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Report to the Congress; by Elmer B. Staats, Comptroller General.

Issue Area: Automatic Data Processing: Social Impacts of Computer-Based Systems (109); Tax Administration (2700).
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Congressional Relevance: Congress; House Committee on Ways and Means; Senate Committee on Finance.
Authority: Privacy Act of 1974 (5 U.S.C. 552a). Tax Reform Act of 1976 (26 U.S.C 6103).

The Tax Administration System (TAS) was proposed to meet the Internal Revenue Service's (IRS's) information needs through extensive use of interactive online processing and decentralization of the tax account master files. Because of uncertainties relating to costs and benefits of the system and concerns about privacy, plans for TAS were discontinued and, instead, funds are being sought to upgrade the current system. Observations developed during a review of TAS may be useful in evaluating requests for future computer systems.
Findings/Conclusions: In seeking approval for TAS, IRS noted that its current computer systems would be overtaken by increasing workload, obsolescence, and decreased manufacturer spare parts and maintenance support by the mid-1980s. IRS' current equipment, with planned enhancements, had substantial workload growth capacity, and there did not seem to be a basis for concerns that manufacturers would withdraw support. IRS' 1975 cost-benefit analysis, used as support for its fiscal year 1977 budget request, overstated expected benefits by about $607 million, and an additional $458 million lacked sufficient documentation for verification. In a revised analysis prepared in May 1977, 50% of expected benefits were again overstated or undocumented. It was difficult to evaluate the adequacy of the system's privacy provisions, but instances were observed in the areas of linkage, consolidation, and derivation of data which may require tightening of laws protecting the confidentiality of tax returns. A long-range equipment replacement plan is needed for IRS' computer system which will require a critical, well-documented analysis of problems and alternatives.
Recommendations: Congress could amend section 6103 of the Internal Revenue Code to expressly prohibit IRS from linking or consolidating tax returns or return information for non-tax administration purposes. (HTW)

1604

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

An Analysis OF IRS' Proposed Tax Administration System: Lessons For The Future

This report describes and analyzes the methodology used by IRS in determining computer system requirements and in documenting the need for those requirements, the capability of existing equipment to handle workload increases, and the privacy implications inherent in a large computer system.

GGD-78-43
MARCH 1, 1978

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

B-137762

To the President of the Senate and the
Speaker of the House of Representatives

This report presents the results of our work on IRS' proposed computerized Tax Administration System (TAS). Our work was done in response to specific requests of the Joint Committee on Taxation and the Oversight Subcommittee of the House Committee on Ways and Means as well as in response to interest expressed by the House Committee on Government Operations, the Senate Committee on Governmental Affairs, and the House and Senate Committees on Appropriations.

TAS, conceived in 1969, was the subject of Congressional concern and controversy since funds were first requested. In fiscal year 1977, funding was denied because of uncertainties over the costs and benefits. IRS again unsuccessfully requested funding in fiscal year 1978. Further problems developed in the wake of increasing Congressional concern over whether TAS would violate the privacy rights of individuals spelled out in the Privacy Act of 1974 and, more recently, the Tax Reform Act of 1976. Finally, in 1978, the Administration announced that it was no longer proceeding with TAS. Instead, funds are being sought to upgrade the current centralized system to improve IRS' administration of the tax laws.

Although the long struggle by IRS to gain approval for TAS is over, Congress may be faced with similar requests for large computer systems in the future. To assist those making such requests and to assist the Congress in making funding decisions, we offer the following observations developed during our review of TAS.

First, Congress should not be placed in the position of reacting to urgent go/no-go decisions. In seeking Congressional approval for TAS, IRS noted that its current computer systems would be overtaken by increasing workload, obsolescence, and decreased manufacturer spare parts and maintenance support by the mid-1980's. These observations were made to stress the importance of gaining immediate approval for TAS.

We found that IRS' current equipment had substantial workload growth capacity. With currently planned enhancements, the outlook appears good to handle anticipated workload increases well into the 1980's. Further, the only truly obsolete computers were those being used as high-speed printers, a job for which IRS was buying specially designed replacement equipment. The remaining equipment, while not the most advanced, is expected, according to the manufacturers, to be supported well into the 1980's and possibly into the early 1990's. IRS is concerned that, in the absence of an obligation to do so, manufacturers may withdraw support. We are not aware of any instances where total support was withdrawn by a manufacturer while its equipment was in use.

Second, Administration studies in support of any new system should stand up to scrutiny. In our November 23, 1976, report on the costs and benefits of TAS ("A Proposed Automated Tax Administration System for Internal Revenue Service--An Evaluation of Costs and Benefits," LCD-76-114), we noted that IRS' 1975 cost-benefit analysis, used as support for its fiscal year 1977 budget request, overstated expected benefits by about $607 million and an additional $458 million lacked sufficient documentation for verification. Together, these overstatements and unsubstantiated benefits accounted for about 50 percent of total claimed benefits.

In reviewing the revised cost-benefit analysis prepared in May 1977, we again found that about $1 billion or about 50 percent of the expected benefits were overstated or undocumented by supporting studies.

Third, in any large-scale system such as TAS in which it is planned to store and use information about individuals, an evaluation of privacy implications should be an integral part of the orderly process of considering the system. During our work, many Congressional concerns were raised about the adequacy of the system's privacy provisions and the governing privacy legislation. IRS continually tried to be responsive to those concerns. But the understandable lack of system specificity at such an early stage of development made it difficult to always discuss adequately some of the privacy concerns and sometimes drew attention away from the basic question of the need for TAS or some other computer system to assure continued efficient administration of our tax laws. Nevertheless, we observed instances in the areas of linkage, consolidation, and derivation of data where the Congress may want to tighten laws already protecting the confidentiality of tax returns.

Unfortunately, the Government cannot stand still while the Administration and the Congress attempt to unravel the costs, benefits, privacy implications, and other matters intrinsic in a large-scale computer system. Even though IRS is no longer seeking TAS, its computer equipment will eventually become obsolete. Therefore, a long-range equipment replacement plan is needed.

During deliberations over the need for new equipment, the Congress may want to require the Administration to support IRS' requests with a critical analysis of the problems faced by IRS' operating divisions; alternatives, including computerization to solving the problems; and the costs and benefits of each alternative. The results of this analysis should be tied into the long-range plan for improving IRS' computer operations.

Well documented analysis is essential. It is not enough, for example, for IRS to assert that tax auditors need rapid retrieval of tax information and that, if they have it, productivity will increase 2 percent. It may be, upon rigorous analysis, that IRS needs to improve its taxpayer services more than its audit efficiency, and the solution may be better training programs, more telephone circuits, and more work space rather than a revised computer system.

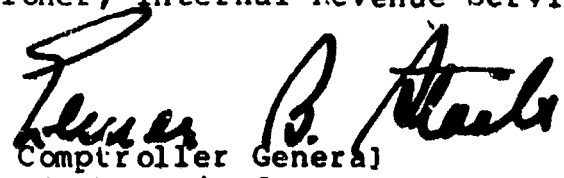
IRS should be allowed to proceed with interim equipment replacements to allow breathing space in those cases where it is apparent that current workload increases will overcome the current computer capacity. Care should be taken, however, not to allow large-scale and costly interim upgrades which, once installed, would need extensive modification to merge with the long-term improvement effort.

Existing legislation generally circumscribes the collection and use of tax returns and return information. However, there are some aspects of existing privacy legislation which could be tailored more closely to any proposed large-scale computer system with the technical potential for internal linkage, data consolidation and derivation, and electronic linkage with other computer systems.

The Congress should act on the recommendation in our January 17, 1977, report ("Safeguarding Taxpayer Information--An Evaluation of the Proposed Computerized Tax Administration System," LCD-76-115), that legislation be passed prohibiting direct electronic linkage between IRS' computer systems and other computer systems. If the Congress wants to provide further protection, it could amend section 6103 of the Internal Revenue Code to expressly prohibit IRS from linking or consolidating tax returns or tax return information for non-tax administration purposes except as authorized by Federal statute.

The Commissioner of Internal Revenue generally agrees with our observations (see appendix I). He agreed to continue to follow through on the implementation of a sound security program and carefully consider our comments on the need for well-documented requirements studies. He agreed to use judicious and prudent care in proceeding with interim equipment upgrades.

We are sending copies of this report to the Acting Director, Office of Management and Budget; the Secretary of the Treasury; and the Commissioner, Internal Revenue Service.



Comptroller General
of the United States

CONTENTS AND SUMMARY

ABBREVIATIONS

CDC	Control Data Corporation
FOIA	Freedom of Information Act
GAO	General Accounting Office
IRS	Internal Revenue Service
OTA	Office of Technology Assessment
TAS	Tax Administration System

CHAPTER 1

INTRODUCTION

TAX ADMINISTRATION WITH COMPUTERS

The Internal Revenue Service (IRS) converted to computers because statistics showed that the Service's workload was increasing beyond the capacity of conventional manual and machine processing capabilities. The Commissioner, in February 1959, presented an ADP program to the Congress and received House and Senate budget approval in June 1959. The system was implemented during the 1960s and has been changed and adapted over the years in response to frequent legislative changes, workload growth, and increasing program demands.

Although the IRS organizational structure is decentralized, the data processing structure within the Service is centralized. Taxpayer master files are maintained at the National Computer Center.

Under the current system, taxpayers usually file returns directly with the service center in their geographic area. The centers put tax data on magnetic tapes, perform certain computer editing and verification checks and send the tapes to the National Computer Center for further processing. In addition, the centers prepare and process taxpayer correspondence and account for tax returns and monies received.

According to IRS officials, the original ADP system was based on early technology, and subsequent enhancements have consisted largely of piecemeal improvements. This has resulted in considerable duplication of effort and inefficient operations. The heart of the problem, according to IRS, is the inability of the present system to readily access master file tax account data needed to answer taxpayer inquiries and meet other IRS program needs.

The Service determined that its tax administration needs could no longer be effectively fulfilled within the constraints of the present system's design. Consequently, in November 1973, the Commissioner of Internal Revenue advised the Department of the Treasury that the ADP structure of IRS' existing system needed complete redesigning. Programmatic approval to acquire a new computer system was granted by the Office of Management and Budget in September 1975.

THE PROPOSED TAX ADMINISTRATION SYSTEM (TAS)

The proposed new system called for extensive use of interactive online processing and decentralization of the tax account master files from the National Computer Center to the 10 existing service centers. The National Computer Center was to be redesignated the National Communications Center. It would have maintained a centralized account directory and backup master files, and served as a switching point for transmission of data between service centers. User terminals were to be located in the service centers and various field offices.

To overcome problems of the present system, IRS envisioned TAS providing

--faster access to all account information by major IRS offices,

--daily posting of tax returns and account information to taxpayer accounts in the master file,

--maintenance of additional data from tax documents on the computer including account history data,

--linkage between related taxpayer accounts,

--five years of accessible data maintained in computer files, and

--reduced transcription of taxpayer identifying data.

IRS estimated in its May 1977 cost-benefit analysis that TAS would cost about $1.8 billion to develop, operate, and maintain during its 12-year economic life as compared to $1.7 billion to enhance and operate the current system.

The Service's principal objective of the redesigned system was to provide more responsive service to taxpayers and IRS functional activities by accelerating tax return processing and by providing increased information for taxpayer inquiries and operational needs of the Service. An essential element of the new service-oriented system was quicker access than in the past to more current information by employees of more IRS offices.

We reviewed

--the capability of IRS' current data processing system to handle projected workload increases,

--the capabilities of TAS identified as being beneficial for tax administration including rapid retrieval of information, taxpayer account audit history, linkage of related accounts, and the extent TAS would collect and retain taxpayer data not presently maintained on the current system,

--the benefits claimed in the May 1977 update of the TAS cost-benefit analysis originally prepared by IRS in 1975,

--the privacy implications of a TAS-like computer system.

We reviewed pertinent documents and interviewed high-level officials and supervisory and staff personnel having responsibilities for the above areas. We visited IRS' national office; San Francisco, Cincinnati and Philadelphia district offices; and the Cincinnati service center.

CHAPTER 2

CAPABILITY OF IRS' EXISTING COMPUTER EQUIPMENT TO MEET FUTURE NEEDS

In our preliminary discussions with IRS officials, we were told that the current equipment at the 10 service centers would be overtaken by workload, obsolescence, and decreased manufacturer support by the mid-1980's. In testimony before the House and Senate Appropriations Committees for fiscal years 1977 and 1978, IRS officials stated that some of the equipment dates from the 1960's and the mid-1980's is about as long as the current equipment could be operated. Since TAS would not have been fully implemented until 1985, IRS believed it important to get Congressional approval to proceed immediately. Given this, we were concerned that, should TAS be delayed until our review was completed, IRS would be put in an untenable position.

Our first effort therefore, in response to Congressional requests, was to evaluate the workload growth potential of the existing systems, and the extent to which the existing systems would be obsolete by the mid-1980's. We limited our work to service center equipment because IRS has stated that this is its greatest area of concern. We concluded that, with several enhancements currently in the process, IRS has substantial growth capability with its existing service center equipment. Further, it appears that manufacturer support will be available at least well into the 1980's and probably into the 1990's. A more detailed discussion of our review of utilization is discussed in the following pages.

The components of IRS' current service center data processing system and related functions are as follows:

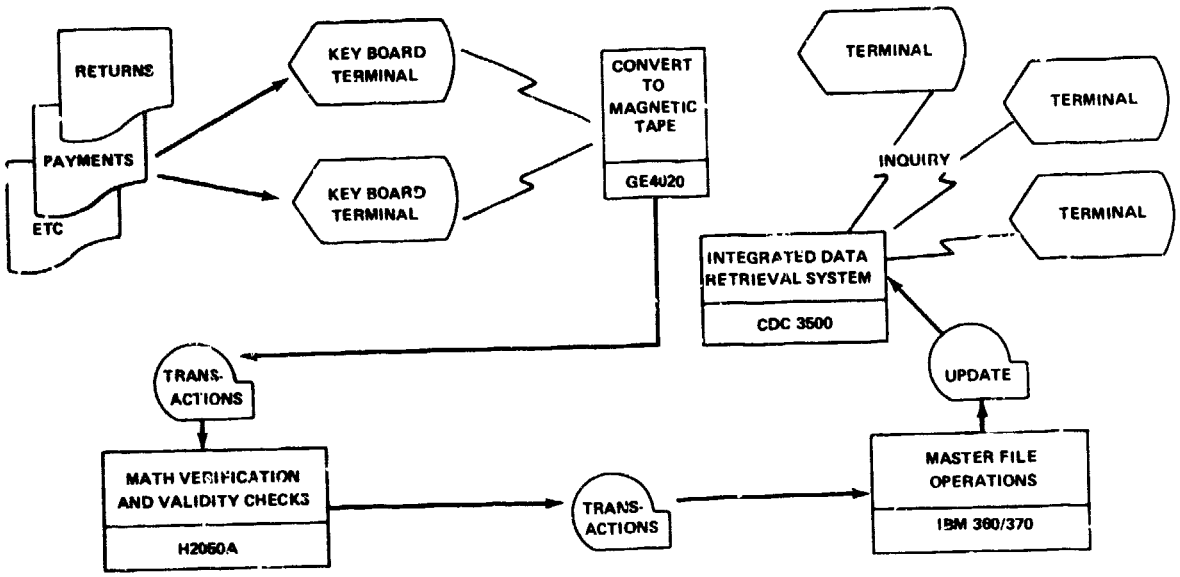
--General Electric 4020. Two 4020s are installed at each service center and are used to convert taxpayers' returns to magnetic tape via keyboard terminals. This process is known as the Direct Data Entry System.

--Honeywell 200. Two H200s are installed at each service center. One, a small model, is used mostly for printing. The second, a larger model, is used also for printing and for other service center processing.

--Honeywell 2050A. These computers, one at each service center, are used to verify taxpayers' calculations and perform other service center processing.

--Control Data Corporation 3500. These computers, one at each service center, support the Integrated Data Retrieval System. This system, through the use of computer terminals, provides immediate access to current information on about 10 percent of the taxpayers on IRS' master file records. Its coverage is based on the probability of taxpayer inquiry and IRS need.

The following shows the general relationship among the major service center computer systems.



GENERAL ELECTRIC 4020

Current Utilization and Potential for Increased Capacity

At the time of our work, each service center had the following keyboard terminals in use to support the Direct Data Entry System.

Andover, MA	448	Fresno, CA	512
Atlanta, GA	448	Kansas City, MO	512
Austin, TX	512	Memphis, TN	512
Brookhaven, NY	544	Ogden, UT	480
Cincinnati, OH	448	Philadelphia, PA	472

One service center conducted a test to determine how many terminals the 4020 computer would support. The center determined that supporting above 320 terminals degrades response time and causes system overloads. Since each service center has two 4020 systems, 640 terminals can therefore be supported per service center. Thus, the service centers have a terminal growth capacity ranging from 96 (15%) to 192 (30%) per center. The overall terminal growth capacity is about 24 percent. In addition to adding more terminals, increased workload capacity can be achieved by more fully utilizing existing terminals. From January 31, 1977, to May 21, 1977, the service centers staffed considerably fewer terminals than were available.

In its TAS computations, IRS estimated that overall returns would increase about 20 percent between 1974 to 1985, from 122 million to 147 million.

Vendor Support

The General Electric computer equipment interests were purchased by Honeywell Information Systems, Inc. Honeywell, therefore, provides support on the 4020 computers. Several years ago, Honeywell made a commitment to IRS to support the 4020s through the life of TAS, as the Direct Data Entry System was going to be continued under TAS.

A follow-on computer called the 4500 is in production. According to Honeywell representatives, the 4500 is program and hardware compatible with the 4020.

HONEYWELL 200

The small H200 computers will be released and replaced by high-speed nonimpact printers in fiscal year 1978.

Part of the larger H200 computers' workload also will be transferred to the new high-speed nonimpact printers before their planned release in fiscal year 1981. The remaining workload will be transferred to the H2050A computers.

Because of the above, we did not review the utilization of the H200 computers. IRS does not have readily available information on what impact phasing-out the larger H200 computers will have on the H2050As, but we have been told that the impact will probably not be significant. However, since these machines are owned by IRS, the option is open to retain them as a supplement to the H2050A computers.

HONEYWELL 2050A

According to IRS, the H2050A computers are the most critical to returns processing in terms of their capacity to handle workload growth and the adverse effect should manufacturer support be withdrawn.

Current Utilization and Potential for Increased Capacity

To determine the extent of current utilization, we obtained utilization data on magnetic tape for all 10 service centers and visited the Cincinnati service center. We conducted a computer analysis of the utilization data covering the period January through April 1977. The results of this analysis show, by day and month

--idle time,

--the number of minutes during which 0, 1, 2, 3, . . ., n jobs were in process, and

--the number of minutes during which various amounts of core storage (memory) were used. 1/

The H2050A is capable of running 10 programs concurrently (multiprogramming). At times, however, operational demands may be such that the possible number of concurrently run programs may be reduced.

1/IRS' H2050A has 256,000 characters of memory. However, not all of the 256,000 is available for job processing. We were informed by IRS that it is reasonable to consider 200,000 characters of memory as being available for job processing, by subtracting 56,000 needed for overhead to operate the computer.

The following tables show the results of our computer analysis of memory usage and multiprogramming levels attained for March 1977. March was the busiest month for eight of the service centers and close to the busiest month for the remaining two centers. All figures are rounded to the nearest percent.

Although IRS does not schedule the H2050A on a 24-hour per day 7-day per week basis, we based our utilization analysis on this period because these hours would be available should the workload expand.

PERCENTAGE OF TIME AT
DIFFERENT LEVELS OF ACTIVITY
BY THE H2050A
MARCH 1977 a/

	Capacity Used			
Service Center	Idle b/	Under 50%	50% to Less Than 75%	75% or More
Andover	26	35	23	16
Atlanta	16	21	28	35
Austin	16	49	26	9
Brookhaven	15	41	33	12
Cincinnati	16	25	33	27
Fresno	6	29	38	28
Kansas City	19	24	31	27
Memphis	10	28	32	30
Odgen	9	31	33	28
Philadelphia	17	19	29	36

a/May not total 100 percent because of rounding. Also, due to IRS' method of accounting, this data does not include system requirements for input reading of the job control language--demanding one partition and 8,000 positions of memory each time used.

b/Idle time is time during which no jobs were recorded as being processed.

PERCENTAGE OF TIME AT DIFFERENT MULTIPROGRAMMING LEVELS ATTAINED BY THE H2050A MARCH 1977 a/

Service Center	Number of Jobs		
	0	1-3	4 or more
Andover	26	65	9
Atlanta	16	32	53
Austin	16	75	9
Brookhaven	15	79	7
Cincinnati	16	59	26
Fresno	6	43	52
Kansas City	19	62	20
Memphis	10	51	39
Ogden	9	69	22
Philadelphia	17	44	39

a/May not total 100 percent because of rounding. Also, due to IRS' method of accounting, this data does not include system requirements for input reading of the job control language--demanding one partition and 8,000 positions of memory each time used.

As shown in the tables, no center was active at 75 percent or greater of capacity more than 36 percent of the time, and only two centers reached a multiprogramming level of 4 or more jobs greater than 50 percent of the time--Atlanta - 53 percent, Fresno - 52 percent.

Based on our analysis of usage, utilization of the H2050A falls below the maximum possible. Although we recognize that it is not practical to continually operate at the maximum, we believe the analysis demonstrates that the H2050A computers have considerable room for growth in the workload.

IRS studies also show room for growth. In 1976, IRS' Internal Audit group conducted computer utilization reviews at the Ogden and Fresno service centers. Also, in 1976, the TAS Evaluation and Procurement Staff conducted a study of the 2050A at the Kansas City service center using a hardware monitor. The Internal Audit group reviewed 2050A utilization during February 1976, while measurements using the hardware monitor were taken during the period April 29 through June 2, 1976.

The following are some highlights of these studies.

	Ogden	Fresno	Kansas City
Percentage of total available time not processing and no maintenance being performed	36a/	28a/	b/
Percentage of average available core storage used	54	59	49
Average number of jobs run concurrently	2.9	2.5	2.4

a/Some of this represents gaps in the processing history.

b/Information not determined in study.

In considering the growth capacity of the 2050A computers, it is clear that the systems are currently being used to less than full capacity.

Future Workload

IRS does not have reliable estimates of the future workload on its H2050A computer systems. While IRS does not plan to add new applications to the H2050A systems, we understand that planned increases in the document matching program will require the H2050As to process an average of less than one additional job concurrently. In addition, it is possible that future tax legislation could impact on the H2050A workload.

The TAS Evaluation and Procurement Staff concluded in a 1976 study that of three potential limiting factors to undertaking additional work--memory, central processing unit, and input/output devices--memory was the most critical factor in limiting the capabilities of the H2050A. IRS is in the process of enhancing the 2050As by doubling each machine's current memory capacity. The purpose is to 1) accomodate a new input/output control system, and 2) allow more jobs to be run concurrently. IRS also plans to add more powerful tape drives to the system.

Vendor Support

IRS' H2050A computers are in the 2000 computer series manufactured by Honeywell Information Systems, Inc. The H2050A was first marketed in September 1972. IRS obtained its H2050As in 1974. In our discussions with Honeywell representatives, we were told that there are upwards of 1,000 computers in use from their 2000 series and that Honeywell foresees providing support to IRS into the 1990's.

We recognize that Honeywell is not obligated to provide indefinite support for its equipment. However, in a March 1977 letter to IRS, Honeywell stated that it plans to support the 2000 series computers for as long as there are ongoing users. Specifically, Honeywell committed itself to 1) accept orders for new H2050A central processing units through 1981, 2) accept orders for peripheral equipment well into the 1980's on an inventory available basis, 3) support the H2050A system software indefinitely, and 4) provide spare parts and on-site equipment maintenance at least until 1984 and probably into the 1990's.

In our discussions with IRS officials, we were told that IRS is concerned that because the manufacturer is not obligated to support its computers indefinitely, support could be withdrawn leaving IRS with no means to maintain its equipment. This is a concern which faces all users of aging computers. We are not aware of any instances, however, where the manufacturer withdrew total support while its equipment was in Government use.

CDC-3500

The CDC-3500's are used for real-time processing during the day and batch processing at night. We have not extensively analyzed current utilization, but there do not appear to be problems in accomplishing current workloads.

IRS is seeking approval to acquire an additional CDC-3500 for each service center and the national office. The purpose of these 11 additional computers is to handle workload growth from existing applications and planned new applications.

IRS' latest estimates on workload growth and capacity of the dual CDC-3500 systems were made during August 1977. These estimates show the dual systems will handle the expected workload through 1985, with considerable growth capacity still remaining.

Vendor Support

IRS obtained its CDC-3500s in 1975. As mentioned in our discussion on vendor support for the H2050A, manufacturers are not obligated to support their equipment indefinitely. In our discussions and correspondence with high-level CDC representatives, however, we learned that support is planned well into the 1980s.

CONCLUSIONS

On the basis of current available information, the outlook appears good for IRS to continue well into the 1980's with existing equipment and still be able to handle its workload and obtain vendor support.

CHAPTER 3

EVALUATION OF TAS

BENEFITS

IRS originally made a cost-benefit analysis in 1975. We made a study of the reasonableness of the analysis in 1976 1/ and concluded that about $1.1 billion of the claimed $2.1 billion in benefits were either overstated or unsubstantiated by quantitative analysis. In May 1977 IRS issued an updated version including our recommended adjustments, interim plan items, a more evolutionary implementation plan and adjustments for cost-price changes. We reviewed $1.5 billion of the $2.0 billion in benefits claimed in the May 1977 cost-benefit analysis and concentrated on the Audit and Intelligence Divisions which, together, account for $1.4 billion or 72 percent of total expected benefits. We did not examine $495.6 million of TAS benefits nor the cost of the system itself as estimated by IRS. A summary of the TAS costs and benefits as shown in the IRS' May 1977 cost-benefit analysis is as follows:

		Amount (in millions)
Benefits:		
Gross TAS benefits	$ 2,004.5	
Gross present system enhanced benefits	- 336.4	
Incremental TAS benefits		$1,668.1
Costs:		
TAS cost	1,842.1	
Present system enhanced cost 2/	- 1,709.9	
Net TAS cost		132.2
Net TAS benefits		$1,535.9

1/"A Proposed Automated Tax Administration System for Internal Revenue Service--An Evaluation of Costs and Benefits" (LCD-76-114, November 23, 1976).

2/Present system enhanced costs include the estimated expenditures which would be incurred to enhance the present system and to maintain the enhanced system, including capital investments and recurring annual costs.

TAS BENEFITS CLAIMED BY IRS

In its May 1977 cost-benefit analysis, IRS estimated gross TAS benefits to be about $2 billion based on a 12-year economic life.

Functional area	Benefits (in millions) Employee cost savings	Additional revenue
Audit	$ 22.8	$1,199.2
Intelligence	16.0	207.6
Tax Return Processing	215.1	-
Collection	22.2	158.1
Taxpayer Service	58.0	-
Data Center	12.0	-
Employee Plans/ Exempt Organizations	.4	83.3
Statistics	4.9	-
Internal Audit	-	4.3
Technical	.4	-
General Litigation	.2	-
Total	$352.0	$1,652.5
Total benefits	$2,004.5	

Due to a general lack of documentation, we were unable to express an opinion on the cost-benefit analysis as a whole. However, our review, which concentrated primarily on the Audit and Intelligence Divisions showed that in the new cost-benefit study benefits again were overstated. IRS included revenue to be gained from the saving of professional staff time resulting from the automation of the Audit Division's monthly time reports which we believe will not be realized. IRS also miscalculated revenue from Audit research and special projects and included Intelligence and Statistics Division benefits which were no longer valid or had already been obtained with the current computer system.

In addition, the benefits IRS estimated from Audit Division's rapid retrieval of and availability of additional taxpayer information were questionable.

In all, we questioned about $1 billion of the $1.5 billion in claimed TAS benefits which we examined. The amount questioned represents about 50 percent of total TAS benefits claimed by IRS.

Schedule of GAO Adjustments to IRS Cost-Benefit Analysis Based On Personnel Savings Plus Revenue Method (in millions)

Gross TAS benefits per 1977 analysis		$2,004.5
Less our adjustments:		
Audit		
Automating monthly time reports	137.7	
Unrealistic projections of staff-year estimates	111.3	
Miscalculation of revenue from research and special projects	4.6	
	253.6	
Intelligence	223.6	
Statistics		
Withdrawal of benefits from computerizing operating programs	4.9	
Total adjustments		482.1
Gross benefits less adjustments		1,522.4
Questionable Benefits for Audit		
Rapid retrieval		
Audit history		512.7
Benefits not examined or unadjusted		$1,009.7

AUDIT DIVISION BENEFITS WERE QUESTIONABLE

IRS estimated that TAS would increase revenue by $1.199 billion and save manpower costs of $22.8 million by satisfying certain computer support requirements (needs) of the Audit Division. These benefits, amounting to a total of $1.22 billion, were to result primarily from the ability to 1) rapidly retrieve computerized tax information, 2) provide additional tax information with every return to be audited, and 3) automate monthly technical time reporting. The benefits from rapid retrieval and additional information were about $512.7 million. Benefits from automating monthly technical time reporting were estimated to be about $137.7 million.

We found that some of the requirements--rapid retrieval of information and audit history--while apparently valid, could not be documented and it was questionable whether estimated benefits of $512.7 million could be achieved. Other stated requirements--automation of time reporting--were invalid. Some additional benefits were computed using improper assumptions. As a result, we found that $253.6 million in stated Audit benefits were unjustified.

Rapid Retrieval of Tax Information May Be Needed But Requirements Undocumented And Benefits Questionable

IRS estimated that the biggest benefit of TAS to tax auditors and revenue agents would be the ability to rapidly retrieve tax information thereby allowing more returns to be audited. In its 1975 cost-benefit analysis, IRS estimated that about $458.3 million in additional revenue would be generated by using this TAS feature. The May 1977 cost-benefit analysis did not identify the amount of additional revenue to be generated, but we found that rapid retrieval was the primary Audit benefit.

Some of the information to be retrieved included information from related returns of taxpayers and spouses, partners and partnerships, and principal corporate officers and corporate returns. In addition, TAS would have allowed Audit personnel to retrieve tax information from previous or subsequent tax years on the same taxpayers.

There May Be A Potential Need For Rapid Retrieval

As discussed on page 19, IRS did not document the need for rapid retrieval of tax information. We, therefore, reviewed 150 office audit cases and 60 field audit cases to determine whether rapid retrieval would have improved IRS audit operations. Office audits are conducted by tax auditors in IRS offices, and field audits are conducted by revenue agents at taxpayers' homes or business places.

Many examinations by tax auditors and revenue agents involve related returns and require comparing information on the related returns. For example, data concerning divorced taxpayers is usually needed to compare alimony paid with alimony received and exemptions claimed for children. Also, on some returns examined, tax auditors and revenue agents must request information from previous or subsequent years' returns for information on transactions or adjustments affecting these years such as carryovers on installment sales of property. Under TAS, IRS believed that audit cases could be closed quickly; thereby avoiding continued taxpayer contact, supervisory reviews, and the need to reassign cases because of delays in obtaining supporting documentation.

Our sample of cases tends to substantiate IRS' claims that the TAS rapid retrieval feature could be useful for tax auditors and revenue agents. However, as discussed on page 20, the extent to which benefits would result was questionable.

In 17 (11 percent) of our sample office audits and in 2 (3 percent) of our sample field audits we believe TAS may have had the potential for saving time by rapidly retrieving information in the files from related returns or from previous or subsequent years. The following examples describe how:

--One case, which was reassigned twice, involved an issue raised subsequent to the initial interview. The new issue related to income received from an installment sale of land. The taxpayer had incorrectly reported this income on the return being audited and possibly on previous years' returns. The tax auditor requested previous years' returns from the taxpayer, because it would have taken too

long to obtain them from storage. The taxpayer never provided previous years' returns and the case was delayed significantly. The tax auditor told us that it may have been very helpful if she could have requested, via the TAS terminal, line items from previous years' returns. TAS may have provided quicker case closing, avoided case reassignment, and provided better taxpayer relations.

--One case involved issues of exemptions, real estate taxes, and alimony payments. Case closing was delayed because the taxpayer's former spouse had to be contacted to verify that she had not claimed the same exemptions and that she had reported alimony income. The TAS retrieval feature may have assisted the tax auditor by providing information from the former spouse's return. The case may have been closed at the initial interview, avoiding contact with the taxpayer's former spouse.

--The issues in one case were exemptions, contributions, casualty losses, and education expenses. To find out whether this taxpayer's ex-husband was claiming a child as an exemption, IRS had to mail him a letter after getting the address from the taxpayer. If TAS had furnished a list of related returns, the tax auditor would have known the name and address of the taxpayer's ex-husband. In addition, information from the ex-husband's return would have told the tax auditor whether the ex-husband was claiming the child as an exemption. In this case, IRS wrote the ex-husband, and after getting no response, wrote again. Two months after the first letter, the taxpayer's ex-husband telephoned the tax auditor and stated that he did not claim the child as an exemption. If the correspondence had not been necessary, the audit would have been closed months earlier, since no additional information was furnished by the taxpayer after the initial interview.

--One case, a complicated one, involved the issues of capital gains and losses and rental income and expenses. The case was reassigned twice and took over a year and a half to complete. The taxpayer had incorrectly reported income from a capital gain on the sale of property. To resolve the case the tax auditor had to adjust a subsequent year return. The tax auditor told us it would have helped had he been able to call up information from the subsequent year return to determine when the taxpayer had reported income from the sale. TAS may have provided this information.

--One case involved two issues which may have had TAS potential: alimony payments and subchapter S stock loss. The taxpayer was divorced and paid alimony which was verified by cancelled checks. The case file did not indicate that the ex-spouse's return was checked to determine whether alimony income was reported. TAS linkage features would have made this possible. In addition, the taxpayer claimed the total losses on stock, although the divorce settlement had given 25 percent of the stock to the ex-spouse. The tax auditor told us that linkage to the ex-spouse would have been useful to determine whether she filed and if she did, whether she claimed her portion of the stock loss. TAS may have avoided the time it took to correspond with the taxpayer's ex-spouse to verify this issue.

--One case was open for one year and three months and was reassigned once. The issue which caused the delay in closing the case was exemptions. The taxpayer had been divorced for eleven years and claimed two children by his former wife (the custodial parent) based on child support payments. The ex-wife had remarried and had another child with her current husband. The tax auditor obtained the address of the ex-wife from the taxpayer and wrote to the ex-wife. The auditor mailed letters on three more occasions before finally receiving a response five and a half months after the first letter. The custodial parent also claimed the children as exemptions and provided more support than the taxpayer. The linkage feature of TAS may have helped the tax auditor determine that this was a contested exemptions case much sooner than it took through correspondence.

Benefits From Rapid Retrieval Not Documented

In computing the benefits to be achieved through rapid retrieval, IRS estimated that this ability would increase auditor productivity by a factor of about 2 percent. As pointed out in our November 23, 1976, report on TAS costs and benefits 1/ this expected increase in productivity was not supported by quantitative analysis.

1/"A Proposed Automated Tax Administration System for Internal Revenue Service--An Evaluation of Costs and Benefits" (LCD-76-114, November 23, 1976).

When we began our work in May 1977, IRS still had not prepared any quantitative analysis to document this expected increase in productivity. It was not until November 1977 that IRS sampled actual audit cases in an attempt to document TAS benefits in the audit function.

In discussing with IRS officials the reasons why this primary requirement was not documented, we were told that the estimated benefits were based on their professional judgment and they felt the expected productivity increases would be achieved.

Attainment of Benefits From Rapid Retrieval Questionable

As stated above, IRS estimated that the ability to rapidly retrieve tax information would increase auditors' productivity by 2 percent thereby resulting in substantial increases in tax revenues.

Although we recognize that rapid retrieval of tax information may be useful, the extent to which benefits would result is questionable. TAS was still in the conceptual stage and had not been specifically defined at the time of our work Further, rapid retrieval features would only have potential in audits involving certain tax issues, and IRS had not determined how much audit time is devoted to examining any particular issue in an audit case.

Benefits to be derived from rapid retrieval depend saving time which can be used to audit additional ret... The initial TAS concept was to provide every auditor and ag... individual access to a computer terminal. This concept, however, proved impractical and IRS changed to the position that terminals would be centralized to serve a group of Audit personnel. Since IRS had not yet specifically defined how audit groups would access the system, we could not determine whether time could be saved.

In November 1977 IRS sampled some actual audit cases in an attempt to document rapid retrieval benefits. This analysis concluded that a 4.4-percent increase in productivity could be achieved.

However, in calculating the increase, IRS had no basis for estimating the time which would be required to access the terminals. IRS assumed it would take virtually no time to access TAS. In reality, accessing TAS may have taken much longer because each auditor would not have a terminal.

Rapid retrieval is not needed in most audit cases. In an audit, most of the information required by the auditor to complete the audit must be furnished by the taxpayer. For example, data supporting contributions, medical expenses, business expenses, casualty losses and other common audit issues are external to IRS and can only be provided by the taxpayer. Dependents and alimony issues, however, had potential TAS benefits because IRS files contain related data which could be retrieved for use in the audit.

To indicate how often rapid retrieval might be needed in resolving audit cases, we examined returns where the audit issues were already identified and were awaiting assignment to tax auditors. We randomly sampled over 700 returns in which 1,567 audit issues had been identified. The results are shown below.

ISSUE	FREQUENCY OF OCCURENCE NUMBER		PERCENT	
Rapid retrieval may have helped in most cases				
--Alimony	32		2.0	
Subtotal		32		2.0
Rapid retrieval may have helped in some cases				
--Dependents	191		12.2	
--Taxes	89		5.7	
Subtotal		280		17.9
Rapid retrieval would not have been helpful				
--Medical, Dental	158		10.0	
--Casualty losses	143		9.1	
--Contributions	140		8.9	
--Interest expense	126		8.0	
--Miscellaneous or business expense	121		7.7	
--Rental income and expenses	86		5.5	
--Other issues	481		30.7	
Subtotal		1,255		79.9
Total		1,567		99.8

As shown above, rapid retrieval may have been useful in only about 20 percent of the total number of audit issues examined. Further, the amount of audit time spent on any given issue was not available. Tax auditors and revenue agents record time spent on cases in total, not by issues. We found that most cases involve more than one questionable issue. Since TAS could only provide benefits on certain issues, we were unable to determine how much time could be saved on those TAS-related issues.

We recognize that the benefits from rapid retrieval, even though applicable to a small percentage of audit issues, could conceivably result in an overall 2-percent productivity increase. However, because the percentage of audit issues for which rapid retrieval would offer potential TAS benefits was limited and the amount of time spent on any given issue was unavailable, we believe that a careful analysis of the potential benefits should have been performed.

Audit History Information Has Potential for Improving Productivity, But Extent Is Unknown

One of the most significant elements of tax information which TAS was to furnish with every return audited was prior year audit history. Audit history would show prior year audit results, the issues examined, the name of the examiner, and other information. IRS believed that having audit history data would enable better selection of returns requiring audit and would eliminate taxpayer contacts on previously audited issues.

As with the benefits to be achieved by rapidly retrieved tax return information, IRS did not have an estimate of the amount of benefits to be realized. We were told, however, that the benefits would be substantial.

Our review of a sample of 150 office audits and 60 field audits indicated that prior audit history information may be helpful. In 6 (4 percent) of our sample office audit cases, and in 12 (20 percent) of the field audit cases, the availability of data on prior year audits may have avoided long delays in closing the case or even eliminated the audit altogether. We also interviewed 80 tax auditors and 49 revenue agents and many believed that having complete audit history information would help in conducting audits.

Specific examples of cases where the audit history data may have been helpful are as follows.

--One case file indicated that the tax auditor had no information on prior audits before the initial interview with the taxpayer. At the time of the initial interview the taxpayer said he had been audited the previous year for the same issues. One of the issues was depreciation expense on rental property. The case was not closed at the first interview because the tax auditor needed additional items of information from the taxpayer. One of the additional items of information needed by the tax auditor was the prior year audit report regarding depreciation. The tax auditor requested this prior year report from the taxpayer and was provided it about a month and a half later. TAS may have helped the tax auditor by providing information from the prior year audit, thereby saving time, resolving the case easier, and resulting in better taxpayer relations.

--Another case involved a widow's 1975 return. Her husband died in October 1974. The most complicated issue examined was the installment sale of property. The tax auditor told us that after spending considerable time on the installment sale issue, the taxpayer's representative informed him that the taxpayer was previously audited by the IRS estate and gift tax group. The taxpayer's representative showed the tax auditor the prior audit report. The tax auditor told us that he could have saved all the time spent on the installment sale issue had he been aware of the previous audit.

--On a field audit case the revenue agent said that he learned during his first meeting with the taxpayer that the taxpayer had been audited repetitively for the same issues for 10 previous years with little or no adjustment. The revenue agent said he would have avoided the audit entirely had he known this before the initial meeting. Avoiding the audit would have not only saved revenue agent time but contributed to better taxpayer relations.

The availability of past audit information would help IRS avoid unnecessary repetitive audits. As noted in our

report on repetitive audits 1/ IRS personnel generally did not know what tax issues were previously examined because such information was not readily available. To reduce repetitive audits, IRS relies on taxpayers to bring to its attention any tax issues scheduled to be questioned which have previously been examined without adjustment.

The current IRS computer system identifies the latest tax year examined and the dollar results of that examination but does not tell what tax issues were previously examined. To obtain this information, the past audit file must be requested or a document listing the issues must be kept locally for reference. Neither is generally done because the time and costs involved would be significant.

It is questionable, however, whether TAS would provide significant additional benefits in this area because in early 1978 IRS plans to implement a system for use when an audit results in no tax change. In such cases, up to five examined issues will be computerized. Although the data would not be as complete as that planned for TAS, this system will undoubtedly assist in eliminating unnecessary repetitive audits.

Expected Benefits from Automated Monthly Time Reporting Questionable

In addition to benefits from its rapid data retrieval and audit history features, IRS estimated that TAS would save tax auditors' and revenue agents' time by reducing the time spent in preparing monthly time records. In its 1975 cost-benefit analysis, IRS estimated that the time saved by this automation would be used to increase the number of audits and could amount to increased revenues of $458.3 million.

In our November 23, 1976, report, we reported that IRS overstated the amount of time to be saved by automating the monthly time reports. As a result, only about $123.3 million in additional revenue could be expected. IRS officials agreed with us and revised their May 1977 cost-benefit analysis accordingly. During our current work, IRS officials told us that savings would still result because TAS would automatically preprint a list of revenue agents' cases in inventory and total and check monthly time records for both tax auditors and revenue agents. When updated for the 1977 cost-benefit analysis, the additional revenue resulting from this time saving would be about $137.7 million.

1/"Repetitive IRS Audits of Taxpayers are Justified" (GGD-77-74, November 18, 1977).

In our current work, we found that the revised estimate of additional revenues was also questionable. Tax auditors in the district offices we visited currently spend little or no time preparing monthly time reports. In all three districts, auditors record time on a daily record. These daily records show tax auditor time expended for every one-tenth hour. A clerk uses these daily records to prepare monthly time reports. Thus, it is questionable whether TAS could save any tax auditors' time on monthly reports, since they do not prepare them.

Revenue agents do prepare a monthly time report. The agent lists cases worked on during the month, shows the time spent on each case and on other activities, and totals the columns. Agents usually keep the time sheet up-to-date by periodically recording time expended on cases. Then, at the end of the month, agents total the time spent, sometimes recopying it first. Based on our interviews, we do not think automatic adding of hourly totals would save any time. We believe most agents would still check all totals for accuracy before submitting the report under such a system. Thus, we do not believe time would be saved.

Revenue agents told us that TAS, by preprinting their cases in inventory each month would save some time, since an agent would only need to add cases picked up during the month rather than listing all cases. The amount of time saved by this feature would vary greatly depending on the number of cases to be listed. Many agents believed this feature would save only a few minutes per month.

Overall, it is highly questionable whether the $137.7 million in estimated additional revenue would be realized.

Growth in Audit Staff-Year and Workload Estimates Unrealistic

In its May 1977 cost-benefit analysis, IRS overstated benefits for the auditing function by $111.3 million because of an unrealistic growth factor in the computations.

IRS assumed a 10-percent annual increase in revenue agent staffing to compute TAS benefits. According to IRS officials, this estimate was based on an average increase of about 10 percent in returns examined for fiscal years 1971 through 1974.

We found that a 10-percent growth factor did not reasonably project IRS' staffing expectations. Historically, IRS has had an increase in revenue agents and tax auditors of 2.3 percent.

	BUDGET REQUEST		ACTUAL	
FISCAL YEAR	Staff Requested	Percent Increase (Decrease) (note a)	Staff Received	Percent Increase (Decrease)
1971	15,959	-	16,012	-
1972	16,521	3.18	16,652	4.00
1973	17,586	5.61	16,638	(.08)
1974	18,238	9.62	18,411	10.66
1975	18,820	2.22	19,027	3.35
1976	18,482	(2.86)	18,548	(2.52)
1977	18,300	(1.34)	18,354	(1.05)
Average compounded increase		2.31		2.30

a/This figure represents the percent increase (decrease) requested over the preceding year actual staffing.

As shown above, IRS has averaged an increase of 2.31 percent in their budget requests to Congress; actual increases averaged 2.3 percent.

On the basis of IRS historical staff-year statistics and requested appropriations received, we believe a reasonable growth factor would be 3 percent. Using this factor, we estimate that increased revenue from staffing growth should be reduced by $111.3 million.

Expected Audit Revenue Overstated Because of Incorrect Adjustments

IRS overstated expected revenue for the Audit Division because savings of 26 technical staff-years were incorrectly included when IRS updated revenue for the 1977 cost-benefit study. Adjusting for this error results in total revenue of $1,194.6 million, $4.6 million less than what IRS computed it to be.

INTELLIGENCE DIVISION BENEFITS NO LONGER VALID

There were three general areas in which it was planned that TAS would satisfy Intelligence needs: 1) storing new and additional information about taxpayers in computer records, 2) providing ready access to all IRS information - both currently available and new information - for use in identifying tax violators, evaluating alleged violations, and developing cases, and 3) providing better case management and control, and improved management information.

These requirements were to be met under four TAS applications

--gather, collate and disseminate background data,

--evaluate alleged violations,

--investigate and prosecute, and

--management information systems.

IRS estimated in the TAS cost-benefit studies that these applications would allow Intelligence to achieve a 14-percent increase in technical productivity. This was to have created minor personnel cost savings and substantial increases in revenue by allowing special agents to work more and better cases. In the May 1977 cost-benefit study, the increased productivity was to result in a revenue increase of about $207.6 million and staff-year savings of about $16.0 million.

Our review showed that none of the stated Intelligence requirements supporting the May 1977 cost-benefit study were valid. Some have been deleted, some have already been accomplished, and some were planned to be implemented before TAS would have been implemented. In November 1977, the Intelligence Division reviewed its stated requirements and concluded that they were no longer valid. Intelligence personnel believed that a major study would be required to update their requirements, but planned no such effort until approval of TAS.

We also found that benefits originally estimated for Intelligence in its 1975 cost-benefit study were questionable. The estimate of a 14-percent increase in technical productivity was based on judgment and could not be supported by empirical data. IRS Intelligence personnel agreed that the 14-percent productivity increase was subjectively assigned without any supporting studies.

Gather, Collate and Disseminate Background Data

As originally planned, this TAS application would have enabled Intelligence to gather and process new information on taxpayers. For example, TAS was to allow entry and retention in computer records of information on large banking transactions, references to illegal activities, and State and Federal licenses. TAS was also to provide the capability to accumulate, by taxpayer account, data on interest, dividends and wages received. This data is currently submitted to IRS on information returns.

Intelligence has now determined that this capability is no longer needed. A current IRS system provides matching of about 40 percent of total taxpayer records with data on wages, interest and dividends received. Disclosure provisions in the tax laws, the Privacy Act and changes in IRS policy on information gathering have altered and restricted Intelligence activities to the extent that remaining portions of this application are no longer needed.

Since Intelligence no longer believes it necessary or desirable to gather and store this data and is already accomplishing the other requirement, it seems apparent TAS could not produce any of the benefits originally envisioned for this application.

Evaluate Alleged Violations

This application was expected to make available to Intelligence all pertinent IRS data for use in evaluating allegations of tax violations. This package was to include data on previous allegations, records of large banking transactions, data from taxpayers' returns, and linkage to related tax returns. This application has, to a large extent, been obtained under existing procedures for evaluating referrals and information items.

Many Intelligence cases come from Audit or Collection Division referrals: about 75 percent of the Cincinnati District's Intelligence cases, about 57 percent of San Francisco's and about 44 percent of Philadelphia's. We reviewed referral files and interviewed Intelligence Division officials and found that information needed for evaluation was collected by the division making the referrals before sending them to Intelligence. Intelligence personnel do not gather any additional information beyond that provided by the referring division except for occasionally requesting a return. Since the referral package which comes to Intelligence is normally complete for evaluation purposes, there was very minor potential for TAS applications in this area.

Information items are allegations of tax violations which may come from the public, other Government agencies or be developed by special agents. They are forwarded to service centers where a clerical staff gathers available IRS information on the taxpayer. A tax examiner or special agent then reviews the item which may be closed to files, referred to Audit or Collection, or forwarded to the Intelligence activity at a district office. At the district office, a special agent continues the evaluation for criminal potential by gathering information from external sources such as county records of deeds and mortgages.

The procedure for gathering available IRS data on information items and making initial evaluations at the service centers was established after the original TAS requirements study. In a recent review of TAS requirements, the Intelligence Division determined that this procedure, called the Centralized Evaluation and Processing of Information Items System, had already accomplished this TAS application for information items.

Since Intelligence already receives all available IRS data for evaluating allegations, no significant TAS benefits remain in this area.

Investigate and Prosecute

The requirements study identified a need to assist the investigative process by

--improving case management and control, and

--providing internally available IRS data quickly on a case under investigation.

The study also indicated a need for complete cross-reference and linkage between related tax entities.

Since then, Intelligence has stated that the planned conversion of the Case Management and Time Reporting System to the existing Integrated Data Retrieval System in October 1978 will meet Intelligence needs for improved case management and control.

Special agents in the three districts we visited spent 73 to 80 percent of their direct time investigating cases. Therefore, we selected and reviewed 64 Intelligence cases at the Cincinnati, Philadelphia and San Francisco districts to determine whether TAS linkage or rapid retrieval features could help in gathering information during an investigation. Out of 64 cases, we found 57 (89 percent) on which TAS would have been no help. In seven cases, TAS may have been of limited assistance to the special agent. For example:

--One case involved an individual who allegedly had underreported his income. The taxpayer and his wife were the sole shareholders in a corporation, of which the special agent did not learn until about two months into the investigation. TAS linkage features may have identified the related corporation sooner, but whether this would have been of benefit to the investigation is questionable.

--Another case involved three persons who were detected as having filed multiple false and fictitious returns. A significant part of the investigation was to identify all the false returns which had been filed by searching service center records by names and addresses. TAS may have helped by providing quicker and more complete file searches.

The information included in the case files which came from internal IRS sources consisted primarily of tax returns and account transcripts. Internal information, however, represented only a small portion of the total evidence gathered during investigations. Further, as stated previously, this internal information is gathered during or before the evaluation phase. Therefore, on most cases, a special agent would not need to obtain this data during the investigative phase.

TAS may have yielded some improvement by providing quicker access to this internal information when it was needed. However, we saw no instances where the special agent could not continue to investigate other aspects of the case while waiting for the internal information.

Although the ability to rapidly retrieve data may occasionally be helpful to Intelligence, we question whether any significant benefits would result. As to TAS linkage features, we could identify only minor instances in which linkage might be helpful. Moreover, IRS has stated that no significant benefits can be projected for Intelligence from this feature.

Management Information Systems

We did not review this proposed TAS application. However, IRS believes that requirements for this application have already been obtained through the current program.

STATISTICS DIVISION BENEFITS SHOULD NOT BE ASSOCIATED WITH TAS

IRS overstated the TAS benefits by including clerical savings of $.7 million and technical savings of $4.2 million from the Statistics Division. (IRS also overstated the present system enhanced benefits by the same amount.)

Prior to the issuance of the May 1977 cost-benefit analysis, representatives from Statistics realized that all of the improvements they had associated with TAS could be accomplished using the current system before TAS was implemented. A significant portion of the estimated benefits previously attributed to TAS have already been realized because of systemic improvements made in Statistics of Income operating programs. The remaining

benefits will be achieved through further improvements in the current system.

OTHER MATTERS

IRS may have understated the Audit revenue through the omission of two claimed benefits from the 1977 cost-benefit analysis: interest savings resulting from faster processing of returns having a refund due and identification of potential unreported income from related accounts.

The Internal Revenue Code requires IRS to pay interest on refunds that are not issued within 45 days from the due date of the return (usually April 15th) or the return's receipt date if filed after the due date. IRS believes that TAS would have reduced the number of returns that require longer than 45 days to issue the refund. In the 1975 cost-benefit analysis, IRS estimated that this would save $11.3 million in interest.

IRS also envisioned that TAS would have enabled auditors to follow up leads on potential unreported income of related accounts such as unreported alimony payments, interest received from financial institutions, or partnership distributions. IRS estimated in its 1975 cost-benefit analysis that this would produce $27.4 million revenue (additional tax plus accrued interest) which would otherwise be overlooked.

Due to the lack of quantitative documentation, we were unable to verify the increased revenue claimed. We, therefore, did not adjust the total TAS benefits to reflect these claimed increases in revenue.

CONCLUSIONS

Some of the planned TAS features could help IRS in carrying out its tax administration responsibilities. For example, the ability to retrieve information from related tax returns and previous and subsequent tax years could help to resolve audit cases.

However, IRS did not adequately demonstrate that TAS was needed. Some of the stated TAS requirements appear to have been invalid or to have been already satisfied. For example, all the Intelligence Division requirements appear to have been satisfied by the current system or planned changes to the current system. Others appear to have questionable bases for computing their benefits. All requirements which we examined were substantially lacking in quantitative documentation.

In total, we believe that about $1 billion of the $1.5 billion in claimed TAS benefits that we examined are questionable.

CHAPTER 4

PRIVACY IMPLICATIONS OF TAS PROPOSALS

The confidentiality of taxpayer information is becoming an increasingly important Congressional and public concern. Realizing the need to safeguard the confidentiality of taxpayer and other information, the Congress passed legislation designed to provide protection--(1) the Privacy Act of 1974 (5 U.S.C. 552 a) and (2) section 1202 of the Tax Reform Act of 1976 (26 U.S.C. 6103).

These Acts are designed to safeguard individuals' privacy from misuse of Federal records, give individuals access to records about themselves held by Federal agencies, and in general provide for confidential treatment of tax returns and return information. The Freedom of Information Act of 1966 (5 U.S.C. 552), as amended, requires an agency to make available to the public certain information about its operations.

Various committees and Members of Congress were still concerned, however, that the immediate availability of personal information provided by TAS would have increased the possibility for widespread abuse. Among the specific Congressional concerns in this regard were

--the extent to which TAS would have collected and retained taxpayer data not currently maintained,

--the possible linkage of taxpayer's accounts to other IRS records and with other computer systems within and outside the Government, and whether controls or limitations with respect to such linkages are necessary,

--the adequacy of privacy legislation in protecting the taxpayer from potential abuses such as those identified in the Office of Technology Assessment (OTA) report of March 1977,

--the security of TAS data,

--the adequacy of IRS' internal policies in implementing privacy legislation, and

--the need for any additional Congressional oversight during the development of TAS.

In attempting to respond to the above concerns, we reviewed as much of the TAS documentation as was available during 1977 and held numerous discussions with responsible IRS officials. Since TAS was still in the conceptual stage, much specific information with respect to its detailed design was not yet available. The results of our work are, therefore, based on the TAS design concept as it existed during much of 1977.

We found that IRS had no plans to collect and retain significant additional information not already in its files. The account linkages planned were consistent with tax administration purposes. The privacy legislation is generally adequate to protect the taxpayer from the potential abuses identified by OTA. Further, IRS is committed to maintaining adequate security over tax data, and has established internal policies in consonance with the privacy legislation.

EXTENT OF NEW INFORMATION IN TAS

We reviewed IRS' October 1977 update of individual taxpayer master file descriptions, discussed file contents with IRS officials, and compared the data proposed for TAS with those transcribed and maintained on the current computer system or paper files. A complete analysis was not possible because: (1) TAS documentation described the type of general information rather than specific pieces of information, (2) a complete listing of all pieces of information contained in current files was not available, and (3) some of the information was obtained from IRS officials without further verification by us. Nevertheless, as best we could determine, IRS projected maintaining or transcribing in TAS about 470 pieces of data on individual taxpayers. This is about 170 pieces of information more than transcribed or maintained on the current computer system.

Type of data	Pieces of information about individual taxpayers to be computerized under TAS
Currently maintained in computerized files	300
Currently maintained in paper files	160
New data not currently in computerized or paper files	10
Total pieces of TAS computerized data	470

This tends to support IRS' contention that the projected contents of TAS files were not new, but rather a consolidation of existing IRS files.

Types of Data to Be Computerized Under TAS

The types of data currently maintained either wholly or partially in paper files but planned for computerization under TAS included

--information on which IRS office is working on an account and the account status,

--cross-references between accounts (discussed further on page 36 thru 39),

--prior year audit results,

--sources for levies on collection cases,

--collection history and status records,

--enforcement history records,

--status of investigations,

--information to verify mathematical computations,

--results of the Taxpayer Compliance Measurement Program,

--data from information documents submitted by employers,

--authorized taxpayer representatives,

--training files of simulated taxpayer data, and

--information to protect the system's security.

An example of information currently in paper files but planned for computerization in TAS is the collection history record. IRS believed that, since about 60 percent of delinquent taxpayers are repeaters, the computerization of such data as delinquent taxpayers' phone numbers, attorney identification, and personal and real property description would facilitate the faster collection of tax liabilities and the securing of delinquent returns.

Another example is data such as wages, interest and dividends paid obtained from information documents submitted by employers (Forms W-2, 1099, and 1087). Currently, about 40 percent of these documents are matched. Under TAS, all would have been matched to assist in detecting failures to file income tax returns and underreporting of income.

The new data that was to be included on TAS, which is neither in current computerized files nor paper files, consisted of data to maintain accounting control over the account, the taxpayers' state of residence and state tax amount to administer piggybacking and an indicator showing whether a taxpayer's representative is properly authorized to represent the taxpayer.

Another concern associated with TAS was whether information on an individual's religious, speech, and assembly habits would be computerized. The confidentiality of medical information was also a concern.

Our review of the TAS documentation showed that IRS had no plans to computerize information on a person's religious, political, and other affiliations, such as union membership. Such information may appear on an individual's income tax return and may, for example, be requested to substantiate a deduction when a taxpayer's return is audited. Similarly, IRS had no plans to computerize an individual's medical information except the amounts deducted for medical and dental expenses (which are already computerized for such purposes as mathematical verification, and audit selection).

Under section 3(e)(7) of the Privacy Act IRS is, however, not prohibited from collecting information about a person's affiliations if pertinent to and within the scope of an authorized law enforcement activity. During our work, we reviewed a statistical sample of closed tax fraud cases to determine whether such information is routinely collected and would, therefore, be available for computerization from these sources, if desired. Of the 40 cases we examined, we found one instance where an individual's affiliation with an organization had been recorded in an Intelligence case file. The individual had volunteered this information to the IRS special agent as a reason why IRS was investigating him. In fact, the investigation was initiated because the individual had allegedly filed false withholding certificates and failed to file his individual income tax return.

As for medical information, we were told that this information is routinely requested of the taxpayer upon initiation of a tax fraud case. If the taxpayer agrees, the information is gathered. Of 40 closed tax fraud cases we sampled, we noted medical information was maintained in six instances. We reviewed the use made of this information and found that it was used in deciding whether to prosecute the taxpayer. IRS, because it is difficult to gain a conviction on tax fraud cases, does not want to increase this difficulty by attempting to prosecute a taxpayer suffering from chronic or severe illness.

We believe that, even though the medical information used in IRS' law enforcement activity is volunteered by the taxpayer, such information should be purged from the file upon case closure. Once purged from IRS' file, the information would no longer be available for possible misuse.

EXTENT TO WHICH TAXPAYERS' ACCOUNTS WOULD HAVE BEEN LINKED TO OTHER ACCOUNTS AND OTHER COMPUTER SYSTEMS

A major area of Congressional concern was the extent to which taxpayers' accounts in TAS would have been linked within IRS' records and with other computer systems within and outside the Government. We were asked to evaluate whether such linkages need to be controlled or limited.

We reviewed the TAS documentation to determine the types of data linkages proposed for TAS and their planned use. We found that the types of linkages planned were cross-references between related accounts to assist in taxpayer audits, tax fraud investigations and collection cases. IRS had no plans to electronically link TAS with other computer systems in or out of Government.

While the creating of cross-references between accounts is not expressly prohibited by law, the use of such cross references is regulated by existing privacy legislation. Similarly, while electronic linkage between other computer systems is not expressly prohibited, the use of such linkage is regulated by law.

Cross-Referencing of Related Accounts is the Only TAS Linkage Planned

With TAS, IRS would have been able to cross-reference related accounts for use in taxpayer audits and intelligence investigations. Our review of the TAS documentation showed some of the cross-references considered included

--taxpayer's individual return with the spouse's return,

--taxpayer's individual return with the ex-spouse's return,

--partner's individual return with the other partners' returns and the partnership return,

--principal officer's individual return with the corporate return,

--beneficiary's individual return with the estate return,

--taxpayer's individual return with the tax preparer,

--taxpayer's individual sole proprietorship return with the related employment and excise return,

--principal shareholder's individual return with the controlled corporation's return, and

--taxpayer's individual return with the return of a trust or joint return.

According to IRS, these linkages could be used as appropriate to offset credits in one account against tax due in another, provide Audit and Intelligence personnel with a complete examination package showing taxpayer relationships to other taxpayers and sources of income, provide an additional source for detecting nonfiling of required returns, identify multiple claiming of dependents, and provide another source for identification and correction of multiple, invalid, or inactive accounts on the file.

Our review of the planned audit uses to be made of these account linkages indicates that they offer a potential for improving the efficiency with which IRS carries out its tax administration responsibilities (see chapter 3). For example, alimony and dependents are common issues examined when auditing the returns of divorced taxpayers. Access to information on the former spouse's return could, based on our work, avoid unnecessary contacts with the former spouse, and, in some instances, speed up the audit process. The linkage between the returns of sole proprietors and their related business returns could assist in determining whether all taxes have been paid. The planned linkage between taxpayers' returns and tax return preparers could assist IRS in administering its return preparer program, which is directed against unscrupulous tax return preparers.

In the intelligence area, linkages may have some limited value in the course of an investigation. For example, in cases where an allegation has been made that a taxpayer has underreported his income, linkages may identify related accounts which may affect the course of the investigation. As pointed out on pages 29 and 30, however, we believe that the linkage feature of TAS has only marginal value in intelligence investigations.

Extent to Which Cross-References Between Accounts Need to Be Controlled

We reviewed the Privacy Act of 1974 and the Tax Reform Act of 1976 and found that, while cross-references between accounts are not expressly prohibited, the use of such cross-references is generally restricted to persons who need the information to perform their official duties.

Section 3(b) of the Privacy Act of 1974 provides that

> "No agency shall disclose any record which is contained in a system of records . . . except . . . to those officers and employees of the agency which maintains the record who have a need for the record in the performance of their duties."

Similarly, section 6103(h)(1) of the Internal Revenue Code, as amended by the Tax Reform Act of 1976 provides that tax return and return information shall be disclosed to Treasury Department officers and employees ". . . whose official duties require such inspection or disclosure for tax administration purposes."

These two provisions, while not expressly prohibiting IRS from arbitrarily cross-referencing accounts would, in our opinion, allow the use of cross-references only for tax administration purposes.

Linkages Between Other Computer Systems

System-to-system linkage between IRS and other computer systems does not currently exist nor was it planned for TAS, although such linkage is not expressly prohibited by law. The Tax Reform Act of 1976 makes confidential treatment of tax information mandatory unless disclosure is authorized by Federal statute. In our January 17, 1977 report 1/ we suggested that the Congress may nevertheless wish to consider legislation making such direct electronic linkage between IRS' Tax Administration System and any other computer system unlawful. IRS officials support this suggestion.

ADEQUACY OF PRIVACY LEGISLATION IN SAFEGUARDING TAXPAYER INFORMATION UNDER TAS

OTA issued a report in March 1977 which noted that the availability of TAS data might make the temptation to misuse the information irresistible, or worse, the actual use undetectable. Many of the issues raised in the report reflected anxieties and fears about how TAS technology could pose a threat to civil liberties, privacy and due process rights of taxpayers. These threats might include a potential for surveillance, harassment, or political manipulation of files.

Congressional committees have also expressed concern that more immediate access to information regarding all facets of an individual's personal life will bring about a greater possibility for widespread abuse and increase the probability that the information will be used for improper surveillance and inequitable treatment of taxpayers. The committees were particularly concerned about the difficulties a system such as TAS presents for assuring individual privacy, due process, confidentiality, accountablity, oversight, and security.

We agree that TAS, like other 20th century technologies, could be an instrument for violating citizens' rights if its uses were unrestricted. The uses of TAS or any IRS computer

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1/"Safeguarding Taxpayer Information--An Evaluation of the Proposed Computerized Tax Administration System" (LCD-76-115, January 17, 1977).

system and the parameters within which IRS can operate, however, are circumscribed by statute. The major privacy legislation governing IRS' operations includes the Privacy Act of 1974, the Freedom of Information Act of 1966, as amended, and the Tax Reform Act of 1976. While the passage of laws has historically not deterred unprincipled men from violating constitutional and statutory restraints, the existence of legislation setting the parameters within which IRS operates cannot be ignored.

In response to Congressional concerns, we reviewed this legislation as it relates to the OTA issues of information in the system, users and uses of information, faster processes, and accountability. We did not address the effectiveness of the legislation nor the effectiveness of IRS procedures in protecting against potential abuses. To have done so would have been beyond the scope of this review.

Following is a summary of our findings. Our complete analysis is included in appendix II.

Information in the System

In this area, OTA was concerned that IRS, using TAS, potentially could violate the privacy rights of taxpayers by collecting, maintaining, controlling, and using personal information.

We reviewed the extent to which existing privacy legislation circumscribes the 1) taxpayer information IRS can collect, 2) criteria used in determining the need for taxpayer information, 3) creation of new personal information (derived data) out of pieces of existing information, 4) consolidation of records, and 5) impact of retaining five years of tax data on civil liberties and due process.

With regard to the taxpayer information which IRS can collect and the criteria used in determining the need for such data, we note that section 3(e)(1) of the Privacy Act restricts the information agencies may maintain to that which is "relevant" and "necessary," and provides that agencies cannot maintain information except pursuant to an agency purpose required to be accomplished by statute or executive order. Moreover, information can be collected only when the agency's goals and programs cannot reasonably be met through alternative means. 1/ In acquiring their information,

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1/Senate Report No. 1183, 93d Cong., 2d Sess. 46 (1974).

agencies are to rely primarily on the individual concerned when the information may result in an adverse determination about the individual's rights.

As to the consolidation and derivation of records, the privacy legislation, while not expressly prohibiting the act of consolidating and deriving data requires information used by an agency to be relevant and necessary and related to the purpose for which it was collected. Further, the Act requires IRS to give notice to the taxpayer as to proposed uses of consolidated or derived data.

None of the Acts relating to privacy specify data retention periods. Under TAS, IRS planned to retain taxpayer data in computerized form for five years rather than three years as is done in its current computer system. IRS believes that the additional two years of data does not alter its basic retention policies which are governed by section 6501 of the Internal Revenue Code on limitations on assessments and collection. In addition to the general rule that taxes must be assessed within three years of filing, the Code provides exceptions which include no time limit for fraudulent returns, willful attempts to evade tax, and nonfiler cases; a six-year limit for a return with a substantial omission of income; a six-year limit on substantial understatements of the gross estate or total gift; and a six-year limit on excise tax omission. IRS also believes that maintaining the additional two years of data on the computer would allow stricter access control than is available under existing manual recordkeeping procedures.

In its October 15, 1975, report on proposed changes in its computerized data processing and accounting system submitted in accordance with the Privacy Act, IRS reported that TAS would retain five years of data in a computerized form, and additional years would be kept for only unpaid or otherwise active accounts.

In our opinion, the Privacy Act of 1974 adequately addresses the types of information which IRS may collect under TAS. Further, IRS' planned computerized retention policies under TAS have been disclosed to the Congress.

Users and Uses of TAS Information

Once personal information has been obtained by IRS, the important issue becomes one of confidentiality--who is

allowed access to taxpayer information and for what purpose? OTA, in its March 1977 report, pointed out that

> ". . . Congress may want to assure that IRS has addressed the uses which may be made of TAS by such users as taxpayers, the press, public interest groups, managers in other Treasury Department agencies, individual employees in the rest of the Federal Government; employees in State governments; managers in businesses, corporations, and organizations; and individual employees of IRS."

OTA was concerned that the installation of a large integrated personal information system like TAS may drastically enhance the Government's information resources and increase the potential for unnecessary surveillance over citizens even though IRS has indicated that the system would not be used for these purposes.

In this regard, the Tax Reform Act of 1976 requires that tax returns and return information shall be disclosed only as authorized by statute. The Act lists categories of permissible disclosures of tax information. Under the Act, IRS has no discretion to permit disclosures of individually identifiable tax information in ways not specifically authorized by Federal statute. In cases where tax return information is given to other government agencies in accordance with the Act, those agencies are prohibited from disclosing it for purposes not related to the purpose for which the information was acquired. A more complete analysis of the provisions of the Act in relation to OTA's concerns is in appendix II.

In our opinion, the Tax Reform Act of 1976 adequately addresses OTA's concerns about who may use TAS information and for what purpose.

Faster Processes

TAS would accelerate the tax administration process. IRS envisioned that major benefits would be greater response capacity for dealing with taxpayer inquiries, faster refunds and earlier notices. According to OTA, these are desirable benefits which have been sought by Congress. However, OTA believed that the speeding up of administrative processes could adversely affect the due process guarantees in the administration and enforcement of tax laws.

Due process in the administration and enforcement of tax laws are protected by the Fifth and Fourteenth Amendments to the United States Constitution. The fundamental purpose of due process is to protect the individual against arbitrary actions by Government and place him under the protection of the law so that the individual is not deprived of a protected interest by lack of some sort of minimal procedural protection.

This constitutional right of due process given to each individual transcends and supersedes any administrative rules or practices to the contrary and prohibits IRS from treating taxpayers in a capricious and unfair manner regardless of the speed with which the administrative process is accomplished.

Accountability

In this area, OTA was concerned that there should be some mechanism by which oversight of the fidelity of TAS to the rules established to govern information policies may be accomplished. OTA suggested that IRS report on the process it will go through to prevent against misuse of data by those having access to it.

The Tax Reform Act of 1976 requires the Secretary of the Treasury to file quarterly reports with the House Committee on Ways and Means, the Senate Committee on Finance, and the Joint Committee on Taxation describing

> " * * * the procedures and safeguards established and utilized by (recipient agencies) * * * for ensuring the confidentiality of returns and return information * * * [as well as] deficiencies in, and failure to establish or utilize such procedures." (Section 6103 (p)(5) of the U.S.C., as amended by the Tax Reform Act of 1976).

The Act also authorizes GAO to audit the implementation of safeguard requirements.

SECURITY OF TAS DATA

Protection of personal data by technical, administrative, and physical safeguards is an integral part of preserving the confidentiality of income tax returns and tax information. Carefully drafted legislation to protect privacy is of little value unless backed up by agency commitment to security and aggressive implementation of sound security policies and practices.

In our January 1977 report, we found that the TAS concept, through proper design and implementation, would be able to provide a high degree of protection for taxpayer information. We found, however, a number of weaknesses which should be corrected within the framework of existing security procedures, methods, and controls.

A second report ("IRS' Security Program Requires Improvements to Protect Confidentiality of Income Tax Information," GGD-77-44, July 11, 1977) discussed in greater detail the weaknesses in the existing system. This evaluation indicated that IRS' security program did not assure confidentiality in the existing system because security safeguards could easily be penetrated--especially by IRS employees and others having access to the facilities. Although the security program was sound in concept, IRS did not strictly enforce prescribed security measures.

In both reports, we made a number of recommendations designed to correct weaknesses in the areas of computer operations, data retrieval, employee access to printed data, employee background investigations, and physical security. The Commissioner of IRS, in commenting on both reports, promised corrective action. In commenting on our second report, the Commissioner replied that, although IRS has not been as aggressive in the past as it might have been in correcting situations that potentially weakened its overall security posture, he was committing IRS to a vigorous course of improvement. For example, IRS plans to establish a Security Standards and Evaluation Division to oversee the IRS security program.

Effective implementation of our recommendations should result in a sound IRS security program to protect the confidentiality of tax information.

INTERNAL POLICIES TO IMPLEMENT ACTS PROTECTING TAXPAYER PRIVACY

The disclosure of information under privacy legislation is a matter of increasing importance and sensitivity. In this regard, we were asked to evaluate internal policies established by IRS to assure compliance with the privacy legislatior

We reviewed IRS' rules, regulations, procedures and manual supplements to determine the types of actions IRS has taker to comply with the privacy legislation. We found that IRS has taken action to comply by publication of its regulations in the Federal Register, publication of a disclosure handbook, and establishment of a disclosure staff.

Privacy Legislation

The Freedom of Information Act is concerned with a person's access to certain types of information maintained by Federal agencies. The Privacy Act governs the collection and maintenance of information by government agencies; prescribes that information gathered for one purpose not be used for another; and permits individuals access, review, and significant control of records concerning themselves. Section 6103 of the Internal Revenue Code is concerned with the confidentiality and disclosure of tax returns and return information.

The Freedom of Information Act requires an agency to make available to the public certain types of information it maintains. This information includes

--descriptions of its central and field organizations,

--statements of the general methods by which it operates,

--rules of procedure, descriptions of forms used, and instructions as to the scope and content of papers, reports or examinations,

--final opinions, including concurring and dissenting opinions, as well as orders made in the adjudication of cases,

--statements of policy and interpretations which have been adopted, and

--administrative staff manuals and instructions to staff that affect a member of the public.

The Privacy Act of 1974 was passed to safeguard individual privacy from the misuse of Federal records and to provide that individuals be granted access to records concerning themselves which are maintained by Federal agencies. The Act also defines conditions of disclosure, access entitlements and the requirements an agency must meet in maintaining systems of records.

Specific provisions of the Privacy Act that relate to computer security include

--maintaining only that information about an individual which is relevant and necessary,

--limiting disclosure of personal information to authorized persons and agencies,

--requiring accuracy, relevance, timeliness, and completeness of records, and

--stipulating the use of safeguards to insure the confidentiality and security of records.

The Tax Reform Act of 1976 also deals with safeguarding the confidentiality of taxpayer information. Section 1202 of the Act amends section 6103 of the Internal Revenue Code to prohibit unauthorized disclosure and provides for penalties to be imposed on certain persons who disclose the information to an unauthorized recipient.

Steps Taken by IRS to Meet the Requirements of Privacy Legislation

In August 1974, IRS issued guidelines for disclosure of information under the Freedom of Information Act. These guidelines covered the disclosure of all IRS materials and records other than tax returns and tax return information which the Service is prohibited from disclosing by law and regulations. Subsequent manual supplements have clarified the types of and conditions under which information may be disclosed.

The Department of the Treasury published its regulations to implement the Privacy Act of 1974 in the October 2, 1975, Federal Register. The regulations prescribe the requirements for the Department, including IRS, for maintaining systems of records pertaining to individuals, the means by which persons may learn whether records pertaining to themselves are being maintained, and limitations on access to such records. They also provided for the annual publication in the Federal Register of notices concerning the existence of, nature of, and intended use of information maintained in the Treasury systems.

The Register also included the indices and notices of IRS' systems of records. For each system of records, the notice includes

--the nature and location of the system,

--the categories of individuals on whom records are maintained in the system,

--the categories of records maintained in the system,

--the routine uses of the records contained in the system, including the categories of users and purposes of each use,

--the policies and practices of the Service regarding storage, retrievability access controls, retention, and disposition of the records,

--the title and business address of the agency official responsible for the system,

--the Service's procedure whereby an individual can be notified at his request if the system contains a record pertaining to him,

--the Service's procedure whereby an individual can be notified at his request how he can gain access to any record pertaining to him in the system, and how he can contest its contents, and

--the categories of sources of records in the system.

The Service has also developed and issued operating procedures to expedite the processing of inquiries from individuals about their records, for inspection and reproduction of their records, and for review of requests for amendment of records and appeal of initial adverse determinations, all within the time limits prescribed by the Privacy Act.

Further, the Service has reviewed and revised its practices and procedures relating to the collection and maintenance of records. This was done to assure that only relevant and necessary information as interpreted by the Service, is maintained.

In December 1976, IRS issued regulations on procedure and administration of IRC section 6103 as amended by the Tax Reform Act of 1976. The regulations describe the circumstances and conditions under which IRS employees are authorized to disclose return information to persons other than the taxpayer to whom such information relates in connection with official duties relating to an examination, collection activity, civil or criminal investigation, enforcement activity, or other offense under the Internal Revenue laws. Subsequent rules, regulations, and procedures have been issued by IRS to provide disclosure guidance to IRS employees.

In addition to the issuance of procedural guidelines to implement privacy legislation, IRS has recently increased its disclosure staff by placing a disclosure officer in IRS regions, districts, service centers, the Office of International Operations, the Assistant Commissioner (Inspection), and the IRS Data Center. These employees are responsible for assuring that unauthorized disclosures do not occur and that accurate and complete accounting of all authorized disclosures is maintained.

To provide program guidance to the newly created Disclosure Officer positions in all IRS field offices, the Disclosure Operations Division was established during fiscal year 1976 in the national office. Field officials now make initial determinations concerning Freedom of Information requests as well as process requests for information under the Privacy Act of 1974. In summary, according to the 1976 Annual Report of the Commissioner of Internal Revenue

> "The Service's disclosure activities are oriented to limit access to tax information, assuring that only those persons entitled by law are properly permitted to inspect such data, and to require that those who have access to such information maintain safeguards for the protection of that information. On the other hand, the Service strives to make available as much nonprotected information and documents under the Freedom of Information Act and the Privacy Act of 1974 as possible."

In our opinion, the Internal Revenue Service is trying to be responsive to the privacy legislation. Policies, procedures and regulations have been issued in order to meet the requirements of the law.

We did not determine if IRS is actually complying with and implementing these policies and procedures, as this was beyond the scope of our work.

CONCLUSIONS

Under TAS, IRS would collect and maintain essentially the same information that is currently collected and maintained. To more efficiently administer taxes, IRS would

aggregate information on each taxpayer into individual files as well as cross-reference related taxpayer accounts. IRS did not plan to link TAS with other computer systems.

IRS has conceived sound security concepts to safeguard the confidentiality of taxpayer information and IRS has indicated its intent to do so. It is important that such concepts be aggressively translated into action.

RECOMMENDATION TO THE CONGRESS

Existing privacy legislation could be tailored more closely to large-scale computer systems with the technical capability for internal linkage, data consolidation and derivation, and electronic linkage with other computer systems.

Congress should act on our previous recommendation to amend existing privacy legislation to prohibit direct electronic linkage between IRS' computer system and any other computer system. If the Congress wants to provide further protection, it could amend section 6103 of the Internal Revenue Code to expressly prohibit IRS from linking or consolidating tax returns or return information for non-tax administration purposes except as authorized by Federal statute.

APPENDIX I

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

FEB 17 1978

Mr. Richard L. Fogel
Associate Director
General Government Division
General Accounting Office
Washington, D. C. 20548

Dear Mr. Fogel,

We appreciate the opportunity to comment on your draft staff study entitled, "An Analysis of IRS' Proposed Tax Administration System: Lessons for the Future." The study presents a fair appraisal of the TAS proposal as well as the present system's computer equipment.

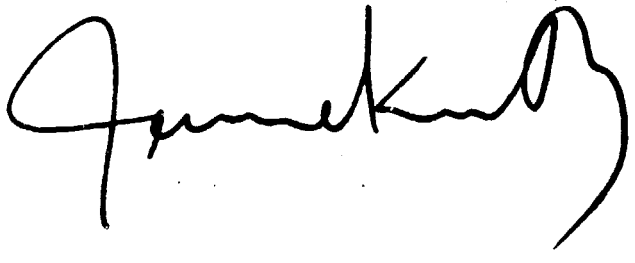
The analysis contains important observations, particularly the substantive comments regarding safeguarding tax information and protecting privacy. As you know, we have made a commitment to the recommendations in previous General Accounting Office reports, and we intend to continue to follow through on their implementation. In this connection we have recently established a Security Standards and Evaluation Division.

In regard to specific comments concerning the adequacy of documentation of benefits, they will be carefully considered in developing th estimated costs and benefits of the equipment replacement plan.

Your comments on our need for some interim equipment capacity upgrades, i.e., "breathing space", are also important to us. Judicious and prudent care will be exercised in proceeding with this effort.

With kind regards,

Sincerely,



ANALYSIS OF PRIVACY ACT, FREEDOM OF INFORMATION ACT, AND TAX REFORM ACT ON TAX ADMINISTRATION SYSTEM

BACKGROUND

The proposed Tax Administration System (TAS) is a redesigned data processing system of the Internal Revenue Service (IRS) to be used to administer the tax laws and to collect taxes. The expanded capabilities of the new system would permit improved taxpayer services by providing faster returns processing, increased responsiveness to inquiries, and retention of 5 years of data for a taxpayer's history. In other words, the TAS proposal would establish a computer system that would make Federal income tax returns of the past 3 to 5 years immediately available within each of the 10 IRS regions via on-line computer terminals. Currently, only about 10 percent of the 132 million tax returns submitted to IRS is immediately available using the present IRS computer systems; the remainder are held on magnetic tape and are available after a wait of several days. 1/

The Privacy Protection Study Commission warns in the preface to Appendix 5 of the Commission's Report, Technology and Privacy, July 1977, that technological developments and their application to personal-data recordkeeping tend to occur on a much shorter time scale than is generally perceived, and that undesirable consequences are highly likely to occur if the proliferation of computer-based recordkeeping is left unattended not because of any sinister act or intent but because of "incremental effects of independent decisions by well-intentioned administrators."

In the case of TAS, as proposed by the IRS, Congress formally sought the assistance of the Office of Technology Assessment (OTA), which issued a preliminary analysis of TAS in March 1977. In that report, OTA identified issues and posed questions about opportunities for oversight of

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1/Witt, Evans, "Lack of Privacy Feared with IRS Computer Plan," The Washington Post, March 4, 1977, p. D11.

TAS as it affects due process, privacy, confidentiality, and security.

In an attempt to respond to the questions posed in that report, we discuss the extent to which the Privacy Act of 1974, the Freedom of Information Act (FOIA), and the Tax Reform Act of 1976 presently protect the taxpayer from potential abuses of the proposed TAS system.

INFORMATION IN THE SYSTEM

Criteria for Collecting and Maintaining Data

Provisions governing the collection and maintenance of information are contained in the Privacy Act. The Tax Reform Act of 1976 is concerned with confidentiality and disclosure of returns and return information; FOIA concerns a person's access to records. Thus, of the three acts, only the Privacy Act circumscribes information that can be collected and establishes criteria for its use.

Under section 3(e) of the Privacy Act (5 U.S.C. §552a (e)), agencies may keep in their records only "relevant" and "necessary" information. The Senate Report No. 93-1183, 45 (1974) suggests that the terms "relevant" and "necessary" were chosen in order to require agencies to make a conscious and continuous evaluation of their needs for information. Not only must the information which goes into a file be relevant to an agency need, but that need must also be a legitimate one. Also, section 3(e)(1) of the Act provides that agencies cannot maintain information except pursuant to an agency purpose required to be accomplished by statute or executive order.

While the OMB Guidelines published at 40 Fed. Reg. 28,960-28,961 (1975) indicate that decisions concerning maintenance of information will be based largely on agency judgment, the agency must nevertheless be able to point to some authority for its action, either in a statute or executive order. In other words, IRS cannot collect or retain information except pursuant to an agency purpose required to be accomplished by statute or by executive order.

Moreover, section 3(e) of the Privacy Act provides that the information maintained must be "necessary." It is not enough that it merely be relevant; rather, it must be determined that the "needs of the agency and goals of the program cannot reasonably be met through alternative means." S. Rep. No. 93-1183, 46. Such a determination may require the balancing of interests, and, in the final analysis, agency judgment.

A key objective of the Act is to reduce the amount of personal information collected by Federal agencies to reduce the risk of intentional or inadvertent improper use of personal data--in other words, information not collected about an individual cannot be misused. OMB Guidelines at 40 Fed. Reg. 28,960.

In acquiring information, the Privacy Act requires agencies to rely to the greatest extent practicable on the individual concerned when the information may result in an adverse determination about an individual's rights. However, "determination" is undefined in the Act. Since virtually all information collected may result in an adverse determination, other factors, such as the amount of time available to collect the information, the ability to locate the individual, and the probability and magnitude of any harm that could result to the individual from the maintenance of the information, should be taken into account in deciding whether to collect the information directly from the individual. S. Rep. No. 93-1183, 47. The OMB Guidelines at 40 Fed. Reg. 28,961 suggest that one consider the nature of the program, the cost, the risk of inaccuracy resulting from third-party sources, and the need for use of a third party to verify the information held.

However, in the final analysis, it is the agency itself, IRS, that will balance the factors for determining what is relevant and necessary, and a considerable degree of flexibility is inherent in making the determination.

Derived Data and Consolidation of Records

Neither FOIA nor the Tax Reform Act would specifically prohibit IRS from consolidating its records or creating

new personal data (derived data) out of several pieces of preexisting personal information. The Privacy Act, however, does circumscribe the maintenance and use of derived data or consolidated records.

As discussed above, sections 3(e)(1) and 3(e)(2) of the Privacy Act restrict the maintenance and collection of information unless it is relevant and necessary. Additionally, the Privacy Act circumscribes the use of derived data or consolidated records by requiring agencies to publicly report in the Federal Register the existence of all systems of records maintained on individuals (sections 3(e)(4) and 3(e)(11)). The Act specifies that, with certain exceptions, information about an individual gathered for one purpose cannot be used for another without the individual's consent (section 3(b)) and requires that information contained in these record systems be accurate, complete, relevant, and up-to-date (section 3(e)(5)). It also provides procedures whereby individuals can inspect and correct inaccuracies in almost all Federal files about themselves.

Retention of Taxpayer Data for 5 Years Rather than 3 Years

None of the above-mentioned acts would prevent the retention of IRS taxpayer data for 5 years rather than 3 years. We note that the Privacy Act provides in section 3(c) that each agency shall retain the accounting of certain disclosures of each system of records under its control for at least 5 years or the life of the record, whichever is longer.

USES AND DISCLOSURE OF INFORMATION UNDER TAS

Privacy Act and Tax Reform Act

Although section 3(b) of the Privacy Act of 1974 permits a Federal agency to disclose information about an individual without his consent only if at least one of the 11 conditions of disclosure is met, the disclosure of IRS records about taxpayers represents a special case.

In this connection, Congress passed the Tax Reform Act of 1976, which is more stringent about disclosures of records made by the IRS than either the Privacy Act of 1974 or the

former confidentiality provisions of the Internal Revenue Code (I.R.C.) then in force. Section 1202 of the Tax Reform Act amends section 6103 of the I.R.C., and establishes the general rule that returns and return information shall be confidential. The Tax Reform Act then lists categories of permissible disclosures of tax information and sets statutory limitations on the disclosure of individually identifiable tax information to Federal and State agencies, to members of the public (section 6103(e) of the I.R.C., as amended), to Committees of Congress (section 6103(f) of the I.R.C., as amended), and to the President and White House staff (section 6103(g) of the I.R.C., as amended).

Transfer of Information on Need to Know Basis

Intra-agency transfer of information on a need to know basis is a condition of disclosure under the Privacy Act; however, such disclosure cannot take place on such a basis unless the disclosure is also authorized by the Tax Reform Act.

As previously stated, the Privacy Act provides in section 3(b) for eleven conditions of disclosure without the individual's consent. One of those conditions is disclosure "to those officers and employees of the agency which maintains the record who have a need for the record in the performance of their duties." (Section 3(b)(1), emphasis added.)

The Tax Reform Act makes confidential treatment mandatory unless disclosure is specifically authorized by Federal statute. The Tax Reform Act does, however, contain what is, in effect, a "need to know" authorization for intra-agency transfers of information. Thus transfer of information can take place within the Treasury Department for purposes relating to the officers' and employees' responsibility with respect to tax administration, such as the administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws or related statutes, including assessment, collection, enforcement, litigation, publication, and statistical gathering functions under such laws, statutes or conventions, and the development and formulation of Federal tax policy relating to existing and proposed internal revenue laws,

related statutes, and tax conventions. (Section 6103(b)(4) and (h)(1) of the I.R.C. as amended by the Tax Reform Act of 1976.)

Interconnection of TAS with Other Systems

The Tax Reform Act mandates that tax returns and return information remain confidential unless disclosure is specifically authorized by Federal statute. Redisclosure is presently limited under section 6103(a) of the I.R.C., as amended by the Tax Reform Act of 1976, which expressly prohibits other Federal and State agencies from redisclosing information for purposes unrelated to the purpose for which the information was acquired. Unless otherwise specifically authorized by statute, future disclosures involving interconnection of TAS with other systems, such as Federal or State agencies, would have to assure compliance with the disclosure limitations of the Tax Reform Act.

USE OF IRS INFORMATION FOR INDIVIDUAL SURVEILLANCE

The Tax Reform Act provides the protective framework against unauthorized or illegal use of IRS information for surveillance of individuals for tax related or nontax related purposes, since the Act makes confidential treatment mandatory unless otherwise specifically authorized by Federal statute. The Tax Reform Act does not conflict with access to data under FOIA because section (b)(3) of FOIA, 5 U.S.C. §552(b)(3), permits nondisclosure of information that is specifically exempted from disclosure by statute. To the extent that the Tax Reform Act specifically exempts disclosure, the result is that information need not be disclosed pursuant to FOIA. Since the Tax Reform Act constitutes IRS' sole authority to disclose its records about individuals to other Federal agencies and to agencies of State government, we need not consider the FOIA and the Privacy Act in the following discussion.

Disclosure for Tax Administration

Justice Department

More specifically, with respect to disclosure of tax data for surveillance of individuals for tax related

purposes, the Tax Reform Act of 1976 authorizes disclosure to the Justice Department for use in investigations and prosecutions of violations of tax laws, provided that the information pertains to a party to the actual or anticipated litigation. (Section 6103(h)(2)(A).)

If the individual is not the object of a tax investigation or prosecution, the Tax Reform Act authorizes disclosure to the Justice Department only if the information is relevant to issues in actual or anticipated tax litigation. (Section 6103 (h)(2)(B) and (C).)

Other Disclosures

Other than the Department of Justice, section 6103(h)(4) authorizes disclosure of tax information in Federal and State judicial or administrative proceedings pertaining to tax administration, but only if the taxpayer is a party to the proceeding or if the information directly relates to an issue or a transaction in the lawsuit.

The Tax Reform Act also authorizes disclosure of tax information to State tax collectors and taxing officials in section 6103(d) for the purpose of the administration of State tax laws, but only upon written request of the head of such agency. This section also denies access to the Chief Executive.

Disclosure for Purposes Other Than Tax Administration

Other categories of permissible disclosure of tax information that may relate to surveillance of individuals include disclosure to the Parent Locator Service of the Department of Health, Education and Welfare (section 6103(l)(6)(A)) and disclosure to the White House and heads of Federal agencies of information about prospective Federal appointees. (Section 6103(g)(2).) Certain Federal programs, such as administration of the Social Security Act and the Employee Retirement Income Security Act, may use IRS data (section 6103(l)) within a limited framework. Disclosure is also authorized for specified statistical purposes (section 6103(j)).

In addition, the Tax Reform Act authorizes disclosures for nontax criminal investigations (section 6103(i)) under specified conditions. In the case of information provided directly by the taxpayer, disclosure is conditioned upon the issuance of a court order (section 6103(i)), which can only be sought upon the authorization of the head of the Federal agency involved or the Attorney General, the Deputy Attorney General, or an Assistant Attorney General. The taxpayer, however, is not notified of the proceedings, since they are ex parte.

On the other hand, the Tax Reform Act authorizes disclosure of information about a taxpayer provided by another source without the necessity of a court order, upon a written request from the head of the agency involved, the Attorney General, Deputy Attorney General, or Assistant Attorney General, specifying the taxpayer's name, address, taxable periods, statutory authority for the investigation, and the reason why the disclosure is material. In other words, information about taxpayers for nontax criminal investigations is easier for Federal agencies to obtain if it was provided by a source other than the taxpayer. In this regard, the Privacy Protection Study Commission suggests that IRS access to records about individuals held by third parties may result in a potential abuse of the information. 1/

DUE PROCESS AND TAS

Due process guarantees in the administration and the enforcement of tax laws are protected by the Fifth and Fourteenth Amendments to the United States Constitution, not the Privacy Act, Tax Reform Act, or FOIA. These constitutional amendments prohibit the Government and its administrative agencies from depriving an individual of life, liberty, or property, without due process of law.

1/The Report of the Privacy Protection Study Commission, Personal Privacy in an Information Society, July 1977, at 556.

The fundamental purpose of due process is to secure the individual against arbitrary action by Government and place him under the protection of the law (see, in this regard, Wolff v. McDonnell, 418 U.S. 539, 558 (1974)), so that the individual is not deprived of a protected interest by lack of some sort of minimal procedural protection. Of course, the type of hearing required in each instance will be a function of the governmental and individual interest at stake although, in any event, some procedural protection must be afforded.

SAFEGUARDS AND OVERSIGHT RESPONSIBILITIES FOR IRS INFORMATION

Both the Privacy Act and the Tax Reform Act have specific provisions relating to safeguards and oversight responsibilities for IRS information.

Subsection (e)(10) of the Privacy Act mandates that each agency establish appropriate administrative, technical, and physical safeguards to insure the confidentiality and integrity of the records. The OMB Guidelines state at 40 Fed. Reg. 28966 (1975) that since few standards exist to guide the agencies about safeguards, agencies themselves must analyze each system as to the risk of improper disclosure and the cost and availability of measures to minimize those risks.

As mentioned previously, the Privacy Act makes the agency itself responsible for the quality of information retained about an individual. Section 3(e)(5) of the Act provides that if the agency makes a determination about an individual, the records used must be in such a condition of "accuracy, relevance, timeliness and completeness as is reasonably necessary to assure fairness to the individual in the determination." Recognizing that an agency properly disclosing information under FOIA is often not in a position to evaluate acceptable tolerances of error for the purposes of the recipient of the information, section 3(e)(6) also provides that records disclosed pursuant to FOIA do not have to be validated before disclosure. 40 Fed. Reg. 28965.

Section 3(d) of the Privacy Act provides another safeguard to ensure the accuracy of the information. Under this section, when an individual learns that a system of records contains information pertaining to him, he has a right of access to that information and he may attempt to amend what he believes to be erroneous information. The agency is to take prompt action upon an individual's request for an amendment. If the request is refused, review is available. If the agency still denies amendment, the individual then has a right to file an action in the Federal district court. (Section 3(g)(1)(A) of the Act.)

In addition to the above civil remedy, an individual may bring a civil action in Federal district court upon a denial of individual access (section 3(g)(1)(B)), or when an adverse determination has been made against an individual because of a failure to comply with any other provision of the Act. The Act also provides criminal penalties for officers and employees who knowingly and willfully disclose material to a person not entitled to receive it. (Section (c).)

The Tax Reform Act of 1976 prescribes a series of safeguards and oversight responsibilities for IRS information, and substantial powers of enforcement are vested in the Federal tax officials. It provides that recipient Federal and State agencies, as a condition of receiving returns or return information from the IRS, shall

> "(A) establish and maintain, to the satisfaction of the Secretary [of the Treasury], a permanent system of standardized records with respect to any request, the reason for such request, and the date of such request made by or of it and any disclosure of return or return information made by it or to it;
>
> "(B) establish and maintain, to the satisfaction of the Secretary, a secure area or place in which such returns or return information shall be stored;

> "(C) restrict, to the satisfaction of the Secretary, access to the returns or return information only to persons whose duties or responsibilities require access and to whom disclosure may be made under the provisions of this title;
>
> "(D) provide such other safeguards which the Secretary determines (and which he prescribes in regulations) to be necessary or appropriate to protect the confidentiality of the returns or return information;
>
> "(E) furnish a report to the Secretary, at such time and containing such information as the Secretary may prescribe, which describes the procedures established and utilized by such agency, body, or commission or the General Accounting Office for ensuring the confidentiality of returns and return information required [thereunder]." (Section 6103(p)(4) of the I.R.C., as amended by the Tax Reform Act of 1976.)

The 1976 law also requires that after using IRS data, the recipient agency must either return it to IRS or render it completely undisclosable. (Section 6103(p)(4)(E).)

In addition, the Tax Reform Act requires the Secretary of the Treasury to file quarterly reports with the House Committee on Ways and Means, the Senate Committee on Finance, and the Joint Committee on Taxation describing

> "* * * the procedures and safeguards established and utilized by * * * [recipient agencies] for ensuring the confidentiality of returns and return information * * * [as well as] deficiencies in, and failure to establish or utilize such procedures." (Section 6103

(p)(5) of the I.R.C., as amended by the Tax Reform Act of 1976.)

The Act also authorizes the Comptroller General to audit the implementation of safeguard requirements. (Section 6103(p)(6).)

In its July 1977 report, Personal Privacy in an Information Society, the Privacy Protection Study Commission stated at page 559 that it was satisfied that the confidentiality of IRS information disclosed to other Federal agencies is "now well protected by the statutory safeguard requirements" mentioned above, including IRS review authority, periodic reporting on safeguards to Congress, and the Comptroller General's audits.

PRINCIPAL OFFICIALS RESPONSIBLE FOR ADMINISTERING ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
SECRETARY OF THE TREASURY:		
W. Michael Blumenthal	Jan. 1977	Present
William E. Simon	Apr. 1974	Jan. 1977
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:		
Jerome Kurtz	May 1977	Present
William E. Williams (acting)	Feb. 1977	May 1977
Donald C. Alexander	May 1973	Feb. 1977
Raymond F. Harless (acting)	May 1973	May 1973
Johnnie M. Walters	Aug. 1971	Apr. 1973
Harold T. Swartz (acting)	June 1971	Aug. 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
ASSISTANT COMMISSIONER (ACCOUNTS, COLLECTION, AND TAXPAYER SERVICE) (note a):		
James I. Owens	May 1977	Present
James I. Owens (acting)	July 1976	May 1977
Robert H. Terry	Aug. 1973	July 1976
Dean J. Barron	July 1971	Aug. 1973

a/Effective January 2, 1977, responsibility for IRS system design, programming, and analysis as well as National Computer Center and Detroit data center operations was transferred from the Assistant Commissioner (Accounts, Collection, and Taxpayer Service) to the Assistant Commissioner (Data Services).

ASSISTANT COMMISSIONER (DATA SERVICES) (note a):		
Patrick J. Ruttle	Apr. 1977	Present
Patrick J. Ruttle (acting)	Jan. 1977	Apr. 1977

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