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Report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

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TAX ADMINISTRATION

Increased Fraud and Poor Taxpayer Access to IRS Cloud 1993 Filing Season

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The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

This report responds to your request that we assess the Internal Revenue Service's (IRS) performance during the 1993 tax filing season. We discuss the processing of tax returns, including the growth in fraudulent electronic returns; the accuracy and accessibility of toll-free telephone assistance; and the availability of tax materials to taxpayers.

Results in Brief

In the several years preceding 1993, the number of individual income tax returns filed increased consistently from year to year, and IRS expected another increase in 1993. As of April 30, 1993, however, about 2 million fewer individual income tax returns had been filed than during the comparable period in 1992. IRS believes that a major reason for the decrease is the change in withholding tables for tax year 1992, which caused fewer taxpayers to receive refunds and more to owe taxes—many of those owing taxes apparently choosing not to file a return. This occurred despite IRS' easing the way for taxpayers to pay taxes owed in installments. Almost anyone could qualify for an installment agreement simply by filing a request with his/her tax return. IRS also believes that the change in withholding tables contributed to a smaller-than-expected electronic filing growth.

Although the number of income tax returns filed decreased, IRS, as of August 31, 1993, identified about 54,000 returns involving fraudulent refund claims, about twice as many as were identified by IRS in 1992. It is unclear how much of the increase is due to more fraud and how much is due to improved IRS monitoring. What does seem clear is that the harder IRS looks, the more fraud it finds.

Electronic filing fraud is a particular problem for IRS because the speed with which refunds on electronic returns are processed leaves little time for IRS to stop fraudulent refunds before they are issued. IRS identified more fraudulent electronic refunds in 1993 than in 1992, continuing the trend of annual increases in fraudulent refund claims since electronic filing became available nationwide in 1990. IRS took several steps in an attempt to better combat electronic fraud in 1993. For example, IRS implemented an up-front computer check to verify that taxpayer names and Social Security numbers on returns matched information in IRS' records.

IRS plans other changes for 1994. For example, IRS provides tax return preparers who offer electronic filing with an indicator on whether IRS is going to honor a taxpayer's request for a direct deposit of a refund. That indicator is needed before a bank will give taxpayers Refund Anticipation Loans (RAL)—loans that enable taxpayers to quickly get money while their refunds are being processed. Because RALS create a climate more conducive to fraud, IRS has decided to change its procedures for first-time filers, a group responsible for a large portion of fraudulent electronic returns filed in past years.[1] Although first-time filers will be allowed to continue using electronic filing, they will not be allowed to get a direct deposit, thus, in effect, precluding them from getting RALS.

We believe that IRS can do other things to improve its ability to identify and stop fraudulent electronic refunds. It could, for example, analyze information provided by banks on rejected RAL applications to see if the information might be useful in improving the profile used by IRS' computers to screen electronic returns for potential fraud.

Except for the continuing problem with fraud, IRS indicators show that it did a good job processing returns during the 1993 filing season. According to IRS data, for example, most refunds were issued quickly and accurately. IRS also implemented procedures that (1) allowed it to make more accurate eligibility determinations on returns where taxpayers claimed the Earned Income Credit (EIC)[2] and (2) made it easier for taxpayers to obtain installment agreements. If IRS decides to continue the latter effort in 1994, it should allow taxpayers requesting an installment agreement to file the request form electronically.

IRS' data showed that toll-free telephone assistors did a good job answering tax law questions, and distribution centers did a good job responding to taxpayers' requests for forms, instructions, and publications. However,

[1]A first-time filer is a taxpayer who has not filed a return as a primary taxpayer during the last 10 years. Such a filer could be either an individual entering the tax system for the first time or a taxpayer who is filing separately after 10 or more years of filing a joint return and being classified as a secondary taxpayer (e.g., a spouse of the primary taxpayer).

[2]In tax year 1992, the EIC was available to low-income workers who had children living with them. In addition to the basic credit, taxpayers could also be eligible for supplemental credits if they paid health insurance for a qualifying child or if a new child was born in 1992.

taxpayers continued having difficulty getting through to telephone assistors. Using IRS data, we determined that IRS answered only about one out of four calls. IRS is taking steps to compile better data on the extent of this accessibility problem. This is a necessary first step toward giving taxpayers the level of service they deserve but are not getting.

Objective, Scope, and Methodology

Our objective was to assess IRS' performance during the 1993 tax filing season. We focused on IRS' ability to accurately and efficiently process income tax returns and refunds. Because we had previously reported on electronic filing fraud,[3] we paid particular attention to that problem during our assessment of IRS' returns processing performance. We also assessed IRS' performance in providing telephone assistance and responding to taxpayers' requests for tax materials.

To achieve our objective, we

- interviewed IRS National Office officials responsible for the various activities being assessed;
- interviewed officials in the Atlanta, Brookhaven, Cincinnati, Fresno, and Kansas City Service Centers;
- reviewed data from IRS' Management Information System for Top Level Executives and from other IRS reports to assess how well service centers processed tax returns and refunds;
- reviewed information and reports from financial institutions and tax return preparers on electronic filing fraud;
- monitored IRS' internal audits of returns processing issues;
- analyzed IRS' telephone accessibility and accuracy data and assessed its plans to better measure accessibility; and
- reviewed IRS data on whether orders for tax materials were filled accurately and timely and reviewed data from a contractor who was assessing IRS' performance.

We did not test and verify statistical data provided by IRS.

We did our work from January through August 1993 in accordance with generally accepted government auditing standards. We discussed our preliminary findings, conclusions, and recommendations in an exit conference attended by responsible IRS officials, including an Assistant Regional Commissioner for Criminal Investigation, the Tax Crimes Section

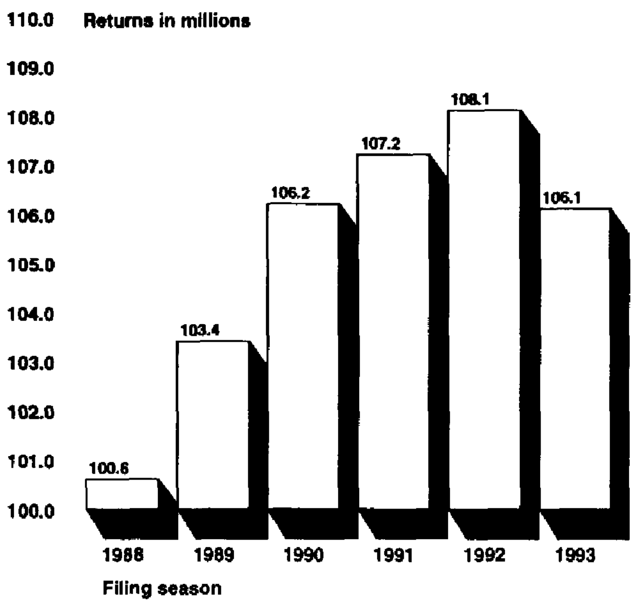
[3]Tax Administration: IRS Can Improve Controls Over Electronic Filing Fraud (GAO/GGD-93-27, Dec. 30, 1992).

Chief in the Criminal Investigation Division in IRS' National Office, and the Chief of the Individual Master File Processing Branch also in the National Office. Their comments are presented and evaluated on page 19. Other changes resulting from their comments were made in the body of the report as appropriate.

Taxpayers Filed Fewer Tax Returns in 1993 Than IRS Expected

IRS received 106.1 million individual income tax returns through April 30, 1993, about 2 million fewer than during a comparable period last year and about 3.7 million fewer than expected. As shown in figure 1, this is the first time in recent years that IRS has experienced a drop in individual income tax return filings.

Figure 1: Individual Income Tax Returns Received During the 1988 Through 1993 Filing Seasons



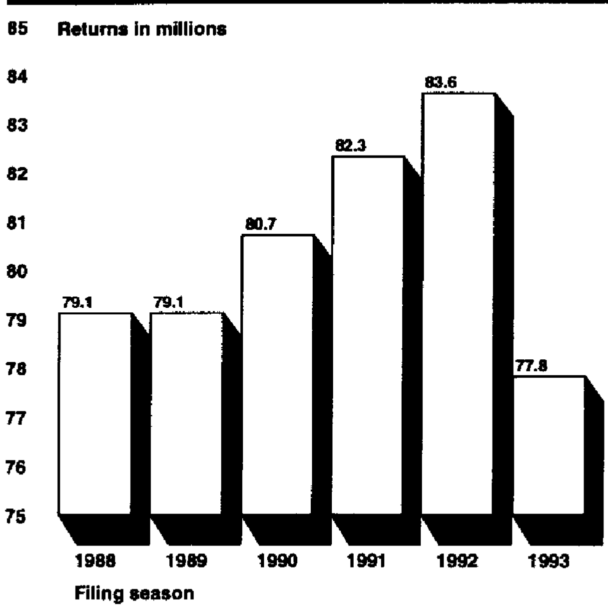
Note: These data are cumulative through May 6, 1988; May 5, 1989; May 4, 1990; May 3, 1991; May 1, 1992; and April 30, 1993, respectively.

Source: IRS' Management Information System for Top Level Executives.

In May 1993, IRS formed a task force to determine why fewer returns were received than expected. As of November 23, 1993, this analysis had not been completed. IRS tentatively explained the 3.7 million difference between actual and expected receipts as follows: (1) expected receipts might have been overstated by as much as 1 million returns due to normal estimating imprecision; (2) about 700,000 more taxpayers applied for extensions to file in 1993 than in 1992; (3) about 800,000 persons who filed in 1992 did not file in 1993 after being notified by IRS in 1992 that they might be filing unnecessarily, given the amount of their income, etc.; and (4) about 1.2 million of the difference was caused primarily by changes to the withholding tables for tax year 1992 that resulted in fewer taxpayers being eligible for refunds and more taxpayers owing taxes. With respect to the latter, IRS' assumption, subject to change based on the results of its analysis, is that those 1.2 million taxpayers, after finding that they owed taxes, decided not to file a return.

IRS' assertion about the impact of the change in withholding tables appears to be supported by figure 2, which shows that the 77.8 million refund returns filed in 1993 were fewer than those filed in 1992 and reversed a pattern of increased refund returns since at least 1988.

Figure 2: Refund Returns Received During the 1988 Through 1993 Filing Seasons



Note: These data are for calendar years 1988 through 1992 and for January 1 through September 14, 1993.

Source: IRS' Research Division.

The number of returns filed decreased in 1993 despite IRS making it easier for taxpayers to file even if they could not pay their taxes. In 1992, to encourage such taxpayers to file, IRS made it easier for taxpayers to request installment agreements and authorized more IRS staff to grant the agreements.[4] In 1993, IRS actively marketed the program and made it even easier for taxpayers to participate by developing Form 9465 to request an installment agreement. These changes seemed to have an effect because about 1.3 million taxpayers requested installment agreements as of June 30, 1993, compared to about 495,000 requests for a similar period in 1992. IRS' internal auditors are assessing the impact of the installment agreement request form on overall IRS operations and whether other alternatives would have been more effective in achieving IRS' goal of collecting taxes. As of November 23, 1993, their report had not been issued.

In 1993, taxpayers could not file Form 9465 electronically because it was not one of the forms that IRS' electronic filing system was programmed to accept. IRS should rectify that situation in 1994, if it decides to continue the program, so that taxpayers requesting installment agreements are not precluded from filing electronically. Because IRS acknowledges receipt of electronically filed returns, taxpayers requesting installment agreements that were filed electronically with their tax returns would have proof, and the peace of mind that goes with it, that IRS had received their requests.

Alternative Tax Return Filing Methods Continue to Grow in Popularity

Although fewer tax returns were filed in 1993 than in 1992, the number of returns received through the various alternative filing methods offered by IRS increased. For example, IRS received 12.3 million electronic returns—up from 10.9 million received in 1992—continuing the consistent growth in electronic filing since it became available nationwide in 1990. However, the number of electronic returns received was 12 percent less than IRS' goal of about 14 million. When taxpayers file electronically, IRS incurs lower tax return processing and storage costs. The main benefit to taxpayers is that they may receive their tax refunds several weeks faster than if they filed paper returns. With that in mind, IRS believes that the change in tax year 1992 withholding tables that led to fewer taxpayers receiving refunds contributed to the smaller than expected increase in electronic filing.

[4]With an installment agreement, a taxpayer agrees to pay the balance due over a specified period. Interest and penalties accrue until the liability is paid. Before 1992, a taxpayer had to wait for the return to be processed and for IRS to send a bill before negotiations for an installment agreement could begin.

A second alternative tax return filing method that allows taxpayers and tax return preparers to compute taxes using personal computer software approved by IRS grew substantially in 1993. Taxpayers using this method (known as 1040PC) produce tax returns in answer sheet format that are typically only two pages long. IRS can process these tax returns more quickly and accurately than normal tax returns. Also, taxpayers using this filing method benefit from lower error rates, decreased postage costs, and the ability to have their refunds deposited directly into their bank accounts. The number of 1040PC returns filed increased by 220 percent, from 1.5 million in 1992 to 4.8 million in 1993.

The number of returns received through the alternative filing method known as TeleFile also increased in 1993. IRS began testing TeleFile in 1992. In both 1992 and 1993, certain taxpayers in Ohio who were eligible to file Form 1040EZ were allowed to file using a toll-free number on touch-tone telephones. A new feature added in 1993 allowed some taxpayers to use a voice signature at the end of the telephone call, instead of sending in a signature on paper. TeleFile returns are easier for taxpayers to file and less costly for IRS to process, and TeleFile users can get their refunds more quickly than if they had filed paper returns. About 149,000 taxpayers used Telefile in 1993, compared to 126,000 taxpayers in 1992. IRS plans to expand TeleFile to seven states in 1994.

IRS Did a Good Job Processing Tax Returns in 1993

Various IRS indicators showed that IRS did a good job processing tax returns and issuing tax refunds in 1993. Two of the more important indicators are the accuracy and timeliness of refunds. IRS data as of May 4, 1993, showed an overall accuracy rate of 98.6 percent—9 of the 10 service centers met IRS' 98-percent goal (the other center's rate was 97 percent). Furthermore, all 10 centers met IRS' goal of issuing tax refunds in an average of 40 days or less. The average for all 10 centers was 36 days.[5]

[5]Using samples of refunds on paper returns, IRS (1) measures accuracy by checking if the name, address, and refund amount on the tax return agree with the master record and (2) measures timeliness by computing the elapsed time from the signature date on the return to the date the taxpayer would have received the refund, allowing 2 days for the refund to reach the taxpayer after it is issued.

Electronic Filing Fraud Continues to Be IRS' Most Critical Returns Processing Problem

In a December 1992 report, we showed that the number of fraudulent electronic returns identified by IRS had grown steadily since electronic filing became available nationwide in 1990.[6] That growth continued in 1993. As of August 31, 1993, IRS had identified 23,413 fraudulent returns involving $48.9 million in refunds and stopped $28.3 million (58 percent) of the refunds before they were issued. For the same period last year, IRS identified 11,724 fraudulent returns involving $31.4 million in refunds and stopped $21.8 million (70 percent) of the refunds.

As a percentage of total electronic returns filed, the number of returns identified as fraudulent is small—less than 1 percent. Nevertheless, IRS recognizes the need to do all it can to resolve the problem, especially considering IRS' goal to substantially increase the use of electronic filing over the next few years. Also, the more IRS does to detect fraud, the more it finds, and no one knows how much is going undetected.

IRS took various steps in response to our report and its own internal studies to help stop electronic filing fraud during the 1993 filing season. Some examples follow:

- IRS implemented an up-front computer check to verify that taxpayer names and Social Security numbers on electronically filed tax returns matched information in IRS' records. If there was a mismatch, IRS refused to accept the filing. In 1993, this computer check resulted in IRS rejecting about 240,000 electronic returns. IRS does not know, however, how many of those returns were submitted by (1) persons attempting to defraud IRS or (2) taxpayers and tax return preparers who made innocent mistakes in recording or transcribing the taxpayers' names and/or Social Security numbers.
- After electronic returns pass the up-front computer check and are accepted by IRS, they are screened by an IRS computer. Using various criteria, the computer identifies returns that are potentially fraudulent. Because IRS statistics indicated that many fraudulent electronic returns in past years were from first-time filers and that most fraudulent returns claimed EICS, IRS revised the computer criteria used in 1993 to give more weight to returns having one or both of those characteristics.
- Of the 12.3 million electronic returns filed through April 30, 1993, about 1 million were identified as questionable through IRS' computer screening. IRS revised its procedures in 1993 to give fraud detection teams in the service centers an extra week to review these returns and thus increase the teams' chances of identifying and stopping fraudulent refunds.

[6] GAO/GGD-93-27.

- IRS added 85 staff years to its fraud detection teams in the service centers. This addition was an increase of about 50 percent over 1992 staff years.

IRS plans other changes in 1994. For example, before accepting an electronic return, IRS will check its records to verify that the W-2 contains a valid employer identification number.[7] IRS will also validate a dependent's Social Security number and year of birth on returns claiming the EIC and reject all returns with mismatches.

One factor that makes it difficult to assess IRS' efforts to combat electronic filing fraud is the uncertainty as to how much fraud might be undetected. IRS tried to get better information on the extent of fraud by matching data on electronic returns for the 1991 tax year with data on information returns (Forms W-2 and 1099) for the same year. By doing so, IRS identified persons who either (1) reported wages and withholdings on their electronic returns for which there was no supporting information return in IRS' files or (2) reported amounts in excess of the amounts on information returns in IRS' files. However, when IRS started following up on identified cases, it realized that some of the data were unreliable and that computer programs had to be revised. As of November 23, 1993, the reprogramming had not been completed.

IRS also hired a contractor to review electronic filing vulnerability. The contractor presented his report to top IRS executives in October 1993. Because of its sensitivity, IRS had not released any results of the study as of November 23.

IRS Revises Plans for Dealing With RALs

In addition to the changes discussed in the previous section, IRS plans a change with respect to RALs, but that change falls short of what IRS originally intended.

Many banks make RALs to taxpayers who file their returns electronically. RALs are attractive to many taxpayers, despite the cost involved,[8] because they allow taxpayers to get money in 2 to 3 days instead of waiting 2 to 3 weeks to get their refund from IRS. Over 90 percent of the taxpayers who filed electronically in 1993 applied for RALs.

[7]The electronic transmission includes the employer identification number that is recorded on the taxpayer's W-2 form.

[8]RALs are provided for the amount of the taxpayer's expected refund less the fee associated with getting the loan. The quick refund is expensive for the taxpayer because the fee represents a high interest rate when considering the short term of the loan.

To be eligible for RALs, taxpayers have to arrange for IRS to deposit their refunds directly in the bank, thereby pledging the refunds as collateral for the RALs (once deposited, the refund is retained by the bank as repayment of the RAL). This process begins when the tax return preparer transmits the electronic return to IRS along with a request that the refund be directly deposited in the taxpayer's bank account. IRS then informs the preparer, through what is known as a "direct deposit indicator," whether it will honor the request. If IRS indicates that it will not honor the request, the taxpayer will be denied an RAL. IRS will not honor a direct deposit request if the taxpayer has a federal debt, such as unpaid child support or unpaid federal taxes, that will be offset against the taxpayer's refund.

Because the opportunity to get money quickly through an RAL was seen as encouraging electronic filing fraud, IRS announced in late 1992 that it would stop giving tax return preparers the direct deposit indicator starting in 1994. IRS' hope was that financial institutions would be more careful in approving RALs and in questioning the accuracy of the returns and the identity of the filers. Tax return preparers and the financial community lobbied to keep the indicator and warned that a reduction in the availability of RALs, which was sure to result if IRS implemented its decision, could have a negative effect on the public's acceptance of electronic filing. IRS subsequently reversed its decision.

Although IRS will continue providing the direct deposit indicator, it has announced a change for 1994 that will preclude first-time filers from obtaining RALs. A first-time filer poses a particular problem because IRS has no record of the individual in its files that can be used to verify the filer's name and Social Security number. IRS data showed that although first-time filers accounted for about 3 percent of all the electronic returns filed in 1993, they were involved in about 30 percent of the fraudulent electronic refunds. In 1994, IRS will continue to allow first-time filers to use electronic filing but, unlike past years, will not allow them to receive a direct deposit of their refunds. Instead, first-time filers will receive checks. This change will prevent these taxpayers from getting RALs. IRS believes that the inability of first-time filers to get money quickly through RALs may deter potential defrauders.

IRS' Procedures for Detecting Electronic Filing Fraud Could Be Further Improved

Despite the changes made and planned, IRS' process for identifying electronic fraud is still labor intensive and inefficient. After IRS identifies potentially fraudulent electronic returns through computer screening, service center fraud detection teams manually review data sheets that include critical information from the returns. These reviews must be done quickly, and team members use their judgment in selecting those returns that appear to have questionable W-2 data that they then must verify through telephone contacts with employers. Despite the amount of effort that IRS devotes to this manual review, very few fraudulent returns are actually identified. For example, of the approximately 3 million potentially fraudulent returns IRS reviewed in 1993, less than 1 percent were determined to be fraudulent.

IRS might have been able to detect more fraudulent returns if it had quicker access to information on potential fraud supplied by banks. In 1993, the four banks that process over 80 percent of all RALs established the Fraud Service Bureau (FSB)[9] to review RAL applications and identify potential fraud. Although the process helped the banks avoid making loans to questionable applicants, IRS believed that the process did little to help IRS avoid issuing fraudulent refunds. The banks provided IRS with the names of about 13,000 RAL applicants that they had rejected on the basis of FSB data. According to IRS officials, although the information helped fraud detection teams identify some fraudulent refunds, it afforded minimal benefit to IRS because the names were generally received too late for the teams to stop the related fraudulent refunds. We discussed with responsible IRS officials the possibility of negotiating quicker access to this information, but they said that all attempts to do so in the past had been futile.

There are, however, a couple of steps IRS could take to better use the data it is getting to enhance its efforts to combat electronic fraud. For example, IRS could analyze the fraud cases it identified from FSB data to determine if there were any unique features that should be included in IRS' computer screening criteria. IRS' efforts to identify potentially fraudulent returns might also be enhanced if it knew which RAL banks were involved with specific fraud cases. IRS does not now compile that information and thus is unaware whether a disproportionate number of fraud cases involve RALs from banks not dealing with FSB. IRS could track these data through the routing transfer number transmitted with the electronic return. This information would help IRS decide if it would be beneficial to pay closer attention to returns with RALs from banks not dealing with FSB.

[9]FSB was set up as an initiative to demonstrate that the banking community was committed to improving its identification of electronic filing fraud. In 1993, FSB analyzed RAL applications for the four banks using scoring programs that had been developed from data on fraudulent returns filed in 1991. On the basis of the score, FSB notified the bank whether a particular application should be rejected. FSB projected that most of the rejections would involve fraud.

Identified Fraud on Paper Returns Has Also Increased

Although we concentrated on electronic filing fraud in our review, we noticed that the number of identified fraudulent refunds on paper returns has also increased significantly. In 1993, as of August 31, IRS identified 30,947 such refunds involving $49.9 million and stopped $40.9 million (82 percent) of the refunds before they were issued. For the same period in 1992, IRS identified 7,517 fraudulent refunds involving $27 million and stopped $25.8 million (96 percent) of these refunds before issuance. IRS is more successful in stopping fraudulent refunds on paper returns because, unlike electronic returns, fraud detection teams can review paper returns to detect irregularities and have more time to contact employers to verify information reported by the taxpayers. As is the case with electronic returns, it is not clear how much of the increase in paper refund fraud is due to an increase in fraudulent activity versus IRS' increased ability to identify fraud.

IRS Corrected Some Returns Processing Procedures in 1993 in Response to Our Past Recommendations

In response to our past recommendations, IRS, in 1993, took steps to revise its procedures for (1) processing large tax payments and (2) granting the EIC.

Timely processing of tax payments is important because the government can lose substantial interest income if there are delays in processing tax payments. In August 1990 and March 1993, we reported on the timeliness of IRS' deposit of tax payments around the April 15 filing season deadline.[10] In the 1993 report, we discussed how one service center gave priority handling to mail in oversized envelopes because past experience indicated that those envelopes contained a high proportion of large tax payments. However, other centers were not convinced that this approach was successful because there were no data to support the theory. We recommended that IRS collect data on the type of mail containing the largest tax payments during the 1993 filing season, so it would be in a better position to make informed decisions that would benefit all centers.

For the 1993 filing season, IRS required that all tax payments received around the April 15 filing deadline be deposited by May 3, 1993. Nine of the 10 service centers met the goal; the other center completed its work 1 day later. In response to our recommendation, two service centers prioritized mail that they received in large envelopes and collected data to show what size tax payments were included in those envelopes. The data confirmed our previous comments that there are benefits in prioritizing mail received

[10] Tax Administration: Delayed Tax Deposits Continue to Cause Lost Interest for the Government (GAO/GGD-93-64, Mar. 22, 1993) and Tax Administration: IRS Needs to Assess Options to Make Faster Deposits of Large Tax Payments (GAO/GGD-90-120, Aug. 31, 1990).

around April 15. One center reported, for example, that its efforts to prioritize mail and thus more quickly identify and deposit larger tax payments had resulted in the government realizing about $625,000 in additional interest income. On the basis of those results, IRS told all its centers to implement similar procedures for the 1994 filing season.

The EIC has been a source of continuing problems for taxpayers in filling out their returns and for IRS in processing them. In 1992, we reported that IRS' (1) practice of giving the EIC to taxpayers who did not apply for it resulted in 270,000 taxpayers incorrectly receiving the EIC at a total cost of more than $175 million and (2) EIC processing procedures caused inequitable treatment of taxpayers.[11] Consistent with our 1992 recommendation, IRS improved its EIC procedures in 1993 and did not give taxpayers the credit unless it was claimed.[12] Despite this change and even though fewer returns were filed in 1993 than in 1992, there was an increase in EIC claims in 1993. As of July 30, 1993, IRS had given $12.9 billion in EICs to 13.8 million taxpayers, compared to $11 billion in EICs given to 13.2 million taxpayers in 1992. The average EIC increased from $833 to $939.

The EIC is still causing problems for taxpayers. The taxpayer error rate in claiming the EIC was 6.8 percent as of July 30, 1993, increasing from 5.7 percent for the same period in 1992. These errors involved cases where taxpayers did not qualify for or did not accurately compute the credit. According to IRS, the increased error rate may be due in part to IRS giving the EIC in 1992 to ineligible taxpayers who had not requested it. Having received the credit in 1992, these taxpayers may have applied for the EIC in 1993 but, unless their situations had changed, would have been found unqualified to receive it.

[11] Tax Administration: IRS' 1992 Filing Season Was Successful but Not Without Problems (GAO/GGD-92-132, Sept. 15, 1992).

[12] Taxpayers are required to claim the EIC by submitting a separate schedule (Schedule EIC). The procedures IRS used in 1993 to process the schedule were an improvement over those used in 1992 and enabled IRS to make more correct eligibility determinations. However, IRS procedures could still allow some ineligible taxpayers to receive the credit or could prevent some eligible taxpayers from receiving the credit or from receiving it promptly. We discussed this issue in a report entitled Tax Policy: Earned Income Tax Credit—Design and Administration Could Be Improved (GAO/GGD-93-145, Sept. 24, 1993). We made several recommendations in that report, including one that called for modifying the basic tax return (Forms 1040 and 1040A) to collect the data now required by Schedule EIC.

Accuracy of Toll-Free Telephone Assistance Remains High, but Accessibility Continues to Decline

Each year, millions of taxpayers call IRS' toll-free telephone lines to ask tax law questions. An important indicator of filing season performance is how well IRS assists these taxpayers. Providing accurate and timely telephone assistance reduces errors on tax returns and promotes taxpayer confidence in IRS.

To measure accuracy, IRS test callers placed anonymous calls to assistors and scored their answers to various tax law questions. IRS statistics on the results of these test calls showed that assistors answered 89 percent of the tax law questions accurately from February 1 through April 24, 1993—a 1-percent improvement over the same period in 1992. IRS' goal for 1993 was to improve the 88-percent rate in 1992.

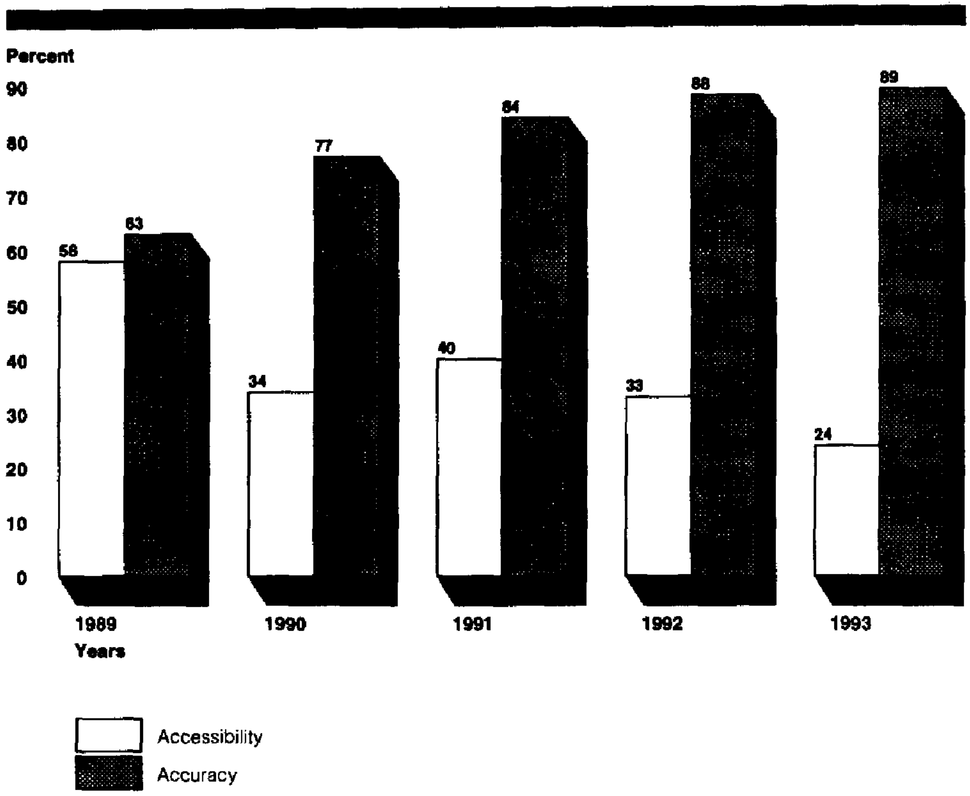
Although taxpayers generally received accurate answers to their tax law questions, they had difficulty getting through to telephone assistors to ask their questions. As in our reviews of previous filing seasons,[13] we measured accessibility using information on actual calls from IRS' Telephone Data Report.[14] We divided the total number of calls answered by the total number of calls received, which we defined as the sum of (1) calls answered, (2) busy signals, and (3) calls abandoned by the caller before an assistor got on the line.

Using Telephone Data Reports for the period January 2 through April 24, 1993, we computed a 24-percent accessibility rate, a decrease from the 33-percent rate computed for the same period in 1992. This rate indicates that about three out of four calls were not answered. As shown in figure 3, the 1993 accessibility rate was 34 percentage points lower than the rate we computed in 1989. During the same 5-year period, the accuracy rate on answers to tax law questions increased by 26 percentage points.

[13] Tax Administration: IRS' 1990 Filing Season Performance Continued Recent Positive Trends (GAO/GGD-91-23, Dec. 27, 1990); Tax Administration: A Generally Successful Filing Season in 1991 (GAO/GGD-91-98, June 28, 1991); and Tax Administration: IRS' 1992 Filing Season Was Successful but Not Without Problems (GAO/GGD-92-132, Sept. 15, 1993).

[14] The Telephone Data Report is a weekly update of toll-free telephone activity.

Figure 3: Comparison of Toll-Free Telephone Accessibility and Accuracy During the 1989 Through 1993 Filing Seasons



Source: IRS data.

According to Taxpayer Service officials, toll-free telephone accessibility was lower in 1993 primarily because the demand for IRS' telephone assistance increased sharply while the resources available to provide it decreased. Productivity gains allowed IRS, with fewer resources, to answer about the same number of calls (over 18 million) in 1993 as it did in 1992. That was not enough, however, to overcome a demand that, according to IRS data for the 4 months ending April 25, 1993, exceeded IRS' estimate by 25 percent. The resulting reduction in accessibility meant that more callers received busy signals or were placed on hold and hung up before IRS could assist them. IRS' data showed, for example, that about 74 percent of the callers in 1993 received busy signals, an increase of 9 percentage points from 1992.

In response to our 1992 recommendation,[15] IRS is working with the company that provides long distance service to the toll-free telephone assistance sites in an attempt to improve its data on busy signals. Currently, IRS' data reflect the number of incoming calls that receive busy signals. The improved data should help IRS better understand how many taxpayers are trying to access the system and how many times individual callers had to dial before getting through. According to Taxpayer Services officials, IRS will start compiling the new data in January 1994. IRS plans another study later in 1994 on busy signals received by local callers who account for about 40 percent of calls received by the telephone assistance sites.

IRS officials said that they expect the 24-percent accessibility rate we computed for 1993 to remain the same in 1994, even though 67 fewer staff years will be used to answer telephone inquiries. IRS expects the impact of this decreased staffing to be offset by further productivity gains resulting from automated call routing equipment at 15 of IRS' 32 telephone assistance sites. IRS' plans, however, do not include any allowance for additional unexpected demand that IRS has experienced in recent filing seasons. If demand does increase, accessibility will drop even further unless additional resources are provided.

IRS Was Effective in Distributing Tax Materials to Taxpayers

Taxpayers can obtain tax forms, instructions, and publications through telephone and mail orders placed with 3 IRS distribution centers or by visiting one of IRS' over 550 walk-in sites. Many banks, post offices, and libraries also stock the more common forms and instructions.

According to IRS officials, distribution centers were adequately stocked with tax materials throughout the 1993 filing season. They attributed the favorable distribution center stock levels to the fact that there were no printing delays caused by tax law changes, and few delays occurred due to tax materials on back order. IRS' objective during the 1993 filing season was to accurately process at least 96 percent of mail and telephone orders received by the distribution centers. Each distribution center assessed its own performance in filling orders. According to IRS data as of April 30, 1993, these quality checks showed that the three centers had achieved a cumulative rate slightly above the 96-percent goal.

For the 1992 and 1993 filing seasons, IRS hired a contractor to independently measure distribution center performance by placing mail

[15]GAO/GGD-92-132.

and telephone orders from various test sites. In our report on the 1992 filing season, we discussed methodological problems that prevented IRS from using the contractor's results and recommended that IRS develop a reliable measure of distribution center performance in filling mail and telephone orders. Our assessment of the contractor's testing procedures during the 1993 filing season indicated that the contractor's methodology improved, and it now provides an accurate assessment of the tax material distribution program. The contractor's results for 1993 showed an accuracy rate of 96 percent, confirming the results reported by the distribution centers.

IRS tells taxpayers who call distribution centers that they should receive their requested tax materials or be advised of any back orders in 7 to 15 workdays. IRS does not measure whether distribution centers are achieving this goal, but its contractor does. As of April 30, 1993, the contractor's data showed an average turnaround time of about 12 calendar days.

IRS required each of its walk-in sites to stock 90 commonly used tax forms, instructions, and publications during the 1993 filing season. To measure adherence to this standard, regional analysts were expected to visit at least 25 percent of the sites and submit performance reports to IRS' National Office. However, IRS does not know exactly how many of the sites had the required items because analysts did not make any site visits. According to IRS Publication Service Branch officials, the requirement was issued too late in the filing season to schedule meaningful visits. Even though analysts did not visit the walk-in sites, IRS officials said that there were few complaints from site managers about not having tax materials. A positive indicator this filing season was that distribution centers filled reorders for tax materials very quickly. This was not always the case in 1992.

Conclusions

The 1993 filing season was marked by a surprising, and as yet not fully explained, reduction in the number of returns filed and the continuation of two disturbing trends: (1) an increase in the number of fraudulent electronic returns and (2) a decrease in the accessibility of IRS' toll-free telephone service.

In 1993, as in the past several years, IRS' performance measures showed that it did a good job processing returns and issuing refunds. Despite that overall good performance, however, IRS continues to be bedeviled by refund fraud. IRS identified about twice as many fraudulent electronic returns in 1993 as it did in 1992, and the number of identified fraudulent paper returns increased even more significantly. What is unclear is (1) whether these increases were due to improved IRS monitoring or an increase in fraudulent activity and (2) how much fraud might be going undetected.

Electronic filing fraud poses particular problems for IRS because of the speed with which electronic returns are processed and refunds issued. Although IRS took steps in 1993 to improve its ability to identify and stop fraudulent electronic refunds before they were issued, it was still unable to stop about 42 percent of those that it identified.

IRS' process for identifying fraudulent electronic refunds has historically been labor intensive, with fraud detection teams manually reviewing data on suspicious returns and following up with employers. This process is inherently time consuming. IRS is taking steps, however, toward more effectively using computers in identifying and stopping fraud. For example, by verifying taxpayer names, Social Security numbers, and employer identification numbers when the electronic returns are being transmitted and refusing to accept returns that involve mismatches, IRS can prevent fraudulent electronic returns from entering the system in the first place. IRS also developed new computer screening criteria to help its staff identify questionable returns after they have been submitted but before the fraudulent refunds are issued. As discussed in this report, however, there are additional steps that we think IRS can take to further improve those criteria.

A successful tax filing season is dependent on IRS effectively helping taxpayers meet their filing obligations. Toward that end, IRS took steps in 1993 to make it easier for taxpayers to request installment agreements. If IRS decides to continue the program in 1994, we believe IRS should make the procedure more available to taxpayers by allowing them to file the form electronically.

IRS also continued to do a good job providing accurate answers to tax law questions and achieved its accuracy and timeliness goals for distributing tax materials. One service problem continued unabated, however—the difficulty encountered by taxpayers trying to access IRS by telephone.

The accessibility of IRS' toll-free telephone assistance, as reflected by available data, is poor and getting worse; and there is little reason to believe it will improve in 1994. IRS has an effort under way to better measure the extent of this problem, which is a necessary first step toward providing taxpayers with the kind of service they deserve. We are not making any recommendations in this area. Instead, we have begun a separate review in an attempt to get a better understanding of the issues surrounding telephone accessibility.

Recommendations

We recommend that the Commissioner of Internal Revenue take the following actions:

- Require Criminal Investigation to (1) analyze the fraud cases IRS identified from information provided by RAL banks to see if those cases involve unique features that should be included in IRS' computer screening criteria and (2) determine which RAL banks were used for fraudulent refunds to see if special attention should be given to banks that do not use the FSB.
- Allow electronic filers to transmit Form 9465 as part of their electronic submission if IRS decides to continue using that form for requesting installment agreements.

Agency Comments and Our Evaluation

We met with IRS officials on November 23, 1993, to discuss a draft of this report. Those officials generally agreed with our recommendations.

While agreeing with our recommendation on electronic filing, the officials noted that IRS' efforts to combat electronic filing fraud should be significantly enhanced beginning in 1995 when IRS starts relying more on artificial intelligence rather than on manual review to assess an electronic return's fraud potential.

Although the officials agreed that the Form 9465 should be included among the forms that can be filed electronically, they said that they did not plan to make such a change until 1995 because of other priorities. The officials also said that Form 9465 has been revised to make it clearer and that IRS would be promoting the form even more in 1994. We discussed the possibility of including the form in tax packages that are mailed to taxpayers before the start of the filing season. The officials believed that such an effort would not be cost effective considering the cost of including the form in all tax packages versus the number of taxpayers who might benefit.

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

The major contributors to this report are listed in the appendix. Please contact me on (202) 272-7904 if you have any questions.

Sincerely yours,

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