



*Increasing Requests for
Offers in Compromise Have
Created Inventory Backlogs and
Delayed Responses to Taxpayers*

March 30, 2012

Reference Number: 2012-30-033

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

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HIGHLIGHTS

INCREASING REQUESTS FOR OFFERS IN COMPROMISE HAVE CREATED INVENTORY BACKLOGS AND DELAYED RESPONSES TO TAXPAYERS

Highlights

Final Report issued on March 30, 2012

Highlights of Reference Number: 2012-30-033 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

An offer in compromise (OIC) is an agreement between a taxpayer and the Federal Government that settles a tax liability for payment of less than the full amount owed. TIGTA found that the IRS did not always contact taxpayers when promised, and inventory backlogs caused processing delays. Delays could impact financial and business decisions because taxpayers do not know if or when their tax liabilities will be resolved.

WHY TIGTA DID THE AUDIT

From 2001 through 2009, the National Taxpayer Advocate reported the OIC Program as one of the most serious problems facing taxpayers. This audit was initiated to assess the effectiveness of the OIC Program to timely process requests, consistently apply OIC guidelines, accurately measure Program results, and effectively promote the Program.

WHAT TIGTA FOUND

The combined impact of a weak economy and IRS efforts to promote the OIC Program has increased the number of requested offers by 28 percent between Fiscal Year 2007 and Fiscal Year 2011. However, the resources available to work the offers have decreased. TIGTA reviewed a statistically valid sample of offers and found the IRS did not process all offers timely. In 73 (74 percent) of 99 offers, the IRS failed to contact the taxpayer by the promised date. TIGTA estimates that 9,509 taxpayers who submitted offers between July 1 and

December 31, 2010, may not have been contacted when promised.

Additionally, as of October 25, 2011, there were 7,472 unassigned offers in holding queues awaiting assignment to OIC staff. TIGTA found that one processing site had more than four times as many unassigned offers from self-employed taxpayers compared with the other site, and 37 percent of the offers were more than six months old.

TIGTA also determined that an incorrect date was used when offers were returned to the IRS because of IRS processing errors. TIGTA estimates that the wrong date may have been used for 712 taxpayers who submitted offers between July 1 and December 31, 2010. Finally, the IRS does not have formal performance measures for streamlined offers.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS revise OIC processing procedures, train employees, and add a formal performance measure for the streamlined offers or apply the streamlined process to all offers.

In their response to the report, IRS officials agreed with the recommendations and plan to take appropriate corrective actions. The IRS plans to keep taxpayers better informed by increasing the amount of time they tell taxpayers it will take until they are contacted as well as issuing an interim letter if contact is not made within the specified time. The IRS plans to initiate reassignment of offers between the sites as needed. In addition, the IRS plans to apply most aspects of the streamlined process to the remainder of the OIC cases. Also, the IRS agreed with the outcome measures in the report.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 30, 2012

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Increasing Requests for Offers in Compromise
Have Created Inventory Backlogs and Delayed Responses to Taxpayers
(Audit # 201130014)

This report presents the results of our review to determine the effectiveness of the Offer in Compromise¹ (OIC) Program to timely process requests, consistently apply OIC guidelines, accurately measure Program results, and effectively promote the Program. This audit is included in our Fiscal Year 2012 Annual Audit Plan and addresses the major management challenge of Providing Quality Taxpayer Service Operations.

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

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.

¹ See Appendix V for a glossary of terms.



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Abbreviations

AOIC	Automated Offer in Compromise
COIC	Centralized Offer in Compromise
FY	Fiscal Year
IRS	Internal Revenue Service
OIC	Offer in Compromise
SB/SE	Small Business/Self-Employed



Increasing Requests for Offers in Compromise Have Created Inventory Backlogs and Delayed Responses to Taxpayers

Background

An offer in compromise¹ (OIC) is an agreement between a taxpayer and the Federal Government that settles a tax liability for payment of less than the full amount owed. Treasury regulations authorize the Internal Revenue Service (IRS) to settle a tax debt on any one of three grounds: doubt that more than the offered amount can be collected, a verifiable doubt as to the amount owed, or to promote effective tax administration.² Policy Statement P-5-100 allows the IRS to accept an OIC when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential. An OIC is a legitimate alternative to declaring a case currently not collectible or to initiating a protracted installment agreement.

The objectives of the OIC Program are to:

- Facilitate collection of what can reasonably be collected at the earliest possible time and at the least cost to the Federal Government.
- Achieve a resolution that is in the best interests of both the individual taxpayer and the Federal Government.
- Provide the taxpayer with a fresh start toward future voluntary compliance with all filing and payment requirements.
- Secure revenue that may not be collected through any other means.

A request for an OIC is submitted on Form 656, *Offer in Compromise*, and may require an application fee of \$150 and a non-refundable payment equal to 20 percent of the offer amount, depending on the type of offer and whether the taxpayer qualifies for the low-income exemption. All initial offer receipts that are submitted must be processed by the appropriate Centralized Offer in Compromise (COIC) sites located in Holtsville, New York, and Memphis, Tennessee. If the IRS does not make a determination on an OIC within 24 months, the OIC will be considered accepted.

From 2001 through 2009, the National Taxpayer Advocate reported the OIC Program as one of the most serious problems facing taxpayers. The IRS has commissioned studies over the last two years to help improve and promote the OIC Program. Some of the recommendations from these studies have been implemented including: simplifying the OIC form and instructions, making the OICs more accessible on the IRS.gov website, creating an OIC informational video that is accessible through the “You Tube” website, and testing a “Fresh Start” initiative to target

¹ See Appendix V for a glossary of terms.

² Treasury Regulation §301.7122-1.



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currently not collectible hardship taxpayers for future tax compliance by informing taxpayers that they may be eligible to pay a portion of their taxes and interest owed through the OIC Program.

In Fiscal Year (FY) 2010, the Small Business/Self-Employed (SB/SE) Division initiated the streamlined OIC process to help expedite the processing of offers for qualified taxpayers. The streamlined OIC process requires IRS employees to telephone taxpayers as the primary means of contact instead of mailing letters requesting information. Offers from wage earners and self-employed taxpayers with incomes of \$100,000 or less and liabilities of \$50,000 or less are categorized as streamlined offers. Offers exceeding these requirements are considered non-streamlined offers and follow the regular process.

This review was performed at the SB/SE Division Campus Compliance Services Office in New Carrollton, Maryland, and the IRS Campuses in Holtsville, New York, and Memphis, Tennessee, during the period June through November 2011. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

Our review results showed that while the streamlined offer program has been effective in processing and closing offers in less time than under the non-streamlined process, OIC procedures could be improved to reduce taxpayer burden and inequitable treatment of taxpayers. Specifically, we determined that:

- The IRS has taken positive steps to improve and promote the OIC Program.
- Offers were not always processed timely.
- Offers reconsidered after IRS processing errors are improperly delayed.
- Streamlined offers lack formal performance measures.

The Internal Revenue Service Has Taken Positive Steps to Improve and Promote the Offer in Compromise Program

The streamlined offer process allows employees to make taxpayer contact by telephone rather than by mail so they can quickly make a determination on the OIC request. This policy has allowed the OIC staff to process and close offers in less time than the non-streamlined process. Faster determinations enabled the IRS to process streamlined offers an average of 28 days faster than non-streamlined offers in FY 2011. More than 67 percent of streamlined offers were closed in less than six months, compared with 49 percent for the non-streamlined offers. In addition, it takes an OIC employee two fewer hours to work a streamlined offer compared to a non-streamlined offer. IRS management informed us that employees assigned to the streamlined offer program are enthusiastic about the program and consider it a significant improvement over the non-streamlined process. In FY 2011, the IRS reported that more than 42 percent of the offer receipts were classified as streamlined offer requests.

In March 2011, the IRS updated Form 656 and the related information booklet to make it easier for taxpayers to understand and complete OIC requests. The IRS also completed an instructional video to help taxpayers when preparing the Form 656. To better promote the OIC Program, the IRS added links to OIC Program information on the IRS.gov website home page and developed a tax tip video to promote OICs on the “You Tube” website.

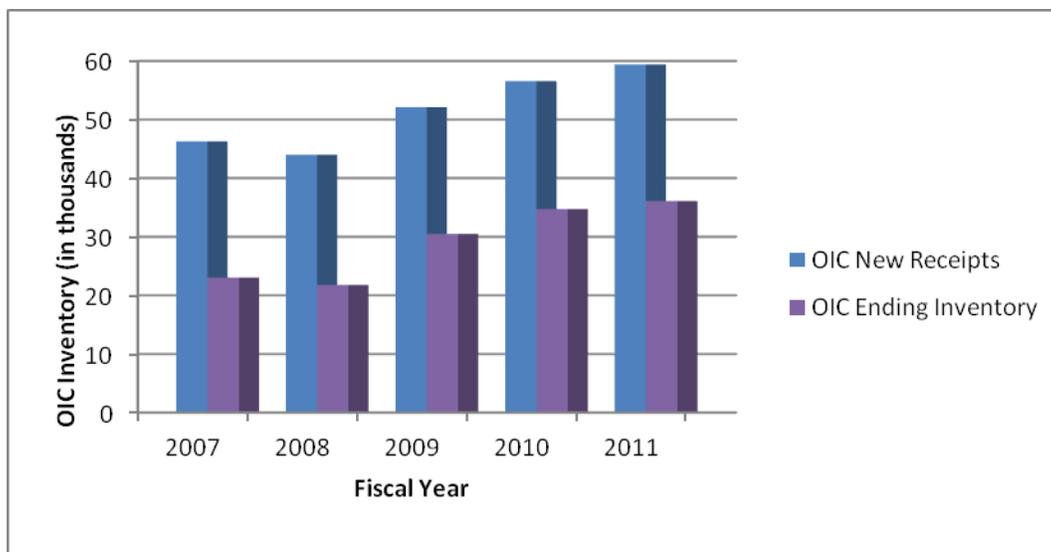


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Offers Were Not Always Processed Timely

The combined impact of a weak economy and IRS efforts to promote the OIC Program has increased the number of requested offers. However, the resources available to work the offers have decreased.³ This condition has created a backlog of offers in inventory. Figure 1 shows increasing trends in the numbers of new OIC receipts and ending inventory over the past five years.

Figure 1: OIC Inventory FYs 2007–2011



Source: Collection Information System Reports from FYs 2007 through 2011.

New offer receipts increased from 46,270 in FY 2007 to 59,411 receipts in FY 2011 (28 percent). This increase in offer receipts, coupled with a decrease in resources to work the offers, has caused the OIC ending inventory levels to increase from 23,003 in FY 2007 to 36,069 in FY 2011 (57 percent).

The OIC staff did not always contact taxpayers when promised

When an OIC request is submitted with all required information, the OIC staff sends the taxpayer a “Combo A” letter. This letter states that the information has been received and provides a date by which the IRS will contact the taxpayer about the status of his or her offer. However, if critical information was omitted and/or if there are processing problems with the submitted offer, instead of sending a “Combo A” letter, the OIC staff initiates contact by issuing a separate letter to the taxpayer requesting additional information.

³ The number of IRS employees who process OICs decreased from 344 employees in FY 2007 to 334 employees in FY 2011.



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Internal Revenue Manual procedures require OIC staff to take action on OIC requests within 45 calendar days from the date the letter is sent to the taxpayer.⁴ Because of the increased number of offers received, the IRS has made informal changes to the process for contacting taxpayers about their offer status.

- In September 2010, management notified OIC staff that they may use a more realistic follow-up date, up to 90 days when appropriate, for the “Combo A” letter (an increase of 45 days).
- In January 2011, management advised OIC staff to send an interim letter to taxpayers who had not been contacted by the date provided in the “Combo A” letter. The interim letter notified taxpayers that it may be another 90 days before the IRS contacted them about their offer. This change extended the promised contact date up to 180 days.

We selected a random statistical sample of 193 streamlined and non-streamlined offers submitted between July 1 and December 31, 2010, to evaluate compliance with OIC processing procedures.⁵ We reviewed information retained in the Integrated Data Retrieval System, Integrated Collection System, and the Automated Offer in Compromise (AOIC) System, as appropriate. In our sample, 99 offers included a “Combo A” letter (these letters are not required if the taxpayer did not provide all required information). In 73 (74 percent) of the 99 offers, the OIC staff did not contact the taxpayer by the date promised. Additionally, in 66 of the 73 offers with late contact, the OIC staff did not send an interim letter notifying the taxpayer that there would be additional time before they would be contacted. Based on the results of our statistically valid sample, we project that 9,509 taxpayers who submitted offers between July 1 and December 31, 2010, may not have been contacted by the date promised by the OIC staff. We are 95 percent confident the number of taxpayers not timely contacted is between 7,569 and 11,450.⁶ Figure 2 shows taxpayers with both streamlined and non-streamlined offers were not contacted by the date promised.

⁴ Internal Revenue Manual 5.8.3.7.1 (March 26, 2010).

⁵ A valid statistical sample of OICs was selected from a population of 28,940 offers received between July 1 and December 31, 2010. The total sample of 193 OICs was based on a confidence level of 90 percent, a precision level of ± 5 percent, and an expected error rate of 10 percent.

⁶ To project the results of our statistical sample, we used a 95 percent confidence level, a 32.86 percent error rate, and a 6.71 percent precision factor.



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Figure 2: Analysis of Timeliness of Taxpayer Contact for Offers With a “Combo A” Letter Sent

Type of Sampled Case	Offers With a “Combo A” Letter Sent	Offers in Which Taxpayer Was Not Contacted by the Date Promised	Offers With an Interim Letter Sent	Number of Days Late Contacting the Taxpayer (Range)
Non-Streamlined Cases	39	24	5	10 – 195 days
Streamlined Cases	60	49	2	8 – 155 days
Total Cases	99	73	7	8 – 195 days

Source: Our analysis of sampled offer cases received from July 1 through December 31, 2010.

When a follow-up date is present in the AOIC System, the offer will be included on a follow-up list and the OIC staff will be notified to take further action on the offer. For example, employees might ensure information requested from the taxpayer has been received, or send the taxpayer an interim letter if more time is necessary before contact.

The Internal Revenue Manual⁷ requires OIC staff to record the mailing date of letters in the AOIC System, which then generates follow-up dates. OIC staff may also manually enter follow-up dates into the AOIC System. However, the OIC staff did not always input mailing dates or manually establish follow-up dates in the AOIC System. As a result, an interim letter was not always sent to notify the taxpayer of a new contact date if contact was not made by the promised date on the “Combo A” letter.

The inventory backlog of offers is unevenly distributed

As of October 25, 2011, the OIC inventory reports showed there were 7,472 unassigned offers in the COIC sites’ holding queues awaiting assignment to OIC staff. Figure 3 shows the total unassigned inventory at the COIC sites. Twenty-two percent of the Memphis COIC site’s unassigned offers were more than six months old, compared to only 0.1 percent at the Brookhaven COIC site.⁸

⁷ Internal Revenue Manual 5.8.3.7.1 (March 26, 2010).

⁸ The Brookhaven COIC site is located in Holtsville, New York.



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Figure 3: Inventory of Total Unassigned Offers at Each COIC Site



Source: IRS AOIC Inventory Management Reports, as of October 25, 2011.

The unassigned offers included both wage earners and self-employed taxpayers. The offers from self-employed taxpayers are generally more complex and are, therefore, assigned to more experienced staff. However, COIC site officials informed us that they do not have a sufficient number of experienced staff who can work them. Figure 4 shows the unassigned inventory for self-employed taxpayers at the COIC sites. The Memphis COIC site had more than four times as many unassigned offers from self-employed taxpayers compared with the Brookhaven COIC site, and 37 percent of the offers were more than six months old. Only 0.15 percent of the unassigned offers from self-employed taxpayers at the Brookhaven COIC site were more than six months old.



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Figure 4: Inventory of Unassigned Offers From Self-Employed Taxpayers at Each COIC Site



Source: IRS AOIC Inventory Management Reports, as of October 25, 2011.

Offers are assigned to the COIC sites based on the taxpayer's State of residence. There is no formal process in place to assess the backlog of offers and possibly redistribute the offer inventory, as needed. Because of the long wait for the offers to be processed, the varying timelines depending on the type of taxpayer, and the location where the offer is assigned, taxpayers are not always being treated equitably. Further, IRS delays could impact taxpayers' important financial and business decisions because they do not know if or when their tax liabilities will be resolved.

Management Actions: After we informed management of our results, COIC site officials transferred approximately 300 self-employed offers that were more than 120 days old from the Memphis COIC site to the Brookhaven COIC site.

Recommendations

The Director, Collection Policy, SB/SE Division, should:

Recommendation 1: Issue an Interim Guidance Memorandum to notify OIC staff of the change to a more appropriate number of days for the contact by date to be used on the



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“Combo A” letters sent to taxpayers. Also, require issuing an interim letter if contact is not made by the specified number of days.

Management’s Response: IRS management agreed with this recommendation. The IRS will issue an Interim Guidance Memorandum to notify OIC staff of the change to a more appropriate number of days for the contact by date to be used on the “Combo A” letters sent to taxpayers. The Interim Guidance memorandum will also require the OIC staff to issue an interim letter if contact is not made within the specified number of days.

Recommendation 2: Require the OIC staff to monitor unassigned offers weekly and generate interim letters for those offers reaching the prescribed number of days.

Management’s Response: IRS management agreed with this recommendation. The IRS will continue to require the OIC staff to monitor unassigned offers weekly and generate interim letters for those offers reaching the prescribed number of days. The IRS has developed a systemic method for generating interim letters that eliminates the possibility of employees failing to do so in a timely manner.

Recommendation 3: Review inventory reports to determine the site level inventory of unassigned offers on a quarterly basis and reassign offers between the sites as needed.

Management’s Response: IRS management agreed with this recommendation. In February 2010, the Director, Campus Compliance Services, directed the headquarters staff to run a report every two weeks showing the cases that have been in inventory for the longest period of time. They will review this report at least quarterly for inventory imbalances and reassign offers between the sites when appropriate.

Offers Reconsidered Due to Internal Revenue Service Processing Errors Are Improperly Delayed

Offers are generally returned to the taxpayer when the taxpayer fails to provide information necessary to determine whether the offer should be accepted. A taxpayer is allowed to request reconsideration of a returned offer within 30 calendar days of the return date. Examples of acceptable reasons when reconsideration may be applicable include:

- An offer that was returned in error.
- Information was sent timely, but it was not associated with the offer file.
- The taxpayer had a serious illness.
- A death in the taxpayer’s family.

For approved offer reconsiderations, a new offer record is entered into the AOIC System with the same data as the original offer, except for the received and pending date fields. These dates



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should be updated with the date that the missing information, substantiation, Forms 656, and/or applicable fees were received from the taxpayer.

In our sample of 193 offers, we identified four offers that involved reconsideration due to an IRS processing error. The COIC site staff incorrectly concluded the taxpayers failed to meet the offer requirements and unnecessarily returned them to the taxpayers. After realizing the mistake (usually after the taxpayer responded to the return notice), the IRS approved the reconsidered offers. However, when establishing the new offer record in the AOIC System, COIC site employees used the date that they established the new offer record as the received date. The correct received date for the new offer record should have been the date the taxpayer provided the required documentation. Based on our statistically valid sample, we project that 712 taxpayers who submitted offers between July 1 and December 31, 2010, may have had their offers returned due to an IRS error, and the wrong received date was used on the reconsidered offer. We are 95 percent confident the number of taxpayers with improper dates is between 93 and 1,537.⁹

We identified inconsistencies in the dates entered by both of the COIC site locations. Additional taxpayer burden is created when an offer is returned to the taxpayer as a result of an IRS error. For an offer to be reconsidered, the taxpayer has to resolve the situation by calling the IRS and providing evidence that they already submitted the requested information. The reconsidered offers require reestablishing the offer on the AOIC System which, depending on the received date used for the offer, can result in increased processing time for the taxpayer's offer.

Recommendation

Recommendation 4: The Director, Collection Policy, SB/SE Division, should ensure employees are properly trained to follow the offer reconsideration procedures and use the appropriate received date for the new offer record.

Management's Response: IRS management agreed with this recommendation. The IRS will train employees to follow the reconsideration procedures and use the appropriate received date for the new offer record.

Streamlined Offers Lack Formal Performance Measures

The IRS Balanced Performance Measurement System was developed to reflect IRS priorities consistent with the mission and strategic goals. The IRS uses balanced measures at both the strategic level and the operational level to measure organizational performance. The IRS's Collection Information System reports assess collection production activity nationwide,

⁹ To project the results of our statistical sample, we used a 95 percent confidence level, a 2.46 percent error rate, and a 2.14 percent to 2.85 percent precision factor.



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including the OIC activity. The Collection Information System *Report of Offer in Compromise Activity* is a cumulative report that measures productivity for the current fiscal year. The report is used by managers for budget planning, program evaluation, operational control, and analysis of resource allocation.

In June 2010, the SB/SE Division initiated the streamlined OIC Program to expedite the processing of offers for qualified taxpayers. The SB/SE Division established an informal process to measure the productivity of the streamlined OIC Program. An offer category code within the AOIC System is used to identify and track the streamlined offers. OIC management created a cumulative *Streamlined Summary Report* to informally measure the streamlined offer activity since its implementation and results are reported to IRS senior management. However, the *Report of Offer in Compromise Activity*, which measures OIC activity nationwide for the current fiscal year, does not differentiate between the streamlined and the non-streamlined OIC activity. The streamlined offer process has had a major impact on the overall OIC Program, accounting for 42 percent of the OIC inventory for FY 2011.

The SB/SE Division does not plan to establish separate measures for the streamlined OICs within the *Report of Offer in Compromise Activity*. Management is considering a policy change to have all offers follow the streamlined process. However, this policy change is still in the discussion phase and it is unknown if or when this change will be implemented.

Because the streamlined offers are a significant part of the overall OIC Program, an identifiable measure needs to be established. Separately reporting streamlined and non-streamlined OIC data will provide IRS management and stakeholders with an effective means to assess the performance of the streamlined OIC Program. Additionally, specific measures provide a basis for establishing goals, budget planning, resource allocation, and creating historical patterns and trends, as well as identifying any potential problems.

Recommendation

Recommendation 5: The Director, Collection Policy, SB/SE Division, should establish a performance measure for the streamlined offers in the Collection Information System *Report of Offer in Compromise Activity* or apply the streamlined process to the entire inventory of offers.

Management's Response: IRS management agreed to apply most aspects of the streamlined process to the entire inventory of taxpayer offers. Although the streamlined process was originally intended for less complex offers, most aspects of the process can be applied to all offers. However, some of the most complex offers would not benefit from complete streamline processing. An Interim Guidance memorandum has been drafted and is awaiting approval.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine the effectiveness of the OIC¹ Program to timely process requests, consistently apply OIC guidelines, accurately measure Program results, and effectively promote the Program. To accomplish the objective, we:

- I. Determined whether current OIC requirements are being followed when the offers are received and processed and if the requirements promote efficient disposition of the OIC.
 - A. Interviewed SB/SE Division analysts to clarify the Internal Revenue Manual criteria for the OICs, including any changes that have been implemented, to improve the processing of the OICs.
 - B. Reviewed a valid statistical sample of 96 streamlined and 97 non-streamlined offers received from July 1 to December 31, 2010. We reviewed each case to determine if OIC policies and procedures were consistently followed, taxpayers were contacted in a timely manner, and if overall processing time (from receipt to closure) was appropriate.

The sample selected was based on random sampling techniques using random case selection from a population of 8,932 streamlined and 20,008 non-streamlined offers. The sample selections of 96 streamlined and 97 non-streamlined offers were each based on a confidence level of 90 percent with a ± 5 percent precision level and an expected error rate of 10 percent. The Treasury Inspector General for Tax Administration contract statistician was consulted throughout the development and selection of this sample.

Validity and reliability of data from computer-based systems: We obtained OIC data processed by the IRS and stored on the Treasury Inspector General for Tax Administration Data Center Warehouse. We compared the data to information processed and stored in the AOIC System, Individual Master File, and Business Master File. We used the Taxpayer Identification Number as the control to validate the accuracy of the matching of the tax return information stored on the AOIC System, Master File, and the Integrated Data Retrieval System. The data were sufficiently reliable to perform our audit analyses.

- C. Reviewed OIC operational reviews to identify any significant issues and determined whether corrective actions were implemented.

¹ See Appendix V for a glossary of terms.



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- II. Determined whether the IRS is effectively measuring the OIC Program results.
 - A. Reviewed the Collection Information System *Report of Offer in Compromise Activity* reports and identified statistics that are available for the OICs for FYs 2007 through 2011 and determined whether there has been any increase or decrease in inventory levels.
 - B. Reviewed the reports used by the SB/SE Division to measure the progress of the streamlined OICs.
 - C. Discussed with SB/SE Division management plans to add performance measures for the streamlined OICs to the Collection Information System *Report of Offer in Compromise Activity*.
- III. Determined whether the IRS has implemented the recommendations from the OIC studies to promote the OIC Program.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: SB/SE Division policies, procedures, and practices for processing and working OICs. We evaluated these controls by reviewing source materials, interviewing management, reviewing a sample of offer case files, and researching taxpayer accounts.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Commissioner, Wage and Investment Division SE:W
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Wage and Investment Division SE:W
Director, Campus Compliance Services, Small Business/Self-Employed Division SE:S:CCS
Director, Collection, Small Business/Self-Employed Division SE:S:C
Director, Filing and Payment Compliance, Wage and Investment Division SE:W:CP:FPC
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
 Commissioner, Small Business/Self-Employed Division SE:S
 Commissioner, Wage and Investment Division SE:W



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Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 9,509 taxpayers affected (see page 4).

Methodology Used to Measure the Reported Benefit:

We selected a random statistical sample of 193 OICs¹ from the total population of 28,940 offers submitted between July 1 and December 31, 2010. We selected this type of sample so that we could project our results to the population of offers for this time period. In our sample of 193 offers, 99 included a letter (“Combo A”) notifying the taxpayer when the IRS would be in contact (these letters are not always required). In 73 of the 99 offers, the IRS did not contact the taxpayer by the date promised. Additionally, in 66 of the 73 offers with late contact, the IRS did not send an interim letter to the taxpayer extending the contact date.

To project the results of our statistical sample, we used a 95 percent confidence level, 32.86 percent error rate, and a 6.71 percent precision factor. Based on these parameters, 9,509 taxpayers with offers submitted between July 1 and December 31, 2010, may not have been contacted by the date the IRS promised (the projected range is 7,569 to 11,450 taxpayers).

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 712 taxpayers affected (see page 9).

Methodology Used to Measure the Reported Benefit:

We selected a random statistical sample of 193 offers from the total population of 28,940 offers submitted between July 1 and December 31, 2010. We selected this type of sample so we could project our results to the population of offers for this time period. In our sample of 193 offers, we identified four offers in which the taxpayer requested the offer be reconsidered due to IRS processing errors. The IRS had incorrectly concluded the taxpayers failed to meet the offer requirements in these offers and unnecessarily returned them to the taxpayers. After realizing

¹ See Appendix V for a glossary of terms.



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the mistake (usually after the taxpayer responded), the IRS reestablished the offers using the resubmitted offer dates instead of the appropriate date. The correct received date for the new offer record should have been the date the taxpayer provided the required documentation.

To project the results of our statistical sample, we used a 95 percent confidence level, 2.46 percent error rate, and a 2.14 percent to 2.85 percent precision factor. Based on these parameters, 712 taxpayers who submitted between July 1 and December 31, 2010, may have had their offer returned due to an IRS error and had the wrong IRS received date used on the reconsidered offer (projected range of 93 to 1,537 taxpayers).



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Appendix V

Glossary of Terms

Area Office – A geographic organizational level used by IRS business units and offices to help their specific types of taxpayers understand and comply with tax laws and issues.

Automated Offer in Compromise System – Computer application where an OIC is recorded and monitored from receipt to closure. COIC sites, Area offices, and the compliance campus share a common database that contains relevant offer information. The AOIC System allows the user to process, view, and track the status of each offer. The program also generates forms, letters, and managerial reports.

Business Master File – The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

Campus – The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

Centralized Offer in Compromise Site – Campus locations (Holtsville, New York, and Memphis, Tennessee) responsible for processing an offer in compromise received based on the taxpayer's State of residency.

Collection Information System – Computer application that is a repository of reports for Headquarters Small Business/Compliance Programs that contain widely used collection activity information.

Currently Not Collectible – As a general rule, accounts will be reported as currently not collectible when the taxpayer has no assets or income which are, by law, subject to levy.

Fiscal Year – A 12-consecutive-month period ending on the last day of any month, except December. The Federal Government's fiscal year begins on October 1 and ends on September 30.

Individual Master File – The IRS database that maintains transactions or records of individual tax accounts.

Installment Agreement – Arrangements by which the IRS allows taxpayers to fully pay liabilities over time in smaller manageable payments



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Integrated Collection System – An information management system designed to improve revenue collections by providing revenue officers access to the most current taxpayer information, while in the field, using laptop computers for quicker case resolution and improved customer service.

Integrated Data Retrieval System – An IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

Master File – The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

Offer in Compromise – An agreement between a taxpayer and the Federal Government that settles a tax liability for payment of less than the full amount owed.

Queue – An automated holding file for unassigned inventory of delinquent cases for which the Collection function does not have enough resources to immediately assign for contact.

Streamlined Offer in Compromise – An expedited offer in compromise program for qualified taxpayers who are wage earners, unemployed, or self-employed (no employees and gross receipts less than \$500,000) with incomes of \$100,000 or less and liabilities of \$50,000 or less. The program includes fewer requests for additional financial information, contacting the taxpayer by telephone for additional information versus by mail, and greater payment flexibility.



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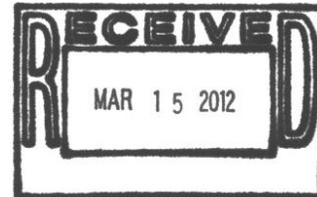
Appendix VI

Management's Response to the Draft Report



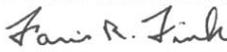
COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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



MAR 15 2012

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Faris R. Fink 
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Increasing Requests for Offers in
Compromise Have Created Inventory Backlogs and Delayed
Responses to Taxpayers (Audit # 201130014)

Thank you for the opportunity to review your draft report titled, "Increasing Requests for Offers in Compromise Have Created Inventory Backlogs and Delayed Responses to Taxpayers." We appreciate TIGTA's acknowledgement that the Offer in Compromise (OIC) streamlined program has been a success to date. The policies established for processing streamlined cases have reduced taxpayer burden and cycle time and have increased communication with taxpayers and their representatives.

We also appreciate TIGTA acknowledging the many positive steps the IRS has taken to improve and promote the program. During fiscal year 2011, we continued to deliver extensive outreach to the practitioner community. We concur that the weak economy and efforts to promote the OIC program have resulted in a 28 percent increase in receipts since 2007. This increase, along with resource limitations, has led to a backlog of inventory.

Regarding the recommendations, we agree that the Centralized Offer in Compromise (COIC) staff was not properly sending acknowledgement letters with the appropriate date for IRS follow-up nor always sending interim letters as required. We are taking steps to keep taxpayers better informed by improving the level of service on the Process Examiner phone line, utilizing the interim letter and increasing the number of days on letters informing taxpayers when they can expect contact.

We also agree there is currently a disparity in inventory backlogs between the two COIC sites. We have developed and tracked the inventories for the wage earner, self-employed; streamlined and non-streamlined work for the past two years and will continue to do so regularly. In fact, we have initiated reassignment of offers between



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the sites as needed. Additionally, we agree refresher training and clarification of procedures is needed to address the few situations where IRS inappropriately returns taxpayers' offers.

Regarding the last recommendation, we will be applying most aspects of the streamlined process to the remainder of OIC cases. Finally, we agree with the two taxpayer burden outcome measures listed in your report.

Attached are our responses to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Michael D. Julianelle, Director, Enterprise Collection Strategy, Small Business/Self-Employed Division at (202) 622-3480.

Attachment



Increasing Requests for Offers in Compromise Have Created Inventory Backlogs and Delayed Responses to Taxpayers

Attachment

RECOMMENDATION 1:

The Director, Collection Policy, SB/SE Division, should issue an Interim Guidance Memorandum to notify OIC staff of the change to a more appropriate number of days for the contact by date to be used on the "Combo A" letters sent to taxpayers. Also, require issuing an interim letter if contact is not made by the specified number of days.

CORRECTIVE ACTION:

We agree with this recommendation. We will issue an Interim Guidance (IG) Memorandum to notify OIC staff of the change to a more appropriate number of days for the contact by date to be used on the "Combo A" letters sent to taxpayers. The IG memorandum will also require the OIC staff to issue an interim letter if contact is not made within the specified number of days.

IMPLEMENTATION DATE:

June 15, 2012

RESPONSIBLE OFFICIAL(S):

Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:

The IRS will monitor this corrective action as part of its internal management system of controls.

RECOMMENDATION 2:

The Director, Collection Policy, SB/SE Division, should require the OIC staff to monitor unassigned offers weekly and generate interim letters for those offers reaching the prescribed number of days.

CORRECTIVE ACTION:

We will continue to require the OIC staff to monitor unassigned offers weekly and generate interim letters for those offers reaching the prescribed number of days. We have developed a systemic method for generating interim letters that eliminates the possibility of employees failing to do so in a timely manner. A query captures cases in offer examiner holding inventories that are between 80-85 days old. The Taxpayer Identifying Numbers are run through a computer interface (GII) that imitates Integrated Data Retrieval System (IDRS) keystrokes and generates the interim letters.

IMPLEMENTATION DATE:

Completed

RESPONSIBLE OFFICIAL(S):

N/A



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CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 3:

The Director, Collection Policy, SB/SE Division, should review inventory reports to determine the site level inventory of unassigned offers on a quarterly basis and reassign offers between the sites as needed.

CORRECTIVE ACTION:

In February 2010, the Director, CCS directed the HQ staff to run a report every two weeks showing the cases that have been in inventory for the longest period of time. The report was reviewed regularly but due to resource limitations, neither site was in a position to accept inventory from the other site until late in FY 11. Approximately 600 cases have been shipped from one site to the other in FY 12 to balance the inventory. There may continue to be occasions when the reports indicate inventory needs to be reassigned but other factors preclude the reassignment; however, we will continue to review inventory reports on at least a quarterly basis and reassign offers between the sites when appropriate.

IMPLEMENTATION DATE:

Completed

RESPONSIBLE OFFICIAL(S):

N/A

CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 4:

The Director, Collection Policy, SB/SE Division, should ensure employees are properly trained to follow the offer reconsideration procedures and use the appropriate received date for the new offer record.

CORRECTIVE ACTION:

We agree with this recommendation. We will train employees to follow the reconsideration procedures and use the appropriate received date for the new offer record.

IMPLEMENTATION DATE:

June 15, 2012



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RESPONSIBLE OFFICIAL(S):

Director, Filing & Payment Compliance, SB/SE Division
Director, Field Collection, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN:

The IRS will monitor this corrective action as part of its internal management system of controls.

RECOMMENDATION 5:

The Director, Collection Policy, SB/SE Division, should establish a performance measure for the streamlined offers in the Collection Information System *Report of Offer in Compromise Activity* or apply the streamlined process to the entire inventory of offers.

CORRECTIVE ACTION:

We agree to apply most aspects of the streamlined process to the entire inventory of taxpayer offers. Although the streamlined process was originally intended for less complex offers, most aspects of the process can be applied to all offers. However, some of the most complex offers would not benefit from complete streamline processing. An Interim Guidance memorandum has been drafted and is in clearance.

IMPLEMENTATION DATE:

June 15, 2012

RESPONSIBLE OFFICIAL(S):

Director, Collection Policy, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN:

The IRS will monitor this corrective action as part of its internal management system of controls.