COMMISSIONER

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

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MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Charles O. Rossotti
Commissioner of Internal Revenue

SUBJECT: Draft Audit Report -- Significant Improvements are Needed in Processing Gift Tax Payments and Associated Extensions to File

Thank you for the opportunity to respond to the draft report entitled "Significant Improvements are Needed in Processing Gift Tax Payments and Associated Extensions to File." We are constantly trying to improve the correct processing of taxpayer payments and our relationship and communication with the lockbox depositories. We believe the actions we have taken and propose to take will greatly reduce some of the concerns identified in your report. These actions include revising and clarifying instructions for both IRS and lockbox employees and expanding quality evaluation measures for the lockbox sites.

IDENTITY OF RECOMMENDATION/FINDING #1
All balance due notices generated for gift tax accounts should be reviewed. We further recommended that tax examiners be instructed to review the taxpayer's corresponding individual income tax and gift tax accounts to determine if the taxpayer's gift tax payments and extensions were correctly processed.

ASSESSMENT OF CAUSE(S)
Some taxpayers who submitted payment(s) with the Form 4868 to request an extension for their individual and gift tax accounts received balance due notices on their gift tax accounts. The payments were incorrectly applied to only the individual income tax account.

CORRECTIVE ACTION(S)
The IRS is currently performing a 100 percent review of large dollar (over $25,000) balance due notices for Form 709. Because most payments received with requests for gift tax extensions are for large amounts, we do not believe that expanding the review to all balance due notices for Form 709 will result in significant improvements.

We will change our programming which we believe will dramatically improve the accuracy of the notices on these accounts by:

1. Creating a tickler file, stopping any notices, and freezing any refund for an individual income tax account with an overpayment and transaction code of TC 670 which indicates a subsequent payment to the account.

2. Creating a tickler file, stopping any notices, and freezing any gift tax module with an underpayment and an approved extension posted (TC 460.)

3. Running the income tax tickler file against all gift tax accounts being processed:

   - If the corresponding gift tax account(s) has a balance due, the affected accounts will be directed to a tax examiner. The tax examiner will determine if the overpayment on the income tax account should be moved to the gift tax account(s) and take appropriate action.

   - If the gift tax account does not have a balance due, the freeze will be released.

4. Running the gift tax tickler file against all income tax accounts being processed:

   - If the corresponding income tax account has an overpayment, both accounts will be routed to a tax examiner to see if the overpayment on the income tax account should be moved to the gift tax account.

   - If the income tax account does not show an overpayment, the notice will be sent.

IMPLEMENTATION DATE
Proposed: January 01, 2002

RESPONSIBLE OFFICIAL(S)
Director, Wage and Investment Submission Processing

IDENTITY OF RECOMMENDATION/FINDING #2
Revise the current IRS service center instructions for the processing of Forms 4868 to

ensure that gift tax payments and extensions are processed to the proper taxpayer accounts. The following should be considered:

- Forms 4868 received at the IRS service centers with gift tax payments should be photocopied and the copies sent to the Code and Edit function. The Code and Edit function should research to see if the gift tax accounts are established, then input the extensions to the gift tax accounts. The payment(s) for the individual income tax accounts and/or gift tax accounts and the extensions for the individual income tax accounts should be processed through Integrated Submission and Remittance Processing (ISRP) Deposit.

- Forms 4868 received at the IRS service centers without payments should also be sent to the Code and Edit function. The Code and Edit function should research the gift tax accounts for those taxpayers requesting extensions for gift tax and input the extensions before forwarding the forms to the Data function. The Data function should input the extensions to the taxpayers' individual income tax accounts.

ASSESSMENT OF CAUSE(S)
Current IRS service center instructions for the processing of Forms 4868 do not ensure that gift tax payments and extensions are processed to the correct taxpayer accounts.

CORRECTIVE ACTION(S)

- We are concerned about processing delays that would occur if we photocopied extension requests and routed them to Code and Edit. Instead, beginning next year we will work all combination Form 1040 and Form 709 extensions (with payments) in the Payment Perfection Unit. The Payment Perfection Unit will research the Integrated Data Retrieval System, establish the Form 709 account (if necessary), and input the approved extension on both the Form 1040 account and the Form 709 account. We changed Internal Revenue Manual (IRM) 3.8.44, Service Center Deposit Activity, to explain this new procedure.

- Under our current procedures, the Form 1040 and Form 709 extensions are input in different units. An Individual Master File (IMF) unit processes the Form 1040 extension and a Business Master File unit processes the Form 709 extension request. The procedures will be changed to allow the IMF Code and Edit Unit to process the extension request for both the income and gift tax accounts.

IMPLEMENTATION DATE
Proposed: January 2, 2001

RESPONSIBLE OFFICIAL(S)
Director, Wage and Investment Submission Processing

FUTURE BUSINESS OWNER(S)
Commissioner, Wage and Investment Division

IDENTITY OF RECOMMENDATION/FINDING # 3
Explore the possibility of updating the ISRP System to permit the posting of extensions to both the individual and gift tax accounts. The Form 4868 is voucher sized and could be scanned. This would also eliminate the need to obtain documents from paper files.

ASSESSMENT OF CAUSE(S)
We can post extensions to both the income and gift tax accounts, and the IRM contains specific instructions for every service center to follow. However, TIGTA auditors observed inconsistencies in Forms 4868 payment processing at the service centers.

Although the vendor initially trained service center employees on basic key entry and verification operations for payments split between more than one account, the training was not specific to the Form 4868. Many operators did not apply what they had been taught to extension payments. In addition, the IRM instructions for posting extensions were unclear.

CORRECTIVE ACTIONS(S)

1. We updated the IRM procedures for the 2001 filing season concerning processing of multiple/split vouchers. The new procedures provide the operator with clear instructions for processing split payments to a taxpayer's individual income tax and gift tax accounts. Training will also be made more specific.

2. We do not agree that Forms 4868 should be scanned. The current system functionality allows us to capture the necessary data to process vouchers. In order to scan Forms 4868, we would have to integrate new scanners into the ISRP system, or use the current transports to image non-scannable vouchers. This would require a contract modification for the vendor to redesign the scanning functionality and would not be cost effective.

IMPLEMENTATION DATE
1. Proposed: January 2, 2001
2. N/A

RESPONSIBLE OFFICIAL
Director, Wage and Investment Submission Processing

RECOMMENDATION/FINDING #4
Ensure that current lockbox guidelines for the processing of Forms 4868 with payments for both the individual income tax and gift tax accounts are followed.

ASSESSMENT OF CAUSE(S)
Lockbox employees did not follow the current guidelines for processing Forms 4868 with payments for individual income tax and gift tax accounts.

CORRECTIVE ACTION(S)
The lockbox banks have agreed to emphasize the Form 4868 processing requirements during training for the 2001 filing season. The IRS will review Forms 4868 during the April peak at the bank sites to ensure the training has been effective and the employees are following guidelines.

IMPLEMENTATION DATE
Proposed: May 1, 2001

RESPONSIBLE OFFICIAL(S)
Director, Wage and Investment Submission Processing

RECOMMENDATION/FINDING #5
Expand and clarify the current lockbox guidelines for the processing of Forms 4868 sent by taxpayers requesting extensions for both their individual income and gift tax accounts but with payments for only one of the accounts.

ASSESSMENT OF CAUSE(S)
Lockbox employees were not sure how to handle Forms 4868 sent by taxpayers requesting extensions for both their individual income and gift tax accounts.

CORRECTIVE ACTION(S)
We are clarifying the Form 4868 procedures in the Lockbox Processing Guidelines. We will take a sample of Forms 4868 and report any gift tax errors identified during the April peak.

IMPLEMENTATION DATE
Proposed: May 1, 2001

RESPONSIBLE OFFICIAL(S)
Director, Wage and Investment Submission Processing

RECOMMENDATION/FINDING #6
Clarify the current lockbox guidelines for the processing of payments and extensions submitted by taxpayers "for gift tax only."

ASSESSMENT OF CAUSES(S)
The guidelines for processing payments and extensions filed "for gift tax only" did not clearly indicate how to handle the extension request.

CORRECTIVE ACTION(S)
We are revising the Lockbox Processing Guidelines to deposit the checks received with a "for gift tax only" extension. The new procedures will instruct the lockbox employees to:

- Deposit the check.
- Indicate the amount deposited on the Form 4868.
- Send the Form 4868 to the service center for processing on ISRP.

These revised procedures will be emphasized in the next training conference.

IMPLEMENTATION DATE
Proposed: January 2, 2001

RESPONSIBLE OFFICIAL(S)
Director, Wage and Investment Submission Processing

RECOMMENDATION/FINDING #7
Determine whether payments and extensions submitted by taxpayers "for gift tax only" could be completely processed at lockbox sites.

ASSESSMENT OF CAUSE(S)
Taxpayers who want to extend only their gift tax account are directed, in the Form 709 instructions, to send a letter with an explanation to the appropriate IRS office. Nevertheless, taxpayers send extension requests with payments "for gift tax only" to lockbox banks. Lockbox employees are not authorized to approve these extension requests because, unlike the income tax extension request (Form 4868), an extension request "for gift tax only" is not automatic. Form 4868 does not have a place to include the required explanation.

CORRECTIVE ACTION(S)
We will not change our procedures to instruct lockbox employees to completely process "for gift tax only" extension requests.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL(S)
N/A

RECOMMENDATION/FINDING #8
Ensure that the Service Center Monthly Lockbox Performance Report used by the lockbox coordinators conforms to the exhibit in IRM 3.0.230-1 (01-01-00). This report requires the lockbox coordinator to record a separate figure for Forms 4868 involving gift tax payments and extensions processed at lockbox sites.

ASSESSMENT OF CAUSE(S)
The Service Center Monthly Lockbox Performance Report did not show separate figures for the volume of extensions involving gift tax accounts and the associated gift tax payments that Lockbox processed.

CORRECTIVE ACTION(S)
We are revising the Service Center Monthly Lockbox Performance Report for January 2001 to include separate Form 4868 volumes for gift tax. Additionally, at the 2000 Lockbox Conference held in August, the lockbox banks were instructed to begin reporting Form 4868 volumes for gift tax separately.

IMPLEMENTATION DATE
Proposed: February 1, 2001

RESPONSIBLE OFFICIAL(S):
Director, Wage and Investment Submission Processing

RECOMMENDATION/FINDING #9
Instruct the lockbox coordinators and the quality reviewers assigned to review lockbox processing to determine whether payments and extensions were applied to the correct taxpayer's accounts (individual and business) during their reviews of Forms 4868 when gift tax extensions and/or gift tax payments are involved.

ASSESSMENT OF CAUSE(S)
It appears from the number of errors found by TIGTA that lockbox coordinators and quality reviews for lockbox processing did not identify the processing problems associated with gift tax payments and extensions.

CORRECTIVE ACTION(S)
New Quality Review Lockbox Measures are being developed for FY 2001. As part of the new measures, we will review the Forms 4868 to determine whether payments and

extensions are being applied to the correct taxpayer's accounts. If the errors are related to a gift tax extension request or the related payment, we will separately annotate them.

IMPLEMENTATION DATE
Proposed: January 2, 2001

RESPONSIBLE OFFICIAL(S)
Director, Wage and Investment Submission Processing

RECOMMENDATION/FINDING #10
Direct the lockbox coordinators to review correspondence both to and from taxpayers involving gift tax accounts as provided for in IRM 3.0.230.6(2)e.

ASSESSMENT OF CAUSE(S):
The IRM reference cited by TIGTA requires lockbox coordinators to review incoming correspondence only during their on-sight visits.

CORRECTIVE ACTION(S):
We do not plan to expand this requirement to cover all correspondence. We will rely on the other improvements we are making to monitor performance and quality.

IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL(S):
N/A

RECOMMENDATION/FINDING #11
Instruct the lockbox depository to perform a review of the Form 4868 during the FY 2001 filing season. Processing payments to the correct accounts is one of their Quality Control Standards.

ASSESSMENT OF CAUSE(S)
The lockbox depository does not perform a separate review of the Form 4868 during the filing season.

CORRECTIVE ACTIONS(S)
The Lockbox Processing Guidelines will include the instructions to be followed when processing Forms 4868 for gift tax. They will not include a separate review for Forms 4868. However, the lockbox banks have agreed to focus on the Forms 4868 processing requirements during training for the FY 2001 filing season.

IMPLEMENTATION DATE
Proposed: January 2, 2001

RESPONSIBLE OFFICIAL(S)
Director, Wage and Investment Submission Processing

MONETARY BENEFITS
The estimated monetary benefits identified in this report appear to be based upon valid assumptions, but we cannot absolutely confirm them.

If you have any questions regarding this response, please call Jimmy Smith, Director Wage and Investment Submission Processing, at (513) 684-6333.