

00264

RELEASED

12/10/76

*REPORT TO THE JOINT COMMITTEE
ON INTERNAL REVENUE TAXATION
CONGRESS OF THE UNITED STATES*

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*



LM100264

Audit Of Individual Income
Tax Returns By The Internal
Revenue Service

Department of the Treasury

Internal Revenue Service examiners generally used their authority for auditing tax returns with discretion, and taxpayers GAO questioned generally reacted favorably to IRS. However, the audit process could be improved if IRS treated taxpayers more consistently and was more careful in making sure that taxpayers are not "agreeing" to audit findings that they do not understand or do not really agree with.

U90619



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

B-137762

To the Chairman and Vice Chairman
Joint Committee on Internal
Revenue Taxation
Congress of the United States

This report, one of a series of reports in response to your Committee's request, addresses the Internal Revenue Service's audit of individual income tax returns and the adequacy of its controls against unwarranted tax assessments.

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretary of the Treasury; and the Commissioner of Internal Revenue.


Comptroller General
of the United States

C o n t e n t s

		<u>Page</u>
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
	The individual income tax	1
	IRS as the administrator	1
	Service centers	2
	National Computer Center	3
	District offices	3
	Data Center	4
	Scope of review	4
2	AUDIT OPERATIONS AT IRS SERVICE CENTERS	6
	Correctness of service center audit adjustments	8
	Errors in the unallowable items program	9
	Conclusions	10
	Recommendations to the Commissioner of Internal Revenue	12
	IRS comments and our evaluation	13
3	DISTRICT OFFICE AUDITS	14
	Beginning the audit	14
	Type of office audit--interview or correspondence	15
	Lack of response to audit notification	17
	Conducting the audit	18
	Assessment versus no change	19
	Advising taxpayers of appeal rights	20
	Conclusions	22
	Inconsistent taxpayer treatment	22
	Production quotas	24
	Appeal rights	24
	Recommendations to the Commissioner of Internal Revenue	25
	IRS comments and our evaluation	26
4	REVIEW OF DISTRICT OFFICE AUDIT FINDINGS	29
	Review by group managers	29
	Review by district office review staff	30
	Conclusions	33

CHAPTER		<u>Page</u>
5	IRS AUDITS--TAXPAYERS' POINT OF VIEW	34
	District audits	35
	Adjusted gross income and tax changes of respondents	36
	Taxpayers' experience in preparing income tax returns	37
	Taxpayers' opinions on the time and type of audit	37
	Nature and extent of documentation	
	IRS required taxpayers to provide	38
	Views of taxpayers who were told they owed more taxes	40
	Taxpayers' views on IRS' conduct during the audit	42
	Service center audits	44
	Adjusted gross income and tax changes of respondents	44
	Taxpayers' experience in preparing income tax returns	45
	Taxpayers' contact with IRS during audit	45
	Taxpayers' views on IRS' changes to their returns	45
	Miscellaneous taxpayer comments	46
	Conclusions	48
	IRS comments and our evaluation	48

APPENDIX

I	Letter dated September 27, 1976, from the Commissioner of Internal Revenue	50
II	Description of service center correspondence audit programs	65
III	Sampling methodology and statistical analysis of taxpayer questionnaires	68
IV	Principal officials responsible for administering activities discussed in this report	70

ABBREVIATIONS

DIF	discriminant function
GAO	General Accounting Office
IRS	Internal Revenue Service
TCMP	Taxpayer Compliance Measurement Program

COMPTROLLER GENERAL'S
REPORT TO THE JOINT COMMITTEE
ON INTERNAL REVENUE TAXATION
CONGRESS OF THE UNITED STATES

AUDIT OF INDIVIDUAL INCOME
TAX RETURNS BY THE INTERNAL
REVENUE SERVICE
Department of the Treasury

D I G E S T

In 1975 the Internal Revenue Service (IRS) audited 3.16 million individual income tax returns out of 81.3 million filed, resulting in recommended additional tax and penalties of \$1.4 billion.

IRS examiners have a difficult job considering that tax laws are complex and changing and that they must deal with all types of persons in an adversary atmosphere. They have to evaluate evidence furnished by taxpayers and decide what additional tax and penalties, if any, to recommend.

Generally, examiners use their authority with discretion. However, taxpayers are not always treated consistently. (See p. 22.)

Most taxpayers are assessed additional tax only after an examiner has reviewed their returns and supporting books and records. Some taxpayers, however, are assessed additional tax based solely on a review of their returns because they failed to respond to IRS' letter notifying them of the audit and asking them to provide certain support. Reasons given taxpayers for these assessments are vague and could result in their agreeing to assessments that they do not understand.

Examiners use varying criteria in determining whether their audit findings are significant enough to warrant assessment of additional tax. As a result, two taxpayers in a similar situation might be treated differently depending on who examines their returns.

Some examiners present their findings to taxpayers without advising them of their appeal rights. Thus, many taxpayers may be "agreeing" to audit findings that they

either do not understand or do not really agree with. (See pp. 22 through 24.)

Also, many taxpayers may be agreeing to incorrect service center audit adjustments because the letter used to notify them of these adjustments has an aura of finality that would tend to discourage disagreement. (See pp. 10 through 12.)

GAO recommends that the Commissioner of Internal Revenue:

- Revise the audit report or the accompanying letter sent a taxpayer who failed to respond to IRS' initial contact letter to make it clear that (1) IRS had sent a previous letter asking him to provide support for certain items, (2) the items are now being disallowed because he failed to provide the requested support, and (3) IRS will reconsider its findings if the taxpayer can provide the support.
- Establish uniform criteria for determining whether additional tax should be assessed or whether the audit should be closed "no change."
- Require examiners to inform taxpayers of their appeal rights, especially the right to meet with the examiner's supervisor, after explaining their audit findings to them but before soliciting their agreement to those findings.
- Consider revising the letter used to notify taxpayers of adjustments for unallowable items to better insure that taxpayers do not agree to erroneous adjustments. (See pp. 12 and 25.)

GAC asked 1,175 taxpayers to describe and evaluate their audit experiences. Overall, the 823 respondents reacted favorably to the way they were treated. Certain matters, however, bothered some taxpayers:

- Audits required some taxpayers to take time off from work without pay. GAO sees no easy solution to this problem.

--Some thought an excessive amount of effort was required to gather documentation. The point at which effort becomes excessive is a matter of judgment. GAO saw little to indicate that examiners were unreasonable in their requests for documentation.

--The major problem identified in the survey was the extent to which taxpayers "agreed" to audit findings that they did not understand or did not really agree with. GAO is recommending steps that could alleviate this problem. (See p. 48.)

IRS has taken steps and plans others to clarify the explanation given taxpayers who failed to respond to IRS' first contact letter. IRS plans also to revise the letter used to notify taxpayers of unallowable item adjustments and to revise its manual so that uniform criteria will be used in deciding whether to assess an additional tax or to close a case with "no change." (See pp. 13 and 26.)

IRS agreed to revise its instructions so that taxpayers are reminded of their right to discuss an examiner's findings with his supervisor. IRS needs to further revise its instructions so that taxpayers are reminded of this and other appeal rights before they are asked to agree to the findings.

IRS' current instructions require an examiner, upon completion of an audit, to explain the basis of his findings to the taxpayer and to attempt to obtain the taxpayer's agreement. If the taxpayer indicates disagreement with any of the findings, the examiner is to remind him of his appeal rights.

In GAO's opinion, the proper sequence would be for the examiner to explain his findings to the taxpayer, remind the taxpayer of his appeal rights, and ask the taxpayer whether he agrees. Only then can IRS be sure that taxpayers are not agreeing simply because they are unaware of the alternatives. (See pp. 26 through 28.)

F-

BLANK

CHAPTER 1

INTRODUCTION

In a June 18, 1973, letter, the Joint Committee on Internal Revenue Taxation asked us to examine the policies and procedures established by the Internal Revenue Service (IRS) for auditing tax returns.

This is one of two reports on individual income tax returns (Forms 1040 and 1040A). It deals with the audit process and IRS' controls against unwarranted tax assessments. The other report ^{1/} deals with the planning process and IRS' procedures for selecting returns for audit.

THE INDIVIDUAL INCOME TAX

Individual income taxation in the United States began in 1863, was declared unconstitutional in 1895, and resumed with ratification of the 16th amendment to the Constitution and enactment of the income tax law on October 3, 1913.

This tax is an important source of funds for Federal operations. Of about \$294 billion in Federal taxes collected in fiscal year 1975, individual income taxes accounted for about \$156 billion (53 percent).

Most income tax revenues are collected under the pay-as-you-go system whereby wage earners have money withheld from their paychecks. Self-employed persons make periodic tax payments directly to IRS.

IRS AS THE ADMINISTRATOR

IRS strives, as administrator of the tax law, to encourage the highest possible degree of voluntary compliance--that is, the ability and willingness of taxpayers to accurately assess their taxes. IRS communicates the requirements of the law to the public determines the extent and causes of noncompliance, and does all things necessary to enforce the law. Its enforcement activities include auditing returns, collecting delinquent taxes and penalties, and recommending prosecution of individuals who evade their tax responsibilities.

Of all enforcement activities, IRS considers the audit of returns to be the greatest stimulus to voluntary compliance. Statistics on audits of individual tax returns for fiscal year 1975 follow.

^{1/}"How the Internal Revenue Service Selects Individual Income Tax Returns For Audit," (GGD-76-55, Nov. 5, 1976).

Number of returns filed in calendar year 1974	81,271, '62
Number of returns audited	3,160,419
Recommended additional tax and penalties	\$1.4 billion

IRS' audit and related activities are carried out by the national office in Washington, D.C., 7 regional offices, 58 district offices, 10 service centers, the National Computer Center, and the Data Center.

Service centers

The 10 service centers process tax returns and related documents using automatic and manual data processing systems and high-speed processing devices, maintain accountability records for taxes collected, and audit certain returns. The offices primarily concerned with processing and auditing individual income tax returns are:

- The receipt and control branch, which receives and sorts incoming returns, remittances, and taxpayer correspondence.
- The examination branch, which prepares returns for computer processing and extracts information from returns for audit and statistical programs.
- The input perfection branch, which resolves errors detected during computer processing.
- The data conversion branch, which transcribes, verifies, and corrects pertinent information on all tax returns and related documents.
- The computer branch, which processes tax information and documents for mailing to taxpayers and for internal use and which generates computer reports, statistical information, and other information used throughout IRS.
- The classification branch, which selects returns to be audited by the service center and maintains a system for (1) insuring that returns with the greatest tax potential are selected for audit and (2) reviewing the audit results.

- The correspondence audit branch, which examines and verifies the selected tax returns by corresponding with taxpayers. These audits, which involve less complex issues, are done by tax examiners.

National Computer Center

The National Computer Center establishes, maintains, and updates the individual master file (a record of all individual income tax filers) through a large-scale computer system. All tax data and related information pertaining to individual income taxpayers are posted so that this file reflects a current record of each taxpayer's account.

The Computer Center receives tapes from the 10 service centers containing information from filed tax returns. In addition to updating the master file, the Computer Center uses the information to determine each return's audit potential. Audit potential is determined through formulas that are programmed into the computer. Using these formulas, the computer assigns weights to basic return characteristics and adds the weights to arrive at a score for each return. The higher the score, the greater the probability that an audit of that return will result in a significant tax change. This scoring process is referred to as the discriminant function (DIF) system.

District offices

Under the direction of the national and regional offices, district offices administer districtwide programs for selecting and examining tax returns. A typical district office audit division is composed of:

- An examination branch, which is staffed by revenue agents and/or tax auditors ^{1/} who are supervised by group managers. Revenue agents usually have a college education with a major in accounting. An accounting major is preferred because the agent is expected to resolve tax issues requiring a high degree of accounting and auditing skills. Agents conduct their audits by interview, usually at the taxpayer's home or at the taxpayer's or his representative's place of business. Generally, tax auditors have a college education or its equivalent but are

^{1/}Where appropriate, revenue agents and tax auditors will be referred to collectively as examiners.

not required to have accounting or related business subjects. Before advancing to the journeyman level, however, they are required to have six units of accounting and are given IRS training in accounting and auditing techniques that enables them to examine most individual tax returns. They conduct their audits either by correspondence or by interview, usually at an IRS office.

--A returns program management staff which develops and administers district programs for selecting returns for audit. Classifiers--examiners temporarily assigned to this staff--screen returns to determine their audit potential.

--A review staff, which reviews completed audits to assure that the examiner did a quality job and that the tax liability has been properly determined.

--A conference staff, which meets with taxpayers who disagree with examiners' findings and attempts to settle their disputes.

--A service branch, which maintains control over tax returns, types form letters and other correspondence to taxpayers, and performs other miscellaneous services.

In some districts, some of these functions and staffs may be consolidated.

Data Center

The Data Center generates statistical reports used by management to monitor audit activities and evaluate their effect on voluntary compliance.

SCOPE OF REVIEW

We examined IRS policies, procedures, and practices for auditing individual income tax returns and for reviewing the quality and results of those audits. We

--reviewed pertinent IRS records;

--interviewed tax auditors, revenue agents, group managers, and other IRS personnel;

--reviewed 1,516 randomly selected files on individual income tax audits closed in 1973 and interviewed and/

or mailed questionnaires to 1,175 taxpayers included in that sample; and

--reviewed 570 examined tax returns closed by the Kansas City or Memphis service centers in 1973.

We did our work at IRS' national office in Washington, D.C.; its Dallas, Philadelphia, and San Francisco regional offices; its Baltimore, Cheyenne, Los Angeles, and New Orleans district offices; and its Kansas City and Memphis Service Centers. The four district offices serve Maryland and the District of Columbia, Wyoming, the southern half of California, and Louisiana, respectively.

CHAPTER 2
AUDIT OPERATIONS AT
IRS SERVICE CENTERS

Before 1972, all of the Internal Revenue Service's audits were done by its district offices. In searching for ways to obtain additional audit coverage, IRS focused on the millions of individual income tax returns containing small errors which had been neglected from an audit standpoint.

Correcting such errors through full-fledged district office audits was considered too costly and would have resulted in underutilizing the skills of district personnel. Accordingly, IRS initiated a test in January 1970 to determine the feasibility of a low-cost audit program at the service centers to identify and correct items on individual income tax returns which were unallowable by law. The test proved successful and an unallowable items program was established in all service centers as of January 1972.

We were informed that, because the unallowable items program began during the income tax filing season and lasted only about 6 months a year and because a full-time audit staff could not be justified for only 6 months' work, IRS looked for other audit areas which could be handled by the service centers. Subsequently, several other service center audit programs, covering a variety of issues that can be handled easily by mail, have been initiated. These programs, described in appendix II, include:

- The head of household program--IRS corrects returns erroneously filed by taxpayers as unmarried head of household.
- The DIF correspondence program--IRS corrects simple itemized deductions on low- and medium-income non-business returns.
- The information returns program--IRS follows up on potential underreporters of income as determined by matching income shown on the taxpayer's return with income shown on documents filed with IRS by employers and interest and dividend paying establishments.
- The multiple filers program--IRS corrects instances where more than one tax return has been filed under the same social security number.

--The Federal-State cooperative audit program--copies of examination reports from State tax agencies are referred to the service centers for correcting the Federal returns.

In discussing service center audits we are faced with a problem of definition. We define an audit as any situation where IRS questions something on the return other than a mathematical error and gives the taxpayer a chance to support the questioned item. According to IRS, an audit occurs only when an examiner has to inspect a taxpayer's records. The IRS definition excludes most of the service center audits our definition includes because in most cases the service centers do not have to inspect taxpayer records.

Using its definition, IRS says that its service centers audited 102,484 returns in fiscal year 1975, and made "limited contacts" with taxpayers on 1,219,377 other returns. We believe that the average taxpayer would not recognize such a distinction and would consider himself audited even if his contact with IRS was limited.

Using our definition, during fiscal year 1975 the service centers, through correspondence with taxpayers, audited about 1.3 million individual tax returns.

<u>Program</u>	<u>Number of returns audited</u>	<u>Additional tax and penalties recommended</u>
Unallowable items	952,120	\$111,504,044
Head of household	209,405	11,975,222
DIF correspondence	67,259	8,028,012
Information returns	34,838	4,431,614
Multiple filers	9,765	1,092,057
Federal-State cooperative	9,076	2,685,075
All other programs	<u>39,398</u>	<u>3,597,032</u>
Total	<u>1,321,861</u>	<u>\$143,313,056</u>

A service center audit generally involves sending the taxpayer a letter which (1) notifies him about the problem with his return, (2) advises him of the impact of the problem on his tax liability, and (3) tells him what to do if he agrees or disagrees. If the taxpayer agrees, the audit is closed; if he disagrees, he can (1) submit information to support his disagreement which the service center will evaluate, (2) request that the case be transferred to a district office examiner, or (3) take advantage of his appeal rights.

The primary exception to this process occurs in the DIF correspondence program, where IRS first sends the taxpayer a letter informing him that his return is being audited and asking him to send information verifying certain items on the return. Only after evaluating the information does the service center advise the taxpayer of the tax consequences, if any. The taxpayer can then agree or disagree.

CORRECTNESS OF SERVICE CENTER
AUDIT ADJUSTMENTS

In 1973 the Kansas City and Memphis service centers examined 117,000 returns, of which 73 percent were examined under the unallowable items program. We reviewed random samples of these returns primarily to determine whether (1) the exceptions taken were proper and (2) the related tax adjustments were correctly computed.

<u>Service center</u>	<u>Cases we reviewed</u>	<u>Cases involving tax adjustment errors</u>		
		<u>Unallowable items program</u>	<u>Other programs</u>	<u>Total all programs</u>
Memphis	217	11	-	11
Kansas City	<u>353</u>	<u>15</u>	<u>6</u>	<u>21</u>
Total	<u>570</u>	<u>26</u>	<u>6</u>	<u>32</u>

Of the 570 cases reviewed, 32 (5.6 percent) involved tax adjustment errors. Service center officials agreed that errors were made on those returns. In 20 of the cases, taxpayers were overassessed (billed for more than they should have been) by a total of \$903, ranging from \$3.60 to \$143. In the other 12 cases, taxpayers were underassessed (billed for less than they should have been) by a total of \$1,702, ranging from \$2.75 to \$675.

Of the 20 overassessed taxpayers, 17 agreed to IRS' erroneous correction by signing the form advising them of the correction, 1 was not contacted because the tax return had a mathematical error which IRS used to offset an unallowable item of equal amount, 1 did not sign the form but paid the additional tax which IRS interprets as agreement, and 1 provided additional information supporting the item in question but also paid the additional tax. An IRS official said the additional information submitted by the taxpayer would have qualified her for the head of household filing status claimed but was apparently overlooked by clerical personnel.

Errors in the unallowable items program

Of the 570 cases reviewed, 405 (about 71 percent) were examined under the unallowable items program. Twenty-six (about 6 percent) of the 405 cases involved tax adjustment errors. Projecting these sample results indicates that between 3,100 and 6,900 of the 85,000 tax returns examined under the unallowable items program that were closed in calendar year 1973, at these two service centers, could involve tax adjustment errors (overassessments plus underassessments) of between about \$194,000 and \$699,000. Of the 26 errors, 16 resulted in overassessments and 10 resulted in underassessments.

Some tax adjustment errors in the 26 cases resulted because:

- Adjustments were made for unallowable items when information furnished by the taxpayers with their returns showed that the items were allowable.
- Adjustments were made twice for the same unallowable item.
- Returns contained unallowable items but the tax was not adjusted.
- The adjustment was calculated erroneously.

Under the unallowable items program, IRS' first contact with the taxpayer is a letter telling him what his additional tax is as a result of the unallowable item and asking him to sign the letter and return it if he agrees. If he disagrees, he is advised to give his reasons on the back of the letter and to submit any additional explanatory material.

Of the 16 overassessed taxpayers under the unallowable items program 15 agreed to the erroneous adjustment and 1 was not notified about the unallowable item because of an off-setting mathematical error on his return. A Kansas City service center supervisor said that the service center does not notify a taxpayer of an unallowable item if it is offset by a math error and there is no net tax adjustment.

Officials at both service centers said the frequency of tax adjustment errors had been reduced since 1973 because of additional training, an added year of experience in examining returns, and a monitoring of audit adjustments through a quality review system initiated in July 1973.

The quality review of audit adjustments under the unallowable items program at the Kansas City service center showed an error rate ranging from 8.5 to 10.7 percent between September and November 1973. For the last 4 months in 1974, however, the rate ranged from .9 to 1.3 percent--below the center's tolerance of 1.5 percent.

Quality review statistics were not available at the Memphis service center for 1973. Quality reviews in 1974, for tax returns examined under the unallowable items program, showed error rates of 9.7 percent for the first 6 months and 7.2 percent for the last 6 months--above the center's tolerance of 5 percent. Memphis officials stated that the error rates were reasonable because they included procedural errors not affecting the tax adjustment, such as an examiner failing to initial the case jacket, and because the 7.2-percent error rate included 100-percent reviews of the work of some employees with high error rates.

The tolerances for Memphis and Kansas City differ because each center establishes its own tolerance based, in part, on its determination of what is achievable and what is desirable. The center considers, among other things, the national average and past error rates.

We did not verify the error rates of the two service centers, but we did examine the quality review procedures used by both centers in 1973 and 1974 to see if the decreasing rates might be due to procedural changes rather than improved performance. We found no such evidence.

CONCLUSIONS

Because of the broad scope of this assignment, we did not review in depth each of the many service center audit programs. However, we did examine a sample of audited returns closed in 1973 to determine the correctness of service center adjustments. Most service center audits are done under the unallowable items program and most of the erroneous audit adjustments we identified were made under that program. Therefore, we concentrated on the unallowable items program to determine how the erroneous adjustments and their effect on taxpayers might be alleviated.

According to our sample, 6 percent of the cases examined under the program involved tax adjustment errors by the service centers. This is a significant error rate considering that most of the taxpayers in our sample who were overassessed because of an IRS error agreed with the erroneous adjustment. Quality review statistics for the unallowable items program at Kansas City showed a considerable improvement in the last

months of 1974 compared to the last months of 1973 and indicated that the 1974 program was operating within the center's performance tolerance. Although the Memphis statistics show improvement in the second half of 1974 compared to the first half, we do not know how these results compare to 1973.

Also, the Memphis statistics show a 7.2-percent error rate in the second half of 1974 which, considered by itself, is significant. Because the rate included procedural errors and was affected by the fact that the work of some employees with high error rates was reviewed 100 percent rather than on a sample basis, we could not tell whether the rate indicated a major program weakness. We believe that service center management would have the same problem. An error rate computed as Memphis did in 1974 does not accurately measure program performance and thus makes the quality review system ineffective. Management does not know whether an excessive error rate is due to serious program weaknesses or to aberrations in computing the rate.

Although quality review statistics indicate that errors are decreasing, some taxpayers may still be agreeing to incorrect adjustments. There are two types of incorrect adjustments; both can result in persons paying more tax than required but only one can be detected by quality review.

The first type involves adjustments, like the ones disclosed during our review, in which the service center made an error in recomputing the tax liability. The second type involves adjustments that are incorrect because the taxpayer filled out his return incorrectly. A taxpayer, for example, may have a valid reason for claiming an expense but may have mislabeled it, entered it on the wrong line on the return, or entered it on the wrong schedule attached to the return causing IRS to consider the item unallowable and to adjust the tax. Quality review can detect only the first type of incorrect adjustment. The second type can only be detected by the taxpayer.

IRS should take every reasonable precaution to assure that taxpayers are not "agreeing" to adjustments that they either do not understand or do not really agree with. This may require IRS to revise its letters to taxpayers. Although the letter used for the unallowable items program tells the taxpayer that he can question IRS' proposed correction, it starts off by telling him how much additional tax he will owe as a result of the correction. In our opinion, it has an aura of finality that would tend to cause the taxpayer to "agree" to the additional tax even though he doesn't really understand or agree with IRS' change.

Also, the unallowable items letter does not explain the type of information the taxpayer would need to send IRS to support the disallowed amount. In contrast, the letter used for the head of household program is more informative because it (1) tells the taxpayer what requirements he must satisfy to qualify as head of household, (2) tells him what his revised tax liability will be if he doesn't qualify, and (3) asks him to answer five simple questions to determine if he does qualify.

Our concern about the finality of the unallowable items program letter is strengthened by the fact that responses to our questionnaire indicated that, of the taxpayers whose returns were adjusted under that program, only 70 percent agreed with the adjustment because they understood why their returns needed to be changed. The others agreed because, for example, they believed that IRS must be right or that the amounts involved were not worth arguing about.

Furthermore, IRS may be adjusting some returns because of an unallowable item without informing the taxpayer. We recognize that this probably would occur only when the return also contains a mathematical error that would offset the unallowable item and, as such, would occur infrequently. In our opinion, however, it should never happen. Any taxpayer whose return is adjusted because of an unallowable item should be given the opportunity to question the adjustment. Also, telling him about the adjustment serves to educate him, which could lead to better compliance.

RECOMMENDATIONS TO THE COMMISSIONER
OF INTERNAL REVENUE

We recommend that IRS:

- Compute its quality review results in a manner that will provide management with meaningful indicators of program performance.
- Consider revising the letter used to notify taxpayers of unallowable item adjustments to better insure that taxpayers do not agree to erroneous adjustments.
- Revise its instructions to make it clear that tax returns are not to be adjusted for unallowable items without advising the taxpayer and enabling him to provide explanatory material

IRS COMMENTS AND OUR EVALUATION

In commenting on our draft report (see app. I), IRS said that a recent internal study had recommended establishing an independent technical and quality review staff in the service center audit divisions. IRS noted that:

"Our guidelines for establishing the Review staffs will provide for a uniform reporting system which will allow management to evaluate the various audit activities performed in the service centers. Quality review results will be segregated as to technical errors, which would result in taxpayers paying more or less than their correct tax, and procedural errors, which would be of concern only to local IRS management as they impede the processing of workload."

IRS said also that it would change its initial contact letters for the unallowable items program by moving the computation of additional tax to the bottom of the letter which "should eliminate the aura of finality in our previous letter which could have caused a taxpayer to 'agree' even though he/she didn't really understand the change or agree with it." IRS plans to further revise these letters by asking taxpayers to explain any deduction they feel is allowable but which may have been mislabeled or otherwise incorrectly reported on the return causing IRS to consider it unallowable.

IRS said that (1) its procedures do provide for the taxpayer to be contacted and advised of both the math error and the unallowable item and that its present instructions in this area are clear and (2) the Kansas City service center instituted corrective action after we informed them of the one case we found in which the taxpayer had not been contacted and advised.

Although IRS' instructions do provide for a taxpayer to be advised if his return contains both a math error and an unallowable item, they do not specifically address the situation of offsetting math errors and unallowable items. A supervisor at the Kansas City service center told us that the center would not notify a taxpayer of an unallowable item if it were offset by a math error. A national office official responsible for the service center audit programs said that it was a matter of judgment whether the taxpayer would be notified in such a case. These apparent misinterpretations of the intent of IRS' instructions lead us to believe that the problem is not limited to Kansas City and that the instructions need to be revised to make it clear that the taxpayer is to be advised of an unallowable item even if it is offset by a math error.

CHAPTER 3

DISTRICT OFFICE AUDITS

In fiscal year 1975 district office examiners audited 1,838,558 individual income tax returns, resulting in recommended additional tax and penalties of \$1,252.3 million. ^{1/} Revenue agents performed 355,170 of the audits (19.3 percent), resulting in \$926.7 million (74.0 percent) of the additional tax and penalties, while tax auditors performed 1,483,388 audits, resulting in \$325.6 million in additional tax and penalties.

The district office audit process consists of (1) notifying the taxpayer of the audit and its scope, (2) examining his records and taking written or oral testimony, (3) evaluating the adequacy of the records and testimony, and (4) advising him of the audit findings.

BEGINNING THE AUDIT

The manner in which a taxpayer is notified of an audit depends on whether the examination is to be done by a tax auditor or a revenue agent. In either case, the initial contact notifies the taxpayer that his return is being audited and advises him of the scope of the audit and the type of records needed.

Revenue agents usually initiate their audits with a telephone call. If he is unable to reach the taxpayer by telephone, the agent sends a letter requesting the taxpayer to call him. During the telephone conversation, the agent advises the taxpayer of the audit's scope and arranges a date, time, and place for the audit. Normally, the audit is conducted at the taxpayer's residence or at his or his representative's place of business.

Tax auditor examinations, called office audits, are usually initiated by a form letter from the district director. These letters are usually mailed before the returns are assigned to specific auditors. Most office audits are

^{1/} Includes audits made by the Internal Revenue Service's Office of International Operations which is responsible for administering U.S. tax laws outside the country. This office, which audited 22,211 individual returns in fiscal year 1975 and accounted for \$16.5 million in additional tax and penalties, was not covered by our review.

conducted at an IRS office. Sometime the tax auditor will conduct the audit at the taxpayer's residence or at his or his representative's place of business if records are too voluminous to carry to an IRS office.

IRS uses four different form letters to notify taxpayers of office audits:

1. The taxpayer is asked to submit relevant material by mail. If preferred, the taxpayer can request that the audit be handled by interview instead of correspondence.
2. If IRS wants to audit a nonbusiness return at an IRS office, it tells the taxpayer what items it needs support for and sets a tentative time and date for the interview which can be changed at the taxpayer's request.
3. Similar to letter 2 except it involves the audit of a business return. 1/
4. Similar to letters 2 and 3 except it asks the taxpayer to call for an appointment.

Type of office audit--
interview or correspondence

Tax auditors conduct their examinations by correspondence when the information needed can be furnished by mail and when the case can probably be resolved by this method. Items that normally can be resolved by correspondence include deductions for interest, taxes, contributions, union dues, and small tools.

Examinations are conducted by interview when (1) oral discussion appears necessary to clarify items on the return, (2) the taxpayer may have difficulty with written communication, or (3) the return is being audited as part of a special program, such as the Taxpayer Compliance Measurement Program (TCMP). 2/ Items resolved best by interview include

1/A business return is a Form 1040 to which the taxpayer has attached a Schedule C (Profit or Loss from Business or Profession) or a Schedule F (Farm Income and Expenses). It should not be confused with a corporate return.

2/A research program for measuring and evaluating taxpayer compliance characteristics.

dependency exemptions; travel, entertainment, and bad debt expenses; and casualty and theft losses.

In recent years IRS has emphasized interviews in lieu of correspondence. The ratio of interview audits to correspondence audits in fiscal year 1973 was 69:31; the goal in 1975 was 80:20; and the goal for 1977 is 80:20 again. Group managers and tax auditors told us that correspondence and interview audits have the following advantages and disadvantages.

Advantages

Disadvantages

Correspondence:

1. Examination takes less time.
2. Taxpayer does not have to travel.
3. Taxpayer does not have to take time off from work and lose pay.

1. Taxpayers often send the wrong material.
2. IRS decisions are sometimes based on incomplete data.
3. Many taxpayers have difficulty expressing themselves in writing.

Interview:

1. Better communication.
2. Chances are better that the examiner's decisions will be based on complete information.

1. Interferes with taxpayer's work schedule.
2. Taxpayer may have to travel a long distance and parking is not always adequate.
3. Examination takes more time.

Overall, the managers and auditors felt that IRS' emphasis on interview audits would benefit all concerned. Our review of interview and correspondence audit cases indicated that taxpayers benefited more from interviews than from correspondence.

Taxpayers also appear to favor interviews over correspondence. We asked taxpayers who had had one of the two kinds of audits if they would have preferred the other kind.

Of the taxpayers in the four districts who had a correspondence audit, about 22 percent would have preferred an

interview primarily because the letter asking them to mail their supporting evidence to IRS was not clear. We do not know why they did not ask for an interview; IRS' form letter gives taxpayers that option.

Of the taxpayers who had interviews, 9 percent would have preferred to mail their records mostly because of the travel time or distance involved and/or conflicts with their working hours. The form letters IRS uses to notify taxpayers of an interview audit do not provide them with the option of mailing their records.

Lack of response to audit notification

If the initial contact letter is not returned to IRS by the Postal Service as undeliverable, and if the taxpayer does not mail his records to IRS, show up for his scheduled interview, or respond in any other way, various actions are taken depending on the district office involved.

Los Angeles, without making a second effort to contact the taxpayer, sends him an audit report disallowing all or a portion of all items that he had been asked to support. Baltimore uses different procedures depending on whether the audit was to be handled by correspondence or interview. If it was to be handled by correspondence, an audit report is sent without any second attempt to contact the taxpayer; if it was to be handled by interview, the examiner tries to telephone the taxpayer before sending an audit report.

The audit report is a document normally given the taxpayer after an audit notifying him of adjustments made to his return by the examiner, the reasons for the adjustments, and their impact on his tax liability and soliciting his agreement to those adjustments. When a taxpayer does not respond to IRS' initial letter, an audit report may be prepared and items disallowed based on the information in the return. The audit report only tells the taxpayer that the items are being disallowed because he has not established his entitlement to them. Neither the report nor the accompanying letter makes it clear that IRS had sent the taxpayer a previous letter asking for support for certain items and that the items are now being disallowed because he failed to provide the requested support. The accompanying letter does

inform the taxpayer that if he disagrees with IRS' adjustments he may, within 15 days, (1) mail additional evidence or information, (2) request a discussion with a tax auditor, or (3) request a meeting with a conference staff member.

IRS procedures also provide that cases involving taxpayers who did not respond to IRS' initial letter need not be reviewed by the district office review staff.

Our review of 1,067 case files of district office audits completed in 1973 showed that 73 taxpayers who had not responded to IRS' initial contact letter did, upon receiving the audit report, provide documentation that caused IRS to revise its findings. We do not know how many of these taxpayers had not received IRS' notice of audit or how many ignored it. A few taxpayers in our sample, however, accepted IRS' changes without attempting to support the disallowed items. We do not know why because these taxpayers either did not return our questionnaires or did not answer our question as to why they agreed with IRS' changes.

In contrast to the above, IRS' procedures call for extensive followup with taxpayers not responding to the initial contact letter notifying them that their returns have been selected for audit under TCMP. If no response is received to the initial letter, a followup letter is to be sent by certified mail with return receipt requested. If there is still no response, and other methods of contact, such as a telephone call, are unsuccessful, the return is to be transferred to an examiner for further followup.

CONDUCTING THE AUDIT

When the taxpayer or his representative provides oral or written support in response to the notice of audit or the audit report, the examiner reviews and evaluates it and then determines the correctness of the items in question.

Tax auditors generally limit their examinations to items identified in the initial contact letter because deviations could (1) inconvenience the taxpayer by having him mail or bring in additional records at a later date and (2) prevent quick closing of the case--an important IRS goal. Exceptions are made if an obviously unallowable item is later spotted or if the taxpayer raises other issues.

Revenue agents usually conduct their audits at the location of the taxpayer's records and, therefore, are better able to examine additional items. Expanding the audit does not bring on the inconvenience of having to mail or bring additional records to IRS and the examiner can still close the audit on the first visit.

Assessment versus no change

After examining and evaluating the support provided by or for the taxpayer, the examiner must decide whether the taxpayer (1) owes more taxes, (2) has paid too much and is due a refund, or (3) has correctly prepared his return. If the examiner determines that the taxpayer's reported liability should be changed, an audit report is forwarded advising the taxpayer of that determination. If the taxpayer agrees with the examiner's findings, he signs the audit report; if not, he can appeal. If the examiner decides that the return is correct or that the errors are insignificant from a tax standpoint, he closes the case "no change" and so advises the taxpayer.

IRS has no uniform criteria for deciding if an error warrants an assessment; the decision is left to the examiner. The criteria examiners use in making these decisions vary. For example, the figure most tax auditors cited as the minimum amount they would propose for assessment was significantly lower than the figure most revenue agents cited. A few tax auditors used differing criteria depending on whether the audit had been done by interview or by correspondence. In deciding whether to close a case "no change" or propose an assessment, a few examiners said that they look at the amount of income or tax liability the taxpayer reported on his return. If the figure is low, they process the change; if high, they close the case "no change".

Returns filed by low- and medium-income nonbusiness taxpayers are also audited by service centers under the DIF correspondence audit program. These audits are similar to correspondence audits done by district office tax auditors. Instructions for the service center program provide that a return will not be selected for audit if the additional tax involved is less than a specified amount. The amount specified is much higher than the amount most tax auditors cited as the minimum they would propose for assessment.

It has been suggested that examiners are pressured to assess additional tax rather than close a case "no change". We asked 103 examiners in Baltimore and Los Angeles if they thought the amount of additional tax affected their promotions. Only eight said yes. We did not get as specific with the 12 examiners we talked to in New Orleans and Cheyenne, but when we asked if they had any specific production goals,

all 12 said no. None of the group managers we talked to in the four districts mentioned dollars as a factor when evaluating their staffs. Likewise, the forms used by IRS to formally evaluate its agents and auditors and to appraise their promotion potential do not provide for, and in some cases specifically preclude, the use of statistics on dollars.

Advising taxpayers of appeal rights

If a taxpayer disagrees with an examiner's proposed changes, he may appeal to three higher levels within IRS (the examiner's supervisor, district conference, and appellate conference) and to the courts. The importance of assuring that every taxpayer is aware of and understands these appeal rights is underscored by the following passage from the Internal Revenue Manual:

"At the beginning of an examination, the examining officer will ask taxpayers whether they have any questions regarding * * * appeal rights. If the taxpayer does have any questions, the examiner is expected to give a clear and concise explanation."

In February and March 1974, IRS' Internal Audit Division conducted a study in which simulated returns were placed into the office audit work stream in 14 districts--2 in each region--and internal audit personnel posed as taxpayers. One objective of the study was to determine whether appeal rights were adequately explained.

The study disclosed that appeal rights were completely explained in 21 of 75 applicable cases (28 percent). In 43 cases (57 percent), the explanations were deemed inadequate because examiners did not explain the 4 appeal levels available to a taxpayer. In 11 cases (15 percent), no explanations were given although the taxpayer specifically asked questions regarding appeals or expressed disagreement with the audit results. The more flagrant cases included:

- An examiner who said he was the law when a taxpayer stated he wanted to show the report to an accountant to verify the examiner's determinations.
- An examiner who ignored the taxpayer's question about alternatives to signing the agreement form and handed him the form and a pen.

We asked selected taxpayers who were told they owed more taxes if they had been advised of their appeal rights. The responses indicated that of the taxpayers in the four

districts who were told they owed more taxes, 25 percent were not told their appeal rights, 43 percent were told, and 32 percent could not remember.

In late 1973 (after the taxpayers in our sample had been audited), IRS revised the initial contact letters used for office audits. The letters now tell the taxpayers that they have the right to appeal any adjustment proposed by IRS and outline the procedures to follow. The letters also refer to publication 556, Audit of Returns, Appeal Rights, and Claims for Refund which is available to the taxpayer on request and which details these procedures. The initial contact for revenue agent audits is usually by telephone or personal letter, so discussion of appeal rights is left to the individual agent.

During an interview the taxpayer may not be orally advised of his appeal rights. About one-third of the agents and auditors we talked to said that they do not always tell a taxpayer his appeal rights, especially if he indicates agreement with the audit findings. Thus, a taxpayer who is audited by a revenue agent and indicates agreement with the agent's findings may never be told his appeal rights.

Taxpayers who are audited by correspondence and whose returns are changed as a result of the audit are again advised of their rights when they receive the audit report which is accompanied by publication 5, Appeal Rights and Preparation of Protests for Unagreed Cases.

There are indications that taxpayers are not taking advantage of their appeal rights perhaps, in part, because they are unaware of or do not understand these rights.

Responses to our questionnaire indicated that only 42 percent of the taxpayers in the four districts who agreed to the examiner's findings understood why their returns had to be changed. The rest agreed because, among other reasons, they (1) felt IRS must be right, (2) wanted to get the audit over with, or (3) did not feel the amount in question was worth arguing about.

The first avenue of appeal is a meeting with the examiner's supervisor. This convenient and inexpensive procedure is being ignored by most taxpayers. Only about 6 percent of the respondents to our questionnaire who were told they owed more taxes indicated that they had requested a meeting with the examiner's supervisor. We also asked group managers how often taxpayers requested a meeting with them. The responses in Baltimore, for example, ranged from

often to not very often with most falling in the latter category.

CONCLUSIONS

IRS examiners have a difficult job considering that (1) tax laws are complex and changing, (2) they must deal with all types of persons in an adversary atmosphere, and (3) they have to evaluate evidence furnished by taxpayers and decide what additional tax and penalties to recommend. Generally speaking, examiners use their authority with discretion.

We addressed certain issues that have been debated at congressional hearings--inconsistent taxpayer treatment, production quotas, and appeal rights. We did not evaluate audit quality because we would have had to thoroughly audit selected taxpayers already audited by IRS to determine the correctness of IRS' findings.

Inconsistent taxpayer treatment

Certain procedures and practices result in inconsistent treatment of taxpayers. Although total consistency is impossible, IRS can improve the situation.

In some cases, IRS' decision to assess additional taxes is based solely on the information in the return because the taxpayer failed to respond to IRS' letter notifying him of the audit. We believe that IRS is justified in disallowing all or a portion of all items identified as questionable if IRS' request for substantiation is ignored. What concerns us is how IRS knows whether the taxpayer is ignoring the request or simply never received it.

Because we only identified a few instances in which taxpayers, without attempting to support the disallowed items, agreed to an audit report issued after they failed to respond to the initial letter, we do not believe that IRS needs to make any sweeping procedural changes. However, IRS should at least offer these taxpayers a clear explanation as to why their returns are being adjusted. Currently, the only explanation offered is that the taxpayer failed to establish his entitlement to the disallowed deductions. Such a vague explanation could confuse a taxpayer who had not received the initial letter and cause him to agree to an adjustment he does not understand.

Examiners use varying criteria in determining whether they should recommend assessment of additional tax. As a

result, two taxpayers in similar situations may be treated differently--one may be billed for additional tax while the other may have his case closed "no change"--depending on who examines their returns. It is not fair to allow some taxpayers to underassess their taxes but not others.

Sometimes it may be in the Government's best interest to assess the additional tax, regardless of the amount. For example, the issue involved may be one that IRS considers a source of widespread noncompliance or the taxpayer may have a history of noncompliance. To combat such noncompliance, it may be preferable to assess small amounts of additional tax. However, once an examiner decides that a case does not involve a special situation and he sees no reason to assess the taxpayer for an insignificant amount, his criteria for deciding what is insignificant should be consistent with other examiners. Uniform criteria would also preclude an examiner from basing his decision on a desire to minimize no change cases.

We considered two arguments against the desirability of uniform criteria: (1) it would be ridiculous or demeaning to assess a high-income taxpayer for a relatively small amount of additional tax and (2) it would damage the tax system if taxpayers found out they could get away with a certain amount of erroneous tax reporting. We believe, however, that it is just as ridiculous to assess a low-income taxpayer, who can least afford it, but not assess a high-income taxpayer. Also, specific criteria have been established for the DIF correspondence and other service center audit programs without any apparent concern about damaging the tax system. Tax laws are so complex and the pitfalls so numerous that a person would be hard pressed to prepare his return with a built-in error of less than the criteria and be sure that an audit would not disclose other errors that would bring his additional tax above the criteria.

All things considered, we believe that the concern for consistent taxpayer treatment should take precedence.

Another inconsistency is that taxpayers who are asked to mail in their supporting documentation are told that they have the option of requesting an interview while those who are asked to come in for an interview are not told that they have the option of mailing in their records. However, we believe that the disadvantages of handling certain cases and issues by mail outweigh the benefits and that it would not be in the taxpayer's best interest to afford him that option.

One alternative we considered was for tax auditors to conduct their examinations at the taxpayer's residence as revenue agents do. This is not feasible, however, because the taxpayer would still have to take off from work and the number of audits would be significantly reduced because of the travel time expended by the tax auditor. Also, tax auditors handle less complex audits that, unlike audits done by revenue agents, generally do not require the taxpayer to provide a large volume of books and records or require the auditor to observe the taxpayer's business operation. Thus a tax auditor can conduct his audit at an IRS office and a revenue agent cannot.

Production quotas

Some examiners felt that the dollar amount of additional taxes affected their promotions. Although IRS procedures specifically preclude consideration of such factors, a group manager could be influenced by dollars and no changes in his evaluation of an examiner. It would be impossible to control these subjective considerations and, sometimes they may be justified. For example, in evaluating an examiner, a manager considers his ability to recognize issues; an unusually large number of no change cases could indicate that the examiner is deficient in that respect.

We also considered whether examiners are pressured to do a certain number of audits. Our findings are discussed in our report on selecting returns for audit (GGD-76-55) because any such pressures would emanate from IRS' annual work plan which is discussed in that report.

Appeal rights

Every taxpayer has the right to appeal an examiner's findings. Some examiners, however, said they advise a taxpayer of his rights only if he indicates disagreement with the findings--the apparent assumption being that a taxpayer who agrees has nothing to appeal. However, as indicated by the responses to our questionnaire this is debatable because only 42 percent of those who agreed to the examiner's findings did so because they understood why their returns had to be changed.

After the reasons for the changes are explained to the taxpayer, he should be advised of his appeal rights, including the right to meet with the examiner's supervisor, without any distinction based on the examiner's personal judgment as to whether the taxpayer needs to know those rights.

It is important that the examiner tell the taxpayer that he can request a meeting with the examiner's supervisor. The responses to our questionnaire indicated that 58 percent of the taxpayers in the four districts who "agreed" to the examiner's findings either did not really agree with the findings or did not sufficiently understand the findings to know whether they agreed or disagreed. In some cases, the taxpayer's disagreement or uncertainty might have been resolved by meeting with the supervisor.

Although a taxpayer may disagree with an examiner's findings, he may not have the time or money to use the more formal avenues of appeal--district conference, appellate conference, and the courts. Such a taxpayer would be more inclined to agree to the finding than would a taxpayer who could incur the time and expense. A meeting with the examiner's supervisor is much more informal and convenient because it can often be arranged the same day as the audit.

Other taxpayers may not be in a position to intelligently agree or disagree with the examiner's findings because they do not understand what the examiner did. The supervisor, as a third party, could help taxpayers better understand the examiner's findings.

Taxpayers should fully understand why their returns are being changed not only so they can intelligently decide whether they agree or disagree but also so they can prepare a more correct return in the future. IRS' goal of improving voluntary compliance through audits is seriously impaired if taxpayers do not know any more after they are audited than before.

RECOMMENDATIONS TO THE COMMISSIONER OF INTERNAL REVENUE

We recommend that IRS:

- Revise the audit report or the accompanying letter sent to a taxpayer who failed to respond to IRS' initial contact letter to make it clear that (1) IRS had sent him a previous letter asking for support for certain items, (2) the items are now being disallowed because he failed to provide the support, and (3) IRS will reconsider its findings if support is provided.
- Establish uniform criteria as to (1) what special situations would require assessment of additional tax regardless of the amount and (2) what constitutes an insignificant amount that need not be assessed in the absence of a special situation.

--Require examiners to inform all taxpayers of their appeal rights, especially the right to meet with the examiner's supervisor, after the examiners have explained their audit findings but before soliciting agreement to those findings.

IRS COMMENTS AND OUR EVALUATION

IRS said that it had a standard paragraph that was supposed to be used to tell the taxpayer that adjustments had been proposed because he failed to respond to the initial contact letter. IRS is "currently revising that paragraph to further advise the taxpayer that the proposed adjustment will be reconsidered if the necessary information is provided" and plans to "ensure that the standard paragraph is used in all 'No Reply Cases' where adjustments are being proposed."

The paragraph IRS referred to reads:

"We have disallowed the benefits you claimed because you have not responded to our specific inquiries about them. To be allowed a deduction, expense, exemption, credit, or other tax benefit, you must establish that you have met all requirements of the law."

This explanation is more informative than the one given taxpayers in the cases we reviewed. If IRS follows through with its plans to further revise that explanation to insure its use whenever appropriate, our concerns will have been answered.

IRS agreed with our recommendation that it establish uniform criteria for deciding whether to assess the additional tax or close the case "no change" and said it would revise its manual accordingly.

IRS said also that it will continue to impress upon examiners their responsibility to explain proposed adjustments to taxpayers and to inform taxpayers of their rights to appeal those adjustments. IRS expressed the belief, however, that it was not possible, without a substantial simplification of the tax law, to completely eliminate the problem of taxpayers agreeing to findings that they do not understand or do not really agree with. According to IRS, many small-income taxpayers lack both the knowledge of taxes and the personal confidence to challenge the examiner's findings.

IRS noted that its procedures require an examiner, after completing an audit, to explain the basis of the proposed

adjustments to the taxpayer or his representative and to attempt to obtain the taxpayer's agreement to the proposed tax liability. If the taxpayer indicates disagreement with any of the proposed adjustments, the examiner is to remind him of his appeal rights.

IRS agreed to revise these instructions to require examiners to advise the taxpayer of his " * * * right to discuss the proposed adjustment with a supervisor, if feasible * * *." We understand, in talking to IRS officials, that the term "if feasible" was intended to convey the fact that discussion with a supervisor may not be feasible when a revenue agent is doing the audit. Revenue agents usually conduct their audits at the taxpayer's home or at his or his representative's place of business. Thus the supervisor would not be readily available for a conference. Our recommendation was caused by a concern for the majority of taxpayers who are audited at an IRS office and who might benefit from an immediate meeting with the supervisor. Thus we do not object to IRS' qualification.

IRS needs to further revise its instructions. As IRS indicated, many taxpayers are not reminded of their appeal rights until after the examiner has failed to obtain their agreement to the audit findings. We believe that all taxpayers, not just those who indicate disagreement, should be reminded of their appeal rights before being asked to agree to the examiner's findings.

The proper sequence would be for the examiner to present his findings to the taxpayer; explain the basis for those findings; remind the taxpayer of his appeal rights, including the right to meet with the examiner's supervisor, if feasible; and ask the taxpayer whether he agrees. Only then can IRS be sure that taxpayers are not agreeing simply because they are unaware of the alternatives. To hold off reminding a taxpayer of his appeal rights until after he indicates disagreement with the examiner's findings is to deny him information that might alter his eventual decision.

IRS pointed out that a reminder of the taxpayer's appeal rights is included with all 30-day letters--letters that give the taxpayers 30 days within which either to agree with IRS' audit findings or to initiate an appeal. Most taxpayers, however, do not receive a 30-day letter. A taxpayer who is audited by interview is given the opportunity to agree right after the interview; if he disagrees, then he is sent a 30-day letter. IRS statistics shows that about 80 percent of the

taxpayers who agreed to district office audit findings in fiscal year 1975 did so before they received a 30-day letter with the accompanying reminder of their appeal rights.

CHAPTER 4

REVIEW OF DISTRICT OFFICE AUDIT FINDINGS

District office audit findings are subject to review by the examiner's supervisor and by the district office review staff to assure both the taxpayer and the Government that the examiner's findings are correct. However, not all audited returns are reviewed, and chances for review vary depending on who the group manager is, where the return was audited, who audited it, what type of audit it was, and whether the taxpayer agreed with the examiner's findings.

REVIEW BY GROUP MANAGERS

Group managers may review an examiner's work while the audit is in process or after its completion. Our interviews with group managers disclosed variances in their review procedures. For example:

- Managers of revenue agents get more involved in audits in process than do managers of tax auditors.
- Managers of revenue agents in the Baltimore district office said they review all completed cases to some extent while New Orleans and Los Angeles managers indicated they generally review only a sample of completed cases. Comparable information was not obtained from the Cheyenne group managers.
- In the two district offices where only a sample of completed cases is reviewed, some group managers take a sample of each examiner's work for in-depth review while others cursorily review work done by agents they consider strong and review in depth work done by agents they consider weak.
- Some managers of tax auditors devote more attention to reviewing unagreed cases than to reviewing agreed cases. Four of the seven managers interviewed in Baltimore, for example, said they review all unagreed cases but only some agreed cases. The other three indicated no difference between agreed and unagreed.

Although there are differences as to what is reviewed, all group managers indicated they rarely change examiner's findings. Any changes are usually procedural and do not affect the findings.

REVIEW BY DISTRICT OFFICE REVIEW STAFF

The district office review staff performs technical and procedural reviews.

Technical reviews generally involve an analysis of how completely and how well the case was developed. The reviewer analyzes the examiner's report and workpapers and the points of law involved and, when the case involves a proposed change to the taxpayer's liability, verifies the examiner's computations.

Procedural reviews include a determination whether (1) all of the proper forms have been used, (2) the statute of limitations has expired, and (3) there is a proper power of attorney, if applicable.

Revenue agent audit cases are divided into two categories: (1) must-review cases, which include unagreed cases, returns reviewed under the Taxpayer Compliance Measurement Program, and returns involving fraud and (2) cases subject to sample review, which are the agreed and no change cases.

Tax auditor cases are divided in the same manner except that only certain unagreed tax auditor cases must be reviewed. Also included among the tax auditor must-review cases are those where the taxpayer had responded to the Internal Revenue Service's initial contact letter but did not respond to the audit report. Tax auditor cases subject to sample review are then further subdivided into nonbusiness and business cases and a sample of each is reviewed.

The size of the sample for revenue agent, tax auditor nonbusiness, and tax auditor business cases depends on the size of the universe--the number of returns audited by the district in a 6-month period that are subject to sample review. For example, the sampling rates for revenue agent cases are 7 of 10 for a universe of less than 200, 1 of 20 for between 5,000 and 5,999, and 1 of 50 for 13,000 or more.

Because the sampling rates go down as the number of cases increases, taxpayers in districts with a small audit caseload are more likely to have their cases reviewed than are taxpayers in districts with a larger caseload. Taxpayers audited by revenue agents and those who file business returns that are examined by tax auditors also are more likely to have their cases reviewed because the number of such audits is relatively small. In 1975 revenue agents audited 355,170 individual returns while tax auditors examined 1,483,388, of

which 1,364,741 were nonbusiness returns and 118,647 were business returns.

If the reviewer detects a mathematical, technical, or procedural error he may issue either an inquiry or advisory memorandum. An inquiry memorandum is issued when action is needed by the group manager and/or examiner and an advisory memorandum is issued to apprise the group manager and the examiner of errors that the reviewer has accepted or corrected with no change in tax liability. The reviewer indicates the type of error noted, such as mathematical, technical, or procedural, and usually explains the error and recommends corrective action.

When the group manager receives an inquiry memorandum, he may disagree with the reviewer, indicate his reasons on a response to reviewer's memorandum, and send it back without the examiner ever seeing it. Otherwise, the memorandum is forwarded to the examiner for corrective action unless he has a valid disagreement with the reviewer. Corrective action is noted on the response to reviewer's memorandum sent back to the reviewer. The taxpayer is notified if his liability has to be revised because of review. He can disagree with the revised liability and appeal.

Instead of issuing a memorandum, a reviewer may issue a feedback report if he believes that an important aspect of the case, not requiring a memorandum, should be brought to the responsible manager's attention. This report may be complimentary or may indicate areas of deficiency in case preparation or the examiner's workpapers.

IRS established a 5-percent error rate as an alarm figure for sample-review cases. If reviewers' memorandums result in tax or income changes on more than 5 percent of the sample-review cases, management should take whatever actions it deems necessary to correct the situation, such as meeting with supervisors, providing training, or requesting approval from the national office for a higher sampling rate.

However, until 1976 IRS did not have a formal management reporting system to provide the necessary information to determine actual error rates. Its statistical reports showed the percent of examined cases that were reviewed but not how many reviewers' memorandums were issued compared to the number of cases reviewed. IRS recently implemented a new reporting system to provide the necessary information and, as of June 1976, was still in the process of refining it.

We examined reviewer's memorandums issued in 1973 and found the following.

District office	Number of cases reviewed	Number of reviewers' memorandums issued	Percent of cases reviewed resulting in memorandums	Number of memorandums we examined	Number of examined memorandums resulting in a tax change	Percent of reviewed cases resulting in a tax change
Baltimore	5,006	297	5.9	a/286	180	3.6
Cheyenne	893	129	14.4	129	50	5.6
Los Angeles	(b)	(b)	(c)	91	62	(c)
New Orleans	<u>7,129</u>	<u>208</u>	<u>2.9</u>	<u>208</u>	<u>107</u>	<u>1.5</u>
Total	<u>13,028</u>	<u>634</u>	4.9	<u>714</u>	<u>399</u>	d/2.6

a/11 memorandums not examined were still open at the time of our review. Thus, we could not determine their final results.

b/The district did not maintain statistics nor did it have a central file of memorandums issued.

c/Not computable.

d/In computing this total we excluded the 62 memorandums issued by Los Angeles that resulted in a tax change because the corresponding figure for number of cases reviewed by Los Angeles was not available.

Of the 399 memorandums resulting in a tax change, 249 caused upward changes totaling \$775,110 while 150 caused downward changes totaling \$347,221. 1/ In all four districts, the number and dollar amount of upward changes exceeded that of downward changes.

1/Although these figures indicate average tax changes of about \$2,000 to \$3,000, a few reviews that resulted in significant changes distort the averages. For example, two Baltimore reviews of unagreed cases resulted in an upward change of about \$320,000 and a downward change of about \$100,000, respectively.

CONCLUSIONS

Because not all audit cases are reviewed either by the group manager or by the review staffs, we can assume that some audit errors go undetected. However, undetected errors are not a serious problem--only 2.6 percent of the cases reviewed in the three districts for which statistics were available resulted in tax changes.

Ideally, every taxpayer should pay his correct tax, no more and no less. Under IRS' current review procedures, however, some taxpayers are more likely to have audit errors detected and corrected. We recognize, however, that (1) it is impossible for a group manager, especially an office audit group manager, to thoroughly review every completed audit case because of the volume of cases and the other demands of his job and (2) the review staff's primary function is to provide a statistically valid measure of the general quality of district audits, thereby alerting management to problem areas. IRS could review every audit case if it increased the number of group managers and/or reviewers or if it reduced the number of audits, thereby making the review caseload more manageable. However, neither alternative seems practical.

Any additional revenue that may accrue to the Government by correcting audit errors would be offset, at least partially, by the additional cost of detecting them. Also, because all unagreed cases are eventually reviewed either by the group manager or the review staff or during consideration of the taxpayer's appeal, the possibility of an undetected audit error arises primarily in agreed cases. We believe that the problem of erroneous audit findings in agreed cases could be alleviated if, as discussed previously, taxpayers are given adequate explanation for the changes to their returns and are properly advised of their appeal rights, including the right to request a meeting with the examiner's supervisor which would result in a review of the examiner's findings. A taxpayer could then better satisfy himself on the correctness of the examiner's findings before agreeing to those findings rather than relying on a postaudit review.

CHAPTER 5

IRS AUDITS--TAXPAYERS' POINT OF VIEW

We solicited the views of a random sample of taxpayers whose audits were closed in 1973 through a mail questionnaire and, in some cases, through personal interview. Although some taxpayers had died, had moved to an unknown address, or did not respond, we did obtain opinions from 607 taxpayers who had a district audit and 216 taxpayers who had a service center audit. The sample size and response by district is presented below. (See app. III for additional details regarding the study methodology.)

<u>IRS district in which taxpayer resided</u>	<u>Sample size</u>	<u>Number of respondents (note a)</u>	<u>Response rate</u> (percent)
District audits:			
Baltimore	210	137	65.2
Cheyenne	194	150	77.3
Los Angeles	238	168	70.6
New Orleans	<u>232</u>	<u>152</u>	<u>65.5</u>
Total	<u>874</u>	<u>607</u>	<u>69.5</u>
Service center audits:			
Baltimore	105	75	71.4
Cheyenne	61	49	80.3
Los Angeles	67	33	49.3
New Orleans	<u>68</u>	<u>59</u>	<u>86.8</u>
Total	<u>301</u>	<u>216</u>	<u>71.8</u>

a/Two terms are used in describing the results of our questionnaire--"respondent" and "sampled population." Respondent refers to people who actually received and returned a questionnaire. Sampled population refers to the universe from which we drew our sample. Projections of what the sampled population would have replied were based on the respondents' replies after correcting for variances in the size of the universe at each location sampled. An explanation of the weighting procedures used to develop sampled population projections is contained in appendix III.

DISTRICT AUDITS

Our analysis of the questionnaire results for taxpayers who had district audits showed that: 1/

- Seventy-two percent of the sampled population believed the Internal Revenue Service gave them the benefit of the doubt or treated them fairly, while 21 percent felt IRS had little regard for their position. Taxpayers' feelings were influenced by the size of the tax change as a result of audit and the effort required to gather documentation for it.
- Eighty-two percent of the sampled population felt that IRS treated them courteously or somewhat so. Those who felt they were treated discourteously or somewhat so (7 percent) usually were told they owed more taxes or considered the effort needed to gather documentation required during the audit to be unreasonable.
- Ninety-two percent of the sampled population considered the time set for the audit reasonable. Those who considered the time unreasonable (8 percent) usually (1) took time off from work without pay to go to the audit or (2) experienced parking problems at the audit site.
- Forty-two percent of the sampled population who agreed to all or part of the tax change understood the need for the change. The taxpayers who did not understand usually (1) had no experience in preparing their own tax returns, (2) said they had not been advised or did not remember whether they had been advised of their appeal rights, and /or (3) considered the effort needed to gather documentation required during the audit to be unreasonable.

1/Here and elsewhere in this chapter, responses to a particular question may total less than 100 percent because some taxpayers either did not answer the question or gave an answer unique to that taxpayer.

--Seventy-seven percent 1/ of the sampled population had their returns prepared by a professional or commercial preparer.

--Audit practices in the four districts were generally uniform.

Adjusted gross income and tax changes of respondents

The following tables present statistical information on the adjusted gross incomes of the respondents and the tax changes as a result of their audits.

<u>Adjusted gross income</u> (dollars)	<u>Number of respondents</u> (note a)	<u>Percent</u>
0 to 3,000	28	5
3,001 to 6,000	96	16
6,001 to 9,000	129	21
9,001 to 12,000	110	18
12,001 to 15,000	57	9
15,001 to 25,000	101	17
More than 25,000	<u>82</u>	<u>14</u>
Total	<u>603</u>	<u>100</u>

a/Information for four respondents was not available.

1/In our report, "No Apparent Need to Regulate Commercial Preparers of Income Tax Returns," (GGD-76-8, dated Dec. 8, 1975) we reported that, based on Taxpayer Compliance Measurement Program data, about 54 percent of the 1971 tax returns filed by low- and medium-income nonbusiness taxpayers and low-income business taxpayers were prepared by commercial or professional preparers. This figure differs from our figure of 77 percent because (1) the 77-percent figure is based on taxpayer responses to a questionnaire while the 54-percent figure is based on TCMP audit findings, (2) our questionnaire covered taxpayers in only four districts while the TCMP is more national, (3) our questionnaire covered taxpayers at all income levels while the TCMP did not, and (4) the TCMP was restricted to 1971 returns while our questionnaire was not.

<u>Tax change</u> (dollars)	Number of respondents (note a)	<u>Percent</u>
Refund	24	4
No change	218	36
1 to 100 increase	98	16
101 to 200 increase	94	16
201 to 300 increase	49	8
301 to 500 increase	57	9
501 to 800 increase	41	7
More than 800 increase	<u>22</u>	<u>4</u>
Total	<u>603</u>	<u>100</u>

a/Information for four respondents was not available.

Taxpayers' experience in preparing
income tax returns

Responses to our questionnaire indicated that only 37 percent of the sampled population had ever prepared their own returns, and that many of these, despite their experience, were assisted in preparing the returns in question. We estimate, that 77 percent of the taxpayers audited in the four districts had their returns prepared by a professional or commercial preparer, while 6 percent prepared their returns with assistance from IRS, a relative, or a friend. Only 16 percent prepared their returns unassisted.

Taxpayers in Los Angeles were more likely to have had their returns prepared by a professional or commercial preparer (82 percent) than were those in other districts, but even in Baltimore, which had the lowest use of such preparers, the rate was still about 66 percent.

Taxpayers' opinions on the
time and type of audit

Most taxpayers in our sampled population (92 percent) were notified by mail of IRS' intent to audit their returns. The method of notification did not differ significantly among districts.

Eighty-two percent of the taxpayers in the sampled population were advised of the audit 2 or more weeks in advance and 7 percent had about a 1-week notice. Most of the remaining 11 percent either could not remember how much advance notice they got or stated generally that they were notified well enough in advance.

Most district audits (64 percent) involved a meeting between the taxpayer and an examiner at an IRS office. Some audits, generally those conducted by revenue agents (7 percent), took place at the taxpayer's residence or place of business, while others (20 percent) were conducted by mail or through a combination of mail and telephone. The other 9 percent were mainly handled by the taxpayer's representative.

Because IRS normally determines the type of audit (correspondence or interview), we wanted to find out whether taxpayers had a preference as to how they were audited. Of those who were interviewed at an IRS office, only 9 percent would have preferred a correspondence audit. The usual reason given was a conflict between the time of the audit and the taxpayer's working hours. Of those who had a correspondence audit, about 22 percent would have preferred an interview, primarily because the letter asking them to mail their supporting evidence to IRS did not clearly explain what was wanted.

About 92 percent of the sampled population considered the time of the audit reasonable. The 8 percent who considered the time unreasonable usually

--took time off from work without pay to go to the audit and/or

--experienced parking problems at the audit site.

Statistical tests showed that taxpayers' opinions on the reasonableness of the time of the audit did not differ significantly among districts. Taxpayers in New Orleans were more likely to have experienced parking problems than those in the other three districts.

Nature and extent of documentation
IRS required taxpayers to provide

To develop information about the audit process, we asked taxpayers about

--the kind of documentation IRS required them to supply,

--the amount of effort required to gather the documentation, and

--the extent and nature of professional tax assistance required to respond to the audit.

Documentation required by IRS

The following table shows the percent of the sampled population that provided each type of documentation (because a taxpayer may have provided all three types, the total for all types exceeds 100 percent).

<u>Type of documentation</u>	<u>Percent sampled population</u>
Normal records and documents	83
Appraisals or other valuation studies	9
Special schedules or reports	11
Other	10

As shown above, IRS usually requested only those records and documents which the taxpayer normally kept. Our analysis indicated no significant difference among districts as to the type of documentation requested.

Effort needed to gather documentation for the audit

About 82 percent of the sampled population who had to gather documentation for the audit considered the effort needed to do so reasonable or somewhat so, while 18 percent considered the effort unreasonable or somewhat so. We found no significant difference among districts.

Extent and nature of professional assistance required

About 43 percent of the sampled population asked for professional tax assistance in preparing for their audits. The professional assistance provided fell into the following categories.

	Percent (note a)
Help with interview	24
Help prepare documents	34
Help with interview and documents	27
Other	16

a/Total exceeds 100 due to rounding.

Views of taxpayers who were
told they owed more taxes

About 64 percent of the taxpayers in the sampled population were told they owed more taxes because of an audit. The percent ranged from 49 in Cheyenne to 68 in Los Angeles.

To find out how taxpayers felt about the additional assessments, we asked them to review a list of reasons they might have had for agreeing to the tax change. The following shows the percent of taxpayers in the sampled population that fell into each category.

<u>Reason for agreeing</u>	Percentage that said yes (note a)
Understood the need for change	42
Did not understand but felt IRS must be right	19
Disagreed with IRS but thought agreeing would complete audit	19
Agreed so that interest charges would stop	9
Disagreed with IRS but felt that the amount in question was too small to bother with	23
Pressure from the examiner to agree	3
Other	11

a/Because the taxpayers could check more than one block, the total exceeds 100 percent.

Only 42 percent of those who agreed with all or part of the tax change understood the need for the change. (We attempted to obtain additional information from taxpayers who did not sign an agreement but so few answered our questions that the results were unusable.) The answers to our questions did not differ among districts except that taxpayers in Los Angeles were more likely to rely on IRS in agreeing to the change and were more likely to agree in order to get the audit over with.

To better understand why taxpayers "agreed" to pay additional taxes even though they did not really agree with the findings or did not understand why their returns needed to be changed, we subjected the problem to statistical analysis. We found that most taxpayers in this group

- had no experience preparing their own tax returns,
- considered the effort needed to gather the documentation required by IRS unreasonable, and/or
- said that they had not been advised, or did not remember if they had been advised, of their appeal rights.

For example, of those who said the effort needed to gather documentation was unreasonable or somewhat so, 99.9 percent also said they did not really agree with or understand the changes to their returns. The figure was only 43 percent for those who considered the effort reasonable or somewhat reasonable.

We found no difference between the type of audit (correspondence or interview) and the taxpayers' understanding of why their returns needed to be changed. Nor did we find that the help of a tax professional during the audit affected the taxpayer's understanding of the tax change.

Of the taxpayers in the sampled population who were told they owed additional taxes, 25 percent said they were not advised of their appeal rights; 43 percent said they were advised of their rights; and 32 percent said they could not remember. Replies did not vary significantly among districts.

We also attempted to develop information on taxpayer reactions to the appeals process and the extent to which

taxpayers, after agreeing to the tax change developed during the audit, were contacted and told they owed still more. In both instances, the number of taxpayers was too small to be meaningful. Only about 6 percent of those who were told they owed more taxes as a result of the audit requested a meeting with the examiner's supervisor and only about 2 percent requested a district conference. About 5 percent of those who agreed to the audit results were later asked to agree to a higher amount. The usual reason cited was that IRS had neglected to include interest charges.

Taxpayers' views on IRS' conduct during the audit

To determine how taxpayers viewed the audit and IRS, we asked the following questions:

--How did IRS treat you?

--What was your overall impression of the manner in which IRS conducted its audit of your return?

The responses were as follows:

<u>Manner treated</u>	<u>Percent</u>
Courteously	68
Somewhat courteously	14
No opinion	11
Somewhat discourteously	5
Discourteously	<u>2</u>
Total	<u>100</u>

<u>Impression of manner in which audit was conducted</u>	<u>Percent</u>
Gave benefit of doubt	9
Fair and impartial	63
Little regard for taxpayer's position	21
Other	<u>7</u>
Total	<u>100</u>

Again, the responses did not significantly differ among districts.

We made a series of statistical tests to better understand why taxpayers felt the way they did about IRS and the audit process.

Manner in which the taxpayer was treated

We found that taxpayers who felt they were treated discourteously or somewhat so were usually those who (1) considered the effort required to gather documentation for the audit unreasonable or, (2) were told they owed more taxes.

Whereas 4 percent of those who did not owe additional taxes saw IRS as discourteous, 11 percent of those who owed more taxes felt they were treated discourteously. This feeling was more pronounced for those who considered the effort to gather documentation unreasonable. While only 6 percent of those who considered the effort reasonable felt IRS was discourteous, 24 percent of those who considered the effort unreasonable felt IRS was discourteous.

Manner in which the audit was conducted

Our analysis showed that taxpayers' feelings about the audit process were influenced by the size of the tax change and the effort required to gather documentation.

Although size of tax change was not significant in explaining how taxpayers felt they were treated, it was important in explaining how they felt about the conduct of the audit. For example, taxpayers who received refunds or had no tax change were more likely to see the audit as fair and impartial than were those who had tax changes above \$500. The following table shows the percent of taxpayers in each of four groups who felt that IRS had little regard for their position during the audit.

<u>Tax change</u>	<u>Percent of group</u>
Refund or no change	8
\$1 to \$200	26
\$201 to \$500	32
Above \$500	36

As shown, the likelihood of a taxpayer feeling that IRS had little regard for his position increases as the amount of tax change increases.

Of those who thought that the effort to gather documentation was unreasonable, 54 percent also believed that IRS had little regard for their position. This compares with only 16 percent of those who did not see the effort as unreasonable.

SERVICE CENTER AUDITS

Our questionnaire showed several differences between taxpayers who experienced a service center audit and those who experienced a district audit. Taxpayers who had service center audits

- had smaller tax increases but fewer no change audits,
- were more likely to have prepared their own tax returns, and
- were more likely to understand why their returns were changed.

Adjusted gross income and tax changes of respondents

The following tables show the adjusted gross incomes of the respondents and the tax changes as a result of their audits.

<u>Adjusted gross income</u> (dollars)	<u>Number of respondents</u> (note a)	<u>Percent</u>
0 to 3,000	8	4
3,001 to 6,000	33	15
6,001 to 9,000	43	20
9,001 to 12,000	36	17
12,001 to 15,000	39	18
15,001 to 25,000	39	18
25,001 or more	<u>17</u>	<u>8</u>
Total	<u>215</u>	<u>100</u>

a/Information was not available for one respondent.

<u>Tax change</u> (dollars)	Number of respondents (note a)	<u>Percent</u>
Refund	4	2
No change	25	12
1 to 100	122	57
101 to 200	37	17
201 to 300	14	6
301 to 500	10	5
501 to 800	1	-
801 or more	<u>2</u>	<u>1</u>
Total	<u>215</u>	<u>100</u>

a/Information was not available for one respondent.

Taxpayers' experience in preparing
income tax returns

Sixty-six percent of those who had a service center audit had experience in preparing their own returns, as compared to 37 percent of those who had a district audit. Of the sampled population, 41 percent prepared their own returns; 32 percent had their returns prepared by a professional or commercial preparer; and 27 percent prepared their returns with assistance from IRS, a relative, or a friend.

Taxpayers' contact with
IRS during audit

Most (88 percent) of the taxpayers in the sampled population had only mail contact with IRS during their audits, 8 percent had mail and telephone contact, and 4 percent had personal contact in addition to mail (the taxpayer may have visited an IRS office to ask questions about the correspondence received from the service center).

Taxpayers' views on IRS'
changes to their returns

Sixty-seven percent of the taxpayers in the sampled population understood why their returns needed to be changed, 17 percent did not really understand but believed IRS might be right, 10 percent did not agree but felt the

amount was not worth arguing about, and 8 percent agreed to get the audit over with or to stop interest. (The total exceeds 100 percent because the taxpayers could check more than one block.)

MISCELLANEOUS TAXPAYER COMMENTS

We solicited any comments the taxpayers might have that either expanded on or went beyond the matters covered in the questionnaire. About 180 taxpayers made additional comments. We categorized their comments as follows (the number of taxpayers who made a particular comment is shown in parentheses; the numbers total more than 180 because some taxpayers made more than 1 comment).

- IRS was correct in what it did; they were fair and/or courteous (51).
- IRS harasses taxpayers and/or subjects them to unnecessary audits (29).
- The tax laws and forms are complex and unfair to the low- and moderate-income taxpayer (25).
- Taxpayers did not understand IRS' audit procedures or why IRS adjusted their returns (17).
- IRS employees were discourteous (16).
- What IRS says goes, no matter what (15).
- IRS spends too much time auditing low- and middle-income taxpayers and not enough time auditing high-income taxpayers (13).
- Miscellaneous, including comments on the audit's timeliness (24).

Some examples of specific taxpayer comments follow.

- Change the tax laws to make the burden lighter on middle-class people.
- The tax laws are often ambiguous and different IRS offices interpret some laws differently.
- Whenever they change the forms it seems to make it all the more difficult.

- "I think it is a shame to have to go in front of a person 'as IRS,' payed by my tax dollar and for them to treat you as I was treated at IRS."
- Cannot understand the audit procedures; have been audited three times while many have never been audited.
- IRS should work on cases that involve a lot of money and leave people alone when they are only questioning a very small amount.
- Once your return is selected for audit you will most assuredly be asked to pay additional taxes because it is expected that the examiner collect more taxes.
- Always found IRS easy to deal with.
- IRS was very nice; they helped the taxpayer and explained her error in detail.
- Was treated fairly by IRS.
- "I have been audited 5 or 6 times and only once had I made an error. It is a pain in the neck to me."
- Unfair to take off work, drive 80 miles and sit for 3 hours only to hear the examiner say it was all a mistake and she was sorry.
- "To say that I felt quite humiliated by this ordeal is an understatement and I resent the implied dishonesty on my part by my contacts with these IRS people."
- Spanish-speaking examiner would benefit non-English speaking taxpayer.
- IRS took too long to do the audit.

These miscellaneous comments are not representative of the sampled population's views and our conclusions are not based on them. We cite them to show what some taxpayers had to say, both good and bad, about the tax laws and IRS on the basis of their personal experiences.

F -

CONCLUSIONS

Respondents to our questionnaire generally reacted favorably as to how IRS treated them and the manner in which IRS conducted its audits. There were certain matters, however, that bothered some taxpayers.

Some taxpayers were unhappy at being required to take time off from work without pay to be audited. Although we understand this concern, we see no easy solution. To make its audits convenient for everyone, IRS would have to work weekends and evenings, which could pose problems. For example, IRS might encounter difficulties in staffing its offices during those hours. If IRS were able to open its offices during the evening and weekend hours, taxpayer requests for appointments during these hours could easily exceed IRS' ability to satisfy them. IRS would then have to decide arbitrarily which requests to honor and which to deny. The result would be continuing taxpayer dissatisfaction. IRS could attempt to handle these audits by correspondence but such audits have their own disadvantages. Several taxpayers who had a correspondence audit indicated that they would have preferred an interview. IRS has recognized the advantages of interviews both to the Government and to the taxpayer and has expanded their use.

Other taxpayers thought that an excessive amount of effort was required to gather documentation for the audit. Unfortunately, when the effort becomes excessive is a matter of judgment, in that the examiner's decision as to what documentation he needs may not agree with the taxpayer's opinion. During our review of case files on audits completed in 1973, we saw little to indicate that examiners were unreasonable in their requests for documentation.

The major problem identified by our questionnaire was the extent to which taxpayers "agreed" to IRS' audit findings even though they did not really agree with the findings or did not understand why their returns had to be changed. Our views on this problem and our recommendations were presented in chapter 3.

IRS COMMENTS AND OUR EVALUATION

In commenting on our draft report, IRS said that (1) our conclusions on the problem of taxpayers "agreeing" to findings that they do not really agree with or understand may be biased because of the subjective nature of our question and (2) the reader is led to believe that IRS is wrong because the taxpayers agreed without understanding why.

The question we asked taxpayers--Which of the following statements best explain your reasons for agreeing?--required a subjective response, as did several of our questions. We wanted to know how taxpayers felt about their audit experiences and their dealings with IRS and why they did what they did. There was no way to avoid asking for their subjective responses.

We also asked taxpayers how IRS treated them and to describe their overall impression of the manner in which IRS conducted its audits. These questions also elicited subjective responses that were generally in IRS' favor as were the conclusions we drew from those responses. IRS did not question the nature of those responses.

We have no doubt that the taxpayers' responses as to why they agreed and the conclusions we drew from those responses are valid. The fact that the taxpayers responded favorably to IRS on other questions lends more credibility to their unfavorable responses to this one question.

We do not intend to imply, as IRS suggests, that all of these taxpayers had agreed to erroneous adjustments. On the contrary, we have no reason to doubt that IRS' audit findings were generally correct. What we are saying, based on the taxpayers' responses, is that many taxpayers are agreeing to audit findings that they think are wrong or that they simply do not understand. That is why we emphasized in chapter 3 the importance of telling a taxpayer that he can meet with the examiner's supervisor.

Commissioner

SEP 27 1976

Mr. Victor Lowe
Director, General Government Division
U.S. General Accounting Office
Washington, D.C. 20224

Dear Mr. Lowe:

We appreciate the opportunity to review your draft report to the Joint Committee on Internal Revenue Taxation entitled, "Audit of Individual Income Tax Returns by the Internal Revenue Service."

The report reflects favorably on the performance of IRS examiners during the examination of individual income tax returns. However, the report indicates a number of areas in which improvements can be made. In most instances, we are in agreement with these recommendations. Our comments regarding specific recommendations are enclosed with explanations in those situations where some disagreement exists. These are referenced to the applicable page number in the digest and report. Also, we noted a number of editorial changes which we feel should be made in the final report. These changes are listed in Attachment A.

[See GAO note.]

As with your draft report entitled "Selection of Individual Income Tax Returns for Audit by the Internal Revenue Service," we also would appreciate the opportunity of meeting with you to discuss our comments on this report. My assistant, Tom Glynn, will follow up on this to arrange a meeting.

With kind regards,

Sincerely,


Commissioner

Enclosures

- GAO notes:
1. IRS' editorial comments are not included as part of this appendix. The suggested changes have been incorporated in the report, where appropriate.
 2. Some of IRS' comments have been deleted because they pertained to points discussed in the draft report but dropped from the final report or because they were not directly pertinent to our findings, conclusions, or recommendations.
 3. Page references in IRS' comments may not correspond to pages in the final report.

GGD-76-54 Digest, Page 1, Paragraph 1

In 1975 the Internal Revenue Service audited 3.2 million individual income tax returns (1.84 million by district office and 1.32 million by service centers) resulting in recommended additional tax and penalties of \$1.4 billion.

Comments:

We recommend the above paragraph be changed to reflect the IRS position as to those returns considered audits

The IRS classifies the service center correspondence programs into two distinct categories: district-type examinations and limited contacts. The ones called district-type examinations constitute an examination of books and records as defined by Section 7602 of the Internal Revenue Code, i.e., taxpayers are required to produce a part of their records (receipts, cancelled checks, etc.) to provide documentation or substantiation to support the income, deductions and credits claimed on their tax return. These examinations, which are included in the definition of coverage, include the DIF correspondence type returns, Federal-State Cooperative programs, Social Security Administration (OAR-7000) examinations and claims. In FY 1975, IRS examined 102,500 returns in the service centers, about .13% of the 81 million returns filed in Calendar Year 1974.

The other category, limited contacts, involves isolated, special issues which do not require examination of books and records, i.e., taxpayers are not requested to provide part of their records to document or substantiate the item being corrected. Thus, these contacts

[See GAO note 2.]

APPENDIX I

APPENDIX I

are not considered examinations within the definition of Section 7602. This category includes the Unallowable Items Program, Information Returns Program, Head of Household Program and similar programs. These limited contacts accounted for 1.2 of the 1.3 million returns in the Service Center Program for FY 1975.

We recommend all references to the 1.2 million limited contacts as being "audits" be changed

[See GAO note 2.]

APPENDIX I

APPENDIX I

Number of returns filed in calendar year 1974	81,271,762
Number of returns audited	1,941,042
Number of returns corrected through limited contacts	1,219,377
Recommended additional tax and penalties	\$1.4 billion"

(3) The last paragraph on page 9 should be changed to read:

"During fiscal year 1975, the service centers, through
correspondence with taxpayers, audited or corrected
about 1.3 million individual tax returns, as follows:

<u>Program</u>	<u>Number of returns audited</u>	<u>Additional tax and penalties recommended</u>
Examinations		
Dif Correspondence	67,259	8,028,012
Federal-State Cooperative	9,076	2,685,075
*Claims	24,186	168,068
Social Security Referrals	1,963	302,385
Corrections by Limited Contacts		
Unallowable Items	952,120	111,504,044
Head of Household	209,405	11,975,222
Information Returns	34,838	4,431,614
Multiple Filers	9,765	1,092,057
Other Programs	13,249	3,126,579
Total	1,321,861	143,313,056"

*The additional tax and penalties figure on the Claims Program represents only the tax assessed above the original tax liability shown on the return and does not reflect the dollar amount of the claim disallowed. Claims disallowed amounted to \$2,221,000.

APPENDIX I

APPENDIX I

GGD-76-54, Page 18, Item 1

We recommend that IRS compute its quality review results in such a manner as to provide management with meaningful indicators of program performance.

Comments

We agree with the recommendation. A recent internal study recommended the establishment of an independent Technical and Quality Review Staff in the Service Center Audit Divisions. It was determined that an independent staff was necessary to provide a quality review and to safeguard the integrity of the review system. In order to ensure independence, the supervisor of this staff will report directly to the Chief, Service Center Audit Division. Currently, these functions are being performed in the various branches.

Our guidelines for establishing the Review staffs will provide for a uniform reporting system which will allow management to evaluate the various audit activities performed in the service centers. Quality review results will be segregated as to technical errors, which would result in taxpayers paying more or less than their correct tax, and procedural errors, which would be of concern only to local IRS management as they impede the processing of workload.

APPENDIX I

APPENDIX I

GCD-76-54-Page 18, Item 2

We recommend that IRS take steps to better insure that taxpayers do not agree to erroneous service center adjustments. In this regard, IRS should consider revising the letter used to advise taxpayers of unallowable items adjustments.

Comments:

We will change our initial contact letters for the Unallowable Items Program by moving the computation of additional tax to the bottom of the letter. This change should eliminate the aura of finality in our previous letter which could have caused a taxpayer to "agree" even though he/she didn't really understand the change or agree with it.

These items are being corrected because they are clearly unallowable by law and as such, they cannot be supported by documentation. Therefore, it is not possible to advise a taxpayer as to the type of information needed to support an unallowable item. For example, unallowable items such as some federal taxes cannot be supported. However, if the taxpayer has a legitimate deduction but has mislabeled it on the return, he/she may send us any explanatory information which will define the item. We are further revising our initial contact letters to ask taxpayers to explain any item they feel is an allowable deduction but incorrectly reported on the return. If the explanation provided by the taxpayer is satisfactory and no other items require correction, the return will not be adjusted. In Head of Household Program, the issue is questionable and therefore, an explanation is necessary in the initial contact letter.

GGD-76-54-Page 18, Item 3

We recommend that IRS revise its instructions to insure that tax returns are not adjusted for unallowable items without advising the taxpayer and giving him the opportunity to provide explanatory material.

Comments:

Our procedures, [Internal Revenue Manual 4(13)24], do not provide for summary assessment of an unallowable item if there is an offsetting math error. These procedures do provide that a taxpayer will be contacted and advised of both the math error and the unallowable item. Full appeal procedures are given for the unallowable item.

In Kansas City Service Center, one return was identified as being closed without contacting the taxpayer. On this case, there was both a math error and an unallowable item. After this problem was identified, the Kansas City Service Center instituted several corrective actions between June 1974 and July 1975. We feel that our instructions in this area (which have been in effect since 1973) are clear and no further corrective action is needed.

GGD-76-54, Page 30, last paragraph

Responses to our questionnaire indicate that only 42 percent of the taxpayers in the four districts who agreed to the examiner's findings understood why their returns had to be changed. The rest of the taxpayers agreed because, among other reasons, they felt IRS must be right, they wanted to get the audit over with, or they didn't feel the amount in question was worth arguing about.

Comments

In some instances during the examination of returns, there is reluctance on the part of taxpayers to utilize the appeal procedure. In an effort to alleviate these reactions, the Service will continue to impress upon examiners their responsibility to explain the proposed adjustments and the relevant tax laws to the taxpayers and to inform the taxpayers of their rights to appeal IRS Audit determinations without fear of reprisal.

However, we do not believe it is possible to eliminate this problem completely without a substantial simplification of the tax law. The Federal income tax law is complex and many small income taxpayers lack both the knowledge of taxes and the personal confidence to challenge the examiner's findings.

APPENDIX I

APPENDIX I

GGD-76-54, Page 34, Paragraph 3

Another inconsistency results from the fact that taxpayers who are asked to submit their supporting documentation by mail are given the option of requesting an interview while those who are asked to come in for an interview are not given the option of mailing their records.

Comment:

While the contact letters appear to make our treatment of taxpayers seem inconsistent, the letter requesting that a taxpayer come in for an interview does not prohibit him/her from mailing records in. In actuality, we know that a certain percentage do send in their records. A test in the Mid-Atlantic Region covering a six-month period showed that of the returns scheduled for interview examination 7.9% were closed by correspondence.

Through experience we have determined that aside from tax issues, other factors may indicate that an office interview examination is necessary to ensure the rights of taxpayers. These include, but are not limited to: low income in relation to financial responsibilities (number of dependents, interest expense, etc.); taxpayer's occupation is of a type requiring only a limited formal education; and, the appearance of the return indicates the taxpayer may not be able to correspond effectively (writing, grammar, etc.).

APPENDIX I

APPENDIX I

GGD-76-54-Page 37, Item 1

We recommend that IRS revise the audit report or the accompanying letter sent taxpayers who failed to respond to IRS' initial contact letter to make it clear to the taxpayer that IRS had sent him a previous letter asking him to provide support for certain items, that the items are being disallowed because he failed to provide the requested support, and that IRS will reconsider its findings if he can provide the support.

Comments:

The Handbook of Standard Explanations for Audit Report Writing System, IRM 428(11), contains a paragraph explaining to the taxpayer that adjustments have been proposed due to a lack of response to the initial request for information. We are currently revising that paragraph to further advise the taxpayer that the proposed adjustment will be reconsidered if the necessary information is provided. We also plan to take appropriate action to ensure that the standard paragraph is used in all "No Reply Cases" where adjustments are being proposed.

GGD-76-54, Page 37, Item 2

We recommend that IRS establish uniform criteria as to (1) what special situations would require assessment of additional tax regardless of the amount and (2) what constitutes an "insignificant" amount that need not be assessed in the absence of a special situation.

Comments

We concur with this recommendation. Currently we do have a general guideline in our manual which defines an "insignificant" amount of additional tax that need not be assessed. However, the manual does not preclude examiners from using judgement and forgoing the assessment of additional tax greater than the manual guideline. We will revise our manual to insure a uniform tolerance be used in all cases provided a special situation does not exist where the assessment should be made regardless of the amount.

APPENDIX I

APPENDIX I

GGD-76-54, Page 38, Item 3

We recommend that IRS require examiners to inform all taxpayers of their appeal rights, especially the right to meet with the examiner's supervisor, after they have explained their audit findings to the taxpayer but before soliciting agreement to those findings.

Comments

We basically concur with this recommendation.

Our initial contact letter (Form L-14) informs the taxpayer of his/her appeal rights, including the right to request a meeting with a supervisor to informally discuss an examiner's proposed adjustment(s) if he/she does not agree with it. IRM 4241.8, Initial Contact with the Taxpayer, requires that "At the beginning of an examination, the examiner will ask taxpayers whether they have any questions regarding the audit process, regular selection procedures and appeal rights. If the taxpayer does have a question(s), the examiner is expected to give a clear and concise explanation(s). Publication 556 (Audit of Returns, Appeal Rights and Claims for Refund) explains in detail our procedures covering examination of tax returns and appeal rights and should be furnished to all interested taxpayers." In addition, IRM 4244.1 requires that upon completion of an examination the examiner will explain the basis of the proposed adjustments to the taxpayer or his/her representative, and make an effort to obtain an agreement to the proposed tax liability. If the taxpayer indicates disagreement with any of the proposed adjustments, he/she should again be informed of his appeal rights. We plan to revise this section of the manual to require the examiner to advise the taxpayer of his/her right to discuss the proposed adjustment with a supervisor, if feasible, and inform the taxpayer of his/her formal appeal rights, i.e., District Conference,

APPENDIX I

APPENDIX I

Appellate, etc. Further, IRM 4431 provides that Publication 5, a reminder of the taxpayer's appeal rights, be included with all 30-day letters issued. In conclusion, we feel that under the procedures discussed above, both the examiner and the taxpayer will be appropriately informed.

GGD-76-54-Page 39, Paragraph 2

Group managers may review an examiner's work while the audit is in process or after the audit is completed. Our interviews with group managers disclosed wide variances in their review procedures.

Comments

This statement is misleading. The term "wide variances" indicates a problem area; however, we do not view this as a problem. There are a number of different methods which can be used by a group manager to assess the quality of an examiner's work.

IRM 4(10)20, Handbook for Audit Group Managers, instructs group managers in the process of reviewing examiners' work. Several methods are outlined in Chapters 700 (Work Performance) and 800 (Completed Work), which, based upon the needs of the various employees in a group, will provide for adequate review of in-process and closed cases. These include on-the-job visitations, workload reviews, joining in case closings, and review of completed cases.

However, it is still left up to the judgement of the manager the extent of review and personal direction each employee should receive.

[See GAO note 2.]

GGD-76-54, Page 56

Only 42 percent of the taxpayers in the sampled population who agreed with all or part of the tax change understood the need for a change.

Comments:

We feel that the conclusions reached on this point and the preceding table may be biased. Questions of this nature are more subjective than objective. Some taxpayers may not understand the reasons for an additional assessment, or will agree for seemingly inappropriate reasons, because of the nature of the tax law itself and their feelings toward it. In many instances, taxpayers may not agree and will not understand, simply because of the requirement to pay additional taxes. Based upon the inferences in the table and the following paragraphs, the reader is lead to believe that IRS is wrong because the taxpayer agreed without understanding why.

During FY 1975, 2,593 Small Tax Cases were disposed of in the Tax Court. These cases involved \$1,451,000 in dispute. Decisions were entered for the Government for \$793,000; a recovery rate of 55%. Of these cases, 1,970 were settled, in which the recovery rate was 46% (\$516,500 out of \$1,128,500). The cases in which decisions on the merits were entered were 328, with \$195,000 in dispute and \$156,000 approved, for a recovery rate of 80%.

DESCRIPTION OF SERVICE CENTERCORRESPONDENCE AUDIT PROGRAMS

Unallowable items--Items on individual tax returns which appear to be obviously unallowable by law are identified and corrected during initial processing. Some unallowable items are manually identified while others are computer identified. For those returns identified as containing unallowable items, service center audit division personnel, through correspondence with taxpayers, make necessary corrections.

Head of household--A high volume, low-cost program that corrects tax returns erroneously filed by taxpayers as unmarried head of household. The program includes returns in which the taxpayer claimed the head of household tax rate but only claimed one exemption. Tax returns meeting this condition are computer identified. The Internal Revenue Service determines if the taxpayers are entitled to the unmarried head of household tax rate by sending them a short questionnaire requiring yes or no answers.

DIF correspondence--Audit division classifiers request the highest DIF-scored low- and medium-income nonbusiness returns, review them, select those to be audited either by the service center or by the district offices, and accept the remaining returns as filed. Returns are selected for audit by the service center if they involve issues that can be resolved easily by mail (such as interest and contributions) and if information on the return indicates that the taxpayer can communicate effectively in writing.

Information returns--Information on certain types of income, such as wages, dividends, and interest, is transcribed from the taxpayer's return onto computer tape. These tapes are compared with informational tapes and samples of paper documents filed by employers, banks, and dividend-paying establishments and with Social Security Administration wage tapes. From the comparison, an inventory of potential underreporters is generated from which the audit division selects specific returns based on tax potential. A computer printed transcript is prepared for each of the returns selected, comparing the amount and type of income reported on information documents with the amount and type of income reported on the taxpayer's return. The transcripts are then screened by service center audit personnel--to further evaluate tax potential--and the returns of apparent underreporters are selected for classification. In classification the tax returns are compared to the transcripts to identify deviations. If a determination can be made that

E-

the taxpayer reported all income, but in the wrong place on the return, or that the amount of the cumulative discrepancies is minimal, the return is accepted as filed. If the cumulative discrepancies are significant, however, the returns are sent to the correspondence audit branch for examination.

Multiple filers--The National Computer Center checks returns to see if more than one return has been filed for the same year under the same social security number. If more than one return has been filed and the names on the returns have certain similarities, the returns are extracted as audit cases. Classifiers select returns for examination by the service center and for examination by the district offices. For example, two joint returns filed by the same taxpayers will be selected for examination by the service center. However, two nonjoint returns involving duplicated dependency exemptions or deductions will be forwarded to district offices.

Federal-State cooperative audit--Copies of examination reports from State tax agencies are referred to the service centers for association with the Federal income tax returns. These State examination reports and the associated Federal returns are reviewed by classifiers to identify the Federal returns to be examined under this program.

Claims--Involves the verification of refund claims filed by taxpayers with issues that can be effectively handled by correspondence. The guidelines followed by the Kansas City service center for this program provide, in part, that an evaluation is to be made of all documents in the file, and if enough information is available to reasonably accept the claim or if the claim is not worthy of examination, it is to be accepted. Also, if the item on the claim would not have been questioned on the original return, it is not to be considered questionable on the claim.

Social security referral--Social security forms OAR-7000 (Notice of Determination of Self-Employment Income) are referred to service centers when the Social Security Administration has made a determination of self-employment income. The referrals involve adjustments to tax returns for self-employment and possibly income tax. IRS procedures require these referrals to be classified.

Interest paid on redemption of H bonds--The Federal Reserve Banks prepare information reports on series H bond payees and sends copies to the service center for the district

in which the bank is located. IRS procedures provide for the taxpayer service division at the service center to assemble these reports with the payees' tax returns and refer them for classification by audit personnel.

Highway use tax--The service centers received, through a private organization, information on State motor vehicle registrations, useful in determining the proper reporting of highway use tax. In selecting returns for examination under this program, IRS instructions provided that service center personnel match this information with the highway use tax return to determine deficiencies. Those returns with apparent deficiencies were sent to service center classifiers who screened out those cases involving a large number of vehicles. Those cases were forwarded to the appropriate district office; cases involving a small number of vehicles were retained for service center examination. This service center program was discontinued in November 1975.

Runaway parents--State welfare agencies periodically requested the last known address of a parent who had deserted and no longer supported his or her family. In addition to supplying the requested addresses, IRS used the names and social security numbers provided by the welfare agencies to identify returns for audit. Under this program, IRS checked whether the runaway parent had claimed a spouse and/or children as exemptions. Instructions for this program provided that only nonjoint returns would be selected for examination by the service centers and that joint returns would be sent to the appropriate district office. In selecting nonjoint returns for examination, the instructions provided that classifiers would screen the returns to insure that the taxpayer had claimed exemptions for children. Also, the complete return would be screened and other significant questionable items would be identified for audit. If the other identified issues required an interview audit, the return would be sent to the appropriate district office. This service center program was discontinued in November 1975.

E-

SAMPLING METHODOLOGY AND STATISTICAL
ANALYSIS OF TAXPAYER QUESTIONNAIRES

To obtain taxpayers' views on audits conducted in the four districts included in our review, we obtained a random sample of taxpayers whose audits were closed in 1973. Our sample included audits conducted by the district offices and by the affiliated service centers. IRS reviewed a list of taxpayers included in the sample and the names of those who were then being audited or who had a collection matter outstanding were deleted to minimize any possible taxpayer relations problems. Tax records of the sampled taxpayers were reviewed and the type of audit (district or service center) was noted.

We mailed questionnaires to the taxpayers, using an abbreviated version for those who experienced a service center audit, ^{1/} and mailed a followup questionnaire to those who failed to respond to the first. We also personally interviewed 59 taxpayers randomly selected from those who had not responded to either the initial or the followup questionnaire to determine if the views of the nonresponding taxpayers differed from the views of the respondents.

Estimating population characteristics

To project the results of the sample to the sampled population, it is necessary to address sampling error and response rate. Because the response rates were about 70 percent, we could not statistically assess the error associated with population projections. Our interviews with taxpayers who did not respond to our questionnaire, however, indicated that the views of those who did not respond were no different from those who did. Therefore, we based our analysis on the assumption that taxpayers from whom we received information, either by questionnaire or interview, were representative of the sampled population.

^{1/}For questionnaire purposes, we considered service center audits done under the DIF correspondence program to be district audits because they are similar to correspondence audits done by the district offices.

Correcting for sample size

Because we were equally interested in taxpayers' views in each of the four districts, we used approximately equal sample sizes. This resulted in a larger proportional sample in the less populated areas. We corrected for this non-proportional sampling whenever we estimated population characteristics. The correction was made by multiplying each response by a weighting factor. The weighting factor for each questionnaire was computed by dividing the ratio of the population of each group to the total population by the ratio of the sample number in each group to the total sample. Separate weighting factors were computed for district and service center audits.

PRINCIPAL OFFICIALS RESPONSIBLE FOR
ADMINISTERING ACTIVITIES
DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
SECRETARY OF THE TREASURY:		
William E. Simon	Apr. 1974	Present
George P. Shultz	June 1972	Apr. 1974
John B. Connally	Feb. 1971	June 1972
David M. Kennedy	Jan. 1969	Feb. 1971
COMMISSIONER OF INTERNAL REVENUE:		
Donald C. Alexander	May 1973	Present
Raymond F. Harless (acting)	May 1973	May 1973
Johnnie M. Walters	Aug. 1971	Apr. 1973
Harold T. Swartz (acting)	June 1971	Aug. 1971
Randolph W. Thrower	Apr. 1969	June 1971
ASSISTANT COMMISSIONER (COMPLIANCE):		
Singleton B. Wolfe	Mar. 1975	Present
Harold A. McGuffin (acting)	Feb. 1975	Mar. 1975
John F. Hanlon	Jan. 1972	Jan. 1975
John F. Hanlon (acting)	Nov. 1971	Jan. 1972
Donald W. Bacon	Sept. 1962	Nov. 1971
DIRECTOR, AUDIT DIVISION:		
John L. Wedick, Jr.	June 1975	Present
Peter J. Medina (acting)	Mar. 1975	June 1975
Singleton B. Wolfe	July 1965	Mar. 1975