

Introduction to Collection Issues: The IRS “Fresh Start” Initiative Has Produced Significant Improvements in Some Collection Policies; However, Significantly More Emphasis on Service Delivery Is Necessary to Realize the Full Benefits of These Important Changes

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OVERVIEW

In fiscal years (FY) 2011 and 2012, the IRS implemented a series of significant operational policy changes collectively known as the “Fresh Start” initiative. Primarily focused on collection policies and procedures, the “Fresh Start” initiative has produced some of the most significant changes to the IRS Collection program in well over a decade, particularly in the areas of flexible payment options, lien-filing practices, and flexibility in issuing lien withdrawals.

In FY 2011, the IRS modified the criteria used in filing Notices of Federal Tax Lien (NFTL), issued expanded guidance enabling more taxpayers to request and obtain lien withdrawals, expanded the criteria under which small businesses may pay past due taxes in installments, and formalized the “streamlined” offer in compromise (OIC) procedures used by the IRS’s centralized OIC operation.¹

In FY 2012, the IRS announced expanded criteria for individual taxpayers to qualify for “streamlined” installment agreements (IAs), and provided an opportunity for a six-month grace period on failure-to-pay penalties for certain wage earners and self-employed taxpayers.² In May 2012, the IRS expanded its “Fresh Start” initiative further by offering more flexible terms to the OIC program in an effort to allow some of the most financially distressed taxpayers to clear up their tax problems.³ New procedures issued concurrently provided more flexibility to collectors in conducting financial analysis to determine the payment options available to delinquent taxpayers. In October 2012, the IRS formalized this guidance in a published revision of the Financial Analysis Handbook (Internal Revenue Manual (IRM) 5.15.1).

With the focus on liens and collection payment options, the National Taxpayer Advocate acknowledges the efforts of the IRS to address collection issues that are highly significant to taxpayers struggling to resolve delinquent tax debts. Past Annual Reports to Congress have addressed these issues, and significant portions of the “Fresh Start” initiative reflect recommendations by the National Taxpayer Advocate.⁴ As a result, TAS has worked exten-

¹ IRS, IR-2011-20, IRS Announces New Effort to Help Struggling Taxpayers Get a Fresh Start; Major Changes Made to Lien Process (Feb. 24, 2011).

² IRS, IR-2012-31, IRS Offers New Penalty Relief and Expanded Installment Agreements to Taxpayers under Expanded Fresh Start Initiative (Mar. 7, 2012).

³ IRS, IR-2012-53, IRS Announces More Flexible Offer-in-Compromise Terms to Help a Greater Number of Struggling Taxpayers Make a Fresh Start (May 21, 2012).

⁴ National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 39-70 (Research Study: *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*); National Taxpayer Advocate 2010 Annual Report to Congress 302-310 (Status Update: *The IRS Has Been Slow to Address the Adverse Impact of its Lien Filing Policies on Taxpayers and Future Tax Compliance*); National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*).

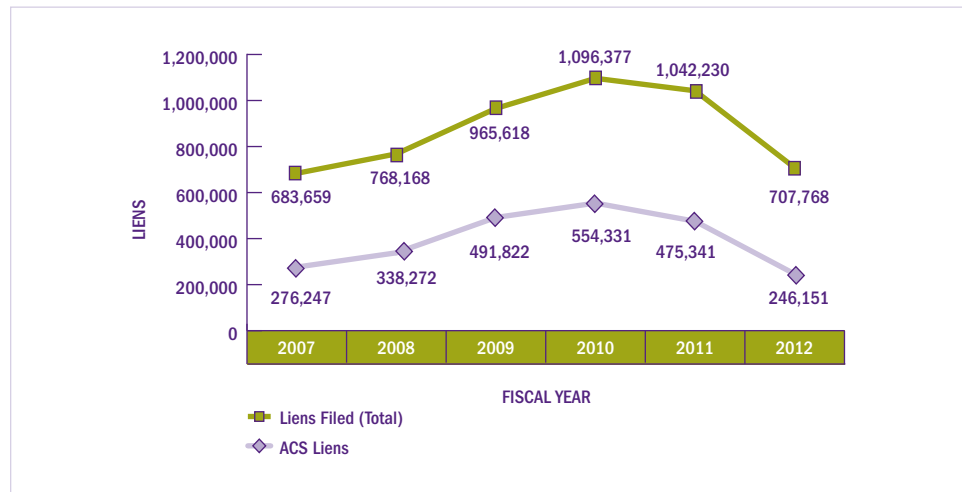
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sively with the IRS on the development of the “Fresh Start” implementation guidance, and has monitored the impact of the initiative in several key areas.

The IRS has filed fewer liens, but the lack of sound judgment in lien-filing decisions remains a problem.

In FY 2012, the IRS filed 32 percent fewer NFTLs than in FY 2011, including a corresponding 48 percent reduction in liens filed by the Automated Collection System (ACS).⁵

FIGURE 1.1, Lien Filings FY 2007-2012



Also in FY 2012, thousands of financially struggling taxpayers have successfully obtained lien withdrawals to help regain their financial viability.⁶ The number of withdrawals issued by the IRS in FY 2012 increased 157 percent over FY 2010.⁷ These results indicate that components of the “Fresh Start” initiative have produced significant changes in IRS practices involving Notices of Federal Tax Lien (NFTL), which in turn have had positive, meaningful results for many taxpayers.

⁵ IRS, Collection Activity Report, NO-5000-25, *Liens Report* (Oct. 2012).

⁶ *Id.* Through September 2012, the IRS issued 12,004 lien withdrawals.

⁷ IRS response to TAS information request (Aug. 14, 2012). In FY 2010, the IRS issued 4,677 lien withdrawals.

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FIGURE 1.2, Lien Withdrawals FY 2007-2012



While the overall reduction in lien filings is a positive change for many taxpayers, the National Taxpayer Advocate continues to urge the IRS to base lien-filing decisions on a thorough analysis of the facts and circumstances of each case, and not simply rely on an arbitrary dollar figure representing unpaid liabilities. Only in this manner can the IRS properly balance the government’s interests in protecting revenue with the taxpayer’s interest in maintaining financial viability and future compliance.

In the 2011 Annual Report to Congress, TAS shared with the IRS the results of a TAS research study that shows how indiscriminate lien filings may actually have a negative influence on revenue collection and future filing compliance, in addition to creating lasting harm to a taxpayer’s financial viability.⁸ In this year’s report, TAS presents new information that further questions the utility of the NFTL as a collection tool. In our 2012 research study on liens, TAS compares the payment and compliance behavior of a sample of cases representing taxpayers that were the subject of IRS liens against a control sample of similarly delinquent taxpayers without liens. The analysis reveals that over a nine-year period (calendar years 2002-2010), the group of taxpayers without liens paid more on the liabilities, and owed less delinquent taxes overall at the conclusion of the study period than the taxpayers with liens.⁹

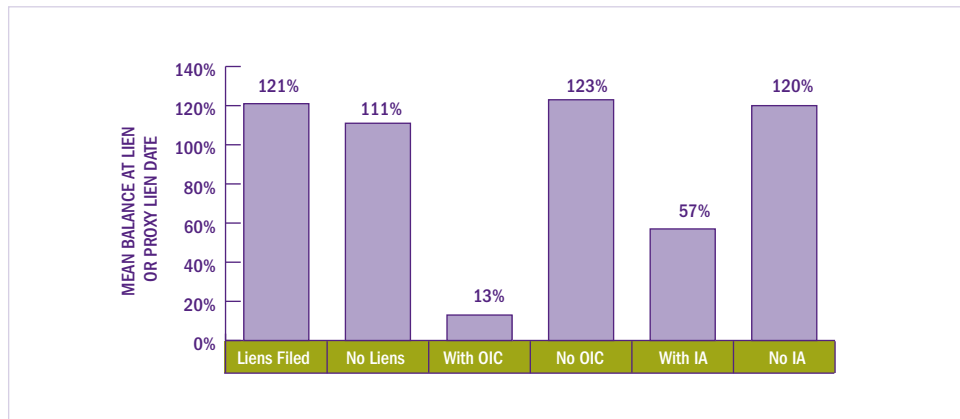
Additionally, the study reveals that the taxpayers who had entered into installment agreements during the study period paid significantly more, and owed substantially less delinquent revenue at the conclusion of calendar year 2010 than the taxpayers who had not received an agreement. Further, taxpayers with OICs accepted during the study period owed substantially less at the end of 2010 than those taxpayers with liens.

⁸ National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-112 (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*).

⁹ See TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, vol. 2, *infra*.

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FIGURE 1.3, Comparing Long-Term Compliance (Liens v. Payment Alternatives)



The findings in this report indicate that flexible payment options are not only more effective than liens in assisting the IRS to collect delinquent revenue, but also appear to be significantly more beneficial in breaking the cycle of noncompliance with delinquent taxpayers than is evident in the IRS’s lien-filing practices.¹⁰ These studies support the National Taxpayer Advocate’s assertion that there is a continued need for the IRS to refine the criteria its collectors use to justify filing NFTLs, and make meaningful adjustments to its lien-filing practices.

Although the new procedures for lien withdrawals have been helpful and productive, TAS is still receiving reports that some IRS employees are not fully aware of the new policies, and tax professionals have found them hard to find on the IRS website. The IRS has just recently updated the IRM material reflecting the new procedures. We believe the IRS should be more proactive in its internal training and external outreach to communicate and support these important changes.

In this report, the National Taxpayer Advocate addresses concerns with IRS lien-filing practices in the Most Serious Problem, *Although the IRS “Fresh Start” Initiative Has Reduced the Number of Liens Filed, the IRS Has Failed to Determine if Its Lien-Filing Practices Are Clearly Supported by Either Increased Taxpayer Compliance or Revenue*, and the TAS Research Study, *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior* in Volume 2.

Despite positive changes in IRS policies and procedures, the Offer in Compromise program remains an underutilized payment option for taxpayers who owe back taxes.

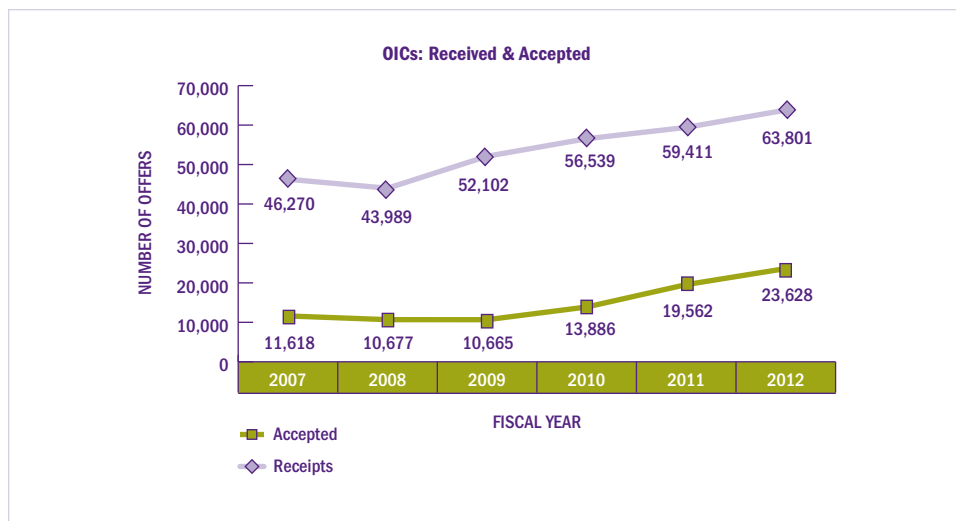
The “Fresh Start” initiative introduced into the OIC program a number of positive, reasonable flexibilities that have been lacking for many years. The National Taxpayer Advocate

¹⁰ See TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, vol. 2, *infra*.

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notes that the IRS has accepted 21 percent more offers in FY 2012 than in FY 2011, and that the actual number of accepted offers has increased by 122 percent compared to FY 2009.¹¹ In FY 2012, the offer acceptance rate of 38 percent was the highest in many years.¹² During FY 2012, the IRS accepted in compromise \$195.7 million, a 27 percent increase over the prior year.¹³

FIGURE 1.4, Offers In Compromise: Receipts & Accepted FY 2007-2012



The positive trends in the OIC program results indicate the “Fresh Start” procedural changes are working as intended. However, the number of taxpayers who have actually been able to benefit from these changes remains surprisingly low. Despite the improving results, access to the OIC program appears to be limited, and consequently the program continues to be underutilized. While OIC receipts have gone up, the nearly 64,000 offers received by the IRS in FY 2012 represents a very small percentage of the delinquent taxpayer population.¹⁴ Although accepted OICs have increased by 122 percent since FY 2009, that increase in FY 2012 represents only approximately 13,000 additional taxpayers.¹⁵

In March 2012, the Treasury Inspector General for Tax Administration (TIGTA) reported inadequate staffing and increased demand in the OIC program have created inventory

¹¹ IRS, Collection Activity Report, NO-5000-108, *Monthly Report of Offer in Compromise Activity* (Oct. 2012).

¹² *Id.*

¹³ *Id.*

¹⁴ IRS, Collection Activity Report, NO-5000-108, *Monthly Report of Offer in Compromise Activity* (Oct. 2012); IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012).

¹⁵ IRS, Collection Activity Report, NO-5000-108, *Monthly Report of Offer in Compromise Activity* (FY 2009–2012).

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backlogs and processing delays that could affect a significant number of taxpayers.¹⁶ The National Taxpayer Advocate shares these concerns. She has questioned the IRS about the very small number of Collection employees authorized to work OIC cases, especially in light of the high volumes of cases routinely assigned to the Collection Queue inventory, and those systemically reported as uncollectible prior to any personal contact with the IRS.¹⁷ The OIC is an important Collection tool, and is especially effective in resolving difficult cases. Yet very few Revenue Officers are empowered to recommend acceptance of a taxpayer’s offer to resolve outstanding tax debts, which would also provide a reasonable path for the taxpayer to return to compliance. Over the past two years, the IRS has made very significant improvements to the OIC program. It would be unfortunate for tax administration if the benefits of these changes were under-realized due to internal limits on the Collection resources available to handle OIC applications.

In this report, the National Taxpayer Advocate discusses missed opportunities for the IRS to use the offer in compromise more effectively in the following Most Serious Problems: *The Diminishing Role of the Revenue Officer Has Been Detrimental to the Overall Effectiveness of IRS Collection Operations*, and *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*. See also the TAS Research Study, *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior* in Volume 2.

The “Fresh Start” increased IRS flexibilities in granting installment agreements; yet, the IRS actually granted fewer of them in FY 2012.

Because the “Fresh Start” initiative introduced new and significantly expanded criteria for “streamlined” installment agreements (SLIAs), the National Taxpayer Advocate is concerned that installment agreements (IAs) approved by the IRS actually *declined* in FY 2012 — by two percent in total, with a corresponding *reduction* in “streamlined” agreements of four percent.¹⁸ The decline in approved agreements affected both individual and business taxpayers.¹⁹ Given the increased flexibilities built into the SLIA process by the “Fresh Start” initiative, the decrease in approved IAs is difficult to explain.

Ironically, in FY 2012, the IRS collected approximately \$10.7 billion through IAs – well in excess of what it collected through all other delinquent account treatments *combined*.²⁰ At the heart of the “Fresh Start” initiative was the recognition that for most collection cases, a simple, well-articulated path to “getting to yes” on a payment solution increases collections

¹⁶ TIGTA, Ref. No. 2012-30-033, *Increasing Requests for Offers in Compromise Have Created Inventory Backlogs and Delayed Responses to Taxpayers* (Mar. 30, 2012).

¹⁷ IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012).

¹⁸ IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Cumulative Report* (Oct. 2011 and 2012).

¹⁹ *Id.*

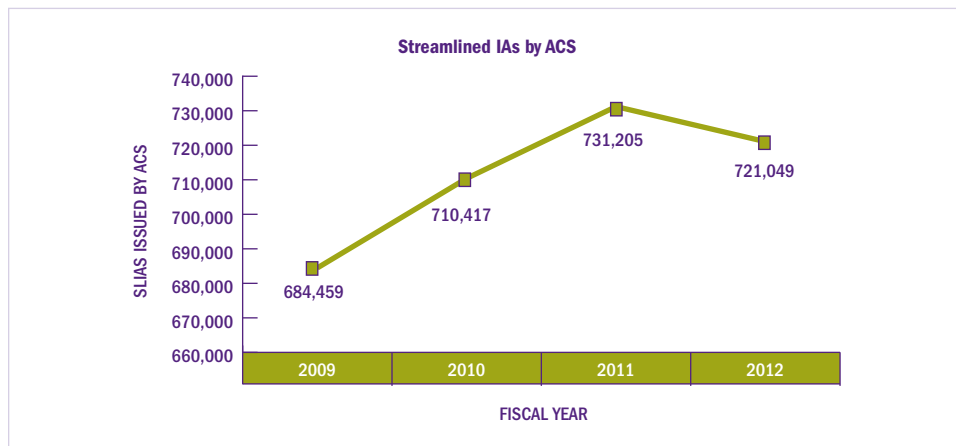
²⁰ IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Cumulative Report* (Oct. 2012); IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2011 and 2012). In FY 2012, the IRS collected approximately \$7.7 billion on taxpayer delinquent accounts (TDAs), excluding IA payments. Note: refund offsets accounted for an additional \$3.8 million in collected revenue.

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and reduces the stress of uncertainty for taxpayers. Particularly in the early stages of the process, *i.e.*, collection notices and an automated system, a hardline approach to debt collection may be driving taxpayers away from working with the IRS to resolve their debts.

Nevertheless, in our work with the IRS, TAS has identified a number of procedural and cultural issues that may be serving as barriers to the IRS’s ability to use the “streamlined” IA tool in the manner intended. The impact of these barriers is particularly evident in the ACS program results for FY 2012, as illustrated below in Figure 1.5.

FIGURE 1.5, Streamlined Installment Agreements Issued by ACS FY 2009–2012



In this report, the National Taxpayer Advocate addresses concerns with cultural and process-related barriers that have negated service delivery in the IRS’s collection call centers in the Most Serious Problem, *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to More Effectively Resolve Collection Workload*.

Small business taxpayers have received little relief through the “Fresh Start” initiative.

The positive impact of the “Fresh Start” initiative on small business taxpayers has been negligible. The expanded criteria for “express” IAs have not succeeded in providing more of these taxpayers with access to this very important payment option. In fact, notwithstanding today’s difficult economic climate, the numbers of business taxpayers receiving IAs and “express” streamlined agreements have actually *declined* during the past fiscal year by approximately six percent and seven percent, respectively.²¹ Installment agreements involving business tax delinquencies continue to account for only a very small portion of IRS installment agreements — three percent of those issued in FY 2012.²² Further, in FY 2012

²¹ IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Cumulative Report* (Oct. 2011 and 2012).

²² *Id.* The term “business tax delinquencies” refers to TDAs that reside on the IRS Business Master File (BMF).

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the IRS granted agreements to only approximately eight percent of the delinquent business taxpayers eligible to receive them.²³

The OIC based on effective tax administration (ETA) also continues to be an underutilized collection tool. The ETA OIC provides the IRS with the means to accept from a taxpayer an amount less than the reasonable collection potential in situations where the facts indicate such a resolution would be fair and equitable. Particularly during the current economic downturn, the ETA OIC allows the IRS to consider the circumstances that led to a delinquency and weigh the long-term benefits of allowing an otherwise viable business to survive, by paying less than the amount legally owed, against the government’s interest in quickly collecting as much as possible through liquidation of the business assets.

Along with a troubled economy, in recent years the IRS has identified numerous situations involving fraudulent actions of third parties that resulted in substantial employment tax liabilities for otherwise compliant businesses. These taxpayers believed the taxes had been paid in a timely manner, and actually did provide the funds to satisfy the tax obligations to the third parties. Despite these conditions, over the past four years, the IRS has accepted an average of 27 ETA OICs *per year* that were not based on doubt as to collectibility.²⁴ It is exceptionally unfortunate that a collection tool that could provide much-needed relief to deserving small business taxpayers has been virtually discarded during these very difficult times. The IRS’s reluctance to use the ETA OIC in appropriate situations has been counter-productive, and potentially harmful to the U.S. economy.

In this report, the National Taxpayer Advocate expresses serious concerns that procedural and cultural barriers in the current IRS collecting process have minimized service delivery for small business taxpayers in these Most Serious Problems: *The Diminishing Role of the Revenue Officer Has Been Detrimental to the Overall Effectiveness of IRS Collection Operations; Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance; and The Automated Collection System Must Emphasize Taxpayer Service Initiatives to More Effectively Resolve Collection Workload.*

The IRS needs to build a service-oriented Collection climate onto the foundation established by the “Fresh Start” initiative.

Prudent use of IRS Collection resources will be a key factor in realizing the benefits of the “Fresh Start” changes. The National Taxpayer Advocate is concerned that the IRS is not using Collection resources in a manner that properly emphasizes personal, “one-stop” service,

²³ IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Cumulative Report* (Oct. 2012); IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2011 and 2012). As of Sept. 2011, the IRS Collection operation reported 694,036 BMF taxpayer cases in open inventory. During FY 2012, 517,415 BMF taxpayer cases were received. The IRS issued 99,687 BMF IAs during FY 2012.

²⁴ IRS response to TAS information request (Oct. 23, 2012). From FY 2009 through FY 2012, the IRS accepted 108 ETA OICs that were not based on economic hardship. This includes individual as well as business delinquencies. By law, business entities cannot be considered for economic hardship determinations.

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effective problem-solving techniques, and the long-term compliance of the affected taxpayers. Collection cases involving complex issues, *e.g.*, determining the viability of a small business struggling with employment tax debt, or accurately evaluating the reasonable collection potential of a self-employed taxpayer, can often benefit from the timely intervention of a local Revenue Officer. With a relatively simple telephone conversation, ACS can often effectively service collection cases involving wage-earners with small balances due. However, the IRS “one-size-fits-all” approach to applying collection resources and treatments to most collection cases does not balance the service and compliance-related needs of many taxpayers with Collection’s priorities and objectives.

In this report, the National Taxpayer Advocate urges the IRS to reassess and adjust its deployment of collection resources to more effectively balance service delivery and long-term compliance with current program objectives that emphasize case-processing efficiencies. These concerns are addressed in the Most Serious Problems, *The Diminishing Role of the Revenue Officer Has Been Detrimental to the Overall Effectiveness of IRS Collection Operations*, and *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to More Effectively Resolve Collection Workload*. For an additional discussion regarding the National Taxpayer Advocate’s efforts to assess the comparative outcomes of IRS Collection case assignment practices, see *Comparing the Impact of Revenue Officers and the Automated Collection System on Future Compliance: A Research Prospectus* in Volume 2.

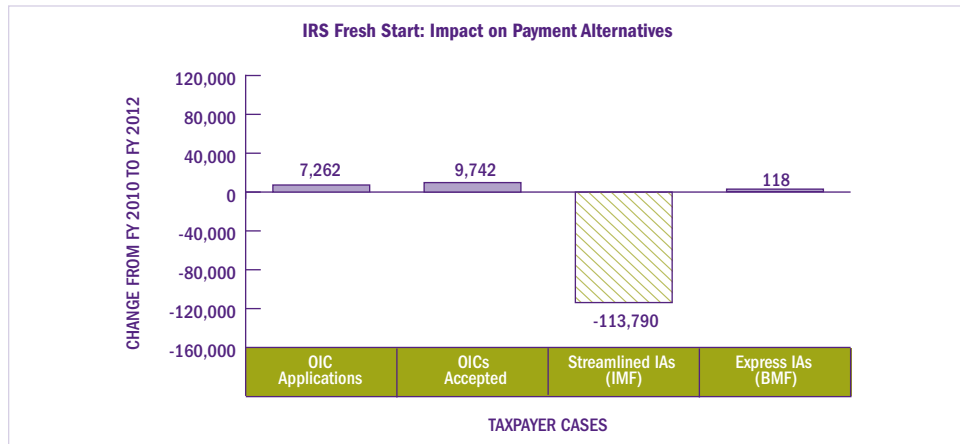
CONCLUSION

The “Fresh Start” initiative was a “good start”; however, much more emphasis on service delivery is needed to make the “fresh start” a reality for taxpayers.

The National Taxpayer Advocate acknowledges that parts of the “Fresh Start” initiative have delivered positive results for some taxpayers, and could provide relief and assistance to many more who are attempting to regain financial viability. However, as illustrated below in Figure 1.6, relatively few taxpayers have yet to actually experience the benefits of the “Fresh Start” changes, particularly in regard to flexible payment options.

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FIGURE 1.6, Offers In Compromise and Installment Agreements Under “Fresh Start”



The IRS needs to expand the scope of the initiative, while removing procedural and cultural barriers that limit taxpayer access to these collection alternatives, in order to maximize the long-term benefits of these important policy changes. In particular, the IRS needs to identify the barriers that deny small business taxpayers the opportunity to resolve tax problems through flexible, realistic payment options, such as installment agreements and offers in compromise.²⁵ Further, the IRS needs to better promote the “Fresh Start” initiative in its internal Collection training and external communication strategies, as well as allocate adequate resources to its functions to ensure the benefits of the initiative are real and sustainable.

The IRS is on the cusp of a significant change in leadership, as Commissioner Doug Shulman has departed, and a new Commissioner will be appointed. Historically, changes in IRS leadership have often resulted in the unforeseen consequence of pro-taxpayer developments, such as the “Fresh Start” initiative, losing focus and momentum. Consequently, the cultural barriers within the Service — Collection, in particular — soon work to dismantle and reverse any positive changes that have not yet firmly taken root. It is very important to note that the “Fresh Start” initiative did not “fix” Collection. Rather, it produced a number of meaningful policy changes that can serve as a foundation for further improvements. The National Taxpayer Advocate sincerely urges the IRS to build on this foundation by creating an environment that actually embraces service delivery as a critically important component of effective tax collection.

²⁵ For more information on the potential long-term benefits of the IRS’s flexible payment options, see the TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, vol. 2, *infra*.