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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Commissioner Of Internal Revenue

Administrative Changes Could Strengthen IRS' Claims For Rewards Program

According to the Internal Revenue Service, billions of dollars in taxes are lost each year due to unreported and underreported legal and illegal income. IRS has various programs for detecting such noncompliance with the tax laws, and its Claims for Rewards Program has proven to be useful in this regard. Under the program, citizens can collect from \$25 to \$100,000 for providing information leading to the collection of delinquent taxes. Between fiscal years 1975 and 1984, IRS was able to recover about \$16.4 million annually through the program and paid rewards of about \$456,000 annually.

GAO believes that, while the program has been useful and effective, it could be more so with some administrative improvements and makes several recommendations to this end. IRS agreed with those GAO recommendations designed to minimize processing times, assure that rewards are paid promptly and accurately, and improve IRS instructions to potential program participants on the kinds of information IRS needs to initiate and develop program cases.



031856
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GAO/GGD-85-11
APRIL 19, 1985

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

GENERAL GOVERNMENT
DIVISION

B-215757

The Honorable Roscoe L. Egger, Jr.
Commissioner of Internal Revenue
Department of the Treasury

Dear Mr. Egger:

This report discusses ways IRS can make the Claims for Rewards Program more effective. We made this review to evaluate IRS' administration of the program and to determine whether it was operating effectively in detecting unreported income. The report makes recommendations to you on pages 17, 18, and 25 designed to decrease the time needed to process reward claims and pay rewards, and better assure that potential program participants are aware of the kinds of information IRS needs to initiate and develop tax evasion cases.

As you know, 31 U.S.C. §720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We appreciate the cooperation and assistance provided us by IRS personnel. We look forward to working with you on other tax administration matters in the future.

Sincerely yours,

W.J. Anderson

William J. Anderson
Director



GENERAL ACCOUNTING OFFICE
REPORT TO THE COMMISSIONER
OF INTERNAL REVENUE

ADMINISTRATIVE CHANGES COULD
STRENGTHEN IRS' CLAIMS FOR
REWARDS PROGRAM

D I G E S T

According to the Internal Revenue Service's (IRS') latest available data, at least \$64 billion in taxes was lost in 1981 due to unreported and underreported income derived from legal and illegal sources. IRS' Claims for Rewards Program is one means for detecting such taxpayer noncompliance. Under this program, IRS offers rewards for information which it does not already have and which leads to the collection of unpaid taxes. Persons providing such information can receive from \$25 to \$100,000, depending on the amount of taxes, fines, and penalties collected as a result of the information.

GAO evaluated IRS' administration of the program to determine whether it was operating efficiently and effectively. (See pp. 1 to 5.)

IMPROVED MANAGEMENT CONTROLS,
PROCEDURES, AND INSTRUCTIONS COULD
MAKE THE PROGRAM MORE EFFECTIVE

Between fiscal years 1975 and 1984, the Claims for Rewards Program led to the collection of about \$16.4 million in taxes annually with rewards averaging about \$456,000 per year. Moreover, GAO found that the program has helped IRS identify and collect taxes which might not have been realized without information provided by program participants. (See pp. 6 to 8.)

IRS has recognized the Claims for Rewards Program's potential for detecting tax evasion and has assigned priority to the program. GAO found, however, that IRS personnel were not fully aware of the program's processing requirements and have not been giving claims for rewards cases priority consideration. IRS' limited compliance resources and competing priorities have precluded claims for rewards cases from receiving priority attention. To improve program effectiveness, GAO

believes that IRS needs to request its managers and staff to refamiliarize themselves with the program's operating guidelines and procedures for handling and processing claims for rewards cases. (See p. 9.)

The program's effectiveness could also be hindered by administrative problems relating to the timeliness of processing claims for rewards and rewarding program participants, and to the accuracy of reward payments. In addition, program participants may not be fully aware of what information IRS needs to initiate and develop program cases.

IRS has no time requirements for processing claims for rewards allegations, submitting agents' claims for rewards evaluation reports, and processing rewards claims. Therefore, GAO formulated criteria based on the length of time IRS national and district officials told GAO that these processing functions should take. Using these criteria, GAO found that in 128, or 79 percent, of 161 reward claims files in two large IRS district offices--Brooklyn and Manhattan--it took longer than IRS officials said it should take to perform one or more processing functions. While the extent of processing times in some cases is uncontrollable because of appeals and litigation and the lack of sufficient resources, IRS could better assure that processing times are minimized by establishing as a goal time frames for accomplishing various functions. (See pp. 9 to 13.)

Persons providing information under the Claims for Rewards Program do not always, as required, receive payment for the full amount of taxes collected. In some instances, a portion of the delinquent taxes are declared uncollectible and rewards are paid on the basis of taxes collected up to that time. GAO found six cases where subsequent tax collection occurred after the taxes had been declared uncollectible. In all of those cases, IRS claims examiners did not routinely check corresponding delinquent account transcripts to

assure that claimants were paid any additional rewards due. As a result, these claimants did not receive additional rewards to which they were entitled. (See pp. 13 to 16.)

The effectiveness of the Claims for Rewards Program cannot be fully achieved if potential program participants are not familiar with the kinds of information IRS needs to initiate and develop cases on tax law violators. Through an analysis of 8 years of program statistics, GAO found that about 87 percent of the claims for rewards files that were closed were disallowed and that most were disallowed because the claimant did not provide sufficient information on the merits of pursuing the claim. Various IRS officials believed this indicates that program participants need to be educated about the kinds of information IRS needs to initiate and develop program cases. This could be done by revising existing IRS Publication 733 to include a section explaining the kinds of information IRS finds useful. Such a revision should not only make potential participants better aware of the program's requirements, but also might help reduce the number of frivolous claims. (See pp. 16 and 17.)

BETTER FINANCIAL INCENTIVES COULD ENHANCE THE PROGRAM

Although IRS' policy and procedures permitted partial reward payments under certain circumstances as tax deficiencies were collected, such payments were not normally encouraged. GAO found that if partial rewards had been permitted more often, some program participants could have received rewards sooner, thus enhancing the program. IRS recently revised its policy and procedures to encourage the payment of partial rewards.

For partial allowances to be used effectively, however, IRS still needs to simplify its procedures for tracking and providing subsequent partial or full payments. Currently, when partial payment has already been made, the claimant is required to file a separate application for any further reward. This is burdensome and could be simplified by eliminating

the multi-application requirement and assigning a permanent claim number to each case for tracking purposes. (See pp. 20 and 21.)

The Claims for Rewards Program could also be enhanced by changing its rewards structure. IRS recently raised the maximum reward from \$50,000 to \$100,000 to better compensate program participants who provide information leading to significant tax recoveries. However, the \$25 minimum reward has not changed in more than 15 years, despite inflation. GAO found that participants often receive small rewards, and they wait a long time to receive them. For example, of the claims GAO looked at which resulted in rewards, 38 percent were for less than \$100, and the claimants waited 5 or more years from the date of submission to be paid. If the minimum reward were raised from \$25 to \$100, for example, the effect on the program's revenue yield-to-cost ratio would be negligible. (See pp. 22 to 25.)

RECOMMENDATIONS

GAO recommends, among other things, that IRS:

- Request its managers and staff to refamiliarize themselves with the Claims for Rewards Program's operating guidelines and procedures. (See p. 17.)
- Establish, as a goal, specific time frames for (1) acknowledging service center receipt of program participants' allegations, (2) referring worthy allegations to district offices for action, (3) submitting agents' claims for rewards evaluation reports, and (4) issuing rewards once claims examiners are aware that assessed deficiencies have been paid. (See p. 18.)
- Establish procedures to ensure that subsequent collections on a rewards case deemed uncollectible are reported to service center program claims examiners so additional rewards can be paid as appropriate. (See p. 18.)
- Include in IRS Publication 733 a section on the specific kinds of information IRS finds useful to make cases against tax law violators. (See p. 18.)

--Consider raising the minimum reward. (See p. 25.)

IRS' COMMENTS AND GAO'S EVALUATION

IRS agreed with GAO's recommendations for minimizing the time for processing claims, assuring that claimants receive all rewards timely and accurately, and revising IRS' Publication 733 to include guidance on the specific kinds of information IRS finds useful in initiating and developing tax evasion cases. IRS disagreed with certain proposed recommendations because it thought they would have the effect of reemphasizing and increasing public awareness of the program.

IRS, for example, did not agree with GAO's proposed recommendation that IRS issue a directive reconfirming its commitment to the Claims for Rewards Program and urging its employees to reacquaint themselves with the program's features and operating procedures. IRS expressed concern that such a directive would be perceived as a reemphasis or expansion of the program and would run the risk of producing an adverse public reaction. IRS also stated that it would be inappropriate to raise the priority of the program. GAO did not intend by its recommendation for IRS to expand or raise the priority of the program. Rather, GAO's recommendation was aimed at having IRS reacquaint its managers and staff with the program's assigned priority, operating requirements, and procedures. Accordingly, GAO revised its final recommendation to more clearly state its intent.

As another example, IRS did not agree with GAO's proposed recommendation that IRS raise the minimum reward or consider various methods for publicizing the Claims for Rewards Program because it was concerned with expanding the program and creating a negative impression with taxpayers. Other than indicating that raising the \$25 minimum reward would constitute reemphasizing or expanding the program, IRS did not provide specific rationale for its objection to raising the minimum reward. GAO believes that raising the \$25 minimum reward would be consistent with IRS' decision to raise the maximum reward from \$50,000 to

\$100,000, particularly since considerably more participants receive small rewards than very large rewards. Raising the minimum reward, in GAO's opinion, would not necessarily be perceived as a reemphasis or expansion of the program anymore than the raising of the maximum reward. GAO states, rather, that because it has been more than 15 years since the minimum reward has been raised, such action should provide more adequate compensation for useful information and enhance participant satisfaction. Accordingly, GAO retains its recommendation in this report.

IRS' comments are included as appendix II to the report. GAO's evaluation of these comments appears on pp. 18, 19, 25, and 26.

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CHAPTER 1

INTRODUCTION

Our Nation's tax system depends on the willingness of taxpayers to voluntarily pay their taxes. In fiscal year 1983, for example, income taxes accounted for about \$576 billion, or about 96 percent of the government's revenues. Over the last decade, however, an increasing number of people have failed to report all of their taxable income or they have otherwise failed to comply with the tax laws.

Taxpayer noncompliance, particularly that involving undocumented cash transactions, is difficult and costly for the Internal Revenue Service (IRS) to detect, especially since IRS' resources have not kept pace with its workload. Therefore, it is essential that IRS efficiently and effectively use those programs at its disposal to stem the growth of noncompliance problems, such as unreported income.

This report is about one such program--the Claims for Rewards Program--that helps IRS detect and deter taxpayer non-compliance even when sufficient documentation either does not exist or is limited. The purpose of our review was to evaluate IRS' administration of the program and to determine how efficiently and effectively the program detects unreported and underreported legal and illegal source income.

TAXPAYER NONCOMPLIANCE IS A SERIOUS PROBLEM

Extensive evidence is available to show that noncompliance among both individual and corporate taxpayers is a serious problem--one which could be undermining our Nation's tax system. The results of one study, completed for IRS in March 1980, indicated that at least 26 percent of the people interviewed admitted to purposely understating their tax liabilities. In July 1983, IRS released estimates that the tax revenue loss, or "tax gap," from noncompliance for fiscal year 1981 may have been as high as \$90.5 billion. Moreover, IRS estimates showed that the tax gap had almost tripled since 1973, when it was about \$31 billion, and that it could reach about \$133 billion in 1985, unless steps are taken to curb its growth. IRS' analysis showed that the \$90.5 billion shortfall in 1981 resulted from several forms of noncompliance:

- \$55.1 billion from individuals either underreporting or not reporting legal income;
- \$13.4 billion from individuals overstating expenses, deductions, or credits;
- \$9.0 billion from unreported income gained illegally by individuals and corporations;

--\$6.8 billion from individuals who filed returns but failed to pay taxes owed; and

--\$6.2 billion from noncompliance by corporations.

These statistics demonstrate that unreported income is the most serious problem that IRS faces. It is also the most difficult to deal with since unreported income obtained through cash or otherwise unrecorded transactions leaves no paper trail, making it very difficult and costly for IRS to detect. These types of transactions and the people who perform them include businesses and individuals who "skim," or fail to record all cash sales or income; individuals performing personal services who fail to report tips; wage earners who moonlight and are paid in cash; and professionals and others who exchange, or "barter," their services and do not report income from these arrangements. At the same time, IRS' resources have not kept pace with the demands placed on the tax system by the decline in compliance, the continuous increases in the scope and complexity of the tax laws, and the increase in our Nation's taxable population. Consequently, it is important that IRS' limited resources be directed at programs which help to detect and deter noncompliance, especially unreported income, and that such programs operate as efficiently and effectively as possible.

IRS HAS SEVERAL PROGRAMS
TO DETER NONCOMPLIANCE

IRS has several programs designed to detect and deter noncompliance. For example, its Criminal Investigation Division uses two programs to identify tax evasion cases with prosecution potential. The Special Enforcement Program identifies and investigates those individuals who derive substantial income from illegal sources. The General Enforcement Program is directed at a broader population--taxpayers who fail to report income derived from legal sources, such as tips and bartering arrangements.

The Collection Division also has programs which help IRS to detect and deter taxpayer noncompliance. The Taxpayer Delinquency Investigations Program is IRS' primary means for dealing with individuals who do not file. This program uses computer matching techniques to identify these people. Under the Returns Compliance Program, IRS uses investigative techniques to detect and secure individual returns not detectable through the Taxpayer Delinquency Investigations Program.

The Examination Division's Examination Program is IRS' largest compliance effort. Under that program, IRS selects individual returns based on the potential for taxpayer error and examines them and their supporting records to verify that taxpayers accurately reported income and accurately claimed deductions, exemptions, and other offsets to income.

All of these compliance enforcement programs help IRS to detect and deter taxpayer noncompliance when financial transactions are documented. However, an examination program which has proven to be useful in detecting unreported income, including that related to undocumented cash transactions, is the Claims for Rewards Program.

THE CLAIMS FOR REWARDS PROGRAM

Section 7623 of the Internal Revenue Code authorizes the Secretary of the Treasury to pay such sums deemed necessary for detecting and convicting persons who violate the federal tax laws. Under this section, IRS has established a program through which third parties can provide information on alleged tax violations in exchange for a reward. This program, which is commonly referred to as the Claims for Rewards Program or Rewards for Information Program, authorizes IRS to pay for information that helps it to assess and collect delinquent taxes resulting from individuals and businesses underreporting all or part of their legitimate and/or illegitimate income and/or falsifying deductions, exclusions, and/or exemptions. The program is implemented by the district offices with assistance from the service centers. Persons who participate in the program are required to complete IRS Form 211, "Application for Reward for Original Information," as soon as practicable after providing the information to IRS. (See app. I.)

Service center personnel initially screen incoming allegations for examination potential. The district offices initiate investigations of worthy allegations and recommend whether a reward should be paid and what percentage the award should be. The program's claims examiners are the administrative focal point for all reward claims received. IRS' National Office, specifically the Assistant Commissioner (Examination), is responsible for establishing procedures and guidelines for the Claims for Rewards Program; collecting and analyzing program statistics; and providing program guidance to IRS' 7 regions, 63 districts, and 10 service centers. The regional offices have oversight responsibility.

According to section 4569 of the IRS manual, to qualify for a reward, which can range from \$25 to \$100,000, a program participant must provide IRS with information which leads to its assessing a civil tax deficiency, penalty, or fine and/or results in a criminal conviction against a taxpayer.¹ IRS will not pay for information which it already has, or which is vague. Rather, information provided by program participants

¹IRS Policy Statement P-4-86 (approved December 12, 1983) increased the reward ceiling from \$50,000 to \$100,000.

must either serve as IRS' primary basis for initiating an investigation, or it must lead to a conclusion on an existing case which would otherwise not have been possible. If the information provided by a program participant is worthy of a reward, the participant receives an amount of money, not to exceed \$100,000, proportionate to the taxes, fines, and penalties actually collected.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to evaluate IRS' administration of the Claims for Rewards Program and, particularly, the program's efficiency and effectiveness in detecting taxpayer noncompliance.

We performed our review at IRS' National Office in Washington, D.C.; the North Atlantic regional office; the Brookhaven service center; and the Brooklyn and Manhattan district offices. We selected the Brooklyn and Manhattan district offices because, from fiscal years 1978 through 1980, both districts were among the 15 highest volume districts in terms of claims for rewards to be processed and total claims disposed of. The initial screening of allegations was performed by the Brookhaven service center, and the North Atlantic regional office was responsible for overseeing program operations in the Brooklyn and Manhattan district offices.

On the basis of discussions with National Office officials during our review, including the then Deputy Assistant Commissioner (Compliance) and the then Assistant Director of the Criminal Investigation Division, we did not expand the scope of our work to include other regional or district offices. These officials agreed that program problems and weaknesses in controls found at the Brooklyn and Manhattan district offices would be sufficiently representative of other IRS districts and would provide an adequate basis for making any necessary administrative changes to the overall program. Consequently, we agreed that expanding our scope would be neither necessary nor cost-effective.

To accomplish our objective, we reviewed pertinent regulations, policies, and procedures and discussed program operations with IRS managers, group chiefs, analysts, revenue agents, special agents, and program claims examiners. We collected, summarized, and analyzed 9 years of program statistics from fiscal years 1975 through 1983. We verified that nationwide totals were accurately calculated from district and regional office summary reports. We also analyzed an IRS proposal to raise the minimum reward and revise the reward formula. We did not obtain the names of program participants during the review because IRS is not authorized to disclose information which would identify a confidential informant.

To help determine the efficiency and effectiveness of the Claims for Rewards Program, we compared the revenue yield-to-cost ratio of regular tax return examinations to claims for rewards examinations. Because IRS does not maintain separate cost data on the Claims for Rewards Program, we extrapolated the total cost of the program by using the average cost of a normal examination. (The specific methodology we used is explained on p. 7.)

To identify program trends and areas needing administrative improvements and management controls, we analyzed 161 randomly selected claims for rewards files at IRS' Brooklyn and Manhattan district offices. These included:

- Twenty-five active claims at each district, collectively representing about 19 percent of these districts' active claims inventory as of September 30, 1981.
- Twenty-five claims which were disallowed by each district, collectively representing 7 percent of the claims disallowed by these districts during fiscal years 1979, 1980, and 1981.
- Thirty-one claims resulting in rewards at the Brooklyn district and 30 such claims at the Manhattan district, representing 100 percent of the claims resulting in rewards during fiscal years 1979, 1980, and 1981 at these district offices.

We conducted our audit of the Claims for Rewards Program between May 1981 and August 1982. Also, between February 1983 and July 1984, we did some limited followup work and held meetings with IRS National Office program officials to update our analysis of program statistics and account for any program policy and regulation changes. Our work was performed in accordance with generally accepted government auditing standards.

CHAPTER 2

INSTITUTING MANAGEMENT CONTROLS AND OTHER CHANGES COULD MAKE THE CLAIMS FOR REWARDS PROGRAM MORE EFFECTIVE

The Claims for Rewards Program has been useful in detecting unreported income and other forms of noncompliance. The program could be more effective if management imposed controls to minimize processing times and to assure that participants receive proper payment for their information. Program effectiveness should also improve if IRS better instructs potential program participants about what kinds of information it needs to initiate and develop tax evasion cases. As we will discuss in chapter 3, IRS could further enhance the program by improving the financial incentives.

THE CLAIMS FOR REWARDS PROGRAM HAS BEEN USEFUL IN DETECTING TAX EVASION

The Claims for Rewards Program has been useful to IRS in detecting tax evasion, particularly that involving unreported income where documentation is lacking. In addition, the program has resulted in the collection of taxes that might not have occurred had it not been for the information provided by program participants.

Our analysis of IRS statistics showed that between fiscal years 1975 and 1984, about 527 claims for rewards annually--about 9 percent of the average claims submitted annually--resulted in rewards nationwide. During this period, taxes recovered as a result of these claims averaged about \$16.4 million and rewards paid averaged about \$456,000 annually. That is, for every dollar the government paid out as a reward, it collected \$36 in delinquent taxes. The program has been more productive in recent than in earlier years. For every dollar paid out as a reward in 1983 and 1984, for example, the government collected \$49 in delinquent taxes.

This ratio, however, does not include the costs associated with administering the program and performing examinations. A more realistic indicator of the program's effectiveness is its revenue yield-to-cost ratio and how this ratio compares with other IRS compliance programs. In this regard, we compared the revenue yield-to-cost ratio of the Claims for Rewards Program with that of the Examination Program--IRS' largest compliance program--because the two programs are similar. Both programs examine individual and corporate tax returns to detect instances of noncompliance. The only difference is the manner in which returns are selected for examination. The Examination Program uses a computer model and mathematical formula to select returns for examination, while the Claims for Rewards Program relies on allegations from the public to select returns for examination.

IRS estimates that for fiscal year 1984, the Examination Program will have an average yield-to-cost ratio of 13.5 to 1. That is, for every dollar IRS expects to spend on the program, the government can expect to collect \$13.50 in additional taxes, penalties, and interest. From fiscal years 1975 through 1984, we estimated that the average annual yield-to-cost ratio of the Claims for Rewards Program was 16.8 to 1, excluding rewards paid to program participants, and 11.4 to 1, including rewards paid as a cost item.¹ Although the latter revenue yield-to-cost ratio is lower than that of the Examination Program, it still compares favorably, particularly when one considers the fact that many cases generated by the Claims for Rewards Program involve unreported income which (1) might otherwise go undetected if IRS had to rely on its more traditional enforcement techniques, like examinations, or (2) might be too costly to detect using investigative techniques.

In this regard, the usefulness of the Claims for Rewards Program in detecting taxpayer noncompliance can be demonstrated by our review of 61 claims which resulted in rewards at the Brooklyn and Manhattan district offices from fiscal years 1979 through 1981, the latest data available at the time of our review. Overall, 82 percent of these allegations contained information that taxpayers were not reporting all their income, or even filing tax returns. Tax deficiencies collected as a result of these 61 claims amounted to more than \$1.6 million, and rewards paid totaled more than \$64,000 at both district offices. Delinquent taxes were collected from individuals and businesses that underreported income, failed to file tax returns, or claimed false deductions and exemptions. Furthermore, 53, or 87 percent, of the 61 allegations reviewed led to the initiation of tax evasion cases which, according to district office personnel, probably would not have been started if it had

¹We arrived at the Claims for Rewards Program's revenue yield-to-cost ratio by extrapolating from available data because cost data is not separately maintained on the program. First, we calculated the average cost of a tax examination by dividing the number of returns examined during fiscal year 1981, excluding surveys (returns IRS decides not to examine), into IRS' fiscal year 1981 estimated cost of examinations. Then, to arrive at the estimated annual cost of the Claims for Rewards Program, we (1) multiplied the average examination cost by the average number of claims for rewards allegations disposed of and (2) added the average total dollar value of rewards paid from fiscal years 1975 through 1984. We then calculated the program's yield-to-cost ratio over the 10-year period by dividing the average annual collections of taxes, penalties, and interest resulting from claims for rewards during the period by the estimated average annual program cost.

not been for the allegations submitted by program participants. In addition, examinations resulting from 7, or 11 percent, of these 61 allegations culminated in successful prosecutions of taxpayers in criminal violation of the tax code.

The following cases illustrate how information provided by Claims for Rewards Program participants was instrumental in the collection of tax deficiencies from noncompliant taxpayers.

--In one case, IRS assessed and collected \$109,000 in delinquent taxes from a taxpayer and his business by using specific information, provided by a participant, concerning the taxpayer not reporting cash sales. The case agent reported that without that information, the case would never have been developed and the additional taxes and penalties would never have been collected. The program participant was rewarded \$8,126 for the information.

--In another case, a program participant provided IRS with information detailing an entertainment company's receipts-skimming scheme and led IRS to a second set of books. The owners were fined, sentenced, and incarcerated on a criminal tax law violation. The case agent said that without the provided information, the second set of books--and thus the unreported income--would not have been detected. The program participant had received a \$5,000 reward that was based on the payment of criminal fines. But, at the time of our review, a reward based on the civil aspects of the case had not yet been paid because the case was still pending.

IMPROVED MANAGEMENT CONTROLS
AND PROCEDURES COULD MAKE
THE PROGRAM MORE EFFECTIVE

The Claims for Rewards Program has not been timely in providing program participants with information on claims submitted and in paying rewards. Furthermore, participants do not always receive the full rewards to which they are entitled. If IRS refamiliarized its management and staff with the program's operating guidelines and procedures, and improved management controls, program participants should not have to wait as long to find out about the status of their claims or to receive their rewards. Also, if IRS processed claims for rewards more rapidly and paid rewards to participants as soon as possible once collections are made, participants might be more satisfied and the program more effective.

Management and staff need to refamiliarize themselves with program operating guidelines and procedures

Although IRS has recognized the potential of the Claims for Rewards Program for detecting tax evasion and has assigned priority to the program, IRS personnel are not fully aware of the program and its requirements, and claims for rewards cases have not been given priority consideration.

The IRS manual assigns priority to claims for rewards cases. In this regard, section 4569.33 stipulates that selected claims for rewards allegations should promptly be assigned to examination groups and that ". . . examinations will be completed as quickly as the taxpayer's cooperation and complexity of the issues permit." We found, however, that agents and group managers in the Brooklyn and Manhattan district offices were not treating claims for rewards cases as a priority. Rather, they treated such cases no differently than other cases. In this regard, we spoke to 13 agents and managers to determine how knowledgeable they were about the Claims for Rewards Program. Eleven were unfamiliar with the program and uncertain about how to process a claims for rewards case.

A major factor which precludes claims for rewards cases from receiving priority attention is IRS' limited compliance resources. Since IRS' resources have not kept pace with the demands placed upon it, IRS management has had to assign examination priority to various target groups from time to time to compensate, in part, for insufficient staff resources. This has resulted in heavy caseloads for agents and delays in assigning cases to agents. Several agents told us that special project cases--those examinations aimed at specific groups--and a heavy workload make it difficult to give priority to claims for rewards cases.

We recognize that IRS' compliance resources are strained. This makes it even more important for IRS to effectively use a program which has proven to be useful in detecting undocumented and otherwise undetected unreported income. Therefore, IRS needs to refamiliarize its management and staff with the program and its operating guidelines and procedures for handling and processing claims for rewards cases.

Controls and procedures are needed to help assure that participants' claims for rewards are processed quicker

The claims for rewards process is, by its nature, lengthy. Claims for rewards application forms (IRS Form 211) and the related information items must be screened at the service centers before being sent to the district offices for further consideration. The service centers send a file to the district

offices which usually includes the claim for reward application form, the allegation, the taxpayer's return(s), and the course of action the service centers recommend. When the file is received at a district office, it is reviewed by a classifier. If the classifier believes the allegation has audit potential, the file is sent to the district's centralized services branch for assignment to an examination group. The file is then assigned to an agent who will initiate an audit. If the taxpayer does not agree with the audit findings, the case will be referred to the Appellate Division for action. Once taxes have been assessed, collections must occur before participants can receive rewards.

Consequently, administrative processing of a claim for reward is usually a lengthy procedure. The 161 claims files we examined at the Brooklyn and Manhattan districts illustrate this.

--Through October 31, 1981, the districts' 50 active claims were in process an average of 3.9 years, ranging from .7 to 13.6 years. Of the 50 claims, 28 had been in process for more than 3 years--11 were 3 to 5 years old, 15 were 5 to 10 years old, and 2 were more than 10 years old.

--The 50 claims which were disallowed during fiscal years 1979 through 1981 were disposed of in an average of 1.4 years, ranging from .4 to 5.5 years.

--The 61 claims which resulted in rewards during fiscal years 1979 through 1981 were open an average of 5.5 years, ranging from 1.6 years to 17.4 years. In 23 instances, claimants had to wait 5 or more years before receiving rewards.

We examined these 161 claims files to determine where in the process delays might have occurred and how they could be eliminated or reduced. We found that in 128 of the 161 claims, or about 79 percent, it took longer than IRS national and district office officials said it should take to perform one or more processing functions. We identified several factors which tend to increase processing time. Some which are not directly controllable by IRS include the appeals and/or litigation processes and untimely deficiency payments by taxpayers. Generally, in these instances, the taxpayer being audited can initiate delaying tactics to lengthen the audit and/or litigation processes and to postpone paying the deficiencies assessed.

Two other factors which affect processing time and over which IRS has little control relate to the availability of IRS resources. These include agents' heavy caseloads and the

untimely assignment of worthy allegations to examination groups and/or agents. Unless IRS' resources begin to catch up with the demands placed upon them, these factors will continue to affect the processing time frames of claims for rewards cases.

In addition to those mentioned above, there are several other factors which contributed to the untimely processing of claims. These involve untimely

- service center processing,
- submissions by agents of claims for rewards evaluation reports, and
- processing by the program's claims examiners.

For these factors, however, we believe IRS can institute some management controls and processing time frames which currently are not provided in section 4569 of the IRS manual. Instituting such controls should help assure that program participants receive information about their claims as soon as practicable after IRS receives the allegations and that participants receive rewards as quickly as possible.

Service center processing

The IRS manual does not specify the time it should take service centers to process claims for rewards allegations and forward them to the district offices so they can act on the claims. Brookhaven service center officials told us that claimants' allegations and related material are usually provided to the district offices about 6 to 8 months after they are received. National Office officials concurred with this estimate. Since IRS has no official criteria, we considered an allegation to be untimely if it took the service center more than 8 months to process and transmit it to a district office.

Using this criterion, we determined that 57, or about 45 percent, of the 128 claims remained at the service center for more than 8 months before being transmitted to district offices. District offices cannot initiate audits based on worthy allegations until the allegations are processed by the service centers. Consequently, audit efforts could be delayed if worthy allegations linger at the service centers.

Furthermore, participants wait an unreasonable amount of time before receiving the required letters from the service centers confirming that their allegations have been received by IRS and are being considered. In this regard, of the 50 active claims we examined, district program claims examiners mailed acknowledgement letters to program participants an average of 5-1/2 months after the claims were received from the service centers; and, in one instance, 2-1/2 years after the claim was

received. In five other instances, letters of acknowledgement should have been sent to program participants in 1980 and 1981 but had not been at the time of our review. Thus, in those instances, participants would not have been aware that their allegations were received or were being considered.

To alleviate this problem, during our review we suggested that program procedures be revised to require that service centers, rather than district offices, send letters of acknowledgement to program participants as soon as allegations are received. IRS revised the procedures and transferred administrative control from the district offices to the service centers. However, no specific time frame was established for sending claims acknowledgement and rejection letters.

IRS should revise its manual to establish as a goal time frames for service centers to provide to district offices allegations having audit potential so that examinations can be initiated sooner. Together, these changes should allow claimants to be informed of the status of their allegations sooner.

Submissions by agents of claims
for rewards evaluation reports

Section 9543 of the IRS manual requires that an evaluation report be prepared as soon as the agent is able to determine whether a participant is entitled to a reward and, if so, how much. If a case is prosecuted, the report can be deferred pending the outcome of the criminal aspects of the case. Evaluation reports provide the program's claims examiners with the information required to either (1) send the participant a letter of disallowance once a case has been completed and the agent determines that a reward is not warranted or (2) process a reward check once deficiencies are collected.

IRS has no time requirement for when evaluation reports should be prepared and submitted. Therefore, after discussions with national and district program officials, we considered evaluation reports to be untimely when such reports were submitted 3 months or more after it had been determined that a reward was due or not. Using this criterion, we found that for 19 of the 128 claims, or about 15 percent, evaluation reports were submitted 3 months or more after it was decided rewards were due or not. The participants in 19 cases found out about the disposition of their claims and received rewards later than they might have had the evaluation reports been submitted more promptly. In one case, for example, a claims for rewards evaluation report was submitted about 5 years after the investigation was concluded and almost 2 years after the deficiencies were paid in full. The reward was paid 1 month after the report was filed, or about 2 years after the deficiencies were satisfied. Had the evaluation report been filed earlier, the participant would more than likely have received the reward much sooner.

To help assure that participants are not kept waiting longer than necessary to learn about the final disposition of their claims or to receive a reward, the IRS manual should be revised to include as a goal time frames for the submission of evaluation reports once a case has been closed. District office group managers should monitor closed claims for rewards cases to assure that evaluation reports are promptly filed once a case has been closed.

Processing by program
claims examiners

The program's claims examiners perform a variety of program-related administrative duties. They may also be assigned responsibilities ancillary to the program. Administrative duties include checking transcripts of taxpayers' accounts to determine whether deficiencies assessed have been liquidated and preparing the paperwork required for issuing a reward check.

IRS has not established time criteria for accomplishing these tasks. Therefore, after discussions with national and district program officials, we considered the program's claims examiners' processing of claims for rewards to be untimely when reward checks were processed more than 6 months after the program's claims examiner became aware that the deficiencies assessed were collected.

Using this criterion, we found that 24, or about 19 percent, of the 128 claims identified took program claims examiners more than 6 months to process after they became aware that the deficiencies had been collected. For example, one reward check was processed 1 year after all tax deficiencies had been paid because transcripts of the taxpayer's account had not been checked until that time for payment of assessed delinquent taxes. Had the transcripts been checked sooner, the reward could have been paid more promptly.

More effective controls and procedures are required to help assure that program participants receive rewards as quickly as possible. Program claims examiners should be required to check transcripts of taxpayers' accounts at prescribed time intervals to allow them to learn as soon as possible if and when assessed deficiencies have been satisfied. Also, time frames should be established, as a goal, for issuing reward checks once a claims examiner becomes aware that the assessed deficiencies have been liquidated.

Controls and procedures are
needed to help assure that
accurate rewards are paid

Claims for Rewards Program participants do not always receive the amount of remuneration to which they are entitled.

We detected several reward underpayments and overpayments which could have been prevented if certain management controls and procedures had been introduced.

Program participants, in some cases, are not receiving the full remuneration to which they are entitled because program claims examiners are not aware of additional collections which occurred after the rewards were paid. Rewards are sometimes paid on deficiency payments realized up to the time the taxpayer's account is declared uncollectible. Many times subsequent collections occur after an account has been rendered uncollectible. However, program claims examiners in the Brooklyn and Manhattan district offices did not check transcripts of taxpayers' accounts to determine whether subsequent collections occurred after the accounts had been declared uncollectible. As a result, some program participants received less money than they were entitled to receive.

Section 5611 of the IRS manual states that reporting an account as currently not collectible is not an abatement of the assessment. It merely moves the account from an active to a suspended status. The amount due is subject to collection at any time before the 6-year statutory period for collection expires. The IRS manual does not state whether taxpayers' uncollectible accounts should be monitored to ensure that program participants receive additional rewards based on subsequent collections. Not to do so, however, could deprive participants from receiving the full rewards to which they are entitled.

From fiscal years 1979 through 1981, 61 claims resulted in rewards at both the Brooklyn and Manhattan district offices. In 14 of these claims, reward allowances were based on deficiency payments made up to the time taxpayers' accounts were declared uncollectible. Subsequent collections occurred in at least 6 of these 14 cases; however, the program's claims examiners were not aware of these additional collections. These 6 program participants had received rewards totaling about \$1,150. However, as a result of additional collections which occurred after the rewards were paid, they were entitled to receive additional rewards totaling about \$783, which they had not yet received at the time of our review. The statuses of the 14 cases as of December 1984 were as follows:

<u>Activity occurring after an account was declared uncollectible</u>	<u>Number of cases</u>
Total deficiencies collected, yielding additional rewards due	3
Partial collection with balance still outstanding, yielding additional rewards due	2
Uncollectible decision reversed and installment payments being made, yielding additional rewards due	1
No collection activity, balance is still outstanding	3
Taxpayer account transcripts incomplete, collection activity not readily traceable	5
Total	14

For program claims examiners to monitor subsequent collection activity on taxpayers' accounts declared uncollectible, transcripts of accounts and collection activity must be monitored until the outstanding deficiencies have been liquidated. Manhattan district officials told us that to facilitate reward payments on collections which occur after taxpayers' accounts have been declared uncollectible, mechanisms must be established to allow the service centers to (1) identify such claims for rewards cases placed in suspense pending collections and (2) monitor the collection activity of such accounts and regularly report collections to the appropriate program claims examiner. We support this position because it would assure that taxpayers' outstanding balances are promptly monitored. It would also relieve the program's claims examiners of the additional responsibility of manually monitoring taxpayers' account transcripts until the currently not collectible balances are liquidated, especially since this process could take place over several years.

In addition to claimants not receiving the full remuneration they were entitled to, a few received rewards they were not entitled to because of calculation errors. Our analysis of 61 claims which resulted in rewards disclosed 3 erroneous reward calculations resulting in overpayments to program participants totaling about \$1,244. In these instances, management failed to detect the computation errors. An important control used to detect such errors was eliminated on July 20, 1981, when section 4414.1 of the IRS manual was revised to eliminate claims for rewards cases from the mandatory review list of the district office's review branch. IRS officials stated that claims for rewards cases were removed from the mandatory review list to reduce the workload of the review branches.

Before this revision, review branches automatically reviewed such cases to verify the appropriateness of the reward level that was recommended and to assure the accuracy of the reward calculation. National Office officials stated that although claims for rewards cases were no longer included on the mandatory review list, they have been subjected to special handling and review action. Brooklyn and Manhattan district office review branch officials stated, however, that since claims for rewards cases no longer appear on the mandatory list, it is unlikely that such cases would be reviewed. IRS' limited resources usually preclude the review branch from reviewing items which are not on the mandatory list. Consequently, by excluding claims for rewards cases from this list, the number of undetected errors could increase because completed claims for rewards cases may not be reviewed by the district offices' review branches--the main checkpoint for calculation errors. In commenting on a draft of this report, IRS stated that, since our review, the duties of reviewing and verifying the accuracy of rewards have been transferred from the district offices to the service centers where all reward computations are now being reviewed by the program claims examiners.

BETTER INSTRUCTIONS ARE NEEDED ON
WHAT INFORMATION IRS REQUIRES TO
INITIATE AND DEVELOP PROGRAM CASES

The potential usefulness and effectiveness of the Claims for Rewards Program as a compliance tool cannot be fully achieved unless potential program participants know what kinds of information IRS needs to initiate and develop cases on tax law violators. However, we found that potential participants may not be aware of the kinds of information IRS needs. In this regard, our analysis of program statistics for fiscal years 1975 to 1982 showed that about 87 percent of the claims for rewards files that were closed were disallowed. According to district office and service center officials, most of these claims were closed after initial screening because the claimant did not provide sufficient information for IRS to reach a decision on the merits of pursuing the claim. Various IRS officials at the national, regional, and district office levels we spoke with believe that the large number of disallowed claims indicates that there is a need to educate potential program participants about the kinds of information needed to initiate and develop cases.

Section 4569.23 of the IRS manual instructs IRS personnel not to suggest or encourage the Claims for Reward Program to a potential participant unless he/she asks about receiving a reward. IRS personnel can then discuss the procedures for applying for a reward and provide the person with both a claim for reward application (IRS Form 211) and a copy of IRS Publication 733, which describes how the program operates.

Publication 733 could be revised to include a section to more specifically explain to potential program participants the kinds of information that IRS finds useful in making cases against noncompliant taxpayers. Such a revision could serve to make potential participants more aware of program requirements, and might also help to reduce the number of frivolous claims IRS receives. For example, if a person submits an allegation to IRS contending that a business associate is hiding money but provides no additional details, IRS might reject the allegation after spending little or no effort to substantiate it. However, if the person also provides IRS with additional details, such as the false names the associate uses to hide the money in one or more named banks or the name of a store from which the associate has allegedly made large purchases, IRS might attempt to substantiate the allegation.

CONCLUSIONS

Over the years, the Claims for Rewards Program has led to the collection of millions of dollars in delinquent taxes. In particular, the program has proven to be useful to IRS in detecting unreported income and taxes, including those derived from cash transactions, which might have otherwise gone undetected.

The program could be more effective if IRS refamiliarized its management and staff with the program's operating guidelines and procedures and if it introduced and revised certain management controls and procedures. These actions should help (1) minimize processing times, (2) assure that program participants are better informed about the status of their claims, and (3) assure that participants receive appropriate rewards promptly and accurately. IRS could also improve program effectiveness by providing better instructions to potential program participants on the kinds of information it needs to initiate and develop cases on tax law violators.

RECOMMENDATIONS

To help assure that the Claims for Rewards Program is used more effectively in detecting taxpayer noncompliance, we recommend that the Commissioner of Internal Revenue require that:

--National Office management request regional office, district office, and service center managers and staff to refamiliarize themselves with the Claims for Rewards Program's operating guidelines and procedures.

To help assure that reward claims are processed in a timely manner and that rewards are paid promptly and accurately, we

recommend that the Commissioner of Internal Revenue institute the following management controls and procedures:

- Specific time frames should be established as a goal for (1) acknowledging service center receipt of program participants' allegations, (2) referring worthy allegations to district offices for action, (3) submitting claims for rewards evaluation reports by case agents, and (4) issuing reward checks once the program's claims examiners are aware that assessed deficiencies have been paid. Such time frames will provide IRS management with benchmarks from which it can assess program administration and implementation.
- Program claims examiners should be required to check, at prescribed time intervals, the transcripts of taxpayers' accounts to determine the status of outstanding tax deficiencies on active claims in which deficiencies have been assessed but collections have not been realized.
- Procedures should be implemented to assure that program participants receive additional rewards when subsequent collections are made after an account has been declared uncollectible and a reward paid. Such procedures should assure that claims for rewards cases are kept in suspense until the balances which were rendered uncollectible are liquidated. Subsequent collection activity should then be routinely reported by IRS' Collection Division to program claims examiners at the service centers so that additional rewards can be paid as warranted.

To help assure that potential program participants know the kinds of information IRS needs to initiate and develop Claims for Reward Program cases, we recommend that the Commissioner of Internal Revenue:

- Revise IRS Publication 733 to include a section on the specific kinds of information IRS finds useful to make cases against taxpayers who do not comply with the tax laws.

IRS' COMMENTS AND OUR EVALUATION

In a July 23, 1984, letter commenting on a draft of this report, the Commissioner of Internal Revenue did not agree with our proposed recommendation that IRS issue a directive to its offices reconfirming management's commitment to the Claims for Rewards Program and urging staff to reacquaint themselves with the program's features and operating procedures. IRS commented that such a directive would be perceived as a reemphasis or expansion of the program and expressed concern about the impact such a perception would have on IRS' public image. IRS also said that it is inappropriate to raise the priority of the program at this time.

We did not intend that IRS should expand or raise the priority of the Claims for Rewards Program. Our proposed recommendation, rather, was aimed at having IRS refamiliarize its staff with the program's usefulness in deterring taxpayer non-compliance and its procedures and requirements for handling and processing claims for reward cases. Accordingly, we revised our final recommendation to more clearly state our intent.

IRS, for the most part, agreed with the management controls we recommended to minimize the time it takes to process reward claims and to assure that rewards are paid promptly and accurately. IRS said it would establish time frames for acknowledging service center receipt of allegations and for referring worthy allegations to district offices for action. IRS stated, however, that rigid time tables are not needed for submitting claims for rewards evaluation reports by case agents and issuing reward checks once assessed deficiencies have been paid. We made this recommendation to assure that program participants are not kept waiting longer than necessary to learn about the disposition of their claims or to receive a reward. Therefore, we continue to believe it is important to establish time frames in each of the areas where processing has been untimely in order to provide IRS management with benchmarks or goals from which it can monitor and assess program administration.

IRS agreed that program claims examiners should periodically monitor the status of outstanding tax deficiencies on active claims, as well as those reward cases kept in suspense, until uncollectible balances are liquidated. IRS stated it will establish procedures to monitor these accounts.

In the draft report on which IRS commented, we proposed that all reward computations should be reviewed by district office program claims examiners for accuracy before payments are made to claimants. IRS agreed and stated that because of recent program procedural changes, this is now being done by program claims examiners in the service centers. Since IRS' procedural changes were responsive to our concern, we eliminated our proposal from this report.

Finally, IRS agreed to revise IRS Publication 733 to include the kinds of information it finds useful in developing cases against noncompliant taxpayers; and IRS indicated that it also planned to establish criteria regarding distribution of the publication.

CHAPTER 3

BETTER FINANCIAL INCENTIVES COULD ENHANCE THE CLAIMS FOR REWARDS PROGRAM

In addition to placing increased management controls on the Claims for Rewards Program and making other administrative changes, IRS could enhance the program's usefulness and effectiveness in detecting unreported income and collecting delinquent taxes by paying rewards sooner and by raising the minimum reward.

SOME CLAIMANTS COULD RECEIVE REWARDS SOONER IF GREATER USE WERE MADE OF THE PROGRAM'S PARTIAL REWARD PAYMENTS PROVISION

According to program officials at IRS' National Office and the field offices we visited, a major criticism levied against the Claims for Rewards Program by program participants is that it takes too long to receive rewards. Our sample of 61 claims which resulted in rewards supports this contention. It showed that it took an average of 5.5 years, ranging from 1.6 to 17.4 years, for a reward to be paid. In 23 of these claims, or about 38 percent, participants had to wait 5 or more years for payment. In chapter 2, we discussed how factors causing administrative processing delays could be better controlled so that participants could receive rewards quicker. Another way to pay participants for useful information sooner is to pay rewards in stages, until all collections have occurred.

Before we began our review, section 4569.9 of the IRS manual in effect permitted the payment of partial rewards as tax deficiencies were collected but stipulated that such payments normally should not be made. The manual stated that partial reward payments could be made on fines paid as a result of criminal prosecutions prior to the civil settlements of the tax liability, or when claimants requested a reward be paid on deficiency payments to date. As we will discuss later, the manual was revised.

In regard to partial payments, our sample of 50 Brooklyn and Manhattan district office claims in process as of September 30, 1981, and 61 claims resulting in rewards during fiscal years 1979 through 1981, disclosed that partial rewards were paid in 5 instances. In 2 of the 5 instances, the claimants requested the partial allowance, and, in the other three instances, the program's claims examiners initiated partial payment on the basis of criminal fines paid. Of the remaining 49 active cases and the 57 claims resulting in rewards, we found 16 claims where

partial rewards could have been paid if the criteria for allowing partial reward payments had been less restrictive. The following are examples:

- In one case, IRS collected about \$13,200 in delinquent taxes and penalties about 13 months after it assessed several taxpayers about \$226,000 in taxes and penalties using information provided by a program participant. Three years later, IRS declared the remaining \$213,000 uncollectible and placed the accounts in suspense. After about 2 more years, IRS paid the claimant a reward of \$1,321. If a partial reward allowance could have been made, the claimant could have received payment earlier.
- In another case, two taxpayers were assessed about \$44,000 in taxes and penalties. Deficiencies attributable to one of the taxpayers, amounting to about \$30,000, were declared uncollectible about 7 months after the assessment was made. The other taxpayer paid off his \$14,000 debt, plus interest, over about 7 years. The program claims examiner waited until all deficiencies were paid before recommending that the participant receive a reward of \$1,144. However, had the criteria for allowing partial payments been less restrictive, the claimant's reward, in this case, might have been paid in installments over a 7-year period, commensurate with the delinquent taxpayer's payments.

During our review, we suggested that the criteria for paying partial rewards be either clarified or expanded so that partial rewards could be used more frequently. In December 1983, IRS revised section 4569 of the IRS manual to encourage the payment of partial rewards whenever feasible.

However, for the partial allowance provision to be used effectively, an administrative requirement still needs to be changed. Section 4569.9 of the IRS manual currently stipulates that when a partial allowance is made, the claimant should be requested to file a separate claim for reward application for any further reward. This procedure is cumbersome and confusing because cross-referencing is required to allow the program's claims examiner to keep track of collections realized and rewards paid. Further, requiring program participants to file another rewards application after a partial reward has been paid imposes an unnecessary burden on the claimants and the program's claims examiners. If this requirement were rescinded, the claimant would not be required to complete any additional claim for reward applications, and one claim number would remain with the case until all reward allowances had been made, thereby also reducing burdensome paperwork.

RAISING THE MINIMUM REWARD COULD
PROVIDE MORE ADEQUATE COMPENSATION

The Claims for Rewards Program's current payment structure ranges from a minimum reward of \$25 to a maximum of \$100,000. Section 4569.12 of the IRS manual provides that rewards will be calculated on fixed percentages of the first \$75,000 recovered and for declining percentages above the \$75,000 level, up to a maximum reward of \$100,000, depending on how useful the information is to IRS in making a case. The table below explains the three "value of information" categories and illustrates for each category the amount of money which must be collected before the minimum and maximum reward amounts are attained.

Comparison of Reward Categories

<u>Value of information categories</u>	<u>Current reward calculation^a</u>	Tax collections required to achieve the	
		\$25 minimum reward	\$100,000 maximum reward
Category 1: Specific information which caused the investigation and resulted in the recovery of taxes, penalties, and fines.	10 percent of the first \$75,000 in taxes, fines, and penalties recovered; 5 percent of the next \$25,000; and 1 percent of any additional recovery, with a total reward not to exceed \$100,000.	\$250	\$9,225,000
Category 2: General information which caused the examination and was of value in determining tax liabilities, or information which did not cause the investigation but was a direct factor in the recovery of taxes, penalties, and fines.	5 percent of the first \$75,000 in taxes, fines, and penalties recovered; 2-1/2 percent of the next \$25,000; and 1/2 percent of any additional recovery, with a total reward not to exceed \$100,000.	\$500	\$19,225,000
Category 3: Information that caused the investigation but was of no value in determining tax liability.	1 percent of the first \$75,000 in taxes, fines, and penalties recovered; and 1/2 percent of any additional recovery, with a total reward not to exceed \$100,000.	\$2,500	\$19,925,000

^aInterest collected by the IRS is excluded from the reward.

IRS recently raised the maximum program reward from \$50,000 to \$100,000 to better compensate program participants who provide information leading to significant tax recoveries. However, the \$25 minimum reward has not changed in more than 15 years, even though inflation has eroded the value of rewards paid to program participants.

Many program participants receive small rewards, such as those valued between \$25 and \$100, and they wait a long time to receive them. For example, during fiscal year 1980, IRS paid 107 rewards of less than \$100, about 26 percent of all rewards paid to program participants that year. Of the 61 claims we sampled which resulted in rewards at both the Brooklyn and Manhattan district offices from fiscal years 1979 through 1981, 23, or about 38 percent, were for less than \$100. The claimants in those cases waited 5 or more years to be paid.

In December 1980, IRS' Southeast region suggested that the minimum reward be raised to \$100 to better compensate program participants. The region also suggested that district directors should have the discretion to pay the minimum reward in those instances where tax deficiencies are collected but the calculated amount of the reward is less than the proposed \$100 minimum reward. In March 1983, IRS' National Office program staff submitted a proposal to the Commissioner's office recommending that the minimum reward be raised to \$100, but also suggesting that no reward should be paid if the recovery was so small as to call for payment of less than \$100 under the reward formula. The impact of this suggestion would be that no reward would result if collections were less than \$1,000. Currently, collections of \$250 could result in a \$25 reward. The latter proposal would result in fewer claimants receiving rewards than presently do.

Using available program data, we found that raising the minimum reward to \$100 would have a negligible effect on the program's revenue yield-to-cost ratio, even if IRS were to decide to pay a minimum reward in those instances where the calculated reward would be less. During fiscal year 1980, 407 claims resulted in rewards nationwide. Of these, 107 rewards were for less than \$100. Assuming an average reward of \$55¹,

¹The dollar value of these 107 rewards was not available. Consequently, we calculated the average value of the 23 rewards under \$100 paid by the Brooklyn and Manhattan districts from fiscal years 1979 through 1981. We used this figure--\$55--to estimate the additional cost of rewards paid if the 107 claimants received rewards of \$100 and to demonstrate the effect this would have on the program's revenue yield-to-cost ratio.

these 107 claims accounted for only 1.4 percent of the total dollar value of rewards paid that year. If these claimants had each been rewarded \$100, the revenue yield-to-cost ratio would have decreased slightly from 8.6 to 8.5 to 1; the administrative costs associated with processing these claims would not have changed. Had the 107 claimants not been paid any rewards--as would have been the case if the National Office's March 1983 proposal had been adopted--IRS would have saved about \$5,900 and the revenue yield-to-cost ratio would have improved by a few cents.

Since a considerable number of program participants receive small rewards, it would seem consistent for IRS to consider increasing the minimum reward, just as it did the maximum reward, to provide more adequate compensation. Such action could possibly lead to better participant satisfaction and to the detection and collection of more delinquent taxes. We would question, however, the benefit of paying the minimum reward in instances where the calculated reward is less than the proposed minimum reward.

CONCLUSIONS

The Claims for Rewards Program has, over the years, been useful to IRS in detecting noncompliance with the tax laws, especially that involving unreported income. Taxpayer non-compliance, particularly unreported income, is a major problem and, if left unchecked, could undermine the Nation's voluntary tax system. Therefore, it is important that IRS programs aimed at detecting noncompliance, such as the Claims for Rewards Program, be as effective as possible. Improving the program's financial incentives could help in this regard. Such improvements could make the program an even more effective tool for IRS to use in combating taxpayer noncompliance. And, with increases in the tax gap and the federal budget deficit, such a tool becomes even more important.

RECOMMENDATIONS

To help assure that the Claims for Rewards Program's financial payments are sufficient, and paid as soon as possible, we recommend that the Commissioner of Internal Revenue:

- Rescind the requirement that claimants must submit separate claims for rewards applications after a partial reward has been paid, thereby eliminating burdensome paperwork.
- Consider raising the minimum reward.

IRS' COMMENTS AND OUR EVALUATION

In commenting on the recommendations in this chapter, IRS agreed to rescind the requirements for submitting a separate

claim for reward application for any further reward after a partial reward is made. IRS did not agree, however, to raise the minimum program reward.

IRS indicated that raising the \$25 minimum reward would constitute reemphasizing or expanding the program, but it did not provide specific rationale for objecting to raising the minimum reward. We believe that raising the minimum reward would be consistent with IRS' decision to raise the maximum reward, particularly since it would affect considerably more participants. Also, since the \$25 minimum reward has existed for more than 15 years, raising it should provide more adequate compensation for useful information and enhance participant satisfaction. Furthermore, we do not believe that such action would necessarily be perceived as a reemphasis or expansion of the program any more than the raising of the maximum reward.

In the draft report on which IRS commented, we discussed the advantages and disadvantages of publicizing the Claims for Rewards Program to increase public awareness of the program and, thus, possibly improve the usefulness and effectiveness of the program in light of the tax gap and federal deficit problems. We discussed various administrative methods available to IRS for publicizing the program and proposed that IRS consider these methods and adopt approaches which would be informative and educational without engaging in a wide-scale publicity campaign. IRS, however, expressed the concern that publicizing the Claims for Rewards Program could create a negative impression with taxpayers and a perception that IRS is unable to detect noncompliance. We have no empirical evidence to show whether the potential benefits, in terms of program effectiveness, of publicizing the Claims for Rewards Program outweigh the risks posed by IRS' concern. Therefore, we eliminated our proposal from this report.

Form 211 Rev. November 1981 Department of the Treasury Internal Revenue Service	Application for Reward for Original Information	OMB Clearance No. 1545-0409 Expires 12/31/83 Claim Number _____
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This application is voluntary and the information requested enables us to determine and pay rewards. We use the information to record a claimant's reward as taxable income, and to identify any tax outstanding (*including that on a return filed jointly with a spouse*) against which the reward would first be applied. We need social security numbers on this application in order to process it. Not providing the information requested may result in the suspension of the processing of this application. Our authority for asking for the information on this form is derived from 26 USC 6001; 6109, 6011, 7623, 7802, and 5 USC 301.

Name of claimant	Social security number
Name of spouse	Social security number

Address, including ZIP code

I am applying for a reward, in accordance with the law and regulations, for original information furnished, which led to the detection of a violation of the internal revenue laws of the United States and which also led to the collection of taxes, penalties, fines, and forfeitures. I was not an employee of the Department of the Treasury at the time I came into possession of the information nor at the time I divulged it.

Name of IRS employee to whom violation was reported	Title	Date violation reported (Month, day, year)
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Name of taxpayer who committed the violation

Address, including ZIP code

Under penalties of perjury, I declare that I have examined this application and my accompanying statements, if any, and to the best of my knowledge and belief they are true, correct, and complete. I understand the amount of any reward will represent what the District Director considers appropriate in this particular case.

Signature of claimant	Date	
The following is to be completed by the Internal Revenue Service		
Allowance of Reward		
District	Sum recovered	Amount of reward
	\$	

In consideration of the original information that was furnished by the claimant named above, which concerns a violation of the internal revenue laws and which led to the collection of taxes, penalties, fines, and forfeitures in the sum shown above, I approve payment of a reward in the amount stated.

Signature of District Director	Date
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Paperwork Reduction Act Notice

The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it, and whether you have to give it to us. We ask for the information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

JUL 29 1984

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, DC 20548

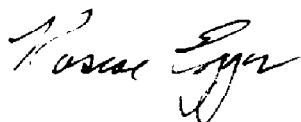
Dear Mr. Anderson:

Thank you for the opportunity to review your draft report entitled "Administrative Improvements in IRS' Rewards Program Could Enhance Compliance Efforts".

Our major concern with the report is the suggestion that the Claims for Rewards Program be reemphasized and expanded. We believe such an approach runs the very real risk of producing an adverse public reaction to the program and the Service. We are concerned that such results could impair tax administration generally. Specific comments are included with each recommendation.

With kind regards,

Sincerely,



Enclosures

IRS Comments on
GAO Draft Report
"Administrative Improvements in IRS' Rewards Program
Could Enhance Compliance Efforts"

Recommendation (page 17)*

National Office management should issue a directive to regional offices, district offices, and service centers stressing the significance of the Claims for Rewards Program as a compliance tool and reconfirming management's commitment to the program. The directive should urge service center personnel, the program's claims examiners, group managers, and agents to reacquaint themselves with the Claims for Rewards Program's features and its operating procedures. Furthermore, the Commissioner should require that the directive be used in IRS' examiner training programs as a basis for reinforcing existing guidance on the handling and processing of claims for rewards.

Response

We believe that such a directive would be perceived as a reemphasis or expansion of the Claims for Reward program, and are concerned about the impact that such a perception would have on IRS' public image. The Service has various programs, including the Claims for Reward program, for addressing noncompliance with the tax laws, and each has an established priority. We believe that it is inappropriate to raise the priority of the Claims for Reward Program at this time.

Recommendations (page 18)

Specific time frames should be established as a goal for (1) acknowledging service center receipt of the program participants' allegations, (2) referring worthy allegations to district office for action, (3) submitting claims for rewards evaluation reports by case agents, and (4) issuing reward checks once the program's claims examiners are aware that assessed deficiencies have been paid. Such time frames will provide the IRS management with benchmarks from which it can assess program administration and implementation.

Program claims examiners should be required to check, at prescribed time intervals, the transcript of taxpayers' accounts to determine the status of outstanding tax deficiencies on active claims in which deficiencies have been assessed but collections have not been realized.

*GAO note: Page references in this appendix have been changed to correspond with pagination in the final report.

GAO modified this recommendation in the final report.

Response

We agree that in certain instances specific time frames can be an effective management tool for assessing certain program goals, and will establish Servicewide time frames for acknowledging service center receipt of allegations and for referring worthy allegations to district offices for action. However, we feel that the other program objectives and goals should not be tied to rigid time tables. Our field offices should have the flexibility needed to accomplish the objectives of all our programs.

Recommendation*

Claims for rewards cases should be reinstated on the mandatory review list to ensure that all reward computations are reviewed for accuracy by the district offices' review branches.

Response

We agree that reward computations should be reviewed for accuracy. Recent procedural changes to this program included the establishment of the position of Informants' Claims Examiner (ICE) in the service centers. One of the duties of the ICE is to verify the mathematical accuracy of the recommended rewards in accordance with the formulas provided in Policy Statement P-4-86.

Recommendation (page 18)

Procedures should be implemented to assure that program participants receive additional rewards when subsequent collections are made after an account has been declared uncollectible and a reward paid. Such procedures should assure claims for rewards cases are kept in suspense until the balances which were rendered uncollectible are liquidated. Subsequent collection activity should then be routinely reported by IRS' Collection Division to program claims examiners at the service centers so that additional rewards can be paid as warranted.

Response

Procedures will be established to monitor these accounts for a maximum of 5 years from the date that the account becomes uncollectible.

*GAO note: GAO deleted this recommendation from the final report.

Recommendation (page 25)

Rescind the requirement that claimants must submit separate claims for rewards applications after a partial reward has been paid, thereby eliminating burdensome paperwork.

Response

We agree with this and will initiate appropriate changes to Internal Revenue Manual 4569.9.

Recommendations (page 25)

Raise the minimum reward.

Consider the various methods available to publicize the program, such as those discussed in this report, and adopt approaches which would be informative and educational without engaging in a wide-scale publicity campaign.*

Response

We do not believe that we should reemphasize or expand this program. We are concerned that this approach would create a negative impression with taxpayers and a perception that the IRS is unable to detect noncompliance.

Recommendation (page 18)

Revise IRS Publication 733 to include a section on the specific kinds of information IRS finds useful to make cases against taxpayers who do not comply with the tax laws.

Response

We agree that a revision to the publication would be useful, and we will attempt to incorporate the new information as soon as practicable.

We also plan to establish criteria regarding distribution of the publication.

*GAO note: GAO deleted this recommendation from the final report.

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