



*Challenges Remain When Processing  
Undeliverable Mail and Preventing  
Violations of Taxpayers' Rights  
During the Lien Due Process*

**May 13, 2011**

**Reference Number: 2011-30-051**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax Return/Return Information

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## HIGHLIGHTS

### CHALLENGES REMAIN WHEN PROCESSING UNDELIVERABLE MAIL AND PREVENTING VIOLATIONS OF TAXPAYERS' RIGHTS DURING THE LIEN DUE PROCESS

## Highlights

Final Report issued on May 13, 2011

Highlights of Reference Number: 2011-30-051 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed Division and the Wage and Investment Division.

### IMPACT ON TAXPAYERS

After filing Notices of Federal Tax Lien, the Internal Revenue Service (IRS) must notify the affected taxpayers in writing, at their last known address, within five business days of the lien filings. However, as noted in previous audits, the IRS has not always complied with this statutory requirement and did not always follow its own internal guidelines for notifying taxpayer representatives of the filing of lien notices. Therefore, some taxpayers' rights to appeal the lien filings may have been jeopardized, and others may have had their rights violated when the IRS did not notify their representatives of lien filings.

### WHY TIGTA DID THE AUDIT

TIGTA is required by law to determine annually whether lien notices issued by the IRS comply with the legal guidelines in Internal Revenue Code Section 6320.

### WHAT TIGTA FOUND

TIGTA reviewed a statistically valid sample of 125 Federal Tax Liens filed for the 12-month period ending June 30, 2010, and determined that the IRS mailed nearly every lien notice in a timely manner as required by Internal Revenue Code Section 6320. However, TIGTA could not determine if all notices were mailed timely. This could result in violations of taxpayers' rights.

In addition, the IRS did not always follow its own regulations for notifying taxpayers' representatives of the filing of lien notices. IRS regulations require taxpayer representatives be given copies of all correspondence issued to the taxpayer. For four of the 30 cases in the sample for which the taxpayer had an authorized representative, the IRS did not notify the taxpayer's representative of the lien filing.

TIGTA estimated that 32,552 taxpayers may have been adversely affected because the IRS did not follow requirements to notify the taxpayers and their representatives of the taxpayers' rights related to liens.

When an initial lien notice is returned undeliverable and a different address is available for the taxpayer, the IRS does not always send the lien notice to the taxpayer's last known address. TIGTA identified cases for which a new lien notice should have been sent to the taxpayer's updated address because IRS systems reflected the updated address prior to the lien filing. These cases could involve legal violations because the IRS did not meet its statutory requirement to send lien notices to the taxpayer's last known address.

### WHAT TIGTA RECOMMENDED

TIGTA recommended that the Directors, Collection and Campus Compliance Services, Small Business/Self-Employed Division, and the Director, Compliance, Wage and Investment Division, ensure that procedures to address the handling of undelivered lien notices are consistent. The IRS agreed with our recommendation and plans to reevaluate procedures to ensure they are consistent across the functions and support the timely resolution of undeliverable notices.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

May 13, 2011

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

*Michael R. Phillips*

**FROM:** Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Challenges Remain When Processing  
Undeliverable Mail and Preventing Violations of Taxpayers' Rights  
During the Lien Due Process (Audit #201130001)

This report presents the results of our review to determine whether liens issued by the Internal Revenue Service (IRS) comply with legal guidelines set forth in Internal Revenue Code (I.R.C.) Section (§) 6320 (a)<sup>1</sup> and related guidance in the Federal Tax Lien Handbook. The Treasury Inspector General for Tax Administration is required by law to determine annually whether lien notices issued by the IRS comply with the legal guidelines in I.R.C. § 6320.<sup>2</sup> The audit was included in our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Taxpayer Protection and Rights.

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

Copies of this report are also being sent to the IRS managers affected by the report recommendation.

Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.

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<sup>1</sup> 26 U.S.C. § 6320 (Supp IV. 2010).

<sup>2</sup> 26 U.S.C. § 7803(d)(1)(A)(iii) (Supp. IV 2010).



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*Abbreviations*

ACS	Automated Collection System
ALS	Automated Lien System
CAF	Centralized Authorization File
FY	Fiscal Year
ICS	Integrated Collection System
IDRS	Integrated Data Retrieval System
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed



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## *Background*

The Internal Revenue Service (IRS) attempts to collect Federal taxes due from taxpayers by sending letters, making telephone calls, and meeting face to face with taxpayers. The IRS has the authority to attach a claim to the taxpayer's assets for the amount of unpaid tax when the taxpayer neglects or refuses to pay.<sup>1</sup> This claim is referred to as a Federal Tax Lien. The IRS files in appropriate local government offices a Notice of Federal Tax Lien,<sup>2</sup> which notifies interested parties that a lien exists.

Since January 19, 1999, Internal Revenue Code (I.R.C.) Section (§) 6320<sup>3</sup> has required the IRS to notify taxpayers in writing within 5 business days of the filing of a Notice of Federal Tax Lien. The IRS is required to notify taxpayers the first time a Notice of Federal Tax Lien is filed for each tax period. A Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320<sup>4</sup> (Letter 3172) (lien notice) is used for this purpose and advises taxpayers that they have 30 calendar days, after that 5-day period, to request a hearing with the IRS Appeals office. The lien notice indicates the date on which this 30-day period expires.

***Upon receiving a lien notice,  
the taxpayer has 30 calendar  
days to request a hearing  
with IRS Appeals.***

The law also requires that the lien notice explain, in simple terms, the amount of unpaid tax, administrative appeals available to the taxpayer, and provisions of the law and procedures relating to the release of liens on property. The lien notice must be given in person, left at the taxpayer's home or business, or sent by certified or registered mail to the taxpayer's last known address.<sup>5</sup>

Most lien notices are mailed to taxpayers by certified or registered mail rather than being delivered in person. The IRS Automated Lien System (ALS) generates a certified mail list which identifies each notice that is to be mailed. The notices and a copy of the certified mail list are delivered to the United States Postal Service. A Postal Service employee ensures that all notices are accounted for, date stamps the list, and returns a copy to the IRS. The stamped certified mail list is the only documentation the IRS has that certifies the date on which the

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<sup>1</sup> 26 U.S.C. § 6321 (Supp IV. 2010).

<sup>2</sup> Notice of Federal Tax Lien (Form 668(Y) (c); (Rev. 10-1999)), Cat. No. 60025X.

<sup>3</sup> 26 U.S.C. § 6320 (Supp IV. 2010).

<sup>4</sup> Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320 (Letter 3172 (Rev. 9-2006)), Cat. No. 26767I.

<sup>5</sup> The last known address is that one shown on the most recently filed and properly processed tax return, unless the IRS received notification of a different address.



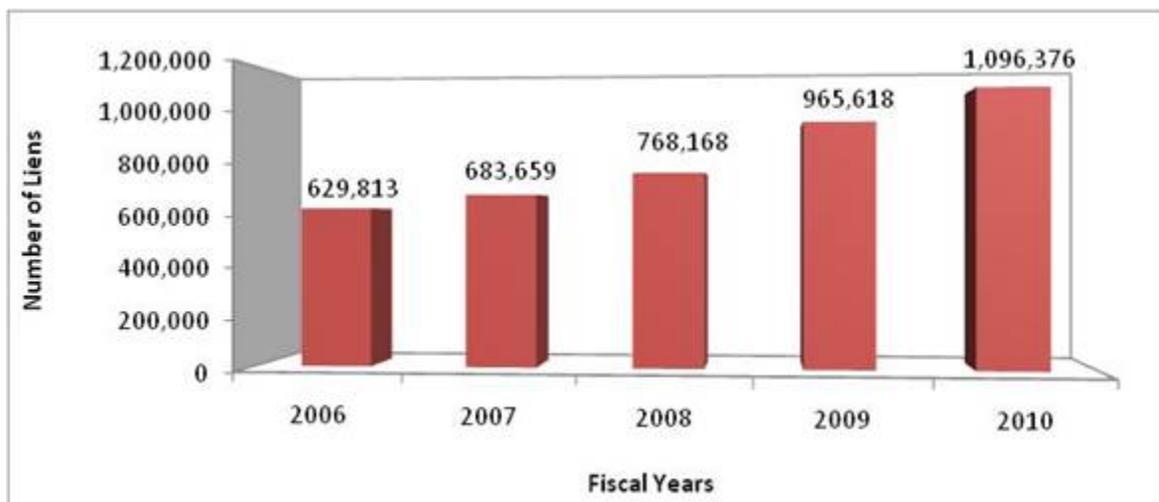
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notices were mailed. A synopsis of the IRS collection and lien filing processes is included in Appendix V.

Depending on employee access, lien requests can be generated using one of three IRS systems: 1) the Integrated Collection System (ICS), 2) the Automated Collection System (ACS), or 3) the ALS. Appendix VI provides a description of IRS computer systems used in the filing of lien notices.

As shown in Figure 1, the IRS has increased the number of Federal Tax Liens it has filed to protect the Federal Government's interest by 74 percent since Fiscal Year (FY) 2006.

**Figure 1: Number of Liens Filed From FYs 2006–2010**



Source: IRS Data Books published in FYs 2003 and 2007 through 2010.

The Treasury Inspector General for Tax Administration is required to determine annually whether, when filing lien notices, the IRS complied with the law regarding the notifications of affected taxpayers and their representatives.<sup>6</sup> This is our thirteenth annual audit to determine whether the IRS complied with the legal requirements of I.R.C. § 6320 and its own related internal guidelines for filing lien notices. In prior years, we reported that the IRS had not yet achieved full compliance with the law and its own internal guidelines. As repeat findings, we identified potential violations of taxpayer rights because the IRS did not timely notify taxpayers or their representatives. In addition, our review of a judgmental sample of undelivered lien notices found potential violations of taxpayer rights when the IRS did not use the taxpayer's last known address.

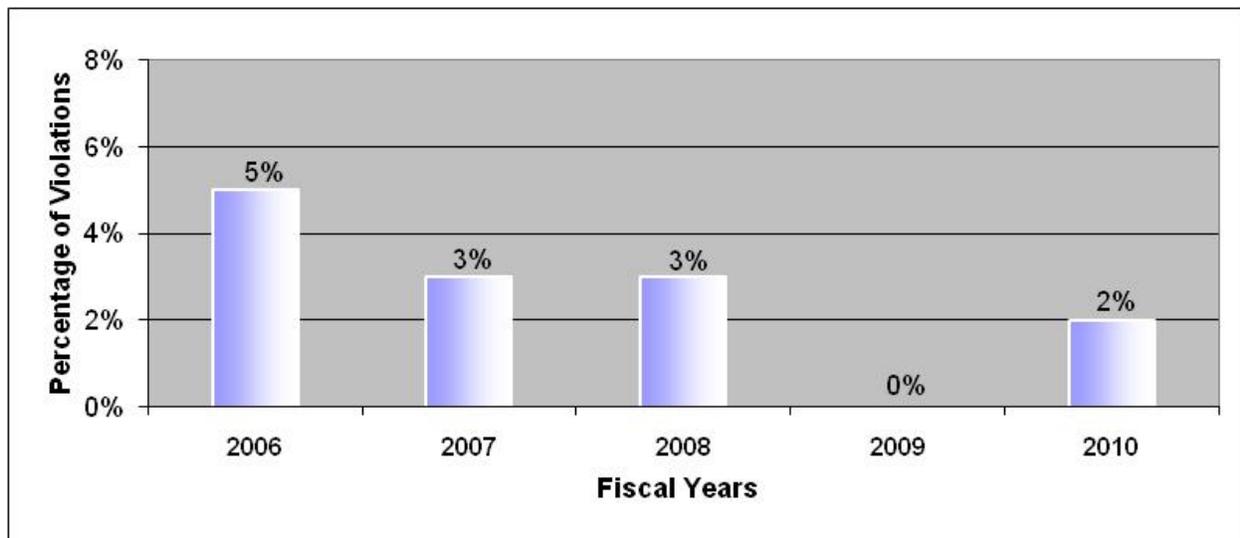
<sup>6</sup> 26 U.S.C. § 7803(d)(1)(A)(iii) (Supp. IV 2010).



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Figure 2 shows the percentages of potential violations of taxpayer rights we identified during our prior annual audits.

**Figure 2: Potential Violations of Taxpayer Rights Based on Timely Notification**



Source: Treasury Inspector General for Tax Administration statutory lien reports issued during FYs 2006–2010.<sup>7</sup>

This review was performed at the Small Business/Self-Employed (SB/SE) Division Office of Collection Policy in Washington, D.C.; the Centralized Case Processing – Lien Unit and the ACS Support function in Covington, Kentucky; and the ACS Support function in Fresno, California, during the period August 2010 through February 2011. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

<sup>7</sup> See Appendix VII for a list of prior reports.



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*Results of Review*

***Lien Notices Were Mailed Timely, but Proof of Mailing Could Not Always Be Located***

I.R.C. § 6320 requires the IRS to notify taxpayers in writing, at their last known address, within 5 business days of the filing of a Notice of Federal Tax Lien. We statistically sampled 125 lien notices from the 1,017,263 lien notices filed between July 1, 2009, and June 30, 2010. The IRS timely and correctly mailed the taxpayers' notices of a lien filing and appeal rights as required by I.R.C. § 6320 for \*\*1\*\* cases (approximately \*\*1\*\* percent). However, for \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*. Proof of mailing consists of certified and registered mail lists showing a United States Postal Service date stamp. The certified mail list is produced by the ALS along with the taxpayer notice and stamped by the United States Postal Service with the date of mailing. The certified mail list is then forwarded to the Centralized Case Processing – Lien Unit for recordkeeping. IRS procedures require retention of the date-stamped copy of the certified mail list for 10 years after the end of the processing year.

\*\*\*\*\*1\*\*\*\*\*  
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After we brought this observation to management's attention, \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*.

***The Internal Revenue Service Did Not Comply With Regulations for Notifying Taxpayer Representatives***

Taxpayer representative information is contained on the Centralized Authorization File (CAF)<sup>8</sup> that is located on the Integrated Data Retrieval System (IDRS).<sup>9</sup> Using the IDRS, employees can research the CAF to identify the types of authorization given to taxpayer representatives.

<sup>8</sup> The CAF contains information about the type of authorizations taxpayers have given their representatives for their tax returns.

<sup>9</sup> IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.



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IRS procedures<sup>10</sup> provide that notices are to be given to recognized taxpayer representatives. Specifically, any notice or other written communication (or a copy thereof) required or permitted to be given to a taxpayer in any matter before the IRS must be given to the taxpayer and, unless restricted by the taxpayer, to the representative. Accordingly, IRS procedures require the requestor of a lien to ensure they notify the Centralized Case Processing – Lien Unit of all powers of attorney and co-obligors that are to be notified. More specifically, when a Notice of Federal Tax Lien is filed, IRS procedures require that a copy of the notice be sent to the taxpayer's representative no later than 5 business days after the notice is sent to the taxpayer.

Our review of the statistically valid sample of 125 liens included 30 cases with representatives authorized to receive notifications at the time the liens were filed. For 4 (13 percent) of the 30 taxpayers, ALS records did not indicate that the IRS had sent copies of the lien notices to their representatives. Specifically:

- \*\*\*\*\* | \*\*\*\*\*  
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We project that 32,552 taxpayers may have been adversely affected because the IRS did not follow requirements to notify both the taxpayers and their representatives of the taxpayers' rights related to liens. We are 95 percent confident that the range of potential violations is between 1,042 and 64,063. In addition to this year's results, Figure 3 shows the error rates reported on the notification of taxpayer representatives in our last five reports.

<sup>10</sup> 26 Code of Federal Regulations § 601.506.

<sup>11</sup> Employees in the Collection Field function who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by the IRS campuses or the ACS. Campuses are the data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



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**Figure 3: Error Rates Reported on Notification of Taxpayer Representatives**

<b>Report FY</b>	<b>Sampled Lien Cases Requiring Representative Notification</b>	<b>Sampled Lien Cases Not Receiving Representative Notification</b>	<b>Error Rate</b>
2006	45	34	76%
2007	25	15	60%
2008	30	12	40%
2009	27	8	30%
2010	31	8	26%
2011	30	4	13%

*Source: Prior and current year results of Treasury Inspector General for Tax Administration tests of taxpayer representative notification.*

While the error rate has been reduced from 76 percent in our FY 2006 report to 13 percent in our FY 2011 report, the potential for violations still exists in cases requiring taxpayer representative notification.

In the FY 2009 report, we identified similar conditions and made a recommendation to implement computer programming enhancements for an automated upload of CAF data to the ALS. The corrective actions for this recommendation are scheduled to be implemented later in FY 2011. Because these corrective actions are scheduled to occur during FY 2012's sample selection, this process will be evaluated during next year's statutory review.

***Ineffective Working of Undelivered Lien Notices Resulted in Potential Violations of Taxpayers' Rights***

IRS procedures require that employees send another lien notice to a new address if: 1) the originally mailed notice is returned as undelivered mail, 2) research confirms the original lien notice was not sent to the last known address, and 3) the new address was effective prior to or during the same cycle<sup>12</sup> of the Notices of Federal Tax Lien filing that caused the lien notice to be issued. Collection function employees are responsible for certain actions when notices are returned as undeliverable. For example, they should research the IRS computer system within 7 calendar days to ensure that the address on the original lien notice is correct. If the employee cannot find a new address on the computer system, the undelivered lien notice will be destroyed and a new notice is not issued.

<sup>12</sup> Cycle refers to the IRS method of documenting dates (i.e., Processing Cycle 201102 is the second week of January 2011).



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If the address on the notice is not the last known address and a different address was in effect prior to filing of the original lien notice, employees should issue a new notice to the better address. A new notice may be created by using an option in the ALS.

We selected a judgmental sample of 250 undelivered lien notices returned to the Cincinnati (125 lien notices) and Fresno (125 lien notices) Campuses in October 2010. The sample included only returned lien notices identified as undelivered and did not include returned mail identified as refused or unclaimed. We selected the Cincinnati and Fresno Campuses because the lien notices issued by the SB/SE and Wage and Investments Divisions' ACS sites returned as undeliverable are sent to those locations. This provided a sufficient volume to select our sample. For these 250 notices, we reviewed computer system audit trails to determine whether IRS employees performed timely research to determine whether the addresses were correct on the originally mailed notices. The 250 returned notices were handled by employees as follows:

- For 204 (82 percent) of the 250 notices, employees did not perform required research of the IRS computer system for a different address within 7 calendar days of receipt of the returned notice.
- For 46 (18 percent) of the 250 notices, employees performed the required research within 7 calendar days of receipt of the returned notice.

Our test of undelivered lien notices identified 23 of 250 notices for which the address on the IRS computer system and the original lien notice did not agree. For 12 (52 percent) of the 23 notices, the address on the IRS computer system was updated after the original lien notice was sent to the taxpayer. Therefore, no additional action was required. For 11 notices (48 percent), the address was updated prior to the issuance of the original lien notice and, according to IRS procedures, a new lien notice should have been sent to the taxpayer at the updated address. However, the IRS only reissued 8 of the 11 notices to the updated address. The three notices not reissued could involve potential violations of taxpayer rights because the IRS did not meet its statutory requirement of sending each lien notice to the taxpayer's last known address. For example, in March 2010, the United States Tax Court<sup>13</sup> found that an IRS lien notice was invalid because it was not mailed to the individual's last known address.

When we brought this observation to management's attention, \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*

In July 2010, the IRS implemented procedures intended to improve customer service to taxpayers. Specifically, the procedures allowed employees to send a courtesy copy of the lien

<sup>13</sup> The United States Tax Court, in a case filed March 1, 2010, found that the lien notice issued with respect to a taxpayer's 2002 tax return was not mailed to the taxpayer's last known address, nor was it received and, therefore, it is invalid. Consequently, the IRS is required, under the provisions of § 6320 and the accompanying regulations, to issue to the taxpayer a substitute lien notice and provide him or her with an opportunity to request a lien hearing.



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notice to a taxpayer's new address if the new address was effective during the cycle after the original lien notice was issued. \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*. While the courtesy copy procedure is voluntary and not a statutory requirement, following the procedure allows the IRS an opportunity to provide better customer service to the taxpayer.

Lien notices are not sent to the most current addresses because, in part, user guides and procedures for the systems that generate lien requests are inconsistent regarding address verification and the timing of the address change. Specifically:

- One set of IRS procedures requires a new notice be sent to the taxpayer if the address change is effective in the same cycle or the cycle before the lien is filed.
- Another set of IRS procedures requires a new notice be sent to the taxpayer if the address change is effective at the time the notice was requested.
- A third set of IRS procedures requires a new notice be sent to the taxpayer if the address change is effective in the cycle that corresponds to the date on the lien notice.

In addition, employees are not always following established procedures for verifying the current address of the taxpayer prior to preparing a lien request. Finally, the ALS does not currently perform an automated verification of the taxpayer's last known address prior to printing the lien notice.

IRS management advised us that the procedures for requiring the research and resolution of undelivered lien notices within 7 calendar days do not pertain to the ACS. However, we identified no exception for the ACS. IRS procedures provide that all undelivered mail be returned to the requesting employee or the office designated the responsibility of processing undelivered lien notices and researched and resolved within 7 calendar days of receipt. The ACS Support functions at the Cincinnati and Fresno Campuses have been designated by the SB/SE and Wage and Investment Divisions to receive all undelivered lien notices filed by the ACS since the process (address verification of undelivered lien notices) was decentralized in August 2007.

IRS management also indicated that the routing of the undelivered lien notices could have contributed to the untimely research of the undelivered mail. Specifically, all returned mail is received at the Cincinnati and Fresno Campuses, where it is extracted and sorted by mail type. The returned lien notices are routed to the ACS Support functions that are located in different buildings, where employees actually perform the research on IRS computer systems to identify the last known addresses. This routing can delay the processing of the mail, which could have caused the undelivered mail not to be researched within the required 7 calendar days of receipt of the returned notice.

In the FY 2009 report, we identified similar conditions and made a recommendation to implement computer programming enhancements to include an automated check of a taxpayer's



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last known address prior to the printing of lien notices. The corrective actions for this recommendation are scheduled to be implemented later in FY 2011. Because these corrective actions are scheduled to occur before FY 2012's undelivered lien notice sample selection, this process will be evaluated during next year's statutory review.

**Employees are still not following procedures designed to monitor undeliverable lien notices**

In August 2007, procedures for handling undelivered lien notices were revised to return the undelivered lien notice directly to the requesting employee or function. Employees handling undelivered lien notices were also required to input a specific IDRS transaction code with an appropriate action code. The transaction code signifies that the lien notice was returned and the action code indicates the reason (i.e., undelivered, unclaimed, or refused). These codes are required to be entered into the IDRS after appropriate research of the returned lien notice is performed.

In August 2009, the ALS was enhanced to perform a weekly systemic extract to send the appropriate undeliverable status (transaction code and action code) of lien notices to the IDRS using a specific command. When this command is used to update the status of the lien notice, no additional input is necessary to update the IDRS. When a lien notice is returned undelivered and research has been completed regarding an updated address, the employee should go to the lien notice screen on the ALS and indicate undelivered status.

Our test of undelivered lien notices determined that the IRS is not complying with this procedure. None of the 250 undelivered lien notices that we sampled had a transaction code or associated action code input to the IDRS. For our sample, the ALS was not updated with the status of the undelivered lien notices and, therefore, the upload to the IDRS (via the ALS) did not occur. As a result, there is no record of the mail status of these lien notices. Management advised us that the requirements to enter these codes do not apply to the ACS. However, as we reported previously, the ACS Support function has been designated by the SB/SE and Wage and Investment Divisions to receive all undelivered lien notices that were filed by the ACS since the process (address verification of undelivered lien notices) was decentralized in August 2007. Accordingly, the requirement provides that the person designated the responsibility of processing undelivered lien notices will also check the IDRS for a last known address and request the input of the transaction code with the appropriate action code or the command code enhancement via the ALS.

Compliance with these procedures is important because it allows management to review the handling of undelivered lien notices. Undelivered lien notices are being sent back to more than 450 Collection function groups throughout the country, where the employees or functions that requested the liens are located. The combination of decentralizing the handling of undelivered lien notices and the failure of employees to update taxpayers' data in the IDRS resulted in management's inability to ensure and enforce the timely resolution of undelivered lien notices.



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This situation continues to contribute to the number of undelivered lien notices that were not researched timely. Past reviews show the percentage increasing from 33 percent in our FY 2008 report to nearly 83 percent in our FY 2009 report, 84 percent in our FY 2010 report, and 82 percent in our FY 2011 report.

Further, because employees are not following the procedures to enter the undeliverable notice status into the IDRS via transaction and action codes, the information about the undeliverable notice is limited to only those employees working the undeliverable mail. IRS management, including Accounts Management organization<sup>14</sup> employees and Centralized Case Processing – Lien Unit employees who have access to the ALS, do not have access to information on undelivered lien notices. As a result, Taxpayer Assistance Center<sup>15</sup> employees would not be able to answer taxpayer questions about their Federal Tax Liens.

This is the third consecutive year in which we have reported 100 percent noncompliance with this procedure. IRS management is aware of this condition and is currently evaluating the necessity of the procedure.

### ***Recommendation***

***Recommendation 1:*** The Directors, Collection and Campus Compliance Services, SB/SE Division, and the Director, Compliance, Wage and Investment Division, should ensure that procedures that address the handling of undelivered lien notices are consistent and include the same requirements for timely research of undelivered notices and when a new notice should be sent.

***Management's Response:*** IRS management agreed with this recommendation. Collection Policy and Campus Filing and Payment Compliance will reevaluate procedures to ensure they are consistent across the functions and support the timely resolution of undeliverable notices.

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<sup>14</sup> The Accounts Management organization is responsible for providing taxpayers with information on the status of their returns, refunds, and for resolving the majority of issues and questions to settle their accounts.

<sup>15</sup> IRS offices with employees who answer questions, provide assistance, and resolve account-related issues for taxpayers face to face.



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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

Our overall objective was to determine whether liens issued by the IRS comply with legal guidelines set forth in I.R.C. Section (§) 6320 (a)<sup>1</sup> and related guidance in the Federal Tax Lien Handbook. To accomplish the objective, we:

- I. Determined whether taxpayer lien notices related to 125 Federal Tax Liens filed by the IRS complied with legal requirements set forth in I.R.C. § 6320 (a) and related internal guidelines.
  - A. Selected a statistically valid sample of 125 Federal Tax Lien cases from the ALS<sup>2</sup> extract of the 1,017,263 liens filed by the IRS nationwide between July 1, 2009, and June 30, 2010. We used a statistical sample because we wanted to project the number of cases with errors. We used attribute sampling to calculate the minimum sample size (n),<sup>3</sup> which we rounded to 125:

$n = (Z^2 p(1-p))/(A^2)$	1,017,263
Z = Confidence Level:	95 percent
p = Expected Rate of Occurrence:	3 percent
A = Precision Rate:	±3 percent
  - B. Validated the ALS extract by comparing the sampled records to online data and discussing with SB/SE Division management data checks ensuring reliability, completeness, and accuracy.
  - C. Determined whether the sampled liens adhered to legal guidelines regarding timely notifications of lien filings to the taxpayer, the taxpayer's spouse, or business partners by reviewing data from the ALS and the certified mail list.
  - D. Evaluated the controls and procedures established for transferring, storing, and safeguarding certified mail lists at the Centralized Case Processing – Lien Unit function.
  - E. Determined whether taxpayers' representatives were provided a copy of the lien due process notice by reviewing data from the ALS, IDRS, ICS, and ACS.

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<sup>1</sup> 26 U.S.C. § 6320 (Supp IV. 2010).

<sup>2</sup> See Appendix VI for descriptions of IRS computer systems used in the filing of Notices of Federal Tax Lien.

<sup>3</sup> The formula  $n = (Z^2 p(1-p))/(A^2)$  is from *Sawyer's Internal Auditing – The Practice of Modern Internal Auditing*, 4th Edition, pp. 462-464.



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1. Reviewed IDRS screens for CAF indicators (Transaction Code 960 and Command Code CFINK) for all sampled cases.
  2. Reviewed ALS history screens for accounts with CAF indicators to see if lien notices were mailed to taxpayers' representatives within 5 business days of mailing the taxpayers' notices.
- F. Reviewed the ACS and the ICS for taxpayer representatives/powers of attorney indicators and matched tax periods to ensure that all taxpayer representatives/powers of attorney listed on the ACS and the ICS were provided notification per the ALS.
- G. Provided all exception cases to the Office of Collection Policy, SB/SE Division, for agreement to potential violations and corrective actions if appropriate.
- II. Evaluated the procedures for processing lien notices (Letters 3172)<sup>4</sup> that are returned as undelivered.
- A. Selected a judgmental sample of 250 unprocessed mail items containing undelivered lien notices received during October 2010 in the Cincinnati (125) and Fresno (125) Campuses<sup>5</sup> and recorded the taxpayer's name, address, Social Security Number, and serial lien identification number. The judgmental sample included only returned mail identified as undelivered. The population of returned mail identified as undelivered is unknown because the IRS does not record the receipt of undelivered mail. A judgmental sample was used for this reason, and the test was conducted to show weaknesses for which management needed to take corrective action.
  - B. Researched IDRS using Command Codes INOLES and ENMOD and determined whether the address on the Master File<sup>6</sup> matched the address on the undelivered lien notice for each sampled case.
  - C. Reviewed taxpayer audit trails to determine whether ACS Support function employees performed the required IDRS research during creation of the lien.
  - D. Reviewed IDRS audit trails to determine whether ACS Support function employees performed the required IDRS research for resolution of undeliverable status within 7 calendar days of receipt.
  - E. Reviewed the ALS and verified whether the status of the lien notice was updated to undelivered.

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<sup>4</sup> Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320 (Letter 3172 (Rev. 9-2006)), Cat. No. 26767I.

<sup>5</sup> Campuses are the data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

<sup>6</sup> The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



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III. Determined whether IRS internal guidelines have been modified since our last review.

**Internal controls methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the SB/SE Division Collection function's policies, procedures, and practices for timely notifying taxpayers of lien filings and timely verifying addresses of undelivered lien notices. We evaluated these controls by interviewing management and reviewing samples of lien notices sent to taxpayers and lien notices returned to the IRS as undelivered.



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**Appendix II**

*Major Contributors to This Report*

Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)  
Carl Aley, Director  
Timothy Greiner, Audit Manager  
Meaghan Tocco, Lead Auditor  
Mike Garcia, Senior Auditor  
Steven Stephens, Senior Auditor  
Nicole DeBernardi, Auditor  
Stephen Elix, Auditor  
Kevin O'Gallagher, Information Technology Specialist



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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Chief Counsel CC  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner, Small Business/Self-Employed Division SE:S  
Deputy Commissioner, Wage and Investment Division SE:W  
Director, Campus Compliance Services, Small Business/Self-Employed Division SE:S:CCS  
Director, Collection, Small Business/Self-Employed Division SE:S:C  
Director, Collection Policy, Small Business/Self-Employed Division SE:S:C:CP  
Director, Compliance, Wage and Investment Division SE:W:CP  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
    Commissioner, Small Business/Self-Employed Division SE:S  
    Commissioner, Wage and Investment Division SE:W



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**Appendix IV**

*Outcome Measures*

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

**Type and Value of Outcome Measure:**

- Taxpayer Rights and Entitlements – Actual; \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*  
\*\*\*\*\*.

**Methodology Used to Measure the Reported Benefit:**

From a statistically valid sample of 125 Federal Tax Lien cases, \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*  
\*\*\*\*\*.

**Type and Value of Outcome Measure:**

- Taxpayer Rights and Entitlements – Potential; 32,552 taxpayer representatives may not have been provided Letters 3172, resulting in potential violations of taxpayers' rights (see page 4).

**Methodology Used to Measure the Reported Benefit:**

From a statistically valid sample of 125 Federal Tax Lien cases, we identified 30 cases with representatives authorized to receive notifications at the time the liens were filed. From those 30 cases, we identified 4 (13 percent) cases for which IRS employees did not provide notice to taxpayer representatives, resulting in potential violations of taxpayers' rights. The sample was selected based on a confidence level of 95 percent, a precision rate of ±3 percent, and an expected rate of occurrence of 3 percent. We projected the findings to the total population provided by the IRS of 1,017,263 Notices of Federal Tax Lien generated by the ALS between July 1, 2009, and June 30, 2010.

<sup>1</sup> Notice of Federal Tax Lien Filing and Your Right to a Hearing Under I.R.C. 6320 (Letter 3172 (Rev. 9-2006)), Cat. No. 26767I.



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**Type and Value of Outcome Measure:**

- Taxpayer Rights and Entitlements – Actual; three taxpayers were not provided Letters 3172, resulting in potential legal violations of taxpayers' rights (see page 6).

**Methodology Used to Measure the Reported Benefit:**

In a judgmental sample of 250 undelivered lien notices, we determined that the IRS did not send notices to the updated addresses of 3 taxpayers. Taxpayer rights could be affected because a taxpayer not receiving a notice or receiving a late notice might be unaware of the right to appeal or might receive less than the 30-calendar day period allowed by the law to request a hearing. In addition, taxpayer rights could be further affected when the taxpayer appeals the filing of the lien and the IRS denies the request for the appeal.



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## **Appendix V**

### *Synopsis of the Internal Revenue Service Collection and Lien Filing Processes*

The collection of unpaid tax begins with a series of letters (notices) sent to the taxpayer advising them of the debt and asking for payment of the delinquent tax. IRS computer systems are programmed to mail these notices when certain criteria are met. If the taxpayer does not respond to these notices, the account is transferred for either personal or telephone contact.

- IRS employees who make personal (face-to-face) contact with taxpayers are called revenue officers and work in various locations. The ICS<sup>1</sup> is used in most of these locations to track collection actions taken on taxpayer accounts.
- IRS employees who make only telephone contact with taxpayers work in call sites in Customer Service offices. The ACS is used in the call sites to track collection actions taken on taxpayer accounts.

When these efforts have been taken and the taxpayer has not paid the tax liability, designated IRS employees are authorized to file a lien by sending a Notice of Federal Tax Lien<sup>2</sup> to appropriate local government offices. Liens protect the Federal Government's interest by attaching a claim to the taxpayer's assets for the amount of unpaid tax. The right to file a Notice of Federal Tax Lien is created by I.R.C. Section (§) 6321 (1994) when:

- The IRS has made an assessment and given the taxpayer notice of the assessment, stating the amount of the tax liability and demanding payment.
- The taxpayer has neglected or refused to pay the amount within 10 calendar days after the notice and demand for payment.

When designated employees request the filing of a Notice of Federal Tax Lien using either the ICS or the ACS, the ALS processes the lien filing requests from both Systems. In an expedited situation, employees can manually prepare the Notice of Federal Tax Lien. Even for manually prepared liens, the ALS controls and tracks the liens and initiates subsequent lien notices<sup>3</sup> to notify responsible parties of the lien filings and of their appeal rights. The ALS maintains an

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<sup>1</sup> See Appendix VI for detailed descriptions of IRS computer systems used in the filing of Notices of Federal Tax Lien.

<sup>2</sup> Notice of Federal Tax Lien (Form 668(Y) (c); (Rev. 10-1999)), Cat. No. 60025X.

<sup>3</sup> Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320 (Letter 3172 (Rev. 9-2006)), Cat. No. 26767I.



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electronic database of all open Notices of Federal Tax Lien and updates the IRS's primary computer records to indicate that a Notice of Federal Tax Lien has been filed.

Most lien notices are mailed to taxpayers by certified or registered mail, rather than delivered in person. To maintain a record of the notices, the IRS prepares a certified mail list (United States Postal Service Form 3877), which identifies each notice that is to be mailed. The notices and a copy of the certified mail list are delivered to the United States Postal Service. A United States Postal Service employee ensures that all notices are accounted for, date stamps the list, and returns a copy to the IRS. The stamped certified mail list is the only documentation the IRS has that certifies the date on which the notices were mailed. IRS guidelines require that the stamped certified mail list be retained for 10 years after the end of the processing year.



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## Appendix VI

### *Internal Revenue Service Computer Systems Used in the Filing of Notices of Federal Tax Lien*

**The Automated Collection System (ACS)** is a computerized call site inventory system that maintains balance-due accounts and return delinquency investigations. ACS function employees enter all of their case file information (online) on the ACS. Lien notices requested using the ACS are uploaded to the ALS, which generates the Notices of Federal Tax Lien<sup>1</sup> and related lien notices and updates the IRS's primary computer files to indicate that Notices of Federal Tax Lien have been filed.

**The Automated Lien System (ALS)** is a comprehensive database that prints Notices of Federal Tax Lien and lien notices, stores taxpayer information, and documents all lien activity. Lien activities on both ACS and ICS cases are controlled on the ALS by Technical Support or Case Processing functions at the Cincinnati, Ohio, Campus.<sup>2</sup> Employees at the Cincinnati Campus process Notices of Federal Tax Lien and lien notices and respond to taxpayer inquiries using the ALS.

**The Integrated Collection System (ICS)** is an IRS computer system with applications designed around each of the main collection tasks such as opening a case, assigning a case, building a case, performing collection activity, and closing a case. The ICS is designed to provide management information, create and maintain case histories, generate documents, and allow online approval of case actions. Lien requests made using the ICS are uploaded to the ALS. The ALS generates the Notices of Federal Tax Lien and related lien notices and updates the IRS's primary computer files to indicate Notices of Federal Tax Lien have been filed.

**The Integrated Data Retrieval System (IDRS)** is an online data retrieval and data entry system that processes transactions entered from terminals located in campuses and other IRS locations. It enables employees to perform such tasks as researching account information, requesting tax returns, entering collection information, and generating collection documents. The IDRS serves as a link from campuses and other IRS locations to the Master File<sup>3</sup> for the IRS to maintain accurate records of activity on taxpayers' accounts.

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<sup>1</sup> Notice of Federal Tax Lien (Form 668(Y) (c); (Rev. 10-1999)), Cat. No. 60025X.

<sup>2</sup> A campus is the data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

<sup>3</sup> The Master File is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



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**Appendix VII**

*Statutory Lien Reports Issued During  
Fiscal Years 2006 Through 2010*

*Fiscal Year 2006 Statutory Review of Compliance With Lien Due Process Procedures*  
(Reference Number 2006-30-094, dated June 21, 2006)

*Fiscal Year 2007 Statutory Review of Compliance With Lien Due Process Procedures*  
(Reference Number 2007-30-051, dated March 20, 2007)

*Fiscal Year 2008 Statutory Review of Compliance With Lien Due Process Procedures*  
(Reference Number 2008-30-082, dated March 27, 2008)

*Additional Actions Are Needed to Protect Taxpayers' Rights During the Lien Due Process*  
(Reference Number 2009-30-089, dated June 16, 2009)

*Actions Are Needed to Protect Taxpayers' Rights During the Lien Due Process* (Reference  
Number 2010-30-072, dated July 9, 2010)



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**Appendix VIII**

*Management's Response to the Draft Report*

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

**COMMISSIONER  
SMALL BUSINESS/SELF-EMPLOYED DIVISION**

April 26, 2011

MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *for* Christopher Wagner /s/ Faris R. Fink  
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report - Challenges Remain When Processing Undeliverable  
Mail and Preventing Violations of Taxpayers' Rights During the Lien Due  
Process (Audit No. 20113001)

Thank you for the opportunity to review your draft report titled "Challenges Remain When Processing Undeliverable Mail and Preventing Violations of Taxpayers' Rights During the Lien Due Process."

We agree with your recommendation as stated in the report. We continue to explore ways to enhance our systemic processes to ensure notices are sent, as required, to the most current addresses of the taxpayers and pursuant to policy, to authorized representatives. We also continue to strive to simplify and unify our procedural approach to handling notices that are returned by the Postal Service.

We concur that the timely and proper issuance of lien Collection Due Process notices is of utmost importance. You sampled 125 cases and found no instances in which a notice was sent to the wrong address.

\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*. Although we do not dispute your finding \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*, we believe this was an isolated instance and \*\*\*\*\*1\*\*\*\*\*

Attached is a detailed response outlining our corrective actions to your recommendations.

If you have any questions, please contact me, or a member of your staff may contact Scott Reisher, Acting Director, Collection Policy at (202) 283-7361.

Attachment



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Attachment

**RECOMMENDATION 1:**

The Directors, Collection and Campus Compliance Services, SB/SE Division and the Director, Compliance, Wage and Investment Division, should ensure that procedures that address the handling of undelivered lien notices are consistent and include the same requirements for timely research of undelivered notices, and when a new notice should be sent.

**CORRECTIVE ACTION:**

We agree with the recommendation. Collection Policy and Campus Filing and Payment Compliance will re-evaluate IRM 5.12 and IRM 5.19 procedures to ensure they are consistent across the functions and support the timely resolution of undeliverable notices.

**IMPLEMENTATION DATE:**

December 15, 2011

**RESPONSIBLE OFFICIAL(S):**

Director, Collection Policy, Small Business/Self-Employed Division (SB/SE)

**CORRECTIVE ACTION MONITORING PLAN:**

The Director, Collection Policy, SB/SE will advise the Director, Enterprise Collection Strategy of any delays in implementing this corrective action.