Treasury Inspector General for Tax Administration
Office of Audit

DESIGNATED PAYMENT CODES ARE INACCURATE AND INEFFECTIVE

Issued on March 28, 2012

Highlights

Highlights of Report Number: 2012-30-026 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

The IRS established Designated Payment Codes (DPC) to identify IRS enforcement actions or other events that result in taxpayers submitting subsequent payments on their balance due accounts. However, the IRS is not consistently or accurately applying DPCs, which reduces the IRS's ability to assess the effectiveness of its collection actions. Ineffective use of IRS collection resources can unnecessarily burden the majority of taxpayers who fully and timely pay their taxes.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether the IRS is consistent and accurate in applying DPCs to subsequent payments received on balance due accounts. The audit is included in TIGTA's Fiscal Year 2012 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

WHAT TIGTA FOUND

TIGTA reviewed a statistical sample of 138 subsequent payments that posted to taxpayer balance due accounts. TIGTA determined that 106 (77 percent) of the 138 subsequent payments were processed without the required DPC. In addition, 11 (34 percent) of the 32 subsequent payments that had a DPC were not accurate. DPCs are not consistently or accurately applied in the majority of cases because: 1) the IRS has not established DPCs to account for all types of subsequent payments, including those made in response to an IRS notice; 2) DPC procedures on how to process subsequent payments submitted directly to an IRS campus are inconsistent; and 3) the format, instructions, and processing of the form used to submit subsequent payments do not ensure that DPCs are applied. As a result, DPC data cannot be used to determine the effectiveness of collection actions, and some IRS collection reports that are used to monitor and report collection activities are not accurate.

TIGTA also reviewed a random sample of subsequent payments made after the IRS filed Letter 3172, *Notice of Federal Tax Lien Filing and Your Rights to a Hearing under IRC 6320*, and determined that DPCs were not always used. After liens were filed, it was not always clear why the taxpayer made the payment. In addition, DPC procedures do not address partial subsequent payments resulting from liens.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) ensure there is a DPC for all IRS actions that are primarily responsible for taxpayers submitting a payment; 2) establish controls to ensure DPCs are applied consistently and accurately; 3) revise Form 3244, *Payment Posting Voucher*, and its instructions to clarify the DPC requirement for all listed transaction codes; 4) revise Letter 3172 to allow the taxpayer to send in the notice with any subsequent payment; and 5) establish a DPC for partial subsequent payments and installment agreement payments made in response to the filing of a lien.

IRS management's planned corrective actions agreed with the intent of our first three recommendations. The IRS plans to conduct an expanded review of DPCs to determine which IRS actions primarily responsible for taxpayers submitting subsequent payments on their balance due accounts may be appropriate to have an associated DPC. The IRS will finalize and execute their review plan with the assistance of the Research Analysis and Statistics Division, Office of Program Evaluation and Risk Analysis. The IRS will analyze the review results and determine additional actions to take related to our recommendations. IRS management did not agree with Recommendations 4 and 5. Management believes Recommendation 4 places undue burden on the taxpayer and can potentially confuse procedures relative to Notice of Federal Tax Lien appeals. Management believes the data yielded by Recommendation 5 would not accurately measure the target metric.

TIGTA believes Recommendation 4 makes the procedures for Letter 3172 consistent with those for Form 8519, *Taxpayer's Copy of Notice of Levy*, which instructs the taxpayer to include a copy of the notice with the payment. This process would allow the IRS to associate payments made in response to lien notices in the same manner that it can associate payments made in response to levies. Furthermore, Recommendation 5 is intended to allow the IRS to measure the impact of filing liens by identifying specific subsequent payments made by the taxpayer due to the filing of a lien.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

http://www.treas.gov/tigta/auditreports/2012reports/201230026fr.pdf.