

RESEARCH PROSPECTUS:
COMPARING THE EFFECT OF
REVENUE OFFICERS AND THE
AUTOMATED COLLECTION
SYSTEM ON FUTURE COMPLIANCE

Research Prospectus: Comparing the Effect of Revenue Officers and the Automated Collection System on Future Compliance¹

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¹ The principal author of this discussion is Eric LoPresti, Senior Attorney-Advisor to the National Taxpayer Advocate.

EXECUTIVE SUMMARY

When a taxpayer does not pay his or her tax liability, the IRS may assign the case to a revenue officer (RO) in the Collection Field function (Cff), to a group of Automated Collection System (ACS) employees in centralized call sites, or to the “queue” to wait until collection resources become available to work the case. Thus, the IRS has to decide which cases to assign to ROs, ACS, or the “queue,” and which to prioritize.

Direct comparisons between ACS employees and ROs present challenges. The IRS-wide measures — Collection Coverage and Collection Efficiency — assume that ACS is more effective than ROs because ACS generally works “fresh” cases, and closes them using fewer resources and lower-graded employees. These measures create an incentive for IRS executives to divert resources from the Cff to ACS, even though ROs could bring in more dollars by protecting revenue (*e.g.*, preventing future delinquencies) and increasing voluntary compliance.

The importance of voluntary compliance cannot be overstated. Taxpayers voluntarily and timely pay about 34 times as much as the IRS collects through enforcement and voluntary late payments.² Moreover, about 78 percent of all late payments come in voluntarily as the result of a notice or an installment agreement, meaning only about 22 percent of all late payments — less than one percent of all dollars collected — come in through less voluntary means of enforcement.³ For example, ROs work priority Federal Tax Deposit (FTD) Alerts — cases where employment tax deposits have inexplicably dropped. One recent IRS study found that ROs working these cases improved the likelihood that the taxpayer would become compliant by 12 percentage points (from 28 percent to 40 percent); increased future tax deposits by an average of \$1,832 per case over a 12-month period; and reduced the average penalties assessed against the taxpayer, as compared to priority Alerts that were not worked.⁴ It also concluded that every dollar spent on ROs working FTD Alerts brought in \$69 by preventing future FTD non-compliance.

ACS employees do not undertake similar proactive activities. Thus, the IRS needs to know the relative impact of ACS and ROs on voluntary compliance for different types of cases. Such information could help to improve both IRS “decision analytics” and “business rules” used to assign cases, as well as collection performance measures. Without it, the IRS’s collection function is operating based on unproven assumptions, assigning cases and allocating resources inefficiently, and potentially undermining long-term voluntary compliance.

² IRS, IR-2012-4, IRS Releases New Tax Gap Estimates, *Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012) (accompanying charts) (discussed below).

³ See Delinquent Accounts Receivable Yield, *Fiscal Year Comparison Cum. thru FY 2012* (Oct. 4, 2012) (discussed below). We say “less voluntary means of enforcement” because the IRS generally counts installment payments as “enforcement” revenue.

⁴ Small Business/Self Employed Division (SB/SE) Research, Federal Tax Deposit Alerts-P3 (*Do Alerts Impact Compliance?*) (Feb. 10, 2012); SB/SE Research, *Federal Tax Deposit Alerts-P2* (Cost and Benefit Evaluation) (Jan. 6, 2012).

Specifically, TAS Research plans to identify similar cases that were assigned to an RO, the ACS, or the queue, and then compare the collection results. Not only will this analysis compare direct collections, but also the revenue protected, penalties assessed, and future payment compliance by each group of taxpayers.

INTRODUCTION

When a taxpayer does not pay, the IRS may assign the case to a revenue officer (RO), Automated Collection System (ACS) employees, or the queue.

When a taxpayer fails to pay a liability, IRS computers send collection notices and offset refunds. If notices and offsets do not collect the balance due, most cases move to the Automated Collection System (ACS).⁵ While the IRS is beginning to implement Collection Decision Analytics (CDA) — a routing system that sends some cases directly to revenue officers (ROs) — it routes most cases to ACS first.⁶

ACS employees may review accounts, answer calls; respond to letters, receive payments, establish installment agreements, receive offer in compromise applications, file the Notice of Federal Tax Lien (NFTL); or levy assets.⁷ They do not make field calls to meet with taxpayers. They may call taxpayers, but they spend only about three percent or less of their direct time making outgoing calls.⁸ One recent IRS study found that to close a case, ACS most often sends a delinquency letter and then answers the taxpayer's call.⁹

If ACS does not resolve a tax delinquency, the IRS generally moves the account to the queue, where it ages unless or until assigned to an RO in the Collection Field function (Cff).¹⁰ ROs are higher-graded collection employees who can handle more complicated collection issues, physically observe local business conditions, and also meet with and educate taxpayers in the field.¹¹

⁵ Internal Revenue Manual (IRM) 5.19.5.2 (Dec. 1, 2007).

⁶ See, e.g., SB/SE Business Performance Review (Nov. 2011) (discussing the development of CDA); IRM Exhibits 5.19.5-9 and -10 (Dec. 1, 2007) (reflecting the few types of cases routed directly to revenue officers).

⁷ See generally IRM 5.19.1 (Nov. 3, 2010); IRM 5.19.5 (July 12, 2012); IRM 5.19.4 (Jan. 3, 2012); and IRM 5.19.9 (Oct. 1, 2010).

⁸ IRS response to TAS information request (Oct. 24, 2010) (indicating that for fiscal years 2010-2012, ACS employees spent 1 to 3 percent of their direct time making outgoing calls, 21 to 31 percent of their direct time working inventory, and 68 to 77 percent of their direct time answering incoming calls). For further discussion of challenges facing ACS, see Most Serious Problem: *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to More Effectively Resolve Collection Workload*, supra. See also National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 39-70 (*An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*).

⁹ SB/SE Research, *Analyzing the Automated Collection System Closed Case Actions* (Aug. 24, 2012) (finding ACS closed nearly 70 percent of its cases: 42 percent were closed after answering the taxpayer's call, 15 percent were closed after releasing a levy on the taxpayer's assets, and 12 percent were closed after sending a delinquency notice).

¹⁰ See generally IRM 5.19.5 (July 12, 2012).

¹¹ For a more detailed discussion of the importance of ROs and challenges facing ACS, including the dollars uncollected and cases unresolved by ACS and referred to the queue or otherwise shelved, see Most Serious Problem: *The Diminishing Role of the Revenue Officer in IRS Collection Operations*, supra, and Most Serious Problem: *The Automated Collection System Must Emphasize Taxpayer Service Initiatives in Order to More Effectively Resolve Collection Workload*, supra.

It is difficult to compare ACS and RO productivity or long-term effectiveness.

It is difficult for the IRS to compare the productivity of ACS employees and ROs because the IRS generally assigns different types of cases to each operation, with ACS often receiving cases that are easier to collect because they have not aged.¹² Moreover, when comparing ACS to ROs, the unmeasured effect of each on long-term voluntary compliance is probably even more important than how much the IRS collects in the short run.

ACS and ROs collect more by improving voluntary compliance than by collecting existing delinquencies.

The IRS's Collection function plays an important role in addressing the "tax gap" (*i.e.*, tax not voluntarily and timely paid).¹³ In fiscal year (FY) 2012, it was responsible for over 60 percent of the IRS's direct enforcement revenue, and indirectly encouraged many more taxpayers to comply with the tax rules voluntarily.¹⁴

In fact, voluntary compliance brings in vastly more dollars than enforced collection. Taxpayers paid about 83.1 percent of their taxes voluntarily and timely (\$2.21 trillion of the \$2.66 trillion due) in tax year 2006, and the IRS projects it will eventually collect another two percent through late payments or enforcement (\$65 billion out of \$2.66 trillion).¹⁵ In other words, taxpayers voluntarily and timely pay about 34 times as much as the IRS collects through enforcement and voluntary late payments. Moreover, about 58 percent of those late payments come in voluntarily as the result of a notice and another 20 percent come in voluntarily as the result of installment agreements, meaning only about 22 percent of all late payments — less than one percent of all dollars collected — come in through less voluntary means of enforcement.¹⁶ As a result, the importance of an IRS collection strategy that promotes long-term *voluntary* compliance cannot be overstated. In addition, if the IRS prioritizes short-term collection dollars over long-term compliance, it may increase long-term enforcement costs if taxpayers do not learn to comply voluntarily, and it has to

¹² The collection industry estimates that the probability of collecting unpaid accounts falls to 70 percent after three months, 52 percent after six months, and 23 percent after a year. BANXQUOTE Rx, Business Debt Restructuring Solutions, www.banx.com/rx/ (last visited Sept. 12, 2012) (citing collectability statistics based on a survey conducted by the Commercial Collection Agency Association among its members, who collectively handle about 80 percent of all commercial debt claims placed for collection in the United States).

¹³ The gross tax gap — the difference between the taxes people owe and the amount they timely pay — is estimated at \$450 billion in 2006. See IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study* (Jan. 6, 2012), <http://www.irs.gov/uac/IRS-Releases-New-Tax-Gap-Estimates;-Compliance-Rates-Remain-Statistically-Unchanged-From-Previous-Study>. The IRS estimates it will eventually collect \$65 billion through enforcement and late payments, leaving a net tax gap of \$385 billion. *Id.* These figures do not include unpaid tax on income from illegal activities.

¹⁴ IRS, Enforcement Revenue Information System, IRS Compliance Data Warehouse, *Total Enforcement Revenue Collected (TERC) by Revenue Collection Year and Major Category for FY 2012* (Dec. 10, 2012) (indicating collection accounted for \$30.4 billion of the \$50.2 billion total direct enforcement revenue for FY 2012).

¹⁵ IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012) (accompanying charts).

¹⁶ Taxpayers voluntarily paid \$39.2 billion of the \$50.2 billion (78.1 percent) the IRS reported as "enforcement revenue" in FY 2012 after receiving a notice. Enforcement Revenue Information System, IRS Compliance Data Warehouse (Dec. 10, 2012). This amount includes \$10.2 billion (or 20.3 percent) voluntarily paid via installment agreements that year. Delinquent Accounts Receivable Yield, *Fiscal Year Comparison Cum. thru FY 2012* (Oct. 4, 2012).

use costly enforcement tools over and over again to collect dollars that taxpayers might otherwise pay voluntarily.

DISCUSSION

IRS-wide measures assume that ACS is more effective than ROs.

According to the government,

The IRS' core long-term goal, applicable to virtually all its enforcement programs, is the voluntary compliance rate (VCR) defined as the proportion of tax for a given year that is paid voluntarily and timely. Due to the time, expense and taxpayer burden involved in collecting data to measure voluntary compliance, IRS measures the effects of collection program activities on the VCR (which includes filing and payment compliance) through the long-term proxy measures of Collection Coverage and Collection Efficiency. . . . the effects of the Collection program on taxpayer behavior is also evidenced through deterrence, though the effect as such is not measured by the IRS.¹⁷

The government has not explained why Collection Coverage and Collection Efficiency are appropriate proxies for the effect of IRS collection program activities on the voluntary compliance rate. Moreover, these measures create incentives (described below) that could ultimately lead IRS executives to make business decisions that *erode* the voluntary compliance rate.¹⁸

Six years ago, the IRS's Future Field Collection Design study expressed similar concerns about the IRS's lack of good collection measures. It noted, "the CFf has not adopted a measure for compliance at any organizational level."¹⁹ It went on to recommend that "the CFf develop and implement an explicit compliance goal and measure," noting that adopting such a measure could "drive organizational behavior and performance that is consistent with CFf objectives to assure that Revenue Officer field presence and actions secure short- and long-term compliance."²⁰

Because ACS employees generally receive cases earlier than ROs, enabling them to close many of them with little effort, the IRS-wide measures (Collection Coverage and Collection Efficiency) essentially assume ACS is more effective in improving voluntary compliance.²¹ Thus, IRS measures establish an incentive for IRS executives to expand the IRS's use of

¹⁷ Office of Mgmt. & Budget, *Detailed Information on the Internal Revenue Service Tax Collection Assessment* § 2.1 (2008), <http://www.whitehouse.gov/sites/default/files/omb/assets/omb/expectmore/detail/10000424.2008.html> (last visited Nov. 29, 2012); see also IRS, *Management Discussion and Analysis For the Fiscal Year Ended* (Sept. 30, 2011).

¹⁸ For a discussion of problematic incentives that various IRS measures create, see National Taxpayer Advocate 2010 Annual Report to Congress 28 (Most Serious Problem: *IRS Performance Measures Provide Incentives that May Undermine the IRS Mission*).

¹⁹ IRS, FFCD Project Team, *Future Field Collection Design, Current State Design* 13 (Nov. 10, 2005).

²⁰ IRS, FFCD Project Team, *Future Field Collection Design, Future State Design - Final Report 2* (June 6, 2006).

²¹ Collection Coverage is the "volume of collection work disposed compared to the volume of collection work available." Collection Efficiency is the "volume of collection work disposed divided by total collection FTE." *MD&A* at 22.

ACS and reduce its use of ROs, even if ROs would be more efficient in collecting revenue and promoting voluntary compliance among the relatively “fresh” cases in ACS’s inventory or assigned to the queue.²² Moreover, in some cases, early intervention by an RO could be more effective than ACS in “protecting revenue” by preventing small delinquencies from turning into large ones and in promoting future compliance.²³

The IRS does not measure the impact of ACS and ROs on future compliance.

The IRS does not know whether early intervention by ACS or ROs has the greatest positive impact on voluntary compliance.²⁴ However, it is difficult for the IRS to formulate a reasonable collection strategy without this information.²⁵ While it is difficult to measure the full impact of an action on voluntary compliance (including, for example, reporting compliance by the delinquent taxpayer and other taxpayers), the IRS could measure and compare the effect of early intervention by an RO and ACS on the delinquent taxpayer’s future payment compliance.

ROs can sometimes prevent future delinquencies better than ACS.

The IRS has long known that ROs can prevent tax delinquencies from becoming more difficult to resolve by addressing them quickly — even before a return is due. For this reason, it sends its ROs on field calls to check on employers when their quarterly deposits inexplicably decline.²⁶ According to the Internal Revenue Manual, this Federal Tax Deposit Alert procedure provides an “early opportunity to assist and educate taxpayers before their liability pyramids and the growing debt becomes more difficult to resolve.”²⁷ One IRS study recently confirmed that when ROs worked priority FTD Alerts, they improved the likelihood that the taxpayer would become compliant by 12 percentage points (from 28 percent to 40 percent); increased future tax deposits by an average of \$1,832 per case over a 12-month period; and reduced the average penalties assessed against the taxpayer, as compared to priority Alerts that were not worked.²⁸ It also concluded that every dollar spent on ROs working FTD Alerts brought in \$69 by preventing future FTD non-compliance. However, this study did not directly compare ACS to ROs or the queue.

²² For further discussion of this problem, see Most Serious Problem: *The Diminishing Role of the Revenue Officer in IRS Collection Operations*, *supra*, and Most Serious Problem: *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to More Effectively Resolve Collection Workload*, *supra*. See also National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 39-70 (*An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*).

²³ In addition, it may be helpful to consider whether ACS generates more rework than ROs (e.g., rework required to release an unnecessary lien or levy) and unnecessary damage to the taxpayer’s credit, which could prevent him or her from earning the revenue needed to repay the IRS.

²⁴ See, e.g., Alan H. Plumley, *The Impact of the IRS on Voluntary Tax Compliance: Preliminary Empirical Results*, Nat’l Tax Assoc., 95th Ann. Conf. on Tax’n 2 (Nov. 2002), <http://www.irs.gov/pub/irs-soi/irsvtc.pdf>.

²⁵ The Government Accountability Office has also recognized the challenges the IRS faces in achieving its goals without relevant data. See, e.g., Government Accountability Office, GAO-05-753, *Better Compliance Data and Long-term Goals Would Support a More Strategic IRS Approach to Reducing the Tax Gap* 22 (July 2005), <http://www.gao.gov/new.items/d05753.pdf>.

²⁶ IRM 5.7.1.1 (May 15, 2012).

²⁷ IRM 5.7.1.7 (May 15, 2012).

²⁸ SB/SE Research, *Federal Tax Deposit Alerts-P3 (Do Alerts Impact Compliance?)* (Feb. 10, 2012); SB/SE Research, *Federal Tax Deposit Alerts-P2 (Cost and Benefit Evaluation)* (Jan. 6, 2012).

TAS Research will analyze the impact of ROs and ACS on future compliance.

Because the primary determinant of IRS enforcement effectiveness is the maintenance or increase in voluntary compliance behavior, TAS plans to study this issue with respect to the IRS collection function. The objective of TAS's study is to compare the effect on compliance of assigning a "fresh" delinquency to an RO, ACS, or the queue. In undertaking this study, TAS plans to:

- Identify all taxpayers who had one or two unpaid employment tax delinquencies (called "taxpayer delinquency accounts" or TDAs) in a given year (or other appropriate period);²⁹
- Identify all such delinquencies that were assigned to an RO;
- Identify all such delinquencies of a similar kind and amount that were assigned to ACS or the queue; and
- Compare direct collections, revenue protected, penalties assessed, and future payment compliance by each group of taxpayers.

CONCLUSION

TAS plans to undertake research to compare the results of assigning a case to ACS or an RO when an employer first begins to fall behind on quarterly tax deposits. The IRS needs to be able to know the likely result of assigning similar cases (of the same age) to be worked by ACS and ROs, including both the short-collections and long-term voluntary compliance. Without such information, the IRS's collection function is operating based on unproven assumptions, assigning cases and allocating resources inefficiently, collecting delinquencies ineffectively, and potentially undermining long-term voluntary compliance. Such information could help the IRS to identify cases that it should assign to ROs immediately. It may also lead the IRS to improve its collection metrics. Better metrics could lead the IRS to allocate its resources between the Cff and ACS more effectively. Because metrics drive behavior, metrics that provide incentives to IRS executives to allocate resources to better promote long-term voluntary compliance will benefit both taxpayers and the government, as nobody benefits from noncompliance in the long run.

²⁹ These taxpayers may have other types of aged tax delinquencies, however.