

GAO

Report to Designated Congressional
Committees

June 1988

TAX POLICY AND ADMINISTRATION

1987 Annual Report on GAO's Tax-Related Work



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General Government Division

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June 6, 1988

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

The Honorable Lloyd W. Bentsen
Chairman, Committee on
Finance
United States Senate

The Honorable Lloyd W. Bentsen
Chairman, Joint Committee
on Taxation
Congress of the United States

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

The Honorable John Glenn
Chairman, Committee on
Governmental Affairs
United States Senate

This is our annual report for calendar year 1987 on our work on tax policy and administration matters. This report is submitted in compliance with 31 U.S.C. 719(d) and consists of the following appendixes.

- I. Open recommendations to Congress from reports issued during calendar year 1987.
- II. Open recommendations to Congress from reports issued before calendar year 1987.
- III. Tax-related recommendations made during calendar year 1987 to the Secretary of the Treasury, the Secretary of Health and Human Services, and the Commissioner of Internal Revenue, and their responses to those recommendations.
- IV. Summary of GAO products on tax matters and related congressional actions during calendar year 1987.

Should you or the Committees have any questions or require additional information, please contact me on 275-6407.

Jennie S. Stathis

Jennie S. Stathis
Associate Director

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Abbreviations

GAO	General Accounting Office
HHS	Health and Human Services
IRS	Internal Revenue Service
SSA	Social Security Administration
VA	Veterans Administration

Appendix I
Open Recommendations to Congress From
Reports Issued During Calendar Year 1987

revenue that would be generated from increasing the penalty would be small. The information in our report will be used in several studies of tax penalties currently underway in the Senate Finance Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service, the House Ways and Means Subcommittee on Oversight, the Internal Revenue Service, and GAO.

Appendix I
Open Recommendations to Congress From
Reports Issued During Calendar Year 1987

Some additional IRS resources or a reallocation of existing resources may be needed to improve compliance. Also, significant resources could be involved in identifying and following up with numerous importers who owe small amounts of the tax. Therefore, we identified two alternatives Congress could consider for collecting the tax more efficiently. Congress could require independent importers to pay the gas guzzler tax to Customs at the time of importation. Alternatively, Congress could require that Customs not release an importer's bond until the importer provides proof of the tax payment. We noted that both alternatives would generate concerns among Customs and taxpayers.

Action(s) Taken and/or
Pending

IRS agreed with our recommendation to develop language on the gas guzzler tax for inclusion in the pamphlet that Customs provides to independent importers. IRS also agreed with the thrust of our recommendation concerning monitoring of enforcement efforts.

The Joint Committee on Taxation presented several proposals for increasing gas guzzler tax revenue in its June 1987 pamphlet. One of these proposals involved having Customs, rather than IRS, collect the tax on all imported vehicles, as we suggested.

Appendix I
Open Recommendations to Congress From
Reports Issued During Calendar Year 1987

Matter(s) for
Consideration by Congress

There are inherent uncertainties involved in predicting the effects of fully extending welfare programs to the insular areas. Thus, if Congress wants to make changes in the programs, it should consider extending one program at a time to an insular area or subarea on an experimental basis. Area views about the programs would be useful in selecting such experiments. This would allow area officials an opportunity to determine the actual cost effects and the nature and extent of other effects. Such an experiment—only one of several options (e.g., block grants) available for serving the areas—could be done as part of proposed welfare reform legislation, if enacted.

Similarly, if Congress wants to make tax changes, it should consider gradually increasing taxes—such as by partly reducing section 936 possession tax credits—to raise revenue to cover the cost of extending welfare programs. In this way, taxes could be increased up to the cost of the programs, rather than totally eliminating tax incentives and other special treatment and possibly jeopardizing the areas' economies and operating revenues. In addition, should Congress consider extending U.S. income taxes to area residents and corporations, it may wish to assess the propriety of such actions in view of the issues raised by area officials.

Action(s) Taken and/or
Pending

No action had been taken or planned as of March 31, 1988.

**Congress Should
Require IRS and Social
Security to Submit an
Action Plan for
Resolving Differences
in Employers'
Earnings Reports**

(GAO/HRD-87-52, 9/18/87)

Since 1978, when employers were first required to report employees' earnings annually to SSA and quarterly to IRS, the total earnings amounts recorded by each agency (as reported to them by employers) have differed. SSA, as of March 1987, had recorded about \$58.5 billion less than IRS for 1978 to 1984 (data after 1984 are preliminary). These earnings differences through 1983 involved about 3.5 million earnings reports for about 2.5 million employers. About one-fourth of these employers' earnings reports showed differences between the two agencies for more than 1 year.

We reviewed a nonprojectable sample of current beneficiaries showing that affected beneficiaries lost nearly \$17 a month. SSA or IRS needs to contact about 2.5 million employers to try to determine whether SSA did not record some employees' earnings. Further, although the actual number of individuals affected is unknown, we estimate that the records of 9.7 million individuals could have uncredited earnings.

SSA and IRS have not adequately resolved differences in employers' earnings reports, nor have they addressed the causes of the differences. Many causes have contributed to the current problem. Changes in employer reporting requirements and weaknesses in SSA's internal controls resulted in larger than anticipated numbers of employers' reports that had to be reconciled. The resultant need for larger than anticipated resources was not addressed by either agency. Changes in SSA's leadership and management's inability to resolve conflicting organizational priorities also contributed to the problem. The unreconciled backlogged reports have prevented identification of the underlying causes of employer reporting differences, which must be known before plans can be developed to prevent or detect future occurrences.

**Matter(s) for
Consideration by Congress**

We recommended that the Secretaries of Health and Human Services and the Treasury direct the Commissioners of Social Security and Internal Revenue to (1) develop and pursue a strategy for examining the backlogged and newer cases indicating employers reported different earnings amounts to each agency and report their plans to Congress and (2) determine the major causes of recording differences in SSA and IRS earnings totals and take corrective action to prevent their occurrence or reduce their frequency.

Congress Should Consider Amending the Internal Revenue Code to Permit the Veterans Administration Access to Certain Tax Information

(GAO/HRD-87-62, 9/21/87)

The Veterans Administration (VA) generally requires veterans to report their annual earnings when they apply for or receive individual unemployment compensation benefits associated with service-connected disabilities. Veterans with earnings above marginal amounts are not eligible for some unemployment benefits. We estimated that over 90 percent of the veterans who should have reported their earnings to VA failed to do so. Potential overpayments to these veterans in 1984 and 1985 could have exceeded \$10 million, depending on the extent to which VA considered the earnings to be marginal.

Lack of information to verify income reported by applicants and recipients in entitlement programs has contributed to significant overpayments. We believe that allowing VA to access tax return information on earned income would help to verify eligibility. However, access to this information is restricted by section 6103 of the Internal Revenue Code. The primary disadvantages of using tax return information for verification in entitlement programs are the potential harmful effects on tax-reporting compliance and individual privacy.

The Deficit Reduction Act of 1984 (Public Law 98-369) amended legislation to allow seven benefit programs to use certain tax information for verification. The VA benefit programs were not included, and the legislative history does not clearly indicate why. The tax information allowed for use by the seven programs was

- net income from self-employment, earnings, and employers' payments of retirement income from files at SSA; and
- unearned income (such as dividends and interest) from the files at IRS.

Except for earnings from self-employed persons, these SSA files contain information reported by third parties. Third-party tax information is reported by employers and payers of pensions, interest, and dividends; this information is required to be reported for the purpose of improving taxpayers' voluntary compliance with tax law income-reporting requirements. Public knowledge that IRS uses this information for verification purposes has, over the years, improved voluntary compliance with the tax laws.

It must be recognized, however, that granting access to tax information, even that provided by third parties, represents a special case concerning

Congress Should Extend IRS' Tax Refund Offset Program for Defaulted Student Loans

(GAO/HRD-87-76, 9/30/87)

The Deficit Reduction Act of 1984 (Public Law 98-369) authorized the Secretary of the Treasury (through IRS) to collect delinquent debts owed the government by offsetting them against tax refunds payable after December 31, 1985, and before January 1, 1988. This 2-year period was established to determine whether the tax refund offset program (1) increased the amount of nontax debts collected and (2) changed taxpayers' filing and withholding practices.

During the first year, the program involved certain delinquent debts owed to five federal agencies including the Department of Education, which was selected for program participation by the Office of Management and Budget and IRS.

According to its records, as of December 31, 1986, the Department of Education offset over 246,000 individuals' tax refunds and collected \$132 million from those who had defaulted on Perkins Loans, Federally Insured Student Loans, and Guaranteed Student Loans. The results for the Guaranteed Student Loan Program showed 67,000 individual accounts offset, with recoveries of \$38 million.

As of September 4, 1987, the Department had received another \$137 million from the second year's effort, with \$79 million of that amount coming from defaulters with guaranteed student loans. The future success of the program for agencies like the Department of Education, however, depends on whether the program is reauthorized by Congress.

Congress should continue the IRS tax refund offset program for defaulted student loans considering its low cost and high yield. In addition, one factor that cannot fully be measured is the deterrent effect the program may have had on taxpayers who contemplated defaulting on a student loan but did not because of this program.

The implementation and progress of the program was included in our report GAO/GGD-87-39BR, 2/9/87 (see page 36.)

Recommendation(s)

We recommended that Congress continue the income tax refund offset program for tax years 1987 and 1988 for defaulted student loans.

Legislation Needed to Eliminate the Tax Advantage of Single Premium Life Insurance Products

(GAO/GGD-88-9BR, 10/16/87)

Single premium life insurance provides a device for capturing investment income without reflecting it on an income tax return. The policies allow a single premium to be paid upfront and combine death benefits with tax-free accumulation of income. Policyholders can also obtain loans against the policies at little or no cost because the income on invested funds is used to offset the interest charged to borrowers. Between 1984 and 1986, single premium life insurance sales grew 318 percent, from about \$1.0 billion to over \$4.3 billion. At the same time, ordinary premium sales grew 13.3 percent, from \$8.3 billion to \$9.4 billion.

Our analysis of single premium life insurance showed that (1) single premium contracts feature the tax-free accumulation of income, which is set aside and invested to finance death benefits; (2) neither the policyholder nor the beneficiary is ever taxed on the proceeds of the policy if funds are paid to the beneficiary by reason of death of the insured; and (3) policy loans are not subject to current taxation. Despite industry claims to the contrary, the investment orientation of single premium life insurance may be inconsistent with congressional efforts pertaining to life insurance and investments.

Matter(s) for Consideration by Congress

We offered two alternative approaches should Congress decide to change the tax status of single premium life insurance. The first would treat loans from the policies in the same manner as distributions from annuity contracts, whereby the part of a policy loan that represents return on investment is considered taxable income in the year withdrawn. The second would change the definition of life insurance so that single premium contracts no longer qualify for favorable tax treatment if policy loans reduce the death benefits below a certain level.

Action(s) Taken and/or Pending

On October 7, 1987, H.R. 3441 was introduced to amend the Internal Revenue Code so that policy loans from the earnings on life insurance contracts would be treated as taxable income during the year withdrawn. The bill would also penalize distributions made prior to age 59 and a half. Hearings on the bill were held on March 15, 1988, before the Subcommittee on Select Revenue Measures, House Committee on Ways and Means.

Open Recommendations to Congress From Reports Issued Before Calendar Year 1987

Legislative Change Needed to Enable IRS to Assess Taxes Voluntarily Reported by Taxpayers in Bankruptcy

(GAO/GGD-83-47, 6/20/83)

The Bankruptcy Reform Act provides qualified debtors with certain protection 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 stop its automated processing of returns from bankrupt taxpayers and perform many special processing steps. These steps include manual processing procedures at IRS service centers and district offices. During fiscal year 1982, these additional process steps cost IRS an estimated \$500,000.

Recommendation(s)

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(s) Taken and/or Pending

No action had been taken or planned as of March 31, 1988.

**Congress Should
Amend the Internal
Revenue Code to Give
IRS an Interest-Free
Period to Process
Certain Non-Income-
Based Returns**

(GAO/GGD-86-72, 7/28/86)

Sections 6611(e), (f), and (h) of the Internal Revenue Code provide an interest-free period for processing income tax refunds, carryback applications, and windfall profit tax refunds. On the other hand, the Code does not provide an interest-free processing period for refunds of such non-income-based taxes as employment taxes, excise taxes, estate taxes, and gift taxes. Interest on these refunds is generally paid for the entire period between the overpayment date and the date of the refund.

In 1983 and 1984, IRS proposed to the Department of the Treasury legislative changes that would have created an interest-free period for processing refunds of such non-income-based taxes as employment taxes, excise taxes, estate and gift taxes, and railroad retirement taxes. In preparing its proposal to create an interest-free processing period for non-income-based tax returns, IRS determined that for an 11-month period ending October 1, 1982, \$72 million in interest was paid on employment tax refunds alone. Of that amount, IRS estimated that \$36.6 million could have been saved if a 45-day interest-free period had been in effect.

We did not verify IRS estimates. It should be noted, however, that IRS has been able to process over 90 percent of income-based refunds within 45 days even though the volume of these refunds is much higher than non-income-based tax refunds.

**Matter(s) for
Consideration by Congress**

We suggested that Congress consider amending section 6611 of the Internal Revenue Code to provide an interest-free processing period for non-income-based tax returns. We did not attempt to determine how long such a period should be. However, a 45-day processing period would make the treatment of non-income-based returns consistent with most income-based returns.

**Action(s) Taken and/or
Pending**

No action had been taken or planned as of March 31, 1988.

**Appendix III
Tax-Related Recommendations Made During
Calendar Year 1987 to the Treasury, HHS, and
IRS, and Their Responses to
Those Recommendations**

**Need to Enhance the
Reliability of
Estimates in
Allocating Motorboat
Fuel Excise Taxes to
the Aquatic Resources
Trust Fund**

(GAO/GGD-87-43BR, 6/9/87)

Our briefing report to the Chairman and Ranking Minority Member of the Subcommittee on Fisheries and Wildlife Conservation and the Environment, House Committee on Merchant Marine and Fisheries, analyzes how gasoline tax revenues from motorboat fuel are allocated to the Aquatic Resources Trust Fund. The fund supports boating safety and sport fishing restoration projects. Treasury is required to determine what percentage of the gasoline sold is used by motorboats and to transfer that percentage into the fund. During the course of our review Treasury completely revised the method it used to estimate national motorboat fuel consumption. Although the new method may be an improvement over the previous method, the data used, though the most current, still have limitations. These limitations generally reflect a lack of reliable data on motorboat fuel use separate from other forms of gasoline consumption.

Recommendation(s)

We suggested that Treasury could enhance the reliability of its future estimates by assuring that updated and new data are routinely incorporated into its calculations.

**Action(s) Taken and/or
Pending**

Treasury officials advised us in March 1988 that they had not reached a decision as to whether our suggestion could be done routinely.

**Appendix III
Tax-Related Recommendations Made During
Calendar Year 1987 to the Treasury, HHS, and
IRS, and Their Responses to
Those Recommendations**

investment purposes, and (3) past promotional efforts have not been successful. Nevertheless, the Assistant Secretary of the Treasury for Management stated in a September 1, 1987, letter to the Chairman of the House Committee on Government Operations that in lieu of implementing our recommendation, Treasury would undertake a nationwide campaign to promote encoding of coupons by financial institutions on a voluntary basis. We plan to monitor the results of this effort and any subsequent actions by Treasury to fully implement our recommendations.

IRS Can Improve on the Success of Its Problem Resolution Program

(GAO/GGD-88-12, 12/22/87)

IRS established its Problem Resolution Program in 1977 to provide special assistance to taxpayers with problems that IRS' normal assistance channels had failed to resolve. The program was also designed to inform IRS management of recurring problems.

We reported that the program has been successful in achieving its taxpayer assistance objectives and helping to improve IRS' image in the eyes of taxpayers. However, we also noted that IRS had not satisfactorily served all taxpayers needing special assistance. Many taxpayers with late refunds or erroneous notices caused by IRS computer problems and errors by inexperienced staff in fiscal year 1985 were not identified nor referred for special assistance at the time they met the IRS criteria for referral. Although some of these taxpayers were later referred to the program, others were not referred at all. IRS employees were not obtaining enough information to identify problem inquiries.

IRS could take steps to improve normal assistance and lessen the need for special assistance; make normal assistance more timely for taxpayers; and reduce the number of subsequent contacts if it encouraged taxpayers with questions to call IRS district offices rather than write to service centers. IRS also needs better information on the quality of its assistance. IRS attempts to obtain taxpayer feedback and evaluate common causes of taxpayer problems have provided biased, incomplete, and inaccurate information.

Recommendation(s)

We recommended that the Commissioner of Internal Revenue take specific actions to (1) improve special assistance case identification, (2) provide more timely taxpayer assistance, (3) improve taxpayer follow-up efforts, and (4) obtain more complete and accurate information on recurring problems.

Action(s) Taken and/or Pending

IRS generally agreed with our recommendations and has initiatives underway or planned to (1) improve the clarity and effectiveness of its notices and its resolution of taxpayer questions, (2) increase the usefulness of its follow-up questionnaire, and (3) obtain more complete and accurate information on recurring problems. IRS is also attempting to obtain better information from taxpayers on prior contacts so that those eligible for the Problem Resolution Program are properly identified and referred to the program.

Information on Lobbying and Political Activities of Tax- Exempt Organizations

(GAO/GGD-87-32FS, 1/16/87)

This fact sheet to the Chairman of the Subcommittee on Oversight, House Committee on Ways and Means, describes the relevant statutes that address political and lobbying activities by tax-exempt organizations and provides information on IRS programs designed to monitor such activities.

Our analyses showed that most tax-exempt organizations are exempt under section 501(c) of the Internal Revenue Code. This section contains 25 categories of tax-exempt organizations, including section 501(c)(3) charitable, educational, and religious organizations; section 501(c)(4) social welfare organizations; and section 501(c)(5) labor unions. IRS statistics indicate that there are over 800,000 section 501(c) organizations, not including section 501(c)(3) religious organizations that do not apply for tax-exempt status.

Current law prohibits section 501(c)(3) organizations from engaging in political activities. Also, they must limit their lobbying activities to an insubstantial portion of their total activities unless they choose to be governed by specific dollar expenditure limitations under section 501(h) of the Code. Churches, private foundations, and certain other organizations may not elect this expenditure test. In addition, an excise tax is placed on the lobbying activities of private foundations.

Available IRS data indicate that less than 1 percent of tax-exempt organizations engage in lobbying and/or political activities, which seem to be concentrated among social welfare organizations, labor unions, and business leagues.

We found that IRS does not have a separate compliance program to monitor the lobbying and political activities of all tax-exempt organizations. IRS issues revenue rulings and provides overall guidance on lobbying and political activities as part of routine compliance examinations, and maintains limited statistical data on lobbying and political activities.

Summary of Related Action(s)

This fact sheet was used as the basis for our testimony on March 12, 1987, before the Subcommittee during its hearings on the lobbying and political activities of tax-exempt organizations. On December 21, 1987,

Computer Support for Tax Processing at IRS

(GAO/T-IMTEC-87-1, 2/6/87)

Our testimony before the Subcommittee on Oversight, House Committee on Ways and Means, discusses IRS' computer systems, which are critical to processing tax returns, answering taxpayer inquiries, and issuing refunds. The computer issues discussed during these hearings were the subject of two GAO reports to this Subcommittee (GAO/IMTEC-87-3BR, 10/14/86, and GAO/IMTEC-87-5BR, 11/3/86) dealing with IRS' data communications and computer capacity. The discussion also covers how well IRS' computers supported tax return processing during January 1987 and comments on the objectives and status of IRS' Tax System Redesign project.

Summary of Related Action(s)

As a result of our testimony, the Chairman requested that we assist the Subcommittee in its oversight and evaluation of IRS' efforts to install a new Communication Replacement System nationwide. We are now reviewing IRS' progress in installing the new system at its National Computer Center in Martinsburg, West Virginia, and its Austin, Texas, and Fresno, California, service centers. A report will be issued to the Chairman upon completion of our work.

Competition Between Taxable Businesses and Tax-Exempt Organizations

(GAO/GGD-87-40BR, 2/27/87)

This briefing report to the Joint Committee on Taxation describes the competition between taxable businesses and tax-exempt organizations engaged in commercial or income-producing activities. Although IRS lacks sufficient data to quantify the extent and impact of such competition, IRS' available data indicate growing competition.

For example, the number of tax-exempt organizations has increased from about 100,000 in 1956 to over 800,000 in 1987. These organizations also have become more diverse as the types of exempt activities in which they engage have grown from 90 to over 260 since 1986. As of 1985, over half of them are engaging in more than one activity and tax-exempt resources are assuming a larger share of the gross national product. Although these growing resources have come from varied sources, tax-exempt organizations are relying more on receipts from commercial activities and less on traditional sources, such as charitable contributions and government funding. While contributions have dropped from 17 to 13 percent of total exempt revenue from 1946 to 1978, revenue from such sources as business receipts, rents, and sales of assets have risen from 57 to 75 percent.

In 1950, Congress passed a tax on income from activities that are not substantially related to a tax-exempt purpose. This tax is better known as the unrelated business income tax. Uncertainty over the tax-exempt nature of income, however, is hampering the administration of this tax. Interviews with representatives of taxable businesses and tax-exempt organizations show they recognize the competition but their views differ on the extent of and reasons for competition. Representatives of six types of taxable businesses—research, racquet sports, veterinarians, travel, tourism, and audiovisuals—express different views on the extent of competition. However, each group questions, to a general extent, the appropriateness of competition from organizations that benefit from a tax-exempt status and is concerned about ambiguities in the administration of the tax. Representatives of tax-exempt organizations generally view their increased commercial activities as contributing to their tax-exempt missions. They believe that more competition exists due to taxable businesses expanding into services that tax-exempt organizations traditionally provided, and they believe that the tax provides a proper enforcement tool when effectively administered.

**IRS' Fiscal Year 1988
Budget Request**

(GAO/T-GGD-87-9, 4/23/87)

In this testimony before the Oversight Subcommittee of the House Committee on Ways and Means, we presented our views on (1) budget increases proposed for IRS' enforcement activities, (2) the effect of staff retention problems on service center quality, (3) the apparent insufficient funding level for taxpayer service, (4) provisions in the budget for automated data processing and information technology, and (5) the potential impact of the Tax Reform Act of 1986 on IRS' resource needs and allocation.

**Summary of Related
Action(s)**

The Subcommittee used the information presented in our testimony in its deliberations on IRS' budget request for fiscal year 1988.

**Selected Tax
Provisions Affecting
the Hard Minerals
Mining and Timber
Industries**

(GAO/GGD-87-77FS, 6/3/87)

This fact sheet to Senator John Melcher presents background information and the latest available statistical data on the hard minerals mining and timber industries. It identifies relevant provisions in the Tax Reform Act of 1986, both general and industry-specific, that affect taxpayers engaged in these industries. It also discusses the arguments, both for and against, special timber tax provisions. It did not, however, attempt to estimate the net effect of tax reform on these industries.

**Summary of Related
Action(s)**

The information contained in this report was used by Senator Melcher during the tax reform debate.

Computer Matching: Assessing Its Costs and Benefits

(GAO/T-PEMD-87-5, 6/23/87)

Our testimony before the Subcommittee on Government Information, Justice and Agriculture, House Committee on Government Operations, discussed the results of prior GAO reports on Computer Matching (GAO/PEMD-87-2, 11/10/86 and GAO/PEMD-87-3BR, 11/10/86). In general, computer matching involves comparing two or more data bases to identify individuals or organizations who appear on both. It has been our experience that computer matching can be a valuable tool in the investigation of fraud, waste, and abuse and in the improvement of internal controls. We have, however, consistently encouraged the employment of technically adequate methods to make decisions and to justify claims of costs or benefits in the use of such tools as computer matching.

As part of our examination of how the costs and benefits of computer matching have been assessed by federal agencies, we collected information on over 40 computer programs in the nine agencies we reviewed, including IRS' credit-for-the-elderly matching program. This match identifies taxpayers who claimed a credit as elderly persons and received pensions or annuities from Social Security or from the Railroad Retirement Program.

We found, in general, that a well-developed methodology for cost-benefit analyses of such matches did not exist. This was not surprising because when agencies made decisions about whether or not to initiate computer matching, other concerns such as legislative requirements and the significance of a problem were more important than assessing costs and benefits. We found, however, that it is feasible to do sound cost-benefit analyses and we developed detailed guidelines for their execution. While the guidelines do not constitute a fully developed methodology, they can be useful to the agencies and Congress in determining whether the benefits of computer matches outweigh their costs.

Summary of Related Action(s)

Our testimony was useful to the Subcommittee's better understanding of the methodology for evaluating costs and benefits of computer matching. In addition, two of the agencies we reviewed, the Departments of Defense and Health and Human Services, voluntarily adopted our guidelines.

**Tax Withholding
Systems Used by U.S.
Tax Treaty Partners**

(GAO/GGD-87-118FS, 9/11/87)

This fact sheet to the Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations, describes the types of withholding systems used by U.S. tax treaty partners when taxing passive income earned by foreign persons. It includes information for 27 countries and categorizes the countries' withholding systems into three basic types—an address system, a certification system, and a refund system.

**Summary of Related
Action(s)**

The Subcommittee used the information in this fact sheet in its preparation for hearings on the adequacy of U.S. efforts against international tax evasion. The Subcommittee held hearings on September 15 and 16, 1987.

Delays Hampering Installation of IRS' Communications Replacement System

(GAO/IMTEC-88-1, 10/8/87)

This report to the Chairman of the Subcommittee on Oversight, House Committee on Ways and Means, discusses IRS' progress in replacing its existing data communications processing system and obsolete terminals with the new \$150 million Communications Replacement System. During our testimony on February 6, 1987, on IRS' computer systems, the Chairman asked that we assist the Subcommittee in its oversight and evaluation of IRS' efforts to install the new Communication Replacement System nationwide.

IRS is conducting tests to find out whether the Communications Replacement System will meet IRS' requirements. IRS testing, called system acceptance testing, is intended to test the capabilities of the new system at IRS' National Computer Center, located in Martinsburg, West Virginia, before it is placed in service at any of IRS' 10 service centers. Between June 15 and August 15, 1987, IRS planned to test the system's hardware and software compatibility. We found that as of August 17, 1987, IRS had completed 45 percent of this testing. IRS estimated that it would take an additional 6 weeks to complete the remaining tests. IRS officials responsible for managing the project attributed the delay to three causes. First, some of the contractor-supplied software needed to conduct the test was not working properly at the start of the system acceptance test period. Second, other contractor-developed software needed to conduct the test was not delivered. Third, the system acceptance test plan provided by the contractor was not acceptable to IRS and needed revision. As a result, nationwide installation of the new system has been delayed by at least 5 weeks.

We also reported that IRS intended to have the new system operational in two of its service centers by the start of the 1988 tax filing season. We found that because of the delay, IRS will have the new system operational in only one service center by that time. While IRS plans to install the system in at least three additional service centers by May 1988, it does not expect serious disruptions in processing tax returns and related data. We reported that IRS is facing a major challenge by installing the new system during the tax filing season. If IRS cannot achieve a smooth transition from the old communications system to the new one, it could experience processing problems at the service centers receiving the new system during the 1988 tax filing season.

**GAO Views and
Observations on
Various Taxpayer Bill
of Rights Issues**

(B-229147, 10/8/87)

This letter to the Chairmen of the House Committee on Ways and Means and Senate Committee on Finance contained our comments on major provisions of several pending bills covering taxpayer rights and safeguard issues. We reviewed and analyzed 10 major issues, provided references and explanations of related GAO studies in the various issues, and gave new analysis of issues not previously studied. In general, we said that certain provisions common to various bills should help assure that the rights of taxpayers are considered and protected in administering the tax system. However, some provisions could result in unanticipated problems for IRS in administering the Nation's tax system and in trying to collect the \$53 billion currently in IRS' accounts receivable. And some provisions may be better dealt with administratively, subject to congressional oversight.

Our views, which included concerns about proposals for GAO audit requirements, were based on various reviews over several years of IRS' examinations, collections, criminal investigations, and other operations. Our letter discusses the legitimate rights of taxpayers to be treated fairly and equitably by IRS and the powers needed by IRS to effectively administer the tax laws.

**Summary of Related
Action(s)**

The information we provided in this letter was used by the Senate Finance Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service in revising its Taxpayer Bill of Rights. During its deliberations on the tax provisions in the Omnibus Budget Reconciliation Act of 1987 (Public Law 100-203), which was enacted December 21, 1987, Senate and House conferees deleted those provisions relating to taxpayer rights and safeguards. On March 29, 1988, S. 2223, cited as the Omnibus Taxpayer Bill of Rights and dealing with taxpayer rights and safeguards, was approved and reported out of the Senate Finance Committee. As of March 31, 1988, S. 2223 was awaiting further Senate action.

IRS' Redesign of Its Tax Administration System

(GAO/IMTEC-88-5FS, 11/9/87)

This fact sheet to the Chairman and Ranking Member of the Subcommittee on Treasury, Postal Service and General Government, Senate Committee on Appropriations, responds to their request for information on IRS' Tax System Redesign, which is a major IRS effort to overhaul the tax administration system. This report is the first resulting from our continuing review of IRS' redesign program.

IRS has long recognized the need to revamp its 1960s-based automatic data processing system that supports tax administration activities. The system prohibits IRS employees ready access to tax account data needed to adequately address taxpayer inquiries. In 1968, IRS initiated a redesign program to address this problem; however, the program never proceeded beyond the conceptual stage because of, among other factors, congressional concerns about data security and taxpayer privacy.

IRS resurrected its redesign program in 1982 by establishing Tax System Redesign. Since that time, IRS has unsuccessfully attempted three approaches to system redesign, ranging from contractual to in-house design and development of a new system. These approaches did not proceed beyond the conceptual stage because of numerous leadership changes within IRS and Treasury. The fourth and current redesign approach, which IRS initiated in October 1986, involves incremental phases toward a target system design featuring data bases and on-line processing. By early 1988, IRS intends to have plans for designing, managing, and acquiring the new system. The fact sheet presents the costs incurred to date and cost projections for the redesign program.

Summary of Related Action(s)

We are examining the progress of Tax System Redesign for the Chairman and Ranking Member of the Senate Subcommittee on Appropriations, as well as for the Chairman of the Subcommittee on Oversight, House Committee on Ways and Means. We provided testimony on the objectives and status of the redesign program during the Subcommittee's February 3, 1987, oversight hearings. We also provided testimony on the background and status of the Tax System Redesign during the Subcommittee's February 23, 1988, oversight hearings on the ability of IRS' computer systems to handle tax processing.

IRS' Implementation of the 1987 Revenue Initiative

(GAO/GGD-88-16, 12/2/87)

This report to the Senate Committee on the Budget provides information on administrative actions taken by IRS to implement the first phase of a 3-year initiative to increase IRS' examination staff. That phase called for IRS to increase its examination staff by 2,500 positions (mostly revenue agents). According to IRS, the additional staff would generate \$593 million in additional tax collections during fiscal year 1987. IRS eventually increased its revenue agent staffing to the level authorized by the revenue initiative but not until several months later than anticipated by the initiative. A primary reason for the delay was that many of the agents hired with appropriated funds actually filled attrition vacancies. Despite the delay, IRS officials expected to meet the revenue projections for 1987.

Summary of Related Action(s)

Because of the prospects for additional revenues, requests for increases in IRS' enforcement staff are anticipated over the next several years. For example, the Omnibus Antidrug Abuse Act of 1988 (S. 2205), provides for additional appropriations for IRS to increase the number of tax enforcement personnel in returns processing, examination and appeals, investigations, collections, and taxpayer service. On March 23, 1988, the bill was referred to the Senate Committee on the Judiciary awaiting further action.

The information in this report will be useful to the Senate Budget Committee and other congressional committees during their deliberations on these requests.

Listing of GAO Products on Tax Matters Issued During Calendar Year 1987

Title	Date
IRS Excise Tax Audits of Manufacturers and Importers of Sporting Goods (GAO/GGD-87-27FS)	1/05/87
Information on Lobbying and Political Activities of Tax-Exempt Organizations (GAO/GGD-87-32FS)	1/16/87
Collecting Federal Debts by Offsetting Tax Refunds (GAO/GGD-87-39BR)	2/09/87
Competition Between Taxable Businesses and Tax-Exempt Organizations (GAO/GGD-87-40BR)	2/27/87
Administration of the Bad Check Penalty (GAO/GGD-87-52BR)	3/30/87
Deficit Reduction Act Income Verification Issues (GAO/HRD-87-79FS)	5/26/87
Selected Tax Provisions Affecting the Hard Minerals Mining and Timber Industries (GAO/GGD-87-77FS)	6/03/87
Allocating Motorboat Fuel Excise Taxes to the Aquatic Resources Trust Fund (GAO/GGD-87-43BR)	6/09/87
Information on Two IRS Computer Projects (GAO/IMTEC-87-26FS)	6/16/87
Federal Tax Deposit Information Can Be Processed More Efficiently (GAO/GGD-87-86)	7/02/87
Profitability of the Medical Malpractice and General Liability Lines (GAO/GGD-87-67)	7/13/87
Gas Guzzler Tax Compliance Can Be Increased (GAO/GGD-87-85)	7/16/87
Tax Withholding Systems Used by U.S. Tax Treaty Partners (GAO/GGD-87-118FS)	9/11/87
Extending Benefits and Taxes to Puerto Rico, Virgin Islands, Guam, and American Samoa (GAO/HRD-87-60)	9/15/87
More Must Be Done to Credit Earnings to Individuals' Accounts (GAO/HRD-87-52)	9/18/87
Improving the Integrity of Veterans Administration Unemployability Compensation Program (GAO/HRD-87-62)	9/21/87
Replacement of Service Center Computers Provides Lessons for the Future (GAO/GGD-87-109)	9/23/87
Guaranteed Student Loans: Legislative and Regulatory Changes Needed to Reduce Default Costs (GAO/HRD-87-76)	9/30/87
GAO Views and Observations on Various Taxpayer Bill of Rights Issues (B-229147)	10/08/87
Delays Hampering Installation of IRS' Communications Replacement System (GAO/IMTEC-88-1)	10/08/87
Taxation of Single Premium Life Insurance (GAO/GGD-88-9BR)	10/16/87
Employee Stock Ownership Plans: Little Evidence of Effects on Corporate Performance (GAO/PEMD-88-1)	10/29/87
IRS' Redesign of Its Tax Administration System (GAO/IMTEC-88-5FS)	11/09/87
GAO Views and Observations on Revenue-Raising/ Budget Reconciliation Legislation (B-229147)	11/16/87
IRS' Implementation of the 1987 Revenue Initiative (GAO/GGD-88-16)	12/02/87

(continued)

Listing of Testimonies Given on Tax Matters by GAO Officials Before Various Committees of Congress During Calendar Year 1987

GAO official	Congressional committee	Subject matter	Date
James R. Watts, Associate Director, Information Management and Technology Division	Subcommittee on Oversight, House Committee on Ways and Means	Computer Support for Tax Processing Needs Continuing IRS Attention	2/06/87
Jennie S. Stathis, Associate Director, General Government Division	Subcommittee on Oversight, House Committee on Ways and Means	Lobbying and Political Activities of Tax- Exempt Organizations	3/12/87
Jennie S. Stathis, Associate Director, General Government Division	Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations	The Merits of Establishing a Business Information Returns Program	3/17/87
Jennie S. Stathis, Associate Director, General Government Division	Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations	IRS' Efforts to Help Taxpayers During the 1987 Tax Filing Season	4/08/87
William J. Anderson, Assistant Comptroller General, General Government Programs	Subcommittee on Commerce, Consumer Protection, and Competitiveness, House Committee on Energy and Commerce	Profitability of the Medical Malpractice and General Liability Lines of Insurance	4/21/87
Jennie S. Stathis, Associate Director, General Government Division	Subcommittee on Oversight, House Committee on Ways and Means	IRS' Fiscal Year 1988 Budget Request	4/23/87
Jennie S. Stathis, Associate Director, General Government Division	Subcommittee on Oversight, House Committee on Ways and Means	Tax-Exempt Organizations and the Unrelated Business Income Tax	6/22/87
Eleanor Chelimsky, Director, Program Evaluation and Methodology Division	Subcommittee on Government Information, Justice, and Agriculture House Committee on Government Operations	Computer Matching: Assessing Its Costs and Benefits	6/23/87
Edward A. Densmore, Deputy Director, Human Resources Division	Subcommittee on Retirement Income and Employment, House Select Committee on Aging	Uncredited Earning for Social Security	10/15/87

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Tax-Related Assignments Authorized Pursuant to 31 U.S.C. 713 During Calendar Year 1987

Subject matter	Objectives	Month authorized
IRS masterfile accounts	<p>To assess IRS' input controls for tax year 1986 individual returns.</p> <p>To assess output controls over refunds and balance due notices generated from tax year 1986 individual tax return data.</p> <p>To assess management controls for identifying problems caused by IRS' own errors and correcting the conditions which are causing the errors.</p>	Feb. 1987
IRS' efforts to test major automatic data processing systems	To develop recommendations for management action to ensure that the problems experienced in past acquisition do not recur in future acquisitions.	March 1987
IRS' telephone and walk-in taxpayer assistance	To assess the availability, accuracy, and adequacy of these IRS activities.	March 1987
Unreported business income of independent contractors	<p>To assess IRS' efforts for monitoring compliance by private and public sector payers with IRS' requirement for reporting payments of income made to independent contractors.</p> <p>To determine whether IRS is effectively using this information to identify potential unreported income.</p> <p>To identify the amount of unreported income identified and collected by IRS using this information.</p> <p>To evaluate the adequacy of IRS' follow-up once potential under-reporting of payments is identified.</p>	April 1987
Terminating small private pension plans	To determine the extent to which terminated small plans benefit company owners and other highly compensated employees versus women and lower paid participants.	April 1987
IRS' revenue accounting control system and remittance processing system	<p>To determine the integrity of the data maintained on the systems.</p> <p>To assess the operational efficiency and effectiveness of these systems.</p>	June 1987
Management and use of exempt organization (990) tax returns	<p>To determine the extent to which IRS has problems in locating 990 tax returns for public disclosure and examination.</p> <p>To examine the completeness of 990 returns.</p> <p>To evaluate IRS' efforts to follow up to obtain correct information on incomplete returns.</p>	July 1987
IRS' efforts to monitor churches and other religious organizations	To provide information on statutory procedures and IRS' policies and programs for monitoring churches and other religious organizations.	Sept. 1987
IRS' administration of the Employee Retirement and Income Security Act	To determine whether the act is being administered in an effective and efficient manner.	Oct. 1987
State and local governments' compliance for reporting independent contractor income	To determine if state and local governments fully comply with form 1099 reporting requirements for nonemployee compensation.	Nov. 1987
Ways IRS can use information to identify employees who are misclassified as independent contractors	To determine if IRS can use information returns on nonemployee compensation payments to identify potentially misclassified independent contractors.	Nov. 1987
IRS' efforts to detect payers who fail to file information returns on independent contractor income	To determine the effectiveness of IRS' programs to detect payers who fail to file information returns on nonemployee compensation payments made to independent contractors.	Nov. 1987

Appendix V
Listing of GAO Products on Tax Matters
Issued During Calendar Year 1987

Title	Date
Accessibility, Timeliness, and Accuracy of IRS' Telephone Assistance Program (GAO/GGD-88-17)	12/03/87
1986 Annual Report on GAO's Tax-Related Work (GAO/GGD-88-13)	12/17/87
IRS Can Improve on the Success of Its Problem Resolution Program (GAO/GGD-88-12)	12/22/87

**Accessibility,
Timeliness, and
Accuracy of IRS'
Telephone Assistance
Program**

(GAO/GGD-88-17, 12/3/87)

This report to the Chairman of the Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations, supplemented and updated our testimony on IRS' telephone assistance program given to the Subcommittee on April 8, 1987. This is the fifth in our continuing reviews of IRS' telephone assistance program. Previous reviews were made in 1986, 1985, 1982, and 1978.

The results of our review showed that for the majority of calls, taxpayers could expect to reach IRS telephone assistors and obtain accurate answers to their questions. We completed 61 percent of our calls on the first attempt and 88 percent within five calls. Of the questions we asked, 79 percent of IRS' answers were correct and 21 percent were incorrect. For questions that required IRS assistors to probe callers for more information in order to sufficiently understand the question, the accuracy rate was 56 percent compared to 90 percent for questions where no probing was required. For questions that dealt with recent tax law changes, the accuracy rate was 68 percent compared to 82 percent for questions that were not affected by these changes. Although IRS agreed that assistors should be able to answer our questions, our results do not necessarily reflect the overall accuracy of assistors' answers to the full range of questions they actually received from taxpayers.

**Summary of Related
Action(s)**

The Commissioner of Internal Revenue has taken steps to improve the quality of taxpayer service. For example, in October 1977, IRS created the position of Assistant Commissioner for Taxpayer Service and Returns Processing to reflect a renewed commitment to and focus on the taxpayer service function. Also, IRS began hiring and training 1988 filing season taxpayer assistors earlier than in previous years, and it established a staff at the national level to promote a quality culture and quality improvement initiatives within taxpayer service nationwide.

On February 23, 1988, we also testified on the results of IRS' telephone assistance program during hearings on the status of the 1988 tax filing season before the Subcommittee on Oversight, House Committee on Ways and Means.

**GAO Views and
Observations on
Revenue-Raising/
Budget Reconciliation
Legislation**

(B-229147, 11/16/87)

This letter to the Chairmen of the House Committee on Ways and Means and Senate Committee on Finance presents our views and positions on a variety of provisions in the Omnibus Budget Reconciliation Act of 1987 (Public Law 100-203). We reviewed and analyzed six separate issue areas and related matters based on our past audit work. Our letter discussed the following issues: (1) the alternative minimum tax, (2) completed contract method of accounting, (3) IRS' nontax debt collection extension and study, (4) lobbying and political activities of exempt organizations, (5) taxpayer rights, and (6) insurance provisions.

**Summary of Related
Action(s)**

The information in this letter was available to Congress during its deliberations on the tax provisions in the proposed bill entitled Omnibus Budget Reconciliation Act of 1987. The bill was enacted into law on December 21, 1987, and generally reflected our views on several tax-related issues.

Effects of Employee Stock Ownership Plans on Corporate Performance

(GAO/PEMD-88-1, 10/29/87)

This report to the Chairman of the Senate Committee on Finance is the fourth and final report on our work on employee stock ownership plans. In the previous reports, we (1) provided a census of employee stock ownership plans and identified factors associated with a firm's decision to establish and continue a plan (GAO/PEMD-85-11, 9/30/85); (2) examined the degree to which these plans have broadened the ownership of capital assets in the United States (GAO/PEMD-86-4BR, 12/7/86); and (3) estimated the cost of tax incentives for these plans in 1977 to 1983 (GAO/PEMD-87-8, 12/29/86).

This report deals with the following questions:

- (1) Do companies with these plans experience an improvement in corporate performance, either in terms of profitability or productivity?
- (2) What factors, if any, are related to changes in performance?

The findings on these questions are then incorporated with our previously reported findings on the benefits and costs of these plans to provide an overall assessment. Generally, our analysis fails to substantiate assertions that employee stock ownership plans improve corporate profitability and productivity.

Summary of Related Action(s)

The information contained in this briefing report was useful to the Chairman and Committee staff in monitoring employee stock ownership plans and related issues.

**Appendix IV
Summary of GAO Products on Tax Matters
and Related Congressional Actions During
Calendar Year 1987**

**Summary of Related
Action(s)**

The Chairman has requested that we continue to assist the Subcommittee in its oversight and evaluation of IRS' effort to install the new system nationwide. We are continuing to review IRS' progress in testing and installing the new system at IRS' National Computer Center and the Fresno, California, and Austin, Texas, service centers.

**Replacement of
Service Center
Computers Provides
Lessons for the Future**

(GAO/GGD-87-109, 9/23/87)

This report to the Subcommittee on Oversight, House Committee on Ways and Means, discusses IRS' acquisition of new mainframe computers for its 10 service centers. When those computers were put into operation in 1985, IRS experienced serious returns processing problems that led to, among other things, delayed refunds and swollen service center inventories. Our work identified two factors related to the acquisition of those computers that contributed significantly to the implementation problems IRS encountered. Those factors involved inadequate quality controls, particularly when it came to testing rewritten computer programs, and an absence of organizational oversight during critical phases of the project. Because IRS had taken or was taking several steps to deal with those factors, we did not make any recommendations.

**Summary of Related
Action(s)**

The Subcommittee used the information in this report in overseeing IRS' acquisition of new mainframe computers.

Profitability of the Medical Malpractice and General Liability Lines of Insurance

(GAO/GGD-87-67, 7/13/87)

This report to congressional requesters supplemented and updated our testimony on the profitability of the medical malpractice and general liability lines of insurance. The testimony was given on April 21, 1987, before the Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations.

Profitability in the insurance industry is determined by combining both underwriting results and investment results. Our analysis showed that despite substantial underwriting losses over the 10-year period 1976 through 1985, the property/casualty insurance industry has more than offset those aggregate losses with investment gains. The underwriting losses resulted in part from the industry's practice of sacrificing underwriting gains in an attempt to attract more business and thereby enhance investment gains.

Profitability estimates for medical malpractice and general liability lines depend primarily on the adequacy of the reserves for future payments of claims. In a prior report (GAO/GGD-85-10, 3/25/85), we recommended that reserves be set-aside on a "discounted" basis so that the amount invested and resulting interest will be sufficient to meet expected future losses as long as expectations do not materially change. When reserves are valued at their full estimated payout, the funds available to cover those losses will produce lower estimates of the profitability of the line. Conversely, the estimated profitability of the line will improve if the reserves are discounted. For example, our work showed that on a discounted basis, the industry had about \$81 billion in after-tax income over the 10-year period. Without discounting, the industry claimed that its after-tax income was about \$54 billion over the same period.

Summary of Related Action(s)

This report presented, for the first time in the medical malpractice and general liability industry, the estimates of profitability using different assumptions about the industry's reserve adequacies and discounting. For example, those estimates showed that over the 11-year period 1975 through 1985, the malpractice line incurred losses when the reserves were valued at their full estimated payment, but it was profitable when the reserves were discounted to present values. This information was useful to the congressional requesters in helping them gain a further understanding of this complex issue.

Information on Two IRS Computer Projects

(GAO/IMTEC-87-26FS, 6/16/87)

This fact sheet to the Chairman of the Subcommittee on Oversight, House Committee on Ways and Means, is the result of one of several reviews requested by the Chairman on January 14, 1987, asking us to assist the Subcommittee in its oversight of computerized processing of tax returns at IRS. On February 6, 1987, we testified on the computer resources that IRS uses to process tax returns. This fact sheet details budget and cost information related to the Communications Replacement System and Tax System Redesign.

For the Communications Replacement System, IRS has planned to spend about \$150 million through 1993, primarily to replace existing front-end communications processors and obsolete computer terminals at its National Computer Center and at each of its 10 service centers. IRS estimated it would obligate about \$50 million on this system between fiscal years 1986 and 1988, which is about \$13.4 million less than the original estimate made in March 1985. In addition to these figures, we provide reasons why the estimates changed.

For Tax System Redesign, IRS has projected expenditures in the billions of dollars to overhaul the systems that support tax administration. Between fiscal years 1982 and 1988, IRS estimated \$83.6 million for the redesign program in its budget submissions to Congress. During this time period, IRS has actually obligated, or planned to obligate, about \$71 million. We reported how funds were spent and explained why obligations were less than original budget estimates submitted to Congress.

Summary of Related Action(s)

The Subcommittee used the information in this fact sheet in its oversight of IRS computer operations, especially with respect to the Communications Replacement System and the Tax System Redesign. We have been reviewing and analyzing budget and cost information related to these systems since February 1987, and we intend to provide this information to the Subcommittee for future IRS fiscal year budget deliberations.

**Deficit Reduction Act
Income Verification
Issues**

(GAO/HRD-87-79FS, 5/26/87)

This fact sheet to the Ranking Minority Member of the Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs, contains narrative and statistical summaries on the early efforts of federal and state agencies to implement the data exchange provisions of section 2651 of the Deficit Reduction Act of 1984. This section required state agencies administering certain federal entitlement programs to have an income and eligibility verification system in place by September 30, 1986. Our work focused on (1) coordination, resource, and procedural problems related to providing and using federal tax data maintained by SSA and IRS on earned and unearned income; (2) the states' ability to effectively use, control, verify, and keep confidential large amounts of federal data; and (3) the need for federal and state oversight of the use of this federal data.

**Summary of Related
Action(s)**

On September 16, 1986, we testified before the Senate Subcommittee on Oversight of Government Management on the preliminary results of our work and on the then-proposed Computer Matching and Privacy Protection Act of 1986. This proposal addressed the need for oversight of computer matching programs, such as those required by section 2651 of the act, and the safeguarding of confidential data, including federal tax data. The information presented in our testimony and later finalized in this fact sheet was useful to the Subcommittee in modifying the proposed legislation that was later reintroduced in February 1987 as Senate bill S. 496. This modified bill was passed by the Senate in June 1987 and referred to the House, where hearings were held in July 1987. No further action had been scheduled as of March 31, 1988.

**Appendix IV
Summary of GAO Products on Tax Matters
and Related Congressional Actions During
Calendar Year 1987**

**Summary of Related
Action(s)**

This briefing report added to the tax community's understanding of the competition issue. We discussed the information in this report during testimony before the Subcommittee on Oversight, House Ways and Means Committee, on June 22, 1987. The Subcommittee is considering legislative changes to (1) clarify whether income-producing activities substantially relate to the organization's tax-exempt purpose and (2) improve administration of the unrelated business income tax.

Collecting Federal Debts by Offsetting Tax Refunds

(GAO/GGD-87-39BR, 2/9/87)

This briefing report to Senator Thad Cochran describes the process by which tax refunds are offset against delinquent debts and provides information on congressional and IRS concerns about the potential impact of the program on IRS resources and on taxpayers' filing and withholding practices. We reported that

- the offset program was quite successful,
- very few individuals were wrongly offset, and
- the cost of administering the program was small in comparison to the results obtained.

Summary of Related Action(s)

In the Omnibus Budget Reconciliation Act of 1987 (Public Law 100-203), Congress extended the Refund Offset Program until July 1, 1988, and required that GAO study the effectiveness of the program and report on the results by April 1989. Our work is now in progress.

**Appendix IV
Summary of GAO Products on Tax Matters
and Related Congressional Actions During
Calendar Year 1987**

Congress passed the Omnibus Budget Reconciliation Act of 1987 (Public Law 100-203), which tightened provisions covering lobbying and political activities.

Summary of GAO Products on Tax Matters and Related Congressional Actions During Calendar Year 1987

IRS Excise Tax Audits of Manufacturers and Importers of Sporting Goods

(GAO/GGD-87-27FS, 1/5/87)

This fact sheet to the Chairman and Ranking Minority Member of the Subcommittee on Fisheries and Wildlife Conservation and the Environment, House Committee on Merchant Marine and Fisheries, contains statistics comparing IRS' excise tax audit coverage of manufacturers with that of importers of sporting goods. These excise taxes apply to manufacturers and importers of four categories of sporting goods—pistols and revolvers, other firearms, shells and cartridges, and bows and arrows.

Using a combination of computer-assisted and manual techniques, we developed statistics for a 3-year period covering fiscal years 1983 through 1985. These statistics showed that

- IRS' audit coverage of sporting goods manufacturers averaged 2.88 percent annually while its audit coverage of sporting goods importers averaged 7.34 percent;
- on average, examinations of importers resulted in slightly higher proposed additional tax and penalties than examinations of manufacturers; and
- on average, the proportion of examinations that did not result in an IRS-proposed change to the taxpayers' reported excise tax liabilities was slightly more than 4 percentage points higher for importers than manufacturers.

Summary of Related Action(s)

The information in this fact sheet was useful to the Subcommittee in its oversight of the funds earmarked for state wildlife conservation and hunter education programs.

**IRS Should Reconsider
Its Decision to
Postpone Providing
SSA With Needed Self-
Employment Data**

(GAO/HRD-87-52, 9/18/87)

Self-employed individuals report their earnings and pay their taxes, including Social Security taxes, to IRS. In turn, IRS shares the reported self-employment earnings data with SSA so that these individuals receive the proper credit for their earnings in their Social Security accounts. SSA must rely on IRS to provide these data because there is now no other way for SSA to obtain the data so that it can credit these individuals' earnings.

In 1985, we reported (GAO/GGD-85-21, May 28, 1985) that the agencies' present methods for processing self-employment records do not ensure that all self-employed persons who have reported earnings receive credit for them. We estimated that for returns processed in 1980, IRS did not provide SSA with information on about 2,600 tax returns with earnings totaling \$20.5 million, and SSA never processed an estimated 65,900 tax returns with earnings totaling about \$237.5 million. IRS and SSA have discussed this issue in 1985 and 1986; and although IRS agreed to provide the data to SSA in 1987, it postponed giving the information SSA needed until late 1988 due to tax law changes to be implemented in 1988. Until IRS provides the data and SSA processes it, those affected individuals who paid their Social Security taxes in 1979 (and who are now receiving less than they are entitled to) will continue to be shortchanged an estimated average of \$8 monthly and \$434 cumulatively (on the basis of our measurement in August 1985).

Recommendation(s)

We recommended that the Secretary of the Treasury direct the Commissioner of Internal Revenue to reassess the decision to further delay providing data to SSA for the 1979 earnings of self-employed individuals, which SSA needs to ensure the accuracy of benefit payments.

**Action(s) Taken and/or
Pending**

As of March 31, 1988, IRS had not provided SSA the records it needed to make the necessary corrections.

Federal Tax Deposit Information Can Be Processed More Efficiently

(GAO/GGD-87-86, 7/2/87)

Federal Tax Deposit coupons are used by taxpayers who make periodic tax payments—mostly withholding taxes—to federal depositories (primarily commercial banks). The payment information is placed on the coupons and forwarded by the depositories to IRS, which is responsible for processing the information and assuring that taxpayers are properly credited for the payments. We found that when the payment information (dollar amount) is encoded on the coupons, rather than handwritten, IRS processes them more efficiently on its optical character recognition equipment, which is used to electronically transcribe the information to computer tape. Currently, depositories are just encouraged rather than required by the Department of the Treasury to encode coupons. We estimated that about 19 percent of all coupons are encoded.

We tested coupon processing at two IRS service centers that IRS management said would be indicative of processing at all 10 centers. At one service center, encoded coupons were processed 36 percent faster and 92 percent more accurately; at the other, encoded coupons were processed 55 percent faster and 56 percent more accurately than noncoded coupons. At this increased level of efficiency, we estimated that the two service centers in our study could have saved about 5,556 staff hours in fiscal year 1986 if all coupons received had been encoded, and 1,996 hours if only 50 percent were encoded.

Recommendation(s)

We recommended that the Secretary of the Treasury establish the necessary regulations and procedures to (1) require federal depositories to encode dollar amounts on coupons before submitting them to IRS for processing and (2) exempt depositories that would incur prohibitive costs in complying.

Action(s) Taken and/or Pending

Treasury disagreed with our recommendation on the grounds that it would increase costs for some depositories, particularly smaller institutions. For this reason, Treasury stated that the compensation issue would need to be dealt with in relation to any action to require encoding. Treasury believed that a promotional effort to encourage depositories to encode would be more practical. In our response, we pointed out that (1) our recommendation exempts depositories that would incur prohibitive additional costs, (2) depositories are already compensated at 50 cents per coupon and have use of the funds for at least 1 day for

Tax-Related Recommendations Made During Calendar Year 1987 to the Treasury, HHS, and IRS, and Their Responses to Those Recommendations

IRS Should Establish a Business Information Returns Program

(GAO/T-GGD-87-4, 3/17/87)

Our testimony before the Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations, discussed the merits of creating an information returns program to identify businesses that underreport their income or do not file tax returns. This program could approximate a current IRS program to match individual taxpayers' returns with information returns from third parties on payments to individual taxpayers such as wages, or by individual taxpayers such as mortgage interest. Using business information returns (which IRS collects but does not match to tax returns) and business tax returns from calendar year 1983, we drew various samples to test the extent to which businesses underreported income or failed to file tax returns.

Our work showed that 33 percent, or 559, of the businesses in our sample may have underreported their interest and dividend income. Projected to a universe of 811,977 corporations, partnerships, and sole proprietorships for which information returns were submitted, these results translate into 316,577 businesses, or 39 percent of the universe, that potentially underreported slightly over \$1 billion, or 13 percent, of what these businesses should have reported. For another sample of businesses, we testified that about 11 percent, or 496 businesses, did not file required tax returns.

Recommendation(s)

We suggested that establishing an information returns program within IRS' existing system could help to identify businesses that do not file returns and sole proprietorships that may underreport income. However, for a full-scale effort, IRS would have to consider the trade-offs of designing a new program that would resolve the differences in information on tax returns versus information returns, such as different filing dates, accounting bases, business taxpayer's name, and treatment of the income for a business subsidiary. While our testimony recognizes the difficulties of overcoming these barriers, it identifies options for doing so.

Action(s) Taken and/or Pending

On the basis of our work IRS is testing various segments of a business information returns program, especially with respect to detecting nonfiling and underreporting by corporations. In February 1988, we began to monitor IRS' efforts.

Congress Should Amend the Internal Revenue Code to Give IRS an Interest-Free Period to Process Refunds Claimed on Most Amended Returns

(GAO/GGD-86-72, 7/28/86)

Section 6611 of the Internal Revenue Code provides that if IRS does not process and issue an income tax refund within 45 days of the overpayment date, it must pay interest. The overpayment date is the due date of the tax return or the date the return is filed, whichever is later. The 45-day processing period does not apply to refunds claimed on most amended returns because the date of overpayment is considered to be either the filing date or due date of the original tax return, whichever is later.

Since taxpayers have up to 3 years to file an amended return and interest must be paid back to the overpayment date of the original tax return, IRS may ultimately pay several years of interest on a refund, regardless of how quickly it processes the amended return. On the basis of our sample of refund claims paid by IRS in fiscal year 1983, we estimated that IRS processed about 1.5 million amended returns and paid \$419.4 million in interest on the resulting refunds. We further estimated that \$330.3 million of this interest involved returns for which IRS does not have an interest-free processing period. These latter returns were filed an average of 1 year from the time the original returns were filed, and they took an average of about 81 days to process.

Matter(s) for Consideration by Congress

So that IRS can reduce the amount of interest paid on amended returns claiming refunds, we suggested that Congress consider amending section 6611 of the Internal Revenue Code to provide IRS with an interest-free processing period for such returns. We did not attempt to determine how long this interest-free period should be. However, a 45-day processing period would make treatment of amended returns consistent with the treatment of original income tax returns.

Action(s) Taken and/or Pending

No action had been taken or planned as of March 31, 1988.

**Appendix I
Open Recommendations to Congress From
Reports Issued During Calendar Year 1987**

During these hearings, we testified on the sales, features, and tax treatment of single premium life insurance and discussed some potential approaches for changing the tax-favored status of single premium life insurance. We recommended that Congress consider legislative remedies that would eliminate the tax advantage associated with investment-oriented single premium life insurance products. In this regard, we reiterated the two alternative approaches contained in this briefing report as described above. Further congressional action on this issue is planned during 1988.

**Appendix I
Open Recommendations to Congress From
Reports Issued During Calendar Year 1987**

**Action(s) Taken and/or
Pending**

In the Omnibus Budget Reconciliation Act of 1987 (Public Law 100-203), Congress extended the Refund Offset Program until July 1, 1988, and required that GAO study the effectiveness of the program and report on the results by April 1989. Our work is now in progress.

privacy and confidentiality issues. Taxpayers and third parties have little choice about revealing personal information for tax administration purposes because this is mandated by law and subject to criminal and civil sanctions. The dilemma is whether personal information required for the purpose of tax administration should be used for another unrelated purpose. This question requires a balance between a potential increase in the efficiency and effectiveness of a legitimate government function and the intrusion by the government into the private lives of individuals.

The legislative history of the Deficit Reduction Act of 1984 shows that Congress intended that (1) safeguards would be used to protect the information used for verification and (2) the individual would receive appropriate notification before any action was taken relating to benefits.

**Matter(s) for
Consideration by Congress**

To improve VA's eligibility process, Congress should consider amending section 6103(1)(7) of the Internal Revenue Code to grant VA the same access to SSA earnings files now granted to seven other benefit programs. Congress would need to weigh the potential benefits of such disclosure with the potential effects on individuals' privacy and their voluntary compliance with the tax system.

**Action(s) Taken and/or
Pending**

Relating to a recent GAO report (GAO/HRD-88-24, 3/16/88) dealing with VA pensions, the Senate Committee on Veterans Affairs proposed on March 17, 1988, an original measure that would amend the Code's section 6103(1)(7) to grant VA access to tax return data to verify income and eligibility for any needs-based pensions provided under chapter 15 of title 38 of the United States Code or any other program administered by VA. This measure would, therefore, give VA access to SSA earnings as we suggested. As of March 31, 1988, the proposal was awaiting further action.

**Appendix I
Open Recommendations to Congress From
Reports Issued During Calendar Year 1987**

Because SSA and IRS have been unable to jointly develop a plan to ensure that all differences in earnings reported by employers are reconciled in a timely manner, Congress should consider requiring the agencies to submit a plan of action to the congressional committees that have oversight responsibility for these agencies. Such a plan should specify a time-phased schedule for eliminating the backlog and for resolving new discrepancies and any additional resources that may be required.

**Action(s) Taken and/or
Pending**

On October 15, 1987, hearings on this issue were held by the Subcommittee on Retirement Income and Employment, House Select Committee on Aging. We testified during these hearings on the matters discussed in this report. Both SSA and IRS also testified at the hearings and assured the Committee Chairman that necessary changes in a memorandum of understanding addressing the problem would be completed by the end of 1987. In a news release dated March 9, 1988, the Chairman of the Select Committee on Aging announced that SSA and IRS had reached an agreement in principle, with the details still to be worked out, to resolve the problems associated with the crediting of individuals earnings. We intend to monitor the progress of this action.

**Congress Should
Amend the Social
Security Act to
Specify a Time Limit
for Certifying Social
Security Earnings**

(GAO/HRD-87-52, 9/18/87)

The differences in earnings recorded by the Social Security Administration (SSA) and IRS raise questions about the amount of tax revenues to which SSA's trust funds are entitled. Since 1978, when the dual reporting system began, SSA has received tax revenues based on quarterly earnings reported to IRS. Despite these interim transfers, the law requires the Secretary of Health and Human Services (HHS) to certify the earnings amounts SSA recorded because Social Security is entitled to retain tax revenues based on that amount only. The law does not specify a time by which earnings for a given year must be certified, and SSA has not certified any since 1978.

As of March 1987, SSA had recorded about \$58.5 billion less than IRS in earnings for the years 1978 to 1984; therefore, SSA may not have a legal basis for retaining as much as \$2.8 billion of \$7.7 billion in tax money related to earnings not recorded in Social Security records once it certifies the earnings it has recorded. For 1978 through 1982, years for which employers are no longer required to maintain wage data that could be needed for future reconciliation, SSA may have to return \$2.8 billion to the Treasury on the basis of SSA's records as of March 1987.

**Matter(s) for
Consideration by Congress**

To provide an incentive for more timely completion of earnings reports reconciliation, Congress should consider amending section 201(a) of the Social Security Act to specify a time limit, such as the employer earnings record retention period (4 years) specified by IRS, for the Secretary of HHS to certify earnings. If Congress chooses not to specify a time limit for certifying earnings, it should consider whether (1) SSA should be required to relinquish trust fund money to general revenue funds for those earnings amounts that employers have reported to IRS, but which SSA has not recorded in its earnings system; or (2) the trust funds should be permitted to retain revenues based on IRS-recorded employers' earnings reports.

**Action(s) Taken and/or
Pending**

No action had been taken or planned as of March 31, 1988.

Congress May Wish to Consider Extending Benefits and Taxes to Puerto Rico, Virgin Islands, Guam, and American Samoa

(GAO/HRD-87-60, 9/15/87)

Extending federal welfare programs, such as Supplemental Security Income, Aid to Families with Dependent Children, child support enforcement, food stamps, foster care, and federal income taxes to the insular areas is controversial. While extending these programs would sharply increase funds available for the needy, extending taxes would boost federal revenues while reducing area revenues. Area officials generally favored program extension, although some officials in each area expressed reservations about extending certain programs, especially some foster care. Area representatives almost unanimously opposed extension of U.S. taxes.

Had federal income taxes been extended in 1983, U.S. revenues would have increased about \$2.7 billion and area revenues decreased about \$1.4 billion—assuming business activity levels remained unchanged. Annual federal revenues could decline over time to \$2.1 billion or less, primarily because some U.S. businesses would close, relocate, or downsize their operations. Nearly all officials with whom we spoke opposed federal income tax extension, noting the potential adverse effects on area economies and government finances.

To the extent actual business activity in the areas differed from our assumptions, our estimates of tax revenue would change. Unemployment and economic slowdown resulting from reduced business activity could further reduce federal revenues while increasing the demand for welfare. Also, if the areas imposed income taxes, (1) area revenues would decrease to a lesser extent than we estimated, and (2) estimated federal revenue would decrease to the extent such taxes were deductible in determining federal tax liability. Finally, federal tax revenue would be affected by such legislative changes as the Tax Reform Act of 1986, which likely would increase corporate tax revenue and decrease personal tax revenue.

While the short-term net effect of program and tax extension could be an increase in federal revenues and a decrease in combined area revenues, we advise caution in using the program and tax estimates because they vary. Smaller net federal revenue increases would result, for example, if extending taxes caused more businesses to relocate, thereby increasing unemployment and welfare services resulting in greater demand than we estimated.

Congress Could Consider Alternatives to Increase Gas Guzzler Tax Compliance

(GAO/GGD-87-85, 7/16/87)

Millions of dollars are not being collected due to independent importers' noncompliance with the gas guzzler tax. Independent importers are those who import vehicles that have been manufactured for the foreign market and generally need to be modified to meet U.S. emissions and safety standards. Our sample of gas guzzler vehicles imported through four Customs districts that accounted for about 80 percent of the independent imports from November 1983 through November 1984 showed that less than 1 percent of the independent importers paid the gas guzzler tax. Our projection of the sample results showed that over \$6 million in tax revenue was not collected on the vehicles entering through the four districts.

IRS believes that the revenue lost through independent importers' noncompliance with the tax law is a problem, and it has undertaken or plans to take a number of actions to improve compliance. These actions, however, may not reduce the gas guzzler tax noncompliance. District offices have the discretion to decide whether and, if so, to what extent, they will establish an enforcement presence. Further, those districts that do initiate enforcement efforts may encounter difficulties because they cannot readily determine who is liable for the tax, when the tax liability is actually incurred, and what amount of tax is owed. We believe that IRS needs to (1) identify and resolve problems the districts encounter in enforcing the tax, (2) communicate solutions and effective enforcement approaches on a Service-wide level, and (3) satisfy itself that the levels of district office enforcement efforts are appropriate.

Recommendation(s) to IRS and Matter(s) for Consideration by Congress

To promote voluntary compliance through increased taxpayer awareness, we recommended that the Commissioner of Internal Revenue arrange for Customs to include an explanation of the gas guzzler tax in the pamphlet Customs gives to independent importers.

To enhance the Service's efforts to improve compliance with the gas guzzler tax and assure that the levels of district office enforcement efforts are appropriate, we also recommended that the Commissioner of Internal Revenue

- monitor district office enforcement efforts and identify enforcement problems as well as effective enforcement approaches, and
- communicate Service-wide information on effective enforcement approaches and actions needed to solve identified problems.

Open Recommendations to Congress From Reports Issued During Calendar Year 1987

Congress May Wish to Consider Whether the Bad Check Penalty Is Still Appropriate

(GAO/GGD-87-52BR, 3/30/87)

Section 6657 of the Internal Revenue Code authorizes the Internal Revenue Service (IRS) to assess a penalty on taxpayer checks that are returned unpaid. The Code established a penalty of 1 percent of the check amount for checks \$500 and over and \$5 or the check amount (whichever is less) for checks under \$500. The Code further stipulates that the penalty shall not apply if the check was tendered in good faith and with reasonable cause to believe that it would be duly paid.

We evaluated IRS' administration of the bad check penalty because the minimum penalty has remained unchanged since 1954, and IRS has twice proposed raising the minimum penalty from \$5 to \$10 without success. We found the following:

- IRS assessed penalties on about 82 percent of the 184,000 checks that were returned from depositaries during the first 6 months of 1986. IRS did not assess penalties on the balance of the checks because it determined that these checks were tendered in good faith and with reasonable expectation that they would be paid.
- The deterrent effect of the bad check penalty is difficult to determine. Taxpayers who submit bad checks are also subject to bank processing charges and possibly other IRS penalty and interest assessments that may act as deterrents.
- IRS' processing costs exceeded the amount of the penalty assessment for about 59 percent of the bad checks processed during the first 6 months of 1986. However, the average penalty assessment was \$20.35, which was \$13.88 higher than IRS' estimated processing costs of \$6.47 per check. This occurred because the 1-percent penalty for bad checks written for large amounts more than offset the costs to process checks written for smaller amounts.

Matter(s) for Consideration by Congress

Because the penalty has remained unchanged since 1954, Congress may wish to consider whether the amount of the penalty is still appropriate and to what extent it should serve as a deterrent or just recover processing costs. Another issue regarding processing costs is whether costs should be recovered in total or on a per-check basis.

Action(s) Taken and/or Pending

The Joint Committee on Taxation does not plan to initiate action to increase the penalty because (1) the average penalty assessment appears adequate to cover IRS' processing costs and (2) the additional

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We are pleased to report that the Department of the Treasury, the Department of Health and Human Services, and the Internal Revenue Service have taken, or plan to take, action on most of the recommendations we made during calendar year 1987. Also, various congressional members and committees used our products in overseeing tax administration operations and in considering tax policy issues.

We look forward to continuing to work closely with Congress in its oversight of tax policy and administration matters and to assist it in considering our legislative recommendations. Also, we would be pleased 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 Secretaries of the Treasury and Health and Human Services, and the Commissioner of Internal Revenue. We are also sending copies to interested congressional committees and to others upon request.

Our work covering tax policy and administration matters is done pursuant to 31 U.S.C. 713, which authorizes the Comptroller General to audit the Internal Revenue Service and the Bureau of Alcohol, Tobacco and Firearms. GAO Order 0135.1, as amended, prescribes the procedures and requirements we follow to protect the confidentiality of tax returns and return information made available to us when we do tax-related assignments. This order is available upon request.

