REPORT BY THE

Comptroller General

OF THE UNITED STATES

Compilation Of GAO's Work On Tax Administration Activities During 1981

This report, required by Public Law 95-125, summarizes the results of GAO's work on tax administration activities for 1981. Among other things, the report discusses open recommendations to the Congress from reports issued during and before 1981, legislative action taken during 1981 on GAO recommendations, and recommendations to the Commissioner of Internal Revenue during 1981 as well as IRS' actions taken or proposed to implement them.

GAO/GGD-82-82
JULY 22, 1982

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-137762

The Honorable Dan Rostenkowski
Chairman, Committee on
Ways and Means
House of Representatives

The Honorable Robert Dole
Chairman, Committee on
Finance
United States Senate

The Honorable Robert Dole
Chairman, Joint Committee
on Taxation
Congress of the United States

The Honorable Jack Brooks
Chairman, Committee on
Government Operations
House of Representatives

The Honorable William Roth, Jr.
Chairman, Committee on
Governmental Affairs
United States Senate

This is the fifth annual report on our work in the tax administration area. The report is submitted in compliance with section 4 of Public Law 95-125 and consists of the following enclosures.

(1) Open recommendations to the Congress from reports issued during 1981.

(2) Open recommendations to the Congress from reports issued before 1981.

(3) Legislative action taken during 1981 on recommendations.

(4) Recommendations to the Commissioner of Internal Revenue during 1981.

(5) Reports on tax administration matters issued during 1981.

(6) Testimony given by GAO officials during 1981 before various committees of the U.S. Congress.

(7) Scope and subject matter of reviews initiated during 1981 pursuant to Public Law 95-125.

(8) GAO order relating to safeguarding tax returns and return related information and procedures followed when undertaking reviews at the Internal Revenue Service and the Bureau of Alcohol, Tobacco and Firearms.

We are pleased to report that IRS has taken, or plans to take, positive action on most of our recommendations made during 1981. We look forward to continuing to work closely with the Congress to assist it in considering our legislative recommendations.

We would be glad to discuss any of the matters included in the enclosures if you, your colleagues, or staff believe it would be beneficial.

Charles A. Bowsher

Comptroller General
of the United States

ENCLOSURE I

OPEN RECOMMENDATIONS TO THE CONGRESS

FROM REPORTS ISSUED DURING 1981

NEED FOR CONGRESS TO ENSURE THAT THE TREASURY AND JUSTICE DEPARTMENTS DEVELOP A STREAMLINED LEGAL REVIEW PROCESS FOR CRIMINAL TAX CASES

GGD-81-25
B-201235
4-29-81

Summary of finding

IRS seeks to promote voluntary compliance with the tax laws by treating taxpayers in an equitable manner and by achieving a balanced criminal tax enforcement program aimed at deterring would-be violators. However, the current legal review process requires that cases be reviewed consecutively by three separate groups of Government attorneys--IRS' District Counsel, the Justice Department's Tax Division, and the cognizant U.S. attorney. This process does not promote IRS' goals because it is time consuming and unnecessarily duplicative. Each year, many taxpayers learn that legal reviewers have declined to prosecute them after they have been subjected to the trauma of a lengthy investigation. Moreover, the impact of successfully prosecuted cases is lessened because the cases often are several years old before they are brought to the public's attention and before the Government can collect past due taxes, penalties, and fines.

The present sequential, postinvestigative legal review process continues to exist despite its time consuming and duplicative nature and IRS' recognition that the Criminal Investigation Division (CID) needs legal assistance during, rather than after, its investigations. The review process seems to be a luxury which the Federal Government can ill afford in light of concern over increased Federal spending and efforts by the executive and legislative branches to balance the Federal budget.

Although the existing legal review process for criminal tax cases clearly needs to be revised, the best means for doing so is not clear. The process can be restructured in various ways. However, any modification should (1) provide a means through which CID can obtain needed legal assistance during its investigations, (2) improve timeliness and eliminate any unnecessary duplication and costs, (3) ensure that criminal tax cases receive a high quality, independent legal review before they are prosecuted, and (4) safeguard the legal rights of taxpayers.

Our analyses of sample cases and discussions with various Federal officials and private sector attorneys enabled us to formulate several alternative approaches to revising the present legal review process. Each alternative has advantages and disadvantages, as well as cost implications; some have more merit than others. For example, one alternative would have District Counsel attorneys carry out ongoing, rather than postinvestigative, legal reviews. That alternative has merit because it would reduce delays in the present legal review process while safeguarding taxpayers' legal rights. CID's productivity would

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increase as attorneys, through early involvement in the investigative process, identify problem cases and/or help ensure efficient development of good cases. Two important IRS goals--equitable treatment of taxpayers and voluntary compliance--would be more effectively promoted. Also, annual recurring cost savings of up to $2.63 million could be realized through the elimination of a postinvestigative review level because fewer District Counsel attorneys would be needed.

Recommendation

We recommended that Congress ensure that the Treasury and Justice Departments develop a streamlined legal review process for criminal tax cases and that any revised system realizes potential cost savings while safeguarding taxpayers' legal rights.

Action taken and/or pending

In December 1981, the Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs, asked Justice and IRS to specify what actions have been taken in response to our recommendation. The Subcommittee has indicated that, depending on the nature of the agencies' responses, it may conduct hearings on the issue. The Subcommittee has received and is analyzing the responses from Justice and IRS.

ENCLOSURE I

CONGRESS SHOULD AMEND THE 1970 BANK SECRECY ACT TO REQUIRE REAUTHORIZATION OF ITS REPORTING REQUIREMENTS

GGD-81-80
B-199000
7-23-81

Summary of finding

After 10 years, the reports required by the 1970 Bank Secrecy Act are not widely used by law enforcement agencies. Further, it is uncertain how well financial institutions and individuals comply with the act's reporting requirements. Until these issues are resolved, there will not be a sound basis for judging whether the act's demands on the private sector are commensurate with the benefits obtained by the Federal Government.

Recent initiatives by the Department of the Treasury and other agencies seek to improve the act's implementation and more widely test the reporting requirements' usefulness. However, there is still no assurance that the act can or will achieve its intended purpose in a cost-effective manner. Unless this can be demonstrated in the next 2 or 3 years, the act's reporting requirements should be repealed.

Recommendation

We recommended that the Congress amend the act to require a reauthorization of its reporting requirements in 1984. On the basis of current progress, we believe Treasury should be able to provide sufficient data by then for the Congress to decide whether the act should be continued, modified, or eliminated.

Action taken and/or pending

None

ENCLOSURE I

LEGISLATIVE CHANGE NEEDED SO THAT IRS CAN REQUIRE CERTAIN INFORMATION FROM U.S. SUBSIDIARIES OF FOREIGN PARENT CORPORATIONS

GGD-81-81
B-202972
9-30-81

Summary of finding

Section 6038 of the Internal Revenue Code authorizes IRS to require that an information return be completed by all U.S. parent corporations showing information on transactions with their foreign subsidiaries. This return must be submitted with the parent corporations' tax returns. In the return, U.S. parent corporations must show the amount of receipts and payments in transactions involving stock in trade, property rights, services, loans, rents, royalties, etc., that occurred between (1) the U.S. parent corporation and each foreign subsidiary, (2) each U.S. subsidiary and foreign subsidiary of the U.S. parent corporation, and (3) each foreign subsidiary.

Foreign-controlled U.S. subsidiaries conduct the same type of transactions with their foreign parents and other controlled corporations of their foreign parents. However, the extent of these intercorporate transactions need not be reported to IRS through the information return.

Consequently, IRS does not have this information available when initially planning the work to be performed during the examination of these corporations. When planning their examination work, international examiners told us that they use the transaction information to identify potential non-arm's length transactions among the controlled corporations. The examiners provide time in their audit plans to analyze such transactions. Not having the transaction data available when beginning the examination delays the planning process and the starting of detailed examination work for international tax issues.

IRS officials expressed the opinion that requiring foreign-controlled U.S. corporations to prepare the information return would not place an added burden on the corporations because the corporations are currently providing similar data in response to examiner's requests. They stated that the need for this information is becoming increasingly important due to the large increase in the number of foreign-controlled U.S. corporations.

Recommendation

We recommended that the Congress amend Section 6038 of the Internal Revenue Code to further provide that every United States person, as presently defined by the code, shall furnish such information as the Secretary may prescribe by regulation with respect to any foreign corporation which controls such person.

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Action taken and/or pending

We informally discussed the thrust of the recommendation with IRS and Treasury officials who had no objection and agreed that legislation was the best solution to the problem.

In testimony before the House Ways and Means Committee on May 18, 1982, we reiterated our recommendation and suggested that it be included in H.R. 6300--the Tax Compliance Act of 1982. That bill currently is under consideration by the House Ways and Means Committee.

ENCLOSURE I

CONGRESS SHOULD AMEND THE INTERNAL REVENUE CODE TO REQUIRE SPONSORS OF TERMINATING PENSION PLANS TO OBTAIN AN IRS REVIEW OF PARTICIPANT PROTECTION REQUIREMENTS BEFORE PLAN DISSOLUTION

HRD-81-117
B-203672
9-30-81

Summary of finding

On the basis of our analysis of pension plan terminations for 1977, we found that plan sponsors for about two-thirds of reported terminating plans were not requesting IRS reviews at the time of termination because such reviews are not mandatory under the Internal Revenue Code. Termination actions were not being reported to the Pension Benefit Guaranty Corporation which is responsible for insuring participants' benefits. Thus, at the time of termination there is no assurance that, for many such plans, the participants are adequately protected as required by the Employee Retirement Income Security Act and the Internal Revenue Code.

Recommendation

We recommended that Congress amend the Internal Revenue Code to require sponsors of terminating pension plans to obtain an IRS review of participant protection requirements before plan dissolution.

Action taken and/or pending

None

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OPEN RECOMMENDATIONS TO THE CONGRESS

FROM REPORTS ISSUED BEFORE 1981

ENCLOSURE II

MANDATORY TAX WITHHOLDING RECOMMENDED FOR AGRICULTURAL EMPLOYEES

GGD-75-53
B-137762
3-26-75

Summary of finding

Both the Federal Government and agricultural employees would benefit from a system of mandatory withholding of Federal income tax from wages earned by agricultural employees. Deduction of Federal taxes would not significantly burden employers because the reports now required to meet the social security reporting and payment requirement would also be used to report and pay taxes withheld.

Recommendation

We recommended that the Congress revise chapter 24 of the Internal Revenue Code of 1954, as amended, to include remuneration received as agricultural wages in the Federal income tax withholding system.

Action taken and/or pending

On April 7, 1981, H.R. 3104, a bill which would accommodate our recommendation, was introduced and referred to the Subcommittee on Social Security, House Ways and Means Committee. No further action was taken during the year.

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OCCUPATIONAL TAXES ON THE ALCOHOL INDUSTRY SHOULD BE REPEALED

B-137762
1-16-76

Summary of finding

Taxpayer compliance with alcohol-related occupational tax laws has dropped below acceptable levels, and enforcement by the Bureau of Alcohol, Tobacco and Firearms is not adequate. Although additional manpower in this area would undoubtedly increase both revenues and compliance, the overriding question is not whether there should be increased enforcement but whether the tax itself ought to be continued. On balance, repeal of the occupational taxes appears preferable to increased enforcement. The lost revenue could be recouped, if desired, by an almost infinitesimal increase in the excise tax on alcohol.

Recommendation

We recommended that the Congress (1) repeal all occupational taxes in sections 5081 through 5148 of the Internal Revenue Code on retail and wholesale dealers in distilled spirits, wines, and beer; manufacturers of nonbeverage alcoholic products; brewers; manufacturers of stills and rectifiers and (2) amend the Federal Alcohol Administration Act to clarify the authority of the Bureau of Alcohol, Tobacco and Firearms to investigate possible consumer and/or unfair trade practice violations of the act prior to a permit hearing.

Action taken and/or pending

Sections 5081 through 5084 were repealed, effective January 1, 1980. However, the other sections relating to occupational taxes remain in effect and should also be repealed. The Treasury Department contends that the taxes should be retained because, among other reasons, they serve as a means for determining compliance with various Federal laws.

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SELF-EMPLOYMENT INCOME REPORTED FOR CREDIT TOWARD SOCIAL SECURITY BENEFITS ALTHOUGH TAX NOT PAID

B-137762
8-09-73
and
GGD-77-78
8-08-77

Summary of finding

IRS reports to the Social Security Administration the amount self-employed persons designate on their income tax returns as self-employment income even though such persons may not have paid the applicable self-employment social security tax. The self-employed person thus receives credit toward social security benefits even if that person has not made the required contribution.

Recommendation

We recommended that the Congress amend section 205(c) of the Social Security Act (42 U.S.C. 405(c)) to prohibit a person from receiving credits toward social security benefits if that person has not paid the required tax on self-employed income.

Action taken and/or pending

During the 95th Congress, the Chairman of the Ways and Means Oversight Subcommittee introduced H.R. 12565, the "Self-Employment Tax Payments Act of 1978," which contained the substance of our recommendation. However, no action was taken on the bill.

In 1979 the Chairman of the Ways and Means Oversight Subcommittee reintroduced the bill which was renumbered as H.R. 5465 and was referred to the Subcommittee on Social Security. The Subcommittee did not take action on the bill during the 96th Congress. No further action was taken during 1981.

NEED FOR LEGISLATIVE SOLUTION TO THE PROBLEM OF DETERMINING WHETHER AN INDIVIDUAL IS AN EMPLOYEE OR SELF-EMPLOYED

GGD-77-88
B-137762
11-21-77

Summary of finding

We determined that there is a need for a legislative solution to the problem of determining whether an individual is an employee or self-employed independent contractor. One of the reasons IRS, employers, accountants, lawyers, and other advisors have difficulty making these determinations is that the common law rules relied upon to define employee and self-employed are general and open to broad and inconsistent interpretation. As a result, IRS often disagrees with an employer's determination that an individual is an independent contractor. When this occurs the following can happen:

--Employers can be retroactively assessed employment taxes for those years not subject to the statute of limitations.

--Double taxation can occur when the employer and employee pay income and social security taxes on the same income.

--Self-employment (Keogh) retirement plans established by individual taxpayers can be declared invalid with all contributions and income earned thereon becoming taxable in the current year.

Recommendation

We recommended that the Congress amend section 3121 of the Internal Revenue Code to exclude separate business entities from the common law definition of employee in those instances where they

--have a separate set of books and records which reflect items of income and expenses of the trade or business,

--have the risk of suffering a loss and opportunity of making a profit,

--have a principal place of business other than at a place of business furnished by the persons for whom he or she performs or furnishes services, and

--hold themselves out in their own name as self-employed and/or make their services generally available to the public.

In addition, we recognized that there may be some situations where a worker is able to meet some but not all of the

above criteria and still have a valid basis for being considered self-employed. In these circumstances some type of common law criteria should be applied but not unless there is evidence that the worker's situation tends toward being one of a self-employed individual.

Accordingly, we recommended that the Congress amend section 3121 of the Internal Revenue Code to require separate business entities to meet three of the four criteria noted in the previous recommendation before using common law criteria to determine employment status. If the independent contractor cannot meet at least three of the criteria, we recommended that he or she be considered an employee.

To avoid unnecessary burdens on those businesses that elect to or must obtain the services of independent contractors, we further recommended that the Congress amend the Internal Revenue Code to provide that, with the exception of fraud, IRS cannot make retroactive employee determinations in those cases where businesses (1) annually obtained a signed certificate from the persons they classify as self-employed stating that they meet all separate business entity criteria and (2) annually provided IRS with the name and the employer identification or social security number of all such certificate signers. The certificate should be signed by the contractor under penalty of perjury and in a form approved by the Secretary of the Treasury.

Action taken and/or pending

In 1979, the Select Revenue Measures Subcommittee of the House Ways and Means Committee cleared H.R. 5460 which would have (1) provided five "safe harbor" tests for determining whether a worker is an independent contractor or an employee and (2) instituted a 10 percent withholding rate on all independent contractors. No further action was taken on the bill.

However, on September 18, 1980, the Chairman, House Ways and Means Committee introduced a bill (H.R. 8156) prohibiting IRS from issuing regulations on reclassifying independent contractors as employees until January 1, 1984. The Congress subsequently enacted the bill but changed the expiration date to June 30, 1982.

In January 1981, the Senate Finance Committee Chairman introduced a bill (S-8) containing the same five safe harbor tests as H.R. 5460, but not containing the withholding requirement. The Chairman expected the measure to be considered and acted upon before the moratorium on IRS reclassification action expired. However, no further action was taken during 1981.

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During the second session of the 97th Congress, several bills were introduced relating to the classification of workers as either employees or self-employed for Federal tax purposes.

For example, S. 2369 was introduced by the Chairman of the Senate Finance Committee on April 14, 1982, as the "Independent Contractor Tax Classification and Compliance Act of 1982." This bill would ease the problems associated with classifying workers as employees or independent contractors and would strengthen information reporting and penalties with respect to independent contractors. A similar bill, H.R.6311, was introduced in the House on May 6, 1982. Neither S. 2369 nor H.R. 6311 would require withholding. An earlier House bill, H.R. 5867, introduced on March 17, 1982, as the "Independent Contractor Tax Act of 1982," would provide alternative standards for determining whether individuals are not employees for purposes of the employment taxes and would also provide a 10 percent withholding requirement on payments made to independent contractors.

On April 26, 1982, in testimony on S. 2369 before the Subcommittee on Oversight of the Internal Revenue Service, Senate Finance Committee, we reiterated the need to clarify the rules for determining employer-employee relationships. We pointed out that while there are some differences between S. 2369 and our recommendations on the worker classification issue, the proposed legislation would accomplish the overall purpose of clarifying the circumstances under which a worker should be classified as an employee or an independent contractor.

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NEED FOR CHANGE IN LAW TO PROVIDE FICA-SECA OFFSET

GGD-77-88
B-137762
11-21-77

Summary of finding

When IRS determines that an individual is an employee instead of an independent contractor it assesses the employer for social security taxes that should have been withheld from amounts paid even though the employee had paid self-employment social security taxes. As a result, social security taxes are frequently collected twice on the same income.

Unless the statute of limitations has expired, IRS is precluded by the Internal Revenue Code from reducing the social security tax assessed under the Federal Insurance Contributions Act by any social security taxes the employees have paid under the Self-Employment Contributions Act. This is because the self-employment tax was technically paid in error and the employees could seek refunds of the tax payments. Generally, however, they have not sought to recover such payments.

Recommendation

We recommended that the Congress amend section 6521 of the Internal Revenue Code to authorize IRS to reduce the employees' portion of social security taxes assessed against employers by an appropriate portion of the self-employment social security taxes paid by reclassified employees for the open statute years.

Action taken and/or pending

In December 1979, H.R. 5460 was reported to the House Ways and Means Committee. This bill would have provided criteria for determining independent contractor status and required withholding on compensation paid to certain independent contractors. Such provisions would reduce the potential for controversy between IRS and taxpayers regarding the determination of who is an independent contractor but would not obviate the need for offset authority such as we recommended. No action was taken on the bill during the 96th Congress.

During the second session of the 97th Congress, several bills were introduced relating to the worker classification issue. As of May 31, 1982, however, none of the bills addressed the need for offset authority such as we recommended. On April 26, 1982, we testified on Senate bill 2369 before the Senate Finance Committee's Subcommittee on Oversight of the Internal Revenue Service. During the hearing, we pointed out that the proposed bill would not eliminate the need for IRS reclassifications and retroactive tax assessments and that problems associated with those actions would continue to exist. We proposed that some

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further legislative and administrative changes would be needed particularly to reduce the potential for double taxation in the event of reclassification. In this regard, we reiterated the need for legislation to allow FICA-SECA offset.

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NEED TO CHANGE REQUIREMENT THAT GOVERNMENT MUST PURCHASE SEIZED PROPERTY AT A SALE AT THE MINIMUM BID PRICE

GGD-78-42
B-137762
7-31-78

Summary of finding

The Government may be required to purchase seized property which may not be in its best interest. This is because section 6335(e)(1) of the Internal Revenue Code now provides that

> "* * * if no person offers for such property at the sale the amount of the minimum price, the property shall be declared to be purchased at such price for the United States * * * ."

It is possible that seized property has a saleable value but that it would not be in the Government's best interest to purchase it. For example, the property may require a substantial investment to repair or clear the title before it can be used or resold. Under such circumstances, the law should be clarified to give IRS the option of either buying the property for the Government or returning it to the taxpayer.

Recommendation

We recommended that the Congress amend section 6335(e)(1) of the Internal Revenue Code to provide that if no person offers to purchase property at a sale at the minimum bid price, the property shall be declared to be purchased at such price for the United States or released back to the taxpayer if IRS determines it is not in the best interest of the Government to purchase the property. Such a determination must be made by IRS prior to the sale on the basis of criteria developed by the Commissioner of Internal Revenue.

Action taken and/or pending

None

ENCLOSURE II

CHANGES NEEDED IN THE TAX LAWS GOVERNING THE EXCLUSION FOR SCHOLARSHIPS AND FELLOWSHIPS AND THE DEDUCTION OF JOB RELATED EDUCATIONAL EXPENSES

GGD-78-72
B-137762
10-31-78

Summary of finding

Section 117 of the Internal Revenue Code, pertaining to the exclusion of scholarships and fellowships, and Treasury regulations section 1.162-5, pertaining to the deduction of job related educational expenses, are difficult to understand and sometimes confusing. As a practical matter, it is virtually impossible for IRS or the courts to apply the many tax computation rules of these two provisions in an even-handed manner because the rules make taxability depend upon innumerable precise factual determinations not relevant to considerations of ability to pay. The rules are focused more on the niceties of refining the definition of net taxable income than on according equal treatment to taxpayers similarly situated.

The result is that taxpayers who protest deficiencies on the basis of disallowing the exclusion under section 117 or the deduction under regulations section 1.162-5 are often propelled to pursue their cases through the administrative appeals process and through litigation quite as much by a sense of personal injustice as by a wish to minimize taxes.

The courts, confronted with a large volume of educational tax litigation which is trivial and time consuming, have expressed impatience with the legal uncertainties created by section 117 and regulations section 1.162-5. Judges frequently have recommended that section 117 be amended to clarify the tax status of educational grants where the element of compensation is present to some extent. Judges have also criticized the bias of the educational expenses deduction regulations in favor of teachers and professors.

Recommendation

We recommended that the Congress amend section 117 of the Internal Revenue Code and add a new educational expense deduction section. We proposed specific legislative language for each.

Action taken and/or pending

None

ENCLOSURE II

DELINQUENT TAXPAYERS DUE REFUNDS ARE NOT PENALIZED FOR FILING LATE

GGD-79-69
B-137762
7-11-79

Summary of finding

Section 6651(a) of the Internal Revenue Code does not encourage nonfilers due refunds to file on time because they are not penalized for filing late. Late filing penalties are assessed only on nonfilers who owe taxes.

Recommendation

We recommended that the Congress consider alternative ways to amend section 6651(a) of the Internal Revenue Code to provide for a similar late filing penalty on nonfilers due refunds as is presently imposed on nonfilers who owe taxes.

We also recommended that the Congress should request the Commissioner of Internal Revenue to provide a series of alternative ways for imposing charges on nonfilers due refunds.

Action taken and/or pending

On March 11, 1982, Senate bill S. 2198, the "Taxpayer Compliance Improvement Act of 1982," was introduced. If enacted, the proposed legislation would adopt our recommendation by requiring a new minimum penalty for the extended failure to file any income tax returns. We supported this provision in testimony given on March 22, 1982, before the Subcommittee on Oversight of the Internal Revenue Service, Senate Finance Committee.

S. 2198 is currently under consideration by the Senate Finance Committee.

ENCLOSURE II

THE PERSONAL CASUALTY AND THEFT LOSS TAX DEDUCTION REGULATIONS ARE COMPLEX AND RESULT IN INEQUITIES

GGD-80-10
B-137762
12-05-79

Summary of finding

Both taxpayers and tax administrators have difficulty understanding and applying the Treasury regulations governing the deduction of personal casualty and theft losses. The result is that the tax relief afforded by the deduction is erratic and unrelated to financial capacity to pay an income tax. Further, there is evidence that the provision lends itself to fraud and abuse.

Recommendation

We recommended that the Congress reassess the need to retain the personal casualty and theft loss provision (section 165(c)(3) of the Internal Revenue Code) in its present form.

We also suggested that, in making such a reassessment, the Congress could consider several alternatives.

--Repeal the personal casualty and theft loss deduction on the ground that it is inherently inadministrable.

--Repeal the personal casualty and theft loss deduction and allow a deduction for all or a percentage of the cost of premiums for casualty insurance covering real property and personal effects.

--Amend the statutory personal casualty and theft loss deduction provision to limit the allowable loss to an amount in excess of a stated percentage of adjusted gross income, restrict the category of loss events and loss property, repeal the netting rules of section 1231, and treat an excess casualty or theft loss as a net long-term capital loss carryforward.

--Amend the Treasury regulations to limit the recognized loss to the amount of realized loss attributable solely to the casualty or theft.

Action taken and/or pending

None

ENCLOSURE II

NEED FOR CONGRESS TO RECONSIDER DISCLOSURE LIMITATIONS SET FORTH IN 1976 TAX REFORM ACT

GGD-78-110
B-137762
3-12-79
and
GGD-80-76
B-199000
6-17-80

Summary of finding

Through the Tax Reform Act of 1976, the Congress tightened the rules governing disclosure of tax information, thereby affording taxpayers increased privacy. However, the disclosure provisions also affected coordination between IRS and other members of the law enforcement community.

Coordination with Department of Justice attorneys has been affected by the fact that IRS is restricted in certain situations from alerting attorneys that it has tax information that may be of value to them in their role as Federal law enforcement coordinators. Coordination with the law enforcement community in general has been hampered by limitations on IRS' ability to disclose information about non-tax criminal and civil matters. The evidence in support of these problems was limited to a few examples, however, and thus the extent to which the disclosure provisions adversely affected law enforcement coordination--and particularly prosecution and conviction rates--was unknown.

Recommendation

In our March 1979 report, we recommended that the Congress may wish to

--consider whether the adverse impacts on Federal law enforcement warrant revision of the legislation and

--determine whether any revision can be made without disrupting the balance between criminal law enforcement and individuals' rights.

Action taken and/or pending

In December 1979, the Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, held hearings on IRS' role in the war against narcotics traffickers. The disclosure provisions were discussed by various witnesses including the Comptroller General. Our March 1979 report was made part of the record. During the hearing, we stated that some changes could probably be made to the provisions to allow IRS, with appropriate controls, to alert law enforcement agencies of pertinent criminal-related information it may have. We made some specific proposals in this regard.

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In January 1980, the Chairman of the Permanent Subcommittee on Investigations introduced three bills--S. 2402, S. 2404, and S. 2405--which, if enacted, would have substantially revised the disclosure provisions. Similar bills were introduced in the House of Representatives. We analyzed the bills in detail, and in June 1980, issued a report to the Chairman of the Subcommittee on Treasury, Postal Service, and General Government, Senate Committee on Appropriations, recommending various changes to the bills. Shortly thereafter, we testified before the Subcommittee on Oversight of the Internal Revenue Service, Senate Committee on Finance.

Senate bill 2402 was amended to incorporate some of our suggested revisions and reintroduced in the 97th Congress as Senate bill 732 and House bill 1502. Although S. 732 was passed by the Senate in July 1981, it did not survive the House/Senate conference on the Economic Recovery Tax Act. The conferees, however, called for a reexamination of the disclosure issue. Subsequently, we testified before the Subcommittee on Oversight of the Internal Revenue Service, Senate Finance Committee, and the Oversight Subcommittee, House Ways and Means Committee, in November and December 1981, respectively. Basically, we recommended enactment of S. 732 with certain modifications. We also analyzed S. 1891, the Administration's legislative proposal, which closely tracked S. 732 but contained several variations.

The tax writing committees reevaluated Senate bills 732 and 1891 and House bill 1502 and developed a compromise legislative proposal for consideration during the second session of the 97th Congress. In this regard, similar bills were introduced in the Senate (S. 2565) and the House (H.R. 6475) on May 25, 1982. These bills, if enacted, would fully accomplish the intent of our recommendations.

ENCLOSURE II

NEED FOR CONGRESS TO CONSIDER REVISING THE SUMMONS PROVISIONS OF THE 1976 TAX REFORM ACT

GGD-78-110
B-137762
3-12-79
and
GGD-80-76
B-199000
6-17-80

Summary of finding

The summons provisions of the Tax Reform Act of 1976 require IRS to notify the affected taxpayer after issuing a summons to a third-party recordkeeper. The taxpayer then has 14 days to stay compliance, that is, to order the recordkeeper not to comply with the summons. If IRS initiates court action to enforce the summons, the taxpayer can intervene in the court proceeding.

Both IRS and the Department of Justice expressed concern that many taxpayers who stay compliance with third-party summonses fail to intervene in the summons enforcement procedure. In considering solutions, both agencies referred to the Right to Financial Privacy Act of 1978 (title XI of Public Law 95-630, Nov. 10, 1978).

Like the summons provisions of the Tax Reform Act, the Right to Financial Privacy Act calls for an individual to be notified when a government agency seeks access to financial records through an administrative summons. The Right to Financial Privacy Act makes it more difficult, however, for the affected individual to stay compliance with the summons. Justice concluded that the rules pertaining to IRS summonses should be no different than the rules pertaining to summonses issued by other agencies and that the Congress should consider amending the Internal Revenue Code accordingly.

Because our review was limited to summonses issued under the Tax Reform Act of 1976 and the Right to Financial Privacy Act had only recently been enacted, we did not compare the effectiveness of the different procedures for staying compliance. We noted, however, that the idea of using the stay of compliance procedure mandated by the Right to Financial Privacy Act for IRS summonses had merit and should be considered by the Congress.

Recommendation

We recommended that the Congress might want to monitor the use of the stay of compliance procedure under the Right to Financial Privacy Act and consider whether the adoption of similar provisions for IRS summonses would be appropriate.

Action taken and/or pending

In December 1979, the Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, held hearings on IRS' role in the war against narcotics traffickers. The summons provisions were discussed by various witnesses including the Comptroller General. Our full report was inserted in the record by the Subcommittee Chairman.

In January 1980, the Chairman of the Permanent Subcommittee introduced S. 2403, which, if enacted, would implement our recommendation. A similar bill was introduced in the House of Representatives. We analyzed S. 2403 in detail, and in June 1980, issued a report basically supporting the bill to the Chairman of the Subcommittee on Treasury, Postal Service, and General Government, Senate Committee on Appropriations. Shortly thereafter, we testified before the Subcommittee on Oversight of the Internal Revenue Service, Senate Committee on Finance. The bill, however, was not enacted.

During the 97th Congress, two bills have been introduced, either of which, if enacted, would implement our recommendation. On January 29, 1981, the Chairman of the House Committee on Ways and Means introduced H.R. 1501, which would provide a stay of summons provision similar to that used under the Right to Financial Privacy Act. We testified in support of the bill in an April 26, 1982, hearing before the Subcommittee on Oversight, House Ways and Means Committee. The Chairman of the House Committee on Ways and Means introduced similar provisions on May 6, 1982, as part of a broader compliance-related bill, H.R. 6300. We also supported the summons provisions of that bill in testimony given on May 18, 1982, before the House Ways and Means Committee.

ENCLOSURE II

EMPLOYEE STOCK OWNERSHIP PLANS SHOULD BE ESTABLISHED FOR THE BENEFIT OF EMPLOYEES

HRD-80-88
B-199055
6-20-80

Summary of finding

The Employee Retirement Income Security Act of 1974 requires that Employee Stock Ownership Plans, as tax-qualified plans, be established and operated exclusively for the benefit of participants and their beneficiaries. Our analysis of Plan transactions showed that most were not being operated in the best interest of participants. Specifically, one or more of the following problems that could affect participants' benefits were present in each of the closely held company plans reviewed.

--The companies sold or contributed company stock to their Plans at questionable prices. These were based on appraisal valuations which lacked independence and/or did not properly consider relevant factors, such as earning capacity, book value, comparability with similar companies, and marketability. If the transactions in company stock were for more than fair market value, they (1) were prohibited transactions under the act of 1974 and subject to an excise tax, (2) could mislead participants about the value of their Plan account, and (3) could increase the amount on which participants would ultimately pay income tax.

--Participants were not assured of a market for company stock distributed by the Plan. The act requires that Plans invest primarily in employer securities, but regulations do not generally require the employer to repurchase stock distributed to participants.

--Participants generally were not permitted to vote or direct the voting of company stock allocated to their Plan accounts. Rather, a Plan committee usually appointed by the employer, voted the Plan company stock without formal direction from the participants.

Recommendation

We recommended that the Congress enact legislation to

--provide that full and unrestricted voting rights be passed to Plan participants for all employer stock allocated to their accounts and

--require Plan provisions for redeeming, at fair market value, all company stock distributed by the Plan.

Action taken and/or pending

None

ENCLOSURE III

LEGISLATIVE ACTION TAKEN

DURING 1981 ON RECOMMENDATIONS

ENCLOSURE III

PENALTY IS NEEDED FOR TAXPAYERS WHO FALSELY CLAIM TAX DEPOSITS ON EMPLOYMENT TAX RETURNS

GGD-78-14
B-137762
2-21-78
and
GGD-81-45
B-202720
4-28-81

Summary of finding

Employers are required to deposit employment taxes--income tax withheld and social security tax--periodically through the Federal Tax Deposit System. Employers who claim fictitious tax deposits on their quarterly tax returns cause delays in IRS' identification of the delinquency and ultimately in any collection actions.

We estimated that 31 percent of sampled delinquent taxpayers had claimed fictitious deposits and delayed collection action by an average of 64 days. Although IRS has attempted various procedural changes to eliminate the problem, it has not been very successful.

Recommendation

We recommended that the Commissioner of Internal Revenue pursue the enactment of a civil penalty--possibly as much as 25 percent of the fictitious deposits--on employers who claim fictitious deposits on their employment tax returns.

Action taken and/or pending

The 97th Congress passed a law (Public Law 97-34) requiring a 25 percent penalty of fictitious deposits claimed by employers and the President signed it on August 13, 1981. The enacted penalty is severe enough to significantly reduce the number of fictitious deposit claims. Not only will this reduce IRS' administrative workload, but it will make it much easier for IRS to identify otherwise delinquent taxpayers. The result should be quicker collection of taxes through more timely payments by taxpayers or through faster identification of delinquent taxpayers and ultimate collection of taxes by IRS.

ENCLOSURE III

LEGISLATIVE CHANGE NEEDED TO ELIMINATE THE REQUIREMENT FOR A DECLARATION OF ESTIMATED TAX

GGD-80-61
B-196969
5-8-80

Summary of finding

Section 6015 of the Internal Revenue Code requires taxpayers to make a declaration of estimated tax if they meet certain eligibility requirements. IRS has developed a declaration-voucher for taxpayers to use in complying with this requirement. When IRS receives an estimated tax payment, it uses the information on the declaration-voucher to credit the taxpayer's account. If a taxpayer elects to use an overpayment of tax for the preceding year as a credit against current year tax pursuant to section 6513(d) of the code, and if the amount of the credit equals or exceeds the estimated tax payment(s), the taxpayer must still file a declaration of estimated tax but does not have to enclose a remittance.

Once a taxpayer makes a declaration of estimated tax by filing the first declaration-voucher, subsequent vouchers need be filed only when making installment payments of the tax. This apparently is confusing to many taxpayers because IRS regularly receives subsequent declaration-vouchers which are not accompanied by remittances. IRS has no need for, and thus routinely destroys, all declaration-vouchers which are not accompanied by remittances.

This situation does not exist for corporate taxpayers. In 1968, the requirement that corporations file declarations of estimated tax was eliminated with the repeal of sections 6016 and 6074 and the amendment of section 6154 of the code. We are not aware of any administrative difficulties caused by this simplification of the estimated tax payment procedure for corporations.

Recommendation

We recommended that the code be amended to remove the requirement that individual taxpayers make declarations of estimated taxes.

Action taken and/or pending

We drafted a proposed amendment and submitted it to the Joint Committee on Taxation. In addition, we informally discussed the thrust of the amendment with IRS and Treasury officials who had no objection and agreed that legislation was the best solution to the problem.

On June 12, 1980, a member of the Senate Committee on Finance introduced a bill, S. 2825, which contained our proposed amendment in its entirety. However, the bill did not pass.

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The Economic Recovery Tax Act of 1981 (Public Law 97-34) increased the tax liability threshold for payment of estimated taxes from $100 to $500 over a 4-year period beginning with taxable year 1982. Individuals whose tax liability in excess of withholding does not exceed the threshold amount would not be required to declare or pay estimated tax nor would they be penalized for underpayment of estimated tax. While this does not fully accomodate our recommendation, it should, nevertheless, alleviate some of the problems we identified.

ENCLOSURE III

NEW FORMULA IS NEEDED TO CALCULATE INTEREST RATE ON UNPAID TAXES

GGD-81-20
B-200489
10-16-80

Summary of finding

By statute the interest rate charged on delinquent taxes was calculated at 90 percent of the prime interest rate and was adjusted every 2 years. This formula failed to properly reflect the Government's costs of borrowing money and credit administration. As a result, we estimated that during fiscal year 1979 alone the Government was deprived of about $206 million in interest charges. Also contributing to an interest rate well below the market rate was the timelag for making adjustments. During 1979 the Government's interest rate was set at 6 percent while the prime interest rate fluctuated from about 12 percent to 16 percent, and taxpayers would have had to pay between 12 and 30 percent to borrow money.

Equally important to the concept of the Government receiving fair compensation is the inherent value of charging interest as an incentive for taxpayers to pay their taxes on time. When the interest rate formula was established, the Congress noted that the rate resulting from the formula should encourage taxpayers to pay their taxes promptly. Using these procedures for calculating an interest rate for unpaid taxes during a time of generally rising interest rates, however, has not encouraged taxpayers to pay promptly and may even discourage payment. According to the Commissioner of Internal Revenue, the low and stable interest rate has served as a source of inexpensive loans for delinquent taxpayers and is responsible, in part, for IRS' increasing delinquency problem.

Recommendation

We recommended that the Congress amend the Internal Revenue Code to require IRS to establish

--an interest rate reflecting the prevailing Government borrowing rate plus a factor for administrative expenses and

--semiannual adjustments of the interest rate stated to two decimal places and restricting changes to 0.25 percent or more.

Action taken and/or pending

The 97th Congress passed a law which the President signed on August 13, 1981, prescribing a new method to calculate the interest rate. The new rate is set at 100 percent of the prime and adjustments are to be made annually. While this method falls

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short of adopting our proposal, it nevertheless is an improvement and should be a positive step toward correcting weaknesses.

On March 11, 1982, Senate bill S. 2198, the "Taxpayer Compliance Improvement Act of 1982," was introduced and referred to the Senate Finance Committee. That bill would, among other things, require that all interest payable under the Internal Revenue Code be compounded semiannually. Thus, the interest computation rules would follow standard commercial practices, and, to that extent, incorporate our proposal. On March 22, 1982, we testified in support of this provision before the Subcommittee on Oversight of the Internal Revenue Service, Senate Finance Committee.

ENCLOSURE IV

RECOMMENDATIONS TO THE COMMISSIONER OF INTERNAL REVENUE DURING 1981

ENCLOSURE IV

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IRS NEEDS TO IMPROVE ITS HANDLING OF UNDELIVERED INCOME TAX REFUND CHECKS

GGD-81-71
B-202443
4-10-81

Summary of finding

As of December 1980, IRS had on its computer files 87,760 accounts for individuals with undelivered refund checks amounting to $24.5 million. The most common cause of undelivered refund checks, according to IRS, is individuals moving and not furnishing the Postal Service with a forwarding address.

In a previous report (FGMSD-77-9, August 4, 1977) we recommended that IRS make lists of individuals due undelivered refund checks available to the news media, particularly newspapers, to aid the Service's efforts in locating these people.

This followup report evaluated IRS' efforts in getting such lists published in newspapers and found IRS' efforts among its district offices were mixed. Most districts displayed little effort in getting such lists published in their local newspapers. In addition, IRS' national office and central regional office did not monitor the efforts and results of the district offices in getting lists published.

Recommendation

We recommended that the Commissioner require routine monitoring of IRS districts' efforts in getting newspapers to publish lists of individuals entitled to undelivered refund checks and measure the effectiveness of these lists in getting checks delivered to rightful individuals.

Action taken and/or pending

IRS concurred with our recommendations and said it would take more active measures in distributing the lists to newspapers. Since the issuance of our report, the national office has begun to routinely monitor district offices' efforts to promote appropriate publicity. Beginning in FY 1982, each region is required to provide additional, more specific information on the publication of undelivered refund lists.

IRS is also attempting to develop a system which will provide the information necessary to measure the effectiveness of the publication of lists of undelivered refund checks.

NEED FOR A STREAMLINED LEGAL REVIEW PROCESS FOR CRIMINAL TAX CASES

GGD-81-25
B-201235
4-29-81

Summary of finding

IRS seeks to promote voluntary compliance with the tax laws by treating taxpayers in an equitable manner and by achieving a balanced criminal tax enforcement program aimed at deterring would-be violators. However, the current legal review process requires that cases be reviewed consecutively by three separate groups of Government attorneys--IRS' District Counsel, the Justice Department's Tax Division, and the cognizant U.S. attorney. This process does not promote IRS' goals because it is time consuming and unnecessarily duplicative. Each year, many taxpayers learn that legal reviewers have declined to prosecute them after they have been subjected to the trauma of a lengthy investigation. Moreover, the impact of successfully prosecuted cases is lessened because the cases often are several years old before the Government can collect past-due taxes, penalties, and fines.

The present sequential, postinvestigative legal review process continues to exist despite its time consuming and duplicative nature and IRS' recognition that the Criminal Investigation Division (CID) needs legal assistance during, rather than after, its investigations. The present review process seems to be a luxury which the Federal Government can ill afford in light of concern over increased Federal spending and efforts by the executive and legislative branches to balance the Federal budget.

Although the existing legal review process for criminal tax cases clearly needs to be revised, the best means for doing so is not clear. The process can be restructured in various ways. However, any modification should (1) provide a means through which CID can obtain needed legal assistance during its investigations, (2) improve timeliness and eliminate any unnecessary duplication and costs, (3) ensure that criminal tax cases receive a high quality, independent legal review before they are prosecuted, and (4) safeguard the legal rights of taxpayers.

Our analyses of sample cases and discussions with various Federal officials and private sector attorneys enabled us to formulate several alternative approaches to revising the present legal review process. Each alternative has advantages and disadvantages, as well as cost implications. Some have more merit than others. For example, one alternative would have District Counsel attorneys carry out ongoing, rather than postinvestigative, legal reviews. That alternative has merit because it would reduce delays in the present legal review process while safeguarding taxpayers' legal rights. CID's productivity would

increase as attorneys, through early involvement in the investigative process, identify problem cases and/or help ensure efficient development of good cases. Thus, two important IRS goals--equitable treatment of taxpayers and voluntary compliance--would be more effectively promoted. Also, annual recurring cost savings of up to $2.63 million could be realized through elimination of a postinvestigative review level because fewer District Counsel attorneys would be needed.

Recommendation

We recommended that the Attorney General and the Commissioner of Internal Revenue jointly develop a streamlined legal review process for criminal tax cases.

Action taken and/or pending

Justice reevaluated its policies and procedures and significantly revised its legal review process as of January 1, 1981. Nevertheless, Justice is only one of the agencies involved in the legal review of criminal tax cases.

IRS recognized the need to consider ways to improve the quality and availability of legal assistance at the investigative level. However, it specified no action plan for responding to our recommendation except to state that its Chief Counsel would try to (1) provide more timely, effective assistance to CID and (2) shorten its review time.

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TAX TABLE HEADING CHANGES RESULTED IN INCREASED RETURNS PROCESSING COSTS

GGD-81-84
B-202441
6-19-81

Summary of finding

Beginning with tax year 1976, IRS changed the column headings on the tax table pursuant to the Tax Reform Act of 1976 (Public Law 94-455). This act increased the tax table ceiling from "less than" $10,000 income to income that "does not exceed" $20,000. IRS officials told us that to ensure that taxpayers with exactly $20,000 in taxable income were covered by the tables, the column heading wording was changed from "at least" to "over" and from "but less than" to "but not over."

Although IRS considered this a minor change, it had a major impact on the processing system. IRS officials told us that due to the tax table heading changes, IRS had to transcribe the cents from many more lines of the forms 1040A and 1040, and supporting schedules, when processing individual income tax returns. This was necessary for IRS to determine the proper tax bracket for taxpayers whose income was within $0.99 of a break in the tax tables.

Because IRS makes extensive use of automated processing to analyze and store tax return information, the need to transcribe cents data from additional tax return lines imposed a heavy burden on major segments of the returns processing system. For example, it increased the workload of direct data entry operators who transcribe data from tax returns to magnetic tape. We estimated that as a result of the 1979 column heading change, IRS made an additional 992 million keystrokes in calendar year 1981 at a total cost of about $1.3 million.

Processing tax returns is a significant part of IRS' operating costs. To reduce these costs IRS should only transcribe cents from the minimum number of lines necessary to verify tax liabilities and the refund or balance due. In this regard, we believe that the column heading change unnecessarily increased processing costs.

Recommendation

We recommended that the Commissioner reinstate the pre-1976 wording for the 1981 tax table column headings except for taxpayers whose adjusted gross income is exactly $20,000 and proceed with the necessary modifications to the returns' processing procedures.

Action taken and/or pending

IRS agreed with our recommendation and has reinstated the pre-1976 wording on tax table column headings for 1981 tax year returns and is making the necessary modifications to the returns' processing procedures.

ENCLOSURE IV

IMPROVEMENTS NEEDED IN PROCEDURES FOR DETECTING ILLEGAL TAX PROTESTERS

GGD-81-83
B-203682
7-8-81

Summary of finding

IRS established a nationwide program to identify illegal tax protesters. Through this program, IRS has identified an increasing number of illegal tax protesters each year. However, weaknesses in certain of its detection procedures allow certain illegal tax protesters to escape detection.

IRS could identify more illegal tax protesters through its nonfiler program by performing annual delinquency checks on previously identified illegal tax protesters and by identifying returns with questionably large contribution deductions. Other protesters could have been identified had IRS personnel been properly trained in existing detection procedures.

Recommendation

We recommended that IRS

--routinely determine whether persons detected through the nonfiler program were protesters,

--conduct an annual delinquency check on previously identified protesters to verify that filing requirements were met and the proper tax assessed and paid,

--develop a service center computer program to identify returns with large charitable contributions and establish procedures for questioning those contributions before making refunds or accepting the return as filed, and

--provide appropriate personnel sufficient training on protester identification procedures.

Action taken and/or pending

IRS said it now requires that an attempt be made to determine if the nonfiler is a tax protester. Cases so identified are supposed to be worked expeditiously in light of the facts in the case.

IRS said that procedures for performing annual delinquency checks are being implemented, and subsequent year returns of previously identified protesters will be scrutinized by its examination personnel.

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To better identify returns with questionably large charitable contributions, IRS said that it is exploring a number of alternatives, and selected service centers are conducting test studies to identify returns through computer application.

With respect to the training of IRS personnel, IRS said that it has developed a special training package covering illegal tax protesters. It has also produced an illegal tax protester video tape addressing protester identification skills among other aspects of the overall protester movement. The video tape was designed for and is being shown nationwide to all taxpayer contact employees and firstline managers as part of organized training efforts. In addition, IRS has established a task force to develop a protester course for IRS' continuing professional education training. This course is intended to be a mandatory 8-hour session for technical employees of the Examination Division.

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IMPROVEMENTS NEEDED IN SERVICE CENTER PROCEDURES FOR ACCUMULATING AND TRANSMITTING TAX PROTESTER INFORMATION TO DISTRICT OFFICES

GGD-81-83
B-203682
7-8-81

Summary of finding

Most protester returns or documents are identified at IRS service centers. These records are then mailed out to district offices along with other returns to be worked. Eventually the protester case is assigned to a district office employee who decides what additional records are needed and requests them usually from the service centers. Protester cases should be given priority over other cases. However, the processing of protester cases was delayed because they were mixed with other nonpriority cases. As a result, district personnel assigned to the case had to stop working until additional records were obtained from the service center.

Recommendation

We recommended that IRS

--have service center personnel accumulate a file of all pertinent data from the various data files within IRS and

--specially handle protester documents being shipped from the service centers to district offices.

Action taken and/or pending

IRS established procedures whereby the service center's illegal tax protester team accumulates a file of information, including prior year returns, on each identified illegal tax protester. In addition, IRS established procedures to special handle cases being forwarded from service centers to district offices.

IRS said it is also considering whether to establish a computer data base for illegal tax protesters in order to expedite cases.

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PENALTIES NOT ASSESSED AGAINST PAID PREPARERS INVOLVED WITH TAX PROTESTER RETURNS

GGD-81-83
B-203682
7-8-81

Summary of finding

IRS has the authority to assess a penalty against a paid preparer for preparing false or inaccurate tax returns such as those filed by an illegal tax protester. Our review showed that a preparer penalty was not assessed even though paid preparers were involved in 199 of the 3870 cases in three districts.

Recommendation

We recommended that when a protester case involved a paid preparer, IRS should expeditiously assess, where appropriate, a penalty against the preparer.

Action taken and/or pending

IRS told us that it was using preparer penalties on tax protester cases when appropriate. IRS said, however, that the imposition of a preparer penalty may be delayed pending (1) the receipt and examination of other returns prepared by the same preparer which would show a pattern of noncompliance or (2) the conclusion of a criminal investigation against the taxpayer or preparer.

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PROGRAM MANAGERS NEEDED
TO DIRECT PROTESTER PROGRAM

GGD-81-83
B-203682
7-8-81

Summary of finding

The tax protester program suffers from a lack of authoritative management direction and attention at the national, regional, and district office levels. Rather than designate a program manager in each of these offices, IRS established coordinator positions in each of its compliance divisions and its Exempt Organizations Division at each office level. None of the coordinators, however, have any authority over the protester program except within their respective divisions. Overall program direction and attention is important because protester cases often cross two or three functional lines and the cases become subject to normal managerial and supervisory priorities and controls within each function.

Recommendation

We recommended that IRS establish a working group in each district to handle protester and other special compliance cases and designate one district official with responsibility and authority for cutting across functional lines. We also recommended that similar positions should be established at the national and regional office levels.

Action taken and/or pending

IRS disagreed with this recommendation. IRS said that the establishment of such a group which would cut "across functional lines" would be disruptive to the existing organizational structure and would jeopardize effective tax administration. IRS believes the district director (who has the capability to cut across functional lines) is in the best position to determine priorities in the district consistent with National program directives.

EXAMINATION OF TAX PROTESTER RETURNS NEEDS TO BE EXPEDITED

GGD-81-83
B-203682
7-8-81

Summary of finding

Many illegal tax protester cases were delayed for months or remained open in the examination phase because illegal tax protesters are usually uncooperative and refuse or delay providing the records needed to complete the examination. It is essential that the examination phase be completed because the case cannot proceed through other phases such as appeals and collection. Another important reason to complete the examination phase is that the taxpayer is placed in the position of defending why IRS' proposed assessment is incorrect.

IRS can counter taxpayer delays in providing records by obtaining income information from other sources, such as employers, and preparing a substitute tax return for the tax protester. We found, however, that this procedure was not being used as frequently as possible.

For those protesters using the family estate trust scheme, IRS has enough information available on the return filed to prepare a substitute return without even contacting the taxpayer. In most cases, however, it waits for the tax protester to bring in requested documents. In other schemes where the taxpayer's records are essential to the completion of the examination, IRS may have to summon the taxpayer. However, it has not provided its examination personnel guidance on how long to wait on the taxpayer to furnish the requested records before starting the summons process.

Recommendation

We recommended that IRS

--prepare substitute tax returns based on information available from other sources such as employers, when protesters are uncooperative,

--provide explicit guidance to examination and appeals personnel regarding how family estate trust cases should be expeditiously handled, and

--establish criteria on the time it will allow for protesters to provide records before issuing a summons.

Action taken and/or pending

IRS agreed with the need to prepare substitute returns for uncooperative protesters. However, no action was considered

necessary because IRS believes that adequate use was being made of this procedure.

IRS issued new procedures for handling family estate trust returns on March 13, 1981, after we completed our audit work. Therefore, we did not determine whether these new procedures cause a more expeditious completion of the examination of such returns.

IRS disagreed with our recommendation regarding summons issuance criteria because flexibility was considered more important in assessing actions to be taken on a case in light of all extenuating circumstances and facts.

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BETTER MANAGEMENT INFORMATION NEEDED FOR PROTESTER PROGRAM

GGD-81-83
B-203682
7-8-81

Summary of finding

IRS relies principally on the fragmented management information systems of each of its compliance activities to manage the protester program. It has no overall protester management information system. Consequently, IRS does not have adequate staff and calendar day information for resource allocation purposes, sufficient information to assess the results of the program, and adequate information to track protester cases from division to division.

Recommendation

We recommended that IRS develop more comprehensive management information for use in planning, allocating resources, and making other strategic decisions relative to the illegal tax protester efforts.

Action taken and/or pending

IRS generally feels that its management information systems provide adequate data for the Criminal Investigation Division and the Examination Division. However, IRS said that its Collection Division has recently proposed a new system to provide required statistics concerning illegal tax protesters which can be used for resource planning as well as providing the Congress and Treasury with information concerning collection activities in the protester area.

IRS said its Collection Division had planned to implement this comprehensive management information system by April 30, 1982. However, implementation has been delayed indefinitely because IRS' Data Center advised that it does not have the equipment or the staff to implement the system.

ENCLOSURE IV

IRS NEEDS AN OVERALL PLAN FOR DEALING WITH PROTESTERS

GGD-81-83
B-203682
7-8-81

Summary of finding

Presently, IRS has no overall plan or strategy for protesters that attempts to maximize deterrent effect while consuming a minimum of resources. While IRS has designated it a priority program and devoted increasing resources to it, the protest movement continues to grow.

IRS needs to work with the Justice Department and the Federal court system in developing an overall plan because of their role in criminal and civil litigation against protesters. In recent years, IRS and Justice have been coordinating their efforts on cases involving certain schemes. While IRS and Justice are moving in the right direction, no efforts are being directed at developing an overall plan or strategy.

Recommendation

We recommended that IRS develop, with input from the Justice Department, an overall plan for dealing with illegal tax protesters.

Action taken and/or pending

IRS contends that there is an established and ongoing liaison with the Department of Justice on tax protesters. IRS said however, it will continue to work closely with Justice to improve planning and coordination.

ADDITIONAL OPPORTUNITIES TO USE THE PUBLIC MEDIA TO DEAL WITH PROTESTERS

GGD-81-83
B-203682
7-8-81

Summary of finding

Section 6103(k)(3) of the Internal Revenue Code allows IRS to disclose tax return information or any other information necessary to correct misstatements of fact provided such disclosure is authorized by the Joint Committee on Taxation. Although protest leaders publicly make false claims, IRS has not attempted to use the provisions of section 6103(k)(3) to counter these false claims.

Recommendation

We recommended that IRS, on a test basis, seek Joint Committee approval under code section 6103(k)(3) to disclose taxpayer return information or other information to correct misstatements of fact.

Action taken and/or pending

IRS has developed a proposal for securing approval from the Joint Committee on Taxation. As of May 31, 1982, the proposal was with the Commissioner pending his approval, after which it will be forwarded to the Joint Committee on Taxation for its approval.

A COMPLIANCE EVALUATION OF BANK SECRECY ACT REPORTING REQUIREMENTS IS NEEDED

GGD-81-80
B-199000
7-23-81

Summary of finding

Among other things, the Congress envisioned that the data required to be kept and reported under the Bank Secrecy Act of 1970 would be very useful to law enforcement agencies and IRS in investigating the financial resources connected with illegal activities. In addition, the Congress made it clear that (1) the reporting and recordkeeping requirements imposed by Treasury should not unduly burden legitimate commercial transactions and (2) the cost of implementing and administering the requirements should not outweigh benefits to law enforcement.

After 10 years, the question of whether the act has achieved its expectations and whether its associated costs are justified is still unanswered. Beyond a few publicized cases, the usefulness of Bank Secrecy Act reports as an investigative tool is yet to be demonstrated or assessed. In our April 1979 report on currency and foreign account reports, we recognized the need for evaluation of the Bank Secrecy Act reports' usefulness. We recommended that Treasury conduct such an evaluation and requested that the Congress reconsider the need for reporting requirements if they are found not to be useful.

Despite our earlier recommendation, no meaningful assessment of the reports' usefulness has been performed. It was not until February 1980 that the Customs Service, IRS, and Treasury signed a memorandum of understanding providing for a study of the usefulness of the Currency Transaction Reports. Customs assumed responsibility for monitoring usefulness of the forms to agencies other than IRS. IRS agreed to monitor the usefulness of the forms to its enforcement efforts.

Recommendation

We recommended that the Secretary of the Treasury establish a system to obtain the data necessary to make a comprehensive assessment of the costs and benefits of the act's reporting requirements.

Action taken and/or pending

Treasury told us that IRS' Collection Division plans to test the usefulness of the Currency Transaction Report (Form 4789), Report of International Transportation of Currency or Monetary Instruments (Form 4790), and the Report of Foreign Bank and Financial Accounts (Forms 90-22.1) in four large districts with significant Customs activity over a 6-month period. The IRS Examination Division is developing a plan to canvass all regions

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and extract report data on cases under examination. The canvass will include between 3,000 and 4,000 open Special Enforcement Program cases (i.e., narcotics traffickers, labor racketeers, organized crime subjects, etc.).

Treasury expects the above actions to provide a basis for evaluating the usefulness of currency transactions report information in these areas. IRS hopes to accomplish these actions by September 30, 1982.

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A COORDINATED POLICY FOR IMPOSING PENALTIES FOR NONCOMPLIANCE WITH BANK SECRECY ACT REPORTING REQUIREMENTS IS NEEDED

GGD-81-80
B-199000
7-23-81

Summary of finding

Treasury has not yet developed a coordinated policy for imposing penalties for noncompliance with the Bank Secrecy Act's reporting requirements. From the beginning, the vague implementing regulations inhibited the use of civil penalties for noncompliance. Additionally, guidance dating back to October 1972 stressed that agencies should use discretion in recommending civil penalties and that each agency should attempt to obtain voluntary compliance with Treasury regulations. It was not until October 1980 that Treasury's Assistant Secretary for Enforcement and Operations sent a memorandum to the bank regulatory agencies articulating a tougher policy. In that memorandum, he stated his determination to scrutinize every violation and to impose civil penalties even against financial institutions which undertake corrective action subsequent to having been found in noncompliance.

Officials of agencies with delegated compliance monitoring responsibilities believe Treasury's guidance for imposing penalties on banks which fail to comply with the reporting requirements has been vague. Treasury's Bank Secrecy Act program administrator agreed that these agencies should be provided more extensive guidelines including examples of situations that should be referred to Treasury for civil penalties or criminal investigations. Recently, Treasury officials expressed disapproval because some bank examiners included in their examination reports opinions which suggested a lack of criminality or willfulness by some banks at which violations were detected. The examiners' opinions were contradictory to Treasury's assessment of the situation, but because they were documented by the examiner, Treasury was precluded from taking further action. Bank regulatory and Treasury officials subsequently met in an effort to develop better guidelines on imposing civil penalties.

Recommendation

We recommended that the Secretary of the Treasury work with the financial institution regulatory agencies in developing a workable compliance enforcement policy specifying penalties to be applied for noncompliance.

Action taken and/or pending

Treasury told us that in July 1981, IRS mailed a Bank Secrecy Act "Compliance Package" to all federally insured banks

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and savings and loan associations. This package provided financial institutions with information and material designed to advise the banks and employees of the reporting and filing requirements of the act.

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TAX ADMINISTRATION EMPLOYEES NEED BETTER INFORMATION TO COMPLY WITH THE POST-FEDERAL EMPLOYMENT RESTRICTIONS	GGD-81-87 B-197223 9-15-81

Summary of finding

Compliance with the restrictions on the post-Federal employment activities of former Justice and Treasury Department, including IRS, employees who work in private tax practice can be difficult. The restrictions, imposed by Federal statute, Treasury Department regulations, and professional codes of ethics, apply under various circumstances and are complex. Difficult judgments may be required to apply the restrictions in specific situations. Violations of the restrictions could occur if former tax administration employees are unaware of or do not understand the restrictions on their postemployment participation in tax matters.

Although the Justice and Treasury Departments expect their employees to comply with the restrictions, the agencies' effort to inform employees of the restrictions before they leave Government service have been minimal and inconsistent. Thus, the amount of information that separating tax employees receive depends on the individual.

We found that of 83 former employees surveyed, 71, or 86 percent, were involved in Federal tax-related work. Of those 71 former employees, 31, or 44 percent, had not received any postemployment restriction information from their former agencies. In addition, 29 of the 71 former employees, or 41 percent, had received some postemployment information but had not been informed of all of the restrictions that they needed to be aware of in light of their postemployment activities. Finally, less than half of the employees who had received postemployment information thought that the information would be helpful for complying with the restrictions if they faced a potential conflict-of-interest situation.

Recommendation

We recommended that the Attorney General and the Secretary of the Treasury

--require separating employees to certify that they have read, understand, and will comply with the restrictions and

--develop a postemployment manual that former employees could consult to determine if their participation in a tax matter would violate a postemployment restriction.

We also recommended that the Secretary direct the Commissioner of Internal Revenue to (1) emphasize the restrictions at employee conduct seminars and (2) revise IRS' power of attorney form to state that the person initiating the form is aware of the restrictions applicable to former tax administration employees and their associates.

Action taken and/or pending

The Justice Department disagreed with our recommendation that it adopt a certification procedure but agreed to consider requiring separating employees to acknowledge receipt of post-employment materials. At the Treasury Department, IRS and Chief Counsel employees are required to certify that they have read, understand, and will comply with the employee conduct regulations which refer to the postemployment statute. Treasury disagreed that this certification requirement should encompass the restrictions imposed by its regulations and professional codes of ethics because most former employees in private tax practice are attorneys and certified public acccuntants who are presumed to be grounded in principles of professional responsibility and to have the ability to understand the restrictions. Treasury also disagreed that the certification requirements should be extended to the small number of attorneys in its Office of Tax Policy because they are knowledgeable about the subjects and sensitive to possible conflict situations.

The Justice Department said it planned to develop examples of the application of the restrictions in many different types of litigation settings in addition to the tax area. It believed this approach would be more economical, cover a broader spectrum of postemployment problems, and be a more valuable educational tool for all attorneys. The Treasury Department is preparing a comprehensive summary of the postemployment rules for distribution to IRS and tax policy employees.

The Treasury Department said that IRS has a well-established practice of emphasizing postemployment restrictions at employee conduct seminars and has placed recent emphasis on briefing senior officials on the special postemployment restrictions applicable to them. Treasury also said that the instructions to the power of attorney form have been revised to include specific notice that former employees are subject to the restrictions imposed by statute and Treasury regulations.

ENCLOSURE IV

POST-FEDERAL EMPLOYMENT RESTRICTIONS NEED TO BE ENFORCED IN THE TAX SYSTEM

GGD-81-87
B-197223
9-15-81

Summary of finding

Because many of the 16,000 tax attorneys and accountants employed by the Departments of Justice and Treasury, including IRS, leave the Government for tax-related jobs in the private sector, some potential postemployment conflicts of interest are bound to occur. However, the agencies do not know (1) if there are many former employees working in the tax system, (2) if there have been many occasions where former employees faced potential conflicts of interest because of their former Government responbilities, or (3) if conflict of interest situations are being resolved or are resulting in violations of the postemployment restrictions imposed by statute, Treasury regulations, and professional codes of ethics.

The extent to which controls should be imposed to monitor conflicts of interest depends largely on the number of employees who are affected by the postemployment restrictions. We reviewed the agencies' personnel records for 1,893 selected attorney and accountant positions and found that 656 employees had left during the 33-month period from January 1, 1976, through September 30, 1978. Of these 656 employees, 433 employees, or 66 percent, left for private sector jobs and could be affected by the restrictions.

The majority of the personnel records did not contain information on whether the employees' private sector jobs involved working on Federal tax matters. However, a questionnaire that we sent to 87 former employees who left for private sector jobs in fiscal year 1975 and whom we could locate, showed that 71 of the 83 respondents, or 86 percent, were involved in Federal tax work. Of the 71 former employees, 15, or 21 percent, told us that they had an opportunity to participate in matters which had been within their Government responsibilities.

Recommendation

We recommended that the Attorney General and the Secretary of the Treasury develop better information on the scope of the postemployment conflict of interest problem in the tax system. Then, on the basis of this information, we recommended that they determine, establish, and periodically review the level of enforcement needed to reasonably ensure compliance with the postemployment restrictions.

Action taken and/or pending

The Justice and Treasury Departments disagreed with our recommendations primarily because they said our report did not uncover undetected postemployment violations.

We fully agree that the postemployment problem needs to be measured as a prerequisite for determining what type of monitoring system would ensure compliance with the restrictions. However, Justice and Treasury are unwilling to develop this information because they do not believe that postemployment conflicts of interest could be a problem in the tax system. This is in spite of the fact that our review clearly indicated that the potential for problems exists. Since the agencies have not tried to find out what types of conflict situations their former employees face or how frequently these situations occur, they have no basis for their belief. This information, in our opinion, is just as important as the number of violations in considering the level of enforcement action needed. The agencies are in the best position to obtain this information because they are most familiar with the positions and matters that are subject to postemployment conflict situations. With the cooperation of their employees, they can obtain this information with a minimal investment of time and effort.

ENCLOSURE IV

JUSTICE AND IRS NEED UNIFORM POLICIES FOR ENFORCING THE POSTEMPLOYMENT RESTRICTIONS WITH RESPECT TO THE ASSOCIATES OF FORMER EMPLOYEES

GGD-81-87
B-197223
9-15-81

Summary of finding

When a former tax administration employee cannot participate in a tax matter because of a postemployment restriction imposed by statute, agency regulation, or professional code of ethics, his or her associates also are disqualified from the matter because the appearance of a conflict of interest could result. The associates, however, can avoid disqualification by isolating the former employee from the matter involved.

The Justice and Treasury Departments do not administer this isolation requirement in the same manner. Justice requires that certain minimum procedures be followed to isolate the former employee while Treasury permits the associates to participate in the matter at IRS, regardless of the isolation procedures followed. On the other hand, the Justice Department has not issued regulations similar to the Treasury Department's, which disqualify former employees' associates from matters in which the former employee had been involved during negotiations for employment, a situation which Treasury believes creates the appearance of conflict of interest.

The differences in the way the isolation requirement is enforced in the tax system could result in the associates of a former employee being permitted to participate in a matter in one part of the system while their participation in the same matter would be prohibited in another part of the system.

Recommendation

We recommended that the Attorney General and the Secretary of the Treasury establish uniform regulations to enforce the postemployment restrictions that apply to the associates of former employees which

--set forth the minimum procedures that former employees' associates must follow to isolate former employees from participation in tax matters and

--define the situations in which the disqualification of the former employee's associates should stand because isolation of the former employee would not remove the appearance of impropriety.

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Action taken and/or pending

The Justice and Treasury Departments have undertaken discussions with each other relative to the feasibility of establishing uniform regulations. Treasury is considering conforming its regulations to the standards generally applied by the courts.

THE TREASURY DEPARTMENT'S ADMINISTRATIVE DISCIPLINARY SYSTEM HAS NOT BEEN USED TO PURSUE SUSPECTED POSTEMPLOYMENT RESTRICTION VIOLATIONS

GGD-81-87
B-197223
9-15-81

Summary of finding

The Treasury Department's Director of Practice administers the system for disciplining violators of the postemployment restrictions imposed by statute and Treasury regulations. Treasury's Inspector General and IRS' Internal Security Division investigate allegations of misconduct and IRS' Office of Chief Counsel responds to inquiries from former employees concerning their postemployment participation in tax matters. These offices have not coordinated their activities or exchanged information. As a result, (1) possible violations of the postemployment restrictions have not been referred to the Director of Practice for administrative action and (2) potential conflict-of-interest situations have not been followed-up to ensure compliance with the restrictions.

During fiscal years 1978 and 1979, 16 suspected postemployment restriction violations involving former IRS employees were investigated and closed. The Director of Practice was involved in only two of these cases. The Internal Security Division closed six cases declined for criminal prosecution by the Justice Department without referring them to the Director of Practice for administrative action, although information in the case files indicated that the Treasury regulations may have been violated.

In addition, the Director of Practice had not been given responsibility for following up on conflict-of-interest situations identified by the Chief Counsel's office and did not review information provided by former employees' associates to determine if they were in compliance with the Treasury regulations.

Recommendation

We recommended that the Secretary of the Treasury

--direct the Inspector General, Chief Counsel, and Commissioner of Internal Revenue to establish procedures for (1) coordinating their postemployment responsibilities with the Director of Practice and (2) informing him of the conflict-of-interest situations and potential restriction violations that come to their attention;

--give the Director of Practice responsibility for ensuring that the restrictions are not violated in identified conflict-of-interest situations; and

ENCLOSURE IV

--direct the Director of Practice to review information provided by former employees' associates to ensure that they are in compliance with the regulations.

Action taken and/or pending

Treasury said that its ethics program is being reorganized to achieve greater coordination among the different offices having responsibilities concerning postemployment conflict matters and to ensure that all appropriate information concerning potential violations of the rules are reported to the Director of Practice. Treasury also said that discussions have begun between the Director of Practice, the Office of Chief Counsel, the Internal Revenue Service, and the Inspector General to streamline the procedures relative to coordination of information.

Treasury also said that procedures relative to the Director of Practice's reviews of information provided by former employees' associates have been altered in order to achieve greater compliance with the regulations. In addition, changes in the regulations are being considered to provide the Director of Practice with specific authority to disapprove the associates' participation in tax matters when the potential conflict-of-interest situation hasn't been resolved.

ENCLOSURE IV

IRS NEEDS TO DEVELOP BETTER MANAGEMENT INFORMATION AND EVALUATE ITS ENFORCEMENT STRATEGY REGARDING SECTION 482

GGD-81-81
B-202972
9-30-81

Summary of finding

IRS must place itself in a better position to make informed decisions for maximizing the use of its limited resources. To do this, IRS needs to assess its current enforcement strategy for section 482 by using information on (1) the universe and locations of multinational parent corporations and their subsidiaries, (2) the extent that these parents and subsidiaries conduct intercorporate financial transactions, (3) the extent that these transactions may not be in compliance with the arm's length standard, and (4) the extent to which IRS enforcement activities are recouping the tax loss. With this baseline data, IRS will have information on the incidence and magnitude of multinational noncompliance in terms of improper shifting of income. IRS can then reaffirm its present strategy or make an informed decision regarding a new approach. It must then monitor the results of its enforcement activities to adjust its overall strategy if necessary.

Recommendation

We recommended that the Commissioner of Internal Revenue aggregate and analyze existing data from a management perspective, consider ways to get a better measure of noncompliance, and establish procedures for continuously assessing the appropriateness of IRS' section 482 enforcement strategy.

Action taken and/or pending

Agreeing that it should obtain and analyze information from a management perspective, IRS said it intended to expand its ongoing section 482 study to meet this need.

ENCLOSURE IV

IRS NEEDS TO MAKE GREATER USE OF ITS ECONOMISTS IN ENFORCING SECTION 482

GGD-81-81
B-202972
9-30-81

Summary of finding

One way IRS can improve its enforcement of section 482 and the use of its limited resources is by making greater use of its economists. Economists can contribute significantly to the development of successful section 482 adjustments where it is necessary to establish an arm's length price. Their expertise brings an added but necessary dimension to the audit process. Given this, they could productively be involved in the development of all such adjustments.

From a practical standpoint, however, it would seem prudent to establish some criteria for economists' participation in recognition of their limited number, and IRS has in fact established such criteria. While we did not evaluate the appropriateness of that criteria, we noted that the dollar criterion was not met in 50 of the 119 cases in our data base where the adjustment was determined on the basis of comparable uncontrolled transactions or one of the alternative methods. Also, IRS has recognized the importance of economic analysis in section 482 adjustments and is presently conducting a comprehensive education program to encourage examiners to request the assistance of economists. Accordingly, IRS should reassess the appropriateness of its criteria and require mandatory participation by economists in each adjustment that meets the criteria established.

Recommendation

We recommended that the Commissioner of Internal Revenue reassess the appropriateness of IRS' criteria for requesting economists' participation in section 482 adjustments and require that participation be mandatory for all adjustments that meet the criteria established.

Action taken and/or pending

In February 1982, IRS issued manual instructions requiring that requests for "economic assistance" must be submitted in all cases in which 482 adjustments are expected to exceed a certain amount. A staff of IRS economists will develop procedures for generating, analyzing, and coordinating the collection and dissemination of economic information within the IRS examination division.

ENCLOSURE IV

DATA DEVELOPED BY ECONOMISTS SHOULD BE AVAILABLE ON A WIDER SCALE

GGD-81-81
B-202972
9-30-81

Summary of finding

In making audit adjustments, economists develop substantial information about the corporate taxpayer. IRS has found through its industry specialization program that communicating this type of information to audit teams examining corporations with similar operations or products is a highly effective technique. This technique should be expanded beyond the industry specialization program. When developing an adjustment, the economists should determine whether the issue may exist at other corporations. If so, the information should be given to other IRS audit teams examining corporations with similar operations or products.

The economists and the Chief of IRS' Coordinated Program Section agreed that economists could make a valuable contribution by identifying potential issues for examinations at corporations having similar operations or products. They also agreed that in these instances communicating issue-related information developed by economists to case managers and examiners would prove useful. We believe IRS should formalize this process.

Recommendation

We recommended that the Commissioner of Internal Revenue require IRS economists to evaluate whether the information they develop in one examination would be useful in other examinations and establish a procedure for communicating such information to other audit teams which examine corporations having similar operations or products.

Action taken and/or pending

IRS said that it would evaluate its present procedures for communicating information developed by its economists to revenue agents and make changes in these procedures provided that disclosure restrictions are not violated.

ENCLOSURE IV

SAFE HAVEN INTEREST RATE SHOULD REFLECT THE CURRENT COSTS OF BORROWING ON THE OPEN MARKET

GGD-81-81
B-202972
9-30-81

Summary of finding

Section 482 regulations require that interest be charged on loan and advance transactions made by one corporation to another in the same controlled group. The regulations permit the corporation in certain instances to use either a "true" arm's length interest rate or a rate within a "safe haven" range. The true arm's length rate is the rate of interest that would have been charged at the time the indebtedness arose in independent transactions between unrelated businesses. If a corporation charges interest within the safe haven range (at the time of our review not less than 6 and not more than 8 percent), no adjustment is considered necessary provided that the corporation is not in the business of making loans or advances of the same general type as the loan or advance transactions made to the related corporation. If, however, the corporation did not charge any interest or charged a rate which did not satisfy the 6 to 8 percent standard, then the rate used by IRS was 7 percent simple interest. Use of the safe haven interest rate eliminates the uncertainty to the corporation of whether the rate charged will be considered an arm's length rate by IRS. It also provides IRS examiners with a criterion to use in making adjustments without having to identify comparable arm's length rates.

Since 1968, the safe haven interest rate has generally been substantially lower than prime interest rates which more closely reflect the actual cost of borrowing. This disjunction has occurred because the rate was revised only once between 1968 and 1980--a 12-year period. Failure to revise the rate to more closely reflect the prime interest rates normally results in substantially lower interest income reported by U.S. corporations for tax purposes.

Recommendation

We recommended that the Secretary of the Treasury adjust the safe haven interest rate as frequently as necessary to realistically reflect the current costs of borrowing on the open market.

Action taken and/or pending

Treasury agreed in principle with our conclusions and recommendations concerning the need to more frequently adjust the safe haven interest rate. Treasury stated that a change in the current safe haven rate was made on July 1, 1981, and it anticipated that the rate in the future will be adjusted periodically so as

to reflect major changes in interest costs. Treasury added that it had considered the possibility of using a self-adjusting rate but believed such a rate would present problems for taxpayers.

ENCLOSURE IV

FORM 2952 REQUIREMENTS FOR REPORTING STOCK IN TRADE AND LOAN TRANSACTIONS NEED CLARIFICATION

GGD-81-81
B-202972
9-30-81

Summary of finding

As presently worded, the information return (form 2952) contains two requirements for information which do not adequately communicate to a corporation the data that IRS needs. The first requirement involves the reporting by U.S. parent corporations of sales and purchases of stock in trade among their foreign subsidiaries. The second requirement concerns the reporting of intercorporate loan transactions. Multinational corporations can shift income by conducting both types of these transactions at other than arm's length terms. According to the IRS manual, examiners are to review these transactions when examining the U.S. parent corporation's tax return. If non-arm's length transactions are identified, the examiners are to prepare a section 482 adjustment.

U.S. parent corporations report on form 2952 the amounts of receipts and payments in transactions among their foreign corporations. The problem in reporting transactions involving the "sales and purchases of stock-in-trade" stems from a clause on the form which reads "* * * except in the ordinary course of business where neither party to the transaction is a U.S. person." When the subsidiary corporations involved in the transactions are all foreign, the wording of the clause is inadequate as it essentially fails to require reporting of all such transactions. This lack of information on sales and purchases among controlled foreign corporations hampers IRS' efforts and may cause IRS to overlook some section 482 adjustments.

U.S. corporations are also required to report on the form the amounts of receipts and payments involved in intercorporate loan transactions. The problem with this requirement is a clause on the form which reads "* * * other than open accounts which arise and are collected in the ordinary course of business." Thus, corporations are required to report only the amount of loan transactions which were closed during the year. They are not required to report open loan accounts. Without this information, examiners may be unaware of loans which have been outstanding for years. IRS officials believe the lack of loan information hampers their enforcement efforts because they do not get a complete picture of the extent of loan transactions. Examiners must do additional work to identify this information or risk not making necessary adjustments.

Recommendation

We recommended that the Commissioner of Internal Revenue clarify the description of the information that corporations

should report concerning the sale and purchase of stock in trade and intercorporate loan transactions either by revising the form 2952 when current supplies are depleted or by issuing the new consolidated form currently being developed. In the interim, IRS should notify its examiners of the shortcomings in the present form.

Action taken and/or pending

IRS agreed to notify its examiners of form 2952's shortcomings but stated that changing the current wording may require a change to the tax regulations. The need to provide better instruction to both taxpayers and IRS examiners is clear. Thus, we think that IRS should take the necessary steps to fill this need.

ENCLOSURE IV

NEED TO IDENTIFY WAYS TO IMPROVE SECTION 482 ENFORCEMENT

GGD-81-81
B-202972
9-30-81

Summary of finding

Making income adjustments using the arm's length standard has posed administrative burdens on both IRS and corporate taxpayers. Because of the structure of the modern business world, IRS can seldom find an arm's length price on which to base adjustments but must instead construct a price. As a result, corporate taxpayers cannot be certain how income on intercorporate transactions that cross national borders will be adjusted and the enforcement process is difficult and time consuming for both IRS and taxpayers.

Parties affected by and knowledgeable about arm's length adjustments--officials at IRS and Treasury, corporate taxpayers, courts, and experts in the field--have voiced substantive and ongoing criticisms of the section 482 regulations. Treasury's decision in the early 1970s to consider several regulation changes indicates that it recognized the validity of the criticism at that time. Given the continued flow of criticism since then and the continued growth in the number and complexity of intercorporate transactions as compared to IRS' limited resources, it seems to us that the need is even greater now than it was a decade ago for Treasury to consider revising the regulations.

Recommendation

We recommended that the Secretary of the Treasury initiate a study to identify and evaluate the feasibility of ways to allocate income under section 482, including formula apportionment, which would lessen the present uncertainty and administrative burden created by existing regulations.

Action taken and/or pending

Treasury stated that it realizes that the arm's length principle may have both conceptual and practical limitations in a world of integrated firms selling differentiated products. Treasury also said that it has examined and will continue to examine specific problems in the regulations and will propose changes if they appear useful or warranted. Treasury added, however, that it believes additional analysis is necessary before it can conclude that a major review of the regulations is warranted.

IRS SHOULD MAKE MORE COMPLETE REVIEWS OF PENSION PLAN TERMINATIONS

HRD-81-117
B-203672
9-30-81

Summary of finding

IRS reviews of private pension plan termination actions have not assured that terminating plans conform to Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code requirements which are designed to protect participants' benefits. Guidelines for IRS reviews have been fragmented and are often unclear on the purpose or objective to be sought by IRS reviewing officials. As a result, terminating plans have been reviewed and favorable determinations of conformance rendered by IRS without

--having information necessary to determine whether plans are qualified,

--having met requirements established under ERISA and the Internal Revenue Code to protect participant benefits, and

--resolving reported discrepancies or questionable plan operations.

IRS reviews had been completed without adequately addressing (1) inconsistent termination dates reported by pension plan administrators, (2) potentially incorrect asset distributions, (3) discrepancies in reported plan assets or eligible plan participants, and (4) possible loss of benefits by participants after many years of service because of termination of employment. Without further pursuit of these issues through inquiries with plan administrators and participants and requests for substantiating documentation, IRS could not assure that plan participants were treated equitably.

Recommendation

We recommended that the Commissioner of Internal Revenue:

--Establish quality control procedures to ensure that approved termination applications contain all necessary data for making such determinations.

--Establish a level of turnover for reviewers to use in deciding whether to question participant departures before plan termination.

--Identify documentation for reviewers to obtain when questioning possible discriminatory vesting, participant forfeitures, and questionable benefit distributions.

ENCLOSURE IV

Action taken and/or pending

IRS said that it has developed (1) an agency training course covering termination reviews and (2) new procedures for IRS reviewers to use in identifying plan problems and issues to be pursued.

IRS also said that it is developing a Terminations Handbook which is intended to serve as a single source document for use by IRS reviewers when processing plan terminations. IRS said that the handbook is intended to identify (1) what the IRS reviewer should do when information provided by pension plans requesting an IRS determination is incomplete or inconsistent and (2) what additional supporting documentation should be obtained when questionable actions of plan sponsors are identified. IRS issued this handbook to its field personnel on March 31, 1982.

In addition, IRS said that since January 1982, all termination cases processed by IRS' reviewers are required to have a second level of review by IRS' technical staff. IRS also said that for fiscal year 1982, field workplans are required to place increased emphasis on the examination of terminated plans to assure compliance with all qualification requirements, especially those relating to employee benefits.

ENCLOSURE IV

BETTER GOVERNMENT PROCEDURES NEEDED TO IDENTIFY UNREPORTED PLAN TERMINATIONS FOR REVIEW

HRD-81-117
B-203672
9-30-81

Summary of finding

IRS has improved its reviews of terminating private pension plans, but this improvement will not, of itself, assure that the participants of terminating plans are adequately protected. IRS reviews before termination are not mandatory. As a result, thousands of sponsors have elected not to subject their plans to an IRS review at termination or have waited long time periods, even years, after terminating their plans before requesting an IRS review. Delays or inaction reduce the opportunity for identification and correction of plan problems to help assure that participants' benefits are protected. Timing is critical to assure Government and participant involvment in decisions on the distribution of assets.

At termination, plan sponsors may (1) self-determine whether their pension plan actions conform to participant protection requirements of the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code or (2) request IRS to determine whether their actions conform. For plans that conform, plan sponsors and their participants are eligible for preferential tax treatment.

Thousands of pension plans have been terminated since the enactment of ERISA without requesting an IRS review or, in some cases, without notifying the Pension Benefit Guarantee Corporation which is responsible for insuring participants' benefits. The Corporation and IRS initiatives directed at obtaining more accurate and timely data on plan terminations have met with limited success because of difficulties in developing reliable computer data on plans that have terminated and reluctance to use faulty data to contact pension plans to determine their status. These difficulties have militated against the effective use of staff and available resources, and a more coordinated effort using Federal automated records is needed. Requiring pension plans to obtain an IRS review before plan dissolution as a basis for tax qualification should better protect participants' benefits and improve reporting of plan terminations.

Recommendation

We recommended that the Executive Director of the Pension Benefit Guarantee Corporation, in cooperation with the Commissioner of Internal Revenue, use the automated records of both agencies to identify nonreporters of plan terminations.

ENCLOSURE IV

Action taken and/or pending

IRS told us that its Employee Plans Division made initial contact in October 1981 with the Corporation and offered to provide any information from the Employee Plans Master File needed to implement this recommendation. As of May 31, 1982, however, the Corporation had not requested any information from IRS.

ENCLOSURE IV

IMPROVED OVERSIGHT OF PENSION ASSET DISBURSEMENTS COULD INCREASE TAX REVENUE

HRD-81-117
B-203672
9-30-81

Summary of finding

Many employees or their beneficiaries receive one-time lump-sum distributions of plan assets (called pension payouts) before their retirement years when pension plans are terminated, employees terminate employment, or employees become disabled or die. During tax year 1976, the most recent year for which total IRS data were available, about 2 million individuals discontinued participation in pension plans and received an estimated $6 billion in pension payouts. IRS procedures for identifying and processing tax compliance information on recipients of these payments have not been adequate. Pension payouts are taxable when received as ordinary income or capital gains unless the recipient elects to reinvest the sum received in another qualifying pension plan.

Although IRS made $4.3 million in tax assessments for unreported pension payouts in tax year 1976, IRS did not process most of the employer pension payment documents it received. Also, it had not developed a method for assuring that employers are filing required forms. If pension payouts are not processed by IRS for the year received there is little likelihood the one-time payments will ever be reviewed. The full loss from not processing pension payouts could not be determined from IRS records. However, we found that $9.6 million in tax revenues were lost for tax year 1976 alone. Also, because IRS had not developed effective computer matching procedures, IRS resources have been expended unnecessarily to manually screen thousands of individuals' income tax returns to reconcile apparent pension payout reporting discrepancies.

Before tax year 1980, IRS sampled about one-third of the pension payouts reported by employers as ordinary income above certain dollar tolerance levels for comparison with individual income tax returns. Unprocessed forms have been destroyed through tax year 1979. We discussed with IRS the potential for additional tax recovery through full processing of pension payouts. As a result, IRS initiated a program in 1981 providing for full matching of tax year 1980 pension payout filings reported by employers as ordinary income above certain dollar tolerances. We believe this is an important step and that additional tax recovery can be obtained by matching pension payout data reported by employers as capital gains.

Recommendation

We recommended that the Commissioner of Internal Revenue:

--Determine the amount of pension payouts reported by employers as capital gains to employees and whether an effective method to compare such reporting with individual tax returns can be developed. If an effective comparison method cannot be developed, discontinue the employer reporting requirements of pension payouts as capital gains.

--Use relevant reporting areas on individual tax returns, such as a reported rollover, for computer matching with employer pension payout reports to alleviate the need for manual reviews.

--Develop procedures for testing employers' filing compliance on pension payouts by obtaining, on pension plan annual reports, summary information on the number of payouts made above established dollar tolerances during the year to be compared with employer summary miscellaneous income reports.

Action taken and/or pending

To alleviate the need for annual reviews to determine taxpayer compliance with pension payouts, IRS said that it planned to improve the quality of computer matching of pension payouts for ordinary income. In addition, IRS said that it planned on developing procedures, such as a payer master file, to test and assure employer filing compliance on pension payout.

IRS said, however, that it could not begin to determine the amount of pension plan payouts reported by employers as capital gains until 1982. Furthermore, it would not be able to establish an effective method for matching such reports with individuals' tax returns until tax year 1985 because of revisions needed in taxpayer reporting requirements and computer matching techniques. Pending completion of these efforts, IRS does not plan to recommend deletion of the employer reporting requirements concerning capital gains distributions.

ENCLOSURE IV

INADEQUATE MANAGEMENT OF ERISA-REQUIRED ANNUAL REPORT INFORMATION

HRD-82-12
B-204000
10-19-81

Summary of finding

Information required to be reported annually by private pension plans is not being effectively, efficiently, or economically managed. Although complex and voluminous, IRS believes almost all of the required annual report information is critical to administer and enforce the Employee Retirement Income Security Act (ERISA). We found, however, that some plans may not be filing the reports and many of the reports filed are incomplete.

IRS attempted in calendar year 1979 to assure that the plans filed reports. These efforts had to be stopped because large numbers of plan administrators were being questioned about reports they had already filed or did not have to file. IRS unnecessarily contacted a large, but indeterminable, number of plan administrators. These efforts not only wasted IRS resources but irritated plan administrators. IRS unnecessarily contacted plans about reports because they did not use all available information on reports filed or establish controls to ensure that the data they used to identify plans not filing reports were accurate.

When information was missing from reports filed, IRS did not take adequate action to obtain the missing data. Although IRS asks plans to provide some missing report information items, it does not further pursue the information if the plans fail to respond. Further, IRS does not ask plans for most types of missing items. This inadequate followup is the primary cause for at least 78,000 plan year 1977 annual reports (covering over 6 million participants) being accepted by IRS with one or more critical information items missing.

Recommendation

We recommended that the Secretary of Treasury reassess the need for each annual report information item and eliminate the reporting requirement for those not needed to carry out ERISA's overall participant protection goals.

For the annual report information items that are needed, we recommended that the Commissioner implement procedures to assure they are obtained including invoking penalties when plans fail to provide the information.

Action taken

IRS said that it is cognizant of its responsibilty to request only items clearly needed for enforcement activities. IRS said that it endeavored to ensure that only needed items

were included on the forms when they were developed. IRS also said that, in implementing the new triennial filing system for smaller plans, it had thoroughly assessed the need for each item on the forms.

IRS indicated that further assessment of the annual report form information items for larger plans would, to a great extent, be duplicative because many of the items are similar or identical to those on the triennial filing system forms. IRS said that additional indepth consideration of the items should await completion of its compliance measurement program and an analysis of the application of the resultant data to returns being filed. IRS officials told us that such an analysis should be completed in 1984. This, in turn, could result in a revised plan year 1985 form for larger private pension plans to file starting in calendar year 1986.

In agreeing with our recommendation that it implement procedures to obtain missing needed annual report information, IRS said that it recognizes the importance of reasonably complete annual reports to the effective and efficient enforcement of ERISA. IRS commented, however, that it has been lenient in assessing penalties for incomplete forms filed by plans until plan administrators become familiar with complex ERISA legislation and regulations. IRS stated that it recently convened a task force to develop procedures for assessing penalties for incomplete reports and examining those report items deemed essential for compliance with the law and IRS processing. IRS said that a plan's failure to provide key items will result in penalty imposition.

ENCLOSURE IV

INEFFECTIVE MANAGEMENT OF PREMIUM COLLECTION AND REPORTING UNDER ERISA

HRD-82-12
B-204000
10-19-81

Summary of finding

For over 6 years, insured benefit plans have been required to pay premiums to finance insurance programs under the Employee Retirement Income Security Act (ERISA). The Pension Benefit Guarantee Corporation has not made sure that insured plans pay required premiums every year or at all. Apparently, this is because of a reluctance to use data (some of which are inaccurate) for identifying and contacting plans about premiums paid one year but not the next. The inaccurate data on premiums paid resulted from inadequate Corporation controls to assure the data's accuracy. Also, the Corporation did not use the ERISA annual report information for collecting unpaid premiums even though it provides a source for identifying insured plans that have never paid premiums.

IRS' annual report information and the Corporation's premium payment information, although partially inaccurate, can be used for judging how many plans may not be paying premiums. Use of the data indicates that millions of dollars in premiums may have been lost. For example, one of GAO's tests indicated that 16,416 plans paying premiums on about 1.7 million participants in 1976 may not have paid as much as $1.4 million in 1977. Further, a comparison of annual report and premium payment information showed that 33,686 insured plans with about 4.6 million participants may not have paid as much as $3.7 million in 1977 premiums.

Recommendation

We recommended that the Executive Director of the Corporation and the Commissioner of IRS establish and carry out a timetable for IRS to assume responsibility for receipt and processing of both premium collection and annual report information. While these steps are being taken, the Executive Director and Commissioner should undertake a cooperative effort to reconcile differences between the annual report and premium files; and the Executive Director should take action to collect unpaid premiums identified by this effort.

Action taken and/or pending

IRS and the Corporation agreed with the thrust of our recommendation that they take steps for IRS to assume responsibility for receipt and processing of both premium collection and annual report information. IRS said, however, that the recommendation could not be implemented until 1985 or later because of planned changes to its computer system. Because we were concerned about

IRS' open-ended commitment to take action, we included in our recommendations the need for a timetable and interim cooperative action between IRS and the Corporation to help assure that unpaid premiums are collected and duplication is eliminated.

IRS SHOULD STOP GRANTING INSTALLMENT AGREEMENTS WITHOUT DETERMINING TAXPAYERS' ABILITY TO PAY	GGD-82-4 B-137762.45 11-5-81

Summary of finding

IRS offers an estimated 97 percent of the individual delinquent taxpayers who are sent third notices the option to pay through installments without considering their ability to pay. This option is offered by mail before the accounts are sent to district offices for intensified collection action. Many of these taxpayers could fully pay their liabilities thereby eliminating the necessity for IRS to monitor these installment agreements and speeding revenues into the Treasury. For example, an estimated 20 percent of the taxpayers we sampled had incomes exceeding the high-income levels as defined by the Department of Labor. Nearly 15 percent of the taxpayers had sufficient savings to fully pay the tax delinquency. In a limited test where IRS obtained financial information from taxpayers who would have been granted installment agreements, IRS requested full payment from 25 percent of them.

IRS first initiated installment agreements under its policy to be more lenient with first-time delinquents without determining the taxpayer's ability to pay and as a means to reduce the workload of district offices. However, IRS has not taken steps to ensure that only first-time delinquents are given the option. An estimated 38 percent of the taxpayers taking advantage of this program were repeaters. Also, the program has not had any significant effect on reducing district office workloads.

Recommendation

We recommended that IRS discontinue the current program of granting installment agreements by mail without determining the taxpayers' ability to pay except for those accounts which would ordinarily not be sent to a district office for intensified collection action.

Action taken and/or pending

IRS is currently studying the mail program, and, although it presently disagrees with our recommendation, it said it would reevaluate our recommendations when the study is completed.

ENCLOSURE IV

EXAMINATION DIVISION NEEDS TO DO MORE TO ASSIST IN COLLECTING DELINQUENCIES

GGD-82-4
B-137762.45
11-5-81

Summary of finding

Delinquent accounts originating from audits of tax returns pose a significant collection problem. IRS' statistics show that 21 percent of the individual delinquent accounts sent to district offices originated through audits. Our review of 852 currently not collectible cases disclosed that 345, or 40 percent, were audit cases. The high proportion of delinquent accounts resulting from audit is itself a matter of concern. Moreover, the disproportionately high number of currently not collectible delinquencies resulting from audit indicates that such delinquencies are harder to collect than other delinquencies. Thus, the Examination Division should do more to assist in collecting delinquencies resulting from audit.

When the Examination Division reaches agreement with a taxpayer on the results of an audit, it requests payment. However, if the taxpayer indicates an inability to pay, there are no procedures for routinely referring the taxpayer to the Collection Division or for obtaining financial information. If the Examination Division was unable to contact the taxpayer, neither this fact nor information on the number of attempts made to contact the taxpayer is passed on to the Collection Division. IRS does not maintain a tracking system to determine the extent to which audit assessments are classified as currently not collectible. Therefore, neither the Examination Division nor the Collection Division know the full extent of the problem.

Recommendation

We recommended that the Commissioner of Internal Revenue:

--Require the Examination and Collection Divisions to make arrangements for referring taxpayers to Collection or having Examination personnel obtain financial statements from those taxpayers who agree, but are unable, to pay their delinquencies in full.

--Develop a system to code delinquent accounts resulting from audits issued to the field to show whether the delinquency resulted from a no-contact audit.

--Develop a statistical information system for audit-originated cases to be used to determine potential problems and to provide feedback for the Examination Division to show the collection outcome of audit cases.

Action taken and/or pending

IRS generally agreed with our recommendations and is revising the Examination Division's procedures to emphasize that examiners are to solicit advance payment of delinquencies in all completed agreed cases. IRS is also considering procedures to require the Examination Division to make immediate contact with Collection Division personnel for cases meeting a certain dollar criteria. IRS said that its Examination and Collection Divisions will jointly determine the desirability of developing a system for coding delinquent accounts issued to the field to show whether the delinquency resulted from a no-contact audit.

ENCLOSURE IV

IRS NEEDS TO BETTER MANAGE THE INSTALLMENT AGREEMENT PROGRAM

GGD-82-4
B-137762.45
11-5-81

Summary of finding

IRS' use of installment payments as a means to pay delinquent taxes has increased significantly in the past few years. However, IRS has not taken adequate steps to ensure that such payments are used as an effective collection tool.

Although voluntary payroll deductions are considered one of the best means of making payments, IRS has made only limited use of this procedure. Only an estimated 9 percent of the wage earners with installment agreements were using payroll deductions.

Also, IRS has not taken adequate enforcement action when taxpayers missed payments or taken adequate steps to determine the reasons for default. IRS tends to reinstate installment agreements rather than default them--35 percent of the taxpayers with installment agreements missed at least one payment and some missed as many as five payments and each time had their agreements reinstated. Even with this liberal reinstatement policy, 54 percent of the taxpayers ultimately default on their agreements.

Recommendation

We recommended that the Commissioner of Internal Revenue:

--Place more emphasis on the use of payroll deductions as a means to collect the monthly installment payments.

--Establish procedures to better enforce installment agreements before defaulted agreements will be reinstated and give collection employees a guide on acceptable reasons for missed payments.

--Develop an evaluation system that would consider dollars collected, case disposition, and cost of collecting through installments to determine the effectiveness of the program, reasons for defaults, and possible corrective action.

Action taken and/or pending

IRS agreed with our recommendations to better enforce installment agreements and to develop an evaluation system. IRS has already instituted the following procedural changes:

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--A requirement for managerial approval to reinstate agreements when the taxpayer has (1) defaulted on a previous installment payment on the same account or (2) alerted IRS of an inability to make a payment and has been allowed to skip more than two consecutive payments in a 12-month period.

--Guidelines for acceptable reasons for permitting a taxpayer to miss an installment agreement payment.

IRS said its present evaluation system cannot be modified to provide the cost information needed to make the evaluation. Therefore, it agreed to consider developing a new evaluation system which would include factors, such as dollars collected, case disposition, and cost of collecting through installment agreements. The system, if established, could be used to determine the effectiveness of the program, reasons for defaults, and possible corrective actions when its system is completed.

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BETTER DETERMINATION OF COLLECTION FOLLOWUP CODES NEEDED

GGD-82-4
B-137762.45
11-5-81

Summary of finding

When IRS determines through a review of taxpayers' financial information that any payments by the taxpayer would cause undue hardship, the delinquencies can be classified as currently not collectible. To ensure that followup collection action will take place if the taxpayers' financial condition changes, a closing code is selected which represents an income level which would allow the taxpayer to begin making payments. IRS has not established specific guidelines for setting the closing code and we found that 39 percent of the codes were set too high. This precludes prompt followup actions to collect the delinquencies.

Recommendation

We recommended that IRS establish more specific guidelines for setting closing codes for accounts classified as currently not collectible due to financial hardship to ensure that prompt and timely followup is made to collect the delinquent taxes.

Action taken and/or pending

IRS has revised its guidelines for setting closing codes and said that these new guidelines, in conjunction with procedures for mandatory followup, will provide for prompt followup action.

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BETTER DETERMINATION OF TAXPAYERS' ABILITY TO PAY WILL INCREASE COLLECTIONS

GGD-82-4
B-137762.45
11-5-81

Summary of finding

IRS obtains taxpayer financial information to determine whether the taxpayer can pay in full, pay in installments, or not pay anything at the time because it would be a financial hardship. However, this financial information has not always been used to its fullest to determine the most appropriate collection action.

IRS does not adequately

--use equity information to require taxpayers to attempt to secure loans or sell assets to satisfy the tax liability,

--use the amounts shown on the financial statement as a basis for determining whether installment payments can be made,

--verify income or expense items,

--question expense items as to their necessity or reasonableness, and

--review financial statements for mathematical accuracy.

Recommendation

We recommended that the Commissioner of Internal Revenue:

--Develop a guide on the basis of equity in assets, gross income, income over expenses, and amount of tax liability to identify cases with loan potential and require taxpayers meeting this potential to seek loans and provide written documentation of rejections.

--Establish more specific guidelines for employees to use in evaluating and analyzing financial statements including guidelines defining the necessity and amount of expenses.

--Require taxpayers to provide information on credit card expenses to ensure that expenses are not duplicated and are for necessities.

--Require taxpayers to provide proof of income and certain expense items which may be questionable.

--Require employees to use dates when liabilities are paid off in order to increase the amount of installment agreement payments, obtain advance dated installment agreements, or reactivate currently not collectible accounts.

--Develop a more detailed quality review of financial statements to ensure that (1) all information is considered in arriving at the decision to grant an installment agreement or classify the account as currently not collectible and (2) the information is mathematically correct.

--Establish installment payments on the basis of taxpayers' ability to pay regardless of whether the payments cover interest charges and increase payments when possible.

Action taken and/or pending

IRS agreed with our recommendations to improve the use of taxpayer financial information and has taken the following actions:

--IRS has developed two separate financial statements, one for businesses and one for individuals.

--IRS revised procedures and is requesting taxpayers appearing for interviews to bring copies of their latest income tax return as well as other information necessary to establish their financial condition. IRS plans to compare information on the financial statements with the tax returns and other documents provided by the taxpayers. If items on the financial statements appear to be overstated, understated, or out of the ordinary, the taxpayers are asked to explain and substantiate the items.

--IRS has developed instructions on the quality of financial information to be considered by employees who secure and review installment agreements and financial statements.

--IRS is developing better criteria for necessary living expenses.

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IMPROVEMENTS IN OFFICE BRANCH COLLECTION ACTIVITIES COULD REDUCE EXPENSE OF WORKING CASES

GGD-82-4
B-137762.45
11-5-81

Summary of finding

IRS district office collection activities are divided into two operations--office branch and field branch. Delinquent accounts are first worked in the office branches by lower graded employees before they are sent to the field. IRS estimates that the office branches close cases at one-fourth the cost of revenue officers. If cases are not fully worked in the office branches, the higher graded field branch personnel must do the same type of work. An estimated 22 percent of the cases closed as currently not collectible in the field branches could have been closed by office branches. The higher graded field personnel took no action that could not have been taken by office branch personnel, and the accounts were within the criteria for office branches to close.

Recommendation

We recommended that IRS establish more specific guidelines for office branches to use in processing delinquent accounts to ensure that they take all available actions before transferring cases to the field branches.

Action taken and/or pending

IRS agreed with this recommendation and is developing more specific guidelines for office branches to use in processing delinquent accounts.

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IRS NEEDS A FIRM POLICY ON THE USE OF OFFERS IN COMPROMISE

GGD-82-4
B-137762.45
11-5-81

Summary of finding

Although IRS' authority to compromise tax debts dates from the 19th century, the Commissioner has yet to establish uniform criteria to help revenue officers decide when to consider using and when to accept offers in compromise. The use and acceptance of offers thus depends on district office policy and has been limited and inconsistent. Taxpayers initiate offers in compromise usually on their own volition and not on the basis of any suggestion by IRS. IRS has little input into who submits an offer and does not know whether the most qualified taxpayers are submitting offers.

Although IRS recognized the inconsistent use of offers and placed added emphasis on the program beginning in March 1979, little change has occurred. Overall, the number of offers received and the acceptance rate have decreased from fiscal year 1978 through the first half of 1980 when only 820 offers were received and 163 accepted. Use of offers varied considerably among districts. In fiscal year 1979, one large IRS district received 25 offers and accepted 2 while a similar-sized district received 217 offers and accepted 75.

In addition, IRS' procedures for collecting liabilities on offers not accepted have not been very effective. Even after investigations revealed an ability to pay, IRS did not automatically reactivate 90 percent of the accounts that had been previously classified as currently not collectible. Similarly, revenue officers are not always provided financial information developed during the offer investigation to assist in collecting the liabilities. Although IRS determined that 50 of the 103 offers rejected or withdrawn in 1978 in the four districts reviewed were for amounts less than what the taxpayer could pay, IRS collected only 78 percent of the amount offered. In fact, only 17 of 50 taxpayers did pay more than was offered.

Recommendation

We recommended that the Commissioner of Internal Revenue:

--Conduct a comprehensive study to determine the most effective use of offers in compromise and the type of cases where offers should be suggested.

--Establish specific policies and procedures showing when and how compromises should be used as an effective collection tool. These procedures should identify how assets should be evaluated to arrive at a minimum acceptable compromise amount.

--Ensure that IRS' review of currently not collectible accounts includes a procedure to determine if revenue officers are suggesting offers in appropriate cases.

--Evaluate periodically the effectiveness of the compromise program as a collection tool.

--Establish procedures to ensure that financial information developed during the offer investigation is used in followup collection action and that accounts previously classified as currently not collectible are reactivated when financial information indicates that collection is possible.

Action taken and/or pending

IRS agreed with our recommendations and plans to complete a study during fiscal year 1982 to determine the most effective use of offers in compromise and the type of cases where offers should be accepted. IRS has already taken some action by revising its procedures to provide that before a liability is reported as currently not collectible, compromise of the liability will be considered and discussed with the taxpayer in appropriate cases.

IRS said that it intends to revise its procedures to require that a supporting Rejection and Withdrawal Memorandum include detailed financial information developed during the offer investigation and that the detailed financial statement be attached to the delinquent accounts for followup collection action. IRS also said that it will develop a procedure to require that currently not collectible accounts are reactivated when the investigation of the offer shows that further collection is possible.

After completion of the comprehensive study to determine the most effective use of offers in compromise and the type of cases where offers should be accepted, IRS said it intends to issue more specific guidelines on when and how offers in compromise should be used and how assets should be evaluated to arrive at a minimum acceptable compromise amount. This comprehensive study of offers in compromise will also provide for followup reviews of any procedural changes and for periodic evaluations of the offer in compromise program.

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FACTORS CONTRIBUTING TO IRS' INADEQUATE HANDLING OF DELINQUENCIES

GGD-82-4
B-13762.45
11-5-81

Summary of finding

IRS collection activities are impaired by several factors.

First, constant criticisms of IRS' use of its strong collection powers has caused it to change its approach to the collection of delinquent taxes. This trend toward a more lenient approach to collections allows taxpayers to unfairly avoid or delay payment of their delinquencies and may encourage more delinquencies in the future.

Second, IRS has not developed a comprehensive means for evaluating its collection activities. Rather it has relied heavily on a single quantitative measure--case closures--to measure district performance. Relying on a single measure can place more reliance on meeting a goal of closing cases quickly rather than collecting delinquent taxes in the most efficient manner.

Third, IRS is faced with increasing numbers of delinquents and a collection force that is not keeping pace. IRS' efforts to deal with this problem are aimed at reducing the number of delinquent accounts sent to the district offices for collection action. These efforts do not resolve the delinquencies, but only delay and possibly forego collection action. Although more resources may be needed, IRS does not have information on the cost and time it takes to adequately work taxpayer delinquent accounts. Therefore, it is not in a position to determine the number of additional resources it needs.

Recommendation

We recommended that IRS:

--Take strong collection action when appropriate based on more accurate and reliable financial information to resolve delinquencies in the best interest of the Government.

--Establish a more comprehensive means of setting goals and measuring performance, including such criteria as dollars collected and type of disposition.

--Determine what resources are needed to adequately (1) work a delinquent account and ensure accurate and reliable financial information, (2) request the additional resources from the Congress, and (3) inform the Congress of the cases IRS will not be able to work under various staffing levels.

Action taken and/or pending

IRS agreed with our recommendations and said it had various procedural changes underway to ensure that accurate and reliable financial information is available to better resolve delinquency problems.

IRS also said that it plans to develop two new systems to obtain information for evaluation purposes. One system designed to capture the time required to perform certain tasks involved in processing cases was implemented on a test basis on July 1, 1981. Also a DIF (Discriminant Function) scoring system is being developed for case selection and eventual resource allocation. Once the systems are in operation, IRS said it will be able to better evaluate its operations and will have more reliable data to better evaluate resource needs.

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REPORTS ON TAX ADMINISTRATION

MATTERS ISSUED DURING 1981

Title	Date
IRS' Handling of Undelivered Income Tax Refund Checks (GGD-81-71)	4/10/81
Fictitious Tax Deposit Claims Plague IRS (GGD-81-45)	4/28/81
Streamlining Legal Review of Criminal Tax Cases Would Strengthen Enforcement of Federal Tax Laws (GGD-81-25)	4/29/81
IRS Collection Activities in the Area of Organized Crime (GGD-81-74)	5/6/81
Observations Concerning the Internal Revenue Service's Management of Criminal Tax Cases (GGD-81-66)	5/12/81
IRS Can Reduce Processing Costs by Not Transcribing Cents Data from as Many Lines on Tax Returns (GGD-81-84)	6/19/81
Illegal Tax Protesters Threaten System (GGD-81-83)	7/8/81
Bank Secrecy Act Reporting Requirements Have Not Yet Met Expectations, Suggesting Need for Amendment (GGD-81-80)	7/23/81
Potential Problem with Federal Tax System Postemployment Conflicts of Interest Can Be Prevented (GGD-81-87)	9/15/81
IRS Could Better Protect U.S. Tax Interests in Determining the Income of Multinational Corporations (GGD-81-81)	9/30/81
Tax Revenues Lost and Beneficiaries Inadequately Protected When Private Pension Plans Terminate (HRD-81-117)	9/30/81
Better Management of Private Pension Plan Data Can Reduce Costs and Improve ERISA Administration (HRD-82-12)	10/19/81
What IRS Can Do To Collect More Delinquent Taxes (GGD-82-4)	11/5/81

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TESTIMONY ON TAX ADMINISTRATION MATTERS

GIVEN BY GAO OFFICIALS DURING 1981

GAO Official	Congressional Committee	Subject Matter	Date
William J. Anderson, Director, General Government Division	Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations	Federal Government Efforts to Administer the Crude Oil Windfall Profit Tax Act of 1980	4/13/81
William J. Anderson, Director, General Government Division	Subcommittee on Oversight, House Committee on Ways and Means	Adequacy of IRS Compliance Resources for FY 1982	5/11/81
William J. Anderson, Director, General Government Division	Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations	Internal Revenue Service's Efforts Against Illegal Tax Protesters	6/10/81
William J. Anderson, Director, General Government Division	Subcommittee on General Oversight and Renegotiation, House Committee on Banking, Finance and Urban Affairs	Implementation of the Bank Secrecy Act Reporting Requirements	7/23/81
William J. Anderson, Director, General Government Division	Subcommittee on Oversight of the Internal Revenue Service, Senate Finance Committee	Effects of the 1976 Tax Reform Act's Disclosure Provisions on Law Enforcement Activities	11/9/81
William J. Anderson, Director, General Government Division	Subcommittee on Oversight, House Committee on Ways and Means	Whether the Existing Tax Disclosure Statute Strikes a Proper Balance Between Privacy Rights and Law Enforcement Information Needs	12/14/81

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SCOPE AND SUBJECT MATTER OF JOBS INITIATED DURING 1981 PURSUANT TO PUBLIC LAW 95-125

Subject matter	Objective/scope	Month started
Non-Income Based Taxes	To identify issues relating to the administration of employment and excise taxes by IRS and other agencies.	May
IRS' Claims for Reward Program	To evaluate IRS' activities directed at rewarding persons for providing useful information on noncompliers with the tax laws.	May
IRS Distribution of Tax Material	To determine if IRS can reduce the cost of providing tax forms and other tax related documents to the public, as well as processing tax returns that are filed, by changing its document distribution practices and procedures.	July
Overall Taxpayer Assistance	To examine the adequacy of the various types of assistance IRS gives taxpayers in meeting their income tax obligations.	July
IRS' Remittance Process	To determine whether IRS can improve its procedures for processing tax payments to accelerate the availability of such payments for use by the Government.	October
IRS' Unreported Income Program	To determine the effectiveness of IRS' unreported income program and its related activities.	November

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Subject matter	Objective/scope	Month started
Private pension plan liabilities assumed by the Pension Benefit Guaranty Corporation and IRS' responsibility under ERISA	To assess ERISA and Internal Revenue Code provisions governing private pension plan liabilities and related activities.	November
Lump-Sum Settlement Cases	To identify Federal agencies involved in lump-sum settlements and to determine the nature and extent of: --cases handled by those agencies; --withholding by employers making lump sum back pay settlements; --reporting of lump-sum payments by recipients; and --revenue loss to the Government due to nonreporting.	December

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GAO FORM-379 (Aug. 72)

United States
General Accounting Office
Operations Manual

Order

0135.1

AUDITS OF THE INTERNAL REVENUE SERVICE AND THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS INVOLVING ACCESS TO TAX RETURNS AND TAX RETURN INFORMATION

August 25, 1980

Distribution: C, N, R, and S

Initiated by: General Government Division

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August 25, 1980 0135.1

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GAO FORM - 378 (Aug. 72)

United States
General Accounting Office
Operations Manual

Order

0135.1

August 25, 1980

Subject: AUDITS OF THE INTERNAL REVENUE SERVICE AND THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS INVOLVING ACCESS TO TAX RETURNS AND TAX RETURN INFORMATION

1. PURPOSE, SCOPE, AND APPLICABILITY. This order:

a. Provides for delegation of authority, assignments of responsibility, and establishes policies and procedures in carrying out GAO audits of the Internal Revenue Service (IRS) and the Bureau of Alcohol, Tobacco and Firearms (ATF).

b. States policies and procedures that are designed to preclude the unauthorized disclosure of tax returns and tax return information coming into the custody of the U.S. General Accounting Office (GAO) or its employees.

c. Establishes minimum standards governing the transmission, custody, and disclosure of tax returns and tax return information, consistent with the provisions of sections 4424 and 6103 of the Internal Revenue Code.

d. Applies to all GAO organizational elements.

NOTE. References throughout this order to the safeguarding of tax returns and tax return information means the safeguarding of information so as to preclude disclosure of tax returns and tax return information in any form which would enable association with or identification of a particular taxpayer. Nothing in this order shall be construed as authorizing disclosure, dissemination, release, handling, or transmission of tax returns and tax return information contrary to the specific provisions of any law.

2. SUPERSESSION. This order supersedes GAO Order 0135.1, Audits of the Internal Revenue Service and the Bureau of Alcohol, Tobacco and Firearms
* Involving Access to Tax Returns and Tax Return Information, June 27, 1978.

* NOTE. Asterisks have been used to indicate new or revised information.

3. REFERENCES.

a. Public Law 95-125.

b. 31 U.S.C. 67.

c. 26 U.S.C. 7213 and 7217.

Distribution: C, N, R, and S

Initiated by: General Government Division

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d. 18 U.S.C. 1905.

e. Sections 4424 and 6103 of the Internal Revenue Code.

4. DELEGATION OF AUTHORITY.

a. In accordance with the provisions of subsection (d)(3) of section 117 of the Accounting and Auditing Act of 1950 (31 U.S.C. 67) as added by Public Law 95-125, the Comptroller General of the United States will once every 6 months designate in writing the name and title of each officer and employee of GAO who is to have access to tax returns and tax return information, or any other IRS or ATF information in a form which can be associated with or otherwise identify, directly or indirectly, a particular taxpayer.

b. Authority is hereby delegated to the Director, General Government Division (GGD), to make such interim designations in writing of additional persons who are to have access to the information described above as might become necessary in connection with any audit. As in the case of designations made by the Comptroller General, each written designation made by the Director, GGD, or a certified copy thereof, shall be delivered promptly to the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, the Joint Committee on Taxation, the Committee on Government Operations of the House of Representatives, the Committee on Governmental Affairs of the Senate, the Commissioner of IRS, and the Director of ATF.

c. The authority hereby delegated to the Director, GGD, may be redelegated to the Associate Director in charge of tax administration audits.

5. INITIATING AUDITS. The following policies and procedures will apply to audits of IRS and ATF for which access to tax returns or tax return information is required:

a. A tentative assignment authorization (GAO Form 100) will be prepared by the tax administration group approximately 45 days before the planned initiation of audit work at IRS or ATF. This preliminary work authorization will be forwarded to the Comptroller General together with an appropriate letter for his signature, notifying the Joint Committee on Taxation of the audit as required by the provisions of subsection 6103(i)(6)(B) of the Internal Revenue Code.

b. The signed letter will be hand-carried to the secretary of the Chief of Staff of the Joint Committee on Taxation and evidence of receipt obtained showing date and time of delivery.

c. Except where unusual circumstances warrant otherwise, notice of the contemplated audit will be provided to the Commissioner of IRS or the Director of ATF, as appropriate, by furnishing them a copy of the Comptroller General's letter after delivery to the Joint Committee on Taxation.

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d. Upon expiration of 30 days after delivery of the Comptroller General's notice to the Joint Committee without Committee objection or upon receipt of an affirmative response from the Committee to such notice, a letter will be forwarded to the Comptroller General for signature making request of the Commissioner of IRS or the Director of ATF as provided in subsection 6103(i)(6)(A) of the Internal Revenue Code, for access to the tax returns and tax return information required for purposes of the audit.

e. GAO and IRS or ATF will then follow the procedures agreed upon regarding the liaison activities that apply in the conduct of GAO audits, and the GAO staff making the audits will complete final assignment authorizations (GAO Form 100) in accordance with normal GAO policies and procedures.

6. DESIGNATION OF GAO OFFICIALS HAVING ACCESS TO TAX RETURNS AND TAX RETURN INFORMATION.

a. The Comptroller General will, at least every 6 months, designate in writing the name and title of each officer and employee of GAO who shall have access to tax returns and tax return information for the purpose of carrying out audits authorized by Public Law 95-125 and section 6103 of the Internal Revenue Code. The Associate Director in charge of tax administration activities shall be responsible for forwarding to the Comptroller General through the Director, GGD, the names of GAO officers and employees whom the Comptroller General should designate every 6 months. The Associate Director of the General Government Division responsible for tax administration activities shall be responsible for delivering to the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, the Joint Committee on Taxation, the Committee on Government Operations of the House of Representatives, the Committee on Governmental Affairs of the Senate, the Commissioner of IRS, and (when appropriate) the Director of ATF certified copies of the lists of GAO officers and employees authorized access.

b. The Director, GGD, shall be responsible for making interim additions or deletions to the list of GAO officers and employees authorized to have access to tax returns and tax return information, and for advising the committees and officials set forth in paragraph 6a of such interim additions or deletions.

7. SAFEGUARD REQUIREMENTS. The policies and procedures established to preclude the unauthorized disclosure of tax returns and tax return information coming into the custody of GAO depends upon the alertness, reliability, and discretion of every individual who receives tax returns and tax return information. The importance of effective security and of the position of trust imposed upon each individual who has possession, access, or control of such
* information is indicated by (1) the criminal penalties imposed by 18 U.S.C. 1905
* and 26 U.S.C. 7213 which provide for a maximum penalty not to exceed $5,000
* and/or imprisonment of not more than 5 years; and, (2) the authority for obtaining
* civil damages under 26 U.S.C. 7217.

a. Access to and Dissemination and Control of Tax Returns and Tax Return Information. The following principles and requirements will be adhered to in GAO:

(1) Access to tax returns and tax return information shall be limited to those employees of GAO designated by the Comptroller General

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or his designee as having a need for such returns and information in connection with the carrying out of their official duties. No person shall be entitled to knowledge or possession of, or access to, tax returns and tax return information solely by virtue of his office or position.

(2) A listing of individuals designated by the Comptroller General or his designee will be provided to the Commissioner of Internal Revenue or to the Director of the Bureau of Alcohol, Tobacco and Firearms, and to others as required by law.

(3) Tax returns and tax return information shall not be disseminated to or discussed with or in the presence of unauthorized persons.

(4) Any person who has knowledge of the loss or possible compromise of any tax return or tax return information shall promptly report the circumstances to the Comptroller General or his designee who SHALL TAKE APPROPRIATE ACTION FORTHWITH, INCLUDING ADVICE TO THE INTERNAL REVENUE SERVICE OR THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS, AS THE CASE MAY BE.

b. Physical Control Over Tax Returns and Tax Return Information. Representatives of the General Accounting Office designated by the Comptroller General or his designee shall be responsible for maintaining, as a minimum, control over tax returns and tax return information consistent with security requirements maintained by the Internal Revenue Service and the Bureau of * Alcohol, Tobacco and Firearms. The Internal Revenue Service requirements * in this regard are set forth in the Service's Physical and Document Security * Handbook.

(1) When documents cannot be personally transmitted between authorized recipients, the transmittal of tax returns and tax return information and related working papers shall be transferred by registered mail with a return receipt to be signed by a designated representative who is authorized access to tax returns and tax return information.

(2) Tax returns and tax return information and related working papers including computerized files shall be stored under the sole control of designated employees who are authorized access to tax returns and tax return information. When copies of tax returns and tax return information and related working papers are no longer needed, they shall be destroyed under the supervision of a designated representative who is authorized access to tax returns and tax return information. GAO shall NOT retain custody of original tax returns except by special arrangement made with the Commissioner of Internal Revenue or his designee.

(3) Computer files containing tax return information shall be protected against disclosure to unauthorized personnel when being processed at non-IRS or non-GAO computer facilities. The following safeguards should be adhered to:

(a) ALL processing phases shall be monitored by onsite designated employees who are authorized access to tax returns and tax return information.

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(b) ALL output resulting from processing shall be received by designated employees at the end of processing.

(c) ALL files, reports, and related items shall be secured before and after processing in accordance with paragraph 7b(2).

(d) ALL undesired computer listings and reports shall be properly disposed of by designated employees.

(e) No tax information shall be left in computer memory at the end of processing.

c. General. The Comptroller General or his designee will cooperate with the Commissioner of Internal Revenue and the Director of the Bureau of Alcohol, Tobacco and Firearms, in implementing any additional control or safeguard deemed necessary to provide security of tax returns and tax return information in the possession of GAO.

8. DISCLOSURE ACCOUNTING. In accordance with the provisions of section 6103(p)(3) and (4) of the Internal Revenue Code, the Director, GGD, shall be responsible for establishing and implementing an appropriate system * of standardized records to record any GAO request and subsequent receipt and * authorized disclosure of tax returns and tax return information in accordance with rules and procedures established by the Secretary of the Treasury. This procedure appears as appendix 1 to this order.

9. ANNUAL REPORT.

a. The GGD Associate Director responsible for tax administration activities shall be responsible for preparing the annual report on audits of IRS and ATF required in accordance with section 4 of Public Law 95-125. The annual report will be submitted by the Comptroller General to the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, the Joint Committee on Taxation, the Committee on Government Operations of the House of Representatives, and the Committee on Governmental Affairs of the Senate as soon as possible after the close of of each calendar year.

b. Upon compilation of the appropriate information needed for the annual report, the Associate Director shall forward it for transmittal from the Comptroller General.

2 Appendixes:

1. Disclosure Accounting for Tax Returns and Tax Return Information Obtained When Doing Audits of the Internal Revenue Service and the Bureau of Alcohol, Tobacco and Firearms
2. Conditions Under Which GAO Will Accept from the Congress Names of Taxpayers Suspected of Incorrect Reporting of Income when Auditing IRS' Administration of the Tax Laws

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August 25, 1980

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Appendix 1

APPENDIX 1. DISCLOSURE ACCOUNTING FOR TAX RETURNS AND TAX RETURN INFORMATION OBTAINED WHEN DOING AUDITS OF THE INTERNAL REVENUE SERVICE AND THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

1. PURPOSE.

a. This appendix implements paragraph 8 of this GAO Order 0135.1, Audits of the Internal Revenue Service and the Bureau of Alcohol, Tobacco and Firearms Involving Access to Tax Returns and Tax Return Information, approved by the Comptroller General. The subject paragraph provides that the Director, General Government Division (GGD), shall be responsible for establishing and implementing an appropriate system of standardized records to record any GAO request and subsequent receipt of tax returns and tax return information in accordance with the rules and procedures established by the Secretary of the Treasury.

b. The procedures described below apply to all GAO organizational elements that undertake work in the tax administration area pursuant to GAO Order 0135.1.

2. BACKGROUND.

a. Section 117 of the Accounting and Auditing Act of 1950 (31 U.S.C. 67), as added to by Public Law 95-125, authorizes GAO to make audits of the Internal Revenue Service (IRS) and the Bureau of Alcohol, Tobacco and Firearms (ATF). Section 6103(i)(6) of the Internal Revenue Code authorizes IRS and ATF to disclose tax returns and tax return information to designated GAO officers and employees for the purpose of and to the extent necessary in making these audits. Section 6103(b) of the Internal Revenue Code defines return, tax returns, and tax return information.

b. These laws also place several recordkeeping requirements on GAO. Among these, GAO is to maintain records of its accesses to tax returns and tax return information provided by (1) IRS and ATF and (2) such other agencies, bodies, or commissions that are subject to GAO audit under section 6103(p)(6) of the Internal Revenue Code. GAO is also to maintain records of any requests it receives for tax returns or tax return information.

(1) Section 6103(p)(4)(A) of the Code requires GAO to--

"establish and maintain, to the satisfaction of the Secretary, a permanent system of standardized records with respect to any request, the reason for such request, and the date of such request made by or of it and any disclosure of return or return information made by or to it; * * *."

(2) Section 6103(p)(6)(B)(i) of the Code requires GAO to--

"maintain a permanent system of standardized records and accountings of returns and return information inspected by officers and employees of the General Accounting Office under

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subsection (i)(6)(A)(ii) and shall, within 90 days after the close of each calendar year, furnish to the Secretary a report with respect to, or summary of, such records or accountings in such form and containing such information as the Secretary may prescribe, * * *."

3. WHAT IS TO BE RECORDED.

a. The primary purpose of the disclosure provisions of section 6103 of the Code is to insure that an audit trail exists whenever IRS discloses to anyone any tax information in any form which can identify an individual taxpayer. IRS is responsible for determining when a disclosure occurs and for documenting each disclosure. GAO will rely on IRS determinations and recordings as they pertain to disclosures by IRS to GAO. The IRS records therefore will be the basis for GAO's standardized records in these instances.

b. When carrying out audits pursuant to section 6103(p)(6) of the Code, GAO will use as a basis for its records the determinations and recordings implemented by the entity under audit pursuant to disclosure procedures issued by IRS.

4. IMPLEMENTING PROCEDURES. To meet these requirements, the following procedures are established.

a. Disclosures to GAO by IRS and ATF.

(1) All disclosures will be recorded by job code.

(2) Authorized GAO personnel at the location where the disclosure is made will arrange with the IRS Disclosure Officer to obtain a copy of each IRS record of disclosure to GAO. IRS personnel are responsible for preparing these records generally on IRS Forms 5466 and 5466A. A copy of the IRS records should be obtained on a daily basis.

(3) The copies of IRS Forms 5466 and 5466A and/or other appropriate IRS records will be used by GAO staff for DAILY posting to GGD Form 4, GAO Disclosure Control Document. (See figure A1-1.) A separate disclosure control document must be kept by each GAO work location for each job. The copies of IRS Forms 5466 and 5466A and/or other appropriate IRS records should be retained as support for the GGD Form 4. MONTHLY, each work location will forward a copy of the GGD Form 4 showing the month's postings to the GGD Associate Director responsible for tax administration reviews. If no disclosures were made during the month, so advise the Associate Director. If the IRS Disclosure Officer at a particular IRS location where GAO is working, requests a copy of the monthly form, it can be provided.

(4) GGD Form 4 and the supporting IRS disclosure documents will be maintained in a separate folder at each work location until job completion. At the end of the job, the complete folder will be sent to the GGD Associate Director responsible for tax administration.

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(5) Similar procedures will be used for work performed at ATF.

b. Disclosures to GAO by Others.

(1) Any other authorized agency, body, or commission, as a condition for receiving returns or return information from IRS, must under section 6103(p)(4) of the Internal Revenue Code, establish and maintain to the satisfaction of the Secretary, a permanent system of standardized records with respect to any request, the reason for such request, and the date of such request made by or of it, and any disclosure of return or return information made by or to it. To accumulate data needed to meet our reporting responsibilities when undertaking any audit pursuant to section 6103(p)(6)(A) of the Code, we will use the disclosure forms prepared by the entity under audit and follow the procedures set forth above for disclosures by IRS and ATF.

(2) Using the information produced as a result of these procedures, the GGD Associate Director responsible for tax administration reviews will prepare and forward to the Director, GGD, all appropriate material necessary for the Director to furnish to the Secretary of the Treasury the report required by section 6103(p)(6)(B) of the Code.

c. Requests for Tax Information Made of GAO by Others.

(1) By law, GAO cannot disclose any tax return or return information to anyone except Congressional Committees when acting as their agents pursuant to section 6103(f) of the Code and the Secretary of the Treasury pursuant to section 6103(p)(6) of the Code. Any requests made pursuant to such sections should be directed to the GGD Associate Director responsible for tax
* administration reviews who will be responsible for accounting for such requests
* pursuant to the requirements of section 6103(p)(4)(A) of the Code.

(2) Nevertheless, others could request such information from GAO. Whenever any such request is made of any GAO employee, the employee should immediately refer the requester to the GGD Associate Director responsible for tax administation reviews, explaining that all such requests must be made to the GGD Associate Director. The GGD Associate Director will deny such requests and be responsible for accounting for such requests pursuant to the requirement of section 6103(p)(4)(A) of the Code.

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FIGURE A1-1. DISCLOSURE CONTROL DOCUMENT

GGD Form 4
(12-77)

U.S. GENERAL ACCOUNTING OFFICE

TAX ADMINISTRATION
DISCLOSURE CONTROL DOCUMENT

GAO OFFICE: ______________________

JOB TITLE: | JOB CODE:

WORK-PAPER INDEX	DATE OF DISCLOSURE	IRS LOCATION (REGIONAL OFFICE, DISTRICT OFFICE, SERVICE CENTER, ETC.)	TYPE OF DOCUMENT (TAX RETURN, DATA PROCESSING RUN, CORRESPONDENCE, ETC.)	NUMBER OF TAXPAYERS ON DISCLOSURE FORM

SUBMISSION DATE:	TOTAL TAXPAYERS THIS MONTH	
	PREVIOUS MONTH	
	TO DATE	

Appendix 1, paragraph 4, provides details for the use of this GGD form.

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APPENDIX 2. CONDITIONS UNDER WHICH GAO WILL ACCEPT FROM THE CONGRESS NAMES OF TAXPAYERS SUSPECTED OF INCORRECT REPORTING OF INCOME WHEN AUDITING IRS' ADMINISTRATION OF THE TAX LAWS

1. STATEMENT OF PRINCIPLE.

a. GAO does not believe it would be consistent with the law providing for its audits of tax administration to investigate and report on the tax status of specific taxpayers identified for GAO by others. The legislative history of Public Law 95-125, as exemplified by the following quotes from House Report No. 95-480, is clear that GAO is not to concern itself with the returns of individual taxpayers:

> "The purpose of the legislation is to resolve * * * the right of the GAO to gain access to records necessary to perform regular audits of the Service. * * *
>
> "[The legislation] scrupulously safeguards the privacy and integrity of income tax returns and information from unauthorized disclosure. * * *
>
> * * * * *
>
> "In performing an audit of IRS, [GAO] would not be concerned with the identity of individual taxpayers nor * * * would [GAO] impose [its] judgment upon that of IRS in individual tax cases. [GAO] would examine the individual transactions on a sample basis and only for the purpose of evaluating the effectiveness of IRS' operations and activities."

b. To assure full compliance with the spirit of the law, GAO audits of the way IRS administers the tax laws will normally be based on a random sampling from appropriate universes of tax returns and return information rather than preselection of individual tax returns. The circumstances and procedures under which GAO will accept from committees and Members of Congress the names of taxpayers suspected of incorrectly reporting income, expenses, or deductions on their tax returns are set forth in the guidelines stated in the paragraphs below.

2. WORK DONE UNDER GAO AUTHORITY. When GAO initiates a review pursuant to Public Law 95-125 and section 6103(i)(6) of the Internal Revenue Code, tax returns and return information will be obtained by sampling from appropriate universes.

a. Receipt of Names from Tax Writing Committees and Appropriate Oversight Committees or Subcommittees.

(1) If the House Ways and Means Committee, Senate Finance Committee, Joint Committee on Taxation, or committees or subcommittees having a jurisdictional interest in the administration of the tax laws

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have knowledge of possible incorrect reporting of income, expenses, or deductions on tax returns by specific taxpayers and want to provide the names of such taxpayers to GAO for audit purposes, GAO will first suggest that they turn the information over directly to the Internal Revenue Service. If these committees still want to turn the names of such taxpayers over to GAO, GAO will accept them upon receipt of a letter signed by the Chairman of these committees or subcommittees or the Chief of Staff of the Joint Committee on Taxation.

(2) GAO will not accept the names of taxpayers for audit purposes from any other congressional committee or Member. GAO will advise other committees and Members that they should send the names directly to the Internal Revenue Service.

b. General Operating Procedures.

(1) GAO may analyze the tax returns and return information provided to it by the tax writing committees, the Joint Committee on Taxation, or comittees or subcommittees having a jurisdictional interest in the administration of the tax laws to gain a better understanding of the issues involved in an ongoing or planned review GAO might make of the way IRS administers the tax laws.

(2) GAO will not intentionally incorporate any names or information so provided into any samples it draws to carry out its audits of IRS' administration of the tax laws. However, if such names are selected as part of a random sampling of appropriate universes, GAO will analyze the circumstances of that taxpayer in the same way it would for all taxpayers so selected.

(3) GAO will not report or disclose to anyone outside of IRS or GAO the names of taxpayers included in its samples or any information on sampled taxpayers. Nor will GAO advise anyone who provided it names of taxpayers any information obtained by GAO about those taxpayers.

(4) The disclosure restrictions cited above are consistent with the December 15, 1977 conclusion of the GAO General Counsel that:

> "* * * except when we act as agents of a committee or subcommittee pursuant to section 6103(f)(4), we do not believe that section 6103 authorizes us to disclose to a committee or subcommittee of Congress any tax return or return information obtained during the course of a self-initiated audit of IRS."

3. WORK DONE UNDER COMMITTEE AUTHORITY.

a. When designated by the House Ways and Means Committee, Senate Finance Committee, or the Joint Committee on Taxation pursuant to section 6103(f)(4) of the Internal Revenue Code, GAO can accept the names of taxpayers from such committee(s) and report back information on such taxpayers to those

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committees. GAO can do the same when designated by other committees acting pursuant to a concurrent resolution or resolution by either House under the provisions of section 6130(f)(4) of the Internal Revenue Code.

b. However, even in these cases it is GAO policy to encourage the above-mentioned committees to provide the names of specific taxpayers directly to the Internal Revenue Service if there is any suspicion on the committees' part that the taxpayers have possibly incorrectly reported income, expenses or deductions.

(990115)

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