Volume 2

TAS Research and Related Studies

Collecting Business Debts: Issues for the IRS and Taxpayers

Collecting Business Debts: Issues for the IRS and Taxpayers[1]

1 The principal authors of this study are Tom Beers, Joe Saldana, and Jeff Wilson, TAS Research and Analysis.

EXECUTIVE SUMMARY

In the preceding year, the Taxpayer Advocate Service published a study of the Individual Master File (IMF) Collectibility Curve, which focused on how dollars collected decrease as the years progress after the IRS assigns the case to Taxpayer Delinquent Account (TDA) status. To further explore the issue of collectibility, TAS Research conducted a study of IRS Business Master File (BMF) collections. The study focuses on the collection of business debts from both the IRS and taxpayer perspectives. The IRS sees a significant decline in the reduction of the initial TDA balance as the years progress after the IRS assigns a liability to TDA status with collection often becoming non-existent after four years. Not unexpectedly, the percent of TDAs fully resolved also decline as the years progress.

The IRS is more likely to abate liabilities, which are not self-reported by the taxpayer (e.g., math error assessments or substitute for return assessments). Interestingly the IRS is actually more effective at collecting larger liabilities. This phenomenon may stem from the method that the IRS used to prioritize collections. The IRS is more likely to assign larger liabilities for immediate collection action including the assignment of large delinquencies to a revenue office for personal contact. However, when more time elapses from the return due date until an unpaid balance due return is filed by the taxpayer, the IRS is significantly less effective at collecting the resulting TDA. Another consequence is that the taxpayer becomes more likely to accrue additional unpaid liabilities. From the taxpayer's perspective, the delay in securing balance due returns also causes additional penalty and interest to accrue.

A clear relationship exists between the due date of a liability and additional penalty and interest, the percent of modules remaining open, and the percent of initial module balance remaining. Tax liabilities due for longer periods are more likely to remain open because more penalty and interest will be charged. As a result, more of the dollars collected are applied to penalties and interest compared to those liabilities, which have been due for a shorter timeframe. Taxpayers are burdened as penalties and interest increase significantly, and may no longer have the ability to pay the debt. This is particularly true when multiple tax returns (employment tax returns are due quarterly) are unfiled for an extended period after their due date. The result is an overwhelming debt for the taxpayer and reduced revenue for the IRS.

The study includes detailed findings related to the following general conclusions:

- Collections decrease as more time elapses from the initial BMF TDA assignment;
- Penalties and interest are a significant component of the unpaid BMF liability, particularly for unresolved TDAs, likely overwhelming most taxpayers;
- Overall, the IRS is more effective at closing smaller BMF TDAs, but collects a larger percent of the TDA when balances are larger. However, the IRS is more effective collecting employment tax TDAs when the balance due is smaller;
- The IRS abates a significant amount of BMF TDA assessments; this means the IRS is using collection resources to resolve incorrect assessments; and
- As more time passes from the due date of a tax return to BMF TDA assignment, the IRS is less likely to close the TDA or see as great of a reduction in the initial TDA balance. The likelihood of accruing sizable new delinquencies also increases when there are longer lapses between the BMF tax return due date and when the IRS secures the return and assesses the tax.

While we believe that the findings and conclusion in this study can have a positive impact on various IRS collection policies regarding BMF TDAs, we have also made the following specific recommendations:

- The IRS should try to determine if unfiled BMF tax returns, particularly employment tax returns, have unpaid liabilities, and should secure those returns as soon as possible after the return due date; and
- The IRS should determine and, to the extent possible, mitigate the factors causing such a large percent of the tax assigned to TDA status to be abated, so that resources are not wasted on assessments not due.

INTRODUCTION

Last year, the Taxpayer Advocate Service published a study on the Individual Master File (IMF) Collectibility Curve. Specifically, we analyzed how dollars collected on taxpayer delinquent accounts (TDAs) decrease as time elapses after the initial assignment to TDA status. For TDAs originating from 2003 to 2012, our analysis showed that: (a) dollars collected decrease by more than 50 percent from the first year to the second year; and (b) in the third year, collections decrease by about one-third from the amount collected in the second year.[2] In other words, collections are over twice as much during the first year as in the following year and over three times the collections in the third year. In addition to the rapid decrease in dollars collected as TDAs age, we also found:

- Penalties and interest increase significantly;
- The IRS is less likely to collect TDAs as the balance increases;
- IRS imposed assessments are more likely to be abated than collected; and
- For cases assigned to revenue officers, the IRS abates about a third of the initial TDA module balance.

This year, TAS Research conducted a study on the Business Master File (BMF) collectibility curve. In past Annual Reports to Congress, the National Taxpayer Advocate noted that many of the TDAs[3] in the IRS Automated Collection Branch and the Collection Field function (CFf) are delinquencies that have existed for several years. The following statistics highlight the age of the IRS BMF TDA inventory at the beginning of fiscal year (FY) 2017:[4]

- Overall, almost 54 percent of the IRS BMF TDA inventory has been in the function assigned the delinquency for at least ten months (the delinquency may have been in TDA status much longer);
- Nearly 64 percent of the BMF TDAs in IRS inventory at the end of FY 2016 are tax year (TY) 2011 and prior liabilities; and
- Over a fifth of the BMF TDAs have less than four years remaining on the collection statute, meaning that the delinquency has existed for over six years.

We examined the BMF Accounts Receivable Dollar Inventory (ARDI) and the Enforcement Revenue Information System (ERIS) to conduct analyses of BMF taxpayers. In particular, we explored patterns in

2 In 2003, collections of new taxpayer delinquent accounts (TDAs) decreased by only about 35 percent from the first to the second year, even though the decrease from the second to the third year was similar to later years.

3 A TDA represents only one module, generally a tax return for a single tax year. Since Forms 941, *Employer's Quarterly Federal Tax Return*, are filed quarterly, many business taxpayers have multiple TDAs. At the end of 2012 (the last year analyzed in this study), the ratio of TDAs to Business Master File (BMF) taxpayers was 3.3. Collection Activity Report 5000-2 (Dec. 9, 2013). A taxpayer may have multiple TDA delinquencies.

4 IRS Collection Activity Report 5000-2 (Oct. 3, 2016).

dollars collected on TDAs during the entire ten-year statutory period for collection.[5] Additional analyses include:

- Dollars abated by the underlying source of assessment (*e.g.*, the major cause of the delinquency such as an unpaid balance due return or an audit assessment);
- How accruals of penalty and interest affect the balance due; and
- How the amount of balance due and the time elapsed from the tax return due date until TDA assignment affect the reduction in TDA balance.

Our focus during the IMF study was the description of the collectibility curve and how it varied by different taxpayer characteristics. While the report highlighted areas for additional IRS consideration and study, it did not have findings directed at collection policy or make specific recommendations. In the BMF study, we also describe the collectibility curve of the BMF taxpayers, but we have a greater focus on findings, which the IRS may be able to use to alter its collection policies. Proper resource allocation makes the effective and efficient collection of delinquencies paramount. As discussed below, although business liabilities represent only a small portion of the IRS TDA inventory, these liabilities comprise over half of the CFf inventory. In addition, the CFf staff is significantly more costly on a per employee basis than other IRS Collection staff. The IRS should carefully study and apply the data on how the failure to resolve liabilities soon after their initial due date often leads to fewer dollars collected and additional unresolved liabilities.

Valuable information on the time available to collect business delinquencies effectively will assist the IRS in determining what liabilities should be collected first, and if it makes sense to defer the collection of smaller, more current liabilities in favor of older, larger liabilities. In addition to discussing the collection of existing delinquencies, the report highlights how delays in addressing delinquencies result in taxpayers accumulating new delinquencies.

BACKGROUND

Overview of the IRS Collection Process

When taxpayers incur delinquent tax liabilities, the IRS sends them a series of notices over a four-month period. This period is referred to as "notice status." If the taxpayer does not resolve the liability during notice status, the account enters into TDA status. The IRS then determines whether the case will be referred to the Automated Collection System (ACS), assigned directly to the CFf for in-person contact by a revenue officer (RO), assigned to the Collection Queue ("Queue") to await assignment to an RO, or shelved.[6] A discussion of each of these alternative assignments follows.

5 We chose the ten-year period for analysis because the IRS's authority to collect delinquent taxes, *i.e.*, the statutory period to collect an assessed tax, generally expires ten years after the date of assessment. Section 3461(c)(2) of Revenue Reconciliation Act of 1998 (RRA 98), which controls most lengthy collection statute expiration date (CSED) accounts, states: — If, in any request to extend the period of limitations made on or before December 31, 1999, a taxpayer agreed to extend such period beyond the 10-year period referred to in section 6502(a) of the Internal Revenue Code of 1986, such extension shall expire on the latest of (A) the last day of such 10-year period, (B) December 31, 2002, or (C) in the case of an extension in connection with an installment agreement, the 90th day after the end of the period of such extension. RRA 98, Pub. L. No. 105-206, § 3461(c)(2), 112 Stat. 685, 764 (1998). In some instances, we only show results through the fourth year after the IRS initially assigns a case to TDA status. Modules generally reach TDA status approximately 120 days after the IRS assesses the tax. Therefore, the statutory period to collect delinquent taxes often expires during the tenth year after reaching TDA status. Since the IRS is required to abate tax assessments after the expiration of this statutory period, this abatement sometimes obscures trends in the amount of the initial TDA balance remaining or the number of TDAs remaining open.

6 Shelving refers to the IRS reporting a liability as currently not collectible (CNC) because of its small balance due.

The ACS is a computerized inventory system and telephone call center. After a case arrives in ACS, the IRS checks for levy sources, telephone numbers, and other characteristics. These actions result in additional computer-generated notices to taxpayers. Customer Service Representatives (referred to as "Collection Representatives")[7] work ACS cases and primarily respond to phone calls from taxpayers who call in response to IRS enforcement actions (*e.g.,* levies or liens) rather than proactively contacting taxpayers.

The Queue is an electronic holding bin that holds TDA accounts awaiting assignment to field ROs based on inventory levels.[8] The IRS prioritizes cases assigned to the Queue using a risk-scoring algorithm. The IRS generally assigns cases to CFf when the taxpayer has accrued significant liabilities, when the accrual of new balances due continues to occur (pyramiding), or when the ACS is unable to resolve the case. Upon assignment to the CFf, an RO will actively work the case, attempting to contact the taxpayer and collect the information necessary to determine how to resolve the delinquency. ROs can take enforcement action (*i.e.,* initiate liens, levies or seizures) when deemed necessary to resolve a case.

If the IRS shelves a case, it does not actively work it, but these cases continue to accumulate penalties and interest. This study does not specifically explore collections on shelved cases.

Overview of the BMF Collection Inventory

Overall, the IRS issues most TDAs on individual liabilities. At the beginning of FY 2017, BMF taxpayers comprised less than 14 percent of the total taxpayers in the IRS TDA inventory. Business taxpayers often file quarterly employment tax returns, and, therefore, these taxpayers are more likely to have more delinquent TDA modules (*i.e.,* be delinquent on more than one business return). Nevertheless, BMF taxpayers still account for less than a quarter of all TDA modules.

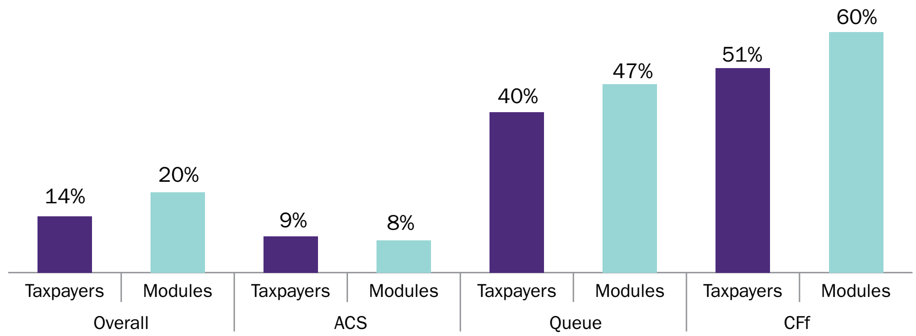
BMF taxpayers comprise less than eight percent of inventory in the IRS ACS. However, BMF taxpayers comprise over 40 percent of the IRS collection queue total taxpayer inventory.[9] This circumstance occurs because business tax liabilities often require personal contact to properly assess and address their unique compliance circumstances. Accordingly, in FY 2016, ACS transferred 45.9% of its BMF modules to the queue, amounting to over $1.4 billion. As a result, BMF cases are often queued, awaiting assignment to a RO. As indicated, BMF taxpayers comprise over half of the IRS CFf (*i.e.,* cases assigned to a RO) total inventory. The following figure depicts the percent of TDA taxpayers and modules contained in the IRS Collection functions.

7 Internal Revenue Manual (IRM) 21.1.1.6, *Customer Service Representative (CSR) Duties*.

8 Work also goes into the Queue from ACS if it cannot be resolved while in ACS status.

9 IRS Collection Activity Report 5000-2 (Oct. 3, 2016).

FIGURE 5.1, Percent of BMF TDA Taxpayers and Modules in IRS Collection Functions



Accordingly, even though business taxpayers are not the majority of the IRS TDA inventory, these taxpayers are the majority of the taxpayer TDAs worked by ROs who represent the most expensive part of IRS Collections operations. To ensure the effective use of IRS Collection resources, TAS wanted to examine what happens over the life of a BMF tax debt: do businesses pay more of the tax debt if the IRS collects earlier in the debt cycle (closer to when the debt actually occurs)? TAS Research examined the BMF ARDI and the ERIS to determine how dollars collected fluctuate over time. We looked at delinquencies that originated in each of ten years (2003 through 2012) and analyzed those delinquencies over the next ten years.[10]

OBJECTIVES

We identified four objectives to explore the relationship between the age of a BMF TDA, the amount of the liability, and the dollars that the IRS collects on these liabilities, *i.e.,* specifically how the module balance declines. We also explore the effect of aging on the number of modules resolved, the accumulation of penalties and interest, the percent abated on various types of assessments, and the accumulation of additional liabilities. Specifically, for BMF liabilities reaching TDA status, we:

1. Explore the effects of aging on BMF TDAs
   - The rate of reduction of these TDA module balances over time;
   - The increase of penalties and interest as a percent of the module balance as a delinquency ages; and
   - The amount and percent of dollars collected as time elapses;
2. Study how the percentage collected and the number of resolved modules change as the TDA balance increases;
3. Determine what percent of the tax comprising BMF TDA liabilities is abated by the IRS and if the percent abated varies by the source of assessment; and

10 We chose the ten-year period for analysis because the IRS's authority to collect delinquent taxes, *i.e.*, the collection statute, expires ten years after the date of assessment. In some instances, we only show results through the fourth year after the IRS initially assigns a case to TDA status. Modules generally reach TDA status approximately 120 days after the IRS assesses the tax. Therefore, the statute to collect delinquent taxes often expires during the tenth year after reaching TDA status. Since the IRS is required to abate tax assessments after the expiration of the collection statute, this abatement sometimes obscures trends in the amount of the initial TDA balance remaining or the number of TDAs remaining open.

4. Examine the effect of the time lapse between the tax return due date and TDA assignment:
    - The effect on the reduction of the initial TDA balance; and
    - The number of delinquent taxpayer modules.

METHODOLOGY

This study analyzes all BMF modules that first entered TDA status between 2003 and 2012 based on the ARDI table of the Compliance Data Warehouse (CDW). Each module was grouped into an inventory year based on the year of its earliest extract cycle posting of TDA status in ARDI. Each inventory year was analyzed separately and then compared to other years to determine where patterns were consistent across inventory years.

ARDI fields for each module were extracted and aggregated over time to analyze the composition of each inventory year, and then to characterize how modules age after reaching TDA status, through up to the full ten years of the statutory collection period. Fields include the total module balance, assessed tax, assessed penalties, interest and accruals of interest and penalties. Modules were also categorized and analyzed based on the age of the module, the quartile of the module balance within its inventory year, and the major source of assessment at the time of TDA assignment.

The analysis was supplemented using matching transaction data (including codes, amounts, dates and cycles) from the BMF Transaction History Table of the CDW. This data was used to compute payments and tax abatement amounts and trends across subsequent years after initial TDA assignment.

Finally, each taxpayer entity's end-of-year module balances owed and total number of debt modules were extracted from ARDI (whether or not the module was in TDA status). These fields were used to contrast the average initial assessment, year ending balance owed, and number of debt modules for each BMF taxpayer entity based on that taxpayer's oldest module in a given inventory year of our study.

As used in this report, the phrase "initial TDA assignment" refers to the time when a module first reaches TDA status, even if the TDA is first assigned to the Collection queue. We have analyzed the data by the year in which the delinquency first reached TDA status. For example, if a taxpayer has an outstanding tax debt assigned to TDA status in 2003 and then an additional module reaches TDA status in 2004, each module is analyzed with respect to the year it became a TDA. However, in the last section on the number of additional delinquent modules, we examine all of the delinquent modules accrued by a taxpayer in the years after the first delinquent module reached TDA status.

Limitations

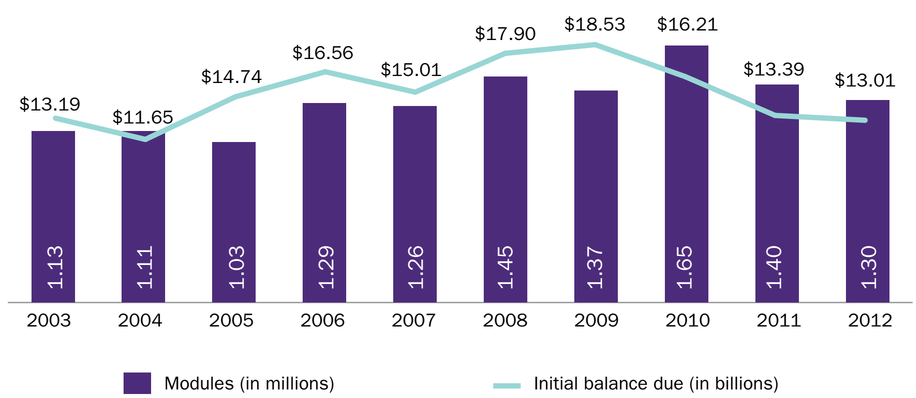
Because tracking in ARDI is limited to monthly extract cycles, there is an unavoidable fuzziness at the edges of time intervals in cases where the actual change in status occurred earlier than posted. However, because this effect only occurs at the boundaries (*e.g.*, at the beginning or end of years of age in the tabulations) the effects are expected to be minimal.

Interest assessed amounts do not contain restricted interest assessments. Although it is a relatively small portion of abatements, dollars abated as a result of accepted offers in compromise (OIC) are included in total abatements.

FINDINGS

For modules reaching TDA status in 2003 (the first year analyzed), the module balance due at the time of TDA assignment was over $13 billion. A similar TDA balance occurred in 2012, the most recent year analyzed. However, the intervening years often saw higher initial TDA balances, with the amount peaking at over $18.5 billion in 2009. At least part of the increase in the amount of liabilities reaching TDA status in 2009 may have been due to the economic recession in the preceding year. Figure 5.2 shows both the number of modules reaching TDA status from 2003 to 2012 and the total amount of the initial TDA balance in each year.

FIGURE 5.2, Number and Amount of Modules Assigned to TDA Status by Calendar Year Initially Assigned to TDA Status



As shown, the amount initially due on TDAs generally reflects the number of TDAs, although there are some slight discrepancies.

Explore the Effects of Aging on BMF TDAs

The Rate of Reduction of These TDA Module Balances Over Time

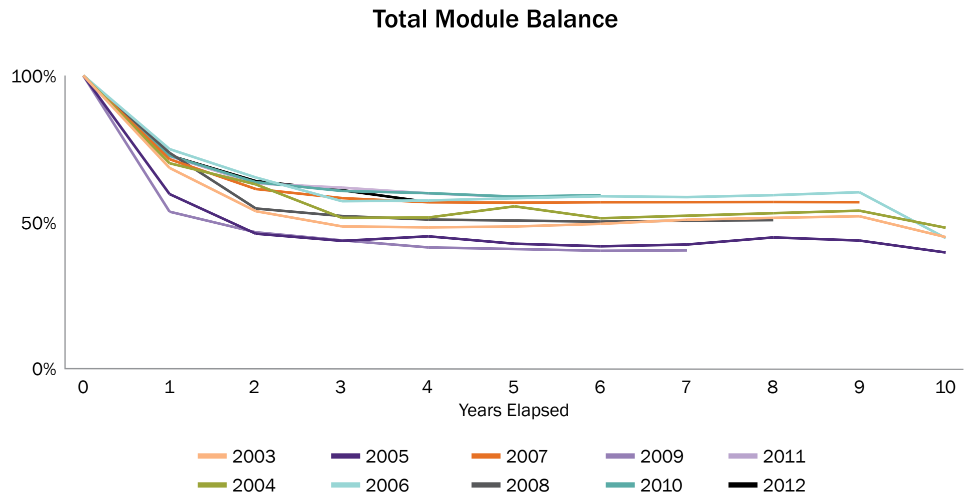
On average, the decline in the initial TDA balance is greatest in the first year after the initial TDA assignment[11] as the balance remaining on the TDA decreases by about 25 to 30 percent from its starting point. However, in 2005, the initial TDA balance decreased by 40 percent, and in 2009, the initial TDA balance declined by nearly 50 percent, even though the initial TDA balance was highest in this year.

In the second year after TDA assignment, the IRS only reduced the initial TDA balance by no more than about an additional 20 percent. By the third year, the initial balance had only further decreased by less than ten percent, with decreases of less than five percent in the fourth year. Further, subsequent to year four, the decrease in the initial TDA balance continued to decline.[12] In general, the ongoing accrual of interest and penalties on unpaid liabilities offsets any additional amounts paid after year four, and we see little or no decrease in the initial TDA balance, and, in fact, the balance due may actually increase. This information is depicted in Figure 5.3.

11 For purposes of this study, the initial TDA balance is the balance due including assessed and accrued penalties and interest upon first reaching TDA status, regardless of whether the IRS assigns the TDA to automated collection system (ACS), Collection Field function (CFf), or the Collection Queue.

12 We have examined the decline in the amount due at the time of the initial assignment to TDA status. The ongoing balances due will often be higher because of additional penalties and interest.

FIGURE 5.3, Percent of Initial TDA Balance Remaining by Years Elapsed After Initial Assignment to TDA Status[13]

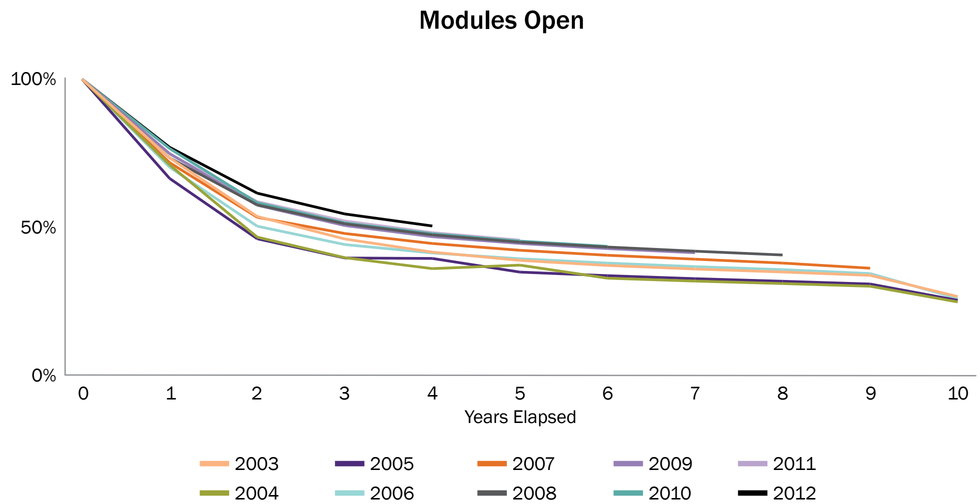


The Rate of Closure of TDA Modules Over the Ten Years of the Collection Statute

As might be expected, the decline in TDA modules remaining open follows a similar trend to the decline in initial TDA balance. Nevertheless, the decline in open TDA modules always exceeds the decline in initial TDA balance, suggesting that the IRS closes smaller TDA modules associated with the overall taxpayer TDA liability. This circumstance may occur because taxpayers are often able to satisfy their Form 940, *Federal Unemployment Tax*, liabilities, even though they cannot satisfy their generally larger quarterly Form 941 employment tax liabilities. The following figure depicts the decline in open TDA modules as the years elapse since assignment to TDA status.

13 The period available to collect delinquent taxes is generally ten years from when the IRS first assesses the tax. Cases generally reach TDA status about 120 days after being assessed. Therefore, the statutory collection period will expire during the tenth years. Absent any extension of the statutory period to collect taxes, the IRS must abate the amount due after the expiration of the collection statute, which is why we see a sharp decline in the percent of the initial TDA balance remaining during in the tenth year after the IRS assigns a case to TDA status. The ten-year period to collect the tax may, however, be extended by certain events such as a taxpayer's bankruptcy or by a voluntary waiver signed by the taxpayer. In addition, some time may elapse between the expiration of the statutory period to collect tax and when the IRS actually abates the outstanding liability.

FIGURE 5.4, Decline in Open TDA Modules by Year After Initial Assignment to TDA Status



The Increase of Penalties and Interest

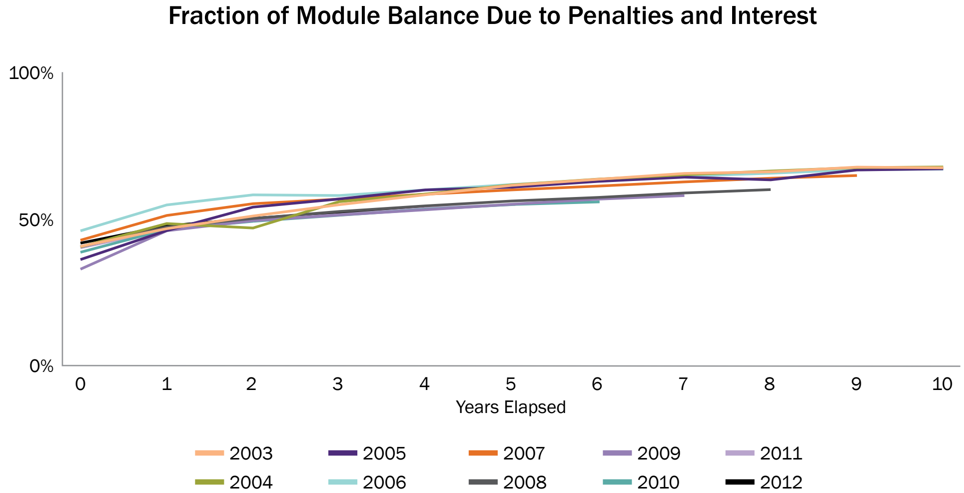
Penalties and interest generally comprised about 40 percent of the balance due when a module reached TDA status.[14] While this initial amount may seem high, the liability does not become a TDA until about four months after the IRS assesses the liability. Furthermore, as we will explore later, due to taxpayer delays in filing unpaid balance due returns, the IRS often does not assess the liabilities until long after the return is originally due. This situation results in significant penalties and interest at the creation of the TDA, since the IRS assesses these amounts from the date the return is due, not from when the taxpayer finally files the return.

For those modules remaining open throughout the ten-year collection statute, penalties and interest comprised over two-thirds of the final balance due. In all the years except 2005, at least half of the balance due by the third year after the IRS assigned the account to TDA status was attributable to penalties and interest.[15] The following figure shows how penalties and interest comprise a growing percent of the TDA balance due as time elapses:

14 In 2009, penalties and interest only comprised a third of the initial TDA balance. This year also saw the highest initial TDA balance.

15 In 2005, penalties and interest were 47 percent of the liability three years after the IRS assigned the delinquency to TDA status.

FIGURE 5.5, Percent of TDA Balance Attributable to Penalties and Interest Increases as the Years Elapse Subsequent to TDA Assignment

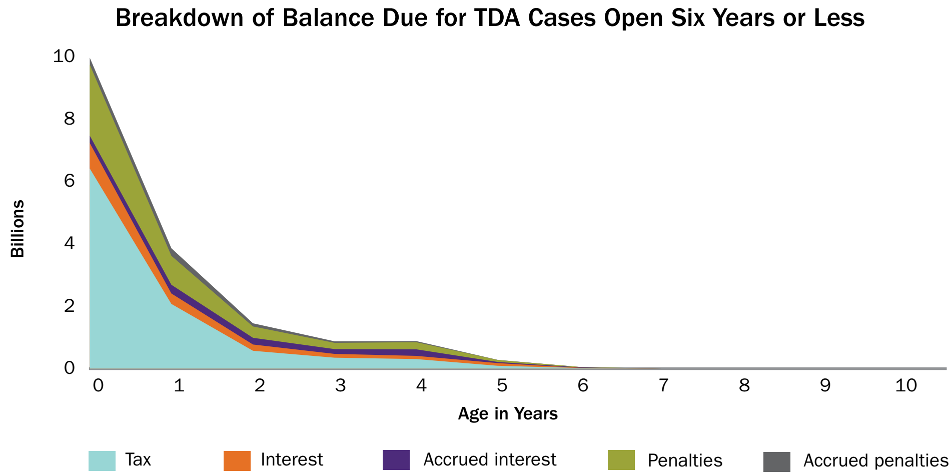


While one reason for the assessment of penalties and interest[16] is to discourage taxpayers from becoming delinquent, interest and penalties are burying many taxpayers. Over time, the total amount paid by the taxpayer is much larger than the amount of tax originally due. The following figures, using the example year of 2006, show the amount of tax, accrued and assessed penalties, and accrued and assessed interest for cases closed within the first six years and cases closed in seven to ten years after TDA issuance.[17] We chose 2006 as an example year, but the other study years where at least 6 years had elapsed show similar results.

16 Interest is also assessed to compensate for receiving tax payments after their original due date. Also, interest accrues daily on outstanding balance, including on penalties.

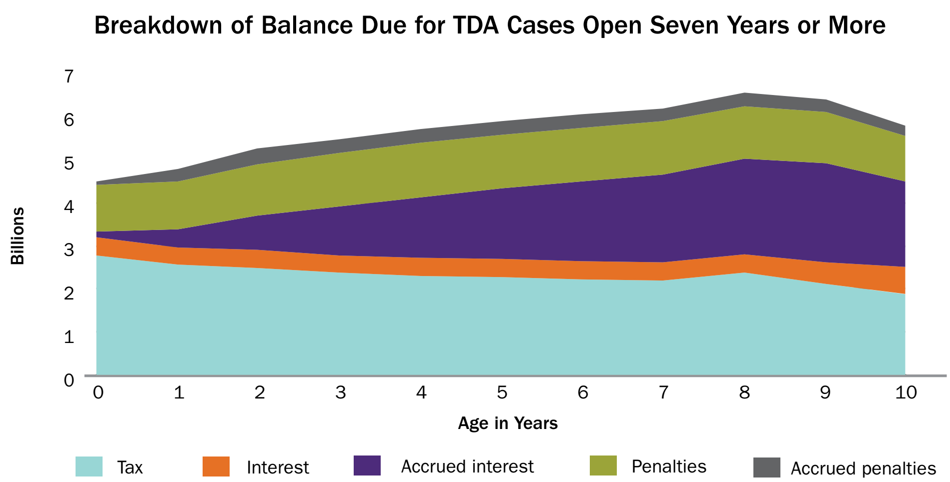
17 The IRS assesses the amount of penalty and interest due when it initially assesses the tax on a module. Penalties and interest continue to accrue until the liability is completely satisfied (or, in the case of penalties, the maximum amount of penalty has been assessed); however, these accruals do not generally become assessments until the assessed tax, penalty, and interest have been paid and additional payments are received, necessitating that accruals be assessed in the amount of the additional payment.

FIGURE 5.6, Composition of Module Balance for TDA Cases Open Six Years or Less — Example Year 2006



As the previous figure shows, for modules closed within the first six years,[18] the assessed and accrued penalties and interest are generally small, compared to the collected tax. Furthermore, the penalties and interest are decreasing as time elapses. However, as the following figure illustrates, the module balance is comprised more of penalties and interest than underlying tax for modules that are open seven years or more. In addition, unlike TDA modules resolved in the first six years, these cases have amounts of penalties and interest that are increasing.

FIGURE 5.7, Composition of Module Balance for TDA Cases Open Seven Years or More — Example Year 2006[19]



18 We chose to look at the difference between penalties and interest assessed and accrued within six years and after six years because the statutory period for collecting delinquent tax was previously limited to six years. However, as we have seen, most collections on delinquent TDAs occur in the first three years. Therefore, if we compared assessed and accrued interest and penalty for modules closed in the first three years and those remaining open past three years, we would see similar trends. A small category of "other" assessments exists, but represents less than .1 percent of the total module balance.

19 We chose 2006 as an example year, but the other years where at least 6 years had elapsed would show similar results. A small category of "other" assessments exists, but represents less than .1 percent of the total module balance.

A comparison of the prior two figures demonstrates several points. First, for the cases closed within the first six years, most of the dollars collected go towards tax due; and the figure shows the amount of dollars applied to tax decreasing throughout the six years.[20] However, since the IRS applies dollars collected to tax first, the decline in penalties and interest does not occur until the latter part of the six years.

On the other hand, cases that remain open in years seven through ten have much more of their total liability attributable to interest and penalty. In fact, in the later years, the amount of interest and penalty may exceed the original liability. Not surprisingly, we only see a minor decrease in the amount of tax due. As discussed previously, the IRS assesses penalties and interest to prevent delinquent behavior so that the IRS receives the monies due it in a timely manner. The IRS also assesses interest to compensate for not receiving tax payments in a timely manner. Unfortunately, for taxpayers struggling to pay off their tax liabilities, penalties and interest can overtake the amount of tax due, making it even more difficult for the taxpayer to pay the delinquency.

How the Percentage Collected and the Number of Resolved Modules Change As the TDA Balance Increases

We divided the balance owed at the initial assignment to TDA status into quartiles when considering all ten years of data. The lowest category has a TDA balance below about $689. The next category has balances between $689 and about $1,877. The third category has balances ranging between $1,877 and $5,623, and the final category has module balances exceeding $5,623.[21] The following figure contains the percent of modules remaining open at the end of the period under study in each TDA balance category.[22]

FIGURE 5.8, Percent of TDA Modules Remaining Open by Amount of Balance Due

Balance Category	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
< $689	19%	18%	19%	19%	27%	33%	36%	36%	40%	45%
$689 – $1,877	20%	19%	20%	20%	31%	36%	38%	39%	43%	48%
$1,877 - $5,623	28%	26%	26%	26%	37%	41%	40%	44%	46%	51%
>$5,623	39%	37%	38%	39%	50%	53%	52%	55%	55%	59%

In all years, we see there are more TDA modules remaining open in the highest TDA balance category. However, while the IRS generally closes more TDAs in the lower dollar TDA balance categories, the IRS realizes more dollars collected in the highest TDA balance due categories. The following figure shows the percent of the initial TDA balance remaining uncollected at the end of the study period for each category.

20 The IRS applies dollars collected to tax, penalty, and interest, respectively, on the oldest assessment. After, the oldest assessment is satisfied the IRS begins the process again with the next oldest assessment. Therefore, older assessments that remain unpaid and accrue more interest and penalty, cause more collections to be applied to penalty and interest, before being applied to tax on the next oldest assessment.

21 We computed the breakpoints for the quartiles by using the data from all ten years; however, when computed separately, by year, the quartiles were very similar. The exact breakpoints for the quartiles, are $688.75, $1,877.10, and $5.623.14.

22 The study period is ten years for modules reaching TDA status from 2000 to 2006. For all other years, it is the end of 2015.

FIGURE 5.9, Percent of Initial TDA Balance Remaining by Quartile of Initial TDA Balance Due

Balance Category	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
< $689	68%	64%	56%	56%	68%	71%	67%	62%	70%	74%
$689 – $1,877	43%	40%	40%	46%	55%	56%	55%	54%	56%	61%
$1,877 – $5,623	49%	43%	42%	41%	55%	55%	52%	54%	55%	58%
>$5,623	44%	48%	39%	44%	57%	50%	39%	60%	59%	56%

In every year, the IRS saw a greater decrease in the module balance of TDAs in the highest dollar category when compared to the lowest TDA balance category. This is different from the analysis of IMF TDAs, where the IRS was both more effective at closing small balance due modules and at collecting more on smaller balance TDAs. Higher dollar TDAs may generate more collections because these TDAs are generally assigned to a revenue officer before other smaller TDA balances. There is also a greater variance of the dollars due in the highest TDA balance category. Therefore, the collection of even a few of the highest dollar liability TDAs is likely to increase the overall percent of dollars collected. Additionally, IRS policy applies dollars collected to the oldest modules first. Since the oldest modules are more likely to have higher amounts of penalties and interest, we likely see more dollars collected on TDAs in the highest dollar category.

In most years, TDAs in the highest balance category saw their module balance reduced by about 15 to 20 percent more than TDAs in the lowest category of balance due.[23] However, the IRS was also more likely to resolve 15 to 20 percent more modules in the lowest TDA balance category than the highest TDA balance category. Interestingly, TDAs in the middle categories of initial TDA balance due have similar percentages of the initial balance remaining as those in the highest category of initial TDA balance. In some years, TDAs in these middle categories saw a greater reduction in the initial TDA balance due than TDAs in the highest initial balance due category. In other years, TDAs in the highest initial balance due category saw a greater reduction of the initial balance.

While it is true overall that the IRS collects a greater percent of the TDA balance due when the most is owed, the initial TDA module balance generally sees a greater reduction when the amount owed is less for employment tax liabilities. Figure 5.10 illustrates the percent of the initial TDA balance remaining when only considering employment tax liabilities.

FIGURE 5.10, Percent of Initial TDA Balance Remaining by Quartile of Initial TDA Balance Due for Employment Tax Liabilities

Balance Category	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
< $689	46%	38%	42%	45%	63%	57%	55%	46%	51%	53%
$689 – $1,877	39%	35%	37%	36%	50%	52%	48%	45%	47%	49%
$1,877 – $5,623	50%	43%	43%	42%	53%	54%	50%	51%	51%	53%
>$5,623	59%	54%	38%	56%	63%	62%	61%	62%	57%	63%

23 The difference was only two percent in 2010, and 11 percent in 2011.

This figure illustrates the IRS has more difficulty collecting employment tax liabilities when the TDA balance increases. Therefore, the IRS should consider an increased reliance on Federal Tax Deposit (FTD) alerts, which assign instances of missed FTDs to field ROs for investigation and quick resolution with the goal of preventing delinquencies from getting out of hand. The IRS might also consider assigning these investigations to ACS, since many FTD alerts are explained by changes in circumstances and do not actually represent delinquent behavior; however, only if true delinquencies could be quickly assigned to ROs so that true problems could be resolved expeditiously. Many FTD alerts occur because the business has suddenly become defunct with no further liabilities. However, some FTD alerts occur because an in-business taxpayer has failed to remit funds withheld from taxpayers. In these latter instances, it is imperative that the IRS initiate immediate taxpayer contact to resolve the current delinquency as well as to begin the timely remittance of newly withheld funds.

When considering non-employment tax liabilities (*e.g.*, Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*, corporate income tax, penalties for failure to file, information returns, etc.), the IRS is clearly more effective at collecting larger balance due TDAs, as indicated by Figure 5.11.

FIGURE 5.11, Percent of Initial TDA Balance Remaining by Quartile of Initial TDA Balance Due for Non-Employment Tax Liabilities

Balance Category	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
< $689	102%	109%	77%	71%	74%	88%	81%	78%	87%	96%
$689 – $1,877	51%	54%	47%	70%	68%	69%	68%	68%	67%	74%
$1,877 – $5,623	43%	41%	35%	39%	63%	59%	57%	63%	63%	65%
$5,623	26%	37%	41%	33%	49%	37%	21%	56%	61%	48%

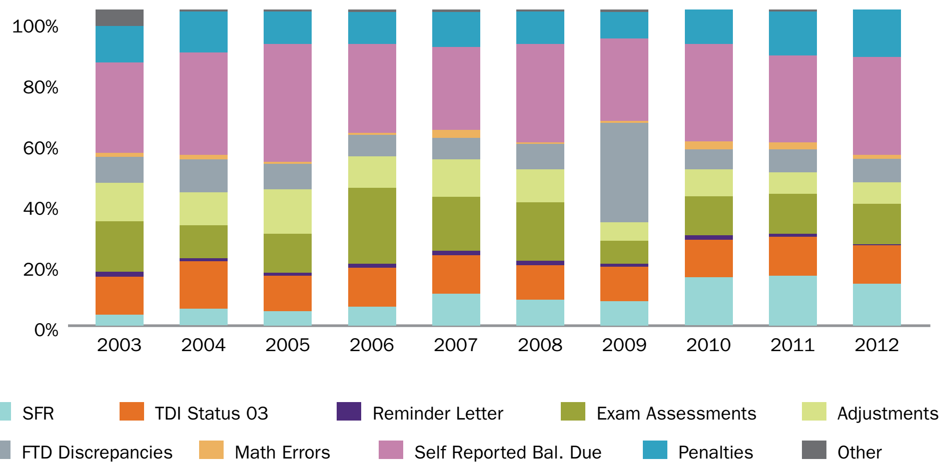
More investigation is needed to determine why, overall, the IRS collects a greater percentage of the initial TDA balance due when more is owed. However, it may be because small non-employment tax liabilities have a low priority in the IRS' significant BMF caseload.

Determine the Percent of Liabilities Abated by the IRS and If the Percent Abated Varies by the Source of Assessment

When considering all types of assessments, the IRS abates about a quarter or more of the initial BMF TDA balances in each year.[24] As a result, the IRS is spending significant resources working erroneous assessments. We are not advocating that the IRS should not abate bad assessments, but rather that the IRS needs to more accurately determine the correct amount of tax when it imposes additional assessments, whether through math error authority, examination, its authority to estimate and assess delinquent unfiled returns (a Substitute for Return (SFR) or Automated Substitute for Return (ASFR)), or other means. Figure 5.12 displays the volume of TDA modules initially assigned in each year by the source of assessment.

24 The percent abated is only 18 percent in 2012, but sufficient time has not elapsed for all of the abatements to occur.

FIGURE 5.12, Source of Assessment of Modules by Year Initially Assigned to TDA Status



While self-reported balance due assessments account for the largest single source of assessment of liabilities reaching TDA status, these assessments generally only account for a quarter to a third of the TDAs assessed in each year. Examination assessments on BMF liabilities usually account for the next largest category of assessments resulting in TDAs, but the IRS usually abates approximately a quarter of these assessments.[25] TDA modules from IRS assessed BMF penalties also account for similar percentages of assessments of the TDA tax liabilities assessed in each year, yet the IRS often abates the majority of the amounts assessed. However, we should note that penalty assessments may be abated because the IRS abates the underlying tax prior to TDA assignment; therefore, the abated amount may be attributable to one of the other sources of assessment.

IRS SFR assessments have increased, accounting for less than five percent of the TDA assessments in 2003, but accounting for about 15 percent of TDA assessments in the recent years. Nevertheless, the IRS consistently abates about 40 percent of the amounts assessed. On the other hand, for every year except 2003, unfiled return investigations (TDI Status 03) resulted in returns that had abatement rates, which were about three times smaller than the abatement rates for SFR assessments.

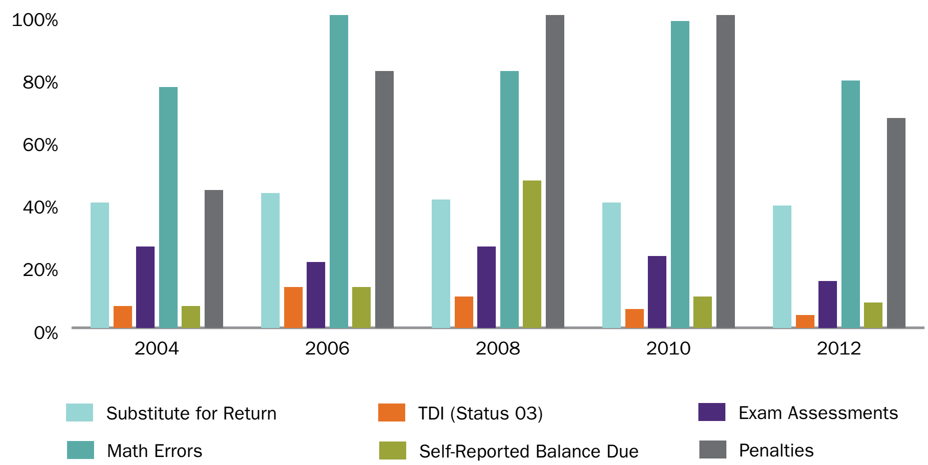
Math error assessments only account for a few percent of the TDAs assessed each year; however, the IRS abates about 80 percent of these assessments.[26] The following figure depicts the major source of the assessment and the amount of the assessment abated.[27]

25 In 2003, the IRS only abated nine percent of BMF examination assessments. In 2012, the IRS only abated 15 percent of BMF examination assessments, but sufficient time may not have elapsed for abatements to occur on these assessments.

26 The IRS assigns a math error to a BMF return when the return contains an apparent mathematical error. For example, the net of two lines is mathematically incorrect, but only because of a transposition error on one of the netted lines. Accordingly, the net amount may actually be correct, but appear incorrect.

27 The figure does not show 2005 Windfall Profits Program Assessments of $27,751. None of this amount was abated.

FIGURE 5.13, Percent of Assessments Abated by Selected Source of Assessment and Selected Years[28]



Examine the Effect of the Time Lapse Between the Tax Return Due Date and TDA Assignment

The Effect on the Reduction of the Initial TDA Balance

To further explore how the age of the liability impacts the dollars collected, we looked at the age of the liability when computed from the original return due date, regardless of when the tax was assessed. For example, a TDA may be delinquent for only 90 days because the return was secured a short time ago, even though the return was actually due two years ago. The following figure depicts the percent of the original module balance remaining open at the end of the study period[29] by quartiles of time elapsed since the original return due date. We divided the time categories from return due date to TDA assignment into quartiles when considering the elapsed time for all years analyzed. We define the resulting categories in the figure below. When the age of the liability is computed from the due date of the tax return to the time of TDA assignment, a clear relationship exists between the time elapsed and the amount of interest and penalty remaining uncollected, as shown in the following figure.

28 The source of assessment represents the major reason for the assessment resulting in the TDA. The percent abated considers tax only, so abatements of penalties due to reasonable cause or the abatement of penalties and interest, because the underlying tax has been abated, are not included. The percent abated for the math error source of assessment in 2006 and the penalties and other source of assessment categories were set to 100 percent for graphical representation purposes, but were actually 112 percent, 133 percent, and 143 percent, respectively. The percent abated may exceed 100 percent when tax assessed prior to TDA assignment is abated subsequent to TDA assignment.

29 The study period is ten years for modules reaching TDA status from 2003 to 2006. For all other years, it is the end of 2015.

FIGURE 5.14, Percent of Module Balance Remaining Attributable to Interest and Penalty

Years from tax return due date to TDA	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Up to 1.25 Years	62%	61%	61%	59%	56%	52%	49%	47%	45%	43%
> 1.25 Years to 2 Years	65%	64%	64%	63%	60%	56%	53%	51%	48%	46%
>2 Years to 3 Years	68%	67%	67%	66%	63%	59%	57%	53%	54%	53%
> 3 Years	75%	75%	72%	73%	71%	66%	67%	63%	62%	62%

In addition to examining how the time elapsed between the due date of a tax return and TDA assignment affects the increase of penalties and interest we also examined how this lapse of time affects the percent of modules remaining open and the percent of the initial TDA balance remaining uncollected. The following figure depicts the percent of TDA modules remaining open by quartiles of time elapsed between tax return due date and TDA assignment four years after the IRS assigned the case to TDA status.

FIGURE 5.15, Percent of TDAs Remaining Open After Four Years by Time Elapsed from Return Due Date to TDA Status

Years from tax return due date to TDA	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Up to 1.25 Years	37%	34%	35%	36%	40%	42%	43%	40%	41%	42%
> 1.25 Years to 2 Years	38%	31%	34%	33%	38%	41%	41%	39%	39%	41%
>2 Years to 3 Years	45%	37%	42%	44%	46%	49%	47%	48%	49%	50%
> 3 Years	50%	43%	48%	50%	52%	56%	55%	59%	57%	61%

The prior figure shows that for all years, when the time between the return due date and TDA assignment is greater than two years, the percent of TDAs remaining open is higher than when no more than 1.25 years elapse from the tax return due date to TDA assignment. The next figure shows the percent of initial TDA balance remaining after four years.[30]

FIGURE 5.16, Module Balance Remaining – After Four Years by Time Elapsed from Return Due Date to TDA Status

Years from tax return due date to TDA	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Up to 1.25 Years	56%	54%	29%	55%	49%	60%	24%	56%	48%	50%
> 1.25 Years to 2 Years	60%	49%	59%	55%	58%	59%	61%	57%	56%	53%
>2 Years to 3 Years	40%	52%	43%	52%	50%	34%	48%	51%	49%	47%
> 3 Years	44%	52%	53%	66%	63%	55%	58%	68%	72%	69%

30 The statutory period to collect tax is limited to ten years after the IRS assesses the tax liability. Modules generally reach TDA status approximately 120 days after the IRS assesses the tax. Therefore, the statutory collection period often expires during the tenth year after reaching TDA status. Since the IRS is required to abate tax assessments after the expiration of the statutory period, this abatement sometimes obscures trends in the amount of the initial TDA balance remaining or the number of TDAs remaining open.

In general, the percent of the initial TDA balance remaining is higher when more than three years have elapsed from the tax return due date to the time the IRS assigns the module to TDA status, especially when compared to modules assigned to TDA status within 1.25 years after the tax return due date. Surprisingly, however, there are three notable exceptions to this trend. In 2003, 2004, and 2008, the TDA module balances declines the most when a longer time elapsed from the due date of the return until the IRS assesses the TDA. Additional analyses, such as the impact of economic factors (*e.g.,* the 2001 and 2008 recessions and subsequent recoveries), and IRS collection policies would be required to identify additional factors that may have influenced these outcomes.

While we have not shown the dollars collected in a figure, no clear trend exists in the ratio of dollars collected to initial TDA balance. In some years, a higher percent of the initial TDA balance is collected when more time elapsed from the return due date to the initial assignment to TDA status; however, this relationship is not always true. In most of the years from 2003 to 2012, the percent of the initial TDA balance collected is very similar regardless of the time elapsed from the tax return due date.

When examined in this light, a clear relationship exists between the due date of a liability and additional penalty and interest, the percent of modules remaining open, and the percent of initial module balance remaining. Tax liabilities due for longer periods are more likely to remain open because more penalty and interest will be charged. Therefore, more of the dollars collected will be applied to penalties and interest compared to those liabilities, which have been due for a shorter timeframe. This can have negative consequences for the taxpayer. Taxpayers are burdened as penalties and interest increase significantly, and may no longer have the ability to pay the debt. This is particularly true when multiple tax returns (employment tax returns are due quarterly) are unfiled for an extended period after their due date. The result is an overwhelming debt for the taxpayer and reduced revenue for the IRS.

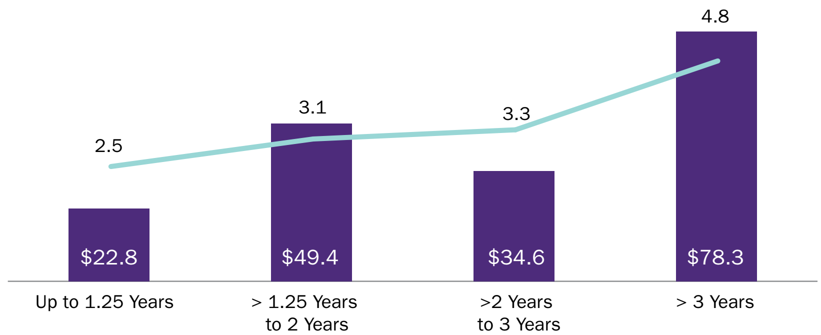
The IRS' failure to secure returns shortly after their due date significantly decreases the number of modules successfully resolved, and, correspondingly, the reduction in the initial TDA balance. The IRS should factor the importance of securing delinquent returns soon after the return's due date into its prioritization of inventory delivery. We also saw, however, that when the IRS assesses estimated liabilities, the IRS ultimately abates a significant portion of these assessments. Accordingly, the IRS needs to focus on securing the taxpayer's self-reported return as soon as possible.

Describe How the Delay in Assignment of BMF TDAs Affects the Number and Amount of Delinquencies Accrued Subsequent to the Initial Unresolved TDA

We have seen that the amount of collections decreases as time progresses from initial TDA assignment, causing liabilities to remain unresolved longer, penalties, and interest to continue to accumulate. This decrease occurs not just because the taxpayer owes less as the IRS collects money to satisfy the debts, but more importantly because a smaller percent of the amount remaining due is collected.

As we have seen, another significant factor negatively influencing collections is the length of time between a tax return's original due date and when the liability reaches TDA status. This delay primarily occurs because the taxpayer files returns late, probably because paying the debt would have been difficult at the time the return was due. However, of more significance than how delays in collecting liabilities decrease the success of resolving the liability is the increase in unpaid modules, as time elapses between the due date of the first delinquent return and the taxpayer's first TDA. The following figure shows how the number of delinquent modules and the total amount due increase as the time from the due date of the first delinquent return to the initial TDA assignment increases.

FIGURE 5.17, Taxpayer's Number of Delinquent Modules and Total Amount Due by Time Elapsed from Tax Return Due Date to Initial Assignment to TDA Status — Example Year 2006[31]



The figure indicates, the longer the time elapses between the due date of a tax return and the taxpayer's first TDA, the greater the number of delinquent modules. Interestingly, the elapsed time shown above in quartiles two and three does not appear to have a large impact on the number and amount of delinquencies. However, when the time between the due date of a tax return and the initial TDA assignment for the taxpayer exceeds three years, the taxpayer owes two to three times as much as when the initial liability reaches TDA status within three years of the tax return due date.[32]

CONCLUSIONS

- Collections decrease as more time elapses from the initial BMF TDA assignment.
- Penalties and interest are a significant component of the unpaid BMF liability, particularly for unresolved TDAs, likely overwhelming most taxpayers.
- Overall, the IRS is more effective at closing smaller BMF TDAs, but collects a larger percent of the TDA when balances are larger. However, the IRS is more effective collecting employment tax TDAs when the balance due is smaller.
- The IRS abates a significant amount of BMF TDA assessments; this means the IRS is utilizing collection resources to resolve incorrect assessments.
- As more time passes from the due date of a tax return to BMF TDA assignment, the IRS is less likely to close the TDA or see as great of a reduction in the initial TDA balance. The likelihood of accruing sizable new delinquencies also increases when there are longer lapses between the BMF tax return due date and when the IRS secures the return and assesses the tax.

31 We show the average number of delinquent modules and total tax due by the quartiles of time elapsed from the tax return due date to a taxpayer's initial assignment in a typical year, 2006. The other nine years have similar trends.

32 During the most recent five years analyzed, the average number of delinquent modules when more than three years had elapsed from the tax return due date until the taxpayer's first TDA assignment had increased to over five.

RECOMMENDATIONS

- The IRS should try to determine if unfiled BMF tax returns, particularly employments tax returns, have unpaid liabilities, and should secure those returns as soon as possible after the return due date.
- The IRS should determine and, to the extent possible, mitigate the factors causing such a large percent of the tax assigned to TDA status to be abated, so that resources are not wasted on assessments not due.
- The IRS should explore how employment tax balances due and time lapses between the tax return due date and TDA assignment should affect how it prioritizes collection inventory.