

GAO

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

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December 1997

TAX  
ADMINISTRATION

IRS' 1997 Tax Filing  
Season



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General Government Division

B-276564

December 29, 1997

The Honorable Nancy L. Johnson  
Chairman, Subcommittee on Oversight  
Committee on Ways and Means  
House of Representatives

Dear Chairman Johnson:

This report responds to your request that we assess the Internal Revenue Service's (IRS) performance during the 1997 tax filing season. Besides providing data on various indicators that IRS uses to measure its filing season performance, we discuss five areas that have been problematic in past filing seasons: (1) the ability of taxpayers seeking answers to questions to reach IRS via the telephone, hereafter referred to as telephone accessibility;<sup>1</sup> (2) the number of returns filed by means other than the traditional paper method; (3) IRS' efforts to deal with returns that have missing or incorrect Social Security Numbers (SSN); (4) the use of banks, known as lockboxes, to process certain tax payments; and (5) performance of the imaging system IRS uses to process certain tax returns. In March 1997, we testified before the Oversight Subcommittee on the interim results of our work.<sup>2</sup>

## Results in Brief

IRS met or exceeded most of its 1997 filing season related performance goals. Of particular note is the substantial improvement in two important areas where we have criticized IRS' performance in past filing seasons—telephone accessibility and the use of alternative filing methods.

According to IRS data, telephone accessibility increased from 20 percent during the 1996 filing season to 51 percent during the 1997 filing season. That improvement was due to an increase in the number of telephone calls IRS answered and a decrease in the number of calls coming into IRS. IRS was able to answer more telephone calls because it devoted more staff to do so and revised its procedures for answering questions on more complex tax issues. IRS' ability to answer more calls also contributed to the decrease in the number of calls coming into IRS by reducing the number of busy signals and thus the need for redials.

<sup>1</sup>Accessibility, as we have traditionally defined it, is the total number of calls answered divided by the number of call attempts, which is the sum of the following: (1) calls answered, (2) busy signals, and (3) calls abandoned by the caller before an IRS assistor got on the line.

<sup>2</sup>Tax Administration: IRS' Fiscal Year 1997 Spending, 1997 Filing Season, and Fiscal Year 1998 Budget Request ([GAO/T-GGD/AIMD-97-66](#), Mar. 18, 1997).

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The number of tax returns filed by means other than the traditional paper method increased by 25 percent over last year, with the number of returns filed by telephone (TeleFile) showing the most significant increase—65 percent. One factor that most likely contributed to the increase in TeleFile was IRS' decision not to include a Form 1040EZ in the tax package sent to taxpayers who appeared eligible to file using TeleFile—the thinking being that if those taxpayers did not receive a form that they could use to file on paper, they would be more inclined to file using the telephone.

Although the revised tax package apparently contributed to an increase in the use of TeleFile, it also apparently contributed to a decrease in the performance of the Service Center Recognition/Image Processing System (SCRIPS)—a document imaging and optical character recognition system that IRS implemented in 1994 to process Forms 1040EZ and certain other tax documents. In that regard, IRS data for the 1997 filing season show that the number of Forms 1040EZ processed per hour on SCRIPS equipment declined from the number processed per hour in 1996. According to IRS, because taxpayers who were eligible to use TeleFile did not get a Form 1040EZ that they could use to file on paper, they also did not get a preprinted address label to affix to a paper form. Thus, if they chose to file on a Form 1040EZ, which many of them did, they had to write in their names, addresses, and SSNs. The additional handwritten information on those returns increased the amount of operator intervention needed to process those returns through SCRIPS, which resulted in decreased productivity.

Another major change during the 1997 filing season involved the procedures IRS used to process returns that were filed with missing or incorrect SSNs. In 1997, as authorized by the Welfare Reform Act of 1996, IRS began treating missing or incorrect SSNs as math errors rather than as issues that, in the past, had to be resolved through a lengthy notice process.<sup>3</sup> As of September 1, 1997, according to IRS, it had protected about \$1.46 billion in revenue through the disallowance of claimed credits or dependent exemptions in 1997. That result more than doubled the amount disallowed using the procedures IRS followed in 1996.

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<sup>3</sup>Section 6213(g)(2) of the Internal Revenue Code specifies those conditions on a return that can be treated as math errors. The conditions include such things as computational mistakes and missing or incorrect SSNs. When IRS finds one of those conditions while processing a return, it can immediately adjust the taxpayer's return (by, for example, correcting the computation or disallowing the dependent exemption, earned income credit, or child care credit associated with the missing or incorrect SSN) and make appropriate changes to the taxpayer's reported tax liability and refund, if any. IRS is to send the taxpayer a notice explaining the change.

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One issue that we discussed in our report on the 1996 filing season<sup>4</sup> and that continues to concern us is the cost effectiveness of IRS' use of lockboxes to process Form 1040 tax payments. Additional information we obtained this year heightened our concern by calling into question a key assumption IRS and the Department of the Treasury's Financial Management Service (FMS) have used to calculate the interest cost savings associated with this use of lockboxes. Although FMS had planned a study to further assess interest cost savings, those plans have been deferred, and there is no assurance when such a study will be done.

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## Objective, Scope, and Methodology

Our objective was to assess IRS' performance during the 1997 filing season, with particular emphasis on those areas that were identified as problematic in our reviews of past filing seasons. To achieve our objective, we

- interviewed IRS National Office officials and IRS officials in the Atlanta, Cincinnati, Fresno, and Kansas City service centers responsible for the various activities we assessed;<sup>5</sup>
- analyzed filing season related data from various management information systems, including IRS' Management Information System for Top Level Executives;
- analyzed IRS data relating to its telephone assistance and conducted a test of IRS' telephone accessibility during the last 2 weeks of the filing season (see app. I for information on our test methodology);
- analyzed IRS data on alternative filing methods, including IRS surveys of TeleFile users and nonusers;
- visited two lockbox banks, one in Atlanta and one in St. Louis, to review remittance processing procedures;<sup>6</sup>
- interviewed staff from FMS, which is responsible for negotiating and administering lockbox contracts, about the use of lockboxes to process Form 1040 tax payments and analyzed cost/benefit data related to lockbox processing;
- interviewed officials from IRS' Taxpayer Advocate's Office about the impact of various filing season activities on taxpayers;
- analyzed activity data for IRS' Internet World-Wide Web site and forms distribution centers; and

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<sup>4</sup>IRS' 1996 Tax Filing Season: Performance Goals Generally Met; Efforts to Modernize Had Mixed Results (GAO/GGD-97-25, Dec. 18, 1996).

<sup>5</sup>We selected these locations because we had staff available to do the work in those cities.

<sup>6</sup>We selected these locations because we had staff available to do the work in those cities.

- reviewed relevant IRS internal audit reports.

We did our work from January through October 1997 in accordance with generally accepted government auditing standards. We obtained written comments on a draft of this report from the Deputy Commissioner of Internal Revenue. Those comments are discussed at the end of this letter and are reprinted in appendix II.

## Filing Season Goals Were Generally Met

IRS uses various indicators to measure its filing season performance. Those indicators relate to workload, like the number of returns processed; timeliness, like the number of days needed to process and issue refunds; and quality, like the accuracy of IRS' answers to taxpayers' questions and the accuracy with which IRS processes individual income tax returns and refunds. As shown in table 1, those indicators show that IRS met or exceeded most of its performance goals for the 1997 filing season.<sup>7</sup>

**Table 1: IRS' Performance Goals and Related Accomplishments for the 1996 and 1997 Filing Seasons**

Indicator	1996 <sup>a</sup>		1997 <sup>a</sup>	
	Goal	Accomplishment	Goal	Accomplishment
Accuracy of individual income tax returns processed by Code and Edit staff <sup>b</sup>	Process 93% accurately	94% were processed accurately	Process 95% accurately	95% were processed accurately
Accuracy of individual income tax returns processed by data transcribers	Process 93.0% accurately	94.2% were processed accurately	Process 95.0% accurately	94.7% were processed accurately
Service center individual income tax returns processing productivity <sup>c</sup>	Process 10,000 returns per staff year	12,174 returns were processed per staff year	Process 11,730 returns per staff year	12,692 returns were processed per staff year
Individual income tax returns processing cycle time <sup>d</sup>	11 days	Various types of 1040s ranged between 8 and 11 days	Less than 16 days	Various types of 1040s ranged between 5 and 14 days
Timeliness of processing tax payments submitted with individual income tax returns	Payments received 4/15/96 thru 5/1/96 were to be deposited no later than 5/1/96	All payments received 4/15/96 thru 5/1/96 were deposited by 5/1/96	Payments received 4/15/97 thru 4/30/97 were to be deposited no later than 4/30/97	All payments received 4/15/97 thru 4/30/97 were deposited by 5/2/97
Accuracy of individual income tax refunds on paper returns	Process 98% accurately	99.6% were processed accurately	Process 99.3% accurately	99.4% were processed accurately

(continued)

<sup>7</sup>The goals shown in table 1 are set by IRS; we did not assess their appropriateness.

Indicator	1996 <sup>a</sup>		1997 <sup>a</sup>	
	Goal	Accomplishment	Goal	Accomplishment
Timeliness of refund check for individual income tax returns filed on paper <sup>e</sup>	Issue within an average of 40 days	Issued within an average of 38 days as of 5/96	Issue within an average of 40 days	Issued within an average of 38 days as of 5/97
Timeliness of refund for individual income tax returns filed electronically <sup>f</sup>	Issue within an average of 21 days	Issued within an average of 16 days as of 5/96	Issue within an average of 21 days	Issued within an average of 15 days as of 5/97
Level of access to taxpayer service telephone system <sup>g</sup>	Provide 41.4% level of access	Provided 51% level of access	Provide 60.2% level of access	Provided 71% level of access
Accuracy of tax law assistance	Answer 90% accurately	91% were answered accurately	Answer 92% accurately	95% were answered accurately
Level of access to forms ordering telephone system <sup>h</sup>	Provide 70% level of access	Provided 54.3% level of access	Provide 70% level of access	Provided 76.7% level of access
Accuracy of processing form orders	Process 96.5% accurately	97.3% were processed accurately	Process 96.5% accurately	97.0% were processed accurately

<sup>a</sup>Data are as of April 1996 and April 1997, unless otherwise noted.

<sup>b</sup>Code and Edit staff are to prepare returns for computer entry by, among other things, ensuring that all data are present and legible.

<sup>c</sup>Returns processing productivity is based on the number of weighted returns processed, which includes all returns (whether processed manually, through scanning equipment, or electronically). The different types of returns are weighted to account for their differing processing impacts. For example, a paper Form 1040 has a higher weighting factor than a paper Form 1040EZ, which in turn has a higher weighting factor than electronically processed returns.

<sup>d</sup>Cycle time is the average number of days it takes service centers to process returns for the entire filing season—January 1 through mid-April.

<sup>e</sup>This indicator is based on a sample of paper returns and is an average calculated starting from the signature date on the return to the date the taxpayer should have received the refund, allowing 3 days after issuance for the refund to reach the taxpayer.

<sup>f</sup>This indicator is based on a sample of electronically filed returns and is an average calculated from the date the return is received to the date the taxpayer should have received the refund, allowing 2 or 3 days after issuance (depending on whether the refund is by check or direct deposit) for the refund to reach the taxpayer or the taxpayer's bank account.

<sup>g</sup>IRS defines this indicator as the number of calls answered divided by demand. Demand is the number of individual callers. As discussed later, we have traditionally used a different indicator to measure IRS' performance in providing telephone service.

<sup>h</sup>IRS defines this indicator as the number of calls answered divided by demand. Demand is the number of individual callers.

Source: IRS data.

## Accessibility to IRS' Telephone Assistance Improved Substantially

During each filing season, millions of taxpayers call IRS with questions about the tax law, their refunds, or their accounts. The number of callers who get through to an IRS assistor is an important indicator of filing season performance. According to IRS data, as shown in table 2, telephone accessibility, as we have defined it in the past, increased substantially during the 1997 filing season. Results of our independent test also pointed to an improvement in accessibility. Despite the improvement, however, accessibility is still low.

**Table 2: Accessibility of IRS' Telephone Assistance<sup>a</sup>**

Filing season <sup>b</sup>	Number of call attempts (in millions)	Number of calls answered (in millions)	Percent accessibility
1997	62	32	51 <sup>c</sup>
1996	114	23	20
1995	236	19	8

<sup>a</sup>The percent accessibility presented in this table is the calculation we have traditionally used to measure IRS' performance in providing telephone assistance. The calculation is the total number of calls answered divided by the total number of call attempts (the sum of calls answered, busy signals, and calls abandoned by the caller before an IRS assistor got on the line). Because the IRS indicator in table 1—level of access to taxpayer service telephone assistance—is based on the number of callers, it shows a higher level of performance than does our indicator, which is based on the number of call attempts.

<sup>b</sup>These data are for January 1 through April 19, 1997, January 1 through April 20, 1996, and January 1 through April 15, 1995.

<sup>c</sup>Numbers do not compute to this percent due to rounding.

Source: GAO analysis of IRS data.

To check whether accessibility had increased, we conducted an independent test to measure taxpayer access to IRS' telephone system from March 31 through April 15, 1997. Our results,<sup>8</sup> compared with the results of a similar test we conducted in 1995, showed that accessibility had improved. For example, during the 1997 test, we had to make 584 calls to gain access to a live assistor 211 times—a 36-percent accessibility rate. That was a significant improvement over 1995, when we had to make 1,655 calls to gain access 98 times—a 6-percent accessibility rate. Also, of the 584 calls placed during the 1997 test, 288 resulted in busy signals—a 49-percent busy rate. That compares favorably with a 92-percent busy rate during the 1995 test. Our test methodology and detailed results are described in appendix I.

<sup>8</sup>Our test was a nonstatistical sample. The results relate just to our test calls and cannot be projected.



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Despite the significant increase in 1997, telephone accessibility is still too low. The National Commission on Restructuring IRS made that point in its June 25, 1997, report. After noting how accessibility had improved to 51 percent, the Commission noted that “the level of access continues to be unacceptable and inferior to service performance in private sector service organizations.”

As table 2 showed, the increase in IRS’ telephone accessibility between the 1996 and 1997 filing seasons was due to a combination of more calls being answered and fewer calls coming in (i.e., “call attempts”).

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## Increase in Number of Calls Answered

Two primary reasons for the increase in the number of calls answered were (1) a revision to IRS’ procedures for handling calls involving complex tax issues and (2) more staff assigned to answer the telephone, some of whom were detailed from other IRS functions. IRS’ decision to detail staff from other functions resulted in some opportunity costs because these staff were not available to perform their normal duties, such as auditing tax returns.

In an effort to increase the number of calls answered, IRS conducted a study to analyze the subject and length of taxpayer telephone calls. According to IRS, the study showed that several areas of complicated tax law involved 20- to 30-minute telephone conversations and that an assistor could answer about 5 simpler calls within the same amount of time. Thus, for the 1997 filing season, IRS revised its procedures so that callers with questions in certain complex tax areas were automatically connected to a voice messaging system.<sup>9</sup> Those callers were asked to leave their name, telephone number, and the best time for IRS to call back, and they were told that someone would be calling back within 2 working days.

According to IRS, it received 619,310 calls to the voice messaging system during the filing season and contacted 451,051 taxpayers in response to those calls. IRS said that there are several reasons why it may not have responded to a message. For example, the message may have been garbled, thus preventing IRS from deciphering the caller’s telephone number; callers may have failed to include an area code; or IRS attempts to contact the caller may have gone unanswered.<sup>10</sup>

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<sup>9</sup>Some of the complicated tax areas involved the sale of a residence, self-employment income and tax, rental property, and depreciation.

<sup>10</sup>According to IRS, staff were to make at least two attempts to contact the caller.

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To help return calls to the messaging system, IRS detailed staff from the Examination function, which is the IRS organization primarily responsible for auditing tax returns. IRS data show that staff who were detailed from the Examination function spent about 125 full-time-equivalent staff years returning calls received by the messaging system. A cognizant official in the Examination function estimated that the use of Examination staff to answer taxpayer questions resulted in about \$55 million in foregone revenue because those staff were not available to audit returns. We did not assess the validity of that estimate.

Another factor that contributed to the increase in the number of calls answered was IRS' decision to assign more staff to answer the telephone. Nationwide, according to data provided by IRS' Customer Service function, IRS dedicated 2,546 full-time-equivalent staff years to answer taxpayers' telephone calls between January 1 and April 30, 1997. This was an increase of 605 staff years over the 1,941 staff years dedicated during the same period in 1996. In addition, some field offices, including the three service centers we visited, temporarily detailed staff to help answer the telephone, some of whom came from functions other than Customer Service. According to IRS, some of these staff were used only as needed, while others were detailed for a few months.

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## Decrease in Call Attempts

The increase in the number of calls answered contributed to the decrease in the number of call attempts. As IRS improves its ability to answer the telephone, taxpayers should encounter fewer busy signals. Fewer busy signals reduce the need for taxpayers to redial, which reduces the number of call attempts. In that regard, IRS' telephone data showed that the number of busy signals dropped from 86.0 million during the 1996 filing season to 22.7 million during the 1997 filing season and that the average number of call attempts per taxpayer dropped from 2.5 during the 1996 filing season to 1.4 during the 1997 filing season.

IRS cited two other contributors to the decrease in call attempts—the elimination of certain notices and the availability of information through other IRS sources, such as the Internet. Before the 1997 filing season began, IRS eliminated 23 notices that it deemed unnecessary, which, in turn, reduced the need for persons to call IRS with questions about these notices. IRS estimated that its action eliminated the issuance of about 7.5 million notices, but IRS could not estimate how many calls might have been eliminated because every notice does not necessarily generate a telephone call to IRS. IRS has a World-Wide Web site on the Internet that

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was first available during the 1996 filing season. The Web site provides, among other things, some interactive applications that answer tax questions, IRS regulations with “plain English” summaries, answers to the most frequently asked tax questions, and tax forms. IRS data showed a significant growth in the use of IRS’ Web site in 1997. For example, taxpayers accessed the Web site about 117 million times between January 1 and April 20, 1997, compared with about 102 million accesses throughout 1996, and taxpayers downloaded about 6.3 million files during the 1997 filing season compared with about 2.4 million files for the same period in 1996.

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## Measuring Telephone Accessibility

As noted earlier, the data in table 2 reflect our traditional way of measuring telephone accessibility. Over the last few years, IRS has used another indicator, which it calls “level of access,” to measure its performance in providing telephone assistance to taxpayers. IRS defines level of access as the number of calls answered divided by the number of callers (i.e., the number of taxpayers seeking assistance). Because IRS’ indicator is based on the number of callers, it shows a higher level of performance than does our indicator, which is based on the number of call attempts. Nonetheless, IRS’ indicator, like ours, showed a significant improvement in performance during the 1997 filing season. IRS reported its level of access as 71 percent through April 19, 1997, compared with 51 percent during a comparable period in 1996.

We have been working with IRS to establish one mutually agreeable measure of telephone accessibility. As a result, we have reached agreement on a measure to be used in future filing seasons. That measure defines accessibility as the number of calls that get into IRS’ automatic call distribution system, including those that are answered and those that are abandoned by the caller before getting assistance, divided by the total number of call attempts, which would consist of calls answered, calls that are abandoned, and calls that receive a busy signal. As part of that measure, IRS agreed to show, for the calls that got into the automatic call distribution system, how many were answered<sup>11</sup> and how many were abandoned by the caller before receiving assistance.

Using IRS data as of April 19, 1997, the new measure shows that taxpayers calling IRS were able to gain access 64 percent of the time (39.8 million calls that got into IRS’ automatic call distribution system divided by

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<sup>11</sup>For purposes of this measure, “answered calls” would include calls to the voice messaging system that were subsequently answered by IRS.

62.4 million call attempts). Of the 39.8 million calls that got into IRS' system, 31.8 million (80 percent) were answered and 8 million (20 percent) were abandoned by the caller before getting assistance.

## Number of Returns Filed Through Alternative Methods Increased

As of October 31, 1997, IRS had received 120.9 million individual income tax returns, an increase of 1.8 percent compared to the 118.8 million received at the same time last year. Although the increase in the overall number of returns filed was small, the increase in the number filed through alternative methods was significant—about 25 percent higher than last year. IRS offers three alternatives—electronic filing, TeleFile, and 1040PC—to the filing of traditional paper returns.<sup>12</sup> Among other benefits, returns filed through these alternatives involve fewer errors and are presumed to be less costly for IRS to process. As shown in table 3, of the three alternatives, TeleFile had the largest percentage change, by far, in 1997.

**Table 3: Number of Individual Income Tax Returns Received Through Alternative Filing Methods**

Type of return	Number filed in 1994 <sup>a</sup> (in thousands)	Number filed in 1995 <sup>a</sup> (in thousands)	Number filed in 1996 <sup>a</sup> (in thousands)	Number filed in 1997 <sup>a</sup> (in thousands)	Percent change in 1997 from 1996
TeleFile	519	680	2,840	4,694	65%
Electronic	13,510	11,144	12,140	14,457	19
Form 1040PC	4,193	2,917	7,042	8,427	20
<b>Total</b>	<b>18,222</b>	<b>14,741</b>	<b>22,022</b>	<b>27,578</b>	<b>25%</b>

<sup>a</sup>Data are as of November 4, 1994, November 3, 1995, November 1, 1996, and October 31, 1997.

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

## Telefile

There were three changes to TeleFile in 1997 that most likely contributed to the large increase in filings: the eligibility criteria were expanded to include certain married persons filing joint returns, persons using TeleFile could request that any refund be directly deposited to their bank account, and IRS changed the tax package sent eligible TeleFile users in an attempt

<sup>12</sup>Under electronic filing, returns are transmitted over communications lines through a third party (such as a tax return preparer or electronic return transmitter) to an IRS service center, where the data are automatically edited and processed. Under TeleFile, certain taxpayers who are eligible to file a Form 1040EZ are allowed to file using a toll-free number on Touch-Tone telephones. Once the return is filed, it is processed like an electronic return. Under the Form 1040PC method, a taxpayer or tax return preparer uses personal computer software that produces paper tax returns in an answer-sheet format. The Form 1040PC shows the tax return line number and the data (dollar amount, name, etc.) on that line. Only lines on which the taxpayer has made an entry are included on the Form 1040PC.

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to encourage their use of the system. IRS data show that about 191,000 TeleFile returns were filed jointly by married couples, thus accounting for about 10 percent of the growth in 1997. The amount of growth due to the other two changes could not be quantified.

IRS' decision to change the TeleFile tax package was the subject of some disagreement within IRS. In past years, IRS sent taxpayers who appeared eligible to use TeleFile a package that included not only TeleFile materials but also a Form 1040EZ and related instructions. Thus, taxpayers who could not or did not want to use TeleFile had the materials they needed to file on paper, assuming they were still eligible to file a Form 1040EZ. For the 1997 filing season, IRS eliminated the Form 1040EZ and related instructions from the package sent to taxpayers who were apparently eligible to use TeleFile—hoping that more taxpayers would be inclined to use TeleFile if they received only the TeleFile materials.

Officials from the Taxpayer Advocate's Office said that they did not agree with IRS' decision. They said that they were originally led to believe that IRS would be sending the revised TeleFile package only to persons who had used TeleFile in 1996 and to a sample of other taxpayers. By the time they learned that IRS was going to send the package to all apparently eligible TeleFile users, it was too late to effect a change. According to the officials, their concern centered on the extra burden the revised package would impose on taxpayers who wanted a Form 1040EZ, as well as the extra costs IRS might incur in filling additional mail and telephone orders for Form 1040EZ from those taxpayers. Internal Audit expressed similar reservations in communications with IRS management before the start of the filing season. Management responded by saying that (1) their intent was to increase the use of TeleFile, which would actually reduce taxpayer burden for those who used it and (2) they expected few of the affected taxpayers to contact IRS' form distribution centers for copies of Form 1040EZ.

Officials from the Taxpayer Advocate's Office told us that they did not receive many complaints from taxpayers and found no evidence that the number of taxpayer orders for Form 1040EZ was significantly higher than in past years. Nonetheless, they said that they continue to be concerned about this procedure, which IRS has indicated will remain unchanged for the 1998 filing season.

For the 1997 filing season, IRS sent about 26 million TeleFile tax packages to taxpayers who, based on the tax returns they filed in 1996, would be

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eligible to use TeleFile in 1997. After allowing for the fact that some of those taxpayers might no longer be eligible to use TeleFile because they no longer met the qualifying criteria, IRS estimated that about 15.6 million of the taxpayers would be eligible to use TeleFile in 1997. As of October 31, 1997, about 4.7 million taxpayers had filed their returns using TeleFile (about 30 percent of the number IRS estimated to be eligible). Assuming the validity of IRS' estimate of eligible users, about 10.9 million of those taxpayers chose not to use TeleFile in 1997.

IRS conducted three TeleFile surveys in 1997—one electronic and one written survey of users and one written survey of nonusers—that shed some light on taxpayers' reactions to the revised tax package and the reasons why more people did not use TeleFile.

Results of the electronic user survey showed that 30.3 percent of the TeleFile users in 1997 were repeat customers, while the rest were using it for the first time. The results also show that 84.5 percent of the users were able to complete their filing with one call to IRS, and 98.8 percent would use TeleFile again. When questioned about the new tax package, 85.2 percent of the respondents said that the package “encouraged” them to use TeleFile, 2.9 percent said that it “frustrated” them, and 2.5 percent said that it forced them to use TeleFile. Results of the written user survey showed that 88 percent of the users were very satisfied with TeleFile and another 10 percent were somewhat satisfied. Also, 97 percent of the users said they would use TeleFile again if they could, and about 96 percent said that they were very satisfied or somewhat satisfied with the new TeleFile tax booklet.

Results from the nonuser survey are critical, in our opinion, if IRS is to identify and effectively deal with barriers that are preventing eligible taxpayers from using TeleFile. In past surveys, IRS learned that most nonusers preferred filing on paper. But IRS did not solicit more specific information on the reasons for that preference. In our report on the 1996 filing season, we recommended that IRS conduct a survey of nonusers during the 1997 filing season that included some specific questions on why they prefer to file on paper.<sup>13</sup> The questionnaire IRS used for the nonuser survey in 1997 solicited more specific data on why taxpayers did not use TeleFile, which, we believe, make the results more useful than earlier surveys.

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<sup>13</sup>GAO/GGD-97-25.

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From a list of several potential reasons provided on the questionnaire, respondents were asked to identify the main reason they did not use TeleFile. The main reasons they cited were:

- filed a Form 1040 or 1040A, which made them ineligible to use TeleFile (25 percent);
- did not receive the TeleFile tax package (17 percent);<sup>14</sup>
- used a tax preparer or accountant (15 percent);
- got help from a friend or family member in filing their return (15 percent); and
- preferred a paper copy of the return for their records (12 percent).

In response to questions about the revised TeleFile package and its impact, 12 percent of the nonusers said that the package caused a great deal of inconvenience. Remembering the Taxpayer Advocate's concern that the absence of a Form 1040EZ in the revised package might significantly increase the number of mail and telephone orders for that form, IRS also asked nonusers who prepared their own returns where or how they got the tax form. Only 2 percent said that they called or wrote IRS. The vast majority (about 82 percent) said that they got the form from a post office, library, or bank. The remaining (about 16 percent) mentioned other methods, such as visiting an IRS walk-in site or downloading a form from IRS' Internet World-Wide Web site.

IRS plans few changes to TeleFile for the 1998 filing season. For example, the TeleFile package for 1998 will again not include a Form 1040EZ. However, one change that might eventually make TeleFile more attractive to taxpayers is a pilot program with Indiana and Kentucky that will allow TeleFile users to submit their state returns at the same time they file their federal return. In that regard, responses to the TeleFile nonuser survey showed that about 44 percent of the nonusers might be encouraged to use TeleFile if they could also use it to file their state tax returns.

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## Electronic Filing

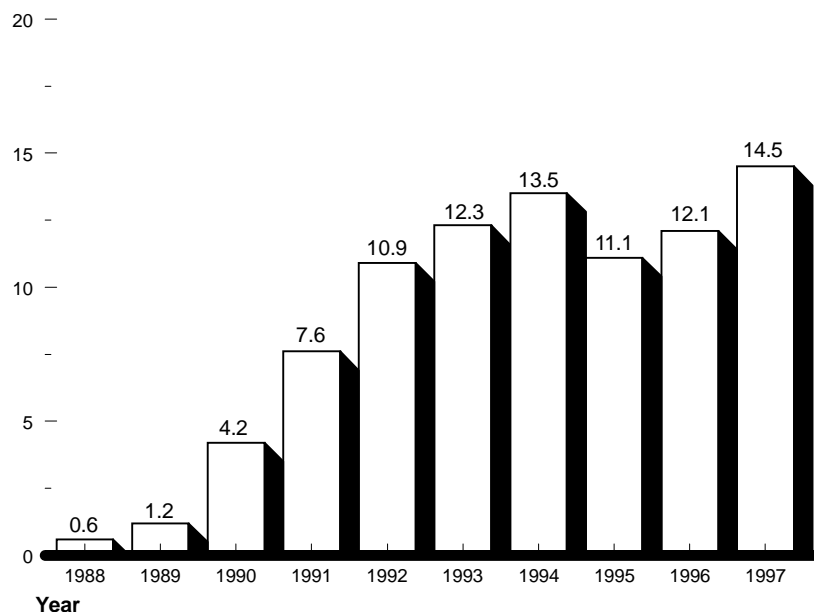
Electronic filing began as a pilot test in 1986, and the number of individual income tax returns filed electronically continued to grow each year until a drop in 1995. IRS attributed that drop to the various steps it took to deal with refund fraud. As shown in figure 1, electronic filing recovered somewhat in 1996 and continued to grow in 1997, establishing a new high of about 14.5 million returns as of October 31, 1997.

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<sup>14</sup>As of the date we completed our audit work, it was unclear why these persons would not have received the TeleFile package.

**Figure 1: Number of Individual Income Tax Returns Filed Electronically**

Number of tax returns (in millions)



Source: IRS data.

One impediment to even more growth in electronic filing is the fact that the method is not completely paperless. Taxpayers must still send IRS their W-2s and a signature document (Form 8453) after their returns have been electronically transmitted. IRS must then manually input these data and match them to the electronic returns.

In an attempt to eliminate the paper associated with electronic returns, IRS began testing the use of digitized signatures at three locations during the 1996 filing season. IRS planned to expand the test to seven locations in 1997. The seven locations included three private tax return preparation offices and four sites that were part of IRS' Volunteer Income Tax Assistance Program. Because of some technical problems with the software, however, IRS delayed its distribution to the seven test sites until April 1, 1997. Because one of the four volunteer sites prepared very few returns after April 1, it did not participate in the test.



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The test consisted of preparers offering eligible taxpayers the option of signing with a stylus “pen” on an electronic signature pad in place of signing a Form 8453.<sup>15</sup> The electronic signature would then be attached to the taxpayer’s electronic return and both would be transmitted to IRS. From April 1 through April 17, 1997, the test generated 435 returns that were submitted with electronic signatures. IRS did not collect information on the number of taxpayers who were offered the chance to participate in the test but declined. According to IRS, the six participating locations provided feedback that was overwhelmingly positive, including the reduced cost or burden from not having to store the Forms 8453 and not having to pay someone to batch, mail, and track the forms. IRS plans to conduct the test again in 1998 at the same seven locations.

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## New Procedures Enable IRS to Protect More Revenue

An important change for the 1997 filing season involved IRS’ implementation of new procedures for handling returns filed with missing or incorrect SSNs. The amount of revenue protected as a result of these new procedures greatly exceeded the amount protected under the previous procedures.

Correct SSNs help ensure that taxpayers are entitled to the credits and dependency exemptions they claim. While missing or incorrect SSNs are often the result of honest taxpayer errors, they have also been linked to fraudulent attempts to reduce tax liabilities and obtain refunds and/or Earned Income Credits. Accordingly, over the last few years, IRS has become more vigilant in checking SSNs.

During the last few filing seasons before 1997, when IRS identified a missing or incorrect SSN, it was to delay the taxpayer’s refund and correspond with the taxpayer to resolve the issue. This procedure often required multiple correspondence and months to resolve. As we reported in 1996, IRS did not have enough resources to pursue all of the cases involving missing or incorrect SSNs and ended up releasing many of the refunds associated with those cases.<sup>16</sup>

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<sup>15</sup>Eligible test participants whose returns did not include any attachments that had to be submitted on paper were also granted a waiver from the requirement to submit W-2s. According to an IRS official, tax return preparers participating in the test were instructed to review the paper W-2s and not prepare electronic returns for taxpayers whose W-2s looked fraudulent.

<sup>16</sup>Earned Income Credit: IRS’ 1995 Controls Stopped Some Noncompliance, But Not Without Problems (GAO/GGD-96-172, Sept. 18, 1996) and IRS’ 1996 Tax Filing Season: Performance Goals Generally Met; Efforts to Modernize Had Mixed Results (GAO/GGD-97-25, Dec. 18, 1996).

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IRS' SSN error procedures changed in 1997 as a result of a provision in the Welfare Reform Act of 1996. That provision authorized IRS to treat missing or incorrect SSNs as math errors, similar to the way it has historically handled computational mistakes. Under the new procedures, if IRS identifies a missing or incorrect SSN while processing a return, it can immediately adjust the return. For example, if a taxpayer claims one dependent and the child care credit, but lists an incorrect SSN for the dependent, IRS is to increase the taxable income by the personal exemption amount claimed for the dependent and not allow the child care credit. IRS then is to adjust the taxpayer's tax liability and reduce the taxpayer's refund, if any. The taxpayer is to receive a notice explaining the change to his or her tax liability and/or refund. The standard notice IRS used in 1997 provided a special toll-free telephone number that taxpayers could call if they wanted to discuss IRS' changes and/or provide corrected information to support their claims. Taxpayers could also write to IRS to resolve the issue. If taxpayers do not respond to IRS' notice, there is to be no further correspondence unless they fail to pay any additional tax that was assessed as a result of IRS' change.

In planning for this new procedure, IRS estimated that it would send about 2.4 million notices to affected taxpayers in 1997 and that those notices would generate about 1.68 million responses (telephone calls or letters) from taxpayers. As of September 1, 1997, IRS had sent about 2.2 million notices, which generated about 876,000 calls and letters. IRS said that based on those responses, it subsequently allowed some of the claims it had originally disallowed.<sup>17</sup> As of September 1, after netting out adjustments made in response to taxpayers' calls and letters, IRS reported that it had protected about \$1.46 billion in revenue (i.e., claimed refunds or credits not paid and additional taxes assessed). That is about 150 percent more than the amount of revenue IRS reported as having been protected as a result of the procedures used in 1996. That year, according to IRS, it sent out about 629,000 notices that resulted in the protection of about \$590 million.

We asked officials in the Taxpayer Advocate's Office whether the new SSN error procedures posed any problems for IRS and/or taxpayers. They said that they did have concerns about the procedures, which they voiced to IRS management before the start of the filing season. They were concerned, for example, that (1) the procedures may lead to an unmanageable

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<sup>17</sup>If a taxpayer provided IRS with a missing SSN or corrected an inaccurate SSN, IRS would adjust its change. However, not every taxpayer response resulted in an adjustment. In some cases, the taxpayer may only have wanted IRS to explain the notice or may have decided, after discussing the law and the facts with IRS, that IRS' position was correct.

workload for IRS and (2) the notices were not clear. According to the officials, as a result of their input, some changes were made before the filing season began. They also told us that they had not received a significant number of complaints from taxpayers nor had there been an increase in the number of problem resolution program cases or hardship requests for refunds.

Even though significant problems did not arise, officials of the Taxpayer Advocate's Office believed that some additional changes are needed. For example, they said that some individuals have problems obtaining an SSN or some other taxpayer identification number either because of religious affiliations or questionable alien status. Officials also think the notices should be revised to provide the taxpayer with specific information about the error.

## Lockbox Processing for Form 1040 Remittances May Not Be Cost Effective

In an effort to improve remittance processing and deposit tax receipts more timely, IRS has been using lockboxes to process tax payments, including the payments associated with individual income tax returns (Forms 1040).<sup>18</sup> IRS and FMS assume that the use of lockboxes is beneficial to the government because, in general, banks can get the payment processed and the money deposited to a Treasury account quicker than service centers can. This means that Treasury would not have to borrow as much to pay government obligations, thereby avoiding interest charges.

In our report on the 1996 tax filing season, we expressed our concern about the way IRS was using lockboxes for Form 1040 payments.<sup>19</sup> Our concern then was not with the processing of the payments but with IRS' decision to have taxpayers send their tax returns along with their tax payments to the lockboxes and to have the banks sort those returns before shipping them to IRS service centers for processing. Information we received from FMS, which has been paying the lockbox fees, and IRS indicated that having banks sort and ship tax returns increased the cost of the lockbox service by about \$4.7 million during the first 8 months of 1996. For example, FMS said that it paid the banks an average of 92 cents per return to sort the 7 million returns received during those 8 months—a

<sup>18</sup>Under the lockbox concept, taxpayers are to mail payments to a lockbox, which is a postal rental box serviced by a commercial bank. The bank is to process the payments and transfer the funds to a federal government account, record the payment and payer information on a computer tape, and forward the tape to IRS for use in updating taxpayers' accounts. In addition to Form 1040 payments, tax remittances processed at lockbox banks include estimated tax payments; various business payments, such as Federal Unemployment tax and Social Security tax; and certain vehicle use taxes.

<sup>19</sup>GAO/GGD-97-25.

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function that, according to IRS, service centers performed at an average cost of 37 cents per return. FMS also paid the banks 13 cents per return to ship the tax returns to IRS for processing.<sup>20</sup>

Our concern about the Form 1040 lockbox program has intensified since last year. We are no longer concerned only about having lockboxes receive and sort tax returns but about the use of lockboxes to process the Form 1040 payments themselves. Information we obtained this year called into question a key assumption used to calculate the interest cost avoidance figures that IRS and FMS have cited to support the use of lockboxes to process those payments.

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### IRS' Decision to Have Taxpayers Send Their Returns to Lockboxes Is Based on Inconclusive Evidence

For the last several years, IRS has been testing the use of lockboxes to process Form 1040 remittances. Those test results and various studies done for IRS led to the decision to have certain taxpayers send their returns and tax payments to lockboxes. Under the current procedure, many taxpayers receive a tax package with one envelope and two differently colored mailing labels. If their return involves a payment, they are to use one label that directs their return and payment to a lockbox. If their return does not involve a payment, they are to use the other label that directs their return to an IRS service center.

In explaining the decision to have persons who were making payments send their returns along with their payments to a lockbox, IRS officials responsible for the lockbox program said that they believed an increase in taxpayer burden would result if taxpayers were required to separate their payments from their returns and mail each to a different address. They cited the results of taxpayer surveys done in 1993 and 1994, which, they said, showed that taxpayers preferred to keep their payment and return together. IRS interpreted this preference as an indicator that asking taxpayers to separate their return from their payment would impose a burden.

We reviewed the taxpayer surveys and considered the results to be inconclusive as they relate to burden—45.9 percent of the taxpayers surveyed said that they felt uneasy about mailing their checks and returns in separate envelopes while 41.2 percent said that they did not feel uneasy (the other 12.9 percent did not know). Even for those respondents who

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<sup>20</sup>According to IRS, the banks handled about 10 million returns through the first 11 months of fiscal year 1997. According to FMS, it paid the banks an average of 86 cents per return to sort the returns and 13 cents per return to ship the returns to IRS (compared to averages of 92 cents and 13 cents, respectively, in 1996).

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said they felt uneasy, it was unclear whether they considered the use of separate envelopes an unreasonable burden when weighed against the extra cost to the government associated with sending returns to lockboxes.

We realized, in preparing our report on the 1996 filing season, that it was too late to do anything to change IRS' lockbox plans for the 1997 filing season. Thus, we recommended that IRS take action that would be effective for filing seasons after 1997. Specifically, we recommended that if the government was unable to negotiate lockbox fees that were more comparable to service center costs and in the absence of more compelling data on taxpayer burden, IRS should either discontinue having returns sorted by the banks or reconsider the decision to have taxpayers send their tax returns to the lockboxes along with their tax payments. As noted earlier, the combined fee paid banks for sorting and shipping tax returns dropped only slightly from 1996. And, as discussed below, IRS still does not have conclusive data on taxpayer burden.

In May 1997, an IRS/FMS task force that had been formed to identify a solution to this issue for 1998 and beyond recommended that IRS have taxpayers separate their returns from their payments—mailing the former to an IRS service center and the latter to a lockbox. While recognizing the extra burden on taxpayers (e.g., the extra postage associated with mailing two envelopes and possible confusion over which envelope to use), the task force said that such a procedure would minimize lockbox costs and would enable the banks to deposit remittances faster because they would no longer have to handle tax returns.

Despite the task force's recommendation, IRS decided that lockboxes would continue to receive and sort tax returns in 1998. The IRS official responsible for the lockbox program told us that IRS continues to believe that an increase in taxpayer burden would result if taxpayers were required to separate their payments from their returns and mail each to a different address, a view shared by representatives from the Taxpayer Advocate's Office. To support its position, IRS cited the results of several focus groups that became available after the task force had completed its work.

IRS held 8 focus groups in 4 cities involving a total of 29 taxpayers who prepared their own federal income tax returns and 31 tax practitioners. According to IRS, "even though there was not a dominant trend from the [focus groups], taxpayers noted the cost of two stamps and the confusion

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of two envelopes as burden issues.” Although focus groups are useful in providing insight on a particular issue, they are not statistically representative of the population and should not, in and of themselves, provide the basis for far-reaching conclusions. Given that and after reviewing transcripts of the focus groups and a July 7, 1997, summary report on the focus group results, we believe that IRS still does not have conclusive evidence that the additional taxpayer burden that may be caused by requiring the use of two envelopes would outweigh the millions of dollars in additional costs the government is incurring to have banks sort and ship tax returns.

For example, although the report noted that participants were concerned about the extra postage associated with using two envelopes, it went on to say that taxpayers participating in the focus groups viewed the extra cost “as something that would be accepted” and that “some taxpayers were willing to accept additional burden so that IRS could operate more effectively.” In that regard, focus group participants were not told about the amount of additional cost being incurred by the government to have banks sort and ship the tax returns. The report also said that “several participants voiced concern about the check being separated from the return prior to receipt by the IRS.” However, there is no evidence that participants were told how the two-envelope procedure compares to the current procedure and that, even under the current procedure, the tax return and check get separated. Under the current procedure, even though returns and payments are mailed in one envelope to one location (the lockbox), they are separated at the bank. The return is shipped to IRS for processing while the bank processes the payment.

In a July 15, 1997, memorandum to the then Acting Commissioner of Internal Revenue, Treasury’s Fiscal Assistant Secretary provided his views on the processing of Form 1040 tax payments. He noted that he had sought IRS’ support for having taxpayers mail their returns and payments separately but that IRS had rejected that option because of the perceived taxpayer burden. That left only two viable options in the Assistant Secretary’s opinion—continue the current arrangement or return the processing of Form 1040 tax payments to IRS’ service centers. The Assistant Secretary noted, however, that it was his understanding that equipment, personnel, and space issues and the lack of sufficient planning time made it infeasible to move processing back to the service centers for fiscal year 1998. Thus, he concluded that it would be in the best interest of the government to continue the current lockbox arrangement for at least 1 more year. He said that this issue should be reviewed in March/April 1998

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to make decisions about fiscal year 1999 and that IRS should continue to seek ways to reduce the cost of this program, by either changing processing procedures or by continuing its search for a resolution on how to direct the Form 1040 returns to the service centers without causing significant taxpayer burden.

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### IRS Study Calls Into Question the Validity of Interest Cost Savings

Our concerns about the Form 1040 lockbox program were heightened this year by new information relating to the interest cost avoidance figures that IRS and FMS have used to show the program's cost effectiveness. This new information calls into question not just the decision to have tax returns sent to the banks but the more basic decision to use lockboxes to process Form 1040 payments.

As part of its review, the lockbox task force compared how much various procedural options for processing Form 1040 remittances would cost IRS and FMS in 1998. Assuming a volume of 11,373,133 items, the task force estimated that the current lockbox procedure would cost about \$23.3 million, compared with about \$14.5 million if two envelopes were used<sup>21</sup> and about \$12.8 million if IRS decided to stop using lockboxes to process Form 1040 remittances and return that function to the service centers. Although this comparison would seem to argue against the use of lockboxes, IRS and FMS assume that having lockboxes process Form 1040 remittances generates savings, in the form of interest cost avoidance, that more than offset the increased IRS and FMS costs.

According to FMS, for example, lockboxes processed about 9.7 million Form 1040 tax payments from October 1996 through July 1997, which resulted in an interest cost avoidance of about \$23.8 million. As in past years, the interest cost avoidance was calculated on the basis of a general assumption that lockboxes can process and deposit tax payments an average of 3 days faster than IRS service centers during peak workload periods. The validity of that assumption is critical because, according to the lockbox task force, if lockboxes are not processing payments at least 2 days faster than service centers, the amount of interest cost avoidance would be insufficient to offset the additional costs associated with having lockboxes handle tax returns.

In that regard, the results of an IRS-commissioned study, issued in March 1997, show that, on average, lockboxes processed payments only

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<sup>21</sup>If the analysis were broadened to reflect the extra cost that taxpayers would have to incur to mail a second envelope, the cost of this option would increase by \$3.6 million (11,373,133 envelopes times 32 cents postage) to a total of about \$18.1 million.

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about 1 day faster than service centers. However, that comparison covered peak and nonpeak workload periods; there was not a similar comparison just for the peak workload period (April 13 to May 1, 1995), when most of the Form 1040 payments are received and when differences in processing times might be more pronounced. Although the reported study results are insufficient to make an informed judgment, they do raise questions about the assumption that lockboxes process payments 3 days faster than service centers. FMS had planned to commission another study to assess the comparative processing times for lockboxes and service centers. However, those plans have been deferred, and FMS could give us no assurance when such a study would be done.

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## SCRIPS Processing Rates Decline

One of IRS' major business objectives is to move away from a labor-intensive tax return processing system that relies on thousands of employees transcribing data from paper tax returns and move to an electronic system that reduces processing costs and eliminates transcription errors. One strategy for achieving that objective is to reduce the number of paper returns by increasing the number of returns filed electronically. We discussed IRS' progress in that area earlier in this report. For returns that will continue to be filed on paper, IRS planned to achieve its objective through document imaging and optical character recognition systems. SCRIPS is one such system.

IRS uses SCRIPS, which was implemented in 1994, to process tax returns filed on Form 1040EZ, Federal Tax Deposit (FTD) coupons, and information returns (e.g., Forms 1099). In January 1997, we reported that one of the major problems with SCRIPS was slow processing rates (i.e., the number of documents processed per hour).<sup>22</sup> As the data in table 4 show, this problem intensified with respect to Forms 1040EZ and FTD coupons in 1997.

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<sup>22</sup>Tax Systems Modernization: Imaging System's Performance Improving but Still Falls Short of Expectations (GAO/GGD-97-29, Jan. 16, 1997).



**Table 4: SCRIPS Processing Rates as of September 30, 1996, and 1997**

Form type	SCRIPS processing rate (documents per hour)		Percent change
	Jan. 1 through September 30, 1996	Jan. 1 through September 30, 1997	
Form 1040EZ	67	57	-15
Information returns	145	145	0
FTD coupons	722	619	-14

Source: GAO computations based on IRS data.

An IRS official in the SCRIPS project office attributed the decline in the processing rate for Forms 1040EZ, at least in part, to IRS' decision, as discussed earlier, to issue TeleFile packages that did not have a Form 1040EZ. Because the package contained no form that the taxpayer could use to file on paper, it also contained no preprinted label for the taxpayer to affix to a paper form. Successful optical character recognition operations depend, in part, on the kind of clearly printed data provided by a label. In that regard, IRS estimated that about 95 percent of the Forms 1040EZ processed through SCRIPS in 1997 did not have the scannable preprinted address label, compared with about 50 percent in 1996, causing a significant increase in the amount of data IRS had to manually transcribe.

IRS attributed the decrease in the processing rate for FTD coupons to a problem associated with the way in which blocks of data are transferred throughout the system. In those instances where characters on the document cannot be identified correctly by the scanner, the electronic block of work that contains those documents is sent to a workstation operator. That operator retrieves the block of work, reviews the image of the document to determine what corrections are needed, then updates the file, which is sent back to the file server. Each time a block of work is moved from one component of SCRIPS to another, a time delay results. According to IRS, the contractor provided a software solution to this problem and, since then, processing times have improved, except on those days when the service centers have to process the largest volumes of FTD coupons.

## Conclusions

IRS made noteworthy progress in several critical areas during the 1997 filing season. It achieved significant increases in telephone accessibility and alternative filings, and it implemented a major change in dealing with missing or incorrect SSNs, all without any noticeable major problems. A

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couple of these successes involved trade-offs. By detailing staff to answer telephone calls, IRS improved accessibility but, according to IRS, the detailing of that staff caused it to forgo some enforcement revenue. By not including a Form 1040EZ in the tax package sent potential TeleFile users, IRS apparently encouraged some taxpayers to file their returns by telephone. But, in doing so, IRS imposed some burden on recipients of the TeleFile package who needed or wanted a Form 1040EZ and caused a reduction in SCRIPS processing rates. Such trade-offs are inevitable, given the fact that IRS does not have unlimited resources, and we saw nothing to indicate that either trade-off was inappropriate.

We are concerned, however, about the cost effectiveness of IRS' use of lockboxes rather than service centers to receive and process Form 1040 tax payments. On the basis of the data currently available, we do not believe IRS is in a position to make an informed decision on whether to continue to use lockboxes for that purpose.

The results of an IRS-commissioned study suggest that the interest cost avoidance figures IRS and FMS have cited to support the use of lockboxes to process Form 1040 payments may not be valid. Although FMS had planned another study to further assess the comparative processing times and costs for lockboxes and service centers, those plans have been deferred, and it is unclear when such a study will be done. As a result, it is unclear whether the government actually realizes savings, and if so how much, through the use of lockboxes.

Because IRS has decided to continue the use of lockboxes for the 1998 filing season and it is too late to alter that decision, it seems that IRS and FMS have an opportunity during that filing season to develop the definitive data needed to make more informed decisions on the future use of lockboxes. Such data would include the average amount of time needed by both banks and IRS to process Form 1040 tax payments during both peak and off-peak periods and the average interest costs to the government of borrowing during those periods. It seems that such data would be readily available and there is still time to make any arrangements that might be needed to capture these data during the 1998 filing season.

We are equally concerned that IRS' decision to continue having taxpayers send both tax returns and payments to lockboxes is also based on inconclusive evidence. Another option would be to have taxpayers mail their payments to a lockbox and their tax returns to IRS. An IRS/FMS task force studied these two options and recommended the latter because it

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would save the government millions of dollars in payments to banks for processing the tax returns. Although Treasury's Fiscal Assistant Secretary also supported this recommendation, IRS decided against this change because of the added taxpayer burden, including mailing cost.

However, our review indicated that IRS did not have persuasive evidence on the amount of taxpayer burden, how this burden would compare with the government's savings, or whether taxpayers considered the burden to be unreasonable. The new evidence available to IRS in making its decision for the 1998 filing season was from taxpayer focus groups. The number of taxpayers participating in the focus groups was small, and the information they provided on burden was inconclusive. In that regard, the participants were not provided all of the information needed to make an informed response about the burden associated with mailing tax returns in one envelope and tax payments in another. Specifically, they were not told that mailing both tax returns and tax payments to lockboxes is costing the government, and thus taxpayers, millions of extra dollars. Had the focus group participants been informed about all the relevant factors—the additional postage and burden involved in separating returns from payments and mailing them in two envelopes versus the savings that would accrue to taxpayers overall in the form of savings to the government if this were done—we believe that they would have been in a better position to assess the trade-offs involved in deciding on the reasonableness of the burden involved.

IRS has three basic options concerning the use of lockboxes for Form 1040 tax payments: (1) continue the existing practice, (2) discontinue the use of lockboxes altogether, or (3) revise the existing practice to have taxpayers send their returns to service centers and their payments to lockboxes. In deciding which option to select, IRS faces the following two basic issues. First, in deciding between options 1 and 2, IRS needs to know whether using lockboxes to process Form 1040 tax payments generates a net savings to the government. Second, if the use of lockboxes generates significant savings, which would remove option 2 from the equation, IRS needs to know, in choosing between options 1 and 3, whether the additional savings to the government of having taxpayers send their tax returns to IRS service centers outweigh the taxpayer burden associated with taxpayers sending two different envelopes to two locations. Although these issues would involve different analyses, the results and related decisions are intertwined. That is, if the analysis for the first issue shows that using lockboxes for Form 1040 tax payments does not result in a

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significant net savings to the government and IRS decides to stop using lockboxes, the second issue would become moot.

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## Recommendations to the Commissioner of Internal Revenue

We recommend that the Commissioner of Internal Revenue require the appropriate IRS officials to conduct, during the 1998 tax filing season, the analyses necessary to determine (1) whether there are net savings to the government attributable to the use of lockboxes to process Form 1040 tax payments and (2) whether the potential savings of requiring affected taxpayers to mail their tax returns to IRS and their tax payments to lockboxes in separate envelopes outweigh the estimated additional cost and other burden that this could be expected to cause taxpayers. In doing these analyses, the officials should collect definitive data on (1) the actual time and interest cost differences between sending tax payments to lockboxes and sending them to IRS during peak and off-peak periods and (2) whether taxpayers believe, given the processing cost savings to the government, that it would cause them an unreasonable burden to mail tax returns and tax payments to different locations. If the analyses indicate that using lockboxes does not produce a net savings to the government, we recommend that the Commissioner take steps to have IRS service centers process all Form 1040 payments starting with the 1999 tax filing season. If the analyses indicate that the use of lockboxes produces savings and that taxpayers would support the practice of mailing returns and payments to different locations, we recommend that the Commissioner change the current lockbox procedures as soon as possible and instruct taxpayers to send their returns to IRS and their payments to lockboxes.

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## Agency Comments and Our Evaluation

We obtained written comments on a draft of this report from the Deputy Commissioner of Internal Revenue (see app. II). He said that IRS generally agreed with our findings and recommendations and that the ultimate determination of the benefit of using lockboxes to the taxpaying public requires information and analysis by both IRS and FMS. He said that IRS would pursue a study with FMS during fiscal year 1998 to reach a long-term decision about lockbox processing and that IRS would welcome the opportunity to assist FMS in analyzing the savings to the government attributable to the use of lockboxes to process Form 1040 tax payments.

The Deputy Commissioner also said that (1) it would be impossible to determine conclusively whether any savings from having taxpayers mail their returns and payments in separate envelopes outweighed the additional cost and other burden to taxpayers because “the perceived

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burden of this new way of paying and filing may involve intangibles which cannot be measured (e.g., a negative reaction to changes in procedures)” and (2) a broad-based study to determine taxpayers’ perception of burden and their willingness to accept that burden would be necessary to satisfy our recommendation. In addition, the Acting Chief of Customer Service, at a meeting to discuss IRS’ comments, told us that IRS would always come down on the side of reduced burden.

We agree that burden cannot be measured conclusively. However, it is not necessary to conclusively measure burden before deciding whether to use two envelopes. In fact, IRS has made other decisions involving new ways of paying and filing without measurable data on burden. For example, the decision to not include a Form 1040EZ in the TeleFile tax package involved a change in procedures that caused additional taxpayer burden by requiring taxpayers who could not or did not want to use TeleFile to find a Form 1040EZ elsewhere. IRS made that decision although it could not measure the impact of the additional burden on taxpayers. In the TeleFile case, IRS did not come down on the side of reduced burden but decided, instead, that the additional burden, though unmeasured, was acceptable given the expected benefits. In fact, IRS plans to send out the same kind of abbreviated TeleFile tax package for the 1998 filing season even though 12 percent of the TeleFile nonusers indicated that the package IRS sent out for the 1997 filing season caused a great deal of inconvenience. We believe that asking taxpayers to use two envelopes might be another instance where IRS might accept a small amount of burden, if the potential savings to the government are significant.

It is unclear what, if anything, IRS intends to do to get better information on burden. However, if it decides to obtain more definitive data, it is important that it structure its data collection to get specific input from taxpayers on their willingness to assume the additional burden of dealing with two envelopes in light of the savings to the government. Among other things, that would mean asking them to compare the two-envelope approach with the current approach and making sure, for both approaches, that they know the government’s costs and benefits.

With respect to our second recommendation, the Deputy Commissioner indicated that necessary studies could not be done and analyzed in time to make changes for the 1999 filing season, given the lead time needed in awarding contracts for the printing of tax packages. We do not understand why this would be the case. It seems to us that at least the first stage of the analysis sought by our recommendation—whether the government saves

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money by using lockboxes—can be made in time. Our prior analyses of IRS data indicate that the key data needed to make that determination—the comparative time it takes lockboxes and service centers to process and deposit Form 1040 payments—should be readily available and can be compiled and analyzed relatively quickly. There is no reason we are aware of that such analysis could not be done using data from the 1997 filing season, rather than waiting for new data from the 1998 filing season. Thus, if the analysis shows that the government is not benefiting from the use of lockboxes, IRS should have time to make the necessary changes to the tax packages for 1999.

The second part of the analysis, which considers burden, would only be needed if the first part shows that using lockboxes to process Form 1040 payments saves the government money. If the analysis shows that it does not save the government money, IRS could change the procedure for handling Form 1040 tax payments without further analyzing burden. The revised procedure would still involve one envelope, but the envelope would be mailed to a service center rather than a lockbox. Since that change would result in all returns (remittance and nonremittance) being mailed to IRS, it would not only avoid the additional burden of having taxpayers deal with two envelopes but also reduce existing burden by negating the need for taxpayers to deal with two mailing labels.

We revised our second recommendation to recognize the different decisions that will confront IRS depending on the results of the analyses called for in our first recommendation. As part of that revision, the reference to the 1999 filing season now applies only if the first part of the analysis shows that the government is not saving money by using lockboxes to process Form 1040 payments.

In commenting on this report, the Deputy Commissioner identified a number of actions IRS took during the 1997 filing season and asked that we include the information in our report (see app. II). Some of the actions identified by the Deputy Commissioner, such as those relating to electronic tax administration, level of access, and complex tax law questions, are discussed in our report. However, we did no audit work on several other actions mentioned by the Deputy Commissioner and thus cannot comment on their effectiveness.

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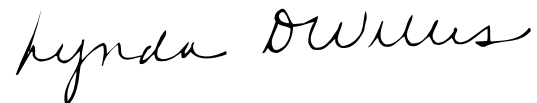
We are sending copies of this report to the Subcommittee's Ranking Minority Member, the Chairmen and Ranking Minority Members of the

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House Committee on Ways and Means and the Senate Committee on Finance, various other 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.

Major contributors to this report are listed in appendix III. Please contact me on (202) 512-9110 if you have any questions.

Sincerely yours,

A handwritten signature in cursive script that reads "Lynda D. Willis".

Lynda D. Willis  
Director, Tax Policy and  
Administration Issues

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## Abbreviations

FMS	Financial Management Service
FTD	Federal Tax Deposit
IRS	Internal Revenue Service
SCRIPS	Service Center Recognition/Image Processing System
SSN	Social Security Number



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# Toll-Free Telephone Accessibility Test

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To assess the ability of taxpayers to reach IRS by telephone to ask a question about the tax law or their accounts, we conducted a nonstatistical test of IRS' toll-free telephone assistance system. Our results relate just to the test calls; they cannot be projected. To conduct the test, we placed telephone calls at various times during each workday from March 31 through April 15, 1997. We made our calls from five metropolitan areas—Atlanta, Chicago, Kansas City, San Francisco, and Washington, D.C. Each attempt to contact IRS consisted of up to five calls spaced 1 minute apart. If we reached IRS during any of the five calls and made contact with an assistor, we considered the attempt successful. If we reached IRS during any of the five calls but were put on hold for more than 7 minutes without talking to an assistor, we abandoned the call, did not dial again, and considered the attempt unsuccessful (abandoned). If we received a busy signal, we hung up, waited 1 minute, and then redialed. If after four redials (five calls in total) we had not reached IRS, we considered the attempt unsuccessful. In conducting our test, we did not ask questions of the assistors because it was not our intent to assess the accuracy of their assistance.

We attempted to contact IRS 330 times. Of 330 attempts to contact an assistor, 211 (64 percent) were successful—162 on the first call, 22 on the second call, and 27 after 3 to 5 calls. When the 16 calls that resulted in access to IRS' voice messaging system were added, accessibility to IRS assistance increased to 69 percent. In another 69 cases (21 percent), we accessed IRS' system but were put on hold more than 7 minutes and thus hung up before making contact with an assistor. The remaining 34 attempts (10 percent) were aborted after we received busy signals on each of our 5 dialing attempts. Our 330 attempts to contact an assistor required a total of 584 calls to IRS' toll-free telephone number. Of those 584 calls, we succeeded in contacting an IRS assistor 211 times—a 36-percent accessibility rate.

We followed the above methodology to conduct our 1995 test, but we placed telephone calls from two additional metropolitan areas (Cincinnati and New York) and for two separate 2-week periods (January 30 through February 11, 1995, and April 3 through April 15, 1995). Results of the 1995 test cited in the body of this report are only for the 2-week period from April 3 through April 15, 1995.

# Comments From the Internal Revenue Service

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

DEPUTY COMMISSIONER

November 26, 1997

Ms. Lynda D. Willis  
Director, Tax Policy and  
Administrative Issues  
U.S. General Accounting Office  
441 G Street, NW  
Washington, DC 20515

Dear Ms. Willis:

Thank you for the opportunity to review the draft report of "Tax Administration: IRS' 1997 Tax Filing Season." We are generally in agreement with the findings and recommendations contained in the report. Although the Service recognizes the need to focus on the areas where it can improve, we also believe this report should convey the overall effectiveness of the IRS. Attachment 1 provides a summary of our accomplishments that either were not addressed or are less prominently reflected within the report.

With regard to all of the specific recommendations in the report, the ultimate determination of the benefit of this practice to the taxpaying public requires information and analysis by both the IRS and Financial Management Service (FMS). We will pursue such a study with the FMS during fiscal year 1998 to reach a long term decision relative to Lockbox processing. The following is a response to each recommendation:

#### RECOMMENDATION

We recommend that the Commissioner of Internal Revenue require the appropriate IRS officials to conduct, during the 1998 tax filing season, the analyses necessary to determine:

- (1) Whether there are net savings to the government attributable to the use of lockboxes to process Form 1040 tax payments.

#### COMMENTS

We agree that this analysis is necessary and would welcome the opportunity to assist the FMS in such an analysis. While the IRS can determine the cost of processing remittances and returns at the service centers, the FMS has responsibility for determining the cost of processing remittances and handling of documents at the

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Ms. Lynda D. Willis

Lockbox sites. The FMS pays the Lockbox fees, receives privileged costing information from the banks, and is the acknowledged source of cost information.

RECOMMENDATION

(2) Whether the potential savings of requiring affected taxpayers to mail their tax returns to IRS and their tax payments to lockboxes in separate envelopes outweighs the estimated additional cost and other burden that this could be expected to cause taxpayers.

COMMENTS

We agree that this information would be helpful. However, even if the FMS determined the cost of Lockbox processing and there was a potential savings by requiring taxpayers to separate their payments and returns, it would still be impossible to determine conclusively whether the additional cost and other burden to the taxpayers would be outweighed. Taxpayer burden is traditionally measured in terms of cost and time spent; however, the perceived burden of this new way of paying and filing may involve intangibles which cannot be measured (e.g., a negative reaction to changes in procedures).

RECOMMENDATION

In doing these analyses, the officials should collect definitive data on:

(1) The actual time and interest cost differences between sending tax payments to lockboxes and sending them to the IRS during peak and off-peak periods.

COMMENTS

We agree that an informed decision cannot be made without this data. However, as mentioned before, the cost differences must be calculated by the FMS and would, at a minimum, involve a planned study which has not yet been initiated. As there is a differing opinion on the advantage of redirecting this workload, we are supportive of a second study. It is important to note that the study should encompass both the off-peak and peak periods, as the two periods are not comparable.

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Ms. Lynda D. Willis

RECOMMENDATION

(2) Whether taxpayers believe, given the processing cost savings to the government, that it would cause them an unreasonable burden to mail tax returns and tax payments to different locations.

COMMENTS

Feedback at previous IRS Tax Forums has indicated that taxpayers are not particularly receptive to cost savings to the government versus their own inconvenience and cost. On the other hand, focus groups have indicated that the additional cost incurred by the taxpayer population would be acceptable if it meant that the IRS was operating more efficiently. A broad-based study to determine taxpayer perception of entailed burden and willingness, in light of the cost benefit to the Service, to embrace change would be necessary to satisfy this recommendation. We would include both individual taxpayers and the tax practitioner community in such a study.

RECOMMENDATION

If the analyses indicate that the use of lockboxes produces significant savings and that taxpayers would support the practice of mailing returns and payments to different locations, we also recommend that the Commissioner change the current Lockbox procedures and instruct taxpayers to send their returns to the IRS and their payments to lockboxes starting with the 1999 tax filing season.

COMMENTS

As noted in the report, there is no conclusive data either way on these issues. If the results are as described in the recommendation, we agree that, ideally, implementation should be targeted to the tax filing season subsequent to the analyses. However, it is our opinion that there may not be enough lead time to set up the necessary focus groups, mail float studies, etc., in time to include the beginning of the 1998 filing season. To delay start-up further into the filing season would result in an abbreviated period for data collection, as in no circumstance could any data collected through the May/June period, at the end of the filing season, be analyzed and recommendations made prior to the award of the 1999 tax package contracts in the spring.

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Ms. Lynda D. Willis

Lockbox processing is only one of many services we offer; therefore, it is our hope that the final report will acknowledge some of our accomplishments that best reflect the IRS' performance during what I believe was an extraordinarily successful filing season. Therefore, I am requesting that our response to the draft report be included in the appendix of the final report.

If you have any questions, please call Floyd Williams, National Director for Legislative Affairs, at 622-3720.

Sincerely,



Michael P. Dolan

Attachment

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Attachment 1

**TAX RETURN PROCESSING:** From January 1 through October 1997, the IRS successfully received and processed over 120 million individual income tax returns. Over 81 million individual taxpayer refunds, totaling almost \$105 billion, were issued with an accuracy rate of 99.6 percent. Published Customer Service Standards for refund timeliness for both paper and electronically filed returns were exceeded.

**ELECTRONIC FEDERAL TAX PAYMENTS:** During FY 1997, the IRS received \$348.3 billion in electronic payments. We enrolled 1,109,210 required, 573,954 voluntary, and 509 individual taxpayers into the Electronic Federal Tax Payment System.

**LOCKBOX:** Lockbox payments of \$213 billion were deposited during the fiscal year. This represents a total of 75,154,895 transactions processed.

**DIRECT DEPOSIT:** Based on this year's change on the 1040 series returns, which allowed taxpayers to request the direct deposit option without preparing a separate form, direct deposit substantially increased by 57.2 percent.

**SCRIPS:** The SCRIPS sites succeeded in processing over 90 percent of the Forms 1040EZ and all paper federal tax deposits (FTDs) through SCRIPS.

**ELECTRONIC TAX ADMINISTRATION:** The IRS has made considerable progress in expanding the electronic filing options available to taxpayers. These options provide significant benefits to both taxpayers and the IRS, including faster refunds and an error rate of less than one percent. In 1997, approximately 14.5 million taxpayers used the electronic filing system which allows individual taxpayers to file tax returns electronically through an IRS approved electronic return originator. More than 4.3 million of these taxpayers also took advantage of the opportunity to file their state tax returns simultaneously. An additional 4.7 million taxpayers filed their tax returns by making a simple telephone call to the TeleFile system, a dramatic 65 percent increase over 1996. This highly successful system recently won the 1997 "Innovations in American Government Award" sponsored by the Ford Foundation. During 1997, the IRS also continued its electronic filing program for Forms 941, Employers' Quarterly Federal Tax Return, receiving well over 400,000 returns electronically. In addition, 165,000 employment returns were filed during the pilot of Form 941 TeleFile, which will be implemented nationwide in 1998.

**LEVEL OF ACCESS:** Improved telephone level of access continues to be a priority. As stated in the report, we increased the level of access over the past two filing seasons to a high of 71 percent – fully a 20 percent increase in service to the public and a number which greatly exceeded our 1997 goal.

See comment 1.

See comment 2.

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See comment 3.

Total calls answered for the fiscal year increased from 99.2 million in 1996 to 103.9 million in 1997. As we continue to improve our use of resources, including the use of corporate routing to improve our responses to incoming calls, and as we acquire updated telephone equipment, we anticipate that customer service will continue to improve.

COMPLEX TAX LAW QUESTIONS: To further increase productivity and improve telephone access, taxpayers with more complex tax law questions were encouraged to leave messages in order to receive call-backs. As a result, the taxpayers who were thus contacted received one-on-one service from experienced examination employees, freeing other employees to receive more calls of a less complex nature. Although the GAO mentioned lost tax assessments caused by use of examination employees, we feel that the program was worthwhile and resulted in reduced taxpayer burden and enhanced customer service. Without this program, the only alternative for these taxpayers would be to visit an IRS office, remain on hold by telephone, or visit a paid preparer's office.

See comment 4.

INITIAL CONTACT RESOLUTION: Initial Contact Resolution (ICR) is a measurement tracking system to determine the extent to which we resolve inquiries at the first IRS contact by the taxpayer. We studied both written and walk-in contacts, and found the ICR rate consistently above 95 percent. This filing season we will track on-line operations and anticipate similar success rates.

SIMPLIFIED INDIVIDUAL INCOME TAX FORMS: The 1996 individual income tax forms were simplified and taxpayer burden was reduced by eliminating several check boxes and a line on Form 1040. We also helped reduce taxpayer burden on Form 1040A by providing segmented lines to enter dollars and cents. The segmented lines ensure that entries are correct, thereby reducing errors and the need to send notices to taxpayers. Another change which reduced taxpayer burden was the addition of a paid preparer signature section on Form 1040EZ. The IRS expanded eligibility to use the shorter Schedule C-EZ for sole proprietors to report income and expenses from the business.

EASIER INDIVIDUAL INCOME TAX FORMS INSTRUCTIONS: All individual income tax packages now include a "Quick and Easy Access to Tax Help and Forms" page which lists all the ways to obtain information and assistance from the IRS. The IRS sent streamlined forms instructions to ten million taxpayers who file the simpler Form 1040.

CD ROM PRODUCT: An expanded CD-ROM product that contained over 2,000 tax forms, publications and other products for small businesses, return preparers and others who frequently need current or prior year items was made more widely available.



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**BANK, POST OFFICE, LIBRARY PROGRAM:** Based on a statistically valid sample of 7292 accounts from the Bank, Post Office and Library Program (BPOL), statistical procedures were used to estimate that the total for the 10 standard products (Form 1040, Form 1040A, Form 1040EZ, Instructions 1040, Instructions 1040A, Instructions 1040EZ, Schedule A & B, Schedule EIC, Schedule 1, and Schedule 2) remaining at all BPOL outlets (approximately 40,000) at the end of the 1997 filing season, was 43.2 million. This was a reduction from 50.5 million the previous year.

Recommended order amounts for the 1997 filing season were developed for each of the approximately 40,000 BPOL accounts. The methodology for developing these recommended amounts and involved the analysis of data from a variety of sources, including initial orders and reorders for all accounts and end-of-season inventory data for over 7,000 accounts. It also used demographic data for each of the 3,200 counties in the United States. It is estimated that the use of this methodology, rather than simply recommending what the accounts received the previous year, resulted in savings for the 1997 filing season.

**NEW RETURN ADDRESS ON TAX PACKAGES:** Changing the return address on the tax packages redirected many tax returns and payments to the Philadelphia Service Center rather than the Area Distribution Centers. Historically, many taxpayers have used the return address as the mailing address when submitting their returns and remittances. By changing the address to a service center, those returns and remittances, approximately \$15 million, were processed and deposited in a more efficient and expeditious method.

**OUTPUT MEDIA PROJECT OFFICE:** We successfully procured the code Address Hygiene software product for implementation in all service centers. Address hygiene is a requirement of the United States Postal Service (USPS) in order for the IRS to continue to receive postal discounts, which involve millions of dollars in savings. An experienced vendor provided assistance to the service to conduct an A-76 study of Print/Mail consolidation versus Contracting Out which resulted in an approved project plan.

**ELECTRONIC INFORMATION SERVICES:** Significant strides were made in providing access to tax information electronically. There was increased availability through 24 hour, 7 day a week service, reducing burden in locating information, and providing faster more cost efficient service. Taxpayers increasingly turn to the IRS' Internet site to get the tax information they need. Hit count on the web site was up 117 percent from last filing season (over 117 million hits recorded in 1997 filing season). Taxpayers also used the Internet more often to download tax forms and information; over 6.3 million tax products were downloaded, up from the 1996 filing season figure of 2.4 million.

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We also piloted answering tax law questions via electronic mail. (No taxpayer account questions were handled due to security concerns.) IRS assistors answered over twice the number of E-mail inquiries per hour as compared to telephone inquiries.

The IRS TaxFax system was by far the fastest growing electronic information service (over 1100 percent in just a year). Taxpayers retrieved over 597,000 faxes this filing season (over 1 million tax products since up to 3 products may be ordered with each fax call). Last year about 50,000 faxes were sent out. Based on the products being accessed, small businesses represent a significant part of the TaxFax audience.

The Digital Dispatch, yet another successful electronic information service to improve customer communications, was launched this year. This service allows customers to sign up for an E-mail newsletter for the latest tax news and information.

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The following are GAO's comments on IRS' letter dated November 26, 1997.

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## **GAO Comments**

1. IRS says that lockbox payments of \$213 billion were deposited during fiscal year 1997. That figure covers all tax payments processed by the lockbox banks. The lockbox discussion in our report focuses only on the processing of Form 1040 tax payments.
  
2. IRS says that the SCRIPS sites succeeded in processing over 90 percent of the Forms 1040EZ through SCRIPS. However, only 5 of IRS' 10 service centers have SCRIPS. The 90-percent figure cited by IRS means that SCRIPS was used to process 90 percent of the Forms 1040EZ filed at those 5 centers. The other five centers used the traditional keypunching system to process the Forms 1040EZ they received. Also, as noted in our report, while the 5 SCRIPS centers may have processed 90 percent of the Forms 1040EZ they received, they did so at a slower rate than in 1996.
  
3. IRS says that the number of telephone calls answered increased from 99.2 million in fiscal year 1996 to 103.9 million in fiscal year 1997. These numbers differ from the numbers cited in table 2 of our report because (1) our numbers are for the filing season (January 1 through mid-April) while IRS' numbers are for the fiscal year (October 1 through September 30) and (2) our numbers include just those calls answered by IRS assistors, while IRS' numbers include calls answered by assistors and by automated systems, such as TeleTax (a system that has prerecorded information on about 150 topics).
  
4. IRS cites an initial contact resolution rate of above 95 percent. However, as IRS says, that rate only covers walk-in contacts and correspondence. It does not reflect the extent to which telephone inquiries are resolved with one contact.

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