taxes more effectively, the Congress passed the Taxpayer Relief Act of 1997, the provisions of which authorized the establishment of the Federal Payment Levy Program (FPLP), which allows IRS to continuously levy up to 15 percent of the payments made to delinquent taxpayers. The Department of the Treasury's Financial Management Service (FMS), which receives payment records from and makes payments on behalf of most federal agencies, collects the continuous levy from the federal payment after IRS has authorized the levy. Subsequent payments are continuously levied until such time that the tax debt is paid or IRS releases the levy.

In a prior report, we noted that inappropriate levies—which subsequently must be refunded—could undermine support for the continuous levy authority, by generating negative public reaction to the program and frustrating taxpayers whose payments are inappropriately levied.¹ Since October of 2001, the inclusion of Social Security recipients and others in the levy program has extended levy use substantially. This expansion heightens the importance of minimizing inappropriate levies.

IRS built controls into FPLP to prevent levying taxpayers who are not subject to levy and to protect against levying payments for more than taxpayers owe. Under FPLP, FMS continuously levies a taxpayer's account based on the taxpayer's account balance in FMS's records. IRS updates FMS's records on the taxpayer's account from its master file once every week,² except during system maintenance and sends FMS

¹See U.S. General Accounting Office, *Tax Administration: IRS' Levy of Federal Payments Could Generate Millions of Dollars*, GAO/GGD-00-65 (Washington, D.C.: Apr. 7, 2000).

²The master file maintains an account for every taxpayer who files a return. The account maintained on the master file includes records related to that taxpayer over the years (returns filed, payments made, additional taxes assessed as a result of audit, etc.).

updated information on the balance owed by each delinquent taxpayer. In part because IRS may receive other payments from taxpayers independent of the levy process, FMS always substitutes IRS's account balance for the one it maintains for each taxpayer's account as soon as it receives IRS's weekly account updates. As discussed below, depending on the specific timing of FMS's levies of taxpayer's accounts and IRS's weekly updates of its master file, FMS's account balance can be in error and taxpayer's accounts can be inappropriately levied. These time-related situations, which give rise to inappropriate levies, should be alleviated when IRS completes the installation of its replacement for the master file. Because the new system will update taxpayers accounts daily, there will be less opportunity for IRS's and FMS's records to differ. However, the system will not be fully installed for several years.

This report identifies one cause for inappropriate levies for which corrective measures can be taken before IRS completes the installation of the replacement for its master file. We identified this issue during follow up work to our April 2000 report that we are conducting at the request of the House Ways and Means Committee and its Subcommittee on Oversight. To determine the causes of inappropriate levies and possible corrective measures, we selected the 3,349 individual taxpayer accounts that were levied during the first quarter of fiscal year 2002, the period from October 1, 2001, through December 31, 2001. From these 3,349 accounts, we identified 160 individual taxpayer accounts that had received a refund as a result of an inappropriate levy under FPLP. The refunds were made between October 1, 2001, and April 1, 2002. We then examined the activity that occurred on the 160 accounts through April 2002 to determine the basis for the inappropriate levies. We interviewed IRS and FMS headquarters officials to obtain information on the operation of the FPLP program, payment posting procedures and refund procedures. Our review was conducted between October 2001 and September 2002 in accordance with generally accepted government auditing standards.

Results

An annual shut down of master file operations for system maintenance causes inappropriate levies and subsequent refunds. We found that 119 of the 160 refunds between October 1, 2001, and April 1, 2002, were issued in February 2002, which was four times the number of refunds issued in any other month during the 6-month period. The refunds ranged from less than \$5 to nearly \$500, with the average refund being \$114.43. Of these 119 refunds in February 2002, 108 resulted because IRS had received payments such as voluntary payments, transfers of tax payments, and levies, sufficient to settle the tax indebtedness. Those payments were not posted to IRS's master file during January 2002. Without updated information, FMS relied on the information it maintained to initiate the next round of levies on the taxpayers.

According to IRS officials, the failures to post taxpayer payments to the master file during January were due to "dead cycle time"—a 3-to-4 week period at the beginning of each calendar year when IRS shuts down master file operations to upgrade software and perform other maintenance. During this period, the master file does not accept new postings, but FMS continues to levy federal payments based on its records for the balance owed by the taxpayers. Taxpayers who had their indebtedness resolved or reduced to less than what would be generated by a 15-

percent levy continued to have their federal payment levied at the full 15-percent because updated IRS data could not be sent to FMS indicating the correct balance. After the master file began accepting new postings, IRS's automatic refund processes issued refunds for the over collections.

The posting delay problem due to the January shut down of IRS's master file can create inappropriate levies in at least two situations. In the levy process, for example, FMS approves the payments to recipients of monthly federal payments, such as those going to Social Security recipients and federal retirees, 1-to-2 weeks prior to the actual issuance of the payments, deducting the levy amount from the payment. FMS records the lower debt balance for the levied taxpayer in files it maintains. After the payment is issued to the taxpayer and IRS receives the levy payment, IRS updates its master file record to show the lower balance amount. IRS sends the lower balance amount to FMS on the next weekly update.

Depending on the timing of IRS's master file update and FMS's next levy of a payment to the taxpayer, FMS may make the next levy based on data showing a higher balance due by the taxpayer than is in fact correct. In one situation, FMS may levy an account and send the payment to IRS shortly after IRS has completed its last update before shutting down its master file. In this case, IRS will have sent FMS a new account balance the week before shutdown that does not reflect the levy payment. Because FMS always substitutes the last update from IRS for its existing account balance, in this case it is substituting a balance that does not reflect the previous levy. This balance becomes the basis for the next levy. If FMS's account balance is zero or less than what would be yielded by a 15-percent levy, substituting IRS's account balance may result in FMS levying a settled account or over-levying an account with a low balance. In another situation, IRS may receive a separate payment from the taxpayer shortly after the last update that could settle the account or reduce it below the amount that would be generated by a 15-percent levy. Again, because FMS's records will not reflect the actual balance due in the taxpayer's account and an inappropriate levy can result.

We found 101 instances resulting from the first situation described above in which an inappropriate levy resulted because the full 15-percent levy was taken from the taxpayer's federal payment, even though the taxpayer's remaining debt balance was less than what would be generated by a 15-percent levy. This number will likely grow now that Social Security recipients are being levied under FPLP. IRS data show that in the first quarter of fiscal year 2002, the period of our sample, FPLP took 8,584 levies from individual taxpayers whereas in the last quarter of fiscal year 2002 FPLP took 177,872 levies from individual taxpayers.

IRS levy program officials told us that they will make programming changes in 2003 to help avoid inappropriate levies due to the down time for the master file. Officials said an approach IRS is considering would address those inappropriate levies that are due to the first situation described above. That is, it would deal with those cases where the balance IRS reports to FMS fails to reflect the last levy made by FMS. Officials are considering suspending IRS's update several weeks prior the dead cycle period and instead having FMS rely only on its own record of the taxpayer's balance to determine the levy amount to be deducted. This would result in correct levies being made in all cases where the only amount being credited to the taxpayer's

account is from the levy. It would not alleviate inappropriate levies that result from taxpayers making other payments on their delinquent account during the period. Officials did not believe these changes would be costly to implement.

Conclusions

Inappropriately levying taxpayers could undermine support for the levy authority that has been granted to IRS and FMS. Although the inappropriate levies we found that are due to the January "down time" for updating IRS's master file were relatively few in number, the potential number of such inappropriate levies could rise substantially now that the levies have been extended to additional types of federal payments, principally Social Security benefits. According to IRS officials, programming changes would not be costly and could help avoid a portion of these inappropriate levies. Because of the inherent data processing time delays, it is inevitable that some over collections will occur and thus refunds will be issued. However, it is imperative that IRS does whatever it can to avoid over collections and prevent unnecessary refunds to ensure that the taxpayer receives his full federal payment once the tax debt has been settled.

Recommendations

We recommend that the Acting Commissioner of Internal Revenue direct FPLP staff to avoid over collections during scheduled dead cycle time for IRS's master file. Planned actions, such as suspending IRS's update several weeks prior to the dead cycle period so as to not supersede FMS record of balance due and allow FMS to rely on its own record of the taxpayer's balance to determine the levy amount to be deducted, would achieve this objective.

Agency Comments

We requested comments on a draft of this report from the Acting Commissioner of Internal Revenue or his designee. We obtained oral comments on December 18, 2002, from the Acting Director, Filing and Payment Compliance, Wage and Investment. She told us they agree with our recommendation and anticipate this change will be in place by December 2003. She also emphasized that the only the last levy of the taxpayer was inappropriate because the delay updating FMS's records caused an incorrect amount to be taken.

We are sending copies of this report to the Secretary of the Treasury and the Commissioner of Financial Management Service. We are also sending copies of the report to the Chairman and Ranking Minority Member, House Committee on Ways and Means; Chairman and Ranking Minority Member, Subcommittee on Oversight, House Committee on Ways and Means; Chairman and Ranking Minority Member, Senate Committee on Finance. We will also make copies of this report available to others upon request. This report is also available at GAO's Web site <http://www.gao.gov>. If you or your staff have any questions, please contact me at (202) 512-9110 or Ralph Block, Assistant Director at (415) 904-2150. Other staff who

contributed to this report include Thomas Bloom, Ellen Rominger, Samuel Scrutchins, Thom Venezia, and Elwood White.

Sincerely yours,

A handwritten signature in black ink that reads "Michael Brostek". The signature is fluid and cursive, with a prominent 'M' at the beginning.

Michael Brostek
Director, Tax Issues

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