



*Expansion of the Delinquent Return Refund
Hold Program Could Improve Filing
Compliance and Help Reduce the Tax Gap*

May 14, 2014

Reference Number: 2014-30-023

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.

Redaction Legend:

1 = Tax Return/Return Information
2 = Law Enforcement Tolerance

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HIGHLIGHTS

EXPANSION OF THE DELINQUENT RETURN REFUND HOLD PROGRAM COULD IMPROVE FILING COMPLIANCE AND HELP REDUCE THE TAX GAP

Highlights

Final Report issued on May 14, 2014

Highlights of Reference Number: 2014-30-023 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed and Wage and Investment Divisions.

IMPACT ON TAXPAYERS

The IRS has the authority to delay issuing income tax refunds for up to six months while it investigates return delinquencies from other tax years. Holding refunds encourages taxpayers to take action and resolve their delinquent filing obligations earlier.

WHY TIGTA DID THE AUDIT

In Calendar Year 2012, the Delinquent Return Refund Hold Program collected nearly \$242 million, which was applied to balances due on delinquent returns. This audit was initiated to determine the effectiveness of the Program as a tool to promote filing compliance.

WHAT TIGTA FOUND

For Calendar Years 2008 through 2012, the Program held an average of 156,422 refunds per year. During the same period, the Program secured an average of 64,222 returns from taxpayers per year and coordinated with the ASFR program to prepare and post an additional 117,895 substitute returns per year.

TIGTA reviewed two separate random samples of 30 taxpayer cases each in which a refund was held and the refund hold was either manually or systemically released. Results showed employees followed procedures when working cases and when refund holds were released.

TIGTA compared delinquent return data for a population of refund hold cases with a certain dollar amount above the threshold criteria to a population of cases with a certain dollar amount

below the threshold criteria (*i.e.*, refunds were not held for these cases). Analysis showed that 88 percent of delinquencies associated with the held refunds were subsequently resolved, compared with less than one percent of delinquencies associated with cases for which refunds were not held, thus indicating the value of this Program in improving filing compliance.

IRS management has considered expanding the Program by lowering the dollar threshold but has not because of limited resources. However, taxpayers who become compliant with their prior period filing requirements could remain compliant in future years and reduce the need for additional enforcement resources in subsequent filing seasons. TIGTA also identified other opportunities for expansion.

The IRS has not established performance measures to evaluate the Program's primary goal of increasing taxpayer filing compliance. As a result, management does not have complete information about how well the Program is achieving its goal, or if it is an effective tool for improving taxpayer filing compliance over time.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) consider opportunities to expand the use of the Program as resources become available and 2) develop specific performance measures to compare actual results with management's goal to improve filing compliance.

In response to the report, IRS management agreed with both recommendations. However, management did not commit to a specific corrective action plan to expand the Program and agreed only to explore the development of performance measures, with implementation dependent on the availability of resources.

TIGTA continues to believe that expansion of this Program is important as it represents an opportunity to increase both taxpayer filing compliance and revenue at a lower cost than traditional Collection programs. In addition, until specific performance measures are implemented, management will not have complete information about how well the Program is achieving its goals.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 14, 2014

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION
COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Expansion of the Delinquent Return Refund Hold
Program Could Improve Filing Compliance and Help Reduce the Tax
Gap (Audit # 201230018)

This report presents the results of our review to determine the effectiveness of the Delinquent Return¹ Refund Hold Program under the direction of the Compliance Services Collection Operation as a tool to promote filing compliance. This audit is included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

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

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Bryce Kisler, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations).

¹ See Appendix VI for a glossary of terms.



Expansion of the Delinquent Return Refund Hold Program Could Improve Filing Compliance and Help Reduce the Tax Gap

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*Expansion of the Delinquent Return Refund Hold Program Could
Improve Filing Compliance and Help Reduce the Tax Gap*

Abbreviations

AMS	Account Management Services
ASFR	Automated Substitute for Return
CP	Computer Paragraph
CSCO	Compliance Services Collection Operation
IDRS	Integrated Data Retrieval System
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
TIGTA	Treasury Inspector General for Tax Administration
W&I	Wage and Investment



Expansion of the Delinquent Return Refund Hold Program Could Improve Filing Compliance and Help Reduce the Tax Gap

Background

The Delinquent Return¹ Refund Hold Program (Program) addresses taxpayer filing compliance by delaying issuance of a taxpayer's income tax refund for up to six months while the Internal Revenue Service (IRS) investigates a return delinquency on another tax year. The refund can be used to offset any balance due on a taxpayer's delinquent return. If there is no balance due, or a refund amount remains after an offset to the delinquent account, the refund is released to the taxpayer. The Program helps to reduce the net Tax Gap by increasing revenue at a lower cost and in a shorter time period than assigning a return delinquency to a revenue officer who attempts to secure the delinquent return. Holding refunds encourages taxpayers to take action and resolve their filing obligations earlier.

The IRS executes and administers the Program under the authority of Internal Revenue Code Sections (§§) 6402(a) and (b)² which state that the IRS may credit the amount of any overpayment against any tax liability or estimated tax liability of the person who made the overpayment. The period for holding the refund is six months, which begins on April 15 of the current tax year or the date of filing, whichever is later. If the IRS does not secure a delinquent tax return or resolve the delinquency during the six-month period, the refund is automatically released to the taxpayer.

The Program is one of a number of refund hold programs that the IRS administers. The Program is under the direction of the Compliance Services Collection Operation (CSCO) and is consolidated at the IRS Austin, Texas, Campus. The CSCO is organizationally placed under the Wage and Investment (W&I) Division's Filing and Payment Compliance function.

Figure 1 shows that for Fiscal Years 2010 through 2012, almost all Program inventory was worked by the CSCO, with a smaller amount worked by other IRS functions.³

¹ See Appendix VI for a glossary of terms.

² Internal Revenue Code §§ 6402(a) and (b) (2004).

³ Other functions include the IRS W&I Division's Compliance Services Examination Operation and the Small Business/Self-Employed Division's Compliance Services Examination Operation Collection Field function.



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Figure 1: Refund Hold Inventory Worked by Function for Fiscal Years 2010 Through 2012

Function	Fiscal Year 2010	Fiscal Year 2011	Fiscal Year 2012
CSCO:			
Returns	16,338	14,536	16,237
Correspondence	5,593	3,907	3,517
Phone Calls	125,616	123,130	113,849
Total for CSCO	147,547	141,573	133,603
Total for Other Functions	890	927	1,208

Source: IRS-provided data from the Joint Operation Center Liaison Staff Phone Report and the Batch/Block Tracking System.

Program refund holds must meet certain criteria. IRS procedures state that individual income tax refunds, Treasury offsets, and credit elects are to be held when a return is filed with the following criteria:

- *****2*****.
- The taxpayer account has one or more delinquent tax modules within the five tax years prior to the current tax year and for which the IRS has third-party information documents.⁴
- *****2*****
*****2*****
2.
- The module contains any type of delinquent return investigation select code.⁵

When a refund return that meets Program criteria is filed, the taxpayer is notified by a computer-generated (CP) refund hold notice,⁶ which provides the taxpayer with a 10-day deadline for resolving the delinquency. This notification informs the taxpayer that the refund is being held because there is a delinquent return. The notice informs the taxpayer how to respond

⁴ Information documents include the Form W-2, *Wage and Tax Statement*, for wages earned; Form 1099-DIV, *Dividends and Distributions*, for dividends earned; Form 1099-INT, *Interest Income*, for interest earned; and Form 1099-MISC, *Miscellaneous Income*, for nonemployee compensation.

⁵ Assignment of select codes (ranging from 01-99) to delinquent returns or nonfiler cases helps quantify their priority for assignment.

⁶ CP 63, *Refund Hold Notification*.



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and, in addition, if a return is not filed, that the IRS may determine the taxes on behalf of the taxpayer.

If the taxpayer does not respond to the refund hold notice and the case meets certain criteria,⁷ it will be moved to the Automated Substitute for Return (ASFR) program.⁸ The IRS uses the ASFR program to file a return on behalf of an individual taxpayer. If a refund is held in the Program, the case may be worked in conjunction with the ASFR program.

The ASFR program determines and assesses the tax liability by computing tax, penalties, and interest based upon third-party information documents received by the IRS. The IRS sends the taxpayer a copy of the IRS-prepared return (substitute for return) and gives the taxpayer an opportunity to file a delinquent tax return if the substitute for return is inaccurate or incomplete. For example, the substitute for return may not include all the taxpayer's dependents or other expenses that the IRS does not have information about.

If the taxpayer still does not respond, the IRS issues Letter 3219, *Statutory Notice of Deficiency* (90-day letter).⁹ Once Letter 3219 is issued, the taxpayer's refund is transferred to the tax year of the proposed deficiency and held on the account until the 90-day letter is resolved. The taxpayer may either respond to the 90-day letter or file a petition in Tax Court to contest the proposed assessment. If the taxpayer does not satisfactorily respond and does not petition the Tax Court, the proposed deficiency is assessed based on the substitute for return and the transferred refund monies are used to pay the balance due. If the refund amount was more than the proposed deficiency, an adjustment notice¹⁰ is sent to the taxpayer and the remaining amount is released to the taxpayer.

CSCO tax examiners work Program cases when the taxpayer responds to the refund hold notice or ASFR notice by telephone or mail correspondence. Working Program cases is their top priority. Procedures are available for tax examiners to use when performing actions such as handling incoming telephone calls, reviewing incoming tax returns, entering transaction codes, and releasing the refund, if required. All actions taken are required to be documented in the Account Management Services (AMS).

CSCO tax examiners may never get involved in a refund hold case if the taxpayer is unresponsive to IRS notifications. Figure 2 shows an example case in which the taxpayer does not respond to various notices. The process can be entirely systemic without CSCO employee involvement.

⁷ See Appendix V for more information on the Automated Substitute for Return program criteria.

⁸ It is possible that the delinquent return has already been assigned and is being worked by the ASFR program when the taxpayer's refund is held by the Program.

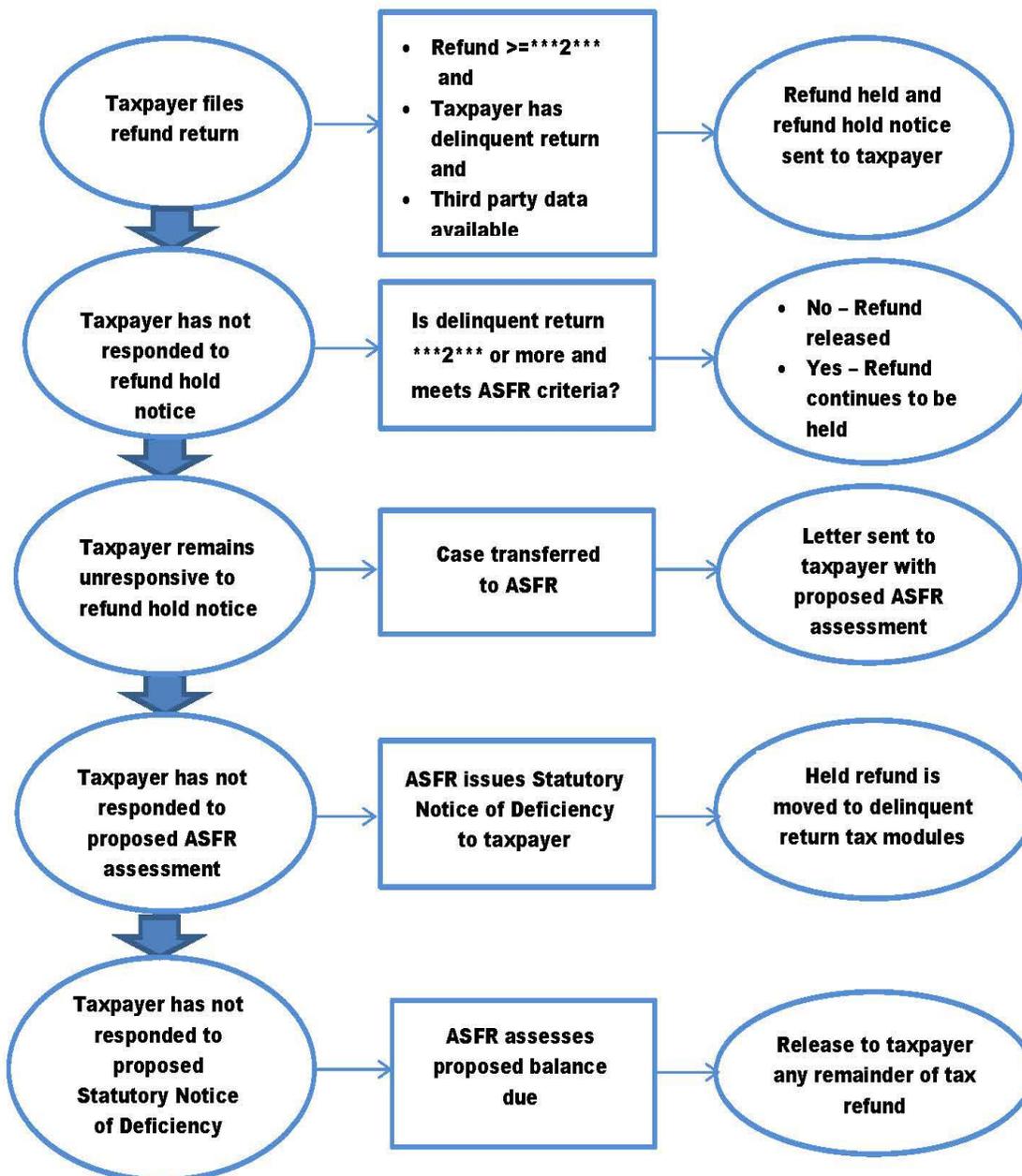
⁹ Internal Revenue Code § 6212 (2004).

¹⁰ CP 21, *Data Processing Adjustment Notice*.



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Figure 2: Systemic Refund Hold Case (Example)



Source: Treasury Inspector General for Tax Administration (TIGTA) analysis from a site walkthrough of the process.



Expansion of the Delinquent Return Refund Hold Program Could Improve Filing Compliance and Help Reduce the Tax Gap

This review was performed at the IRS campus in Austin, Texas; the Small Business/Self-Employed (SB/SE) Division Headquarters in New Carrollton, Maryland; and the W&I Division Headquarters in Atlanta, Georgia, during the period November 2012 through September 2013. 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.



Expansion of the Delinquent Return Refund Hold Program Could Improve Filing Compliance and Help Reduce the Tax Gap

Results of Review

The Program provides the IRS with leverage to motivate taxpayers, who have not filed a return for a previous year and who may have a tax liability, to file their return. The Program has successfully generated revenue and helped secure unfiled returns. However, because of limited resources, the IRS has been unable to expand its use, even though there could be tangible benefits in doing so. Aligning the Program's performance measures with Program goals could help quantify Program benefits, keep managers focused on key goals, and provide the information necessary to make strategic decisions regarding how to use the Program to address delinquent filers and nonfilers.

Refund Holds Promote Filing Compliance and Employees Are Properly Working Cases

In Calendar Year 2012, the Program collected nearly \$242 million which was applied to balances due on delinquent returns (offset transactions). Over the past five calendar years, refund offset transactions have averaged approximately \$232 million annually, which represents an average of 26 percent of the total refund dollars held. During Calendar Years 2011 and 2012, an additional \$1.2 million was received from taxpayers each year when delinquent returns were filed after refunds were held. Figure 3 shows the Program results over the last five calendar years.



Expansion of the Delinquent Return Refund Hold Program Could Improve Filing Compliance and Help Reduce the Tax Gap

Figure 3: Delinquent Return Refund Hold Program Data for Calendar Years 2008 Through 2012

	CY* 2008	CY 2009	CY 2010	CY 2011	CY 2012	Average
Refunds Held	155,325	150,734	145,637	161,403	169,008	156,422
Amount of Refunds Held	\$780,162,208	\$836,328,291	\$857,821,553	\$973,008,212	\$942,853,692	\$878,034,791
Taxpayer Filed Delinquent Returns	69,128	78,508	59,230	49,869	64,374	64,222
Substitute Return Filed Delinquent Returns	113,076	105,186	109,478	121,755	139,981	117,895
Dollars Collected with Returns	\$635,974	\$713,862	\$612,414	\$1,243,123	\$1,217,869	\$884,648
Refund Dollars Offset	\$123,455,281	\$344,758,682	\$221,622,561	\$230,766,489	\$241,510,165	\$232,422,636
Interest Paid	\$7,485,784	\$6,077,639	\$5,211,563	\$4,702,759	\$3,883,147	\$5,472,178

Source: IRS Refund Hold Management Information Report data. *CY = Calendar Year.

The overall goal of the Program is to increase taxpayer filing compliance. For Calendar Years 2008 through 2012, the Program held an average of 156,422 refunds per year. The IRS reported that, during the same time period, the Program also accomplished the following:

- Secured an average of 64,222 delinquent returns from taxpayers per year.
- Coordinated with the ASFR program to prepare and post an average of 117,895 substitute returns per year.

There are also indications that the Program is working cases more quickly, thereby minimizing the interest paid on refunds held longer than 45 days. Specifically, interest payments to taxpayers on refunds held by the Program steadily declined from \$7,485,784 in Calendar Year 2008 to \$3,883,147 in Calendar Year 2012 (a 48 percent drop over five years).

Sample Program cases showed employees properly followed procedures when working and releasing refund holds

CSCO tax examiners in the Austin Campus are cross-trained to work both telephones and correspondence to answer taxpayer questions or concerns related to Program cases. In addition to Program cases, tax examiners also work other types of cases such as delinquent return investigations and balance due accounts. However, refund hold cases are their top priority.



Expansion of the Delinquent Return Refund Hold Program Could Improve Filing Compliance and Help Reduce the Tax Gap

When taxpayers respond to refund hold notices, tax examiners perform a variety of actions. Tax examiners are required to:

- Verify the refund hold freeze is on the taxpayer's account.
- Verify the delinquent return status on the taxpayer's submitted return and whether any other delinquent returns remain outstanding.
- Review the submitted return to verify Social Security Numbers, address information, telephone numbers, signatures, income, and schedules to determine if they appear to be complete.
- Enter transaction codes on the taxpayer's account including those to manually release the refund when appropriate and satisfying transaction codes to indicate that the delinquent returns have been resolved.
- Input comments in the AMS to document all actions taken on the taxpayer's account.

Our review of a random sample of 30 cases in which taxpayers had a refund held through the Program and a subsequent manual refund hold release during the period April 1, 2011, through March 31, 2012, identified no errors. CSCO tax examiners who worked these cases appropriately verified refund holds, researched delinquent returns on taxpayer accounts, and ensured that all related delinquent returns had been resolved before releasing the refund. In addition, employees properly documented the AMS history on case actions taken.

Refunds can also be released systemically by Master File programming. We also reviewed a random sample of 30 Program cases in which refunds were held and systemically released during the same time period and identified no errors requiring corrective action.

Management Has Not Expanded the Refund Hold Program Because of Limited Resources

Program results show that when taxpayers' refunds are held, they are significantly more likely to resolve return delinquencies on previous tax years than taxpayers whose refunds are not held. We evaluated the impact the Program has on taxpayer filing compliance by comparing delinquent return data¹¹ on a population of refund hold cases with dollar amounts up to \$500 above the Program threshold criteria to a population of cases with dollar amounts up to \$500 below the criteria (refunds issued).¹² Figure 4 shows the number of delinquent tax modules still

¹¹ Delinquent return data results are as of March 28, 2013.

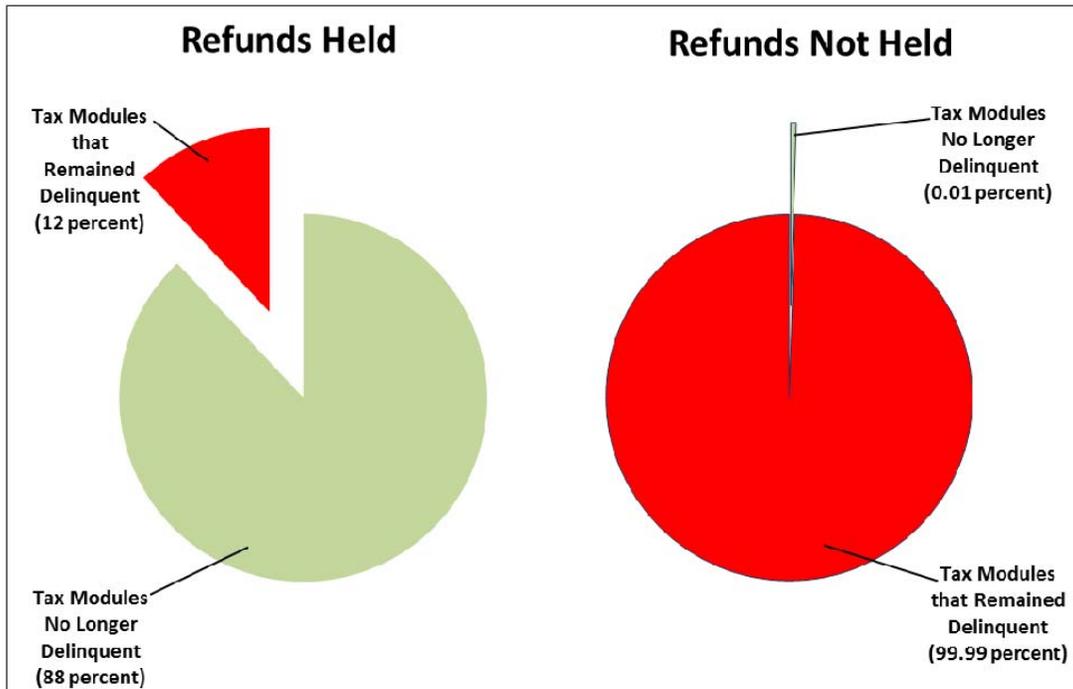
¹² These populations are based on when the refund was held or issued and covered the time period from April 1, 2011, through March 31, 2012. We used calendar dates here; however, this population was identified by using weekly processing cycle dates. See Appendix I for details.



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outstanding after refunds were held compared with delinquencies still outstanding when refunds were not held.¹³

Figure 4: Impact of Holding Refunds on Outstanding Delinquencies



Source: TIGTA analysis of refund populations for the period April 1, 2011, through March 31, 2012.

This comparison shows that the Program significantly increased taxpayer filing compliance by successfully prompting taxpayers to resolve return delinquencies from previous tax years. Specifically, 19,432 (88 percent) of 21,962 modules that were in delinquent status at the time the refund was held were no longer in delinquent status. Conversely, when the refunds were not held, just three (0.01 percent) of the 20,400 tax modules that were in delinquent status at the time the refund was issued were no longer delinquent.

In a 2004 report,¹⁴ TIGTA recommended that the IRS reevaluate the administrative dollar tolerance for holding refunds to determine if it can be reset at a lower level. Upon evaluation, the IRS proposed lowering the Program threshold from *****2*****. According to the proposal, a tolerance change from ***2***** would

¹³ As of the time of our analysis, March 28, 2013.

¹⁴ TIGTA, Ref. No. 2004-30-127, *The Return Delinquency Notice Program Could Be Used More Effectively to Promote Filing Compliance and Reduce the Tax Gap* (Aug. 2004).



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have resulted in approximately 50,000 additional refund returns held during Fiscal Year 2009, adding potential revenue of \$21,000,000.

However, data from the evaluation also projected tax return volumes received by the W&I Division's Program and ASFR campuses would increase by 13,600 based on Fiscal Year 2009 return figures. In addition, approximately 10.68 full-time equivalents¹⁵ would be required for the additional work created by the Program change. In light of these increases, the IRS decided it would be unable to handle the additional impact on resources at that time due to resource reductions in the W&I Division's CSCO and the SB/SE Division's ASFR programs.

In the current budget environment, lowering the threshold and expanding the Program represents an opportunity to increase both taxpayer filing compliance and revenue dollars at a lower cost than traditional Collection programs, such as assigning cases to revenue officers in the field. Further, such efforts could have a direct positive impact on lowering the Tax Gap. In addition, if the same trend of taxpayers becoming compliant with their prior period filing requirements continues and if they remain compliant in future years, it may reduce the need for the IRS to devote additional enforcement resources to secure delinquent returns in subsequent filing seasons.

Other opportunities for Program expansion may exist

There are some circumstances in which refunds that otherwise meet refund hold criteria are not held because IRS management has determined such circumstances warrant exclusion from the Program. Management informed us that these exceptions to the Program have been part of IRS policy since Calendar Year 1995, but could not provide the basis for these decisions because there were insufficient historical data. For example, refunds may not be held when:

- The taxpayer is experiencing an economic hardship and supporting documentation has been provided by the Taxpayer Advocate Service with an Operations Assistance Request.¹⁶
- The taxpayer is in a declared disaster area and has self-identified as an affected taxpayer.
- The taxpayer filed jointly with a spouse and there are no balance due conditions related to the taxpayer (even if there are balance due conditions with the spouse).
- The taxpayer is deceased.

¹⁵ Full-time equivalents are a measure of labor hours in which one full-time equivalent is equal to eight hours multiplied by the number of compensable days in a particular fiscal year.

¹⁶ Form 12412, *Operations Assistance Request*, is a form used by the Taxpayer Advocate Service to request assistance from the IRS to complete an action on a case when the Taxpayer Advocate Service lacks the authority to do so, e.g., a refund hold release.



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- The taxpayer is in a combat zone and there is no exit date present on the Individual Master File On-Line system.
- The taxpayer is in bankruptcy.
- The taxpayer is under criminal investigation.

*****2*****
 *****2*****
 *****2*****
 *****2*****
 *****2*****.

We reviewed a random sample of 60 taxpayer cases in which refunds were issued in the amount of *****2***** and were not held through the Program even though the taxpayers had other modules in delinquent status.¹⁷ From the 60 sampled cases, we identified 13 cases that appeared to meet Program criteria, but the refunds were not held due to IRS policy which exempted certain circumstances from the Program.¹⁸ Figure 5 shows the exceptions involved with these 13 cases.

Figure 5: Refunds Not Held for Procedural Exception

Reason	Number of Cases
*****1*****	** 1 **
***** 1 *****	** 1 **
***** 1 *****	** 1 **
***** 1 *****	** 1 **
***** 1 *****	** 1 **
***** 1 *****	** 1 **
***** 1 *****	** 1 **
***** 1 *****	** 1 **
***** 1 *****	** 1 **

Source: TIGTA case review for the period April 1, 2011, through March 31, 2012.

¹⁷ Data on delinquent, unfiled tax returns were for the period April 1, 2011, through March 31, 2012. We used calendar dates here; however, this population was identified by using weekly processing cycle dates. See Appendix I for details.

¹⁸ The remaining cases were properly released for some other reason, such as timing issues or estimated liabilities below a certain dollar threshold.



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needed to expand use of the Program will be available in the foreseeable future. Management did not commit to a specific corrective action plan with milestone dates.

Office of Audit Comment: TIGTA continues to believe that lowering the dollar threshold and reevaluating Program exception criteria is important. While we acknowledge that the IRS budget is limited, expansion of the Program represents an opportunity to increase both taxpayer filing compliance and revenue at a lower cost than traditional Collection programs. In addition, taxpayers who become compliant with their prior period filing requirements could remain compliant in future years and, therefore, reduce the need for additional enforcement resources in subsequent filing seasons.

Program Performance Measures Are Not Aligned With Program Goals

IRS management uses the refund hold effectiveness calculation to measure the effectiveness or performance of the Program. Refund hold effectiveness, measured in dollars, is equal to the gross tax collected on a refund hold case, less the interest paid to the taxpayer on the refund held if held longer than 45 days. Refund hold effectiveness annual totals are compared to each other from year to year. Management also tracks numerous other data about the Program such as the number of refunds held, number of delinquent returns secured, interest paid on refunds, amount of offset transactions, and the amount of money collected through the Program. All data are reported monthly on the Refund Hold Management Inventory Report. Management stated that they use the report to obtain Program results and to help predict inventory levels based on prior year volumes.

The Government Performance and Results Act of 1993²¹ establishes that Federal Government agencies are expected to identify performance measures for program activities and compare results of activities with measures identified. Performance measures, as well as methods of performance assessment, provide management with information on how resources should be allocated to ensure program effectiveness. They help support development and justification of budget proposals by indicating how taxpayers and others benefit. Determining the best method of performance assessment, including the establishment of performance measures, helps managers to focus on the key goals of the program. In addition, they help provide management with the information necessary to make strategic decisions regarding the best ways to address delinquent filers and nonfilers.

The overall goal of the Program is to increase taxpayer filing compliance. However, the Program does not have a specific measure for this goal. In addition, there have been no special projects, research reports, or studies in the SB/SE Division's Enterprise Collection Strategy operation or in the W&I Division's Filing and Payment Compliance function to measure the

²¹ Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).



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impact that refund holds may have on taxpayer filing compliance in subsequent periods. Management informed us that they rely on the refund hold effectiveness measure (the tax dollars collected on a refund hold case); however, refund hold effectiveness is only a component of the overall goal of improving taxpayer filing compliance. As such, management does not have complete information needed to assess progress and the effectiveness of achieving its primary goal.

Recommendation

Recommendation 2: The Director, Enterprise Collection Strategy, SB/SE Division, and the Director, Filing and Payment Compliance, W&I Division, should develop specific performance measures in the Program that compare actual results with management's goal of improving filing compliance.

Management's Response: IRS management agreed with this recommendation. Specifically, management will initiate a project to explore the development of performance measures. However, they further stated that implementation of any specific performance measures would be dependent on the availability of resources needed to support the measures and the usefulness of the measures as a predictive tool in determining the effectiveness of the Program.

Office of Audit Comment: TIGTA continues to believe that development, as well as implementation of specific performance measures for the Program, is important. Until measures are implemented, management will not have complete information about how well the Program is achieving its goal, or if it is an effective tool for improving taxpayer filing compliance over time.



Expansion of the Delinquent Return Refund Hold Program Could Improve Filing Compliance and Help Reduce the Tax Gap

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine the effectiveness of the Delinquent Return¹ Refund Hold Program under the direction of the CSCO as a tool to promote filing compliance. To accomplish our objective, we:

- I. Identified CSCO's policies, procedures, and performance measures for the Program.
 - A. Researched and reviewed applicable Internal Revenue Manual sections, internal guidance, management directives, and prior audit reports.
 - B. Interviewed IRS headquarters and CSCO management and obtained further information and understanding of refund hold policies and procedures. We visited the Austin Campus, which is CSCO's consolidated operation for the Program. We interviewed the CSCO Program Coordinator, operations management, headquarters staff employees, and Program group managers.
- II. Determined how management measures the performance and/or effectiveness of the Program and evaluated the measures for reasonableness.
 - A. Interviewed IRS headquarters and CSCO management and determined how the Program is currently measured for effectiveness and/or how they believe it should be measured.
 - B. Analyzed Program data for trends that could help measure Program effectiveness, such as:
 1. How long refunds are held until ultimately released.
 2. The amount of interest paid on Program cases for refunds held more than 45 days.
 3. The amount of money collected from refunds held.
 4. The number of delinquent returns secured and/or resolved prior to the refund hold release.
 - C. Obtained from the Data Center Warehouse a population of taxpayers with refunds between *****2***** (this is below the threshold of selection) and between processing cycles 201113 and 201215.

¹ See Appendix VI for a glossary of terms.



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1. Reviewed the population to determine if the taxpayer had unfiled returns in delinquency status (02 or 03) at the time of the refund, and compared them to the population of refund holds between *****2***** from the population identified earlier in the audit.
 2. Identified trends and determined the potential impact on filing compliance on cases in which the refunds were between*****2*****.
- III. Performed case reviews to determine if CSCO tax examiners are following proper procedures to process Program cases.
- A. Obtained from the Data Center Warehouse an extract of released Program cases (systemic and manual) between processing cycles 201113 and 201215. We validated the data extract by selecting 25 taxpayers and comparing the data to Integrated Data Retrieval System (IDRS) data to ensure accuracy. We determined that the data were sufficiently reliable for the purposes of this report.
 - B. Selected for review a random sample of 75 manually released Program cases from the population of 19,476 taxpayers with manually released refund holds in Step III.A. Because no exceptions were found, we stopped after reviewing the first 30 cases.
 1. Reviewed manually released cases to determine if tax examiners were following all proper procedures. We:
 - a. Reviewed AMS histories to see if case actions taken and reasons for releasing the refunds were being documented.
 - b. Verified on the IDRS the closing transaction codes and dates on the five prior tax years (from the refund hold return) to ensure that all associated delinquent returns were resolved prior to the refund release.
 - c. Verified on the IDRS the refund hold release date to ensure that it was timely released after delinquent returns were resolved.
 - C. Selected for review a random sample of 75 systemically released Program cases from the population of 35,515 taxpayers with systemically released refund holds in Step III.A. Because no irregularities were identified, we stopped after reviewing the first 30 cases.
 1. Reviewed systemically released cases to determine if any irregularities exist.
 - a. Verified on the IDRS the dates from refund hold freeze to refund hold release for timeliness.
 - b. For cases in which the refund hold was released prior to the expiration of the statute, verified on the IDRS the closing transaction codes and dates on the



Expansion of the Delinquent Return Refund Hold Program Could Improve Filing Compliance and Help Reduce the Tax Gap

five prior tax years (from the refund hold return) to ensure that all associated delinquent returns were resolved prior to the refund hold release.

- c. For cases where the refund hold was released due to the expiration of the statute, verified on the IDRS if the associated delinquent returns were resolved.

D. Determined if the Program is properly holding cases that meet Program criteria.

1. Obtained from the Data Center Warehouse an extract of cases in which refunds were issued between processing cycles 201113 and 201215 for *****2***** when there were delinquent returns present on the accounts five years prior to the refund return.
2. Validated the data extract by selecting 15 taxpayers and comparing data to IDRS data to ensure accuracy. We determined that the data were sufficiently reliable for the purposes of this report.
3. Selected a random sample of 60 taxpayer cases from the population of 17,303 taxpayers extracted in Step III.D.1. We attempted to eliminate all cases in which there was a refund hold on the module by removing the population identified in Step III.A. from this population. However, in reviewing our sampled cases, we needed to replace 15 cases (therefore, a total of 75 cases were selected) due to the refund being held by the Program.
4. Reviewed the sampled cases on the IDRS to determine if one or more of the associated delinquent returns showed a potential liability of ***2***** (no Federal Employee/Retirement Delinquency Investigation cases were included in our sample) on the Information Reporting Processing Transcript Request. If the delinquent module showed a potential liability of *****2*****, the case was reviewed to determine why the refund was not held. Any cases in which we were unable to determine the reason why the refund was not held were sent to the IRS for explanation. During this review, we identified potential areas for the IRS to expand the use of the Program.

IV. Discussed exception cases with management and determined the causes.

V. The contract statistician reviewed and agreed with our sampling methodology and sampling plans.



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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: Program policies and procedures, ASFR procedures related to the Program, the Refund Hold Management Inventory Report which tracks program data, and the AMS and IDRS programming controls. We evaluated these controls by observing how CSCO employees receive and work Program cases, interviewing management, and reviewing samples of Program cases.



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Appendix II

Major Contributors to This Report

Nancy Nakamura, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
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Frank Dunleavy, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations)
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Rebecca Arendosh, Auditor
Nicole DeBernardi, Auditor



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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
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Wage and Investment Division SE:W
Director, Compliance, Wage and Investment Division SE:W:CP
Director, Enterprise Collection Strategy, Small Business/Self-Employed Division SE:S:CS
Director, Field Collection, Small Business/Self-Employed Division SE:S:FC
Director, Strategy and Finance, Wage and Investment Division SE:W:S
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 Measure

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

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$105,000,000¹ (see page 8).

Methodology Used to Measure the Reported Benefit:

In Calendar Year² 2009, the IRS created a proposal, Proposed Refund Hold Tolerance Change for Calendar Year 2010, to *****2*****
*****2*****for the Program would be instrumental in reducing the Tax Gap and bringing additional taxpayers into filing compliance. According to the proposal, *****2***** shows that approximately 50,000 additional refund returns would have been included in the Program for Fiscal Year 2009, adding potential revenue of \$21 million. In addition, new refunds are held each year. The collection potential from the 50,000 additional refund returns for one year was multiplied by five to obtain a five-year forecast³ of \$105 million. This forecast does not include any increased revenue that might occur if the IRS reevaluates Program criteria and reduces the number of exceptions to the Program, allowing more refunds to be held.

¹ The potential revenue would be offset by the Program's additional full-time-equivalent resources required to work the cases as identified in the study conducted by the IRS.

² See Appendix VI for a glossary of terms.

³ The five-year forecast is based on multiplying the base year by five and assumes that economic conditions and tax laws do not change, as well as other considerations such as the number of refund returns submitted, the number of refunds held, the additional potential revenue, *etc.*, over the next five-year period.



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Appendix V

Automated Substitute for Return Program

Internal Revenue Code Section 6020(b) provides the IRS with the authority to prepare a tax return for a nonfiling taxpayer if the taxpayer appears to be liable for the return, the person required to file the return does not file it, and attempts to secure the return fail. For nonfiled individual income tax returns, the IRS uses this authority in its ASFR program.

The ASFR program determines and assesses the correct tax liability by:

- Securing valid income tax returns from taxpayers, or
- Computing tax, penalties, and interest, based upon Information Reporting Program information submitted by payers, combined with other internally available information.

A module meets ASFR program criteria if all the following conditions exist:

- It is not older than five years prior to the current processing year.
- It has Information Returns Processing information with a proposed tax liability of *****2*****.
- Information Returns Processing information exists on the IDRS under the Information Returns Processing Transcript Request for the module.
- It has no associated balance due modules in the Collection Field function, Automated Collection System, or the Queue; and no associated modules that are Currently Not Collectable or on Installment Agreements.
- The total number of Information Reporting Program documents for the module is 60 or less.
- There are no bankruptcy, litigation pending, account selected for audit, criminal investigation, or refund scheme freezes on the module or account.
- The select code is not a Criminal Investigation or IRS employee selection code.

In the W&I Division, the CSCO administers the ASFR program. In the SB/SE Division, the ASFR is a separate operation. The ASFR program is worked in two W&I Division Compliance campuses—Austin, Texas, and Fresno, California, and in one SB/SE Division campus—Brookhaven, New York.



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Appendix VI

Glossary of Terms

Term	Definition
Account Management Services	A web-based resource that enables Appeals employees to interface with various other IRS systems. It was formerly known as “Desktop Integration” or “DI.” The AMS brings various IRS systems together into one common view. The AMS emphasizes the sharing of key business data by integrating access to many tools into a common interface.
Assessment	A determination by the IRS that an amount of tax (including penalty, interest, <i>etc.</i> , if applicable) is owed by the taxpayer.
Balance Due Module	Occurs when the taxpayer has an outstanding (unpaid) liability for taxes, penalties, and/or interest.
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.
Calendar Year	The 12-consecutive-month period ending on December 31.
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.



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Computer Paragraph	Computer-generated notices and letters of inquiry that are mailed to taxpayers in connection with tax returns for the Business Master File and Individual Master File. CP numbers are located in the upper right corner of the notices and letters.
Credit Elects	A taxpayer may elect to have all or a portion of an overpayment credited to the next year's estimated tax.
Data Center Warehouse	An online database maintained by TIGTA. The Data Center Warehouse pulls data from IRS system resources, such as IRS Collection files and IRS Examination files, for TIGTA access.
Delinquent Return	A tax return that a taxpayer does not file with the IRS by the due date (including extensions) for any year in which a filing requirement exists.
Federal Employee/Retirement Delinquency Investigation	Program that promotes Federal tax compliance among current and retired Federal employees. Federal Employee/Retirement Delinquency Investigation taxpayers are identified by matching delinquent taxpayer records against personnel records maintained by the U.S. Office of Personnel Management, the Department of Defense, and the U.S. Postal Service.
Fiscal Year	A 12-consecutive-month period ending on the last day of any month. 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.
Information Reporting Processing Transcript Request	A screen displayed on the IDRS that shows all of the taxpayer's Forms W-2, <i>Wage and Tax Statement</i> , Forms 1099, <i>U.S. Information Return</i> , series of returns, and other tax information documents for a specific year.



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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 contains individual, business, and employee plans and exempt organizations data.
Module/Tax Module	Part of a taxpayer's account that reflects tax data for one tax class, <i>e.g.</i> , individual or business, and one tax period. For example, a taxpayer has filed 12 Forms 941, <i>Employer's QUARTERLY Federal Tax Return</i> , and three Forms 940, <i>Employer's Annual Federal Unemployment (FUTA) Tax Return</i> , within a three-year period. The taxpayer has only one account on the Master File, but 15 modules.
Nonfilers	Individual and business taxpayers who have been identified as liable to file a tax return but have not filed a tax return by the return due date or extended due date.
Processing Cycle	The week within the calendar year that a return, document, or transaction is processed by the IRS.
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.
Refund Return	A tax return in which the taxpayer has overpaid income taxes and is due a refund from the IRS.
Small Business/Self-Employed Division	The IRS organization that services self-employed taxpayers and small businesses by educating and informing them of their tax obligations, developing educational products and services, and helping them understand and comply with applicable tax laws.



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Tax Examiner	Employees in field offices who conduct examinations through correspondence. Among other duties, a tax examiner processes tax returns, establishes and edits tax account records, and determines proper tax liabilities.
Tax Gap	The Tax Gap is the estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.
Taxpayer Advocate Service	An independent organization within the IRS whose employees assist taxpayers who are experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe that an IRS system or procedure is not working as it should.
Treasury Offsets	Tax refund applied to other Federal debts including tax and nontax debts, such as unpaid student loans and child support, as well as State tax debts.



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Appendix VII

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

April 4, 2014

MEMORANDUM FOR MICHAEL E. MCKENNEY
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Karen Schiller /s/ Karen Schiller
Commissioner, Small Business/Self-Employed

SUBJECT: Draft Audit Report - Expansion of the Delinquent Return Refund Hold Program Could Improve Filing Compliance and Help Reduce the Tax Gap (Audit# 201230018)

Thank you for the opportunity to review your draft report titled *Expansion of the Delinquent Return Refund Hold Program Could Improve Filing Compliance and Help Reduce the Tax Gap*. We agree with the findings and appreciate your acknowledgement that our employees are following proper procedures when they work cases in the field and when they release refund holds.

The Delinquent Return Refund Hold Program is one of a number of refund hold programs that the IRS administers. The program addresses taxpayer compliance by delaying issuance of a taxpayer's income tax refund for up to six months while we investigate a return delinquency for another tax year. The program increases filing compliance at a lower cost and in a shorter timeframe than assigning a Revenue Officer to attempt to secure the delinquent return. Holding refunds also encourages taxpayers to take action and resolve their filing obligations sooner. The program has enabled IRS to successfully secure unfiled returns and tax payments associated with the liabilities reported on those returns.

Due to the Program's effectiveness in resolving return delinquencies and increasing tax payments, you have recommended that we consider opportunities to expand the Delinquent Return Refund Hold Program and suggested several opportunities we should consider. For example, you suggested that a *****2*****
*****2***** would potentially increase revenue by \$21 million a year. This translates into a monetary benefit of \$105 million for a five-year period.

As you noted in your report, implementation of a lower dollar threshold or a change in the program exception criteria will require additional resources. When those resources become available, we will consider lowering the dollar threshold and reevaluating certain program exception criteria. However, with no certainty as to when those



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resources may become available, we are not able to predict what monetary benefits may be realized.

Attached is a detailed response outlining our corrective action. If you have any questions, please contact me, or a member of your staff may contact Darren Guillot, Director, Enterprise Collection Strategy at 202-317-3583.

Attachment



Expansion of the Delinquent Return Refund Hold Program Could Improve Filing Compliance and Help Reduce the Tax Gap

Attachment

RECOMMENDATION 1:

The Director, Enterprise Collection Strategy, SB/SE Division, and the Director, Filing and Payment Compliance, W&I Division, should consider opportunities to expand the use of the Program as resources become available, including lowering the dollar threshold and reevaluating Program exception criteria. Analysis should consider the return on investment, the impact on the Tax Gap, as well as the impact that subsequent period taxpayer filing compliance would have on enforcement resources.

CORRECTIVE ACTION:

As you noted, implementation of a lower dollar threshold or a change in the program exception criteria requires additional resources. If these resources become available, we will consider lowering the dollar threshold and reevaluating certain program exception criteria, including refunds based on ****2****, refunds in cases in which the taxpayer is under criminal investigation, and refunds when the taxpayer is deceased or in bankruptcy. However, in the current budget environment, we are not anticipating that the resources needed to expand use of the Delinquent Return Refund Hold Program will be available in the foreseeable future.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL:

N/A

CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 2:

The Director, Enterprise Collection Strategy, SB/SE Division, and the Director, Filing and Payment Compliance, W&I Division, should develop specific performance measures in the Program that compare actual results with management's goal of improving filing compliance.

CORRECTIVE ACTION:

We agree that Delinquent Return Refund Hold Program would likely benefit from specific performance measures. We therefore will initiate a project to explore the development of performance measures for the program. However, implementation of any specific performance measure will be dependent on the availability of resources needed to support the performance measures, and the usefulness of the measures as a predictive tool in determining the effectiveness of the program.



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IMPLEMENTATION DATE:

May 15, 2015

RESPONSIBLE OFFICIAL:

Director, Collection Analytics, Automation, Inventory Selection and Delivery, Small Business/Self-Employed

CORRECTIVE ACTION MONITORING PLAN:

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