REPORT BY THE U.S.

General Accounting Office

1984 Annual Report On Tax Matters

This report, required by 31 U.S.C. 719(d), summarizes the results of GAO's work on tax matters for calendar year 1984. The report discusses open recommendations to the Congress from reports issued during and before calendar year 1984 and legislative action taken on GAO recommendations during calendar year 1984. It also discusses recommendations made during 1984 to the Secretary of the Treasury, the Commissioner of Internal Revenue, and the Chief Judge of the Tax Court, as well as their actions taken or proposed as of April 30, 1985, in response to those recommendations. In addition, the report contains listings of reports issued and testimonies given by GAO and jobs initiated by GAO on tax matters during calendar year 1984.

GAO/GGD-85-65
AUGUST 2, 1985

Request for copies of GAO reports should be sent to:

U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20877

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are $3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are $1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".

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 Bob Packwood
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 our annual report for calendar year 1984 on our work in the tax area. The report is submitted in compliance with 31 U.S.C. 719(d) and consists of the following appendixes:

I. Open recommendations to the Congress from reports issued during calendar year 1984.

II. Open recommendations to the Congress from reports issued before calendar year 1984.

III. Legislative action taken on recommendations during calendar year 1984.

IV. Recommendations made during calendar year 1984 to the Secretary of the Treasury, the Commissioner of Internal Revenue, and the Chief Judge of the Tax Court and their actions taken or proposed as of April 30, 1985, in response to those recommendations.

V. A listing of reports on tax matters issued during calendar year 1984.

VI. A listing of testimonies given on tax matters by GAO officials before various committees of the U.S. Congress during calendar year 1984.

VII. Tax-related jobs initiated pursuant to 31 U.S.C. 713 during calendar year 1984.

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

We are pleased to report that the Treasury, IRS, and the Tax Court have taken, or plan to take, action on most of our recommendations made during calendar year 1984. We look forward to continuing to work closely with the Congress in its oversight of tax matters and to assist it in considering our legislative recommendations.

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

We are sending copies of this report to the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Commissioner of Internal Revenue. We are also sending copies to other appropriate congressional committees and will make copies available to others upon request.

W. J. Anderson

William J. Anderson
Director

OPEN RECOMMENDATIONS TO THE CONGRESS FROM REPORTS ISSUED DURING CALENDAR YEAR 1984

	Page
Congress Should Continue To Provide IRS With Adequate Funds For Taxpayer Assistance Programs	2
Legislative Change Relating To The Issuance Of Tax Deficiency Notices Could Improve Administration Of The Crude Oil Windfall Profit Tax	3
Congress Should Amend The Crude Oil Windfall Profit Tax Act Of 1980 To Establish A Consolidated Appeals Process	5

CONGRESS SHOULD CONTINUE TO PROVIDE IRS WITH ADEQUATE FUNDS FOR TAXPAYER ASSISTANCE PROGRAMS

GAO/GGD-84-13
B-212824
4-5-84

Summary of finding

IRS has long believed that taxpayer compliance is based on both the willingness and the ability of taxpayers to comply with the tax laws. To help the taxpayer comply, IRS has established taxpayer assistance programs, such as toll-free telephone assistance, walk-in assistance, and correspondence assistance. Despite these efforts, noncompliance continues to be a major problem. In light of this problem, IRS has shifted its priorities away from taxpayer assistance programs and towards enforcement efforts. For example, while budgeted taxpayer service program staff years for fiscal year 1983 decreased by 1,691 staff years over 1982, budgeted staff years for examination and appeals increased by 1,195 staff years.

At this time, IRS cannot provide the Congress with data which will ensure that the adverse effects of taxpayer assistance program cutbacks will not exceed the cost reductions to be achieved. Therefore, given the potential risks associated with further program cutbacks, the Congress should continue to provide IRS with adequate funds to operate the various taxpayer assistance programs.

Recommendation

We recommended that the Congress continue to provide IRS with funds to operate telephone, walk-in, and correspondence assistance programs. In deciding on the level of funding for future appropriations, the Congress should consider the information contained in our report on the (1) accuracy, availability, and timeliness of service being provided at current funding levels; and (2) kinds of assistance needed as identified by users of IRS' various programs.

Action taken and/or pending

IRS' fiscal year 1985 budget requests called for a reduction of 69 staff years for taxpayer service activities. In the continuing resolution for fiscal year 1985, however, the Congress mandated that the fiscal year 1985 staffing levels for taxpayer service activities should not be less then they were for fiscal year 1984.

LEGISLATIVE CHANGE RELATING TO THE ISSUANCE OF TAX DEFICIENCY NOTICES COULD IMPROVE ADMINISTRATION OF THE CRUDE OIL WINDFALL PROFIT TAX

GAO/GGD-84-15
B-206634
6-18-84

Summary of finding

Because the windfall profit tax on producers is calculated on a property-by-property basis, administration of the tax could be simplified if IRS were able to issue deficiency notices on that same basis. However, current law prohibits IRS from issuing more than one statutory notice of deficiency per taxpayer per taxable period. If the Congress were to amend the applicable portion of the Internal Revenue Code, both IRS and affected taxpayers could benefit from faster resolution of tax liability issues.

Under section 4995(a)(8) of the Internal Revenue Code, a producer-taxpayer cannot be mailed a deficiency notice with respect to windfall profit tax liability until 2 months after the close of the calendar year in which the crude oil was removed from the premises. Further, section 6212(c) of the Internal Revenue Code provides that if IRS mails a notice of windfall profit tax deficiency to a producer-taxpayer, and the taxpayer then files a petition in a timely manner with the U.S. Tax Court for a deficiency redetermination, IRS cannot issue additional deficiency notices for the same taxable period with respect to this taxpayer.

However, because the windfall profit tax is calculated on a property-by-property basis, section 6212(c) has the effect of forcing IRS to delay issuance of deficiency notices until the applicable statute of limitations expiration date is near. Section 6212(c) restricts IRS to issuing a producer only one deficiency notice with respect to a given taxable quarter. For this reason, IRS needs all available time within the applicable statute of limitations period to examine oil properties and consolidate the deficiencies of producers who own interests in more than one property. This procedure has the effect of (1) delaying revenue flows to the government and/or (2) increasing taxpayers' interest costs. In some instances, tax revenues may be foregone entirely.

Recommendation

We recommended that the Congress amend section 6212(c) of the Internal Revenue Code to enable IRS to issue deficiency

notices after examination of each oil-producing property without precluding later issuance of additional notices covering the producers' interest in other properties during the same quarter.

Action taken and/or pending

On June 26, 1984, H.R. 5934 was introduced in the House of Representatives. The bill, if enacted, would have revised the basis for issuing notices of deficiency in accordance with our recommendation. No action was taken on the bill during the second session of the 98th Congress. On January 31, 1985, the bill was reintroduced as H.R. 898 and was referred to the House Ways and Means Committee where action was still pending as of April 30, 1985.

CONGRESS SHOULD AMEND THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980 TO ESTABLISH A CONSOLIDATED APPEALS PROCESS

GAO/GGD-84-15
B-206634
6-18-84

Summary of finding

Until IRS changed its administrative appeals rules in June 1983, each oil producer whose windfall profit tax liability was affected by an IRS examiner's adjustments was entitled to a separate appeals conference to contest the examiner's findings. Therefore, for any given issue, there could have been as many administrative hearings as there were persons owning interest in an oil property. Similarly, a large number of duplicative court cases still occur under the judicial appeals process. For example, it is not uncommon to have 50 or more owners of a single oil-producing property. And, except for partnerships, each of these owners can separately appeal the same issue judicially within the court system.

The Tax Equity and Fiscal Responsibility Act of 1982 (Public Law 97-248), which was enacted on September 3, 1982, specified that, for certain issues, partnerships would be treated as taxable entities for appeals purposes. The concept of the partnership as a taxable entity provides a precedent for actions which could facilitate windfall profit tax administration. That is, for certain issues relating to a given oil property, a consolidated appeals procedure may be more efficient than allowing each producer-taxpayer to appeal separately. IRS recently made a regulatory change to eliminate duplicative administrative appeals, but legislation is needed to preclude duplicative judicial appeals.

Recommendation

We recommended that the Congress pass legislation to consolidate judicial appeals for a given property's "oil" issues. A consolidated appeals process would conserve both IRS and judicial resources while also protecting taxpayers' rights. Precedent legislation is provided by title IV of the Tax Equity and Fiscal Responsibility Act of 1982 which, among other things, attempts to avoid duplicative judicial reviews of the tax treatment of partnership items.

Action taken and/or pending

On June 26, 1984, H.R. 5934 was introduced in the House of Representatives. The bill, if enacted, would have provided for a

consolidated appeals procedure. No action was taken on the bill during the second session of the 98th Congress. On January 31, 1985, the bill was reintroduced as H.R. 898 and was referred to the House Ways and Means Committee, where action was pending as of April 30, 1985.

OPEN RECOMMENDATIONS TO THE CONGRESS FROM REPORTS ISSUED BEFORE CALENDAR YEAR 1984

	Page
Mandatory Tax Withholding Recommended For Agricultural Employees	8
Persons Should Not Receive Credit Toward Social Security Benefits If Self-Employment Income Taxes Have Not Been Paid	9
Need For Legislative Solution To The Problem Of Determining Whether An Individual Is An Employee Or Self-Employed	10
Need For Change In Law To Provide FICA-SECA Offset	13
Need To Change Requirement That Government Must Purchase Seized Property At A Sale At The Minimum Bid Price	15
Changes Needed In The Tax Laws Governing The Exclusion For Scholarships And Fellowships And The Deduction Of Job Related Educational Expenses	16
Need For Congress To Ensure That The Treasury And Justice Departments Develop A Streamlined Legal Review Process For Criminal Tax Cases	18
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	20
Key Issues Affecting State Taxation Of Multijurisdictional Corporate Income Need To Be Resolved	21
Congress Should Adopt A Tax Treatment Which Better Recognizes Changes In Some Electric Cooperatives	24
Legislative Change Needed To Enable IRS To Assess Taxes Voluntarily Reported By Taxpayers In Bankruptcy	26

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, House Committee on 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 have amended the Internal Revenue Code to subject agricultural labor to withholding for income tax purposes and, thus, would fully adopt our recommendation. The bill was referred to the House Ways and Means Committee, where no further action was taken during calendar year 1984. The same legislation is expected to be reintroduced during calendar year 1985.

APPENDIX II

PERSONS SHOULD NOT RECEIVE CREDIT TOWARD SOCIAL SECURITY BENEFITS IF SELF-EMPLOYMENT INCOME TAXES HAVE NOT BEEN PAID

GGD-77-78
B-137762
8-8-77

B-137762
8-9-73

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

In May 1978, 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 September 1979, the Chairman of the Ways and Means Oversight Subcommittee reintroduced the bill as H.R. 5465 and referred it to the Subcommittee on Social Security. No further action has been taken since that time.

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.

Recommendations

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 names 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 September 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.

On September 18, 1980, the Chairman, House Ways and Means Committee, introduced H.R. 8156 which prohibited 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 S. 8, a bill 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 have accomplished 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.

No further action has been taken since that time.

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.

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 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 social security tax obligations, it does not fully resolve the FICA-SECA offset issue. No further action has been taken on this issue since that time.

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

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 . . . ."

For this reason the government may be required to purchase seized property which may not be in its best interest. It is possible that seized property has a salable 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 are 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 dependant upon innumerable precise factual determinations. 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 often decide to pursue their cases through the administrative appeals process and through litigation based on a sense of personal injustice as much as a wish to minimize taxes.

The courts, confronted with a large volume of educational tax litigation which they consider to be 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

On several occasions, the Congress has provided, on a temporary basis, that National Research Service Awards should be treated as excludable scholarships or fellowship grants. For example, the Tax Equity and Fiscal Responsibility Act of 1982

extended the exclusion for National Research Service Awards through the end of 1983. While this action related to certain awards being treated as excludable scholarship or fellowship grants under section 117 of the Internal Revenue Code, it did not fully encompass either of our recommendations. No further action has been taken since that time.

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 taxpayers 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 also 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 the Congress ensure that the Treasury and Justice Departments develop a streamlined legal review process for criminal tax cases and that any revised system realize 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 our 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. No action was taken by the agencies during 1983 in response to the Appropriation Committee's suggestion. The substance of the recommendation was included in the August 31, 1983, report of the President's Private Sector Survey on Cost Control in the Federal Government (Grace Commission). No further action has been taken since then.

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

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

Summary of finding

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

Recommendation

We recommended that the 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.

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

GAO/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 recommendation, we concluded that the key issues affecting state taxation of multijurisdictional corporate income need resolving. In the more than 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 multistate 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

In response to concerns of foreign governments and U.S.- and foreign-based multinational corporations, the President directed the Secretary of Treasury to form a special working group on unitary taxation to recommend solutions to the problems resulting from state taxation of multinational corporate income. The working group was formed in October 1983 and consisted of representatives from states, corporations, and key interest groups. In November 1983, we made an extensive presentation before the task force of the working group based on issues covered in our report on state taxation and in a related report on federal taxation of multinational corporations (GGD-81-81, Sept. 30, 1981).

Since 1965, bills covering interstate corporate taxation have been introduced in every session of the Congress through 1984. Each of these bills has contained income tax provisions. However, primarily because of state opposition, none of the bills has become law.

In August 1984, the working group on unitary taxation issued its report containing several recommendations, including one which would provide for a federal law requiring corporate taxpayers to file information with the IRS disclosing its tax liability and method of calculation for each state in which it operates. IRS would then share this information with the individual state in which the corporation did business.

The substance of this recommendation is included in proposed legislation which was in the review process at the Treasury Department as of April 30, 1985.

CONGRESS SHOULD ADOPT A TAX TREATMENT WHICH BETTER RECOGNIZES CHANGES IN SOME ELECTRIC COOPERATIVES

GAO/GGD-83-7
B-207753
1-5-83

Summary of finding

Under section 501(c)(12) of the Internal Revenue Code, electric cooperatives are provided tax-exempt status and are permitted to earn substantial untaxed income from nonmember sources, which subsidizes cooperative members' cost of electricity. This exemption was initially granted over 60 years ago when electric cooperatives were generally small, struggling associations which primarily distributed electricity to sparsely populated rural areas. Since that time, however, the operations of many cooperatives and the environment in which they do business have changed substantially.

Today, many electric cooperatives are still small associations which continue to need assistance in order to provide electricity to rural areas at rates comparable to those charged in urban areas. Others, however, have substantially changed in character or have progressed to the point where they closely resemble their taxable counterparts. Yet, unlike other federal assistance programs which can be directed to those organizations having a continuing need for assistance, all electric cooperatives continue to benefit from tax exemption. Under the broad requirements of the law, tax exemption applies across-the-board to all electric cooperatives.

IRS, in administering the tax exemption requirements, has tried to recognize the changes in electric cooperatives. However, it has experienced difficulties because of the broad nature of the law. Therefore, the Congress needs to consider alternatives to the present tax treatment of electric cooperatives and adopt a treatment which would better recognize the changes in their operations and the environment in which they operate. As a framework for the Congress' consideration, we proposed alternatives to the present law which would (1) modify electric cooperatives' nonmember income allowance, or (2) eliminate that allowance, or (3) apply tax rules already applicable to other types of cooperatives. These alternatives, which would have an estimated revenue impact ranging from $2 million to $45 million, are by no means all inclusive.

Recommendation

We recommended that the Congress, using the alternatives we provided as a guide, establish a tax treatment which better addresses electric cooperatives' present operating environment.

Action taken and/or pending

None.

LEGISLATIVE CHANGE NEEDED TO ENABLE IRS TO ASSESS TAXES VOLUNTARILY REPORTED BY TAXPAYERS IN BANKRUPTCY

GAO/GGD-83-47
B-211231
6-20-83

Summary of finding

The Bankruptcy Reform Act provides qualified debtors with certain protections from creditors--including IRS. The act restricts IRS' authority in many cases to assess, collect, or recover a claim against an individual or a business during bankruptcy proceedings. Administratively, this restriction has caused problems for IRS because it requires IRS to process returns from bankrupt taxpayers manually rather than through its automated processing system. During fiscal year 1982, these additional processing steps cost IRS an estimated $500,000.

Recommendation

We recommended that the Bankruptcy Act be amended to allow assessment of the taxes that bankrupt taxpayers report on their returns. Allowing IRS to assess--but not collect--these taxes would still protect bankrupt taxpayers but at less cost to IRS than is presently being incurred.

Action taken and/or pending

None.

APPENDIX III

LEGISLATIVE ACTION TAKEN ON RECOMMENDATIONS DURING CALENDAR YEAR 1984

	Page
Taxation Of The Life Insurance Industry Needs To Be Updated	28
The Federal Government Can Save $1.7 Million Annually By Eliminating Strip Stamps	31
Changes To The Disclosure Provisions Of The Internal Revenue Code Could Improve Verification Of Welfare Recipients' Income And Assets	33

TAXATION OF THE LIFE INSURANCE INDUSTRY NEEDS TO BE UPDATED

PAD-81-1
9-17-81

Summary of finding

The income of U.S. life insurance companies is taxed under the Life Insurance Company Income Tax Act of 1959 which was tailored to fit the life insurance industry at that time. When the act was passed, for example

--the industry was dominated by mutual companies (cooperative ventures) that represented only about 11 percent of the total number of companies in business but held 75 percent of industry assets and sold 63 percent of U.S. life insurance;

--the predominant product sale was whole life insurance (a life insurance policy for the whole of life payable at death) which generated large reserves and investment income; and

--the rate of inflation in the U.S. was low (0.8 percent annually compared to recent rates over the last few years of 10 percent and more), and earnings rates on investments were much lower than rates over the last few years.

The Congress considered the structure of the industry in 1959 and provided special features in the Act that recognized

--the competitive balance between mutual and stock companies (mutual companies, unlike stock companies, do not have stockholders);

--the importance of fostering the survival of small life insurance companies that were by far the largest in number of companies doing business; and

--the long-term nature of life insurance business (life insurance contracts span many years).

In the last 20 years many changes have taken place in the industry, not only in its structure but also in the products it offers. Moreover, the economic environment in which life insurance companies operate has also changed. These changes include the following:

--The balance in the industry has shifted, and mutual companies no longer dominate, though they are still a major factor in the industry.

--The lines of business which life insurance companies write have shifted from whole life to term and group insurance. (Term life coverage is for a specified number of years and expires without cash value if the insured survives, and group insurance provides coverage to many insureds under a single policy.)

--The growth in the pension line of business and tax deferred annuities (money on which income tax is deferred until a payment is made) has increased dramatically but has yet to peak.

--Policy loan provisions have induced unanticipated demands on life company assets in recent years.

--Interest rates have risen sharply, primarily because of inflationary pressures.

Because of these changes, we concluded that the Life Insurance Company Income Tax Act of 1959 needs to be updated.

Recommendations

We recommended that, primarily due to changes in the insurance industry structure, its product offerings, and the effects of inflation, the Congress should consider changing the sections in the 1959 Act dealing with

--the method by which the reserve deduction, that portion of current income necessary to meet future obligations, is calculated (Section 805);

--the definition of taxable income (Section 802 (b)); and

--the method for approximating those reserves that are computed on a preliminary term basis. (Under a preliminary term basis, a company adds less to its reserves during the early years of a policy and then makes up for the deficiency in later years. The company may elect to compute these reserves either exactly or approximately). (Section 818(c).)

We also suggested that the Congress reconsider the provisions of the Internal Revenue Code relating to deferred annuities. (Section 818(c).

Action taken and/or pending

The Tax Reform Act of 1984 (Public Law 98-369, dated July 18, 1984) incorporated all three recommendations and revised the Internal Revenue Code provisions applicable to deferred annuities.

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, but decided legislation would be needed to accomplish this purpose. Therefore, Treasury proposed a bill to repeal 26 U.S.C. 5205 and related provisions of the Internal Revenue Code. That proposal became part of the Tax Reform Act of 1984 (P.L. 98-368) which was enacted on July 18, 1984. The act repealed the strip stamp requirement for distilled spirits containers, effective July 1, 1985.

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 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; and

--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

The Tax Reform of 1984 (Public Law-98-369), enacted on July 18, 1984, adopted our recommendations by requiring the (1) Commissioner of Social Security to disclose tax information concerning wages, self-employment and retirement income to an authorized agency; and (2) Commissioner of Internal Revenue to disclose tax information concerning unearned income to an authorized agency administering federally funded needs-based programs.

RECOMMENDATIONS MADE DURING CALENDAR YEAR 1984 TO THE SECRETARY OF TREASURY, THE COMMISSIONER OF INTERNAL REVENUE, AND THE CHIEF JUDGE OF THE TAX COURT AND THEIR ACTIONS TAKEN OR PROPOSED AS OF APRIL 30, 1985, IN RESPONSE TO THOSE RECOMMENDATIONS

	Page
IRS Needs To Examine The Compliance Impact Of Taxpayer Assistance Programs Before Making Cutbacks	36
IRS Should Determine The Need For Further Consolidation Of Its Telephone Assistance Sites	37
IRS Needs To Emphasize Telephone Use To Improve Taxpayer Assistance	38
IRS Needs To Determine Whether Benefits Could Be Derived From Expanding Use Of Library Audio Tapes	39
The Tax Court Needs To Make Administrative Changes To Reduce Costs And Improve Operations	40
The Tax Court Needs To Improve Case Scheduling Practices Which Have Contributed To Backlogs	43
Tax Court Action Needed To Close Settled Cases More Promptly	44
Long Range Organizational and Operational Changes Are Needed To Improve The Tax Court's Overall Effectiveness	45
The Tax Court Should Take Steps To Reduce Its Opinion Backlog	47
IRS Can Improve Its Guidance For Making Penalty Abatement Decisions Based On Reasonable Cause	49
IRS Employees Making Penalty Abatement Decisions Need Better Training	51
IRS Needs An Effective Management Review System To Evaluate Penalty Abatement Requests	53
Treasury Needs To Properly Account For Net Windfall Profit Tax Revenues	55

APPENDIX IV

Page

IRS Needs A More Effective Means For Selecting Oil Property Operators For Windfall Profit Tax Examinations 56

IRS Needs To Assure That Windfall Profit Tax Has Been Assessed And Paid On Oil In Multiple Transactions 57

IRS Needs To Develop Effective Procedures For Examining Net Income Limitation Claims And Adjustments 59

IRS Needs To Decide Whether Adjustments In Windfall Profit Tax Are Needed For Past Taxable Periods 61

IRS Should, Where Practical, Reconcile Windfall Profit Tax Returns With Information Returns 63

IRS' Criminal Investigation Division Needs To Begin Information Gathering Projects Pertaining To The Windfall Profit Tax Program 65

Treasury Should Minimize Revenue Loss Possibilities And Windfall Profit Tax Evasion Opportunities Presented By Treating Facilities' Reclaiming Tank Bottom Oil 66

Treasury Should Determine Whether Extending The Time In Which Withholding Adjustments Can Be Made Could Improve Windfall Profit Tax Administration 68

IRS' Enforcement Program Should Be Expanded To Include Data From Pension Plan Participants 70

IRS NEEDS TO EXAMINE THE COMPLIANCE IMPACT OF TAXPAYER ASSISTANCE PROGRAMS BEFORE MAKING CUTBACKS	GAO/GGD-84-13 B-212824 4-5-84

Summary of finding

IRS has long believed that taxpayer compliance is based on both the willingness and the ability of taxpayers to comply. Because of this, IRS has established taxpayer assistance, consisting mainly of telephone, walk-in, and correspondence programs. Despite these efforts, we pointed out in a prior report entitled Further Research into Noncompliance is Needed to Reduce Growing Tax Losses (GAO/GGD-82-34, July 23, 1982) that noncompliance continues to be a major problem.

IRS' desire to cut back on taxpayer service activities and to enhance compliance efforts stems, in part, from the fact that it has developed data which show, to some extent, the utility of specific compliance programs. In this regard, IRS can measure the revenue yield associated with some of its enforcement activities more readily than it can for others. For example, IRS estimated that it produces $5 in additional revenue for every $1 it spends on examination. On the other hand, IRS has not measured whether revenues are also enhanced through maintenance of a taxpayer assistance program. Without such information, IRS is not in a position to predict, with reasonable certainty, the effects of major program revisions.

Recommendation

To provide reasonable assurance that proposed cutbacks in IRS' taxpayer assistance programs will not have adverse effects on the tax system, we recommended that the Commissioner of Internal Revenue develop better management information on the overall utility of IRS' various taxpayer assistance activities.

Action taken and/or pending

IRS told us that it has continued to expand its testing program as part of its effort to better develop management information on the overall utility of IRS' taxpayer assistance programs. For example, IRS conducted a General Purpose Opinion Study using alternative Forms 1040 and 1040A involving over 1,000 taxpayers in ten cities. IRS also completed tests of Form W-4 and Social Security Benefit reporting.

IRS SHOULD DETERMINE THE NEED FOR FURTHER CONSOLIDATION OF ITS TELEPHONE ASSISTANCE SITES

GAO/GGD-84-13
B-212824
4-5-84

Summary of finding

As the result of a 1977 study, IRS reduced its toll free telephone answering sites from 70 to 52 by 1981. This action led to an estimated annual operational savings of $3.3 million and a net savings of nearly $17 million over a 10-year period. Further consolidations were suspended due to an IRS Internal Audit Division report which recommended that the cost-effectiveness of consolidations be verified. In response to these recommendations, IRS completed an analysis of three previously consolidated sites in May 1982. The study, based on actual costs before and after consolidation, showed that the sites were, in fact, cost-effective.

Despite its findings, IRS has not implemented any more consolidations. To improve the efficiency of taxpayer assistance, we believe IRS should decide whether further consolidations would prove cost-effective without unreasonably reducing telephone service to the taxpayer.

Recommendation

We recommended that the Commissioner of Internal Revenue decide whether and, if so, to what extent and when IRS should consolidate its current toll-free telephone assistance sites.

Action taken and/or pending

IRS told us that its 52 toll-free telephone answering sites were consolidated to 40 locations in FY 1984. IRS also told us that its long range plans to further reduce these sites to 30 locations were being finalized.

IRS NEEDS TO EMPHASIZE TELEPHONE USE TO IMPROVE TAXPAYER ASSISTANCE

GAO/GGD-84-13
B-212824
4-5-84

Summary of finding

Historically, IRS has provided taxpayers with answers to tax-law and account-related questions both over the telephone and at IRS walk-in offices. Yet, IRS has determined that telephone assistance is less costly and more efficient for handling these questions. Based on its data, IRS estimated that if it could divert all questions from walk-in offices to telephone assistors, the results in annual savings would be $8.5 million.

IRS has recognized the potential benefits that could be derived from greater reliance on telephone assistance and has encouraged those who visit walk-in sites to use available telephones for their questions. However, our observations revealed that the availability and the extent of usage of these telephones was limited. We believe, therefore, that IRS needs to emphasize its telephone assistance program and educate taxpayers about the convenience and availability of this program in order to improve taxpayer assistance.

Recommendation

We recommended that the Commissioner of Internal Revenue educate and encourage taxpayers who have tax-law or account-related questions to use telephone rather than walk-in assistance and better inform walk-in office assistors on the need for and utility of diverting taxpayers with such questions to telephone assistors.

Action taken and/or pending

IRS told us that it has emphasized and would continue to emphasize the use of the telephones in all contacts with the public and in forms, instructions, publications, and media releases. IRS also told us it has provided and would continue to provide (1) posters about toll-free telephone assistance in walk-in areas and (2) hotlines connecting walk-in areas to telephone answering sites.

IRS NEEDS TO DETERMINE WHETHER BENEFITS COULD BE DERIVED FROM EXPANDING USE OF LIBRARY AUDIO TAPES

GAO/GGD-84-13
B-212824
4-5-84

Summary of finding

In 1979, IRS began making audio cassette tapes with line-by-line instructions on how to prepare federal income tax forms 1040A and related schedule 1040B available to taxpayers in libraries across the country. However, IRS' data show that taxpayers have made only limited use of this program due to several factors, such as the lack of publicity concerning this activity and the limited access to tapes available.

We found that IRS not only needs to emphasize use of the audio tape assistance program, but IRS also needs to collect and analyze data on taxpayer satisfaction with the use of the audio tapes. Without such data, IRS is unable to determine (1) if the audio tape program is beneficial and cost-effective and (2) whether taxpayers need further assistance in preparing their tax forms.

Recommendation

We recommended that the Commissioner of Internal Revenue test the feasibility of expanding the use of library audio tapes by taxpayers. One way IRS could do this would be to determine, in selected areas, what effects greater promotional efforts would have on motivating more taxpayers to use library audio tapes.

Action taken and/or pending

IRS told us that it had increased promotional efforts regarding the audio tape program and had expanded the number of libraries participating in this program nationwide.

THE TAX COURT NEEDS TO MAKE ADMINISTRATIVE CHANGES TO REDUCE COSTS AND IMPROVE OPERATIONS

GAO/GGD-84-25
B-214560
5-14-84

Summary of findings

The Tax Court can reduce its costs and improve the efficiency of its operation by making certain administrative changes. These changes relate to (1) reducing reliance on rented courtrooms, (2) reducing the number of cities in which trials are held, (3) improving the handling of cash and checks, (4) developing written travel guidelines, and (5) evaluating staff productivity.

The Tax Court, because it visits its trial cities as rarely as once a year, generally tries to borrow courtrooms for its sessions from other federal, state, or local courts. In cities where it has had repeated problems in obtaining courtrooms, the Tax Court rents courtrooms by paying an annual fee to the General Services Administration (GSA). The court estimated that in 1984, it would spend about $1,122,000 to rent space in 31 of its 105 trial cities.

To effectively conduct trial sessions, judges need to have adequate space. But, because of the high costs associated with renting space, this alternative should be adopted only as a last resort. The Tax Court has not considered other alternatives to leasing space in cities where it has been unable to obtain courtroom space for its trial sessions. For example, in order to assure access to needed space, the court should attempt to negotiate suitable arrangements with the Administrative Office of the U.S. Courts.

In addition, the court has not undertaken an overall review of whether it is conducting sessions in too many locations to promote the efficient use of valuable trial time. The court has been gradually increasing the number of trial locations as the caseload grows. The court has not, however, looked at whether all the cities at which sessions are now held should continue to be used.

The Tax Court does not have written internal guidelines for the handling and processing of cash and checks. Although no shortages have been reported, the Tax Court personnel did not always keep cash and checks secure or make timely deposits of funds.

The Tax Court has no guidelines to supplement applicable travel regulations to provide additional reimbursement information to traveling court personnel nor does the court have clear guidelines to control the use of first-class travel accommodations. The court's written supplement should advise the judges and administrative personnel what they are and are not entitled to claim while they are traveling.

Finally, the number of court staff needed, especially on the judges' staffs, may not match the amount of the work required. For example, regular judges have two secretaries on their staff. The court may be able to use these staff positions more efficiently in other areas.

Recommendations

We recommended that the Chief Judge and the Clerk of the Tax Court

--establish a mechanism for periodically reviewing the court's trial locations and courtroom leasing arrangements to determine (1) whether the number of trial locations could be reduced and (2) whether arrangements can be made to secure space other than through yearly leases.

--develop written guidelines for handling and processing cash and checks and take appropriate steps to physically secure checks and cash in a safe while petitions are being processed.

--develop guidelines to supplement the Travel Regulations for U.S. Justices and Judges and GSA Travel Regulations and to establish procedures for justifying the use of first-class travel accommodations.

--provide for the periodic assessment of staffing levels required by the court. In this regard, the need for the regular judges to have two secretaries should be examined.

Action taken and/or pending

The Tax Court studied the number of trial locations at which it hears cases and has decided to reduce the number of small case trial locations. The court did not agree that it

should reduce its current reliance on leasing space. Instead, it pointed out the advantage it offers other agencies by providing them, rent free, the space it leases but is not using. In addition, rather than paying full rent, the court entered into agreements for joint-use courtrooms in two cities.

To better safeguard filing fees, the court agreed that it would take steps to secure the cash and checks in a safe after they are removed from the petitions.

Instead of issuing supplemental travel guidelines, the court modified the annual travel authorization for employees. These new travel authorizations specify conditions for first-class travel.

With regard to reevaluating whether the regular judges need to have two secretaries, the court agreed in principle that staffing should be periodically reassessed. However, it believed that the two secretaries were required by each judge to support his or her work and that of the law clerks and any additional personnel assigned to the judge. The court said it would consider the potential impact word processing and other automation might have on the secretarial staffing.

THE TAX COURT NEEDS TO IMPROVE CASE SCHEDULING PRACTICES WHICH HAVE CONTRIBUTED TO BACKLOGS

GAO/GGD-84-25
B-214560
5-14-84

Summary of findings

To better cope with its increasing caseload, the Tax Court needs to more fully use the time it has available for hearing cases. The Tax Court does not periodically review its trial scheduling criteria to determine whether the number of cases being scheduled is consuming the full amount of trial time that has been allotted. We found that the Tax Court was conducting trials on about two-thirds of its scheduled trial days. This "shortfall" could be contributing significantly to the Tax Court's backlog not only because the number of trials being conducted is less than what the court can accommodate but also because, historically, the mere scheduling of cases for trial has been a major impetus for producing settlements without the need for a trial.

We also found that the court could use a mathematical model to better schedule its cases for trial. The model allows the court to project how many cases it should place on each of its calendars to assure full use of its limited trial time.

Recommendations

Because of the serious backlog problem facing the court and the importance of the trial sessions in getting cases closed, we recommended that the Chief Judge of the Tax Court

--gather and analyze data on the length of trial sessions so that periodic adjustments to case scheduling can be made in the future, and

--test the model we developed as a basis for estimating the number of cases to be scheduled for trial sessions.

Action taken and/or pending

The Tax Court generally agreed with our recommendations but had reservations about using our model for regular cases. The court increased the number of cases being scheduled on the calendars, which resulted in increased case closings. In addition, the court was planning to gather data on the length of trial sessions in order to make periodic scheduling adjustments and to test the model for small case trial sessions.

TAX COURT ACTION NEEDED TO CLOSE SETTLED CASES MORE PROMPTLY

GAO/GGD-84-25
B-214560
5-14-84

Summary of finding

The Tax Court needs to develop techniques for monitoring the progress being made in closing the cases that have been reported by the parties involved as being settled in order to forgo their trial date. During calendar year 1981, 63 percent of all such regular cases reported as settled were not closed by the agreed-upon date and had to be rescheduled for later trial sessions. Such cases disrupt the scheduling process and keep other cases from being set for trial.

Recommendation

We recommended that the Chief Judge of the Tax Court take action designed to reduce the number of cases that are presently reported as settled, but are not closed, within 90 days.

Action taken and/or pending

To reduce the number of cases that are reported as being settled but are not being closed, the Tax Court told us that it requires its judges to retain cases reported as settled until documents are filed, thus closing them. We believe that this approach could be effective if the judges actively follow up on these cases.

LONG RANGE ORGANIZATIONAL AND OPERATIONAL CHANGES ARE NEEDED TO IMPROVE THE TAX COURT'S OVERALL EFFECTIVENESS

GAO/GGD-84-25
B-214560
5-14-84

Summary of findings

Long range changes in the court's organization and operations should be considered to improve overall effectiveness. Some of the changes that should be considered include (1) placing more emphasis on having petitioners and the respondent move their cases more quickly and (2) assigning some court trial staff to areas other than Washington, D.C., on a limited basis.

Under the current Tax Court calendar system, regular cases can remain open for years without the court taking action. To a large extent, the court relies on both the petitioners and the respondent (IRS) to move their cases through the court system. This nonaggressive approach has resulted in a "hard-core" group of cases that repeatedly go through the court's trial setting and motions hearing process without being tried or otherwise resolved. At the end of 1982, over 3,000 cases from before 1978 had not yet been to trial. By using a system similar to that used by the International Trade Court, we believe that the Tax Court could reduce the number of old cases.

We also found that the current location of the court in Washington hindered its effectiveness in dealing with case backlogs that are concentrated in other major cities. Only 3 percent of the cases have requested Washington, D.C., as a place of trial. By contrast, as of September 30, 1983, almost 30 percent of the regular cases had requested places of trial in California. Almost 50 percent of the total caseload was located in five cities. Given the large portion of the caseload located in a few areas like California and New York, the court should experiment with a limited assignment of special and/or regular judges to some of the areas for a fixed period.

Recommendations

To improve the long range operations of the Tax Court, we recommended that the Chief Judge

--modify the calendar system at the court to encourage the parties to move cases more rapidly through the process, and

--test the feasibility of some decentralization of the court.

Action taken and/or pending

In discussing our recommendation to modify the calendar system, the Tax Court pointed out that it contacts the parties in most cases at least once a year. In small cases, the court noted that it schedules most of them for trial within a year of filing the petition. The court also pointed out that it has made a special effort to close older cases, stating that the number of cases 5 years old has been reduced to less than 3,000 cases--a reduction of 10 percent. In addition, it had decided to utilize special trial judges to assist in disposing of old cases. Court officials told us that they studied approaches used at the International Trade Court to determine whether they were adaptable to the Tax Court and concluded that these approaches were not suitable to the Tax Court's system. Nevertheless, the court had begun to automate its operations in a manner similar to that of the International Trade Court. In this regard, the court awarded a contract for a mini-computer system that should help it manage its workload and increase staff productivity.

The court agreed with our recommendation that it experiment with decentralizing its operations, and in December 1984, the court established a branch in Los Angeles. Furthermore, the court had planned to assess the effectiveness of this effort after about 1 year to determine whether other branches should be established.

THE TAX COURT SHOULD TAKE STEPS TO REDUCE ITS OPINION BACKLOG

GAO/GGD-84-25
B-214560
5-14-84

Summary of findings

The Tax Court has a growing "opinion" backlog that could worsen if the court attempts to reduce its growing "case" backlog by scheduling more cases for trial. The number of cases tried by special, regular, and senior judges each year has risen from about 1,450 in 1978 to about 2,100 in 1981. Each of these cases requires the court to issue an opinion. From 1978 to 1981, the opinion backlog of regular judges grew by 16 percent, from 554 to 641. This occurred because the number of trials increased faster than the regular judges increased their number of opinions.

The growing opinion backlog has also led to another problem--an increase in average time between the trial and the filing of the opinion by the court. The average time in regular cases has increased from 11 months in 1978 to over 14 months in 1982--an increase of 27 percent. Lengthy delay between trial and opinion can have many costs, such as additional interest charges on taxes owed. Also, taxpayer uncertainty about how the case will be decided could result. In addition, other cases on related issues may be delayed while the parties await the outcome.

On the other hand, although the number of small cases filed has increased, the special trial judges have been able to deal with the increased filings without their opinion backlog growing. It has decreased from 235 in 1978 to 213 in 1982, even though the number of trials has increased. The special trial judges increased their annual opinion output 93 percent in that period--from 616 to 1,187. One factor in their increased productivity has been an effort to write shorter opinions for small tax cases.

The authority granted special trial judges by the Miscellaneous Revenue Act of 1982 (Public Law 97-362) to issue bench opinions rather than the more time-consuming written opinions should enable those judges to issue more opinions than they have in the past. Bench opinion authority is helpful in cases involving (1) the value of property, (2) proof of a deduction, and (3) tax protestors.

We also found that the Tax Court should experiment with assigning pre-trial motions in regular cases to special trial judges. This could help reduce both the case backlog and the regular case opinion backlog by allowing regular judges to try more cases and write more opinions.

Recommendations

We recommended that the Chief Judge of the Tax Court appoint a committee of judges to monitor opinion production for the purpose of identifying ways to increase the number of opinions issued. Some approaches that the committee should consider include

--standardizing opinion formats, encouraging shorter opinions, expediting opinion reviews, and developing production targets; and

--assigning special trial judges to handle pre-trial matters in regular cases so that regular judges have more time to devote to trying cases and drafting opinions.

Action taken and/or pending

The Tax Court agreed to establish a committee of judges to monitor opinion production. Although the court pointed out the approaches we cited were things it had already used or encouraged, the committee developed additional suggestions for increasing the opinion productivity of judges. For example, as a result of the committee's suggestion, the court had simplified the procedures for issuing opinions on relatively easy cases.

The Tax Court agreed with our recommendation relating to assignments of special trial judges. It pointed out that special trial judges were being assigned increasing numbers of regular cases under special court rules. In addition, it had planned to use special trial judges to decide claims for reasonable litigation costs in regular cases. It felt, however, that where regular judges wished to retain pre-trial responsibility for their calendars, they should do so.

IRS CAN IMPROVE ITS GUIDANCE FOR MAKING PENALTY ABATEMENT DECISIONS BASED ON REASONABLE CAUSE

GAO/GGD-84-21
B-213919
5-22-84

Summary of finding

Most types of penalties that are assessed by IRS may be abated if a taxpayer can show reasonable cause for not meeting the requirements of the Internal Revenue Code. IRS' guidelines listed certain examples that were considered to be acceptable as reasonable cause, but the guidelines did not show IRS employees how to properly analyze such requests.

Improved guidance would have enabled IRS employees to better identify the pertinent facts in each situation and to determine whether these facts justified an abatement. It would have also helped to ensure that requests for penalty abatements were treated more consistently. We estimated that in the six districts we visited, about 49,000 of the 408,000 abatements granted by IRS involved reasonable cause and that, of these, about 12,740, or 26 percent, were incorrectly decided upon by IRS employees.

As part of our review, we presented 10 cases to 112 IRS employees at the three service centers and six district offices where we did our work. We asked them to decide, according to the guidance normally available to them, whether the information in the abatement request was justified based on reasonable cause. The decisions the employees arrived at were inconsistent. In 1 of the 10 cases, more than 70 percent of the employees agreed on the decision reached. In most cases, however, there was a general lack of agreement. Although some inconsistency can be expected when judgement is involved, the wide variation in employees' comments showed that IRS guidance on reasonable cause could be improved.

Recommendation

We recommended that the Commissioner of Internal Revenue develop guidance to better explain how employees should proceed in making determinations on the reasonableness of abatement requests and to describe the type of documentation that should be considered in making such determinations.

Action taken and/or pending

In commenting on our recommendation, with which it agreed, IRS stated that it had asked three of its service centers to review a list of questions for use in penalty abatement determinations that included the criteria we used in our review, as well as additional items proposed by IRS. Based on the results, IRS incorporated the expanded criteria into a revised Internal Revenue Manual issuance.

IRS EMPLOYEES MAKING PENALTY ABATEMENT DECISIONS NEED BETTER TRAINING

GAO/GGD-84-21
B-213919
5-22-84

Summary of finding

IRS officials in the national office and the field acknowledged that very little effort had been devoted to training IRS personnel on handling penalty abatement requests. For example, a training coordinator at one service center commented that instructors emphasized to their classes the familiarization with tax forms rather than the actual practice of making account adjustments, such as handling abatement requests. In one district office, an instructor told us that one day's training was devoted to penalties and that only a small portion of this time was spent on abatement requests. This instructor characterized such training as "awareness training" and stated that because there was generally no time to teach the handling of abatement requests in the classroom, students were advised to read the training material on their own time.

We also found inconsistencies in the training materials that were used. One reason for this problem was that the division responsible for the procedural guidelines handbook for reasonable cause and penalty abatements was not being consulted in the review process for all of the training materials which were prepared. Also, in some cases, training material cited certain examples of reasonable cause that were contrary to IRS policy.

Recommendation

We recommended that the Commissioner of Internal Revenue expand and standardize penalty abatement training and make it available to all employees likely to decide or review abatement requests.

Action taken and/or pending

IRS agreed with our recommendations to expand and standardize penalty abatement training and make it available to all employees likely to decide or review abatement requests. IRS had made revised training material available to the service centers on January 1, 1984. In addition, however, IRS took action to ensure recurring training for service center tax examiners on reasonable cause and penalty abatements and had

planned to conduct a special training class during fiscal year 1985 for all tax examiners in the service centers who do penalty abatements.

IRS NEEDS AN EFFECTIVE MANAGEMENT REVIEW SYSTEM TO EVALUATE PENALTY ABATEMENT REQUESTS	GAO/GGD-84-21 B-213919 5-22-84

Summary of finding

IRS officials were unaware of any problems dealing with penalty abatement requests. This was one reason they cited for the lack of emphasis on abatement training. After we began our review, two regions undertook a review of the penalty abatement process at their respective service centers and identified the same deficiencies we found in processing reasonable cause abatement requests. One region found that 50 percent of the reasonable cause decisions it tested were incorrect, and the other found that 20 percent of its sampled cases were incorrect.

IRS needs to review the abatement process so that it can be alerted to any systemic weaknesses that might exist. Currently, IRS has two types of review programs--management review and quality review--that could serve this purpose. Although there are some problems with both review programs, certain modifications should help them to be effectively used in assessing the abatement problems.

Recommendation

We recommended that the Commissioner of Internal Revenue establish a penalty abatement review program so that the process and the decisions being made can be periodically evaluated.

Action taken and/or pending

IRS generally agreed with our recommendation and has taken steps to establish a penalty abatement review program. IRS told us that it would

--expand its current quality review program to aid in determining whether the expanded criteria issued by IRS were being used and whether sufficient documentation was present,

--conduct a series of program review visitations during fiscal year 1985 in at least three service centers,

--undertake "quality analyses" of service center abatement activities to determine whether abatement decisions were consistent with IRS' expanded guidelines, and

--incorporate procedures into its National Office Review Program process to ensure that penalty abatement guidelines were being followed.

TREASURY NEEDS TO PROPERLY ACCOUNT FOR NET WINDFALL PROFIT TAX REVENUES

GAO/GGD-84-15
B-206634
6-18-84

Summary of finding

The crude oil windfall profit tax has generated and probably will continue to generate substantial revenues. For example, over $42 billion in gross revenues were collected during the period March 1, 1980, through September 30, 1982. Gross revenues represent the total amount of windfall profit tax collected before considering the fact that the windfall profit tax is deductible for income tax purposes.

Because the Congress intended that revenues derived from the windfall profit tax be appropriated for three specific purposes--income tax reductions, low-income assistance, and energy and transportation programs--proper accounting is important. In this regard, the Windfall Profit Tax Act of 1980 requires that the Secretary of the Treasury record net windfall profit tax revenues into a separate Treasury account and establish subaccounts for the three specified purposes. Treasury, however, is recording gross, rather than net, revenues in the account and has not established the three subaccounts. As a result, the amounts that could be appropriated for the three purposes set forth in the act have not been specified. The Secretary of the Treasury needs to correct this problem.

Recommendation

We recommended that the Secretary of the Treasury comply with the accounting requirements of the Crude Oil Windfall Profit Tax Act. Specifically, the Secretary should allocate net windfall profit tax revenues into the established Windfall Profit Tax Account.

Action taken and/or pending

In commenting on our recommendation the Department of the Treasury told us that it would adjust maintenance of the Windfall Profit Tax Account to conform to the statutory accounting requirement for net revenues. In followup discussions, Treasury Department officials told us that the subaccount requirement was met through the budget process. That is, the President's annual budget proposal includes a proposed allocation of windfall profit tax revenues for the three statutory purposes.

IRS NEEDS A MORE EFFECTIVE MEANS FOR SELECTING OIL PROPERTY OPERATORS FOR WINDFALL PROFIT TAX EXAMINATIONS

GAO/GGD-84-15
B-206634
6-18-84

Summary of finding

Oil property operators play a key role in the windfall profit tax process because they supply first purchasers with the basic data on oil tier, base price, and, in certain situations, producer status, etc. First purchasers use these data to compute the windfall profit tax. Despite their key role in the process, however, operators generally are not required to file any windfall profit tax returns. Nevertheless, IRS necessarily must promote tax compliance through operator examinations designed to assure that accurate information is supplied to first purchasers. Because they do not file returns, however, IRS has found it difficult to develop an effective means for selecting operators for examination.

Recommendation

We recommended that the Commissioner of Internal Revenue develop and implement a more effective means for selecting oil property operators for examination. One means for accomplishing that objective would entail requiring operators to submit annual information returns to IRS. This, of course, would require issuance of Treasury Department regulations. The returns could contain property-by-property data on such items as oil production volume, oil tiers, base prices, and state severance taxes. IRS could use such information as a basis for developing an effective operator examination selection approach. In considering this option, however, the increased paperwork burden on and costs to the oil industry should be taken into account.

Action taken and/or pending

IRS has reviewed windfall profit tax regulations and has determined that any requirement for an annual information return to IRS could require legislation. According to IRS, no such legislation had been proposed because there was no standardized, uniform designation of properties. IRS told us, however, that it had secured information such as name, address, and taxpayer identification number of the operator concerning certification and election form 6458 and operator listings. This information should help IRS to better select operators for examination.

IRS NEEDS TO ASSURE THAT WINDFALL PROFIT TAX HAS BEEN ASSESSED AND PAID ON OIL IN MULTIPLE TRANSACTIONS	GAO/GGD-84-15 B-206634 6-18-84

Summary of finding

When IRS conducts an examination of a first purchaser, it often identifies oil purchases on which the buyer withheld no windfall profit tax. In such instances, the purchaser may inform IRS that, with respect to those particular transactions, it had purchased the oil from a reseller, middleman, or oil trader and thus was not the first purchaser of the oil. Because a given quantity of oil can change hands many times, IRS is experiencing difficulty in seeking to assure that the windfall profit tax has been assessed and paid on such oil. Similar problems confronted the Department of Energy in prior years when it sought to enforce price controls on oil involved in multiple transactions. To avoid a repetition of those problems, the Treasury and IRS need to initiate action directed at assuring accountability for the windfall profit tax at all stages of the oil production and marketing process.

Recommendation

We recommended that the Commissioner of Internal Revenue develop and implement an effective means for assuring that the windfall profit tax is assessed and paid on oil involved in multiple transactions. In this regard, requiring the use of a "tax paid" certificate or similar document throughout the oil production and marketing process may be an effective means for resolving this problem. Again, however, the increased paperwork burden on and costs to the oil industry need to be taken into account. Regardless, we think the issue is sufficiently significant for IRS to evaluate the need for such a certificate. If such a certificate is deemed necessary and appropriate, either Treasury regulations should be promulgated or, if needed, legislation should be sought.

Action taken and/or pending

IRS agreed with our recommendation and proposed legislation which would amend Chapter 45 of the Internal Revenue Code to empower IRS with the right of requiring evidence (such as a "tax paid" certificate) that the correct amount of windfall profit tax

has been withheld or otherwise paid. The certification would "follow the oil" and would incorporate data reflecting the property from which the oil was removed; the removal price, type, tier, and gravity of the oil; and amount of windfall profit tax withheld or deposited. In September 1984, IRS' proposal was submitted for review and approval to the Treasury Department where action was still pending as of April 30, 1985.

IRS NEEDS TO DEVELOP EFFECTIVE PROCEDURES FOR EXAMINING NET INCOME LIMITATION CLAIMS AND ADJUSTMENTS

GAO/GGD-84-15
B-206634
6-18-84

Summary of finding

Although the windfall profit tax is an excise tax, the net income limitation links taxpayers' windfall profit tax liability directly to their income tax liabilities. That is, by law, the taxable windfall profit on any barrel of oil is limited to 90 percent of the net income attributable to that barrel.

This requirement creates unique and severe difficulties for IRS. The net income limitation claims or adjustments of large oil companies involve calculations of such volume and complexity that examiners face formidable tasks. For instance, some claims may have hundreds of pages of supporting documents. Moreover, the necessity to examine both excise tax and income tax records when conducting a complete windfall profit tax audit presents IRS cross-district and cross-tax-year coordination problems.

Cross-district coordination may be required because a taxpayer's windfall profit tax and income records may be located in different areas of the country. Also, because windfall profit tax examinations generally are about 3 years more current than corporate income tax examinations, cross-tax-year coordination is needed to avoid duplication of effort and its possible effects--inconsistencies of results, inequities to taxpayers, and strained IRS-taxpayer relations.

For these reasons, and because the net income limitation provision potentially involves billions of dollars, IRS needs to devote considerable attention to developing effective examination procedures for examining net income limitation claims and adjustments.

Recommendation

We recommended that the Commissioner of Internal Revenue develop effective, coordinated procedures for examining net income limitation claims and adjustments.

Action taken and/or pending

IRS is developing additional guidance for examining net income limitation claims and adjustments. This guidance is

included in IRS' Techniques Handbook for Specialized Industries - Oil and Gas. In addition, IRS drafted a legislative proposal with respect to certain net income limitation claims. In September 1984, this proposal was submitted for review and approval to the Treasury Department where action was still pending as of April 30, 1985.

IRS NEEDS TO DECIDE WHETHER ADJUSTMENTS IN WINDFALL PROFIT TAX ARE NEEDED FOR PAST TAXABLE PERIODS

GAO/GGD-84-15
B-206634
6-18-84

Summary of finding

Most states with nonrenewable natural resources, such as oil and gas, impose a severance tax on either the value or quantity of resources extracted. The Congress was well aware of state severance taxes in drafting the Crude Oil Windfall Profit Tax Act. Accordingly, the act provides for a severance tax adjustment in calculating windfall profit tax liabilities. The severance tax adjustment is the amount by which any qualified state severance tax imposed on a barrel of crude oil exceeds the severance tax which would have been imposed if the oil had been valued at its adjusted base price.

To qualify as an adjustment in computing the windfall profit tax, each state's severance levy must meet four specific tests. Even given these tests, questions still arose about whether certain states' taxes qualified for the deductible adjustment in calculating the windfall profit tax. The need to resolve which state's severance taxes qualify for the windfall profit adjustment was highlighted as early as June 1980 by several oil companies in their formal comments to Federal Register notices of proposed rulemaking. However, IRS was unable to publish revenue rulings on this matter until May 10, 1982. The published rulings discuss the allowability of a windfall profit tax adjustment for severance taxes imposed by 22 states. Some of the severance tax adjustments used by oil companies over the previous 2-1/2 years were disallowed by the May 1982 IRS revenue rulings.

Recommendation

We recommended that the Commissioner of Internal Revenue analyze the windfall profit tax liability effects of IRS' May 1982 revenue rulings which discuss the allowability of various states' severance taxes. IRS needs to decide whether adjustments to affected taxpayers' windfall profit tax liability can and should be made for past taxable periods.

Action taken and/or pending

IRS told us that it does not plan to establish a separate examination classification and selection program for severance tax issues. IRS said that the May 1982 revenue rulings have been

made available to all regional windfall profit tax coordinators and all agents working windfall profit tax cases. IRS contends, therefore, that any taxpayer's examination will include the severance tax issue--an approach which appears to us to be reasonable given limitations on IRS' resources.

IRS SHOULD, WHERE PRACTICAL, RECONCILE WINDFALL PROFIT TAX RETURNS WITH INFORMATION RETURNS

GAO/GGD-84-15
B-206634
6-18-84

Summary of finding

IRS' ability to structure effective compliance programs for identifying delinquent windfall profit taxpayers depends largely on the availability, completeness, and accuracy of Form 6248 annual information returns. IRS officials consider these information returns essential to enforcing the windfall profit tax with respect to individual producers. Yet, many thousands of the information returns received by IRS for calendar year 1980 were substantially incomplete, lacked taxpayer identification numbers, or contained inaccurate data. IRS should try to resolve these three types of deficiencies.

The Internal Revenue Code has civil penalty provisions applicable to returns which are substantially incomplete or lack identification numbers. Use of these penalties may promote better compliance. Inaccurate information returns, however, are more difficult to detect and correct. IRS may need to focus more examination effort in this area.

Revenue agents have been able to identify and correct some inaccurate Form 6248 information returns during first purchaser examinations by comparing or reconciling the entity's information returns with the Form 720 Quarterly Excise Tax Returns. While the recordkeeping or accounting problems experienced by withholding agents may limit the effectiveness of such comparisons, the audit practice is still useful for identifying systemic withholding problems. However, IRS audit guidelines do not specifically direct revenue agents to verify the reliability of Form 6248 information returns.

Recommendation

We recommended that the Commissioner of Internal Revenue require revenue agents to perform, where practical during first purchaser examinations, a reconciliation of the withholding agent's quarterly excise tax returns (Forms 720) for the year with the producers' windfall profit tax liability as shown on annual information returns (Forms 6248).

Action taken and/or pending

IRS agreed to formalize interim instructions to provide that any examination of a first purchaser or qualified disburser include a reconciliation of the withholding agent's quarterly excise tax returns (Forms 720) for the year with the producers' windfall profit tax liability as shown on annual information returns (Forms 6248). The instructions are contained in IRS' Techniques Handbook for Specialized Industries - Oil and Gas. In addition, IRS was considering the possibility of moving windfall profit tax reporting to a separate return, which would enhance the capabilities of IRS to verify, check, and cross-check windfall profit tax withholding.

IRS' CRIMINAL INVESTIGATION DIVISION NEEDS TO BEGIN INFORMATION GATHERING PROJECTS PERTAINING TO THE WINDFALL PROFIT TAX PROGRAM

GAO/GGD-84-15
B-206634
6-18-84

Summary of finding

IRS' Criminal Investigation Division is responsible for investigating criminal violations of the tax laws. The existing criminal sanctions in the Internal Revenue Code apply also to the windfall profit tax. In developing criminal tax cases, district office special agents investigate and evaluate information from three basic sources: (1) referrals from IRS' Examination and Collection Divisions, (2) self-initiated information gathering efforts, and (3) information items received from the public and other sources.

As of January 1983, IRS had not developed and referred any windfall profit tax cases to the Department of Justice for criminal prosecution. In fact, as of January 1983, IRS' cumulative inventory of windfall profit tax cases handled by the Criminal Investigation Division was only eight cases--all within the Southwest region. In one respect, the Service's small inventory of criminal investigations is a function of the difficulties encountered by the Examination Division, a traditional source of referrals. Until effective examination approaches are developed for issues such as oil exchanges, the volume of examination referrals is not likely to increase significantly. Therefore, to better establish a Criminal Investigation Division presence in the windfall program, the division needs to begin some self-initiated information gathering efforts.

Recommendation

We recommended that the Commissioner of Internal Revenue have the Criminal Investigation Division begin some information gathering efforts under the Windfall Profit Tax Program. Potential targets which should be considered include multiple transaction oil, stripper oil, and tank bottom oil.

Action taken and/or pending

IRS told us that all of its districts having large oil producers within their jurisdiction had initiated projects and/or investigations which address the potential non-compliance problems cited in our recommendation.

TREASURY SHOULD MINIMIZE REVENUE LOSS POSSIBILITIES AND WINDFALL PROFIT TAX EVASION OPPORTUNITIES PRESENTED BY TREATING FACILITIES' RECLAIMING TANK BOTTOM OIL

GAO/GGD-84-15
B-206634
6-18-84

Summary of finding

Oil storage tank cleaners periodically remove from the tanks a substance known as basic sediment and water and then transport the substance to a treating facility where the oil content can be extracted for sale to a refinery. Crude oil recovered in this manner is not exempt from the windfall profit tax. Often, however, no tax may be due on tank bottom oil transactions because they do not generate a windfall profit at current prices. This could change if oil prices rise. Out of concern about imposing a potentially unnecessary paperwork burden, IRS has not specified that tank cleaners must file windfall profit tax returns. This situation, however, has created some revenue loss possibilities and tax evasion opportunities.

The Treasury Department and IRS need to foreclose the revenue loss possibilities and tax evasion opportunities associated with tank bottom oil. This perhaps can best be accomplished by clearly defining the windfall profit tax withholding and filing requirements for all of the parties having an economic interest in tank bottom oil. In this regard, the Treasury and IRS may wish to consider designating the reclaimer or treating facility as a "producer" for windfall profit tax purposes. The actual crude oil content of basic sediment and water is not known until it is reclaimed by the treating facility. Then the reclaimed oil is generally sold to a refinery. Taxing reclaimed oil when it is sold by the treating facility to the refinery would utilize the normal withholding agent approach in crude oil sales. The refinery, as a first purchaser of crude oil, already has established administrative withholding procedures. Taxing the reclaimer and having the refinery withhold the tax would effectively eliminate any potential tax evasion problem. There would be no advantage for lease operators to divert oil into basic sediment and water sales.

Recommendation

We recommended that the Secretary of the Treasury develop and issue regulations directed at minimizing revenue loss possibilities and tax evasion opportunities. In so doing, the

Secretary should consider the feasibility of taxing reclaimed oil when it is moved from the treating facility to the refinery. Such an approach should foreclose the revenue loss possibilities and the tax evasion opportunities in this area.

Action taken and/or pending

The Treasury Department and IRS agreed that the issues relating to tank bottom oil should be addressed and anticipated that the necessary guidelines and rules would be issued. In this regard, IRS officials informed us that a revenue ruling project is in the review process and is expected to be issued by August 1985.

TREASURY SHOULD DETERMINE WHETHER EXTENDING THE TIME IN WHICH WITHHOLDING ADJUSTMENTS CAN BE MADE COULD IMPROVE WINDFALL PROFIT TAX ADMINISTRATION

GAO/GGD-84-15
B-206634
6-18-84

Summary of finding

Current IRS regulations generally provide that purchasers and other withholding agents cannot make corrections of errors in producers' windfall profit tax liabilities and/or payments after March 31 of the year following the year the crude oil is removed from the premises. This time frame for making adjustments results in many taxpayers being over- or underwithheld because, for various reasons, many withholding errors are not detected before the March 31st cut-off date. This, in turn, leads to the filing of many tax forms related to refund claims or supplementary windfall profit tax payments.

If withholding agents had a longer time frame for making adjustments to producers' tax liabilities and/or payments, there could well be a very substantial decrease in windfall profit tax paperwork and a considerable decrease in IRS' returns processing workload. The benefits associated with reduced paperwork would also accrue to the many taxpayers who would no longer have to file certain tax returns and/or deal with amended returns.

Recommendation

We recommended that the Secretary of the Treasury, in consultation with IRS, conduct a study of the advantages and disadvantages involved in allowing purchasers an extended period in which to correct windfall profit tax withholding errors. The study should seek, among other things, to assess potential benefits to be derived and the related costs and should also determine whether an effective compliance program could be maintained under a revised withholding system.

Action taken and/or pending

The Treasury Department told us that IRS initially agreed to consider the feasibility of conducting a study regarding an extended period for purchasers to correct windfall profit tax withholding errors. However, after further study of this matter, IRS decided to disregard this recommendation. IRS told us that it had conducted a specialized study concerning correction of Windfall Profit Tax errors (including withholding errors) by

reviewing previously filed Form 720 Quarterly Excise Tax Returns in the Southwest Region. This study indicated that extended periods of time to correct past errors or adjustments often resulted in erroneous refunds and credits. The study was subsequently expanded to all IRS regions. As a result, revised instructions for paying crude oil windfall profit tax were issued in June 1984.

IRS' ENFORCEMENT PROGRAM SHOULD BE EXPANDED TO INCLUDE DATA FROM PENSION PLAN PARTICIPANTS

GAO/HRD-84-38
B-21441
9-6-84

Summary of finding

Complete and accurate data from plan participants are needed to insure the reliability of values placed by actuaries on multiemployer pension plans. IRS' guidelines for reviewing multiemployer pension plans do not require an examination of the completeness and accuracy of participant data.

We believe that IRS' enforcement program should be expanded to include the review of actuarial valuation reports so compliance with the regulations on maintaining participant data can be determined.

Recommendation

To assist the Department of Labor enforce regulations for the maintenance of pension plan participant data, we recommended that the Commissioner of Internal Revenue expand IRS enforcement efforts to include examination of actuarial valuation reports to identify multiemployer pension plans lacking sufficient participant data.

Action taken and/or pending

In December 1984, IRS issued actuarial guidelines for use by its field personnel in examining defined benefit plans which include multiemployer plans. In addition, IRS said its field work plans specifically provide for the examination of multiemployer plans using the new actuarial guidelines. IRS also intended to identify those plans in which the actuary indicates that participant data are incomplete and to provide the Department of Labor with that information.

A LISTING OF REPORTS ON TAX MATTERS ISSUED DURING CALENDAR YEAR 1984

Title	Date
Statistical Analysis Of The Operations And Activities Of Private Foundations (GAO/GGD-84-38)	1/5/84
Information On Historic Preservation Tax Incentives (GAO/GGD-84-47)	3/29/84
Need To Better Assess Consequences Before Reducing Taxpayer Assistance (GAO/GGD-84-13)	4/5/84
State Experiences With Taxes On Generators Or Disposers Of Hazardous Waste (GAO/RCED-84-146)	5/4/84
Tax Court Can Reduce Growing Case Backlogs And Expenses Through Administrative Improvements (GAO/GGD-84-25)	5/14/84
IRS Generally Does A Good Job When Abating Civil Penalties--And Has Made Recent Improvements (GAO/GGD-84-21)	5/22/84
GAO Observations On The Use Of Tax Return Information For Verification In Entitlement Programs (GAO/HRD-84-15)	6/5/84
Importance And Impact Of Federal Alcohol Fuel Tax Incentives (GAO/RCED-84-1)	6/6/84
IRS' Administration Of The Crude Oil Windfall Profit Tax Act of 1980 (GAO/GGD-84-15)	6/18/84
Compilation Of GAO's Work On Tax-Related Activities During 1983 (GAO/GGD-84-81)	6/27/84
Incomplete Participant Data Affect Reliability Of Values Placed By Actuaries On Multiemployer Pension Plans (GAO/HRD-84-38)	9/6/84
Implementation Of The Uniformed Services Former Spouse's Protection Act (GAO/NSIAD-85-4)	10/24/84
Response To Questions About The Windfall Profit Tax On Alaskan North Slope Oil (GAO/GGD-85-12)	12/10/84

A LISTING OF TESTIMONIES GIVEN ON TAX MATTERS BY GAO OFFICIALS BEFORE VARIOUS COMMITTEES OF THE U.S. CONGRESS DURING CALENDAR YEAR 1984

GAO official	Congressional committee	Subject matter	Date
William J. Anderson, Director, General Government Division	Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations	Federal Government Efforts to Prevent Tax Treaty Abuse	2/28/84
William J. Anderson, Director, General Government Division	House Ways and Means Committee	Legislative Proposals to Revise the 30-percent Withholding Tax on U.S. Source Interest Income Paid to Foreign Persons	5/1/84
Johnny C. Finch, Associate Director, General Government Division	Subcommittee on Oversight, House Committee on Ways and Means	The Use and Effectiveness of the Research and Experimentation Tax Credit	8/2/84
Allan I. Mendelowitz, Associate Director, National Security and International Development	Joint Economic Committee	Japanese Tax Incentives to Save and Invest	9/24/84

APPENDIX VI

TAX-RELATED JOBS INITIATED PURSUANT TO 31 U.S.C. 713 DURING CALENDAR YEAR 1984

Subject matter	Objectives	Month started
Exempt Organization Enforcement	To determine how IRS administers the Internal Revenue Code prohibition against the use of public charities, private foundations, and social welfare organizations for private benefit. To determine how effectively the available enforcement sanctions enable IRS to deal with those instances of private benefit when they are uncovered during examinations.	January
Optional Self-Employed Tax Methods	To determine the magnitude of self-employed persons who use the optional tax method. To sample IRS tax returns and social security administration earnings records of optional tax method users to see if the method achieved intended affect.	January
Administrative Appeals	To determine the feasibility of implementing several alternatives involving taxpayers going to appeals before going to the Tax Court. To identify legislative and administrative changes needed to implement these alternatives.	April

Subject matter	Objectives	Month started
Overseas Non-Filers	To identify, with respect to U.S. taxpayers residing abroad, (1) the extent of the non-filer problem, (2) the extent of income underreporting, and (3) actions needed to prevent these federal tax revenue losses. To determine whether IRS has adequate systems in place and presence abroad to prevent tax losses.	May
Employee Stock Ownership Plans (ESOP)	To obtain an accurate census of ESOP companies, participants and assets, and other descriptive statistics. To determine whether and to what extent ESOPs are expanding the ownership of capital. To determine whether ESOP companies experience an improvement in productivity and profitability. To determine the cost of ESOP incentives in terms of tax expenditures.	May
Oil and Gas Trusts and Partnerships	To determine the significance of the tax administration and policy issues presented IRS by publicly traded royalty trusts and limited oil and gas partnerships. To ascertain what regulatory and/or legislative actions may be needed and the tax policy implications of each.	July

Subject matter	Objectives	Month started
Tip Income Reporting	To assess IRS' overall efforts in dealing with tip income noncompliance and analyze the problems associated with the reporting requirements imposed by the Tax Equity and Fiscal Responsibility Act and the food and beverage industry.	October
Investment Tax Credit for Offshore Drilling Rigs	To determine whether it is feasible to quantify the revenue implications resulting from the current administrative practice relating to the investment tax credit. To determine IRS' consistency with congressional policy and the need for further legislative action.	November
Unreported Business Income	To determine to what extent the congressional intent regarding unreported business income--to eliminate unfair competition between tax-exempt organizations engaged in commercial type activities and taxable businesses conducting similar activities--is being fulfilled.	November
Service Center Replacement System Program	To identify problems relating to acquisitions of Service Center Replacement System Program equipment. To assess effectiveness of applications software. To evaluate equipment replacement plans.	November

APPENDIX VII

Subject Matter	Objectives	Month started
IRS' Service Center Examinations	To evaluate the adequacy of IRS' policies and procedures for selecting returns for service center examinations, conducting examinations through correspondence, and reviewing the quality of service center examinations.	December

APPENDIX VIII

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

APPENDIX VIII

GAO FORM-379A (Aug. 72)

RECORD OF CHANGES

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

August 25, 1980 0135.1

TABLE OF CONTENTS

Appendix Figure	Paragraph	Title	Page
		TABLE OF CONTENTS	1
	1.	Purpose, Scope, and Applicability	1
	2.	Supersession	1
	3.	References	1
	4.	Delegation of Authority	2
	5.	Initiating Audits	2
	6.	Designation of GAO Officials Having Access to Tax Returns and Tax Return Information	3
	7.	Safeguard Requirements	3
	8.	Disclosure Accounting	4
	9.	Annual Report	5
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	1
	2.	Background	1
	3.	What Is To Be Recorded	2
	4.	Implementing Procedures	2
		a. Disclosures to GAO by IRS and ATF	2
		b. Disclosures to GAO by Others	3
		c. Requests for Tax Information Made of GAO by Others	3
Figure A1-1.		Disclosure Control Document	4
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	1
	2.	Work Done Under GAO Authority	1
		a. Receipt of Names from Tax Writing Committees and Appropriate Oversight Committees or Subcommittees	1
		b. General Operating Procedures	2
	3.	Work Done Under Committee Authority	2

APPENDIX VIII

GAO FORM - 378 (Aug. 72)

United States
General Accounting Office
Operations Manual

Order

0135.1

August 25, 1980

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

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

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

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

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

d. Applies to all GAO organizational elements.

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

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

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

3. REFERENCES.

a. Public Law 95-125.

b. 31 U.S.C. 67.

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

Distribution: C, N, R, and S

Initiated by: General Government Division

d. 18 U.S.C. 1905.

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

4. DELEGATION OF AUTHORITY.

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

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

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

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

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

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

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

APPENDIX VIII

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

5 (Reverse Blank)

APPENDIX VIII

August 25, 1980

0135.1
Appendix 1

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

1. PURPOSE.

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

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

2. BACKGROUND.

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

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

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

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

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

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

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.

(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.

0135.1
Appendix 1

August 25, 1980

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.

4

August 25, 1980 0135.1
Appendix 2

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

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

August 25, 1980

0135.1
Appendix 2

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.

3 (Reverse Blank)

(268215)

B1859

AN EQUAL OPPORTUNITY EMPLOYER

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

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE $300

BULK RATE
POSTAGE & FEES PAID
GAO
PERMIT No. G100