

United States General Accounting Office

**GAO**

Report to Designated Congressional  
Committees

September 1989

# TAX POLICY AND ADMINISTRATION

## 1988 Annual Report on GAO's Tax-Related Work







United States  
General Accounting Office  
Washington, D.C. 20548

General Government Division

B-137762

September 29, 1989

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

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

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

The Honorable John Conyers, Jr.  
Chairman, Committee on  
Government Operations  
House of Representatives

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

This report summarizes our work on tax policy and administration during 1988. This report is submitted in compliance with 31 U.S.C. 719(d) and consists of the following appendixes.

- I. Summaries of tax-related products issued in 1988 by subject matter.
- II. Summaries of tax-related products issued before 1988 with open recommendations to Congress.
- III. Legislative actions taken in 1988 on GAO recommendations.
- IV. Listing of open recommendations to Congress.
- V. Listing of recommendations made in 1988 to the Commissioner of Internal Revenue.
- VI. Chronological listing of GAO products on tax matters issued in 1988.

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VII. Listing of assignments for which GAO was authorized access to tax data in 1988.

VIII. Listing of major contributors to this report.

We do work on tax policy and administration matters 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.

We are pleased to report that the Internal Revenue Service (IRS) has taken, or plans to take, action on most of the recommendations we made in 1988. 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 Secretary of the Treasury, and the Commissioner of Internal Revenue. We are also sending copies to interested congressional committees and to others upon request.

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



Jennie S. Stathis  
Director, Tax Policy and  
Administration Issues



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**Abbreviations**

INS	Immigration and Naturalization Service
IRS	Internal Revenue Service
QMB	Qualified Mortgage Bond
RACS	Revenue Accounting Control System
SSA	Social Security Administration
VA	Veterans Administration

# Summaries of Tax-Related Products Issued in 1988 by Subject Matter

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## ADP and Information Technology

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### IRS' Tax System Redesign Progress and Plans for the Future

(GAO/T-IMTEC-88-1, 2/23/88; GAO/IMTEC-88-23BR, 4/27/88)

In 1982, IRS began Tax System Redesign—a major program to make its automated tax processing system more efficient and effective. Since then, IRS has pursued four different conceptual redesign approaches. The fourth approach, which IRS is currently pursuing, depends on the agency's own staff, complemented by outside technical help. Our testimony before the Subcommittee on Oversight, House Committee on Ways and Means, discusses the progress of the Redesign project. The briefing report to the Chairman and Ranking Minority Member, Subcommittee on Treasury, Postal Service, and General Government, Senate Committee on Appropriations; and the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, provides an overview of IRS' Tax System Redesign.

In March 1988, IRS approved a Tax System Redesign management plan that described organizational responsibilities and the preliminary design concepts for a redesigned tax processing system. The preliminary design concept describes how IRS will redesign its tax administration system by the late 1990s. The redesign process will gradually automate and streamline the tax processing system in an integrated environment, which will reduce the need for manual and paper-intensive processes.

Over the next 2 years, IRS plans to (1) identify system design alternatives, (2) do cost-benefit analyses on the alternatives, (3) complete an acquisition strategy for procurements, and (4) define user requirements.

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## Agencies Need to Consider Adequate Security Controls in Developing Information Systems

(GAO/IMTEC-88-11 and GAO/IMTEC-88-11S, 5/31/88)

Adequate security controls in federal automated information systems are becoming increasingly more important as government agencies become more dependent on their systems to maintain and process mission-critical, sensitive information. IRS, along with seven other agencies we reviewed, did not properly assess security features when basic system requirements were being decided. Unless agencies study the cost and feasibility of security features when choosing a system, controls may not be adequate or cost effective.

The IRS system included in our review, the Automated Examination System, is intended to automate a labor-intensive, paper-oriented tax return examination process. In developing the system, IRS assessed the feasibility of three alternative designs. Each alternative had identical security controls to protect sensitive tax return information, and IRS did not formally evaluate their feasibility. According to IRS officials, the agency had enough experience with security for other systems processing taxpayer information to assess the feasibility of security controls without formal studies. We believe, however, that IRS should have used its experience to fully document the feasibility of alternative security controls.

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## Recommendation(s)

We recommended that the heads of agencies whose systems we reviewed, including IRS, evaluate existing agency policies and procedures governing the development of sensitive information systems to determine if revisions are needed to assure that systems are developed with appropriate security controls. These officials should also review sensitive information systems being developed to see if a sound security foundation is being built in. These evaluations should be considered in formulating agency information security plans required by the Computer Security Act of 1987 (Public Law 100-235).

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## Action(s) Taken and/or Pending

IRS said that it had corrected the cited problems relating to the security controls for its Automated Examination System. In addition, the Federal Computer Performance Evaluation and Simulation Center is assisting IRS in (1) reviewing federal and information systems security and control requirements, (2) documenting IRS' information systems security program, (3) identifying the information systems security requirements resulting from IRS' tax system modernization project, and (4) developing an action plan to ensure that proper controls are put in place.

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IRS expects to complete the plan in 1989. IRS was also evaluating the feasibility of using system development practices suggested by the National Institute of Standards and Technology (formerly the National Bureau of Standards) and the President's Councils on Management Improvement and on Integrity and Efficiency.

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## Questions About Proposed Funding for IRS' Personnel and Payroll Projects

(GAO/IMTEC-88-44, 6/15/88; GAO/IMTEC-88-45, 6/15/88)

We issued two reports to the Subcommittee on Treasury, Postal Service, and General Government, Senate Committee on Appropriations, for its use in evaluating IRS' fiscal year 1989 budget request. In these reports we questioned IRS' need for \$10.5 million to fund its part of a suspended Department of the Treasury payroll system project and \$10.3 million to fund modifications to its automated personnel system.

IRS' request for \$10.5 million was to support a conversion from its existing payroll system to the Treasury system. The conversion required staff to test the new system, train field personnel, and convert data. Treasury had terminated the contract to develop its system in December 1987, however, and was evaluating other alternatives, including the selection of another payroll system. In that regard, a Treasury study team had recommended, in April 1988, that Treasury select the Agriculture Department's integrated payroll and personnel system for use throughout Treasury.

IRS had also requested \$10.3 million for staff, equipment, and support related to an automated personnel system. In September 1987, IRS began converting from a Burroughs-based system to a Sperry-based system to maintain hardware compatibility with the system's developer—the Air Force. Principally because of telecommunication network software problems, however, only one IRS region had been converted as of May 1988. Also, according to a Treasury official, a decision to use Agriculture's integrated system, as recommended by the Treasury study team, could eliminate the need for IRS' personnel system.

In light of the above, we suggested that the Subcommittee examine IRS' justification for the requested funds.

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## IRS Needs to Improve Its Revenue Accounting Control System

(GAO/IMTEC-88-41, 6/17/88)

IRS' Revenue Accounting Control System (RACS) is inefficient and susceptible to errors. In fiscal year 1987, IRS processed 193 million tax returns and related documents, collected over \$866 billion in taxes, and refunded \$97 billion—all of which was accounted for by RACS. The system, put in operation in 1984, was intended to

- help account for and classify tax revenues, disbursements, and related financial transactions at each of IRS' 10 service centers;
- report revenue classification data to the Treasury Department; and
- help ensure that state and local governments, as well as other federal agencies, are properly reimbursed for such programs as child support and unemployment.

Although IRS had originally intended to fully automate its manual accounting system, it did not do so. Accounting data generated by other automated IRS systems and needed by RACS still must be entered manually, which has contributed to errors in classifying tax revenues.

In addition, RACS' account files must be balanced and reconciled manually, and RACS cannot identify categories of repeated errors or help analyze IRS' accounts receivable balance, which had increased from \$18.4 billion in fiscal year 1981 to \$53.7 billion in fiscal year 1987. IRS did not automate interfaces with other IRS accounting systems nor implement the automated balancing or reconciling features of RACS because (1) modifications to the other automated systems would have been required, and IRS was reluctant to do this; (2) some balancing functions were thought not to be needed with RACS; and (3) software for other balancing functions was not ready when RACS was made operational and has not been added since.

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## Recommendation(s)

We recommended that the Commissioner of Internal Revenue, in reviewing IRS' plan for replacing RACS, ensure that it is supported by a thorough requirements and compatibility analysis that (1) clearly specifies actions to reduce manual data input, balancing, and reconciliation, and improves RACS' ability to identify and track errors; and (2) identifies changes needed to ensure compatibility between RACS and other automated systems.

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**Summary of Related  
Action(s)**

In November 1988, IRS officials presented a proposal for RACS' replacement to its Information Systems Policy Board. As of March 31, 1989, according to the acting RACS Section Chief, the Board was considering whether to approve RACS' replacement as a separate project or as part of a larger effort to redesign service center information systems. He said that, as an interim measure, several actions were initiated to enhance RACS and permit direct input and transfer of accounting data generated by other automated systems.



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## Progress on IRS' Electronic Filing System

(GAO/IMTEC-88-40, 7/13/88)

This report to the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, summarizes IRS' development of an Electronic Filing System for professional tax preparers whose clients claim refunds. IRS believes that electronic filing will speed refunds and cut the costs and time associated with processing, storing, and retrieving tax returns.

We described IRS' efforts during the 1988 tax year to (1) correct software deficiencies that limited the benefits of electronic filing, (2) help preparers solve problems in sending returns, and (3) modify the new computer system that received returns. We also discussed efforts to address three unresolved issues that will affect IRS' nationwide implementation of the Electronic Filing System: (1) how to encourage more preparers to participate, (2) whether to install equipment and software in all or just some of IRS' 10 service centers, and (3) how to address certain technical and legal issues such as eliminating mandatory paper documents.

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## Summary of Related Action(s)

IRS replaced the software that permanently stores and retrieves electronic return data because the software used in 1988 did not work as intended. IRS also redefined its requirements to better ensure the receipt of acceptable software. In March 1989, we testified on this system before the Oversight Subcommittee (GAO/T-IMTEC-89-2, 3/16/89).

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## IRS Can Reduce Processing Errors With Better Quality Controls and Information

(GAO/IMTEC-88-25, 8/2/88)

Effective tax administration depends on accurate filing and processing of over 100 million tax returns annually. Complex, changing tax laws and high turnover of processing personnel contribute to mistakes made either by taxpayers or by IRS. According to IRS, 160,000 adjustments were needed to correct mistakes made during the 12-month period ended June 30, 1987.

To assess IRS' controls for correcting errors, we randomly selected 389 adjustments from a universe of 10,501 adjustments made by four service centers between April and June 1987. We found that about 72 percent of the adjustments would not have been needed if error resolution examiners and, in some cases, data transcribers had adhered to required procedures for correcting errors identified by an automated system. Most of these errors were eventually detected through a final check by another automated system. Because the errors were not corrected earlier, however, taxpayers received refunds and tax due notices within about 7 to 15 weeks rather than the normal 4 to 6 weeks. Correcting errors at the end of the process is also more costly than correcting them earlier.

In 21 percent of the cases, errors were not corrected before updating taxpayer accounts. As a result, some taxpayers received excess refunds ranging from \$7 to nearly \$5,000; others received tax due notices requiring them to pay from \$1 to over \$8,100 more than they actually owed.

IRS has increased its controls to identify the causes of processing errors, but some activities are not as effective as they can be because (1) the resulting management reports have been inaccurate and untimely and (2) service center unit managers do not consider certain reports to be useful to their needs.

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### Recommendation(s)

We recommended that the Commissioner of Internal Revenue:

- (1) Require service center directors to implement a program to review tax returns corrected by error resolution units.
- (2) Ensure that feedback on the nature and source of errors identified in these reviews is given promptly to the processing units and to National Office managers, so that both parties can act quickly to prevent future errors.

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(3) Review the completeness, timeliness, and accuracy of management information produced by quality monitoring, and modify those reports that do not meet management needs.

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Action(s) Taken and/or  
Pending

In response to our recommendations:

- IRS is analyzing test results from two service centers to see if an Error Resolution Unit review program can be implemented nationwide.
- IRS has developed a process review program to track error trends within functions and give next-day feedback to the units who made or missed the errors. IRS believes this immediate identification and correction of errors will let managers correct work before it moves on, thereby reducing the volume of errors that go forward to the next function.
- IRS is developing training on the use of quality monitoring data for distribution in 1989.

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## Compliance

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### The Tax Gap— Definition, Studies, Assumptions, and Components

(GAO/GGD-88-66BR, 3/25/88; GAO/T-GGD-88-22, 3/31/88)

As defined by IRS, the tax gap is the difference between the amount of income taxes voluntarily paid by individuals and businesses and the amount of income taxes that are owed. In March 1988, we issued a briefing report and testified on that gap.

In our briefing report to the Chairman of the Subcommittee on Oversight, House Committee on Ways and Means, we described (1) IRS' definition of the tax gap; (2) IRS' 1979, 1983, and 1988 studies in which it estimated the size of the tax gap; (3) changes in IRS' methodology and assumptions for the 1988 study compared to earlier ones; (4) components of the tax gap and dollar estimates for each component in the 1988 study; and (5) trends in the size of the tax gap.

Our overall analysis showed that IRS' 1988 study had major changes compared to earlier studies. The 1988 study excluded tax estimates for illegal source income and remittance problems, changed the method for computing taxes on unreported income, and assumed that compliance rates will remain constant. It also showed a higher tax gap for 1987 than for 1973, a decreased tax gap from 1986 to 1987, and an increased tax gap from 1987 through 1992.

Our testimony before the Senate Budget Committee discussed the tax gap and our efforts over the past several years to help IRS narrow it. While the tax gap is difficult to measure precisely, IRS' estimates show that it remains substantial. Our reports on several IRS enforcement programs had shown that IRS could take additional steps to reduce the tax gap. For example, IRS could implement a business document matching program, more actively pursue tax collection from closed criminal investigations, and use better tip income detection methods.

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**Comprehensive  
Review of Civil  
Penalties Is Needed**

(GAO/T-GGD-88-24, 3/31/88; GAO/T-GGD-88-55, 9/28/88)

We testified on the need for a comprehensive review of civil penalties before the Subcommittee on Oversight, House Committee on Ways and Means; and the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service, Senate Finance Committee. We presented a summary of prior studies on IRS' administration of various civil penalties. The studies had shown problems in computing and assessing penalties, applying varying district office policies, and having good information for managers to effectively oversee and evaluate the penalty program. We also discussed the usefulness of the Commissioner's Study of Civil Penalties and whether it would have a sufficient empirical base to identify the extent of problems, determine causes and impacts of identified problems, and develop specific recommendations to correct them.

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**Summary of Related  
Action(s)**

Our work on civil penalties is continuing. We expect to issue several reports upon its completion.

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## Opportunities Exist for Improving IRS' Administration of Alien Taxpayer Programs

(GAO/GGD-88-54, 4/11/88)

Many aliens are only in the United States temporarily. Difficulties that arise in trying to enforce compliance with U.S. tax laws once they leave make it imperative that IRS take reasonable steps to ensure compliance while they are still in the country. Mechanisms that were intended to deal with that problem by ensuring an alien's compliance before he or she leaves the United States are not working. Those mechanisms include (1) a statutory provision that is not being enforced and may, in fact, be impractical to enforce and (2) programs that are not being administered in accordance with established procedures.

At the time we issued our report, IRS did not have the kind of information needed to assess its alien compliance efforts. For example, certain aliens are statutorily required to obtain compliance certificates before leaving the country to document that they have met their U.S. tax responsibilities. IRS, however, did not maintain aggregate information on the number of certificates issued and the amount of tax collected as a result of that process. IRS also had no aggregate information on (1) the number of alien leads received from the Immigration and Naturalization Service (INS) and the results obtained or (2) the results of final tour accountings of foreign entertainers. Such information is needed to assess the effectiveness of current efforts and to provide a basis for deciding whether significant changes to those efforts are warranted. We also identified steps IRS could take to better ensure that incoming aliens are aware of their tax responsibilities and that IRS' compliance efforts are appropriately focused.

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### Recommendation(s)

We recommended to the Commissioner of Internal Revenue that IRS:

- Begin collecting management information needed to assess the effectiveness of alien compliance efforts. That information should include the number of tax compliance certificates issued and the amount of tax collected as a result, the number of leads received from INS and the results obtained, the results from final tour accountings, and costs and tax revenues associated with administering alien compliance efforts.
- Arrange with the Department of State to have U.S. embassies distribute information on the potential tax obligations of aliens, including, where applicable, the need to obtain a tax compliance certificate.
- Obtain from INS the kinds of information necessary to better meet IRS' nonresident alien information needs.

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- Designate district office personnel to be responsible for coordinating nonresident alien compliance efforts.
  - Revise the letter used to contact agents responsible for withholding taxes from foreign entertainers to bring it into conformity with current IRS forms and information.

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

IRS generally agreed with our recommendations and initiated a study to gauge the extent of alien taxpayer compliance. As of May 1989, IRS was analyzing the results of that study. IRS also has

- coordinated with State Department officials about the possibility of making more tax information available to aliens who apply for visas,
- coordinated with INS officials about obtaining additional information on aliens,
- established coordinators in the two district offices where most nonresident alien compliance efforts will be focused, and
- revised the text of the withholding agent contact letter.

## Investigating Illegal Income—Success Uncertain, Improvements Needed

(GAO/GGD-88-61, 4/25/88)

IRS has a Special Enforcement Program that is intended to investigate and seek criminal prosecution of major criminals involved in illegal activities—mainly important drug traffickers and organized crime figures who violate the tax laws. According to IRS' most recent estimate at the time we prepared our report, three illegal activities—drug trafficking, gambling, and prostitution—accounted for \$34 billion in unreported income in tax year 1981, or about \$9 billion in unpaid taxes.

On the basis of our analysis of nationwide samples of closed criminal cases, we found the following:

- From a criminal investigation standpoint, IRS did more Special Enforcement Program investigations and generated more convictions in 1985 than in 1982. For cases closed during fiscal year 1985, we projected that about half resulted in a conviction, about two-thirds of those convicted received a jail sentence, and about one-third of those investigated were major criminals.
- From a tax administration standpoint, the Special Enforcement Program cases closed in fiscal year 1982 (the latest year with complete data available) generated about \$11 million in tax revenue, of which about \$2 million represented taxes on illegal income.

Because specific goals and any other evaluation criteria had not been established, we could not conclude whether these results met Congress' or IRS' expectations for a successful program. However, we identified three management improvements that could enhance program operations.

First, IRS does not have management information relating to key program objectives, such as investigating major criminals and pursuing tax revenues from completed cases. Of the management information available, 76 percent of the 509 cases we reviewed contained inaccurate or incomplete data. Inaccurate information has resulted in erroneous and misleading reports to IRS management, Congress, and the public. With better information, IRS management would have a more complete picture of progress made toward key law enforcement and tax administration objectives.

Second, IRS' guidance on what constitutes grand jury information is not clear. Thus, IRS officials in different locations inconsistently interpreted what constitutes grand jury information. Unclear guidance could have



resulted in referable cases not being forwarded to Examination for tax assessment. Better guidance could help assure that potential tax revenues from these cases are pursued.

Third, IRS could more actively pursue tax revenues from closed criminal cases. Criminal Investigation did not forward 443 of 1,013 prosecuted grand jury cases closed in 1985 to Examination, thus foregoing potential tax assessments. We also found that Examination took an average of 14 months to assess taxes in sample cases closed in 1982, thus giving taxpayers an opportunity to dissipate assets and conceal income.

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**Recommendation(s)**

We recommended to the Commissioner of Internal Revenue that IRS:

- Collect key management information, such as major criminals investigated, cases referred for tax assessment or collection, and tax revenues generated.
- Review input controls to improve the accuracy of management information.
- Work with the IRS Chief Counsel and the Department of Justice to provide better guidance on grand jury information. Also, require special agents to consult with appropriate attorneys at the close of grand jury cases to determine what information may be forwarded to Examination for civil action.
- Establish a district office program to monitor the civil actions taken by various IRS components on closed criminal cases.

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

IRS agreed with our recommendations and has taken or plans to take several actions to implement them. In particular, IRS

- established a task force of top-level officials to analyze the current management information system and to recommend improvements;
- plans by October 1989 to implement a formal plan for tracking tax revenues generated from criminal investigation cases;
- plans to review district and region data controls to improve the accuracy of the management information system;
- revised its Chief Counsel Directive Manual to provide better guidance on grand jury information; and
- is developing a nationwide plan to monitor civil actions on closed criminal cases.

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## IRS Could Reduce the Number of Unproductive Business Nonfiler Investigations

(GAO/GGD-88-77, 5/24/88)

Each year, many businesses fail to file one or more required tax returns, such as those relating to income, employment, and excise taxes. IRS identifies most potential business nonfilers through a computerized program, which matches tax returns filed to the types of returns each business is required to file as recorded on IRS' Business Master File. In fiscal year 1986, IRS completed 3.7 million investigations of potential business nonfilers and assessed about \$5.9 million in taxes. However, IRS closed about 73 percent of the investigations without obtaining returns and assessing taxes. In other words, 73 percent of IRS' investigations were unproductive.

We analyzed a random sample of 1,976 business nonfiler cases that IRS closed in fiscal year 1987 and identified certain factors that contributed to unproductive investigations. Specifically, (1) in 15 percent, or 298 cases, IRS had erroneously issued more than one employer identification number to businesses that, in turn, had filed all required tax returns under only one of the numbers; and (2) in 19 percent, or 369 cases, businesses did not follow IRS regulations to file employment tax returns when no tax was owed.

We also found that in about 16 percent, or 317 cases, IRS did not use the results of its nonfiler investigations to update its records on businesses' filing requirements. As a result, IRS did not delete invalid filing requirements or incorrectly deleted valid requirements. Inaccurately maintained filing requirements will likely cause IRS to initiate more unproductive investigations or fail to detect business nonfilers.

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### Recommendation(s)

We recommended to the Commissioner of Internal Revenue that IRS

(1) adopt additional research techniques, such as using variations of the business' name and the signed name on the return, and actively pursue the receipt of Form SS-4, which is the application for an Employer Identification Number, to identify businesses with previously-issued employer identification numbers;

(2) revise employment tax return instructions and business nonfiler notices to emphasize to businesses the importance of filing required quarterly employment tax returns;

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(3) modify criteria for deleting invalid employment tax filing requirements to include the results of nonfiler investigations; and

(4) ensure that the filing status determined from nonfiler investigations is accurately recorded on the business master file.

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

IRS expects to have all four recommendations substantially implemented during 1989. Specifically, IRS:

- Included additional research procedures in July 1988 revisions to the IRS manual. IRS plans to issue follow-up instructions on securing Form SS-4.
- Is reviewing all business nonfiler notices and letters for tone and content to determine how to best emphasize the importance of filing the required quarterly employment tax returns.
- Changed its procedures for recording that a taxpayer is not liable for filing a return based on information resulting from its investigations. This required a systemic code change that was implemented March 1989.
- Revised its manual instructions to require all information to be input properly to the Business Master File from nonfiler investigations.

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## IRS' Efforts to Establish a Business Information Returns Program

(GAO/GGD-88-102, 7/22/88)

Our report to the Chairman, Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, provided a status report on IRS' plans, time frames, and accomplishments concerning its evaluation and implementation of a document matching program for business taxpayers. This program would match information returns for income such as interest and dividends to tax returns that were filed by sole proprietors, partnerships, and corporations. IRS already has an information returns program for identifying individuals who underreport their income or fail to file tax returns. (See our earlier testimony on this subject, GAO/T-GGD-87-4, 3/17/87.)

Following Subcommittee hearings in March 1987, IRS developed a plan to further test the feasibility of a document matching program for business taxpayers. We reported that IRS was proceeding on schedule to complete the three initiatives in its plan by 1991:

- IRS developed a cross-reference file that contains sole proprietor Social Security numbers and employer identification numbers. IRS plans to use this file to combine information returns submitted under both types of identification numbers before matching them with income reported on tax returns.
- IRS completed a pilot project in its Manhattan District Office that demonstrated that information returns are useful for detecting partnership and corporate nonfilers.
- IRS developed methodologies for determining the costs and benefits of a document matching program for corporate taxpayers.

We suggested that IRS (1) expand its cross-reference file, (2) verify taxpayers' statements that they had filed the required returns, (3) include the proper mix of personnel costs in computing the costs of a document matching program for corporations, (4) evaluate information from all delinquent returns, and (5) include just the additional tax revenue that would result from using information returns to identify unreported income in calculating the benefits of a corporate document matching program. IRS agreed with our suggestions and is either adopting them or further studying their merits before deciding what action to take.

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## Summary of Related Action(s)

On October 6, 1988 the Subcommittee issued a report entitled Implementation, by IRS, of a Document Matching Program for Income Paid to Business Taxpayers Should Produce Billions of Additional Dollars of Tax

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Revenue. The report, which refers to our 1987 testimony and 1988 report on IRS' progress, recommended that IRS proceed as rapidly as possible with its efforts to develop a business document matching program.

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## IRS Restructured Its Program to Curb Abusive Tax Shelters

(GAO/GGD-88-69, 7/25/88)

Congress authorized IRS to assess several penalties against those who (1) organize, promote, and sell abusive tax shelters; (2) aid and abet others in understating their tax liabilities; and (3) fail to register their shelters with IRS or register late. Accordingly, IRS established the tax shelter registration program and the detection team program, whose major purposes were to identify and penalize abusive tax shelters as early as possible, thereby reducing the number of related investor returns entering the examination process.

We found that (1) the registration program did not provide district examination personnel with enough information with which to decide whether to initiate an examination and (2) the detection team program selection criteria did not provide district personnel with shelter cases that had a high probability of being subject to penalties.

Furthermore, the penalty Congress provided IRS to curb the promotion of abusive shelters did not sufficiently reduce the financial incentives for selling shelters. Likewise, the financial disincentive of the penalty for aiding and abetting others in understating their tax liability had been minimized by IRS' difficulty in developing the level of proof required by law. Also, IRS was administering the penalties in such a fashion that they were often either overlooked or computed incorrectly. We concluded, therefore, that revised legislation and administrative action were needed to improve IRS' efforts in dealing with abusive tax shelters.

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## Recommendation(s) to Congress and IRS

We recommended that Congress revise the Internal Revenue Code to (1) significantly increase the penalty for abusive tax shelters above the current 20 percent of gross income derived, or to be derived, from the sale of an abusive tax shelter; and (2) reduce the level of proof needed to apply the penalty for aiding and abetting from "knowingly" to "knows or reasonably should have known" that an understatement of tax liability would result.

To improve the efficiency and effectiveness of the abusive shelter identification programs, we recommended that the Commissioner of Internal Revenue:

- Require organizers of registered shelters to provide the shelter prospectus and offering documents to their respective IRS district offices at the time of registration.

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- Require districts to review these documents in deciding whether to initiate an examination to determine if the shelter is subject to penalty.
  - Develop and periodically update national selection criteria that can be used by IRS service center detection teams and district examination personnel to identify the tax shelter returns most likely to contain a gross overvaluation of an asset or false or fraudulent statement.
  - Make maximum use of computers to identify and thus reduce cases for detection team review.

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Action(s) Taken and/or  
Pending

In passing the Tax Reform Act of 1986, Congress intended to curtail abusive tax shelters. In 1988, about 3,000 tax shelters registered with IRS; but thus far, IRS believes only a few of them would be deemed abusive. Consequently, IRS delayed implementing our recommendations pending an analysis of the impact of the Tax Reform Act of 1986 on the use of abusive tax shelters.

Instead, after our report was issued, IRS restructured its tax shelter identification programs to become one of many functions of its newly established compliance teams. These teams are supposed to (1) screen returns to identify early noncompliance problems with the 1986 Tax Reform Act, (2) identify emerging areas of noncompliance and the need for studies and research, and (3) continue to identify potentially abusive tax shelters.

Registrations have dramatically declined and only a few abusive tax shelter returns have been identified since enactment of the Tax Reform Act of 1986. Therefore, IRS does not intend to establish any further criteria for identifying, or issue any further guidance on penalties relating to, abusive tax shelters until new tax avoidance schemes have surfaced.

## Difficulties in Accurately Estimating Tax Examination Yield

(GAO/GGD-88-119, 8/8/88)

Congress provided IRS with funds that would enable it to increase its examination staff by 2,500 additional positions in fiscal year 1987. In its budget request for that year, IRS estimated that the additional staff would enable it to audit 120,000 more returns from which it would eventually assess \$829 million in additional taxes, penalties, and interest. IRS also estimated that its overall examination effort in fiscal year 1987, including the additional positions, would generate \$15.7 billion in assessed taxes, penalties, and interest for that year.

At the Senate Budget Committee's request, we assessed the major assumptions IRS used in computing its examination yield estimates. We found that each year since 1978, IRS' estimates of the amount of additional tax to be recommended by its examination staff have been consistently less than the amount of additional tax IRS showed as actually recommended that year. The annual underestimate averaged 28 percent over the period and ranged from about \$100 million in 1978 to about \$3.8 billion in 1986. Future estimates of revenues to be gained from audits would be more reliable if IRS used more realistic assumptions. For example, IRS needs to better recognize actual hiring and training patterns and the amount of staff time devoted to audits in past years.

One key assumption IRS uses in developing its estimates is that a certain percentage of the additional tax recommended by its examination staff will eventually be assessed. The percentages IRS uses were derived from data generated by tracking the results of audits closed in 1972. IRS recognizes that the tracking data need to be updated and has been trying, unsuccessfully so far, to do so. IRS uses the same percentages, based on the same tracking data, to compute the "actual" assessed amounts shown in its budgets. As such, the "actuals" are really only estimates—a fact not previously disclosed in IRS' budgets.

For various reasons, including a decision to divert audit staff to other IRS functions and an inability to bring new staff on board as quickly as anticipated, IRS fell short of the examination staffing level approved by Congress for fiscal year 1987. IRS also did fewer audits in 1987 than in 1986. Nevertheless, IRS computed \$847.5 million in assessed taxes, penalties, and interest as having been generated as a result of the 1987 staffing increase. We believe that IRS' computation excluded some things and assumed others that caused it to be overstated.



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Recommendation(s) to  
Congress and IRS

We recommended that Congress consider requiring IRS to include in its annual budget submission information on actual revenues derived from audits. We recommended also that the Commissioner of Internal Revenue (1) systematically reexamine and validate IRS' estimating process to include an analysis of how historical trends should be used and an updating of audit tracking data and (2) fully disclose in IRS' budget requests that assessed amounts shown as actual are really only estimates.

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Action(s) Taken and/or  
Pending

Congress and the Congressional Budget Office used our report in estimating the revenues that could reasonably be expected if Congress were to authorize another increase in IRS' examination staff. IRS agreed that it needs to reexamine the revenue estimating process. IRS said it has drafted a report that (1) discusses various concerns about IRS' estimating process, including those discussed in our report, and (2) proposes corrective actions. IRS expects to issue its report by the end of fiscal year 1989.

No steps have yet been taken to require including actual audit revenues in IRS' budget, primarily because IRS has yet to devise a methodology for generating such numbers. IRS' report is expected to address that issue. In the meantime, IRS revised the wording in its budget request for fiscal year 1990 to make it clear that the "actual" results were estimates.

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## Resolving Differences in Wage Amounts Being Reported to IRS and the Social Security Administration

(GAO/T-HRD-88-29, 8/9/88)

We testified before the Subcommittees on Social Security and Oversight, House Committee on Ways and Means, on the July 12, 1988, agreement detailing responsibilities under the Combined Annual Wage Reporting Program by IRS and the Social Security Administration (SSA). The agencies revised their prior agreement, after we had reported in September 1987 (GAO/HRD-87-52, 9/18/87) that they had failed to reconcile differences in wages being reported to them by employers.

We said that the new agreement is an improvement over the old one and should result in more employees' wages covered under Social Security being properly reported to and recorded by SSA. The new agreement (1) better recognizes the agencies' responsibilities and enforcement authorities for wage reporting, (2) more clearly delineates responsibilities and performance periods, (3) establishes accountability for nonperformance, and (4) works toward reducing future workloads.

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## Evaluation of IRS' Refund Offset Study

(GAO/GGD-88-117, 9/1/88)

The Omnibus Budget Reconciliation Act of 1981 (Public Law 97-35) authorized IRS to use individual income tax return refunds to offset delinquent child support payments. In this report to the Joint Committee on Taxation, we discussed our evaluation of IRS' report entitled Study of the Effect of Refund Offsets for Delinquent Child Support Payments on Compliance.

IRS analyzed the effect of tax year 1981 refund offsets on tax law compliance in tax years 1982 and 1983 and the effect of tax year 1982 offsets on compliance in 1983. IRS concluded that offsetting the refunds caused taxpayer compliance problems in subsequent years. Specifically, IRS concluded that those offset, as a group, were more likely in later years to (1) not file tax returns, (2) become delinquent in their taxes, (3) decrease their tax withholdings, and (4) have smaller refunds.

Our analysis showed that IRS' conclusions, other than the one related to nonfiling, could not be fully supported. IRS' study methodology did not consider whether the observed difference between its offset and control groups existed before the offset occurred. In addition, we reported that although IRS selected taxpayers for its control groups to closely match the taxable income and filing status of taxpayers in the offset group, the various groups may not have been comparable in nontax-related respects, such as taxpayer's age, geographic location, etc. We do not know whether considering nontax characteristics would have produced different results.

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## Summary of Related Action(s)

The refund offset program temporarily expired on July 1, 1988. On October 13, 1988, Congress passed the Family Support Act of 1988 (Public Law 100-485), which retroactively extended the program to January 10, 1994.

IRS continues to study the impact of the refund offset program on taxpayer compliance and has corrected the methodological weakness discussed above by considering prior taxpayer behavior in its analyses.

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## Accuracy of Taxpayer Identification Numbers on Information Returns Can Be Improved

(GAO/GGD-88-110, 9/6/88)

Each year, financial and other institutions (called payors) pay out hundreds of billions of dollars in interest and dividends and file information returns with IRS to report those payments. To ensure that recipients of the income (called payees) pay appropriate taxes, IRS matches data reported by payors on their information returns with income reported by payees on their tax returns.

The success of IRS' matching depends, in part, on payors accurately reporting payees' identification numbers, which are generally Social Security numbers. If the identification number on an information return is missing or incorrect, IRS may not be able to include that return in its matching program, thus compromising IRS' ability to detect underreported income and collect any resulting tax. Accordingly, Congress established requirements and penalties to encourage accurate reporting of identification numbers.

Of the 405.6 million interest and dividend information returns IRS received for tax year 1985 (the most recent year for which complete data were available), the identification numbers on 28.4 million could not be matched to IRS or Social Security files. Of those nonmatches, 5.5 million involved returns with missing identification numbers; the rest involved returns with incorrect numbers. IRS was able to correct 11.6 million of those numbers through computerized techniques. The numbers on the other 16.8 million returns could not be corrected, and thus those interest and dividend returns could not be used in IRS' matching program. We identified several steps IRS could take to improve the accuracy of payor identification numbers and thus the usefulness of interest and dividend returns in IRS' matching program. For example:

- IRS could enforce the requirement that payors withhold and remit to the Treasury 20 percent of all interest and dividend payments made to a payee who failed to provide a correct identification number. Because withholding limits the amount of interest or dividends a payee actually receives, it can serve as an incentive for payees to provide correct identification numbers.
- IRS could make more interest and dividend returns available for matching by using available manual research procedures to resolve erroneous identification numbers. In December 1987, IRS completed a test of those procedures, which appeared to demonstrate that manual research was effective. At the time we issued our report, IRS had not yet assessed whether expanded use of those procedures was cost effective.

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Recommendation(s)

We recommended to the Commissioner of Internal Revenue that IRS establish and implement procedures to (1) determine whether payors are complying with withholding requirements on interest and dividend returns and (2) enforce those requirements. We recommended, also, that if IRS decides, after assessing its test results, to use manual research procedures on interest and dividend returns with missing identification numbers, it should consider expanding that use to returns with incorrect numbers and focus on returns with the highest potential to yield additional taxes.

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Action(s) Taken and/or  
Pending

IRS agreed with our recommendations and said that it plans to start monitoring the withholding requirement in October 1989 and is assessing how it can use manual research to resolve incorrect numbers. In the meantime, IRS (1) has provided payors with an educational notice they can send to payees who were identified as having incorrect identification numbers and (2) has expanded its computerized research techniques in an attempt to resolve more erroneous identification numbers without having to refer them to the payors.

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## Information on IRS' Combined Annual Wage Reporting Reconciliation Program

(GAO/GGD-89-21, 12/14/88)

This report to the Joint Committee on Taxation summarizes information on the operation of IRS' Combined Annual Wage Reporting Reconciliation Program and provides data on taxes assessed, abated, and collected as a result of the program.

The primary purpose of the reconciliation program is to ensure that employers submit correct wage and tax withholding information to both the SSA and IRS so that (1) employees' Social Security accounts can be properly credited and (2) proper income and employment tax withholding can be collected from employers. Under the program, annual wage and tax information submitted by employers to both agencies is supposed to be reconciled and the reasons for any discrepancies are supposed to be determined. IRS is primarily interested in those discrepancies in which employers reported more earnings and tax withheld to SSA than to IRS because such discrepancies may indicate that taxes are due on earnings that were not reported to IRS.

Our study showed that (1) IRS identified about 500,000 discrepancies a year between 1981 and 1984 with tax potential and resolved over 50 percent of them; and (2) IRS assessed discrepant employers additional taxes, interest, and penalties of \$2.7 billion, of which \$1.4 billion had been abated and \$500 million collected as of September 1987. Considering that IRS spends about \$7 million a year to resolve about half of the program-related discrepancies with tax potential and collects an average of about \$125 million a year in additional taxes, interest, and penalties, we concluded that it would be cost-beneficial for IRS to add staff to the reconciliation program.

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## Summary of Related Action(s)

Responding to our concerns as well as those of the House Subcommittee on Aging and the House Committee on Ways and Means about the increased discrepancies, IRS reprogrammed about \$7.5 million in fiscal year 1989 to fund an expansion of its reconciliation effort.

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## Excise and Estate Taxes

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### Effect of Federal Estate Tax on Historic Properties

(GAO/GGD-88-56, 3/31/88)

This report to former U.S. Senator Paul S. Trible discussed the effect of federal estate tax on historic properties and evaluated a proposal to provide some federal estate tax relief for historic properties transferred to heirs upon the death of the property owner.

We did not identify any historic properties lost to preservation because of the federal estate tax since 1976, when major changes to the federal estate tax provisions reduced tax rates and the number of taxable estates. The few properties suspected of being sold for estate tax purposes either were never listed on the National Register of Historic Places or were lost to preservation for other reasons, such as deterioration, fire, vandalism, or unacceptable modifications.

We noted that the proposal to reduce the estate tax burden on historic properties addressed two areas of concern: (1) high valuation of the properties and (2) the short time frame before the tax is due. However, the proposal did not contain a provision to recapture tax benefits if the properties were not preserved, nor did it obligate heirs to maintain the property in its historic state.

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### Summary of Related Action(s)

Senator Trible decided not to introduce the tax relief proposal. His office said that the report would greatly benefit the historic preservation community because it (1) summarized useful information about various tax issues that could affect federal estate tax on historic properties and (2) documented the absence of statistical data to quantify any adverse effects of federal estate taxes.

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## An Analysis of Posted Prices and Fair Market Value of California Crude Oil

(GAO/GGD-88-114, 9/8/88)

This report to the Chairman of the Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, and Congressman Jim Bates examined whether posted prices for California crude oil reflected fair market value. Posted prices for crude oil are important because they are generally the prices used to calculate federal windfall profit tax and royalties. If posted prices are lower than fair market value, the federal government loses tax and royalty revenues.

The issue of whether crude oil posted prices reflect fair market value has been a long-standing controversy in California. It has been studied by IRS, Interior, and other federal and state government agencies and courts. On the basis of our work, we could not conclude that IRS or Interior should use any other standard than posted prices to calculate federal windfall profit tax or royalties.



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## 1988 Filing Season

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### IRS' Implementation of the 1986 Tax Reform Act and Its Performance During the 1988 Filing Season

(GAO/T-GGD-88-13 and GAO/T-IMTEC-88-1, 2/23/88; GAO/IMTEC-88-31, 3/31/88; GAO/T-GGD-88-30, 4/13/88; and GAO/GGD-89-2, 11/14/88)

The Tax Reform Act of 1986, the most sweeping tax legislation in three decades, amended or repealed over 2,000 subsections of the Internal Revenue Code. The 1988 filing season was the first in which IRS and taxpayers had to implement many of those changes. In preparing for the filing season, IRS, among other things, had to (1) revise existing forms and develop new ones, (2) provide taxpayers with clear and timely guidance, (3) hire and train the staff needed to process the additional tax returns and answer the additional telephone inquiries it expected to receive, and (4) revise computer programs used to process tax returns at its 10 service centers.

During 1988, we testified three times before the Oversight Subcommittee of the House Committee on Ways and Means and issued two reports to the Subcommittee and the Joint Committee on Taxation on IRS' implementation of the 1986 act and on IRS' performance during the 1988 filing season. Our overall message was that IRS did a good job implementing the act and that, as a result, the 1988 filing season was uneventful. In particular, we noted that:

- IRS mounted an extensive media campaign to inform taxpayers about tax law changes and to encourage them to file early, hired and trained additional staff to answer taxpayer questions and process tax returns, extensively tested tax forms before distributing them, and tested service center readiness before the filing season began.
- IRS had generally modified and tested the computer software needed to process tax information by February 1, 1988, the start of IRS' peak processing period. We did not find nor did IRS report any major software problems affecting the processing of tax returns filed in 1988.
- The service centers' mainframe computers were available 98.1 percent of the time they were scheduled to operate during the filing season, which was consistent with IRS' 98-percent standard.
- IRS was able to rely on its old communications processors (computers that provide IRS employees with access to taxpayer information) to achieve its availability goal of 95 percent during the filing season. Those processors have since been replaced.

- IRS met its target date for issuing taxpayer refunds and met its goal of handling the increased volume of telephone calls from taxpayers seeking assistance.
- Although IRS was meeting the demand for telephone assistance in terms of quantity, improvements in the accuracy of assistors' responses were needed.
- Taxpayers we interviewed at IRS' walk-in offices were generally satisfied or very satisfied with IRS' assistance.
- Members of the tax practitioner community had mixed views on the adequacy of written guidance IRS had issued to help taxpayers and practitioners interpret the 1986 act.

In our November report, we identified some opportunities for IRS to improve the effectiveness of future filing seasons by (1) revising sections of tax forms that were the source of numerous errors in 1988, (2) tailoring tax packages mailed to taxpayers to encourage the use of simpler forms, and (3) ensuring that taxpayers have ready access to tax forms and publications. IRS said that it had taken or planned to take steps to address each of these areas.

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**Summary of Related  
Action(s)**

In 1989, we issued three additional reports that related to IRS activities during the 1988 filing season. These reports discussed

- the accessibility, timeliness, and accuracy of IRS' Telephone Assistance Program (GAO/GGD-89-30, 2/2/89),
- interest on tax refunds paid by IRS in 1988 (GAO/GGD-89-42, 3/7/89), and
- IRS' interpretive guidance implementing the Tax Reform Act (GAO/GGD-89-40, 6/19/89).

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## General Management

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### Analysis of IRS' Fiscal Year 1989 Budget

(GAO/T-GGD-88-30, 4/13/88)

We testified before the Subcommittee on Oversight, House Committee on Ways and Means, on the Administration's fiscal year 1989 budget request for IRS. That request was for \$5.3 billion and 113,811 positions, an increase of \$240.8 million and 1,650 positions over the authorized levels for fiscal year 1988. In commenting on that request, we noted that the budget appeared to include enough staff for returns processing and taxpayer service to provide the same level of service in 1989 as in 1988. We could not conclude, however, whether there were sufficient resources in the budget to improve the quality of that service and pointed, in particular, to concerns about the quality of telephone assistance and taxpayer correspondence.

Our testimony also included discussions of (1) IRS' request for information technology, which accounted for most of the budget increase; (2) various program changes, including one directed at providing taxpayers with more information on interest and penalty computations; and (3) selected revenue initiatives that were proposed by IRS, but deleted by The Office of Management and Budget during the budget process.

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### Summary of Related Action(s)

On May 2, 1988, the Chairman of the House Committee on Ways and Means and the Chairman of the Oversight Subcommittee wrote the Chairman of the House Appropriations Subcommittee to say that the Administration's budget request did not provide the resources necessary to remedy quality deficiencies or fund certain initiatives necessary to advance the best interests of our tax system. They asked the Appropriations Subcommittee to provide an additional \$25 million. IRS received an appropriation of \$5.2 billion, about \$100 million less than the Administration had requested.

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## Managing IRS: Actions Needed to Assure Quality Customer Service in the Future

(GAO/GGD-89-1, 10/14/88)

This report was the result of a joint effort between IRS and GAO to find solutions to the major management issues confronting IRS. IRS' most pressing challenges are to

- better plan and direct its information systems modernization effort,
- address the deterioration in its ability to attract and retain a quality workforce and leadership cadre,
- strengthen management of financial systems to resolve significant internal control problems,
- devise an effective approach to ensure that a "quality first" mindset permeates the agency's internal culture, and
- ensure more rigorous evaluation of field operations to improve uneven performance and ensure uniform and equitable treatment for all taxpayers.

These challenges cannot be met quickly. They require a well-formulated, long-term strategy and sustained attention by IRS management. Congress and the Administration also must support the strategy if it is to succeed.

IRS took several actions before the report was issued. It reorganized its top management structure to improve accountability and strengthen communication. It improved management decisionmaking by setting up a strategic management system and initiated efforts to improve the quality of its services.

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## Recommendation(s)

We made a total of about 40 recommendations. Key ones were ensuring the strategic business plan effectively drives IRS' information systems modernization efforts and the annual budget process; improving critical data processing and accounting operations; developing an agencywide performance measurement system to, among other things, gauge progress toward improving quality service to the public; and strengthening internal evaluations of field activities.

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## Action(s) Taken and/or Pending

IRS fully supports the report's recommendations and has implemented several of them, assigned executive responsibility for their implementation, and set up a monitoring procedure.

In February 1989, the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service, Senate Finance Committee,

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held a hearing on IRS' actions on the report's recommendations during which we testified (GAO/T-GGD-89-6). In addition, we have an ongoing review to monitor IRS' progress.

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**Transition Series:  
Internal Revenue  
Service Issues**

(GAO/OCG-89-26TR, 11/88)

In this report, which was part of a series of reports presenting GAO's views on the most pressing issues facing the new Administration during the next few years, we summarized several tax administration issues that need closer management attention. If these issues are not addressed, the Commissioner can expect (1) serious problems in processing tax returns, (2) a decline in taxpayer confidence in the tax system, and (3) a significant loss in tax revenues that could help reduce the deficit.

IRS needs to modernize its information technology, strengthen human resources, improve collection activities, and narrow the tax gap. As discussed fully in our report on overall management at IRS (see p. 42), and in other GAO reports and testimonies, IRS has agreed to take steps to address many of these issues. The Commissioner of Internal Revenue will need to direct and encourage these efforts to improve overall management of the Nation's tax system and to collect additional revenues.

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## Transition Series: The Budget Deficit and Revenue Options

(GAO/OCG-89-1TR and GAO/OCG-89-3TR, 11/88)

In these reports, which were part of a series of reports presenting GAO's views on the most pressing issues facing the Administration during the next few years, we addressed the need to resolve one of the most urgent problems facing the Nation today—the budget deficit. Unless this problem is solved—including finding ways to finance the growing list of unavoidable, but so far unfunded, costs—it will hamstring the Administration's ability to achieve other vital policy goals, it will make it very difficult to begin addressing the Nation's unmet needs, and it could sap our long-run economic vitality.

The situation is even worse than it seems. The reported deficit understates the real situation. And many unfunded costs, such as an insolvent savings and loan insurance fund, confront the Administration. We also presented several examples in which federal agencies are undertaking badly needed modernization of key computer and telecommunications systems, which involve substantial capital investment and operating costs. One such example is IRS' Tax System Redesign, which is expected to cost several billion dollars over the next 10 years.

Any agreement on budget numbers will likely unravel quickly unless there is also agreement on how the numbers will be achieved. On the basis of past experience, it will be extremely difficult to bring down the deficit solely through management efficiencies and spending cuts. Many people, including those involved in our domestic and overseas financial markets and institutions, would not view a deficit reduction effort as credible without some revenue increases. Therefore, the Congress and the Administration must carefully consider the advantages and disadvantages of various revenue options available to deal with the deficit. There are no quick or painless solutions. The problem can only be solved by hard, good faith political bargaining between the Administration and the Congress.

Our report on revenue options discusses certain frequently proposed options such as raising income tax rates, broadening the income tax base, enacting a consumption tax, increasing revenue from federal excise taxes, and strengthening IRS enforcement. A combination of these options could emerge because each option alone has some drawbacks.

For example, although we strongly support more rigorous enforcement of the tax laws, hiring and training the thousands of needed revenue agents will take several years. The administrative costs will be large

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before significant results are seen, and even then the revenue yield will be modest compared to the enormity of the problem.



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## Life Insurance

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### Congress Revised Taxation of Single Premium Life Insurance

(GAO/T-GGD-88-20, 3/15/88)

Single premium life insurance policies provide a device for capturing investment income without reflecting it on an income tax return. The policies allow one large premium to be paid up-front and combine death benefits with earnings that accumulate tax-free. Policyholders can also obtain loans from the policies at little or no cost because the income on funds invested is used to offset the interest charged to borrowers. Between 1984 and 1987, sales of single premium life policies grew 850 percent, from \$1 billion to \$9.5 billion. During the same period, the premiums on sales of other than single premium life insurance policies grew 20 percent, from \$8.3 billion to \$10 billion.

During hearings before the Subcommittee on Select Revenue Measures, House Committee on Ways and Means, we discussed several aspects of single premium life insurance policies which were initially addressed in our report Taxation of Single Premium Life Insurance (GAO/GGD-88-90BR, 10/16/87).

We expressed our conclusion that the tax advantages of single premium policies were inconsistent with congressional efforts to limit the favorable tax treatment once afforded investment-oriented life insurance products. We pointed out that single premium policies require large initial premiums, thus favoring individuals who have enough wealth to afford these sums. The policies offered low- or no-cost loans, which policyholders did not have to reflect on tax returns, thus providing tax-free investment income. These distributions tended to be similar to distributions from deferred annuities, which are taxed.

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### Recommendation(s) to Congress

We recommended that Congress consider legislative remedies that would eliminate the tax advantage associated with investment-oriented single premium life insurance products. We discussed two alternative approaches—one would treat tax loans from single premium policies as income in the year withdrawn, the other would remove favorable tax treatment from policies if loans reduced death benefits below certain levels.

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

One intention of the Technical and Miscellaneous Revenue Act of 1988 was to discourage the purchase of life insurance as a tax-sheltered investment vehicle. The act created a new category of products called modified endowment contracts—any policy funded at a more rapid rate than seven equal annual premiums. The act required that loans or other amounts received from these contracts would be taxable to the extent of the interest that had built up inside the policies. Thus, single premium policies would be classified as modified endowment contracts, and loans from them would be taxable. This provision, therefore, is consistent with the thrust of our recommendation.

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## Congress Restricted Mortality Charges on Single Premium Life Insurance

(GAO/GGD-88-95, 6/14/88; GAO/GGD-88-120FS, 8/8/88)

In June 1988 we reported to Congressman Fortney H. (Pete) Stark on the mortality charges (those related to the insured's age, health, and probability of death) in single premium life insurance policies. Life insurance companies set their premiums based on the mortality charges specified in policies. This made it possible to enhance a policy's investment potential, because companies could specify mortality charges in excess of those normally considered reasonable for a life insurance contract. Higher mortality charges could be used to provide insurance to individuals who were considered substandard risks. They could also be used, however, to artificially inflate premiums for individuals normally considered standard risks.

On investment-oriented products like single premium life insurance, policyholders, by paying higher premiums, could shelter more money for investment. In an examination of 40 single premium life insurance policies that had been filed with the District of Columbia, we found that 8, or 20 percent, stated a maximum mortality charge that was based on a rate of at least 200 percent, or 2 times the standard rate. Sixteen other policies specified mortality rates from 1.1 to 1.9 times the standard rate.

At the time of our report, several alternatives had been offered to eliminate tax advantages associated with single premium life insurance (see our related report on p. 47). Whichever alternative might be chosen, we concluded that it should limit the tax advantages associated with using mortality charges to enhance the investment attributes of a life insurance contract.

In August 1988, we issued a subsequent report to Congressman Stark in response to questions about whether higher mortality charges in the policies we reviewed resulted from a District of Columbia law that prohibited insurers from discriminating because of Acquired Immune Deficiency Syndrome. Of the 40 policies in our sample, over 40 percent were filed before the District's anti-discrimination law was enacted. The same 40 policies were filed in the State of Maryland, which did not have a similar anti-discrimination law. With one exception, the mortality charges specified in the policies filed in Maryland were the same as those specified in the policies filed in the District.

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**Summary of Related  
Action(s)**

The information in these reports was used extensively in the House of Representatives' mark-up of proposed tax legislation, which evolved into the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647, dated November 10, 1988). The act, among other things, limited the ability of life insurers to specify unreasonable mortality charges in a life insurance policy.

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## Information on the Stock and Mutual Segments of the Life Insurance Industry

(GGD-88-88FS, 9/26/88; GAO/T-GGD-88-54, 9/27/88)

In a fact sheet to the Chairmen of the Subcommittees on Health and on Select Revenue Measures, House Committee on Ways and Means, and in testimony before the latter Subcommittee, we provided information on the stock and mutual segments of the life insurance industry. These products updated information in a previous fact sheet (GAO/GGD-86-31FS, 12/12/85).

This fact sheet presented numerical data on both segments of the life insurance industry with regard to insurance in force, insurance issued, investment yields, assets held, and taxes incurred for calendar years 1984, 1985, and 1986. According to the data, mutual companies (which are owned by their customer policy holders) accounted for a higher percentage of total industry assets than stock companies, while stock companies (which are owned by shareholders who may or may not be customers) accounted for a higher percentage of total insurance in force, premium income, and new insurance issued.

The amount of federal income tax incurred by the life insurance industry rose from \$2.8 billion in 1984 to \$4.7 billion in 1986. Of the 1986 amount, mutual companies accounted for \$2.4 billion and stock companies accounted for \$2.3 billion. The \$4.7 billion total included \$3.2 billion in taxes incurred on realized capital gains, a figure significantly higher than the combined 1984 and 1985 tax on realized capital gains of \$1.2 billion.

Congress had envisioned, when it changed the way life insurance companies were taxed as part of the Deficit Reduction Act of 1984, that mutual companies would account for 55 percent of the industry's taxes. As noted in our testimony, however, the mutual segment accounted for only 44 percent of industry taxes for 1984, 49 percent for 1985, and 51 percent for 1986. Our testimony also included preliminary observations on the effectiveness of section 809 of the Internal Revenue Code, which was enacted to equitably allocate taxes between the stock and mutual segments (known as segment balance).

We noted that if segment balance were evaluated in terms of a 55/45 mutual-stock breakdown, balance was not achieved over the 1984 through 1986 period. But if segment balance were evaluated by determining whether the mutual-stock breakdown of taxes is consistent with the breakdown of income, the conclusion might be different. For the

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period 1984 through 1986, the segment balance of taxes appears consistent with the segment balance of income as computed using section 809.

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## Tax-Exempt Bonds

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### Tax-Exempt Mortgage Bonds Have Been Better Targeted to Those in Need

(GAO/RCED-88-111, 3/28/88; GAO/RCED-88-190BR, 6/27/88)

Tax-exempt Qualified Mortgage Bonds (QMBS) are to provide financial assistance to first-time home buyers who would not be able to buy a home otherwise. We found that QMBS, which are issued by state and local housing authorities, benefit mostly those who could afford homes without such assistance and have done little to increase home affordability for low- and moderate-income people. Using a standard mortgage affordability test, about two-thirds of those in our sample of 178,000 buyers receiving bond-assisted mortgage loans from January 1983 to June 1987 could have probably bought the same house at the same time with either a market-determined, fixed-rate or adjustable-rate loan.

We concluded that QMBS, besides helping those who did not need it, were costly and inefficient. Every \$1 billion in bonds issued cost the federal government about \$150 million in lost tax revenue over their life. We compared the benefits to home buyers with the cost to the federal government and found that the benefits ranged from 12 cents to 45 cents for every dollar of cost.

On the basis of our analysis of these and other aspects of qualified mortgage bonds, we concluded that QMBS accomplish little when compared with the tax revenue foregone by the federal government. Accordingly, we questioned whether QMB issuance authority, which was due to expire on December 31, 1988, should be extended and we discussed certain issues that Congress should consider in conjunction with deliberations on extending that authority.

In a briefing report to Congressman Jim Moody (GAO/RCED-88-190BR, 6/27/88), we provided supplemental information on various ways the eligibility criteria could be tightened to better target QMB assistance for first-time home buyers. Existing income and purchase price eligibility standards could be changed. Household size or age eligibility standards could also be established so that those who are eligible would not have the same characteristics as unassisted first-time buyers. A portion of the subsidy could be recaptured from house price appreciation.

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Matter(s) For  
Consideration by Congress

If Congress chose to extend bond issuance authority, we suggested that it limit the assistance to those who could not otherwise afford a home. Even so, the buyer's benefit would continue to be relatively small and QMBS, as a mortgage assistance device, would remain cost-ineffective.

If Congress chose not to extend the authority, we suggested that it consider reducing the private activity bond volume cap accordingly. QMBS are just one type of bond that can be issued within annual volume limitations established by the Tax Reform Act of 1986. If the cap were not reduced, other tax-exempt bonds could be issued in place of the QMBS, and the revenue loss to the federal government would remain unchanged.

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Action(s) Taken and/or  
Pending

Congress extended the authority to issue QMBS through December 31, 1989, as part of the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647, dated November 10, 1988). The act also tightened the targeting rules for QMBS. Among other things, it modified the income restrictions to reflect different housing costs and family sizes and provided for a recapture of a portion of the subsidy if the property is sold within 10 years.



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**Administrative  
Changes Could Help  
IRS Enforce the  
Volume Limit on Tax-  
Exempt Bonds Issued  
for Tax-Exempt  
Organizations**

(GAO/GGD-89-7, 10/14/88)

Section 145 of the Internal Revenue Code, which was enacted as part of the Tax Reform Act of 1986, imposes a \$150 million volume limit on outstanding bonds (with the exception of hospital bonds) issued by state or local governments on behalf of individual tax-exempt organizations. These tax-exempt organizations, as defined under section 501(c)(3) of the Code, can use tax-exempt bonds to finance, among other things, housing for the elderly.

When state and local governments issue private activity tax-exempt bonds, the governmental unit must file an information return (Form 8038) with IRS. The filer indicates on the form whether a bond is a qualified 501(c)(3) bond. The 1987/1988 form, however, did not identify the 501(c)(3) organization that would use the proceeds of the issue. Because IRS could not link particular bond issues with individual 501(c)(3) organizations, it could not easily enforce the \$150 million limit on the outstanding bonds of an individual 501(c)(3) organization.

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**Recommendation(s)**

We recommended that the Commissioner of Internal Revenue require that the employer identification number of the users of qualified 501(c)(3) bonds be reported on Form 8038. With such data, IRS could make computer checks to ensure that organizations complied with the Code.

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

The Commissioner of Internal Revenue agreed with our recommendation and had the Form 8038 revised accordingly. In responding to our report, the Commissioner said that once the employer identification numbers became available, IRS would develop and implement a compliance program to ensure organizations adhered to the Code.

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## Information Reporting Needed on Tax- Exempt Interest Income

(GAO/GGD-89-14, 12/19/88)

The federal tax code is designed to tax net income—gross income minus expenses incurred in the production of that income. If a deduction for interest expense incurred to produce tax-exempt income is allowed, a taxpayer can engage in what is called arbitrage by using the deduction to offset other taxable income. Internal Revenue Code section 265 disallows the deduction of interest expense associated with tax-exempt income. The amount of disallowed interest expense is calculated in a different manner for financial institutions than for individuals and nonfinancial corporations.

We found that parts of section 265 are difficult to administer, and little is known about how well taxpayers comply with this section.

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## Recommendation(s)

To improve its administration of section 265, we recommended to the Commissioner of Internal Revenue that IRS

- study the costs and benefits of requiring information reporting for tax-exempt interest income, and
- consider changing Schedule L on the U. S. Corporation Income Tax Return to separately identify tax-exempt securities from other securities.

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## Action(s) Taken and/or Pending

IRS said it would solicit information on tax-exempt interest income in its Taxpayer Compliance Measurement Program. It pointed out, however, that this data would not provide enough information to fully evaluate the costs and benefits of requiring information reporting on such income. IRS said that further research is needed on using its measurement program data to determine compliance with section 265, and we are working with IRS in that regard.

IRS also said that its Tax Forms Coordination Committee will consider the recommended change when developing the 1989 corporate form.

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## Tax-Exempt Organizations

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### Competition Between Tax-Exempt Organizations and Taxable Businesses

(GAO/T-GGD-88-43 (6/28/88))

In testimony before the House Committee on Small Business, we presented information on the nature and extent of competition between tax-exempt organizations and taxable businesses. The testimony summarized information in our 1987 report on this subject (GAO/GGD-87-40BR, 2/27/87).

We said that complete information does not exist to quantify the exact nature, extent, and impact of competition between the tax-exempt and taxable business communities. We pointed out, however, that tax-exempt organizations have apparently become more reliant on income-producing activities and less reliant on charitable and government sources of revenue to fund their activities.

The business community is voicing increased concern about competition from tax-exempt organizations' income-producing activities. While some representatives of tax-exempt organizations believe that these activities further their exempt purposes, representatives from taxable businesses view income producing activities as exceeding the traditional role of tax-exempt organizations.

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### Summary of Related Action(s)

The House Ways and Means Subcommittee on Oversight has continued its development of a legislative proposal to revise the unrelated business income tax in those instances in which tax-exempt organizations' activities are unrelated to their tax-exempt purposes.

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**Tax Law Compliance  
of Churches and Tax-  
Exempt Religious  
Organizations**

(GAO/GGD-88-84, 8/11/88)

This report to Congressman Charles Rangel presents information on how IRS ensures tax law compliance by churches and other religious organizations. It also provides information on the difficulties IRS has identified in ensuring that churches are complying with the tax laws.

IRS believes it has difficulty in assuring that churches comply with the tax laws because of the (1) lack of information it receives on churches; (2) special audit procedures required by law; and (3) complexity of issues common to all tax-exempt organizations, which can also affect churches.

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**Summary of Related  
Action(s)**

As part of its oversight of IRS activities, the House Committee on Ways and Means is receiving quarterly reports from IRS on examinations of tax-exempt religious organizations—particularly those dealing with religious broadcasters and evangelists.

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## Full Disclosure of Information on Tax Returns for Tax- Exempt Organizations Is Needed

(GAO/GGD-88-128, 9/30/88)

Each year, over 300,000 tax-exempt organizations file annual information returns (Form 990) with IRS. These returns are designed to provide IRS and the public with detailed information useful for monitoring tax-exempt organizations' activities and their sources and uses of funds. In addition, 32 states accept the Form 990 for state reporting purposes. IRS makes the Form 990 available for public inspection and has an Incomplete Returns Program that is designed to identify whether tax-exempt organizations file complete annual information returns.

In this report to the Chairman of the Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, we reported on the availability and completeness of Form 990s. On the basis of an analysis of 450 sample Form 990s and discussions with IRS officials, we found the following:

- IRS could usually locate and provide a requested Form 990 if the name the organization used to obtain tax-exempt status was provided. Returns that could not be provided were usually being used by somebody in IRS.
- Almost half of the Form 990s were missing supporting schedules, such as for investments or payments to affiliates, required by filing instructions and needed for public inspection and tax administration purposes. Even with the missing schedules, most of the sample Form 990s were considered complete under IRS' Incomplete Returns Program criteria.

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## Recommendation(s)

To ensure full disclosure of tax-exempt information, we recommended to the Commissioner of Internal Revenue that IRS:

- (1) Establish procedures to ensure that copies of requested Form 990s being used internally are provided to requesters.
- (2) Expand the criteria for the Incomplete Returns Program to ensure that missing supporting schedules are obtained from tax-exempt organizations.

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## Action(s) Taken and/or Pending

IRS agreed with our recommendations and has taken steps to implement them. IRS has issued procedures to provide the Form 990s to those requesting them, and plans to monitor compliance with these procedures. IRS is also evaluating the schedules required in support of Form 990 to determine whether any can be required in a standardized format

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or eliminated altogether. We believe requiring forms in a standardized format will make it easier for IRS field personnel to determine if schedules are missing and will better ensure that exempt organizations provide IRS complete information.

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## Taxpayer Service

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### IRS' Service Centers Need to Improve Handling of Taxpayer Correspondence

(GAO/GGD-88-101, 7/13/88; GAO/T-GGD-88-47, 7/13/88)

We reviewed a random sample of 718 letters that tax examiners in the Adjustments/Correspondence Branches at three IRS service centers sent to taxpayers from May 4 to July 31, 1987. On the basis of our review, we reported that (1) 31 percent of the letters sent by those three centers during the time period had critical mistakes in that accounts were incorrectly adjusted or taxpayers' questions were not answered or were answered incorrectly and (2) another 16 percent had less critical mistakes involving such things as unclear or incomplete letters. We also found that 68 percent of the cases did not comply with IRS procedures, such as sending acknowledgment letters, that were designed to enhance IRS' service to taxpayers.

These sorts of correspondence problems can lead to incorrect determinations of tax and penalties. They can also confuse and frustrate taxpayers, increasing the correspondence workload as taxpayers write again trying to resolve the same issue.

In our report and in testimony before the Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, we discussed several factors that may have contributed to the problems we noted. Those factors included a computerized letter writing system that did not allow the examiner to view the completed letter, the need for improved quality assurance, and the need for improved training and supervision. We also discussed the job requirements and pay levels of those service center employees (known as tax examiners) who respond to taxpayers.

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### Recommendation(s)

We recommended that the Commissioner of Internal Revenue (1) ensure that the system IRS is developing to help tax examiners compose letters to taxpayers allows examiners to view letters after they have been composed; (2) report separately the quality assurance rates associated with Adjustments/ Correspondence Branch work involving correspondence sent to taxpayers; and (3) determine whether the qualifying requirements, the quality and quantity performance standards, and the opportunities for advancement for the Branch's tax examiner position need to be revised.

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Action(s) Taken and/or  
Pending

IRS agreed with our recommendations. In May 1989, IRS said that (1) a new system for composing letters would be fully implemented by the end of July 1989 and would allow tax examiners to view the completed letter as well as print copies at a location close to their offices; (2) a program has been developed for tracking correspondence errors; and (3) some service centers are testing use of new "super tax examiners" and assigning them only the most complex correspondence cases.

As part of its budget request for fiscal year 1990, IRS asked for \$2 million and 52 positions to finance the use of a computerized system to monitor the quality and accuracy of correspondence. In asking for those resources, IRS said it would analyze error trends and take corrective action by providing additional training, management oversight, and clerical support.



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## Concerns About IRS' Telephone Assistance Program

(GAO/T-GGD-88-47, 7/13/88)

In testimony before the Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, we discussed the results of 1,908 test calls we made to 29 of IRS' 32 telephone assistance call sites from February 9 through April 15, 1988. We noted that:

- IRS' telephone assistors correctly answered GAO's test questions 64 percent of the time; in the other 36 percent, the answers were incorrect.
- The types of questions that posed the most difficulty were those that required probing and those that related to recent changes in the tax law.
- Several factors that influenced the accuracy of assistors' responses to questions included training, working conditions, turnover among experienced assistors, and the large number of new hires each year.

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## Summary of Related Action(s)

Because of continuing concerns about the Telephone Assistance Program, IRS established an Integrated Test Call Survey System. The System is designed to (1) enable IRS to measure the accuracy of answers it gives taxpayers who call IRS call sites and (2) provide diagnostic feedback to improve the quality of IRS' customer service. We are working closely with IRS in developing and refining this system.

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## Other

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### Tax Data Needed to Verify the Accuracy of Beneficiary Income Reporting Under the Veterans' Pension Program

(GAO/HRD-88-24, 3/16/88)

Annually, the Veterans Administration (VA) pension program pays about \$4 billion to 1.6 million persons. Eligibility and payment amounts mostly depend on beneficiaries' incomes, and VA relies almost entirely on beneficiaries' self-reporting. We compared the earnings data for VA's entire file of pension beneficiaries on the rolls as of November 1984 with appropriate 1984 tax data.

Of the 1.4 million VA pension recipients included in our match, 549,000 had \$947 million more income on tax records than was recorded on VA records. We estimated that VA, by not including this income in its pension calculations, made potential overpayments of \$182.5 million. Of the potential overpayment cases:

- More than 26,000 beneficiaries reported no earned income to VA, but tax data showed individual earnings of at least \$1,000. Some beneficiaries had reported no earnings over several years, although tax data showed significant earnings in those years.
- About 60 percent of the cases were solely attributable to unrecorded interest and dividend income.

Pension beneficiaries' self-reported year-end income adjustments would have allowed VA to identify and act on approximately \$25.3 million in potential overpayments. VA would have been unable to identify the remaining \$157.2 million in potential overpayments to 134,200 beneficiaries because it lacks access to tax data.

The most practical means to verify self-reported beneficiary income is to allow the VA pension program access to third-party-reported tax data, such as information on interest earned on bank accounts. Use of such tax data would increase VA's pension program effectiveness and could save millions of dollars. Moreover, the monetary benefits of using this data to verify income appear to outweigh costs by a ratio of at least 11 to 1.

We addressed, in our report, various IRS concerns about authorizing the VA pension program access to tax data and the potential effects of using tax data for nontax purposes on taxpayer privacy and compliance with

the tax laws (see page 75 for more information on this subject in the context of another VA program). IRS was concerned, for example, that our cost estimates did not include any potential revenue losses from decreased compliance with the laws. We noted that IRS had no data to show whether there has been any change in voluntary compliance as a result of access to tax information for nontax administration purposes.

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**Recommendation(s) to Congress**

Given the potential savings and the absence of data on potential adverse consequences to the tax system and taxpayer privacy, we recommended that Congress amend the Internal Revenue Code to allow VA to access tax information so that VA can prevent improper payments by verifying the income information that pension program beneficiaries report.

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

On March 17, 1988, the Senate Committee on Veterans' Affairs expanded on the scope of our recommendation and proposed amending Section 6103(d)(7) of the Internal Revenue Code to grant VA access to tax return data to verify income and eligibility for any needs-based pensions provided under any program administered by VA. The Congressional Budget Office prepared a cost/savings analysis indicating that if enacted and implemented by VA, the bill would result in net savings of \$698 million over 5 years. A measure containing these provisions (S. 2011) was passed by the Senate on October 18, 1988.

The House Committee on Veterans' Affairs, on September 16, 1988, reported out similar provisions as part of a separate bill (H.R. 5114) and referred the measure to the House Committee on Ways and Means. However, on September 19, 1988, before the Ways and Means Committee could complete its consideration of the measure and by mutual agreement with its Chairman, the Chairman of the Veterans' Affairs Committee withdrew the tax-data-access provisions from the bill.

Proposed legislation to grant VA's successor Department of Veterans' Affairs access to tax return information for income verification purposes was reintroduced in Congress during 1989. As of June 30, 1989, no tax-data-access legislation had been enacted.

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**Information on  
Interest Deducted for  
Financing Mergers Is  
Not Available**

(GAO/GGD-88-58, 3/29/88)

This report to Congressman William J. Coyne describes the lack of government data on tax-deductible interest used to finance mergers. We found that the Federal Trade Commission does not need and therefore does not collect information on how mergers are financed. IRS does not require that the interest expense associated with mergers be separately identified from other interest expense. The Securities and Exchange Commission collects some data relating to the financing of corporate mergers; but because debt refinancings cannot always be identified, an accurate indication of the total amount of interest eligible for deduction is not available.

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**Summary of Related  
Action(s)**

The report was used in conjunction with various congressional hearings held during the first 3 months of 1989 on leveraged buyouts, which are currently being used as a method of financing corporate mergers.

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**1987 Annual Report  
on GAO's Tax-Related  
Work**

(GAO/GGD-88-89, 06/06/88)

This report is a compilation of GAO's work on tax policy and administration matters in 1987. It contains (1) open recommendations to Congress from reports issued during and prior to 1987; (2) tax-related recommendations made during 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; (3) a listing of GAO products on tax matters issued during 1987 and summaries of each of those products; (4) a listing of testimonies on tax matters during 1987; and (5) a listing of assignments for which GAO was authorized access to tax returns and return information during 1987.

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## Preliminary Analysis of the Research and Experimentation Tax Credit

(GAO/GGD-88-98BR, 6/17/88)

This briefing report to Congressman Brian Donnelly contains our preliminary analysis of the research and experimentation tax credit. The credit is allowed for qualified research expenses paid or incurred by a taxpayer for a specified tax period. The report covers the period 1981 through 1984 for large corporations—those with assets of \$150 million or more. We analyzed income tax return data for a sample of 927 of these corporations, which accounted for about 70 percent of the credit claimed during that period.

The report contains tables on (1) who used the credit; (2) when the credit was used (e.g., the year it was earned or later years); and (3) how much of the credit was earned and used in relation to growth in research expenditures.

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## Summary of Related Action(s)

The Technical and Miscellaneous Revenue Act of 1988 linked, for the first time, the research credit with deductions for research expenditures on the same research dollar. The act requires taxpayers who expense or amortize research expenditures to first deduct an amount equal to 50 percent of the research credit claimed from those expenditures.

The act also requires that GAO report by December 31, 1989, on (1) the credit's effectiveness in stimulating investment, (2) IRS' performance in assuring that taxpayers who use the credit comply with the Internal Revenue Code, and (3) alternatives to the credit's current structure. As of June 30, 1989, our work was proceeding on schedule.

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## Data on IRS' Investigations of Employee Misconduct

(GAO/GGD-89-13, 11/18/88)

This report to the Chairman, Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, analyzed data that the Subcommittee received from IRS on its investigations of alleged misconduct, such as bribery and embezzlement, by IRS employees. The data categorized the nature and results of 3,861 investigations of alleged employee misconduct that IRS' Internal Security Division had completed from 1984 through 1987. IRS extracted the data from its Internal Security Management Information System, which was designed to record and manage Internal Security investigations.

We made a detailed analysis of 2,633 of these investigations and identified numerous errors due to invalid and missing codes.

Invalid codes are those shown in the system data but not listed among Internal Security's prescribed codes. Missing codes involve those characteristics, such as the disposition of the closed investigation, that should have been, but were not, coded in the system's data. On the basis of our analysis of the data, we concluded that the management information system could not be used to gain a broad perspective of IRS' investigations into alleged employee misconduct.

IRS said that the data contained coding errors because the system did not contain sufficient validity checks. Because complete and accurate data cannot be assured, IRS said it plans to replace its current management information system with a better one by the end of fiscal year 1989.

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## Summary of Related Action(s)

At the Subcommittee's request, we intend to examine IRS' plans for the new system to determine whether it will overcome the deficiencies existing in the current system.

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# Summaries of Tax-Related Products Issued Before 1988 With Open Recommendations to Congress

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**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.

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**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. A 45-day processing period would make treatment of amended returns consistent with the treatment of original income tax returns.

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

No action had been taken or planned as of June 30, 1989.

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**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 at the time we prepared our report, IRS had been able to process over 90 percent of income-based refunds within 45 days even though the volume of these refunds was much higher than non-income-based tax refunds.

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**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. A 45-day processing period would make the treatment of non-income-based returns consistent with most income-based returns.

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

No action had been taken or planned as of June 30, 1989.

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**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. Many independent importers may have been unaware of the tax and, therefore did not pay; while others may not have believed the tax applied to them. 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 believed that the revenue lost through independent importers' noncompliance with the tax law was a problem, and it took a number of actions to improve compliance. These actions alone, however, may not reduce the gas guzzler tax noncompliance.

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

Because significant IRS resources could be involved in identifying and following up with numerous importers who owe small amounts of the gas guzzlers tax, 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.

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

The Joint Committee on Taxation presented several proposals for increasing gas guzzler tax revenue in a June 1987 pamphlet that contained a listing of possible revenue sources. One of these proposals involved having Customs, rather than IRS, collect the tax on all imported vehicles, as we suggested. No further action was taken as of June 30, 1989.

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**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 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 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. At the time we did our work, SSA had not certified any earning 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 the \$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.

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

To provide an incentive for more timely reconciliation of earnings, 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 Health and Human Services 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.

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

No action had been taken or planned as of June 30, 1989.

## Congress Should Consider Amending the Internal Revenue Code to Permit VA Access to Certain Tax Information

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

VA generally requires veterans to report their annual earnings when they apply for or receive individual unemployability compensation benefits associated with service-connected disabilities. Veterans with earnings above marginal amounts are not eligible for some unemployability 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 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

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**Appendix II  
Summaries of Tax-Related Products Issued  
Before 1988 With Open Recommendations  
to Congress**

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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. Further, this information is gathered for a specific purpose—revenue gathering. The dilemma is whether, in the context of tax administration, personal information required for one purpose 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 tax information used for verification and (2) the individual would receive appropriate notification before any action was taken relating to benefits.

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**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.

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

While several proposals had been introduced, no tax-data-access legislation had been enacted as of June 30, 1989. Proposed legislation to grant VA's successor Department of Veterans Affairs access to tax return information for income verification purposes was reintroduced in Congress during 1989. (See p. 64.)

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# Legislative Actions Taken in 1988 on GAO Recommendations

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Congress Revised Taxation of Single Premium Life Insurance	47
Congress Restricted Mortality Charges on Single Premium Life Insurance	49
Tax-Exempt Mortgage Bonds Have Been Better Targeted to Those in Need	53
Congress Extended IRS' Tax Refund Offset Program for Defaulted Student Loans	78
Congress Acted to Obtain an IRS/SSA Plan for Resolving Differences in Employers' Earnings Reports	80
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## Congress Extended 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. Thus, we concluded that the tax refund offset program for defaulted student loans should be continued considering its low cost, high yield, and potential deterrent effect on taxpayers who may have contemplated defaulting on a student loan but did not because of this program.

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## Recommendation(s) to Congress

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

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## Action(s) Taken

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 report (GAO/GGD-89-60) was issued on April 25, 1989.



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**Appendix III  
Legislative Actions Taken in 1988 on  
GAO Recommendations**

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On October 13, 1988, Congress passed the Family Support Act of 1988 (Public Law 100-485), which extended the refund offset program to January 10, 1994.

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## Congress Acted to Obtain an IRS/SSA 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 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 had not been finalized at the time of our review). 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.

SSA and IRS had not adequately resolved differences in employers' earnings reports, nor had they addressed the causes of the differences. Many causes contributed to the 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 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.

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## 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 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.

Because SSA and IRS had been unable to jointly develop a plan to ensure that all differences in earnings reported by employers are reconciled in a timely manner, we suggested that Congress require 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.

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**Appendix III**  
**Legislative Actions Taken in 1988 on**  
**GAO Recommendations**

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**Action(s) Taken**

Following hearings by the House Select Committee on Aging's Subcommittee on Retirement Income and Employment, IRS and SSA signed an agreement in July 1988, detailing each agency's responsibility under the Combined Annual Wage Reporting System. We believe the agreement should result in a better understanding of what each agency is expected to do under the program. This agreement, if properly implemented, should help in assuring that all differences in earnings as reported by employers are resolved and would, therefore, respond to our recommendation.

The Subcommittees on Social Security and Oversight, House Committee on Ways and Means, held hearings in August, 1988, to review the IRS and SSA agreement, during which we presented our views on the agreement (see p. 32). In December 1988, we reported on the operation of IRS' Combined Annual Wage Reporting Reconciliation Program (see p. 36).

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## Congress Amended the Bad Check Penalty

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

Section 6657 of the Internal Revenue Code authorizes 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 stipulated that the penalty should 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 had remained unchanged since 1954, and IRS had 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 depositories 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 cost of \$6.47 per check. This occurred because the 1-percent penalty for bad checks written for larger amounts more than offset the cost to process checks written for smaller amounts.

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## Matter(s) for Consideration by Congress

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

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## Action(s) Taken

The Technical and Miscellaneous Revenue Act of 1988 increased the penalty to 2 percent of the check's amount. If the amount of the check

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**Appendix III**  
**Legislative Actions Taken in 1988 on**  
**GAO Recommendations**

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or money order is less than \$750, the penalty is the lesser of \$15 or the amount of the check or money order.

# Listing of Open Recommendations to Congress

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Congress Should Revise the Internal Revenue Code to (1) Significantly Increase the Penalty for Abusive Tax Shelters Above the Current 20 Percent of Gross Income Derived or to Be Derived from the Sale of an Abusive Tax Shelter and (2) Reduce the Level of Proof Needed to Apply the Penalty for Aiding and Abetting from "Knowingly" to "Knows or Reasonably Should Have Known" That an Understatement of Tax Liability Would Result	28
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Congress Should Amend the Internal Revenue Code to Allow VA Access to Tax Information So It Can Verify the Income Reported by VA Pension Program Beneficiaries	64
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# Listing of Recommendations Made in 1988 to the Commissioner of Internal Revenue

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Improve IRS' Administration of Alien Taxpayer Programs	20
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Improve IRS' Process for Estimating Examination Yield	30
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Improve IRS' Management to Assure Quality Service in the Future	42
Help Enforce the Volume Limit on Certain Tax-Exempt Bonds	55
Improve Administration of Section 265 Dealing With Tax-Exempt Interest Income	56
Promote Full Disclosure of Tax-Exempt Information	59
Improve IRS' Handling of Taxpayer Correspondence	61

# Chronological Listing of GAO Products on Tax Matters Issued in 1988

Title	Date
Testimony on the Status of the 1988 Tax Return Filing Season (GAO/T-GGD-88-13)	02/23/88
Testimony on Computer Support for Tax Processing Needs Continuing IRS Attention (GAO/T-IMTEC-88-1)	02/23/88
Testimony on Taxation of Single Premium Life Insurance (GAO/T-GGD-88-20)	03/15/88
Veterans' Pensions: Verifying Income With Tax Data Can Identify Significant Payment Problems (GAO/HRD-88-24)	03/16/88
IRS' Tax Gap Studies (GAO/GGD-88-66BR)	03/25/88
Mortgage Bonds Are Costly and Provide Little Assistance to Those in Need (GAO/RCED-88-111)	03/28/88
Information on Interest Deducted for Financing Mergers is Not Available (GAO/GGD-88-58)	03/29/88
Testimony on Why a Comprehensive Review of Civil Penalties Is Needed (GAO/T-GGD-88-24)	03/31/88
Computer Readiness for 1988 Filing Season (GAO/IMTEC-88-31)	03/31/88
Federal Estate Tax on Historic Properties (GAO/GGD-88-56)	03/31/88
Testimony on the Tax Gap (GAO/T-GGD-88-22)	03/31/88
Opportunities Exist for Improving IRS' Administration of Alien Taxpayer Programs (GAO/GGD-88-54)	04/11/88
Testimony on the 1988 Tax Return Filing Season and IRS' Fiscal Year 1989 Budget (GAO/T-GGD-88-30)	04/13/88
Investigating Illegal Income—Success Uncertain, Improvements Needed (GAO/GGD-88-61)	04/25/88
IRS' Tax System Redesign Progress and Plans for the Future (GAO/IMTEC-88-23BR)	04/27/88
IRS Could Reduce the Number of Unproductive Business Nonfiler Investigations (GAO/GGD-88-77)	05/24/88
Information Systems: Agencies Overlook Security Controls During Development (GAO/IMTEC-88-11) (GAO/IMTEC-88-11S)	05/31/88
1987 Annual Report on GAO's Tax-Related Work (GAO/GGD-88-89)	06/06/88
Mortality Charges on Single Premium Life Insurance Should be Restricted (GAO/GGD-88-95)	06/14/88
IRS' ADP Budget: Issues That Could Affect Funding of Personnel System Project (GAO/IMTEC-88-45)	06/15/88
IRS' ADP Budget: Funds for a Suspended Payroll Project Need Further Justification (GAO/IMTEC-88-44)	06/15/88
Need to Improve the Revenue Accounting Control System (GAO/IMTEC-88-41)	06/17/88
Preliminary Analysis of the Research and Experimentation Tax Credit (GAO/GGD-88-98BR)	06/17/88
Home Ownership: Targeting Assistance to Buyers Through Qualified Mortgage Bonds (GAO/RCED-88-190BR)	06/27/88
Testimony on Competition Between Tax Exempt Organizations and Taxable Businesses (GAO/T-GGD-88-43)	06/28/88
IRS' Service Centers Need to Improve Handling of Taxpayer Correspondence (GAO/GGD-88-101)	07/13/88
IRS' Progress on the Electronic Filing System (GAO/IMTEC-88-40)	07/13/88
Testimony on IRS Correspondence With Taxpayers and Its Telephone Assistance Program (GAO/T-GGD-88-47)	07/13/88
IRS' Efforts to Establish a Business Information Returns Program (GAO/GGD-88-102)	07/22/88
IRS' Abusive Tax Shelter Efforts Need Improvement (GAO/GGD-88-69)	07/25/88
IRS Can Reduce Processing Errors with Better Controls and Information (GAO/IMTEC-88-25)	08/02/88
Additional Information on Life Insurance Mortality Charges (GAO/GGD-88-120FS)	08/08/88
Difficulties in Accurately Estimating Tax Examination Yield (GAO/GGD-88-119)	08/08/88
Testimony on Resolving Differences in Wage Amounts Reported by Employers to the Internal Revenue Service and Social Security Administration (GAO/T-HRD-88-29)	08/09/88
Tax Law Compliance of Churches and Tax-Exempt Religious Organizations (GAO/GGD-88-84)	08/11/88
Evaluation of IRS' Refund Offset Study (GAO/GGD-88-117)	09/01/88
Accuracy of Taxpayer Identification Numbers on Information Returns Can Be Improved (GAO/GGD-88-110)	09/06/88
California Crude Oil: An Analysis of Posted Prices and Fair Market Value (GAO/GGD-88-114)	09/08/88

(continued)



**Appendix VI  
Chronological Listing of GAO Products on  
Tax Matters Issued in 1988**

<b>Title</b>	<b>Date</b>
Information on the Stock and Mutual Segments of the Life Insurance Industry (GGD-88-88FS)	09/26/88
Testimony on Taxes Incurred by, and Business Trends of, the Life Insurance Industry (GAO/T-GGD-88-54)	09/27/88
Follow-up Testimony on Comprehensive Review of Civil Penalties (GAO/T-GGD-88-55)	09/28/88
Availability and Completeness of Returns for Tax-Exempt Organizations (GAO/GGD-88-128)	09/30/88
Preliminary Data on Tax-Exempt Bonds Used to Finance Housing for the Elderly (GAO/GGD-89-7)	10/14/88
Managing IRS: Actions Needed to Assure Quality Service in the Future (GAO/GGD-89-1)	10/14/88
Transition Series: The Budget Deficit (GAO/OGC-89-1TR)	11/88
Transition Series: Revenue Options (GAO/OCG-89-3TR)	11/88
Transition Series: Internal Revenue Service Issues (GAO/OCG-89-26TR)	11/88
Effective Implementation of the Tax Reform Act Led to Uneventful 1988 Filing Season (GAO/GGD-89-2)	11/14/88
IRS' Data on Its Investigations of Employee Misconduct (GAO/GGD-89-13)	11/18/88
IRS' Combined Annual Wage Reporting Reconciliation Program (GAO/GGD-89-21)	12/14/88
Deducting Interest on Funds Borrowed to Purchase or Carry Tax-Exempt Bonds (GAO/GGD-89-14)	12/19/88

# Listing of Assignments for Which GAO Was Authorized Access to Tax Data in 1988

Subject matter	Objectives
Effectiveness of the Research and Experimentation Tax Credit	To (1) examine the credit as an incentive to investment and (2) determine IRS' effectiveness in assuring that taxpayers comply with rules that restrict the credit's use.
Revenue Yield From IRS' Examinations	To provide Congress with information on the reliability of assumptions used by IRS to estimate expected revenue yields from increased examination resources.
IRS' Enforcement of the Employee Retirement Income Security Act of 1974	To determine how many plans are reviewed, how many plans are cited for violations, what the major violations are, and what sanctions are imposed.
IRS' Administration of Civil Penalties	To determine (1) whether IRS is assessing four civil penalties fairly and consistently, (2) how adequate the information is that IRS relies on in assessing and abating the penalties, (3) how often and to whom these penalties are applied, and (4) if these civil penalties are effective.
IRS' Information Returns Program	To determine (1) how accurately the program identifies potential underreporters and nonfilers, (2) how effectively IRS communicates with taxpayers that have potentially underreported their income or did not file tax returns, and (3) how effectively IRS resolves unagreed cases.
IRS' Civil Penalties Study	To monitor the progress of IRS' penalty task force and to comment on its report.
IRS' Tax-Exempt Organizations Examination Program	To evaluate (1) IRS' efforts to select the most appropriate tax-exempt returns for examination, (2) the effectiveness of the examinations conducted, and (3) revocations of tax-exempt status.
IRS' Administration of Civil Penalties	To determine (1) whether IRS is assessing several civil penalties fairly and consistently, (2) how adequate the information is that IRS relies on in assessing and abating the penalties, (3) how often and to whom these penalties are applied, and (4) if these civil penalties are effective.
Charity-Issued Tax-Exempt Bonds to Finance Housing for the Elderly	To determine (1) the extent of new tax-exempt bond issues, (2) the effect of current law restrictions, (3) IRS' procedures in granting 501(c)(3) organizations tax-exempt status, and (4) the effect this financing vehicle has had on other housing programs.
Tax-Exempt Bond Issuance Costs	To (1) determine the average issuance costs for tax-exempt bonds, (2) evaluate whether limits should be placed on issuance costs, and (3) determine if limits would restrict the ability of state and local governments to issue bonds.

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