



*Trust Fund Recovery Penalty Actions
Were Not Always Timely or Adequate*

May 23, 2014

Reference Number: 2014-30-034

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

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HIGHLIGHTS

TRUST FUND RECOVERY PENALTY ACTIONS WERE NOT ALWAYS TIMELY OR ADEQUATE

Highlights

Final Report issued on May 23, 2014

Highlights of Reference Number: 2014-30-034 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Employers are required to withhold amounts from their employees' salaries to cover individual Federal income, Social Security, and Medicare taxes (trust fund taxes). When a business does not remit trust fund taxes withheld from its employees, the IRS can collect the unpaid taxes from the individuals responsible by assessing the Trust Fund Recovery Penalty (TFRP) when appropriate. Employees who have taxes withheld from their wages expect the funds to be properly remitted to the IRS. In addition, businesses that do not pay their taxes have an unfair advantage over businesses that do pay their taxes in full and on time.

WHY TIGTA DID THE AUDIT

As of June 30, 2012, employers owed the IRS approximately \$14.1 billion in delinquent employment taxes. This audit was initiated to determine whether the Collection Field function is taking adequate and timely TFRP actions on trust fund cases.

WHAT TIGTA FOUND

TFRP actions were not always timely or adequate. Specifically, TIGTA found untimely TFRP actions, expired assessment statutes, unsupported collectibility determinations, and incomplete TFRP investigations associated with installment agreement and currently not collectible cases. TFRP actions were untimely and/or inadequate in 99 of the 265 cases reviewed in a statistically valid sample. For 59 of the 99 cases, the untimely actions averaged more than 500 days to review and process the TFRP assessment.

When TFRP assessments are not made timely, taxpayers' financial ability to pay can decline, thereby decreasing the IRS's chances to collect the trust fund taxes due. In addition, the Government's interest is not protected if potential TFRP assessments are overlooked or missed.

In recent years, the IRS has introduced new TFRP guidance to better control the TFRP process and has achieved some improvement in the average time it takes to complete investigations and assess the TFRP. However, significant untimeliness still exists.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS emphasize to group managers their responsibilities to monitor TFRP cases and ensure that revenue officers take timely TFRP actions; enhance TFRP communication and training; ensure completion and adequacy of scheduled system improvements and take appropriate actions to implement the changes; and revise TFRP guidance regarding the accuracy of the collectibility determination support and controlling the completion of TFRP investigations when installment agreements or currently not collectible closures are approved.

In their response to the report, IRS officials agreed with all of our recommendations and plan to take corrective actions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 23, 2014

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

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

SUBJECT: Final Audit Report – Trust Fund Recovery Penalty Actions
Were Not Always Timely or Adequate (Audit # 201230015)

This report presents the results of our review to determine whether the Collection Field function is taking adequate and timely Trust Fund Recovery Penalty (TFRP) actions on trust fund cases. This audit was included in our Fiscal Year 2013 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 V. Although they agreed with all of our recommendations, Internal Revenue Service (IRS) management responded that our analysis would have been more accurate if we limited the scope of our review to exclude case actions that occurred prior to Fiscal Year 2012. Management made improvements based on Government Accountability Office recommendations, and the improvements were not fully implemented prior to Fiscal Year 2012.

The audit report acknowledges that timeliness improvements have been made since the Government Accountability Office made its recommendations in July 2008. To properly and independently assess the impact of the IRS's improvements, it was necessary to include investigations with case actions that were made both before and after all corrective actions were taken. Furthermore, the inclusion of case actions made since Fiscal Year 2010 identified other weaknesses and resulting corrective actions that otherwise may have been undetected.

Copies of this report are also being sent to the IRS 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).



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Abbreviations

ATFR	Automated Trust Fund Recovery
CPM	Control Point Monitoring
ICS	Integrated Collection System
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
TFRP	Trust Fund Recovery Penalty
TIGTA	Treasury Inspector General for Tax Administration



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Background

Employers are required to withhold amounts from their employees' salaries to cover individual Federal income, Social Security, and Medicare taxes. The employee share of taxes, which the business has a fiduciary responsibility to hold "in trust" until paid to the Internal Revenue Service (IRS), is referred to as a trust fund tax.¹ Employers should also make matching contributions for their own amounts for Social Security and Medicare taxes and deposit both amounts with the IRS through the filing of employment tax returns.

Form 941, *Employer's Quarterly Federal Tax Return*, is used to file and establish the tax liability for the majority of trust fund taxes. Employers with tax liabilities of \$2,500 or more per quarter are required to make Federal tax deposits. Employees who have taxes withheld from their wages expect the funds to be properly remitted to the IRS.

However, employers sometimes fail to make the required deposits. Businesses that do not pay their taxes have an unfair advantage over businesses that do pay their taxes in full and on time.

As of June 30, 2012, employers owed the IRS approximately \$14.1 billion in delinquent employment taxes.

IRS procedures state that successful resolution of delinquent trust fund taxpayer cases requires early intervention by the Collection Field function to prevent taxpayers from incurring future additional tax liabilities. The large number of taxpayers who repeatedly accumulate employment tax delinquencies continues to be a major compliance problem for the IRS. As of June 30, 2012, employers owed the IRS approximately \$14.1 billion in delinquent employment taxes.² This total does not include the substantial amount of employment tax delinquencies that the IRS determined were currently not collectible. As of the end of March 2013, the IRS's total dollar inventory of currently not collectible employment tax accounts was \$24.9 billion.

When a business does not remit trust fund taxes, the IRS has the authority to assess all responsible persons individually for the unpaid taxes via the Trust Fund Recovery Penalty (TFRP).³ The IRS has the authority to assess the TFRP regardless of whether the business is ongoing or has ceased operations. A responsible person is any person required to collect, account for, and pay over taxes held in trust who willfully fails to perform any of these activities or willfully attempts to evade or defeat any such tax or its payment. The TFRP is equal to the total amount of trust fund taxes due, but is not the full amount of the employment tax

¹ See Appendix IV for a glossary of terms.

² This represents the total cumulative amount of delinquent employment taxes owed by employers as of that date.

³ 26 U.S.C. § 6672 (2006). Also, per 26 U.S.C. § 7202 (1954), the IRS can pursue criminal proceedings on anyone who willfully fails to collect or truthfully account for and pay over such tax.



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delinquency because it is only the employee's share of the trust fund taxes. Consequently, employment tax delinquencies can be much larger than trust fund tax delinquencies.

To show willfulness, the Internal Revenue Manual (IRM) requires that the Government generally must demonstrate that an individual with responsibility was aware, or should have been aware, of the outstanding taxes and intentionally did not make the payments. A responsible person's failure to investigate or correct mismanagement after being notified that withholding taxes have not been paid satisfies the TFRP "willfulness" element.

Responsibility is a matter of status, duty, and authority. A determination of responsibility is dependent on the facts and circumstances of each case. A responsible person has: (1) the duty to perform; (2) the power to direct the act of collecting trust fund taxes; (3) the accountability for, and authority to pay, trust fund taxes; and (4) the authority to determine which creditors will or will not be paid. A responsible person may be one or more of, but not limited to, the following:

- Officer, director, shareholder, or employee of a corporation.
- Limited/nominal partner or employee of a partnership.
- Employee of a sole proprietorship.
- Another corporation.
- Limited liability company member, manager, or employee.

The decision of whether to pursue the TFRP against a responsible person(s) should be made by the revenue officer after the initial contact with the trust fund taxpayer—as soon as possible but no later than 120 calendar days after assignment of the balance due account(s). That initial 120-day period is known as the determination date. The Integrated Collection System (ICS) controls revenue officer case inventories and will provide warning notices when there are 60 days remaining on the determination date and when it has expired. A decision to pursue or not pursue the TFRP must be made within this time period unless the trust fund liability is less than the established threshold amount or the group manager authorizes a delay prior to expiration of the 120-day determination time period. However, there is no prohibition against assessing the TFRP if the amount is below the threshold. If the revenue officer's decision is to pursue the TFRP, the recommendation to assert the penalty should be submitted on a Form 4183, *Recommendation re: Trust Fund Recovery Penalty Assessment*,⁴ to the group manager for approval no later than 120 calendar days from the date the determination was made.

The Automated Trust Fund Recovery (ATFR) system is used by revenue officers to control TFRP case inventories and to support the preparation and input of TFRP assessments and related transactions. TFRP cases are created in the ATFR system when the ICS sends the case creation date to the ATFR system. The ATFR system uses the ICS case creation date to monitor

⁴ A recommendation to not assert the TFRP is also made on the Form 4183.



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determination dates. The subsequent monitoring of TFRP action dates performed by the ATFR system is based upon the case action dates that the revenue officers input in the ATFR system. To assist group managers with monitoring and ensuring that TFRP actions by their revenue officers are timely, the ATFR system provides status reports that group managers are required to use at least monthly. The ATFR reports are also available to revenue officers to assist them in working their TFRP case deadlines.

The TFRP is assessed only on responsible persons determined to have the ability to pay. Though the TFRP may be assessed against several individuals, the total liability is collected only once from the business, one or more responsible persons, or a combination of the two. Because unpaid trust fund taxes include amounts for Social Security and Medicare, the Government may have to transfer money from the General Fund to those programs for the unpaid trust fund taxes that the IRS does not collect.

This review was performed at the Small Business/Self-Employed (SB/SE) Division Headquarters Collection function office in New Carrollton, Maryland, and the SB/SE Division Campus Compliance Services offices in El Segundo, California, and Laguna Niguel, California, during the period October 2012 to 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.



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Results of Review

Trust Fund Recovery Penalty Actions Were Not Always Timely or Adequate

We reviewed a statistically valid sample of 265 cases to determine the adequacy of TFRP decisions and Collection function actions taken on trust fund cases. For our sampled cases, 146 TFRPs were assessed for 108 of the 265 cases, totaling \$38.4 million.⁵ We found that TFRP actions were untimely and/or inadequate in 99 of the 265 cases reviewed. For the 99 cases:⁶

- 65 cases had untimely TFRP actions, ranging from 31 to 910 days late.
- 20 cases had TFRPs that could not be assessed because the assessment statutes expired on the tax delinquent accounts in the Collection Queue prior to assignment to revenue officers.
- 10 cases did not have adequate support for collectibility determinations when the TFRP was not assessed.
- 9 cases with incomplete TFRP investigations were closed with an installment agreement or as currently not collectible before determining whether the TFRP should be assessed.

The Collection Field function can improve the timeliness of TFRP actions

Sixty-five of the 265 cases reviewed contained one or more untimely TFRP actions. For the 65 cases⁷ with untimely actions:

- 9 cases took an average of 94 days for revenue officers to calculate the TFRP. Revenue officers are required to make the calculation within 45 days after initial case assignment.

⁵ The TFRP was not required or possible in many of the Collection Field function cases in our sample; for example, cases with unpaid trust fund taxes below the dollar threshold, business structures not applicable for the TFRP, or for which the assessment statutes had expired. The TFRP assessments in our sample of open and closed business cases spanned from June 2003 through March 2013. The wide range of years occurred because taxpayers sometimes accrue additional liabilities even after responsible persons are individually assessed the TFRP.

⁶ The number of cases noted in the bullets total to more than the 99 reported because some cases are represented in more than one bullet.

⁷ Many of the 65 cases had more than one of the untimely actions listed. Therefore, the cases reported in the bullets sum to more than the 65 cited.



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- 24 cases involving 25 investigations⁸ took an average of 209 days for revenue officers to decide to pursue the TFRP.⁹ Revenue officers are required to make this determination within 120 days after assignment of the balance due account(s).
- 43 cases involving 47 TFRP investigations took revenue officers an average of 343 days to submit the Form 4183 to the group manager. Form 4183 is required to be submitted to the group manager within 120 days from the decision to pursue the TFRP.
- 14 cases took the revenue officers an average of 104 days to deliver Letter 1153, *10-Day Notification Letter, 100% Penalty Proposed Against Filer for Corporation*, to notify the responsible person(s) of the proposed TFRP. Delivery is required within 20 days of Form 4183 approval.
- 27 cases involving 29 TFRP investigations were not timely submitted to the Control Point Monitoring (CPM) unit for review and processing of the TFRP file for assessment.
 - In 27 of the 29 investigations, the responsible person did not respond with their concurrence to the proposed TFRP assessment. These cases should have been submitted to the CPM unit within 90 days from the delivery date of the Letter 1153. Instead, it took an average of 185 days for the revenue officers to submit these cases.
 - *****1***** investigations, the revenue officers averaged 277 days to submit cases to the CPM unit. The responsible persons agreed to the proposed TFRP assessments (signed Form 2751, *Proposed Assessment of Trust Fund Recovery Penalty*, which waived the 60-day restriction). These cases should have been submitted to the CPM unit within 30 days from the delivery date of the Letter 1153.

Overall, the 65 cases with untimely TFRP actions included 59 cases that went through all five action steps previously discussed, including submission to the CPM unit for processing.¹⁰ In these 59 cases, it took revenue officers from 180 to 1,250 days (an average of 517 days) to submit the cases to the CPM unit for review and processing of the TFRP assessment.

⁸ Business cases with more than one delinquent tax period can have multiple TFRP investigations. Because revenue officers are required to decide whether or not to pursue the TFRP within 120 days of assignment of a balance due account (delinquent tax period), a single business case can have multiple TFRP investigations if additional tax periods are assigned in a prior investigation subsequent to delivery of Letter 1153, *10-Day Notification Letter, 100% Penalty Proposed Against Filer for Corporation*.

⁹ In eight of these 25 untimely determinations, revenue officers had not opened a TFRP investigation in the ATFR system at the time of our review. As of September 2008, guidance required this to be done within 120 days of the balance due modules being assigned. In seven of the 25 untimely determinations, the balance due modules were assigned prior to September 2008 when the revenue officers were required to make determination within 180 days of assignment.

¹⁰ At the time of our review, six of the 65 untimely cases were not submitted to the CPM unit.



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Group managers are responsible for the quality of all work assigned to their group and must provide oversight and direction to revenue officers. Group manager oversight responsibilities include ensuring that revenue officer case actions are timely and in accordance with policies and procedures. To assist group managers with monitoring and ensuring that TFRP actions by their revenue officers are timely, the ATFR system provides reports that group managers are required to use at least monthly. The following four reports can be accessed/generated at any time and should be used by group managers to ensure that revenue officers take timely TFRP actions:

1. The Pending Determination Report should be used to ensure that revenue officers make timely TFRP determinations.
2. The Pending 4183 Report should be used to ensure that Forms 4183 are timely submitted.
3. The Pending 1153 Report should be used to ensure that Letters 1153 are timely provided to responsible parties.
4. The Pending 2749 to CPM Report should be used to ensure that the TFRP files are timely forwarded to the CPM unit.

Although site interviews revealed that group managers are familiar with these useful ATFR system reports, they are not always used to monitor TFRP cases and ensure that revenue officers take timely action. Group managers currently need to log in to the ATFR system and select each of the specific TFRP action reports at least monthly in order to be compliant. IRS management agreed that more consistent use of the monthly ATFR system reports would help address the untimely cases we identified.¹¹

The ICS provides a warning notice when there are 60 days remaining on the determination date and when the deadline has expired. However, there is no similar ICS warning notice for the Form 4183, which is submitted for cases for which revenue officers have determined to pursue the TFRP. IRS management stated that the ICS provides the determination date reminder based upon the case assignment date in the ICS, but that a reminder for a Form 4183 submission would require extensive programming because the Form 4183 submission due date field resides only in the ATFR system. However, more consistent monitoring of revenue officer TFRP actions by group managers would potentially improve the collection of unpaid trust fund taxes and ensure consistent treatment of taxpayers.

Further, the TFRP is only assessed on responsible persons determined to have the ability to pay. When TFRP assessments are not made timely against responsible persons, their financial ability to pay can decline, thereby decreasing the IRS's chances to collect the trust fund taxes due.

Our sample case review also found another opportunity to improve group manager oversight of TFRP actions and adherence to requirements. The 43 cases with late Form 4183 submissions

¹¹ The IRS also advised us that some TFRP action delays were the result of organizational decisions such as case reassignments due to retirements, staffing concerns, or other inventory balancing issues.



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represents 66 percent of the 65 cases found to have untimely TFRP actions. None of the 43 cases included entries in the ICS histories by the group managers, as required by the IRM, to grant revenue officers more time with the Form 4183 submissions. Moreover, the circumstances that existed to warrant the additional time were not noted. Including this documentation would help to demonstrate that group managers are involved in monitoring cases and addressing any revenue officer performance issues when necessary.

The 65 untimely cases resulted in approximately \$12.5 million in TFRPs being assessed more than 30 days late. In all 65 cases, revenue officers had determined that the responsible individual had the ability to pay prior to assessing the penalty. However, as of April 2013, the average trust fund balance due in these business cases had increased by 11 percent, generally because of penalties and accumulating interest. Based on our statistically valid sample, we project that approximately \$167 million¹² in TFRPs may be assessed late annually.

Management actions:

Based on our findings, IRS management has requested an ATFR system programming change to systemically create a new ATFR case to account for subsequent trust fund modules that often are not considered after the Form 4183 has been approved or the ATFR case closes and the ICS stays open with new modules accruing. This change will improve the processing for cases such as those for which revenue officers had not timely opened a TFRP investigation in the ATFR system (as noted in footnote 9).

The TFRP could not be pursued because assessment statutes expired before the cases were assigned to revenue officers

The TFRP could not be pursued on delinquent accounts in 20 of the 265 cases reviewed, with an estimated total trust fund balance of \$1.1 million, because the assessment statutes for the payroll tax returns expired before the tax modules were assigned to revenue officers. IRS management stated that the assessment statutes expired while the delinquent accounts resided in the Collection Queue, a holding area for cases awaiting assignment. The Collection case routing criteria and prioritization does not consider imminent assessment statute expiration dates on cases in the Collection Queue.

IRS management stated that newer payroll tax cases receive a higher priority over older ones. Management also stated that diminishing Field Collection resources have affected its ability to work all high-priority cases, which contributed to the assessment statutes expiring.

Because the current Collection inventory delivery prioritization often results in the TFRP assessment statutes expiring before cases are assigned to revenue officers, the TFRP cannot be pursued and the corresponding trust fund liabilities may go unpaid. IRS management advised us

¹² Based on our statistically valid sample, we are 90 percent confident that between \$115,135,576 and \$218,976,159 in TFRPs may be assessed late annually.



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that because of diminishing Field Collection resources, there will continue to be cases with assessment statutes expiring in the Queue. Since the limited resources cannot be resolved with the current budget constraints, we are not making a recommendation to address this issue at this time.

Collectibility determinations were not adequately supported when the TFRP was not assessed

Our audit tests included a review of the documentation used by revenue officers to support their decisions to not assess the TFRP against responsible individuals. Of the 265 cases reviewed, 20 cases included 21 Forms 9327, *Nonassertion Recommendation of Uncollectible Trust Fund Recovery Penalty or of Uncollectible Personal Liability for Excise Tax*. However, 10 of the 21 collectibility determinations were not adequately supported.

Determining collectibility involves the revenue officer securing and reviewing a taxpayer's Collection Information Statement (if the taxpayer agrees to provide one or the IRS obtains one through a summons, when applicable) as well as researching and verifying the income and asset information to assess the taxpayer's ability to pay. Prior to approving the revenue officer's collectibility determination, the group manager is required to determine if the taxpayer's latest income tax return was reviewed, if a current Collection Information Statement was secured and verified, and if a full compliance check was conducted. If this research is not properly documented, managers cannot be assured that collectibility has been adequately assessed. Although managers approved the Forms 9327 in these 10 cases, they did not ensure that they were adequately researched or contained the appropriate supporting documentation.

IRS management advised us that better adherence to existing criteria could improve the accuracy of the Forms 9327, which would better support the collectibility determination. However, the current guidance does not specifically require revenue officers to provide the actual dates of the investigation for the collectibility items in Section II of Form 9327, nor does it require managers to adequately review and verify the research performed by the revenue officers.

For the 10 cases in which the collectibility determination was not properly documented, there was a total unpaid trust fund balance of \$782,231 in the related tax delinquent accounts.¹³ If the collectibility determination is not adequate, a revenue officer may not assess the TFRP against a responsible person who has the ability to pay, resulting in the potential loss of revenue and inequitable treatment of taxpayers. Based on our statistically valid sample, we project that

¹³ One of the 10 cases was already included in the timeliness finding, so the liability was not included in this section to avoid double counting.



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documentation to support collectibility determinations in nonassertion cases could be missing from 768 cases with trust fund liabilities of approximately \$20 million¹⁴ per year.

TFRP investigations were incomplete when cases were closed with installment agreements or as currently not collectible

We found that TFRP investigations were not completed as required for nine of the 265 cases reviewed. Of the nine cases with incomplete TFRP investigations, five involved in-business installment agreement closures and four were closed as currently not collectible.

When the TFRP is not assessed and an installment agreement will not fully pay all balances due at least one year prior to the earliest assessment statute expiration date, the IRM requires revenue officers to protect the future ability to assess the TFRP by: (1) obtaining waivers from the responsible person(s) to extend the statute to the expected end-date of the agreement plus one year and (2) assembling all documentation for completion of the penalty to the point of assessment, including securing approval of Form 4183. In addition, management must ensure that the TFRP and statute expiration dates are protected before granting any installment agreements.

The IRM also requires revenue officers to secure approval on Form 4183 before trust fund tax cases are closed as currently not collectible. The IRM allows group managers to approve installment agreements and currently not collectible closures on cases with incomplete TFRP investigations if Other Investigations¹⁵ are opened to protect the Government's interest.

- **Five installment agreement cases.** There were no Other Investigations opened in the five installment agreement cases that did not obtain waivers or approved Forms 4183. In all five cases, the installment agreement request in the ICS contained the following statement: *“The TFRP has been appropriately addressed, including securing waivers for all potentially responsible parties.”* The IRS clarified that this statement is automated text included with each installment agreement and is not a history notation indicating that waivers were actually secured. Management action number 1 below was initiated to address this issue.
- **Four currently not collectible closure cases.** There were no Other Investigations opened in the four currently not collectible closure cases without Forms 4183.

The Government's interest is not protected if TFRP investigations are not timely completed on installment agreement or currently not collectible closures. When TFRP investigations are not completed as required, the ability to timely assess the TFRP on the associated unpaid trust fund

¹⁴ Based on our statistically valid sample, we are 90 percent confident that documentation to support collectibility determinations in nonassertion cases could be missing from between 144 and 1,392 cases with trust fund liabilities of between \$4,871,265 and \$35,120,100 per year.

¹⁵ An “Other Investigation” is opened prior to case closure to provide an administrative tool from which the revenue officer can continue to perform TFRP actions until the TFRP investigation is complete.



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tax periods is in jeopardy if the taxpayers go out of business, default on their installment agreements, or report additional revenue or assets in the future. If this occurs and the IRS is not able to assess the TFRP, the IRS may not be able to collect the delinquent trust fund taxes. Revenue would be protected if the IRS opens an Other Investigation when it closes the TFRP investigation when there is an in-business installment agreement or when the delinquent employment tax account is closed as currently not collectible.

Management actions:

Based on our results, IRS management has requested:

1. An ICS programming change to add a checklist box when initiating an installment agreement. The checklist box will allow the revenue officer to select the specific actions taken during the TFRP investigation. This change will remove the erroneous automated text and help ensure that ICS histories reflect only those actions actually performed. This programming is scheduled to take effect in January 2015.
2. An ICS programming change to automatically create an Other Investigation when selections during the closing process indicate that the TFRP investigation has not been completed. This programming is scheduled to take effect in January 2015.

For the nine cases for which revenue officers and group managers did not follow existing guidance to ensure that TFRP investigations were adequately considered and/or completed, there was an estimated total unpaid trust fund balance of \$275,663 in the related delinquent tax accounts. Based on our statistically valid sample, we project that TFRP investigations may not be adequately considered in 581 cases with approximately \$16.5 million¹⁶ in unpaid trust fund liabilities annually.

Recommendations

The Director, Field Collection, SB/SE Division (for Recommendations 1, 2, and 4), and the Director, Collection Policy, SB/SE Division (for Recommendation 3), should:

Recommendation 1: Emphasize to group managers their responsibilities to:

- a. Use ATFR system reports at least monthly to promote timely TFRP investigations and actions by their revenue officers. Also, determine why group managers are not using the ATFR system reports and take appropriate actions to address the issues identified.
- b. Document the ICS case history with the circumstances that warrant additional time when revenue officers do not submit the Forms 4183 timely.

¹⁶ Based on our statistically valid sample, we are 90 percent confident that TFRP investigations may not be adequately considered for between 65 and 1,098 cases with unpaid trust fund liabilities of between \$2,445,624 and \$30,589,088 annually.



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Management's Response: IRS management agreed with this recommendation. Specifically, management will: a) Revise the IRM to emphasize the requirement for managers to use ATFR reports at least monthly. Additionally, the IRS will review the use of these reports in operational reviews conducted by the Director, Field Collection, to ensure that ATFR system reports are used regularly. b) Revise the IRM to emphasize that managers must document the ICS case history with the circumstances warranting the additional time when a Form 4183 delay is approved.

Recommendation 2: Enhance TFRP communication and training. Specifically:

- a. Conduct Fiscal Year 2014 Manager TFRP training that includes emphasizing group manager responsibility for reviewing ATFR reports at least monthly to monitor timeliness of TFRP actions.
- b. Include a component to review and measure the timeliness of TFRP actions in Fiscal Year 2014 operational reviews conducted by the Director, Field Collection.
- c. Use systemic messages to remind revenue officers about existing system functionality to facilitate timely TFRP actions.

Management's Response: IRS management agreed with this recommendation. Specifically, management will: a) conduct training emphasizing group manager responsibility to review ATFR reports at least monthly to monitor timeliness of TFRP actions; b) review and measure the timeliness of TFRP actions as part of the operational reviews conducted by the Director, Field Collection; and c) initiate a process to use the ATFR Message of the Day feature to remind revenue officers about existing system functionalities to facilitate timely TFRP actions.

Recommendation 3: Work with the IRS Information Technology organization to ensure the completion and adequacy of the ICS improvements that are scheduled to be implemented in January 2015. Take appropriate actions to make sure the programming changes work as planned and implement them appropriately. These changes will:

- a. Update the installment agreement request process to present a checklist box.
- b. Automatically create an Other Investigation when selections during the installment agreement and currently not collectible closing processes indicate the TFRP investigation has not been completed.

Management's Response: IRS management agreed with this recommendation. Specifically, management will periodically contact the IRS Information Technology organization to inquire about the status of the ICS improvements. Once the programming changes are made, the SB/SE Division will work with the Information Technology organization to ensure that the improvements work as intended.



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Recommendation 4: Work with Collection Policy to revise the IRM guidance to:

- a. Require that group managers verify the accuracy of the collectibility determination support and research listed by the revenue officer in Section II of Form 9327.
- b. Reflect that an Other Investigation will be created on the ICS to control the completion of the TFRP investigation when installment agreements or currently not collectible closures are approved before the TFRP investigation is complete.

Management's Response: IRS management agreed with this recommendation. Specifically, management will revise the IRM to: 1) require managers to verify the accuracy of Form 9327 actions prior to approval and 2) reflect that an ICS Other Investigation must be created for completion of TFRP actions, if necessary, when approving installment agreements or currently not collectible closures.

The Internal Revenue Service Has Made Some Improvements in Trust Fund Recovery Penalty Guidance

The IRS has introduced new TFRP guidance in an effort to better control the TFRP process and improve the average time it takes to complete investigations and assess the TFRP. Prior to September 2008, the IRM allowed revenue officers 180 days, or about six months, to make a determination about whether or not to pursue a TFRP. However, the IRM was silent about how long it should take revenue officers to subsequently submit the Form 4183 to the group manager to proceed with the TFRP assessment.

In September 2008, the IRS implemented new guidelines requiring revenue officers to make the determination of whether or not to pursue the TFRP within 120 days of case assignment and to then submit the TFRP Form 4183 recommendation to the group manager within 120 days after the determination.

Additionally, prior guidance did not provide revenue officers with a time period to submit the completed TFRP package to the CPM unit for final review and processing. Nor was there guidance on how long a revenue officer could take to deliver the Letter 1153 after the group manager approved the TFRP recommendation. In August 2010, the IRM was updated to require revenue officers to complete TFRP processing and forward the case to the CPM unit no later than 30 days after the required response period in Letter 1153. In April 2011, the IRM was updated to require revenue officers to deliver the Letter 1153 within 20 days after approval of the TFRP recommendation.

While timeliness is still an issue with the TFRP process, the new guidance appears to have contributed to a decrease in the average amount of time that revenue officers take to complete TFRP investigations. In Fiscal Year 2001, the Treasury Inspector General for Tax



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Administration (TIGTA) reported¹⁷ that it took the IRS 18 months to determine whether to pursue the TFRP for cases assigned as of September 1998.

The Government Accountability Office reported in Fiscal Year 2008 that it took revenue officers an average of about nine months to pursue the TFRP on cases assigned in Fiscal Year 2007 and about another nine months to assess the penalty.¹⁸ Although the decision to pursue the TFRP took about nine months less than reported in Fiscal Year 2001, total time from case assignment to the TFRP assessment averaged approximately 18 months.

Our test results showed that it took an average of about two months for revenue officers to determine whether to pursue the TFRP (significantly less than the four-month deadline) and about another 10 months for the TFRP assessment to post to the account.

TFRP assessments that occurred in cases assigned after Fiscal Year 2010 showed further improvement since the Government Accountability Office reported in Fiscal Year 2008 that it took 18 months for the entire process. Analysis of the 53 sampled TFRP assessments that occurred in cases assigned after Fiscal Year 2010 showed that it took about eight months on average for the entire process—an average of about one month for the revenue officer to determine whether to pursue the TFRP and an additional seven months for the TFRP assessment to post.

¹⁷ TIGTA, Ref. No. 2001-30-014, *The Internal Revenue Service Does Not Effectively Use the Trust Fund Recovery Penalty As a Collection Enforcement Tool* (Nov. 2000).

¹⁸ Government Accountability Office, GAO-08-617, *Tax Compliance: Businesses Owe Billions in Federal Payroll Taxes* (July 2008).



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether the Collection Field function is taking adequate and timely TFRP¹ actions on trust fund cases. To accomplish the objective, we:

- I. Determined if guidance and oversight are adequate to enable the Collection Field function to perform sufficient TFRP decisions and actions.
 - A. Reviewed applicable TFRP guidance within the IRM, training materials, and other sources to assess the adequacy of the guidance in ensuring that TFRP actions and decisions are adequate and timely on trust fund cases.
 - B. Performed on-site interviews and walkthroughs of the TFRP processes and systems used by the Collection Field function for cases involving trust fund taxpayers.
 - C. Interviewed SB/SE Division Territory managers, group managers, revenue officers, advisory Territory managers, and advisory group managers to obtain insight on the TFRP process and obtain any job aids or relevant reports used for national statistics.
 - D. Reviewed operational reviews or visitations conducted of the trust fund or TFRP program since Fiscal Year 2011 to determine the level of managerial review and employee accountability.
- II. Determined the adequacy of TFRP decisions and Collection function actions taken on trust fund cases and selected a statistically valid stratified sample of open trust fund taxpayer accounts for review.
 - A. Identified a population of 3,296 open trust fund taxpayer accounts, with a total outstanding employment tax balance of \$717 million, in TIGTA's Data Center Warehouse ICS Tax Module file as of October 15, 2012, that: 1) had an aggregate Form 941 tax liability greater than \$10,000 and at least one delinquent tax period assigned to a revenue officer in Calendar Year 2010 and 2) had at least one other delinquent tax period subsequently assigned in Calendar Year 2011 or later. On October 31, 2012, we received an ATFR system extract from the IRS that contained all taxpayer accounts that were assessed a TFRP after Calendar Year 2009. Matching that ATFR system extract to the open trust fund population of 3,296 resulted in breaking that total into two unique stratified open populations:

¹ See Appendix IV for a glossary of terms.



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1. Population of 2,111 open trust fund taxpayer accounts that were assessed a TFRP between January 1, 2010, and October 31, 2012.
 2. Population of 1,185 open trust fund taxpayer accounts that were not assessed a TFRP between January 1, 2010, and October 31, 2012.
- B. Based upon input from our contracted statistician, our statistically valid sampling methodology from the populations identified in Step II.A. resulted in a statistical sample of 173 open trust fund business cases (88 from the population of 2,111 and 85 from the population of 1,185). The statistical sample was based on a confidence level of 90 percent, a precision level of ± 6 percent, and an expected error rate of 12 percent. In order to improve the potential variability in projecting error dollars, we oversampled 19 cases among the few large dollar cases in the population.
- C. Reviewed the 173 open sample cases to assess the adequacy and timeliness of TFRP decisions and actions as prescribed in guidance such as IRM 5.7.4, *Investigation and Recommendation of the TFRP*.
- D. Determined if other actions were adequate, such as supporting collectibility determinations when the TFRP was not assessed due to hardship or collectibility concerns and protecting the Government's interest when the TFRP was not assessed in conjunction with granting an installment agreement or closing a case currently not collectible. We also determined if unnecessary TFRP actions were performed in investigations for which the TFRP was not applicable or possible.
- E. Calculated projections across the population.
- III. Determined if the IRS is sufficiently considering the TFRP on trust fund cases closed as currently not collectible.
- A. Per TIGTA's Data Center Warehouse ICS Tax Module file as of October 25, 2012, that we matched to the ATFR system extract noted in Step II.A., we identified a population of 17,940 trust fund taxpayer accounts, with a total outstanding employment tax balance of \$1.3 billion, that: 1) had an aggregate Form 941 tax liability greater than \$10,000; 2) were closed currently not collectible in Calendar Year 2011; and 3) did not have a TFRP assessed between January 1, 2010, and October 31, 2012.
- B. Based upon input from our contracted statistician, our statistically valid sampling methodology from the population identified in Step III.A. resulted in a statistical sample of 92 cases closed currently not collectible in Calendar Year 2011. The statistical sample was based on a confidence level of 90 percent, a precision level of ± 6 percent, and an expected error rate of 12 percent. We oversampled 11 cases among the few large dollar cases in the population in order to improve the potential variability in projecting error dollars.



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- C. Used tests similar to the open sample review in Steps II.C. and D. to determine the adequacy and timeliness of TFRP decisions in the 92 sample cases closed currently not collectible.
- IV. Determined the status of the IRS's corrective actions to address TFRP recommendations from prior TIGTA and Government Accountability Office reports.

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 Collection function's policies, procedures, and practices for TFRP actions to ensure that TFRP actions and decisions are adequate and timely on trust fund cases. We evaluated these controls by reviewing statistical samples of Collection Field function trust fund cases and interviewing Collection function personnel.

Data validation methodology

During this review, we evaluated the reasonableness of the Form 941 data we extracted from the ICS Tax Module files in TIGTA's Data Center Warehouse. Specifically, we compared the number of tax modules, trust fund businesses, and aggregate Form 941 tax liability in the extracts we received to the IRS's Collection report 5000-2, *TDA Cumulative Report*, to validate or assess the reliability of the data we obtained. These tests determined that the data were sufficiently reliable and could be used to meet the objective of this audit.



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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
Director, Campus Compliance Services, Small Business/Self-Employed Division SE:S:CCS
Director, Field Collection, Small Business/Self-Employed Division SE:S:FC
Director, Filing and Payment Compliance, Wage and Investment Division SE:W:CP:FPC
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
Chief Counsel CC
National Taxpayer Advocate TA
Audit Liaisons:
 Commissioner, Small Business/Self-Employed Division SE:S
 Commissioner, Wage and Investment Division SE:W



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Appendix IV

Glossary of Terms

Assessment Statute – For employment taxes, the statutory period of limitation is three years from April 15 of the year following the year for which the return was due or three years after the date the return was actually filed, whichever is later.

Automated Collection System – A telephone contact system through which telephone assistants collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.

Automated Trust Fund Recovery System – Used to help support the preparation and input of TFRP assessments and related transactions.

Collection 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.

Collection Field Function – The unit in the Area Offices consisting of revenue officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.

Collection Queue – A function of the Integrated Data Retrieval System, the Collection Queue is a holding area where the IRS places cases awaiting assignment to Collection function personnel.

Control Point Monitoring – A function within the Collection Advisory unit that is responsible for ensuring that TFRP case files received from revenue officers are complete and accurate, the assessment statute expiration dates are protected, and the final disposition of the case has been accurately recorded.

Currently Not Collectible – Accounts can be declared currently not collectible for numerous reasons including: Bankruptcy, Defunct, Hardship, In-Business, Unable to Locate, Unable to Contact, Decedent, *etc.*

Data Center Warehouse – Delivers data analysis capabilities to the TIGTA business units. This availability to data and analysis tools enables TIGTA to conduct audits, investigations, integrity projects, and administrative support activities in a timely and efficient manner.

Determination Date – The determination date is 120 calendar days after the trust fund balance due account is assigned to a revenue officer.

Federal Tax Deposits – Federal tax deposits are advance payments made by business taxpayers for trust fund taxes. Generally, these payments are made once, twice, four, or eight times a month, depending upon the amount of the quarterly liability and frequency of the payroll.



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Installment Agreement – Arrangements in which the taxpayers agree to pay their liabilities over time.

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 – The IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer’s account records.

Internal Revenue Manual – The operations manual for employees of the IRS.

Letter 1153 – Used by revenue officers to officially advise taxpayers of the proposed TFRP and to provide them with their appeal rights. The letter requests the filer to return Part 1 of the enclosed Form 2751, *Proposed Assessment of 100% Penalty*, if the assessment is agreed to; otherwise, the IRS is to be contacted within 60 days.

Revenue Officer – Employees in the Collection Field function who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by the IRS campuses (formerly known as service centers) or the Automated Collection System.

Territory – Collection function geographic locations across the country, with direct supervision by one of seven Area Office directors. A Territory is headed by a second-level manager in the Collection function (Territory manager) responsible for supervision of all group managers within the Territory.

Trust Fund Recovery Penalty – A Collection tool provided by Internal Revenue Code Section 6672 against any person required to collect, account for, and pay over taxes held in trust who willfully fails to perform any of these activities, or willfully attempts to evade or defeat any such tax or its payment.

Trust Fund Tax – Trust fund tax is the employee portion of employment taxes (income, Social Security, and Medicare taxes) withheld from an employee’s wages by an employer and held “in trust” until paid to the IRS.



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Appendix V

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

MAY 2 2014

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

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

SUBJECT: Draft Audit Report – Trust Fund Recovery Penalty
Actions Were Not Always Timely or Adequate
(Audit #201230015)

Thank you for the opportunity to review your draft report titled: "Trust Fund Recovery Penalty Actions Were Not Always Timely or Adequate." We agree with your recommendations and appreciate your acknowledgment of our efforts to improve the timeliness and adequacy of Trust Fund Recovery Penalty (TFRP) actions.

We have significantly improved the timeliness of TFRP case actions as a direct result of the actions that we took following a prior GAO report titled "*Tax Compliance: Businesses Owe Billions in Federal Payroll Taxes*" (July 2008). Our overall average improvement in timeliness of TFRP case actions increased from 74% in FY 2010 to 93% in FY 2013. In particular, we achieved significant timeliness improvements in the following two measured categories: (1) Form 4183, Recommendation re: Trust Fund Recovery Penalty Assessment, submissions improved from 69.4% to 94.4% from FY 2010 to FY 2013, and (2) Form 2749, Request for Trust Fund Recovery Penalty Assessment(s), control point monitoring improved from 66.1% to 95.1% from FY 2010 to FY 2013.

Unfortunately, the sample you used for the analysis in your report included cases with actions prior to 2012 before our improvements had been fully implemented; therefore, your report does not fully incorporate these successes. As we discussed during the audit, we worked diligently to implement the recommendations made by GAO and to improve the timeliness and adequacy of all TFRP actions. Limiting your review to case actions that occurred after FY2012, when increased controls and guidance had been completely implemented, would have provided a more accurate picture of our current program.

We remain committed to continued improvement and recognize the opportunity for additional systemic enhancements to increase our case processing efficiency and accuracy. Our upcoming Automated Trust Fund Recovery (AFTR) programming



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changes will ensure that subsequently assigned Integrated Collection System (ICS) case modules are systemically added to ATFR and will systemically document the ATFR recommendation narrative in the ICS history. We also are committed to additional training for our managers. To that end, we will deliver a TFRP course in the 2014 Group Manager Continuing Professional Education (CPE) training curriculum.

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

Attachment



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Attachment

RECOMMENDATION 1:

The Director, Field Collection, Small Business/Self-Employed Division, should emphasize to group managers their responsibilities to:

1. Use ATFR system reports at least monthly to promote timely TFRP investigations and actions by their revenue officers. Also, determine why group managers are not using the ATFR system reports and take appropriate actions to address the issues identified.
2. Document the ICS case history with the circumstances that warrant additional time when revenue officers do not submit the Forms 4183 timely.

CORRECTIVE ACTION:

We will do the following:

1. Revise Internal Revenue Manual (IRM) 1.4.50, *Collection Group Manager, Territory Manager and Area Director Operational Aid*, to emphasize the requirement for managers to use ATFR reports at least monthly. Additionally, we will review the use of these reports in Operational Reviews conducted by the Director, Field Collection to ensure that ATFR system reports are used regularly.
2. Revise IRM 5.7.4, *Investigation and Recommendation of the Trust Fund Recovery Penalty*, to emphasize managers must document the ICS case history with the circumstances when Form 4183 delay is approved.

IMPLEMENTATION DATES:

1. November 15, 2015
2. November 15, 2015

RESPONSIBLE OFFICIAL(S):

1. Directors, Field Collection and Collection Policy, Small Business/Self-Employed Division
2. Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 2:

The Director, Field Collection, Small Business/Self-Employed Division, should enhance TFRP communication and training. Specifically:

1. Conduct Fiscal Year 2014 Manager TFRP training that includes emphasizing group manager responsibility for reviewing ATFR reports at least monthly to monitor timeliness of TFRP actions.



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2. Include a component to review and measure the timeliness of TFRP actions in Fiscal Year 2014 Operational Reviews conducted by the Director, Field Collection.
3. Use systemic messages to remind revenue officers about existing system functionality to facilitate timely TFRP actions.

CORRECTIVE ACTION:

We will do the following:

1. Conduct training emphasizing group manager responsibility to review ATFR reports at least monthly to monitor timeliness of TFRP actions.
2. Review and measure the timeliness of TFRP actions as part of the Operational Reviews conducted by the Director, Field Collection.
3. Initiate a process to use the ATFR Message of the Day feature to remind revenue officers about existing system functionalities to facilitate timely TFRP actions.

IMPLEMENTATION DATES:

1. June 15, 2015
2. September 15, 2015
3. June 15, 2015

RESPONSIBLE OFFICIAL(S):

1. Directors, Field Collection and Collection Policy, Small Business/Self-Employed Division
2. Director, Field Collection, Small Business/Self-Employed Division
3. Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 3:

The Director, Collection Policy, Small Business/Self-Employed Division, should work with the IRS Information Technology organization to ensure the completion and adequacy of the ICS improvements that are scheduled to be implemented in January 2015. Take appropriate actions to make sure the programming changes work as planned and implement them appropriately. These changes will:

1. Update the installment agreement request process to present a checklist box.
2. Automatically create an Other Investigation when selections during the installment agreement and currently not collectible closing processes indicate the TFRP has not been completed.



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CORRECTIVE ACTION:

We will contact the IRS Information Technology organization periodically to inquire about the status of the ICS improvements and to ask whether their programmers have any questions that we can answer. Once the programming changes are made, we will work with IT to ensure that the improvements, including updating the ICS installment agreement closing process to present a checklist box to note actual actions taken on the account related to the TFRP and automatically creating an Other Investigation when the TFRP has not been completed and the employee is closing the case as an installment agreement or currently not collectible on ICS, work as intended.

IMPLEMENTATION DATE:

June 15, 2015

RESPONSIBLE OFFICIAL(S):

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

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 4:

The Director, Field Collection, Small Business/Self-Employed Division, should work with Collection Policy to revise the IRM guidance to:

1. Require that group managers verify the accuracy of the collectibility determination support and research listed by the revenue officer in Section II of Form 9327.
2. Reflect that an Other Investigation will be created on the ICS to control the completion of the TFRP investigation when installment agreements or currently not collectible closures are approved before the TFRP investigation is complete.

CORRECTIVE ACTION:

We will do the following:

1. Revise IRM 5.7.5, Collectibility Determination, and IRM 1.4.50, *Collection Group Manager, Territory Manager and Area Director Operational Aid* to require managers to verify the accuracy of Form 9327 actions prior to approval.
2. Revise IRM 1.4.50, *Collection Group Manager, Territory Manager and Area Director Operational Aid*, to reflect that an ICS Other Investigation must be created for completion of TFRP actions, if necessary, when approving installment agreements or currently not collectible closures.



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IMPLEMENTATION DATE:

November 15, 2015

RESPONSIBLE OFFICIAL(S):

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

CORRECTIVE ACTION MONITORING PLAN:

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