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

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MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Joseph Kehoe
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report - The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations

We appreciate the opportunity to respond to your draft report, "The Internal Revenue Service Needs to Better Address Bankruptcy Automatic Stay Violations." The report is a review of the process used to prevent violations of the Bankruptcy Code when a taxpayer files bankruptcy and to promptly correct those that occur.

While we agree that the proposed recommendations will improve the program, we feel the need to emphasize several points. First, based on published Chief Counsel opinions, acceptance of voluntary payments, by check or automatic debit payments from post-petition earnings for pre-existing installment agreements does not violate the automatic stay on Chapter 7 non-dischargeable taxes and may not violate the stay in Chapter 13 cases. We cannot determine how many of the 115 stay violations cited meet this criteria. Second, even using the number of violations cited in the report, the review sample would project violations in 3 percent of the cases in the districts reviewed. Therefore, in at least 97 percent of all cases, the IRS is complying with the automatic stay provisions. Payments received after the petition date will include some that are acceptable to process and retain and some that are violations of the automatic stay. Given the time sensitive nature of this work and limitations in resources, it will be difficult to eliminate all violations. We will, as discussed below, continue to make every effort to avoid all preventable violations and to identify those payments that are in violation of the automatic stay.

Our comments on the recommendations in this report are as follows:

IDENTITY OF RECOMMENDATION 1
Ensure bankruptcy examiners are properly resolving violations of the automatic stay by reviewing the litigation transcripts on a timely basis.

ASSESSMENT OF CAUSE
The current paper process for litigation transcripts has become unworkable with the enormous growth in bankruptcy filings.

CORRECTIVE ACTION
We submitted a request to convert the paper transcripts to electronic format for delivery to Automated Insolvency System (AIS) in 1998; we will implement this electronic delivery in January 2001. Instructions will be issued for timely review of the electronic transcripts.

IMPLEMENTATION DATE
April 1, 2001

RESPONSIBLE OFFICIAL
Director, Compliance Policy, Small Business/Self-Employed (SB/SE)

CORRECTIVE ACTION MONITORING PLAN
The office director of the Technical and Insolvency Section will monitor progress of the corrective action and will report the status to the Director, Compliance Policy (SB/SE).

IDENTITY OF RECOMMENDATION 2
Provide additional computer programming enhancements to improve the value of litigation transcripts. Management needs to determine if an electronic version of the transcripts can be matched against AIS so exception cases can be automatically identified, giving examiners the ability to pinpoint those cases having the most potential risk of violations. In addition, payments that are received as part of the bankruptcy closure should be eliminated from the litigation transcripts.

ASSESSMENT OF CAUSE
Under current paper processing, bankruptcy employees need to review the individual transactions to determine if any action is required. With the availability of electronic transcripts, they can review the transactions systemically to identify needed actions.

CORRECTIVE ACTION
For the upcoming filing season, AIS programming will identify refund returns from the electronic transcripts and set up the cases for generating a refund request to either the taxpayer or the trustee, as appropriate. We will ask for enhancements to AIS to identify potential stay violation conditions such as payments and lien filing indicators after the petition date.

IMPLEMENTATION DATE
February 1, 2002

RESPONSIBLE OFFICIAL
Director, Compliance Policy (SB/SE)

CORRECTIVE ACTION MONITORING PLAN
The office director of the Technical and Insolvency Section will monitor progress of the corrective action and will report the status to the Director, Compliance Policy (SB/SE).

IDENTITY OF RECOMMENDATION 3
Provide additional guidance to Special Procedures function (SPf) employees on specific conditions that may be considered violations of the automatic stay. This includes "voluntary" payments received outside of the Chapter 13 payment plan, and payments received and applied to dischargeable tax from taxpayers who file under Chapter 7.

ASSESSMENT OF CAUSE
Legal interpretations and case law have changed in recent years on the treatment of payments received after the petition date in bankruptcy.

CORRECTIVE ACTION
We will work with the Assistant Chief Counsel (Collection, Bankruptcy and Summons) to draft specific guidelines for identifying specific types of payments and circumstances and the proper method of disposition.

IMPLEMENTATION DATE
April 1, 2001

RESPONSIBLE OFFICIAL
Director, Compliance Policy (SB/SE)

CORRECTIVE ACTION MONITORING PLAN
The office director of the Technical and Insolvency Section will monitor progress of the corrective action and will report the status to the Director, Compliance Policy (SB/SE).

IDENTITY OF RECOMMENDATION 4
Provide specific guidance in the Internal Revenue Manual (IRM) so the field offices know when and how to refund payments received after the bankruptcy petition date.

ASSESSMENT OF CAUSE
Current IRM procedures require us to return payments received in violation of the automatic stay by initiating a manual refund within two workdays of the Service becoming aware of the payment.

CORRECTIVE ACTION
Along with the guidance to be issued in the corrective actions to Recommendation #3, we will reinforce and clarify current IRM instructions on the timing, procedures and controls for issuing manual refunds.

IMPLEMENTATION DATE
April 1, 2001

RESPONSIBLE OFFICIAL
Director, Compliance Policy (SB/SE)

CORRECTIVE ACTION MONITORING PLAN
The office director of the Technical and Insolvency Section will monitor progress of the corrective action and will report the status to the Director, Compliance Policy (SB/SE).

IDENTITY OF RECOMMENDATION 5
Provide consistent guidelines to the SPf units on how to notify the Examination function that the taxpayer is in bankruptcy.

ASSESSMENT OF CAUSE
Previously, we notified the Examination function by forwarding listings or individual notices of new cases. The Examination function also identified cases through the bankruptcy freeze code, which was not always established.

CORRECTIVE ACTION
We completed our nationwide implementation of the Insolvency Notification System (INS) in August 2000. INS standardizes notification to the Examination function by matching Audit Information Management System (AIMS) data against both open and closed bankruptcies in the AIS database. We will coordinate with the Examination function to review procedures in service center examinations to ensure proper handling of bankruptcy cases.

IMPLEMENTATION DATE
April 1, 2001

RESPONSIBLE OFFICIAL
Director, Compliance Policy (SB/SE)

CORRECTIVE ACTION MONITORING PLAN
The office director of the Technical and Insolvency Section will monitor progress of the corrective action and will report the status to the Director, Compliance Policy (SB/SE).

IDENTITY OF RECOMMENDATION 6
Request that the AIS be reprogrammed so the actual receipt date of the case can be input into the system to provide management with more accurate data on timeliness of input of new case information.

ASSESSMENT OF CAUSE
Currently, we can track approximately 75 percent of cases by the date of receipt of the electronic notice. For the remaining cases where we receive notification on paper, the system records the date we created the case instead of the date of receipt.

CORRECTIVE ACTION
We will request a programming change for AIS to add a field for the date of receipt of notice of a new case. We will instruct management to ensure local controls are in place for timely input of paper notices.

IMPLEMENTATION DATE
February 1, 2002

RESPONSIBLE OFFICIAL
Director, Compliance Policy (SB/SE)

CORRECTIVE ACTION MONITORING PLAN
The office director of the Technical and Insolvency Section will monitor progress of the corrective action and will report the status to the Director, Compliance Policy (SB/SE).

IDENTITY OF RECOMMENDATION 7
Ensure employees review the Potentially Invalid Taxpayer Identification Number (PIT) report and resolve all cases promptly to ensure timely posting of the bankruptcy to the taxpayer's account.

ASSESSMENT OF CAUSE
The PIT report does not identify the date a case was first listed on the report, which does not allow for monitoring the length of time it is on the list for resolution.

CORRECTIVE ACTION
We will request an addition for the PIT report that includes the date a case is first listed on the report. We will issue instructions that cases must be resolved from the PIT list to meet the new case processing timeframe.

IMPLEMENTATION DATE
July 1, 2001

RESPONSIBLE OFFICIAL
Director, Compliance Policy (SB/SE)

CORRECTIVE ACTION MONITORING PLAN
The office director of the Technical and Insolvency Section will monitor progress of the corrective action and will report status to the Director, Compliance Policy (SB/SE).

If you have any questions, please call Frank Nixon, Director, Compliance Policy, at (202) 622-5563.