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General Accounting Office

Compilation Of GAO's Work On Tax Administration Activities During 1982

This report, required by Public Law 95-125, summarizes the results of GAO's work on tax administration activities for 1982. Among other things, the report discusses open recommendations to the Congress from reports issued during and before 1982, legislative action taken during 1982 on GAO recommendations, and recommendations to the Commissioner of Internal Revenue during 1982 as well as actions taken or proposed by IRS.

GAO/GGD-83-89

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT DIVISION

B-137762

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

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

The Honorable Dan Rostenkowski
Chairman, Joint Committee
on Taxation
Congress of the United States

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

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

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

(1) Open recommendations to the Congress from reports issued during 1982.

(2) Open recommendations to the Congress from reports issued before 1982.

(3) Legislative action taken during 1982 on recommendations.

(4) Recommendations to the Commissioner of Internal Revenue during 1982.

(5) Reports on tax administration matters issued during 1982.

(6) Testimony given by GAO officials during 1982 before various committees of the U.S. Congress.

(7) Scope and subject matter of reviews initiated during 1982 pursuant to Public Law 95-125.

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

We are pleased to report that IRS has taken, or plans to take, action on most of our recommendations made during 1982. Also, in enacting the Tax Equity and Fiscal Responsibility Act of 1982 (Public Law 97-248), the Congress implemented several of our open legislative recommendations from prior years.

We look forward to continuing to work closely with the Congress to assist it in considering our legislative recommendations. We would be glad to discuss any of the matters included in the enclosures if you, your colleagues, or staffs believe it would be beneficial.

W.J. Anderson

William J. Anderson
Director

OPEN RECOMMENDATIONS TO THE CONGRESS FROM REPORTS ISSUED DURING 1982

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CHANGES TO THE DISCLOSURE PROVISIONS OF THE INTERNAL REVENUE CODE COULD IMPROVE VERIFICATION OF WELFARE RECIPIENTS' INCOME AND ASSETS

HRD-82-9
B-203669
1-14-82

Summary of finding

Underreporting of income and assets by recipients of benefits from needs based programs results in hundreds of millions of dollars in improper payments each year. Current requirements and practices for verifying program eligibility are not adequate to prevent such payments. Verification requirements vary widely but generally are extremely vague or overly restrictive. Furthermore, some Federal laws and regulations preclude the use of information which, if available, would significantly enhance the verification process.

Financial data, such as interest and dividend income, in the Internal Revenue Service's (IRS) Information Return Processing File would be useful in verifying income and assets in welfare programs. Because of the concerns about individual privacy, however, exchange of these data is prevented by the Tax Reform Act of 1976.

Recommendation

We recommended that the Congress amend the Internal Revenue Code to permit disclosure of:

- --Data on individual wages, net earnings from self-employment, and payments of retirement income maintained by SSA to Federal, State, and local agencies administering federally funded needs-based programs, whenever comparable data are not available at the State level.

- --IRS Information Return Processing File data on sources and amounts of unearned income to Federal, State, and local agencies administering federally funded needs-based programs.

Action taken and/or pending

None

KEY ISSUES AFFECTING STATE TAXATION OF MULTIJURISDICTIONAL CORPORATE INCOME NEED TO BE RESOLVED

GGD-82-38
B-202972
7-1-82

Summary of finding

At present, State taxation of multijurisdictional corporate income is administratively unwieldy. Forty-five separate political jurisdictions attempt to equitably divide the income of often complex and geographically dispersed taxable entities, and each jurisdiction formulates its own specific rules for determining how much of an entity's total income is attributable to operations in that jurisdiction. The resulting lack of uniformity is extensive.

The problems of nonuniformity are even more critical today than they were when the special House subcommittee issued the Willis report in 1964 extensively documenting the lack of uniformity in interstate tax provisions. The issues have become more complex and controversial as the number of corporations has grown, and certain States have expanded their taxing efforts to take foreign operations into account.

The issues which have developed in recent years have broad policy implications potentially affecting international tax policy. Furthermore, the issues are at the center of the long-standing constitutional debate over the balance between State sovereignty and congressional Commerce Clause powers. Moreover, lack of uniformity among the States causes problems for States and corporate taxpayers. The problems--higher return preparation costs, potential overtaxation or undertaxation, and numerous disputes--result in a tax system which is unduly uncertain, inefficient, and often inequitable.

Recommendation

None. While we made no recommendations, we concluded that the key issues affecting State taxation of multijurisdictional corporate income need resolving. In the almost 20 years since the House subcommittee issued its report, little progress has been made to increase the uniformity with which States tax corporate income. The States have made some voluntary efforts but substantial nonuniformity still exists.

The Supreme Court has attempted to deal with some of the issues affecting State taxation of multijurisdictional corporate

income. For example, the Court recently ruled that a state can take into account a corporation's worldwide income when taxing that corporation. But, in the past the Court has also recognized the inherent limitations of the judicial approach to solving the interstate and international policy issues and has acknowledged that the Congress is the appropriate body to resolve such issues.

The Congress appears to be in the best position to fully evaluate the multiple factors and assess the arguments surrounding the policy issues involved in State taxation of multi-State and multinational corporate income, especially foreign source income. Also, because the Congress can fully consider the States' rights and foreign policy issues, it can best devise a comprehensive solution which adequately and fairly balances the competing interests of the States and corporate taxpayers.

Action taken and/or pending

Since 1965, bills covering interstate corporate taxation have been introduced in every session of the Congress, including the current one. Each of the 33 bills introduced has contained income tax provisions. However, primarily because of state opposition, none of the bills have become law.

The two identical bills now before Congress, S. 1225 and H.R. 2918, are similar to other bills introduced in recent sessions of Congress. These two bills would prohibit States from using the worldwide combined reporting method when taxing multinational corporations and would restrict States from taxing a greater portion of a corporations's foreign source dividends than the Federal Government effectively taxes.

OPEN RECOMMENDATIONS TO THE CONGRESS FROM REPORTS ISSUED BEFORE 1982

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MANDATORY TAX WITHHOLDING RECOMMENDED FOR AGRICULTURAL EMPLOYEES

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

Summary of finding

Both the Federal Government and agricultural employees would benefit from a system of mandatory withholding of Federal income tax from wages earned by agricultural employees. Withholding Federal income taxes from agricultural wages would ease problems of agricultural employees by placing them on a pay-as-you-earn basis similar to other wage earners, lessen IRS collection problems, and reduce revenue loss from unreported agricultural wages.

Recommendation

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

Action taken and/or pending

On April 7, 1981, H.R. 3104, a bill which would have accommodated our recommendation, was introduced and referred to the Subcommittee on Social Security, Committee on House Ways and Means. However, no further action was taken on it.

On April 12, 1983, H.R. 2492 was introduced. The bill, if enacted, would amend the Internal Revenue Code to subject agricultural labor to withholding for income tax purposes and, thus, would fully adopt our recommendation.

OCCUPATIONAL TAXES ON THE ALCOHOL INDUSTRY SHOULD BE REPEALED

B-137762
1-16-76

Summary of finding

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

Recommendation

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

Action taken and/or pending

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

No Congressional action has been taken to amend the Federal Alcohol Administration Act.

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

B-137762
8-9-73
and
GGD-77-78
8-8-77

Summary of finding

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

Recommendation

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

Action taken and/or pending

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

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

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

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

Summary of finding

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

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

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

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

Recommendation

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

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

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

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

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

In addition, we recognized that there may be some situations where a worker is able to meet some but not all of the above criteria and still have a valid basis for being considered self-employed. In these circumstances some type of common law criteria should be applied but not unless there is evidence that the worker's situation tends toward being one of a self-employed individual.

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

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

Action taken and/or pending

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

However, on September 18, 1980, the Chairman, House Ways and Means Committee, introduced a bill (H.R. 8156) prohibiting

IRS from issuing regulations on reclassifying independent contractors as employees until January 1, 1984. The Congress subsequently enacted the bill but changed the expiration date to June 30, 1982.

In January 1981, the Senate Finance Committee Chairman introduced a bill (S-8) containing the same five safe harbor tests as H.R. 5460 but not containing the withholding requirement. However, no action was taken during 1981.

During the second session of the 97th Congress, several bills were introduced relating to the classification of workers as either employees or self-employed for Federal tax purposes. For example, S. 2369 was introduced by the Chairman of the Senate Finance Committee on April 14, 1982, as the "Independent Contractor Tax Classification and Compliance Act of 1982." This bill would have eased the problems associated with classifying workers as employees or independent contractors and would have strengthened information reporting and penalties with respect to independent contractors. A similar bill, H.R. 6311, was introduced in the House on May 6, 1982. Neither S. 2369 nor H.R. 6311 required withholding. An earlier House bill, H.R. 5867, introduced on March 17, 1982, as the "Independent Contractor Tax Act of 1982," would have provided alternative standards for determining whether individuals are not employees for purposes of the employment taxes and would also have provided a 10 percent withholding requirement on payments made to independent contractors.

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

The Tax Equity and Fiscal Responsibility Act of 1982 (Public Law 97-248), which was enacted on September 3, 1982, dealt with part of the independent contractor issue by defining salespersons who are licensed real estate agents and individuals who are direct sellers as self-employed for Federal income and employment tax purposes under certain conditions. The act also

indefinitely extended the moratorium on IRS reclassification action from July 1, 1982, until such time as the Congress enacts legislation concerning the classification of workers as independent contractors or employees.

NEED FOR CHANGE IN LAW TO PROVIDE FICA-SECA OFFSET

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

Summary of finding

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

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

Recommendation

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

Action taken and/or pending

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

During the second session of the 97th Congress, several bills were introduced relating to the worker classification issue. However, none of the bills addressed the need for offset authority, such as we recommended. On April 26, 1982, we testified on S. 2369 before the Senate Finance Committee's

Subcommittee on Oversight of the Internal Revenue Service. During the hearing, we pointed out that the proposed bill would not eliminate the need for IRS reclassifications and retroactive tax assessments and that problems associated with those actions would continue to exist. We proposed that some further legislative and administrative changes would be needed, particularly to reduce the potential for double taxation in the event of reclassification. In this regard, we reiterated the need for legislation to allow FICA-SECA offset.

The Tax Equity and Fiscal Responsibility Act of 1982 reduced the employer's liability by providing that an employer would be liable for only 20 percent of the worker's share of FICA tax that should have been withheld if the employer erroneously treated the worker as a nonemployee for social security tax purposes. Although this provision reduces the employer's liability and the corresponding overpayment of social security taxes, it does not fully resolve the FICA-SECA offset issue.

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

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

Summary of finding

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

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

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

Recommendation

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

Action taken and/or pending

None

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

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

Summary of finding

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

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

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

Recommendation

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

Action taken and/or pending

None

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

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

Summary of finding

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

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

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

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

Recommendation

We recommend that the Congress enact legislation to

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

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

Action taken and/or pending

None

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

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

Summary of finding

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

The present sequential, postinvestigative legal review process continues to exist despite its time consuming and duplicative nature and IRS' recognition that the Criminal Investigation Division (CID) needs legal assistance during, rather than after, its investigations. Although the existing legal review process for criminal tax cases clearly needs to be revised, especially in light of concern over increased Federal spending and efforts by the executive and legislative branches to balance the Federal budget, the best means for doing so is not clear. The process can be restructured in various ways. However, any modification should (1) provide a means through which CID can obtain needed legal assistance during its investigations, (2) improve timeliness and eliminate any unnecessary duplication and costs, (3) ensure that criminal tax cases receive a high quality, independent legal review before they are prosecuted, and (4) safeguard the legal rights of taxpayers.

Our analyses of sample cases and discussions with various Federal officials and private sector attorneys enabled us to formulate several alternative approaches to revising the present legal review process. Each alternative has advantages and disadvantages, as well as cost implications; some have more merit than others. For example, one alternative would have District

Counsel attorneys carry out ongoing, rather than post investigative, legal reviews. That alternative has merit because it would reduce delays in the present legal review process while safeguarding taxpayers' legal rights. CID's productivity would increase as attorneys, through early involvement in the investigative process, identify problem cases and/or help ensure efficient development of good cases. Two important IRS goals--equitable treatment of taxpayers and voluntary compliance--would be more effectively promoted. Also, annual recurring cost-savings of up to $2.63 million could be realized through the elimination of a postinvestigative review level because fewer District Counsel attorneys would be needed.

Recommendation

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

Action taken and/or pending

In December 1981, the Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs, asked Justice and IRS to specify what actions have been taken in response to our recommendation. In their responses, Justice and IRS described a series of actions they had taken to streamline the review process. Given that, the Subcommittee decided to defer consideration of a hearing on the issue. The Subcommittee believed that some time would be needed to assess the utility of the actions taken by the agencies in response to the General Accounting Office's (GAO's) report.

On September 16, 1982, the Senate Appropriations Committee, in its report accompanying IRS' 1983 appropriation bill, responded to our recommendation by suggesting that IRS and the Justice Department develop a streamlined legal review process which would prevent duplicate oversight of criminal tax cases. IRS and Justice officials told us that as of June 1, 1983, no agency action had been taken in response to the Appropriation Committee's suggestion.

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

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

Summary of finding

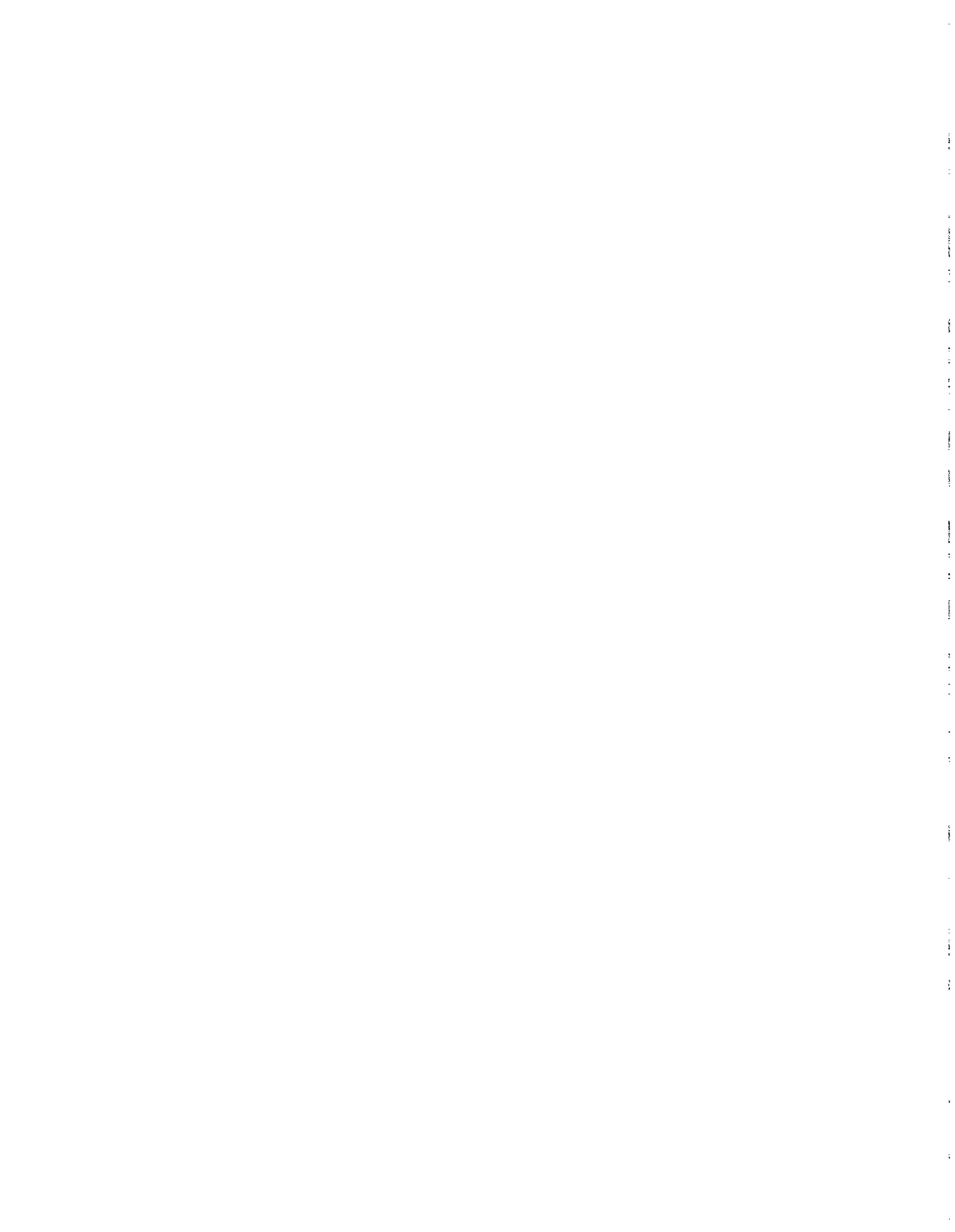
On the basis of our analysis of pension plan terminations for 1977, we found that plan sponsors for about two-thirds of reported terminating plans were not requesting IRS reviews at the time of termination because such reviews are not mandatory under the Internal Revenue Code. Termination actions were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

Recommendation

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

Action taken and/or pending

None



LEGISLATIVE ACTION TAKEN DURING 1982 ON RECOMMENDATIONS

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

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

Summary of finding

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

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

Recommendation

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

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

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

Action taken and/or pending

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

part of the record. During the hearing, we stated that some changes could probably be made to the provisions to allow IRS, with appropriate controls, to alert law enforcement agencies to pertinent criminal-related information it may have. We made some specific proposals in this regard.

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

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

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

The substance of those two bills was incorporated in the Tax Equity and Fiscal Responsibility Act of 1982, which provided broader disclosure rules in line with our recommendations. For example, the act:

- --modified the standards for granting an ex parte order for the disclosure of tax returns and return information,
- --expanded the number of personnel who are permitted to request disclosure,
- --allowed the disclosure of return information for the purpose of locating fugitives from Federal justice, and
- --granted IRS authority to disclose return information on its own initiative in emergency circumstances.

These amendments to the Internal Revenue Code should facilitate coordination among law enforcement agencies and, hopefully, lead to the detection and taxation of more illegal profits.

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

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

Summary of finding

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

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

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

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

Recommendation

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

Action taken and/or pending

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

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

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

The substance of the summons provisions in H.R. 1501 and H.R. 6300 were incorporated into the Tax Equity and Fiscal Responsibility Act of 1982. This should help deter potential tax evaders from using the stay of compliance procedure to delay criminal tax investigation.

DELINQUENT TAXPAYERS DUE REFUNDS ARE NOT PENALIZED FOR FILING LATE

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

Summary of finding

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

Recommendation

We recommended that the Congress amend section 6651(a) of the Internal Revenue Code to provide for a similar late filing penalty on nonfilers due refunds.

Action taken and/or pending

The Tax Equity and Fiscal Responsibility Act of 1982 adopted our recommendation by providing for a penalty when an income tax return is not filed within 60 days of the due date, whether or not taxes are owed.

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

GGD-80-10
B-137762
12-5-79

Summary of finding

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

Recommendation

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

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

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

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

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

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

Action taken and/or pending

The Tax Equity and Fiscal Responsibility Act of 1982 contained a provision similar to one of the alternatives that we proposed. That provision, which the Treasury Department estimated would yield $3.1 billion in revenues through 1987, limits the amount of any loss to the amount in excess of 10 percent of adjusted gross income provided the loss exceeds $100. Although the provision is not as comprehensive as our suggested alternative, it will alleviate some of the inequities we identified.

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

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

Summary of finding

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

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

Recommendation

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

Action taken and/or pending

During hearings on July 13, 1982, members of the House Subcommittee on General Oversight and Renegotiation, Committee on Banking, Finance and Urban Affairs, concluded that progress had been made in administering and using the act's provisions since the GAO review. The Chairman pledged the subcommittee's continued oversight.

This action addressed the intent of our recommendation, which was to provide a mechanism for continued periodic congressional oversight to ensure proper attention to the administration and use of the act's reporting requirements by the Treasury and other agencies.

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

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

Summary of finding

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

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

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

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

Recommendation

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

Action taken and/or pending

The Tax Equity and Fiscal Responsibility Act of 1982 incorporated our recommendation by amending the Internal Revenue Code to require foreign-controlled corporations operating in the United States to disclose dealings with foreign affiliates. Specifically, the act requires annual reports from United States and foreign corporations engaged in U.S. business if they are at least 50 percent controlled by foreign parties. These reports should help IRS identify a true arms-length price when auditing multinational corporations' transactions with their subsidiaries.

RECOMMENDATIONS TO THE COMMISSIONER OF INTERNAL REVENUE DURING 1982

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EXCESSIVE SPECIFICATIONS ARE LIMITING COMPETITION FOR IRS SPECIAL DESIGN TAX RETURN FOLDERS

GGD-82-61
3-24-82

Summary of finding

IRS' solicitation and resulting contracts for tax return folders contain specifications which limit the number of bidders on this procurement. IRS contracts for special design tax return folders contain specifications which were developed 9 years ago, are costly, and may exceed IRS's minimum needs. This view is shared by cognizant Government officials, file folder manufacturers, and a representative of a paper manufacturers trade association. The unique, more costly paper and inward gusset design requirements have precluded some manufacturers from bidding on this solicitation, thus denying IRS the benefits of maximum competition. (Gussets are the creases along the edges of a folder that allow its expansion.)

Recommendation

We recommended that IRS:

- --Evaluate its tax return folder specifications with a view toward using the less costly, standard 11 point kraft paper, which conforms to General Services Administration and Joint Committee on Printing guidelines. Using this paper should increase the number of bidders and enhance competition.

- --Purchase, on a test basis, tax return folders with an outward folding gusset and subject these to actual work conditions to determine usability.

Action taken and/or pending

In January 1983, after surveying its regions and the National Archives and Records Service, IRS proceeded to implement our recommendations by letting three contracts, each on a one-year basis, for designing less expensive tax folders. In January 1984, IRS intends to determine future folder specifications on the basis of the results of these tests and report to us on its conclusions.

LABOR AND IRS NEED TO REMOVE THE TRUSTEE'S CONTROL AND INFLUENCE OVER THE MONEYS RECEIVED BY THE TEAMSTERS' CENTRAL STATES PENSION FUND

HRD-82-13
B-199238
4-28-82

Summary of finding

The trustees of the Teamsters' Central States Southeast and Southwest Areas Pension Fund attempted to reassert control over the Fund's assets and investments. This attempt was made contrary to an unwritten agreement with IRS and Labor and after the appointment of independent investment managers whose performance in handling the assets and investments appeared to have been successful. We believe that the Fund should be operated and managed prudently and for the exclusive benefit of the plan participants and beneficiaries as required by the Employee Retirement Income and Security Act (ERISA).

Recommendation

We recommended that the Secretary of Labor, in consultation with the Commissioner of Internal Revenue, obtain an enforceable commitment, such as a consent decree, from the trustees for the Fund to (1) continue having an independent investment manager control and manage the Fund's assets and investments after the present managers' contracts expire in October 1982 and (2) use the same selection criteria and qualifications as in the past--independent, professional expertise, and national stature--if the trustees decide to replace the present investment managers after October 1982.

We also recommended that the Secretary, in consultation with the Commissioner, obtain a further written enforceable commitment from the trustees to reorganize the way the Fund handles and controls the employer contributions and its other moneys to remove the trustees' control over any of these funds. The proposed reorganization should provide for

--the Fund to employ a financial custodian with professional expertise and national stature to (1) receive and control all moneys due the Fund, (2) pay the Fund's administrative expenses and pension benefits, (3) retain an appropriate reserve, and (4) turn over the remainder to the investment managers;

--IRS and Labor to have veto power over the selection of the independent investment manager and financial custodian, if the trustees' selections do not meet the Government's qualifications; and

--limiting the trustees' roles and responsibilities to (1) establishing overall investment objectives, (2) determining eligibility requirements for pension benefits and employers' contributions, (3) monitoring the investment managers' and custodian's activities, and (4) administering relevant collective-bargaining requirements.

We further recommended that the Secretary, in consultation with the Commissioner, take action to require that the above-proposed reorganization and any other reforms imposed on the Fund, be included in a formal written, enforceable agreement signed and agreed to by Labor and IRS and the Fund's trustees.

Action taken and/or pending

Labor and IRS generally concurred with the goals of our recommendations and said they were attempting to achieve those goals.

Labor emphasized, however, that no Federal agency may unilaterally require--through regulation, order, or otherwise--the safeguards recommended. Labor stated that there are only two ways to achieve enforceable requirements regarding independent trustees, independent asset management, a limited role for trustees, and similar reforms. Those are (1) a voluntary undertaking by the trustees incorporated in a consent decree or (2) the imposition of a court order following successful litigation. Labor committed itself to vigorously pursuing both ways.

IRS stated that it continued to believe it is important to have most Fund assets subject to the control of independent asset managers. In this regard, after coordination with Labor, on November 11, 1981, IRS issued a new determination letter to the Fund that included a condition requiring the continuation of an independent asset manager arrangement. IRS said that the Fund has agreed to the letter, which also continued the Fund's tax-exempt status for its pension plan and set forth several additional conditions for the Fund.

On September 22, 1982, a consent decree was entered into between Labor and the trustees of the Fund. Among other things, the terms of the decree required that, following the expiration of the contract with the present investment managers on October 2, 1982, most assets of the Fund would continue to be managed by a named fiduciary for the duration of the consent decree (a minimum period of 10 years). We believe that the reforms adopted in the consent decree should result in the Fund's assets being managed prudently and in the interest of the plan participants as required by ERISA.

LABOR AND IRS' INVESTIGATIONS TO REFORM TEAMSTER'S CENTRAL STATES PENSION FUND FOUND INADEQUATE

HRD-82-13
B-199238
4-28-82

Summary of finding

The Department of Labor's and IRS' investigation and subsequent dealings with the trustees of the Teamsters' Central States Southeast and Southwest Areas Pension Fund had shortcomings and deficiencies and left numerous problems unresolved.

Both Labor and IRS did not require a written agreement to restore the Fund's tax-exempt status and did not insure that the Fund's new trustees met stated qualifications. IRS, after coordinating with Labor, restored the Fund's tax-exempt status in April 1977. However, rather than have the trustees enter into a written agreement with Labor, IRS--with Labor's approval--based the requalification on the trustees' agreement to operate the Fund in accordance with ERISA and to comply with eight specific conditions prescribed by Labor and IRS. We believe that without a court enforceable consent decree, Labor and IRS did not have an effective means to require the trustees to adhere to the conditions that they might otherwise have had. Furthermore, as a condition for requalification the Fund agreed to Labor's and IRS' demand that the four holdover trustees resign. Labor and IRS also developed qualifications that the new trustees should meet. However, Labor and IRS did not play an active role in insuring that the new trustees had met the qualifications they had developed even though Labor knew some of the former trustees--who allegedly mismanaged the Fund--were members of the Teamsters' union organizations that selected some of the new trustees.

Recommendation

We recommended that the Secretary of Labor, in consultation with the Commissioner of Internal Revenue, require that future Fund trustees meet the criteria and qualifications similar to those established in 1977--independent, professional, neutral, etc; closely monitor the selection of future trustees; and veto the selection of a trustee not meeting the criteria.

Action taken and/or pending

Labor concurred with the goals of our recommendations to (1) assure that the Fund is operated and managed prudently and (2) reorganize the way the Fund handles and controls the employers' contributions and other moneys in order to remove the trustees' control over any of these funds. Labor stated it is attempting to achieve the goals in our recommendations through a comprehensive court-enforced consent decree agreeable to the Fund.

IRS did not believe that it has the authority to establish qualification requirements for the selection of trustees by the Fund. It strongly agreed with our objective, however, and believed it could best be accomplished under Title I of ERISA. To this end, IRS said that the Task Force created in March 1981 by the Secretaries of the Treasury and Labor and the Attorney General has been conducting negotiations with the Fund. On September 22, 1982, a consent decree was entered into between Labor and the trustees of the Fund. The terms of the consent decree generally follow our recommendations on what needs to be done to protect the assets of the Fund.

IRS HAS NOT REVIEWED THE FINANCIAL SOUNDNESS OF THE TEAMSTERS' CENTRAL STATES PENSION FUND

HRD-82-13
B-199238
4-28-82

Summary of finding

ERISA requires that employee pension plans satisfy minimum funding standards each year and that each plan submit an annual report which includes actuarial information. IRS is to use the annual reports and actuarial data to enforce ERISA's minimum funding standards.

Since 1975, the trustees of the Teamsters' Central States Southeast and Southwest Areas Pension Fund have had five actuarial valuations of the Fund's financial soundness. The last report, issued on April 3, 1981, stated that the current funding should satisfy ERISA's requirements and that the Fund is operating on a sound financial basis. However, the actuary's report described some problems and situations that could have serious financial implications for the Fund. Consequently, the actuary recommended that until the effects of deregulation on the trucking industry and the Multiemployer Amendments Act of 1980 can be evaluated, the Fund should adopt a conservative posture with respect to any liberalizing of benefits. Moreover, the actuary's April 1981 report showed that the Fund's unfunded accrued liability for current and future pension benefits was about $6.05 billion at January 1, 1980. In this regard, IRS needs to closely monitor the financial status of the Fund to assure that it, in fact, meets ERISA's funding standards.

Recommendation

We recommended that the Commissioner of Internal Revenue direct IRS officials to closely monitor the Fund's financial operations to ascertain that the Fund meets the minimum funding standards of ERISA and, if not, take whatever action is needed to assure that the Fund meets the act's requirements.

Action taken and/or pending

IRS stated that the Fund's July 1982 annual report would be thoroughly examined to insure compliance with the minimum funding standards.

LABOR AND IRS DID NOT INVESTIGATE UNRESOLVED PROBLEM AREAS OF ALLEGED MISMANAGEMENT OF THE TEAMSTERS' CENTRAL STATES PENSION FUND

HRD-82-13
B-199238
4-28-82

Summary of finding

During its original work at the headquarters of the Teamsters' Central States Southeast and Southwest Areas Pension Fund, the Department of Labor's investigators identified patterns of apparent abuse of the Fund by former trustees that went uninvestigated. Also, IRS was not able to adequately investigate the Fund's compliance with the eight conditions of the April 1977 requalification letter. As a result, in April 1980 Labor renewed its investigation of the Fund. Then, in July 1980, after securing a court order, IRS renewed its investigation. We noted, however, that neither investigation would cover all of the potential areas of alleged abuse and mismanagement by the former trustees. Furthermore, after telling the Fund and the Congress that they were fully coordinating their investigations, we found both agencies were examining the same records. For example, both agencies were examining the Fund's management of the Benefits and Administration account.

Recommendation

We recommended that the Secretary of Labor and the Commissioner of Internal Revenue direct their respective investigative staffs to more closely cooperate to prevent coordination problems and duplication between the two agencies' investigations.

Action taken and/or pending

Labor and IRS generally concurred with our recommendation on the need for closer coordination on their current investigations of the Fund.

IRS stated that since the revocation of the Fund's qualified status in 1976, the Chicago IRS and Labor field offices have coordinated closely in conducting their simultaneous examinations of the Fund. IRS stated that procedures for sharing information about the Fund's operations have been established and the two agencies' investigators are in almost daily contact with each other.

Labor also stated that the two staffs are now fully cooperating on the investigations. Labor said that each agency

reviews the Fund's documents for its own purposes but gets an opportunity to review all documents provided by the Fund, regardless of which agency requests them. This minimizes duplication and coordination problems. Moreover, since the two staffs generally sit in the same room during the review process, Labor said that there are constant discussions and any problems are resolved quickly.

TEAMSTERS' CENTRAL STATES PENSION FUND BENEFITS AND ADMINISTRATION ACCOUNT NOT ADEQUATELY MONITORED BY LABOR AND IRS

HRD-82-13
B-199238
4-28-82

Summary of finding

Although the Teamsters Central States Southeast and Southwest Areas Pension Fund transferred substantial funds to its financial managers for investments, the Fund's trustees retained a significant amount of the Fund's income in the Benefits and Administration account. For example, the account had $142 million at December 31, 1979. The trustees were supposed to use the Benefits and Administration account to record the employers' contributions, pay the employees' benefits and the Fund's administrative expenses, and maintain an appropriate reserve for the Fund. The remaining moneys were to be given to the independent managers for investments. The Labor Department and IRS were responsible for monitoring the Benefits and Administration account to assure the funds were prudently managed. Despite Labor officials' assurances to a congressional subcommittee, we found that Labor, as well as IRS, had not adequately monitored the trustees' control over the account. As a result, in one case, the trustees apparently imprudently attempted to use the moneys to make a $91 million questionable loan to settle a court suit.

Recommendation

We recommended that the Secretary of Labor and Commissioner of Internal Revenue direct their investigative staffs to review the trustees management and use of the Benefits and Administration account to determine the appropriate reserve the Fund should maintain in the account.

Action taken and/or pending

Labor and IRS concurred with the goal of our recommendation on the trustees' management and use of the Benefits and Administration account.

IRS stated its concern about the possible abuse of assets which are in the Benefits and Administration account for payment of current benefits and administrative expenses and are not subject to the control of the independent manager. IRS stated

that in addition to monitoring the trustees' management and use of the account as part of its current examination, it considered the question of the appropriate amount of the account in connection with its review of the Fund's new application for determination of favorable tax treatment.

As a result, IRS' November 11, 1981, determination letter contained a condition limiting assets retained by the Fund to those the Fund actually determines are necessary for benefits and administration expenses, considering assets available from the independent managers. According to IRS, under the condition, the Fund must (1) use an overriding formula that requires benefits and administration assets not to exceed 2-1/2 times the sum of the previous month's benefit payments and administrative expenses and (2) manage and invest benefits and administration assets in accordance with the advice of qualified independent managers.

THE FEDERAL GOVERNMENT CAN SAVE $1.7 MILLION ANNUALLY BY ELIMINATING STRIP STAMPS

GAO/GGD-82-60
B-207193
5-7-82

Summary of finding

Section 5205 of the Internal Revenue Code provides for the use of strip stamps, which are the paper strips placed over the neck and cap of distilled spirits containers. The stamps are printed by the Bureau of Engraving and Printing at a current cost of $1.7 million annually. The stamps are distributed to distillers and bottlers at no charge.

For many years, strip stamps were numbered and generally controlled by Federal employees physically located at the distillers' premises. The stamps were applied to containers after the Federal employees were satisfied that the spirits had been bottled in conformance with Federal laws and had determined the appropriate tax.

However, the Distilled Spirits Tax Revision Act of 1979 significantly changed the Federal regulation and taxation of distilled spirits. The act eliminated the need for the physical presence of Federal employees at distilled spirits plants to control certain operations, including the determination of taxes on distilled spirits before bottling. Consequently, strip stamps are now provided to distillers and placed on distilled spirits containers generally before the tax has been determined or paid. In short, the strip stamp no longer signifies that the tax on the spirits has been paid or that the spirits have been lawfully bottled.

The only practical purpose strip stamps now serve is to provide consumers some assurance that the bottled contents have not been tampered with. However, since the Government does not actually inspect the bottling, some consumers may be misled, particularly if they view strip stamps as the Government's stamp of approval or official endorsement of the product.

Recommendation

We recommended that the Secretary of the Treasury revise Treasury regulations to eliminate Government-supplied strip stamps while retaining a requirement that bottlers and distributors provide and use approved closure devices.

Action taken and/or pending

The Treasury agreed with our recommendation that Government-supplied strip stamps should be eliminated and has proposed a bill to repeal 26 U.S.C. 5205 and related provisions of the Internal Revenue Code. If enacted by the Congress, the bill would repeal the statutes relating to both Government-supplied stamps and industry-provided alternative devices.

UNCERTAINTIES ABOUT THE DEFINITION AND SCOPE OF THE PROPERTY CONCEPT MAY REDUCE WINDFALL PROFIT TAX REVENUES

GGD-82-48
B-206634
5-13-82

Summary of finding

The Crude Oil Windfall Profit Tax Act of 1980 contains a target revenue amount--$227 billion--to be collected over approximately a 10-year period. The basic determinant of the windfall profit tax rate is the meaning of the term "property", a concept which the act incorporates by reference to Department of Energy (DOE) regulations. Thus, property has the same meaning for windfall profit tax rate purposes as it had for DOE price control purposes. The property concept is singularly important because it controls the category or tier of crude oil which, in turn, establishes the applicable windfall profit tax rate from a range of 30 percent to 70 percent.

Our review work in IRS' Southwest region indicated that considerable uncertainty surrounded the property concept within IRS. Specifically, we found that IRS examiners were inconsistently and inaccurately treating property issues. District office personnel did not understand the property concept and its relation to tax tier. In particular, IRS examiners did not know that the term property, as incorporated from DOE regulations, refers to the right to produce oil as that right existed in 1972. In some instances, examiners were simply accepting existing leases as properties regardless of the lease dates. In other instances, examiners did look for original leases but without regard to any reference year.

On the basis of the results of our district office visits, we evaluated IRS' windfall profit tax training program in terms of sufficiency of treatment of the property concept. We also attended a DOE training course on the property concept and found that it was much more comprehensive than that given by IRS. In our view, IRS' training was inadequate because it did not (1) emphasize the importance of the property concept, (2) identify a base year for making property determinations, or (3) specify how examiners should make property determinations.

Our finding led to a joint IRS/GAO evaluation of the two "most-developed" examination cases involving property issues in IRS' Dallas district office. Together, GAO and IRS found that

IRS examiners had verified oil tier classifications without determining the status of each lease with reference to the base year--1972.

Following this evaluation, IRS Southwest region representatives informed us that they had (1) suspended closure action on certain windfall profit tax operator audits pending issuance of revised guidance, (2) arranged for discussions with DOE representatives on the property issue, (3) started to reevaluate windfall profit tax training materials and audit guidelines, and (4) informed IRS' national office of the need for resolution of property-related issues. Subsequently, IRS brought the property issue to the attention of the Treasury Department.

Recommendation

We recommended that the Secretary of the Treasury give a high priority to clarifying the property concept for windfall profit tax purposes. Specifically, we recommended that the Secretary clarify the definition and scope of property for tax tier purposes, including the correct reference year for making property determinations and the proper treatment of land tracts which were unleased and/or did not produce oil in 1972.

As part of this process, we also recommended that the Secretary require the Commissioner of Internal Revenue to (1) revise windfall profit tax training materials and (2) provide IRS examiners more specific guidance on how to make property determinations.

Action taken and/or pending

Treasury generally agreed with our recommendation and, in November 1982, issued new regulations defining the meaning of the term "property" for windfall profit tax purposes. IRS told us that as of December 1982 it was using the regulations and giving priority to closing out, in a consistent manner, all windfall profit tax examinations previously held in suspense due to property definition uncertainties. IRS also said that it had revised its windfall profit tax training materials and provided examiners with more specific guidance on how to make property determinations.

MORE COMPLIANCE RESEARCH IS NEEDED TO REDUCE GROWING TAX LOSSES

GAO/GGD-82-34
B-207207
7-23-82

Summary of finding

IRS estimates that the total tax revenue loss attributable to individual noncompliance may be as much as $97 billon for 1981, more than twice the estimated loss for 1976. Failing to report income accounts for 3 times more lost tax revenue than the combined result of overstating tax deductions and other "offsets" to income, failing to file returns, and not paying assessed taxes. Some studies show that up to one out of every four people cheat on their tax returns.

IRS' overall mission is to maximize voluntary compliance with the tax laws. IRS had nine programs--costing about $1.6 billion in fiscal year 1981--which were designed to help it accomplish this mission. However, IRS has depended mainly on its examination program to deal with taxpayer noncompliance. In fact, its entire compliance strategy is built around the examination of tax returns. Underlying this strategy, which has consumed more than one-half of IRS compliance resources the past 10 years, is the notion that IRS will audit enough tax returns each year to cause people, in general, to voluntarily assess at least 90 percent of the taxes they owe.

IRS' own measures of voluntary compliance show, however, that the examination program is not having the results intended. For example, IRS compliance data for seven classes of individual taxpayers indicated that voluntary compliance steadily declined for all classes between 1965 and 1976--the latest year for which data was available. Moreover, compliance for four of the seven classes was below 90 percent.

One factor that may at least partially explain this decline is the decreasing percentage of tax returns that IRS has examined in recent years--from 4.8 percent in 1965 to an estimated 1.6 percent in 1982. However, in some years, between 1973 and 1976 for example, IRS increased the percentage of tax returns examined and voluntary compliance did not visibly improve.

Furthermore, the examination of tax returns often fails to detect the most serious problem--unreported income--which accounts for almost three-fourths of the estimated tax revenue

lost through noncompliance. IRS' own estimates indicate that even its most intensive examinations were only able to detect about 25 percent of the income not reported by those taxpayers audited. This fact has obvious implications regarding the extent to which IRS can rely on its normal, less intensive audits to detect unreported income. Other programs such as document matching and criminal investigations, which receive less resources than the examination program, have as their primary target the detection of unreported income. Thus, IRS needs to find out which of its various compliance programs can most effectively deal with this problem.

IRS has completed some research to find out how the examination program affected taxpayers who were selected for examination. However, to effectively combat unreported income, as well as other forms of noncompliance, IRS needs to better understand how each of its compliance programs affects the willingness of people to comply with the tax laws. In this regard, IRS had several compliance research projects planned or underway at the time of our review. However,

--none was designated a high priority;

--none addressed the impact of IRS' compliance programs on taxpayers not directly contacted, the so-called "ripple effect"; and

--none related to how well compliance programs deal with unreported income.

Recommendation

We recommended that the Commissioner of Internal Revenue design, and assign a high priority to, compliance research which will:

--Provide data on how and why IRS compliance programs, both collectively and individually, affect taxpayers' willingness and ability to accurately report taxable income and to otherwise comply with the tax laws.

--Identify techniques for measuring and analyzing the effects of the compliance programs on both those taxpayers actually contacted and others who might be affected.

--Determine the overall effectiveness of the current IRS approach, including the appropriateness of the resource allocations, for dealing with unreported income and other forms of noncompliance.

Action taken and/or pending

IRS stated that our recommendations had merit and that it intended to continue research to determine the impact of its programs on voluntary compliance. In May 1983, the Commissioner announced that the Administration would include recommendations in the fiscal 1985 budget for new research in the compliance field. He said the program would make use of social scientists from the private sector, as well as experts from other agencies, states, and local governments.

IRS SHOULD FOCUS ON INCREASING TAX REVENUE AS AN INTERIM ENFORCEMENT STRATEGY

GAO/GGD-82-34
B-207207
7-23-82

Summary of finding

Because IRS has tried to stimulate voluntary compliance primarily through its examination strategy, it has sacrificed substantial tax revenue, both in the examination program and in some other programs. Until IRS has better data on how well its programs actually affect voluntary compliance, a better strategy would be to place greater emphasis on increasing the tax revenue yield from its programs. IRS could shift some staff years among and within certain programs and increase the flow of tax revenue to the Treasury.

With the exception of its examination program, IRS does not have good cost and marginal yield data for maximizing tax revenue from its various programs. However, available data indicates that some programs result in a much higher rate of return--more tax revenue for each dollar invested--than other programs. Therefore, IRS could immediately increase overall revenue from its programs by allocating its existing resources differently. For example, IRS could increase overall tax revenue by examining a higher percentage of tax returns which historically have extremely favorable cost/yield ratios and by shifting resources to programs, such as the taxpayer delinquent accounts program, that have a higher average yield-to-cost ratio than other programs. To illustrate, using average yield data, we determined that by shifting 2 percent of the resources within four programs to the highest yielding program, IRS could increase overall tax revenue by an estimated $190 million.

Similarly, IRS could also increase the tax revenue collected from its examination program by shifting some resources within the program and using more complete cost and tax revenue yield data. To illustrate, on the basis of fiscal year 1980 data, we estimated that IRS could increase the revenue from examinations by $92 million annually while still maintaining an examination presence in each audit class.

Recommendation

We recommended that until IRS has adequate data to determine the overall impact of its compliance programs, the Commissioner of Internal Revenue should place more emphasis on allocating resources both among and within the programs to optimize tax revenue. Specifically, we recommended that IRS:

--Use existing cost/revenue data to reallocate staff years from those compliance programs with historically lower average revenue yields to those with much higher yields in order to increase tax revenues from those programs.

--Develop additional data so that resources can be allocated among all compliance programs to increase, insofar as practicable, overall tax revenue. For example, rather than using the current approach of developing revenue estimates in terms of dollars assessed, IRS could develop estimates in terms of dollars actually collected for such programs as the taxpayer delinquency investigations program.

--Plan and budget within each program to maximize revenue using the best available cost/revenue data.

Action taken and/or pending

IRS agreed to consider a revenue-maximizing approach in its examination program during an upcoming planning cycle, but it made no commitment to adopt such an approach in allocating resources within that program or among IRS' various programs. IRS stated that an agencywide revenue-maximizing approach would require comparable data which IRS had so far been unable to develop.

BETTER COST/TAX REVENUE DATA ARE NEEDED FOR RESOURCE ALLOCATIONS

GAO/GGD-82-34
B-207207
7-23-82

Summary of finding

IRS' management information systems do not provide adequate data to optimally allocate resources within and among its various compliance programs. The systems generally do not accumulate and report complete cost and revenue data for a compliance program, even though the data components exist at various places within the agency. Generally, each division or function within IRS has its own information systems, designed to serve its own needs, and the systems usually do not track cases or projects across divisional lines. As a result, cost/revenue data for a particular program are often incomplete.

IRS recognized the need for an agencywide management information system as early as 1976. National, regional, and district managers have expressed a critical need for data that cross divisional lines. However, IRS' progress in developing a system to meet those needs has been slow.

Recommendation

We recommended that to further improve IRS' resource allocations and the overall management of IRS' compliance resources the Commissioner of Internal Revenue implement a system to provide cost, revenue, and other needed data from a total program and agencywide perspective.

Action taken and/or pending

IRS stated that it had long recognized the urgent need for a management information system, but a lack of resources had been an obstacle in developing such a system. It stated that it had recently sent a plan to the Treasury Department concerning management information and was well on the way to developing a comprehensive management information system. IRS received funds in its fiscal year 1983 appropriation to begin implementing a system.

APPEALS DIVISION MANAGEMENT REVIEWS ARE NOT ADEQUATE FOR DETERMINING IF UNIFORM AND CONSISTENT SETTLEMENTS ARE MADE

GGD-82-54
B-206894
7-28-82

Summary of finding

IRS' Appeals Division is not completely evaluating whether or not its objective of uniform and consistent decisions is being met because its control system is not adequate. The two reviews which should provide management with this type of information do not. One of the reviews, the regional post review, contains design and procedural weaknesses that result in inadequate measurement of whether or not settlements are uniform and consistent. The other review, the nationwide post review, depends on documentation which frequently does not provide sufficient information to judge settlement decisions. The reviews also do not provide feedback to managers and staff in positions to take corrective action.

Recommendation

We recommended that the Commissioner of Internal Revenue:

--Furnish more guidance to appeals officers on the information needed in supporting statements to adequately explain action taken on cases in order to improve file documentation quality.

--Revise the system for recording regional review results so that reviewers can communicate their results more accurately and uniformly.

--Establish criteria for consolidating and reporting regional review results to produce data which can be further analyzed and compared at the National Office level.

--More clearly define the standards against which settlements are measured.

--Improve appeals officers' awareness of new technical information by providing branch supervisors and appeals officers with comprehensive information on the results of all regional post reviews.

--Furnish a synopsis of all regional review results to appeals regional directors so that each region can benefit from the collective review effort.

Action taken and/or pending

In response to our recommendations regarding management reviews, IRS took the following actions which should improve the appeals post review process:

--IRS substantially revised its manual for preparing supporting statements. According to IRS, these revisions will improve the quality of the appeals officers' write-ups explaining and supporting the bases for decisions rendered in cases.

--IRS revised its manual to specify how regional review results will be recorded and reported.

--IRS revised its manual for regional reporting requirements to insure that specific information is uniformly covered. According to IRS, the quality of regional reports will continue to be closely monitored at the National Office level.

--IRS better defined standards by requiring reviewers to measure settlements in accordance with Post Review Guidelines.

--IRS revised its manual to require regions to provide appeals officers with comprehensive information on the results of the regional post review.

IRS also said that it would disseminate the regional post review findings to all regions so that each region can benefit from the collective review.

TIMING OF REVIEWS CONDUCTED BY APPEALS DIVISION SUPERVISORS IS TOO LATE TO BE EFFECTIVE

GGD-82-54
B-206894
7-28-82

Summary of finding

An Appeals Division branch office supervisor can follow present IRS supervisory case review guidelines and still be in a poor position to insure the quality of settlements. The only time the guidelines require a supervisory review of a case file is after the appeals officer has worked out a settlement proposal with the taxpayer and obtained a signed agreement form. This practice discourages supervision over technical aspects of the work in progress.

The practice of requiring reviews after the fact makes it very difficult to introduce any substantive changes to the case settlement proposal. This is because the supervisor is faced with the awkward predicament of having to reopen negotiations with the taxpayer after an agreement has apparently been reached. In commenting on this problem, one supervisor noted that he will approve a marginal decision, one which is adequate but which clearly could have been better, rather than antagonize the taxpayer by overturning a previous agreement.

Five of the eight Appeals Division supervisors we contacted told us they get involved in reviewing only 5 to 10 percent of their cases prior to when the initial settlement proposal has been negotiated. The limited involvement of supervisors was further confirmed by the appeals officers' responses to our questionnaire which showed that the supervisors provided technical guidance on only about 4 percent of the cases prior to when the initial settlement was proposed.

The appeals officers also reported that appeals supervisors rarely alter case settlements. This was corroborated by our review of sampled cases. Our sample indicated that there was little or no change in 99.8 percent of the fiscal year 1979 settlements in the three appeals branch offices as a result of supervisory reviews.

Recommendation

We recommended that the Commissioner of Internal Revenue initiate changes to existing guidelines to require, when possible, supervisory review of proposed decisions before an agreement on the settlement has been reached with the taxpayer.

Action taken and/or pending

Although recognizing the value of supervisory advice, assistance, and review of proposed decisions before an agreement has been reached, IRS said that such supervisory action should occur only under circumstances that clearly warrant it. According to IRS, going beyond this would be impractical and would have the effect of inhibiting settlement of cases and duplicating effort in the vast majority of the cases where no difference occurs.

We had not envisioned a review system that was extensive or duplicative but rather a selective system that would insure uniform and consistent settlements.. We believe that if IRS provides supervisory review of proposed decisions when warranted and effectively monitors this through its regional evaluation system, the intent of our recommendation related to supervisory reviews of proposed decisions will be met.

APPEALS DIVISION SUPERVISORY REVIEW SHOULD NOT BE DEPENDENT ON LOCAL MANAGEMENT PHILOSOPHY

GGD-82-54
B-206894
7-28-82

Summary of finding

The extent and depth of supervisory reviews varies according to the philosophy of appeals management in the various locations. The Internal Revenue Manual does not specify how case reviews should be done or if and how the reviews should be documented. Instead, the regional offices determine what the case review process will be through the policies they adopt regarding branch office visits and post review results and recommendations.

Our work showed that one of the three appeals branch offices we visited appeared to place more emphasis on supervisory case reviews than the other two. Case review duties were almost never delegated to appeals officers in this branch, except to help develop personnel for future management positions. Our review of sample cases indicated that the supervisors made written comments on how appeals officers handled cases in over 70 percent of the cases settled in fiscal year 1979. File evidence at the other two locations suggested that the supervisors there made significantly fewer comments on closed cases. Comments appeared in about 30 percent of the files at one branch office and in less than 20 percent of the files at the other.

Recommendation

We recommended that the Commissioner of Internal Revenue require that (1) regional managers monitor supervisory review procedures at the appeals branch offices to insure that existing guidelines and those to be generated are consistently applied and (2) the depth and detail of the reviews being performed are adequate to insure that the settlements reached conform with IRS policy regarding consistency and uniformity.

Action taken and/or pending

IRS agreed with our finding relating to improving supervisory review of appeals case work and fully implemented our recommendation.

APPEALS DIVISION SUPERVISORY CASE REVIEWS DO NOT ADEQUATELY ASSESS UNIFORMITY AND CONSISTENCY

GGD-82-54
B-206894
7-28-82

Summary of finding

Appeals branch office chiefs and associate chiefs are the appeals supervisors who review settlement proposals for uniform and consistent treatment. These supervisors are key to insuring quality appeals decisions because they have the opportunity not only to review proposals but also to correct and change deficiencies before cases have been closed.

IRS guidelines do not require that branch office supervisors enter written comments in case files indicating that reviews have occurred. Documentation in the case files at the three locations we visited showed evidence of such reviews less than half the time. Nearly all the cases contained a supervisor's signature representing approval of the proposed settlement. However, we estimated that less than 40 percent of the cases settled in the three appeals branch offices contained even such minimal review documentation as comments on the inventory control card regarding how the case was handled or an evaluation of the quality of the settlement.

A lack of file documentation showing whether appeals supervisors had reviewed new issues raised in favor of the Government during negotiations with taxpayers further indicated that supervisors may not be adequately carrying out their roles in the quality control process. Appeals officers may raise new issues during negotiations with the taxpayer if the issue is in the taxpayer's favor. We were told that new issues in the Government's favor should be carefully considered by both the appeals officer and supervisor before they are raised with the taxpayer in order to avoid the impression that appeals is a continuation of the audit process.

However, we could not tell if most of the new issues raised in favor of the Government had been given proper supervisory consideration and review before they were raised with the taxpayer because evidence was lacking in the case files we examined. On the basis of the cases we reviewed, we estimated that about 100 cases in the three appeals branch offices we visited involved the raising of one or more new issues. Approximately 60 percent of the new issues were in the Government's favor.

During our review of case files, we found review notes indicating that the appeals supervisor had approved raising such issues only about 5 percent of the time.

Recommendation

We recommended that IRS require appeals' supervisors to document their case assessments.

Action taken and/or pending

IRS agreed with our recommendation and has taken action to clarify guidance provided appeals supervisors. IRS now requires a narrative evaluation of the manner in which the case was managed, decided, and written up by the appeals officer.

ACTIONS NEEDED TO CURB EXCESSIVE KEOGH DEDUCTIONS

GGD-82-85
B-208060
8-26-82

Summary of finding

The results of IRS' 1976 Taxpayer Compliance Measurement Program and our work showed that many taxpayers claiming Keogh deductions do not fully understand the rules applicable to such deductions. As a result, significant amounts of tax are going uncollected. For tax year 1976, IRS estimated that excessive Keogh deductions totaled $34 million.

Our estimate of the amount of excessive Keogh deductions for tax year 1977 was about $114 million. That is, however, a qualified estimate because of an assumption we had to make concerning the representation of defined contribution plans in the sample of cases we reviewed. Nevertheless, the results of our review indicated that the problem identified by IRS' 1976 Taxpayer Compliance Measurement Program continued in 1977.

Recommendation

We recommended that the Commissioner of Internal Revenue:

--Provide taxpayers with some basic guidance on Keogh deductions in the form 1040 instructions and publications 17 and 334. At a minimum, the guidance should specify that taxpayers must be self-employed to be eligible for such deductions. It should also specify that different rules govern defined benefit and defined contribution plans. Further, the guidance should specify, with respect to defined contribution plans, that an individual must have net profits from self-employment to be eligible for a deduction and that the deduction cannot exceed certain percentage and dollar limits. Also, the Commissioner may want to consider developing a worksheet for use by taxpayers in computing Keogh deductions. The worksheet could be included in publications 17, 334, and/or 560.

--Develop and implement a service center error correction program for excessive Keogh deductions. In so doing, the Commissioner may wish to revise the Form 1040 to require taxpayers to specify whether they contribute to defined contribution or defined benefit plans.

Action taken and/or pending

IRS agreed with the need to provide better guidance on Keogh deductions and to establish a means to more effectively identify and correct returns with excessive Keogh deductions. IRS has already revised line 26 of the 1982 form 1040 instructions by adding a caution to advise taxpayers that they must have self-employment income to take the Keogh deduction. IRS has rewritten the Keogh deduction section of publication 334 to better inform taxpayers. Publication 17 was also revised to include basic information about Keogh plan eligibility requirements. By January 1, 1984, IRS plans to rewrite publication 560 with a view toward trying to simplify the complex discussions contained in that document. In so doing, IRS also plans to develop and insert in the publication a worksheet designed to make it easier for taxpayers to compute allowable Keogh deductions.

With regard to excessive Keogh deductions, IRS' Counsel has determined that the service center Math Error Correction Program cannot be used to disallow excessive Keogh deductions. Formal deficiency procedures would be required. IRS has initiated recovery projects for excessive IRA and Keogh deductions for tax years 1980 and 1981. A test will also be conducted to determine the need for a recovery program in tax year 1982. Beginning for tax year 1983 and subsequent years, the Service has decided to use information reporting documents to verify contributions to the various retirement accounts.

DOMESTIC DISTRICTS NEED
TO BETTER PREPARE AUDITORS
TO EXAMINE INTERNATIONAL TAX ISSUES

GGD-82-77
B-207784
8-27-82

Summary of finding

Because income tax returns filed by U.S. citizens abroad and nonresident aliens contain special international tax issues, IRS has centralized the related examination responsibility in its Foreign Operations District in Washington, D.C. To accommodate the needs of certain taxpayers, however, the Foreign Operations District transfers their returns to other district offices which do not specialize in international tax issues. Tax auditors in these districts find it difficult to effectively examine such returns because they do not receive sufficient guidance or training on how to examine international issues.

Also, examinations of these returns are generally handled in the same manner as U.S. resident tax returns and are not afforded special treatment. In particular, the practices used by districts to assign returns, which originate in the Foreign Operations District, do not provide tax auditors either the opportunity to become familiar with the issues through experience or the time to research the laws and regulations before scheduled interviews with taxpayers. These problems make it difficult for the districts to effectively examine international returns.

Recommendation

We recommended that the Commissioner of Internal Revenue:

--Provide a limited number of auditors in selected district offices with training in international issues or, after considering the feasibility from a cost benefit standpoint, send Foreign Operations District auditors to certain districts to examine the international returns which accumulate over a period of time.

--Provide each district with Foreign Operations District training manuals and appropriate reference material.

--Revise return assignment procedures to provide tax auditors with experience and preparation time needed to examine the international returns transferred from the Foreign Operations District.

Action taken and/or pending

IRS has provided international tax training to a limited number of tax auditors in selected districts and provided tax training materials to those who participated in such training. It also has advised district offices to (1) assign transferred Foreign Operations District returns with international issues to tax auditors with appropriate experience and (2) give these auditors time to analyze the returns prior to the first interview with the taxpayer.

FOREIGN OPERATIONS DISTRICT
NEEDS TO BETTER DOCUMENT ACTION
TAKEN ON TRANSFERRED EXAMINATIONS

GGD-82-77
B-207784
8-27-82

Summary of finding

Many case files transferred by the Foreign Operations District in Washington, D.C. to other districts involve examinations started and at least partially completed by tax auditors trained in examining international tax issues. The work done by the Foreign Operations District should facilitate followup work carried out by the tax auditors receiving the transferred returns. The Foreign Operations District, however, does not always (1) adequately summarize the work performed and (2) specify the name and telephone number of a person for other tax auditors to call should questions arise concerning prior examination work conducted.

If the Foreign Operations District were to prepare standard summary reports for returns it transfers and require group managers to make sure that case files contain these summaries before approving their transfer, tax auditors receiving the returns could conduct more effective and timely examinations. Also, the tax auditors would be less likely to duplicate work already performed by the Foreign Operations District.

Recommendation

We recommended that the Commissioner of Internal Revenue:

Require that the Foreign Operations District develop and make effective use of standard summary reports for returns transferred to domestic district offices.

Include the name and telephone number of an appropriate Foreign Operations District contact in all case files transferred to domestic district offices.

Require that Foreign Operations District group managers assure that standard summaries are prepared.

Action taken and/or pending

IRS disagreed with our findings and, therefore, does not plan to act on our recommendations. IRS reviewed 52 case files and found that they contained (1) summaries in one form or

another, (2) the names and telephone numbers of Foreign Operations District contacts, and (3) transfer forms approved by group managers.

We do not know why the files reviewed by IRS contained this information while the files we reviewed did not. IRS may have taken corrective action subsequent to our review or used different criteria in evaluating the files. Nevertheless, the summaries IRS found were not in a standard format, the contact names and numbers were in different places in the file, and the group managers' approval of transfer forms does not mean that the file has been reviewed for completeness. Therefore, IRS should implement our recommendations because the standard summary information reports would provide a ready reference document which would help tax auditors complete the examinations in a timely and accurate way.

IRS' QUALITY MONITORING ACTIVITIES DO NOT PROVIDE ALL THE DATA NEEDED TO CORRECT RETURN PROCESSING PROBLEMS

GAO/GGD-83-8
B-202441
10-14-82

Summary of finding

IRS' present quality monitoring activities at the service centers include a quality review program, an error correction workload review, and a math error notice review. Also, IRS' National Office used an error register report and monitoring program to assess specific processing weaknesses. While each of these activities had merit, we found that they were fragmented and did not provide management with all the data needed for evaluating the return processing system and planning corrective action. The data produced by these activities were not specific as to the type of errors made, who made the errors, why the errors were made, and where the errors occurred on the return. As a result, IRS did not have all the data needed for planning and taking corrective action to prevent errors from occurring.

Recommendation

We recommended that the Commissioner of Internal Revenue have the quality monitoring activity gather more specific data on the types of errors made, who made the errors, why the errors occurred, and where the errors occurred. This data should then be analyzed at both the service center and national office levels to determine the corrective action that can be taken to prevent similar future errors.

Action taken and/or pending

IRS agreed that it needs to expand its service center quality monitoring program and said that it would actively pursue our recommendation to gather more specific information from the error correction process.

RETURN PROCESSING COSTS CAN BE REDUCED WITH BETTER DATA TRANSCRIPTION EQUIPMENT AND PROCEDURES

GAO/GGD-83-8
B-202441
10-14-82

Summary of finding

About 5 percent, or 120 of our 2,543 error register sample cases taken at four service centers, had errors where the data transcribers either did not key in data from subsidiary tax documents, such as a Schedule D "Capital Gains and Losses", or failed to enter the form 1040 line items associated with certain other subsidiary tax documents, such as Form 5695 "Energy Credits." When these errors occur, the data transcribers cannot go back and key in the omitted data unless they realize their mistakes before they finish keying in the rest of the data for that tax return. Even if the omissions are detected during key verification, to which all returns are subjected, the data still cannot be keyed into the computer. The returns must go to the error register for correction.

Also, IRS may be able to reduce return processing costs if the new direct data entry equipment, which IRS was in the process of purchasing, would allow transcribers to key in both the line number and the money amounts from tax return lines. If a transcription line contains no money amount the transcribers usually have to make a keystroke which is called a "breaker" to indicate to the computer that the line is blank. Data we obtained from the California State Franchise Tax Board and our analysis of our sample error register cases showed that transcribing the line numbers, as well as the money amounts, can increase data transcription productivity, that is the number of keystrokes per hour, with only a slight increase in the number of keystrokes per return.

Recommendation

We recommended that the Commissioner of Internal Revenue:

--Determine the cost effectiveness of providing new direct data entry equipment with the capability to prompt transcribers when they fail to key certain tax data into the computer. If cost effective, insure that the new direct data entry equipment includes this prompting feature.

--Determine the merits of having data transcribers key into the computer both the money amounts and line numbers from tax returns.

Action taken and/or pending

At the time of our report, IRS could not make a specific commitment to incorporate our recommendations for improving the direct data entry system. It agreed, however, to consider our recommendations when it evaluates vendors' proposals for new direct data entry equipment. IRS stated that if the winning vendor's proposal does not contain prompting features and the ability to enter both the line number and the dollar amount, these features can almost certainly be incorporated later.

RETURN PROCESSING AND TAXPAYER ERRORS CAN BE REDUCED BY CHANGING RETURN PROCESSING PROCEDURES, TAX FORMS, AND INSTRUCTIONS

GAO/GGD-83-8
B-202441
10-14-82

Summary of finding

IRS has an effective return processing system considering the large number of tax documents it processes annually and the age of some of its processing equipment. However, it could do more to increase the efficiency of the system and thereby reduce processing costs. On the basis of our analysis of a random sample of 2,543 tax returns which appeared on the error register at four service centers, we found that IRS' national returns processing costs may be as much as $1.7 million higher than necessary because

--IRS' error correction procedures allow tax examiners to correct only one error condition at a time on tax returns with multiple errors,

--IRS manually reviews all tax returns for which it computes the tax for the taxpayers, and

--taxpayers sometimes mistakenly claim FICA withholding as Federal income tax withholding.

Recommendation

We recommended that the Commissioner of Internal Revenue:

--Change procedures for correcting tax returns with multiple error conditions so that all readily identifiable independent errors can be corrected when they first appear on the error register.

--Require taxpayers who want IRS to compute their tax for them to enter their income tax withholding on their returns. IRS should change its processing procedures so that these returns do not automatically appear on the error register.

--Clarify for taxpayers the difference between FICA tax withheld and Federal income tax withheld by changing the wording on the form W-2, clarifying tax booklet instructions, and revising the math error notice message presently sent to taxpayers who mistakenly enter the amount

of FICA tax withheld instead of the amount of Federal income tax withheld.

Actions taken and/or pending

IRS agreed with our recommendations to change return processing procedures, tax forms, and instructions and has taken the following actions to implement them:

--IRS has revised its error correction procedures for 1983 so that the most common independent errors will be corrected together.

--IRS will require taxpayers who file form 1040A and who want IRS to compute their tax to enter the amount of their income tax withholding. IRS is changing its processing procedures so that only certain returns will appear automatically on the error register.

--IRS will begin referring taxpayers to specific boxes on forms W-2 and W-2P on the 1983 forms 1040 and 1040A and in the related instructions. In addition, IRS will substitute "Soc. Sec." for "FICA" on the 1983 form W-2. Also, IRS will revise the math error notice message in 1983 for taxpayers who mistakenly enter the amount of FICA tax withheld instead of the amount of Federal income tax withheld.

POSSIBILITY OF IMPROPER GEOTHERMAL ENERGY TAX CREDIT CLAIMS

GAO/RCED-83-1
B-208806
12/2/82

Summary of finding

The Energy Tax Act of 1978 (P.L. 95-618) provides a residential energy tax credit for certain energy conserving and renewable energy source expenditures made in connection with a taxpayer's principal residence. The credit applies to expenditures on energy-conserving items such as insulation and storm windows, as well as to investments in solar, wind, and geothermal energy property, categorized as renewable energy source property. Internal Revenue Service statistics indicated that taxpayers may have been improperly claiming residential energy tax credits for geothermal energy expenditures. These tax credits had been claimed by taxpayers residing either in States without geothermal resources as defined by IRS, or in States with such resources but at depths too great to be economically useful.

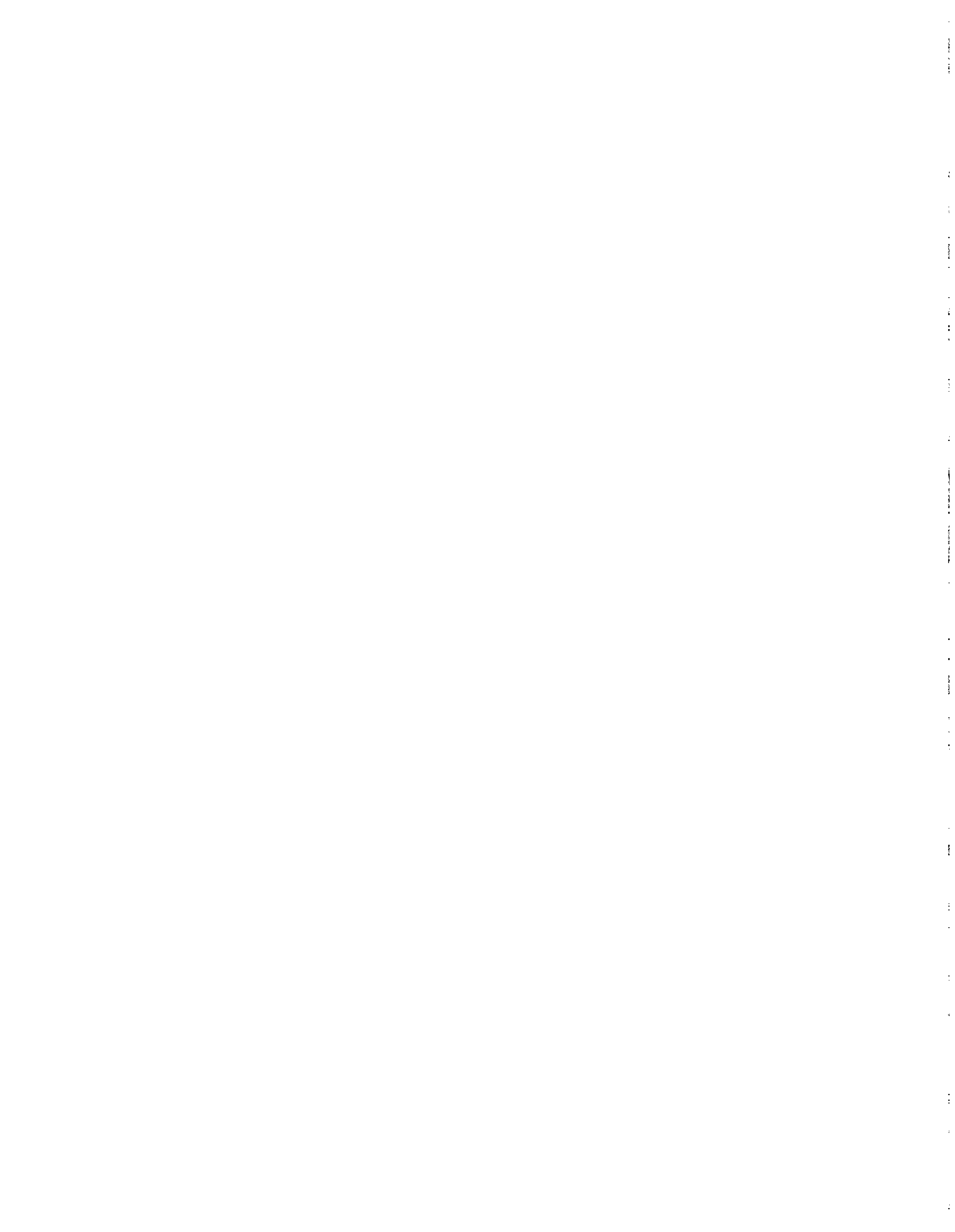
Without an examination of individual tax returns, it is not possible to prove that improper tax credit claims have been made. We believed, however, that there were sufficient indications of a potential problem to warrant IRS attention and action.

Recommendation

We recommended that the Commissioner of Internal Revenue (1) test the propriety of selected geothermal tax credit claims and (2) determine the extent to which a problem exists that warrants expanded action on IRS' part. One way this could be accomplished would be through sampling or selectively screening out and examining returns containing such claims from taxpayers in States without geothermal resources meeting IRS' definition and in States with such resources but at depths too great to be economically useful. On the basis of its examination of the returns in question, IRS would then be in a better position to assess the extent to which a problem exists and, as appropriate, take corrective measures. In any case, it would be beneficial for examiners to have access to information identifying those States or regions of the country which are likely to have geothermal resources that would qualify for the credit.

Action taken and/or pending

IRS generally concurred with our findings and agreed to take corrective action. In January 1983, IRS distributed information to its district offices and service centers to assist in identifying questionable geothermal energy tax credit claims. This information included IRS' definition of a geothermal deposit and a list of States showing those with resources that would probably qualify for the credit, those without geothermal resources, and those with deep resources where credits claimed by its residents would be questionable. IRS also decided to review the instructions it provides taxpayers for submitting energy tax credit claims in order to clarify the definition of a geothermal resource to help prevent misinterpretations by taxpayers.



REPORTS ON TAX ADMINISTRATION MATTERS ISSUED DURING 1982

Title	Date
Legislative and Administrative Changes to Improve Verification of Welfare Recipients' Income and Assets Could Save Hundreds of Millions (HRD-82-9)	1/4/82
Excessive Specifications Are Limiting Competition for IRS Special Design Tax Return Folders (GGD-82-61)	3/24/82
Investigation to Reform Teamsters' Central States Pension Fund Found Inadequate (HRD-82-13)	4/28/82
The Federal Government Can Save $1.7 Million Annually by Eliminating Strip Stamps (GAO/GGD-82-60)	5/7/82
Uncertainties about the Definition and Scope of the Property Concept May Reduce Windfall Profit Tax Revenues (GAO/GGD-82-48)	5/13/82
Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving (GAO/GGD-82-38)	7/1/82
Impact of the Paperwork Reduction Act on the Internal Revenue Service's Ability to Administer the Tax Laws (GAO/GGD-82-90)	7/6/82
Compilation of GAO's Work on Tax Administration Activities During 1981 (GAO/GGD-82-82)	7/22/82
Further Research into Noncompliance is Needed to Reduce Growing Tax Losses (GAO/GGD-82-34)	7/23/82
Changes to Appeals Process Could Improve Settlements and Increase Taxpayers' Satisfaction (GAO/GGD-82-54)	7/28/82

IRS Needs to Curb Excessive Deductions for Self-Employment Retirement Plans (GAO/GGD-82-85)	8/26/82
Special IRS Examination Procedures Are Needed for Certain Returns Containing International Tax Issues (GAO/GGD-82-77)	8/27/82
IRS Can Do More to Identify Tax Return Processing Problems and Reduce Processing Costs (GAO/GGD-83-8)	10/14/82
Multiemployer Pension Plan Data Are Inaccurate and Incomplete (GAO/HRD-83-7)	10/25/82
Possibility of Improper Geothermal Energy Tax Credit Claims (GAO/RCED-83-1)	12/2/82

TESTIMONY ON TAX ADMINISTRATION MATTERS
GIVEN BY GAO OFFICIALS DURING 1982

GAO Official	Congressional Committee	Subject Matter	Date
William J. Anderson, Director, General Government Division	Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations	Adequacy of IRS' Resources	3/17/82
Morton A. Myers, Director, Program Analysis Division	Senate Finance Committee	Taxation of Insurance Companies	3/18/82
William J. Anderson, Director, General Government Division	Subcommittee on Oversight of the Internal Revenue Service, Senate Finance Committee	Senate Bill 2198, Taxpayer Compliance Improvement Act of 1982	3/22/82
William J. Anderson, Director, General Government Division	Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs	Status of IRS' Taxpayer Service Program	3/24/82
Daniel F. Stanton, Deputy Director, General Government Division	Subcommittee on Oversight of the Internal Revenue Service, Senate Committee on Finance	Senate Bill 2369, Independent Contractor Tax Classification and Compliance Act of 1982	4/26/82
William J. Anderson, Director, General Government Division	Subcommittee on Oversight, House Committee on Ways and Means	IRS Policies and Procedures to Safeguard Taxpayer Rights and the Effects of Certain	

ENCLOSURE VI

GAO Official	Congressional Committee	Subject Matter	Date
William J. Anderson, Director, General Government Division	House Committee on Ways and Means	House Bill 6300, The Tax Compliance Act of 1982	5/18/82
Wilbur D. Campbell, Acting Director, Accounting and Financial Management Division	Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs	Computer Matching to Detect Error, Waste, and Fraud in Government Programs	12/16/82

ENCLOSURE VI

SCOPE AND SUBJECT MATTER OF JOBS INITIATED DURING 1982 PURSUANT TO PUBLIC LAW 95-125

Subject matter	Objective/scope	Month started
IRS Taxpayer Assistance	To obtain information on who uses IRS assistance and what assistance the users or taxpayers in general need. To evaluate the resulting data to determine how IRS could use its limited resources more effectively.	January
Multiemployer Pension Plan Amendments Act of 1980	To assess the impact of the act and its provisions on (1) participants, beneficiaries, employers, employee organizations, and other affected parties, and (2) the self-sufficiency of the insurance fund established to guarantee payment of basic benefits of insolvent multiemployer plans.	January
	To address the usability of multiemployer pension plan data maintained by the Government.	January
	To monitor efforts of IRS, Labor, and Pension Benefit Guaranty Corporation to administer the act.	January
	To assess effects of the basic withdrawal liability provisions of the act.	January

Subject matter	Objective/scope	Month started
Multiemployer Pension Plan Amendments Act of 1980 (Continued)	To assess effects of the funding and reorganization provision of the act.	January
	To determine the role of the actuary in the administration of multiemployer pension plans.	January
	To assess effects of the special withdrawal liability provisions of the act.	April
IRS' Use of Computers	To determine whether IRS is effectively and efficiently using computer technology and the relationship of planned systems to future developments.	July
Federal Unemployment Tax Certification Program	To assess the cost and benefits of the program, extent of unnecessary taxpayer contacts, IRS and State compliance efforts and the importance of States maintaining accurate program data.	July

Subject matter	Objective/scope	Month started
IRS/State Exchange Activities	To evaluate (1) what kinds of income information sources the States have which IRS could use to detect noncompliance, (2) whether IRS is using available income information data that the States have, (3) whether IRS is providing States with data needed to reduce noncompliance, and (4) whether the States are properly safeguarding the Federal tax information they receive.	August
Administration of Taxes on Petroleum	To determine how well IRS is administering taxes on petroleum and petroleum products.	October
Use of Tax Treaty/Tax Haven Countries to Reduce or Escape U.S. Taxes	To evaluate how IRS uses tax-related information it receives concerning international transactions. To determine how IRS and selected tax treaty countries monitor the use of treaties to ensure that their provisions are not being abused. To analyze the Department of the Treasury's approach to negotiating and modifying tax treaties, especially those identified as being subject to abuse.	October

Subject matter	Objective/scope	Month started
Foreign Operations Division Examination Methods	To develop information on efficiency and effectiveness of FOD's correspondence and interview exam methods.	October
Self-Employed Data Accuracy	To determine extent and tax impact of earning errors on the Schedule SE. To explore feasibility of providing IRS a detecting and screening capability for its own data base.	October
Further Tax Withholding	To identify major pockets of noncompliance involving nonreporting or underreporting where further withholding might be applicable. To determine feasibility of assessing potential costs and revenue and compliance benefits associated with applying further withholding versus using other methods of compliance enforcement.	December

GAO FORM-379 (Aug. 72)
United States
General Accounting Office
Operations Manual

Order

0135.1

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

August 25, 1980

GAO NOTE:

This order is being revised to incorporate additional access authority given to GAO in the Tax Equity and Fiscal Responsibility Act of 1982. Section 358 of the Act authorizes GAO access to tax returns and return information in the possession of any Federal agency when GAO is auditing a program or activity of the agency which involves the use of tax information. Furthermore, under certain circumstances, GAO is permitted access to tax information that a Federal agency could have requested for nontax administration purposes.

Distribution: C, N, R, and S Initiated by: General Government Division

RECORD OF CHANGES

GAO FORM-379A (Aug. 72)

CHANGE NO.	DATE OF CHANGE	DATE ENTERED	INITIALS OF PERSON ENTERING CHANGE

August 25, 1980 0135.1

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GAO FORM - 378 (Aug. 72)

United States
General Accounting Office
Operations Manual

Order

0135.1

August 25, 1980

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

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

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

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

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

d. Applies to all GAO organizational elements.

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

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

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

3. REFERENCES.

a. Public Law 95-125.

b. 31 U.S.C. 67.

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

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Initiated by: General Government Division

d. 18 U.S.C. 1905.

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

4. DELEGATION OF AUTHORITY.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

9. ANNUAL REPORT.

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

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

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

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

1. PURPOSE.

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

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

2. BACKGROUND.

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

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

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

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

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

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

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

3. WHAT IS TO BE RECORDED.

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

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

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

a. Disclosures to GAO by IRS and ATF.

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

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

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

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

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

b. Disclosures to GAO by Others.

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

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

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

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

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

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FIGURE A1-1. DISCLOSURE CONTROL DOCUMENT

GGD Form 4
(12-77)

U.S. GENERAL ACCOUNTING OFFICE

TAX ADMINISTRATION
DISCLOSURE CONTROL DOCUMENT

GAO OFFICE: ____________________

JOB TITLE:	JOB CODE:

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

SUBMISSION DATE:	TOTAL TAXPAYERS THIS MONTH	
	PREVIOUS MONTH	
	TO DATE	

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

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

1. STATEMENT OF PRINCIPLE.

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

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

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

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

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

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

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Appendix 2

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

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

b. General Operating Procedures.

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

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

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

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

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

3. WORK DONE UNDER COMMITTEE AUTHORITY.

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

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

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

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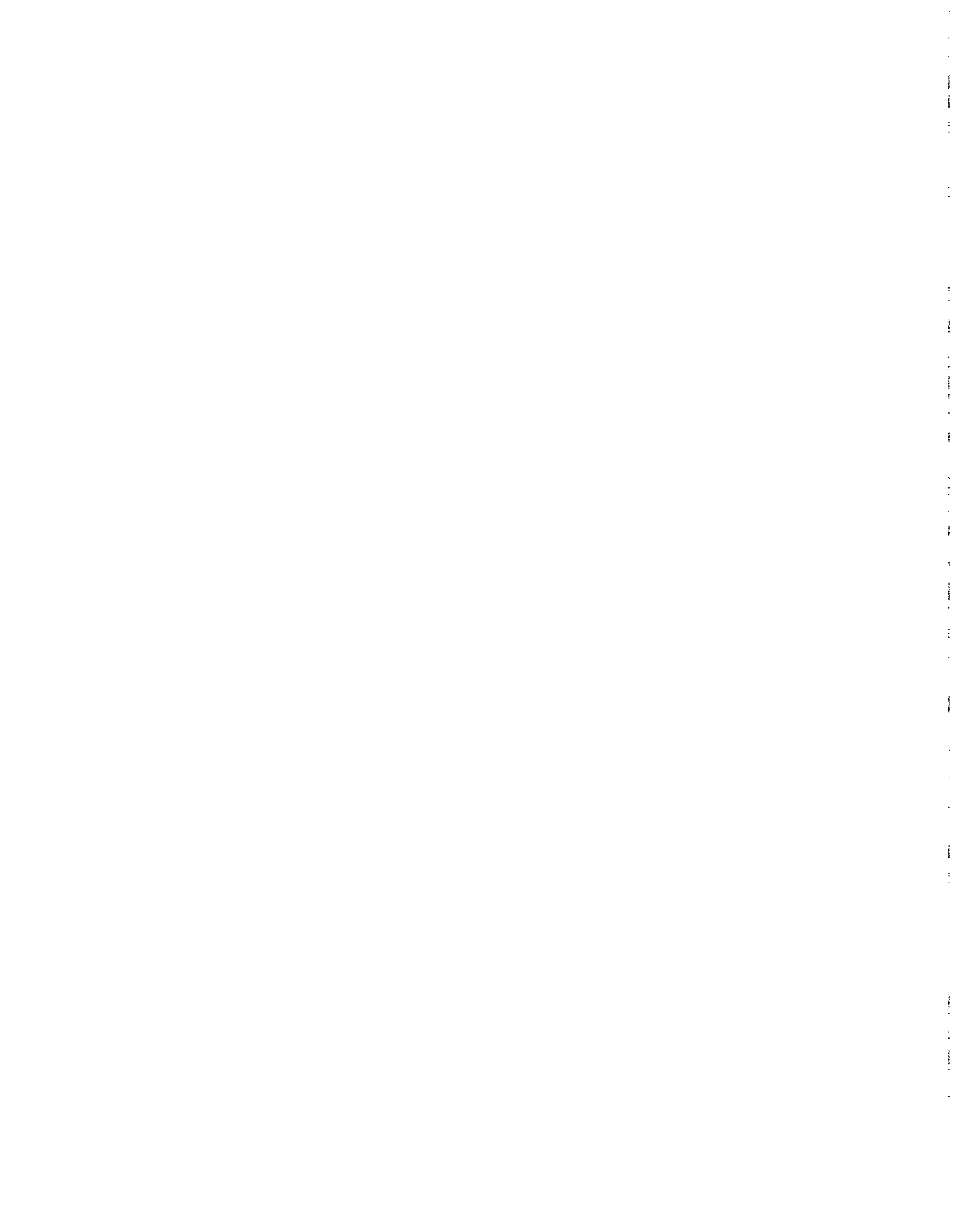

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