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GAO

Report to the Honorable Rob Portman, Committee on Ways and Means, House of Representatives

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TAX ADMINISTRATION

IRS Measures Could Provide a More Balanced Picture of Audit Results and Costs

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GAO

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The Honorable Rob Portman
Committee on Ways and Means
House of Representatives

Dear Mr. Portman:

The Internal Revenue Service's (IRS) mission is to collect the proper amount of taxes at the least cost to the federal government and taxpayer. As part of its effort to achieve its mission, IRS audits all types of tax returns to determine whether taxpayers have reported their correct tax liabilities. IRS spends over a billion dollars annually on its audit programs, including staff costs. These audits also impose costs and burdens on taxpayers. On the basis of its audits, IRS annually recommends that taxpayers pay additional taxes totaling tens of billions of dollars.

IRS has traditionally measured the overall results of audits by the amount of recommended additional taxes and by the amount of direct staff time used in an audit. In 1994, we reported that these measures for large corporations provided an incomplete picture of audit results, because much of the recommended taxes had not been assessed and collected after being disputed by taxpayers.[1] As a result, we recommended that IRS expand its measures for audits of large corporations to include the percent of recommended taxes that is ultimately collected. In its budget request to Congress for fiscal year 1999, IRS continues to report audit revenues only as dollars recommended.

This report responds to your request for information about IRS' measures of the results of its audits of tax returns. Our objective was to determine how much of the additional taxes recommended in all types of audits that were closed in fiscal years 1992 through 1997 had been settled or were still in dispute and, if settled, how much had been assessed and collected as of September 27, 1997. In addition, for audits closed in fiscal year 1992, our objectives were to determine how much of the recommended additional taxes had been assessed and collected across all types of audits and whether broad IRS measures of audit results fully represented audit revenues and costs.

[1]Tax Administration: Compliance Measures and Audits of Large Corporations Need Improvement (GAO/GGD-94-70, Sept. 1, 1994).

Background

IRS has a multistage process that governs audits and settlements of disputes over the additional taxes recommended. In an audit, an auditor, usually from IRS' Examination Division, is to review a taxpayer's books and records to determine compliance with tax laws in reporting the proper amount of tax. Auditors usually recommend additional tax assessments but may recommend a decrease or no change in the tax reported on the return, depending on the documentation provided by the taxpayer. If the taxpayer agrees to pay or does not respond to IRS' notices on recommended additional taxes, IRS assesses the tax—that is, formally notifies the taxpayer that the specified amount of tax is owed and that interest and penalties may accrue if the tax is not paid by a certain date.

Taxpayers who do not agree with the recommended additional taxes can (1) file a protest with the IRS Office of Appeals, (2) take the dispute to tax court without paying the recommended tax, or (3) pay the tax and claim a refund in the U.S. Court of Federal Claims or a federal district court. Of these options, taxpayers usually protest to IRS Appeals.[2] Appeals settles most of these disputes, and the remainder are docketed for trial. If Appeals is unsuccessful in settling the dispute, the Office of Chief Counsel gets involved in settlement as well as in any trial. The agreements made in settlements and the rulings made in trials dictate how much of the disputed amount gets assessed. The assessed amount—not the recommended amount—establishes the taxpayer's liability. If taxpayers do not pay the taxes that are assessed, IRS can take action to collect the taxes.

IRS tracks the additional taxes recommended by audit classes, which are based on the amount of reported income or assets and type of return. Across the audit classes, tax returns vary in complexity, ranging from simple individual returns to complex corporation returns. The classes include specialized audit programs, such as the Coordinated Examination Program (CEP) for the nation's largest corporations.

The range of size and complexity across tax returns affects the amount of time and resources IRS uses to audit a return and resolve disputes over the assessment of recommended taxes. Audits of large corporations usually take 2 to 3 years. If the large corporation disputes the recommended additional taxes, another 2 to 3 years can elapse in trying to settle the dispute through Appeals; several additional years may be needed if the dispute goes to trial. For smaller, less complex returns, the time IRS uses to

[2]Taxpayers also may appeal audits that recommend decreases or no changes to the reported tax when they believe that their tax liabilities should be even less.

audit and settle any disputes over recommended tax assessments is shorter; but these processes usually take at least 1 year.

To deal with this varying complexity, IRS has three types of auditors. First, lower graded tax examiners at IRS service centers audit simpler individual returns through correspondence. Second, higher graded revenue agents from IRS district offices visit individuals, corporations, and other types of taxpayers to address the most complex tax returns; they also work in teams to audit CEP and some other large corporations. Third, tax auditors, who usually do audits by meeting with taxpayers at a district office, fall in the middle ranges regarding their grades and the complexity of their audits. IRS' appeals officers also differ by their grades and by the complexity and size of their workloads.

Results in Brief

For audits closed in fiscal years 1992 through 1997, IRS recommended tens of billions of dollars in additional taxes for each year. IRS reported these recommended taxes to Congress as its audit results. However, not all recommended taxes are assessed; and not all assessed taxes are collected. For example, as a result of the fiscal year 1992 audits, IRS had assessed 34 percent ($8.5 billion) of the $24.8 billion in recommended additional taxes as of September 27, 1997. IRS had settled another 40 percent ($9.9 billion) without assessing the recommended taxes, usually because of Appeals' decisions, and had yet to settle the assessment status of the other 26 percent ($6.4 billion). Of the $8.5 billion assessed, IRS had collected 72 percent ($6.1 billion), which means that 25 percent of all recommended taxes for fiscal year 1992 audits had been collected as of September 27, 1997. For audits closed in fiscal years 1993 through 1997, assessment and collection results were less complete because less time had elapsed for these actions to occur compared with 1992.

The assessment and collection rates varied by the type of audit closed in fiscal year 1992. In general, IRS assessed a higher percentage of the recommended taxes but collected a lower percentage of the assessed taxes for simpler audits compared with complex audits. However, IRS collected a higher percentage of the recommended taxes from the simpler audits than complex audits. For simpler service center audits, IRS had assessed 76 percent of the recommended taxes but had collected 56 percent of the assessed taxes as of September 27, 1997. As of that date, all of the service center audits had been settled. At the other extreme, after audits of complex returns from CEP corporations, IRS had assessed 20 percent of the recommended taxes but had collected 97 percent of the assessed taxes. As of September 27, 1997, 39 percent of the amounts recommended in CEP audits were still in dispute. Overall, IRS had collected less than half of the recommended taxes across all types of audits—ranging from 20 percent (CEP) to 43 percent (service center).

IRS' existing performance measures do not cover all audit-based revenues or costs. Measuring the taxes recommended does not account for the related assessments and collections; nor does it account for indirect revenue gains, such as when audits enhance voluntary compliance. Measuring other types of revenues is important because not all recommended taxes are assessed or collected. IRS measures the staff time directly charged to audits but not the dollar costs of this direct time. Likewise, IRS does not measure indirect costs incurred by the Examination Division for training, office space, and the like or the direct and indirect costs that audits create outside of the Examination Division for IRS as well as for taxpayers. Compiling complete and reliable data on the indirect revenues and taxpayer costs can be very difficult to do because of limitations in the data sources and research.

Beyond these limitations, IRS did not use other existing data to develop and report measures that more fully represented audit results. For example, in reporting audit results, data on taxes recommended could be balanced with data on taxes assessed and collected. If these existing assessment and collection data were reported, fuller insights would be available on IRS' audit revenues. For additional measures, audit revenues could be compared with related costs. To develop such measures, IRS would need more data on both direct and indirect costs. Given the problems inherent in collecting and analyzing data on indirect costs, the role of management judgment in making decisions about audits and audit resources will continue to be essential.

Scope and Methodology

To address our objectives on the assessments, collections, and costs related to taxes recommended in audits, we used IRS' Enforcement Revenue Information System (ERIS) data as of September 27, 1997.[3] Our analyses started with audits closed in fiscal year 1992. According to IRS officials, ERIS data were unreliable prior to 1992. We focused most of our analyses on 1992, instead of later years, to allow the most time for assessment and collection actions to have been taken on additional amounts recommended in audits. Because ERIS attempts to continually

[3]Since 1990, IRS has used ERIS to track actions taken outside of the Examination Division on recommended additional taxes (app. I provides further information on ERIS).

update the status of these recommended amounts, ERIS' data could differ from data in other IRS systems that are not doing such updating.

We did not test the reliability of the data provided to ERIS by other IRS systems or data processed by ERIS.[4] However, we followed up with IRS on any anomalies that we found in the data and adjusted the data or our methodology as needed. For example, as a result of questioning by us and other IRS officials, ERIS officials discovered a mistake during April 1998 in the documentation provided to us for interpreting ERIS data on the settlement status of recommended taxes. Subsequent discussions with ERIS officials clarified the approach to use for interpreting the ERIS data. IRS officials concurred with the analytical results generated from using this approach.

To determine how much of the recommended additional tax amounts had been settled, assessed, and collected as of September 27, 1997, for audits closed in fiscal years 1992 through 1997, we matched the recommended amounts to actions taken in Appeals or the Office of Chief Counsel.[5] In calculating the final assessments, we subtracted amounts that IRS initially assessed from the additional taxes recommended but later abated.[6] Then, for each fiscal year, we added the assessments and collections that took place in each IRS function—Examination, Appeals, and Chief Counsel—to obtain the overall results for the audits. We arrayed these results by the fiscal year of the audit closure to develop a broad picture of what happened to recommended tax amounts. (App. II shows the results for each fiscal year for seven types of audits.)

To determine how much of the recommended additional tax amounts had been assessed and collected as of September 27, 1997, by type of audit closed in fiscal year 1992, we did analyses similar to those done for our first objective. We expanded the analyses to array the results by seven types of audits. We developed these 7 types from 30 subcategories that IRS used to classify audits by type of tax return, tax, or taxpayer (app. III

[4]These systems include the individual and business masterfiles, the Audit Information Management System, and other systems on IRS enforcement actions.

[5]In addition to recommending additional taxes, IRS officials said audits produce revenue in other ways. For example, IRS audits "protect" revenue (e.g., disallow claims filed by taxpayers for refunds of previously assessed taxes) and generate interest on additional assessments. Our analyses excluded protected revenue because our objective was to track the recommended additional taxes. We excluded interest because it is a function of time and is not recommended by Examination.

[6]Auditors can recommend (1) additional taxes, (2) reductions in taxes, or (3) no changes in taxes. The audit results in this report do not include recommended reductions in taxes because our objectives dealt with actions taken on the recommended additional taxes.

shows the subcategories).[7] The seven types include income tax audits at IRS service centers or at IRS district offices of nonbusiness individuals, business individuals, small corporations, non-CEP large corporations, and CEP corporations as well as those audited for other types of tax liabilities.[8] At the request of IRS officials, we separately analyzed service center and CEP audits because of their specialized natures.

To determine whether IRS' broad measures of audit results fully represented audit revenues and costs, we reviewed IRS' budget submissions for fiscal years 1998 and 1999 to see the data reported as audit results and performance measures. We analyzed available ERIS data on the revenues and costs associated with audits to identify audit measures that could be developed. We then created three ratios of tax revenues to costs for audits closed in fiscal year 1992. These ratios compared additional taxes recommended, assessed, and collected with the related direct costs through each of these stages. We arrayed these three ratios across the seven types of audits.

For the revenues, we used available IRS data on the additional taxes recommended, assessed, and collected. For the costs, we used available data on direct time charged by staff who do the audits and settle disputes over the additional taxes recommended;[9] data on the direct staff time to collect the additional taxes assessed were not available. We identified the direct hours charged by staff grade level in Examination, Appeals, and Chief Counsel.[10] We then applied an hourly rate to the grade levels by using the General Schedule pay tables for 1992 through 1997. For each grade, we adjusted the midpoint of the pay scale to account for locality pay. We accounted for work hours available and costs of staff benefits, such as paid vacation and sick leave, by using Office of Management and Budget Circular No. A-76.[11] Using these factors, we computed the direct staff costs.

[7]The categories used by IRS to classify audits may change if IRS is restructured as proposed by the Commissioner of IRS.

[8]The difference between nonbusiness and business individuals depends on whether most of the reported income derives from self-employment in a business. The difference between a small and large non-CEP corporation depends on whether a corporation reports less than $10 million in assets. The large corporation category also includes audits of foreign corporations. The “other” category includes all other tax liabilities, such as employment, gift, and estate taxes.

[9]Direct time charged by staff excludes time charges for such things as training or administration.

[10]In computing the direct costs, we included audits that resulted in no change or in a reduction to the tax reported on the return. We reasoned that IRS incurred these costs in an attempt to identify taxpayers owing additional tax amounts.

[11]When we began our review, ERIS data did not include the costs of staff benefits. We shared our computation of these costs with IRS officials. ERIS now includes the costs of staff benefits.

We discussed our methodology and our results with IRS officials who manage ERIS or who manage the audit, settlement, and collection activities. We incorporated their suggestions into our work as appropriate. We requested comments on a draft of this report from the Commissioner of Internal Revenue. His comments are discussed near the end of this letter and reprinted in appendix V. We performed our audit work at IRS' National Office in Washington, D.C., between July 1997 and May 1998 in accordance with generally accepted government auditing standards.

IRS Assessed and Collected Only Part of the Taxes Recommended

IRS annually reports to Congress on the amount of additional tax and penalties recommended in audits closed in each fiscal year. For the years we reviewed, the recommended amounts ranged up to about $32 billion. However, the recommended amount does not represent the actual revenue resulting from IRS' audits. As of September 27, 1997, less than half of the recommended amount had been assessed as additional taxes, and not all of the assessed amount had subsequently been collected.

For fiscal year 1992 audits, as of September 27, 1997, IRS had assessed $8.5 billion (34 percent) of the $24.8 billion in recommended additional taxes. IRS settled another 40 percent of the recommended additional taxes without ultimately assessing the recommended additional taxes for various reasons. These reasons included taxpayer claims; decisions in Appeals or the courts; and reductions (i.e., abatements) of amounts that had initially been assessed.[12] Disputes on the final 26 percent of the additional recommended taxes had yet to be settled. As of September 27, 1997, IRS had collected $6.1 billion—or 72 percent of the additional taxes assessed and 25 percent of the additional taxes recommended. Table 1 shows these results for audits closed in fiscal year 1992 as well as for fiscal years 1993 through 1997.

[12]Certain factors can reduce or eliminate assessments from audit-based recommendations. For example, (1) prior to assessment, recommended taxes that were upheld by Appeals can be offset by taxpayers' claims, such as those for net operating losses carried over from other tax years and (2) after the audit and appeals processes, taxpayers may provide additional information that can offset the taxes assessed. IRS' databases cannot easily track all these factors. In our report GAO/GGD-94-70, we recommended that IRS improve its databases to begin accounting for such factors.

Table 1: Status of Additional Amounts Recommended for Audits Closed in Fiscal Years 1992 Through 1997, as of September 27, 1997

Dollars in millions[a]

		Settlement status of recommended amounts			Collection status		
Fiscal year	Recommended amounts[b]	Percent of disputes unsettled	Percent not assessed[b]	Percent assessed	Collected amounts	As percent of amount assessed	As percent of amount recommended
1992	$24,833	26%	40%	34%	$6,138	72%	25%
1993	22,022	25	35	40	6,022	68	27
1994	22,637	31	28	41	6,059	65	27
1995	27,184	41	19	40	6,878	63	25
1996	30,771	46	18	36	6,737	61	22
1997	31,691	55	7	38	6,447	54	20

Note: Appendix II shows these results for each fiscal year for the seven types of audits.

[a]Dollars are in current dollars.

[b]Recommended amounts are considered "not assessed" when (1) they are not sustained during IRS' appeals process; (2) they are sustained during appeals but offset by taxpayers' claims, such as net operating losses from other tax years, before being assessed; and/or (3) they were initially assessed but later abated because of information or claims filed by the taxpayers.

Source: GAO analysis of IRS ERIS data.

Since 1992, the results of the audits were less complete because larger percentages are unsettled for each succeeding year, reaching 55 percent in 1997. As more settlements occur over time, the rates at which the recommended taxes are assessed and collected should increase. IRS officials said they believe that this assessment rate is higher in more recent years compared with 1992 because IRS has been trying to obtain taxpayer agreement with any taxes recommended before the audit is closed. However, it is not yet clear whether the rate at which assessed amounts are collected for 1993 through 1997 audits will exceed the rate for 1992. Because of the incomplete results for audits closed in these more recent years, our analyses focused on 1992 audits.

Collection and Assessment Rates Vary by Type of Audit

Table 2 shows how much of the recommended additional taxes had been settled, assessed, and collected as of September 27, 1997, for seven types of audits closed in fiscal year 1992. In general, the assessment and collection rates varied by the complexity of the audit. With more complex audits, such as corporation audits, taxpayers were more likely to reduce additional assessments by appealing amounts recommended but also more likely to pay almost all of the amounts assessed. For example:

- Assessment rates for the simpler audits done at service centers and for the audits of individuals were higher than for corporate audit categories. The rates were 76 percent for service center audits and about 59 percent for audits of individuals, but the rates were 20 percent for CEP audits and 33 percent for other large corporation audits.
- The rates for collection of assessed amounts were higher for corporation audits. IRS collected about half of the assessed amounts for service center and individual audits compared with 97 percent for CEP and 73 percent for other large corporation audits.

The percentage of recommended amounts that IRS collects is also affected by these assessment and collection rates. For fiscal year 1992 audits, the percentage of recommended taxes that IRS had collected as of September 27, 1997, ranged from 20 percent for CEP audits to 43 percent for service center audits.

Table 2: Status of Additional Amounts Recommended for Fiscal Year 1992 Across Seven Types of Audits, as of September 27, 1997

Dollars in millions

		Settlement status of recommended amounts[a]			Collection status		
Type of Audit	Recommended amounts	Percent of disputes unsettled	Percent not assessed[b]	Percent assessed	Collected amount	As percent of amount assessed	As percent of amount recommended
Service center	$1,464	0%	24%	76%	$ 625	56	43%
Individual nonbusiness	2,763	4	37	59	894	55	32
Individual business	1,290	6	33	60	371	48	29
Small corporations	1,001	6	42	52	301	58	30
Large corporations	2,221	7	60	33	543	73	24
CEP	13, 893	39	41	20	2,757	97	20
Other[c]	2,202	27	34	40	646	74	29
Total[d]	**24,833**	**26**	**40**	**34**	**6,138**	**72**	**25**

Note: Table III.1 shows this information by the 30 selected categories

[a]Percentages do not total to 100 percent due to rounding.

[b]Recommended amounts are considered “not assessed” when (1) they are not sustained during IRS’ appeals process; (2) they are sustained during appeals but offset by taxpayers’ claims, such as net operating losses from other tax years, before being assessed; and/or (3) they were initially assessed but later abated because of information or claims filed by the taxpayers.

[c]“Other” includes audits of returns for employment tax, estate tax, excise tax, and gift tax; audits conducted in IRS training; and audits categorized by IRS as other.

[d]Amounts do not add to totals due to rounding.

Source: GAO analysis of IRS ERIS data.

We asked IRS officials to explain differences in the assessment and collection rates across the types of audits. IRS officials said several factors contributed to these variances. For example, comparing the service center and corporation audits, they said:

- The rate for assessing the recommended amount is higher for service center audits, because the taxpayers are (1) more likely to not respond to IRS correspondence and notices, which leads IRS to assess the recommended amounts and (2) less likely to dispute the recommended amounts, usually much smaller and involving simpler tax issues, compared with audits of corporations for which disputes are much more likely.

- The rate for collecting the assessed amount is lower for service center audits because the taxpayers tend to have fewer assets to pay the tax assessment. Further, CEP and large corporations are more likely to pay the assessments to avoid large interest charges. Small corporations and individuals with businesses also may have difficulties finding the funds to pay the additional tax assessments.

IRS' Performance Measures Do Not Fully Reflect All Audit Revenues and Costs

IRS' performance measures do not fully reflect all audit-based revenues and costs. For example, IRS' existing measures on taxes recommended do not include indirect revenues resulting from the effect of audits on voluntary compliance. Although IRS measures the staff time directly spent on audits, it does not measure the dollar costs of this direct time or the indirect costs incurred by the Examination Division for such things as training time or office space. IRS also does not measure direct and indirect costs that audits create outside of the Examination Division for IRS as well as taxpayers. Compiling complete and reliable data on the indirect revenues and costs from outside IRS can be very difficult because of limitations with the data sources and research.

Further, IRS does not use its available data to develop and report measures that would provide a fuller, more balanced picture of audit results. For example, data on taxes recommended could be balanced with data on taxes assessed and collected in reporting audit results and, as we previously recommended for audits of large corporations, in developing additional performance measures. In developing these measures, such revenue data could be related to information on the costs of audits. In addition, IRS has the capacity to track more data beyond the direct staff costs.

IRS Data on Revenues From Audits Are Incomplete

IRS data on taxes recommended, assessed, and collected do not represent all revenues from audits. Data are not available on the indirect revenue effects from audits. For example, when audits induce both audited and unaudited taxpayers to be more voluntarily compliant, tax collections increase indirectly. Other indirect revenue effects occur if audits adjust how much of a tax deduction can be claimed in one tax year versus other years or reduce that claim for future years.[13]

[13]If an audit reduces a depreciation claim by $100 but allows that $100 to be claimed in future years, tax revenue would be higher for the audited year but lower whenever the claims are allowed. If an audit reduces but does not eliminate a net operating loss claim, the audit would produce no tax revenue for the audited year but higher tax revenue in the future when, because of the audit, a smaller loss is claimed.

IRS has difficulty measuring the indirect revenue effects because of limitations with the data and research methods. Such measurements require (1) data that reflect the impact of audits and other IRS activities on the compliance of individual taxpayers and (2) a research methodology that reliably distinguishes the effect of audits on voluntary compliance from other influencing factors. IRS has researched the indirect effects of audits but has yet to develop reliable estimates because of these limitations.

IRS data also do not include the marginal revenue effects from doing audits. Such marginal effects are the changes in total revenues that result when IRS incrementally changes the number of audits in an audit class. As with indirect effects, developing data on marginal effects can be challenging. Without data on the indirect and marginal effects, IRS and Congress cannot know the full impacts of audits.

IRS Data on Costs of Audits Are Incomplete

IRS data on both its direct and indirect costs from doing audits are incomplete. IRS associates its direct costs with the time charged by the staff who do the audits, settle the audit disputes, and collect the audit assessments for specific types of audits. IRS has data available for computing the direct staff costs for the audit and settlement activities. However, IRS did not have such data for the collection activity because IRS' Collection Division did not track the time that staff spent trying to collect the additional assessments arising from specific types of audits. Our analyses of the significance of the direct costs of collection were inconclusive because of missing data.[14]

Also, IRS did not have data on its indirect costs for an audit. IRS considers its indirect costs to include management time, training time, space, and other support given to those who do audits, settle audit disputes, and collect audit assessments. Likewise, IRS does not account for indirect costs outside IRS, such as those imposed on the audited taxpayer or on society when a taxpayer evades tax liabilities.[15] However, as with indirect revenue, collecting the data for quantifying these external indirect costs is

[14]Our analysis focused on the amount of time IRS took to collect additional tax assessments arising from audits. Appendix IV describes our analysis and results.

[15]If audits reduce tax evasion, the social costs involving the efficiency and equity of the tax system also could be reduced. Some taxpayers choose investments or occupations that provide opportunities to evade taxes. With fewer evasion opportunities, taxpayers may use their resources more efficiently elsewhere in the economy. Reducing evasion also could make the tax system more equitable. Tax evasion creates inequities when taxpayers with the same tax liability pay different tax amounts. Greater equity may balance, at least in part, any increased costs imposed on audited taxpayers.

a difficult task. IRS has been working on ways to measure taxpayers' costs and is starting to survey taxpayers on their satisfaction with the audit process. This survey does not gather data on taxpayers' costs but may prove useful to IRS in deciding how to quantify these costs.

IRS Does Not Report All Existing Data on Audit Results

Although IRS lacks data on all of the revenues and costs associated with audits, it does have data that could be used to measure selected revenues and costs. However, IRS does not measure and report all its existing data on audit revenues, such as additional taxes assessed and collected on the basis of taxes recommended in audits. Further, IRS has not developed data and measures on the costs related to each type of revenue.

This report discusses broad, IRS-wide dollar measures of audit results to track actions on any additional taxes recommended in audits. Such measures do not account for all aspects of audit performance, such as the proper treatment of taxpayers and the decision to recommend no change or a reduction to the tax liability reported on a return. These measures are not intended to be used to evaluate the performance of individual IRS employees.

Over the years, IRS has measured the overall results of audits done in the Examination Division by the amount of additional taxes recommended and time charged directly to an audit by Examination staff. These measures do not employ existing data that could more fully represent the revenues and costs associated with audits. First, the measures do not report how much of the recommended taxes are actually assessed and collected. Second, the measures do not report the dollar costs of the direct time charged to an audit or the indirect costs for the audit, settlement, and collection activities.

Although useful in some ways, measuring audit performance by just taxes recommended and direct audit staff time presents an unbalanced picture of the audit results. Tables 1 and 2 show large differences between the amounts recommended, assessed, and collected. Taxpayers dispute most of the additional recommended amounts, and settlement of these disputes results in smaller amounts being assessed and collected.

Relying too heavily on additional taxes recommended as a measure of audit results may create undesirable incentives. Our previous work on audits of large corporations has raised concerns that relying on recommended taxes as a performance indicator may encourage auditors to recommend taxes that would be unlikely to withstand taxpayer challenge and thus not be assessed and collected. To the extent that this happens, audited taxpayers could be unnecessarily burdened. We recommended that IRS balance its measures of audit performance by adding such measures as taxes ultimately collected.

Further, the direct time charged to audits does not measure the dollar costs. In computing the costs of the direct time charges, one must recognize that the pay grade levels of staff assigned to audits vary by type of audit. Further, the direct time charged in the Examination Division excludes direct staff time charged in Appeals, Chief Counsel, and Collection as well as indirect costs for the audit, settlement, and collection activities.

To illustrate the importance of developing a more complete set of measures, we compared three ratios that each measured a type of audit revenue with the related direct cost for seven types of audits. We calculated direct costs using hours charged by staff in Examination, Appeals, and Chief Counsel. The audit revenues included the amounts recommended, assessed, and collected.

Table 3 shows that these ratios differ widely. Many factors affect audit-based revenues and costs. For example, recommended amounts are affected by the number of audits and amount recommended per audit. The number of auditors as well as their time charges and pay grades affect direct audit costs. Service center auditors have the lowest grades and charge the least amount of time per audit, while CEP auditors have the highest grades and charge the most amount of time. Also, the costs of settlement in corporate audits are likely to be higher than in other audits because corporations are more likely to dispute recommended assessments. As a result, reliance on a single measure gives a less complete picture of audit results than relying on all three measures.

Table 3: Taxes Recommended, Assessed, and Collected Compared With Related Direct Staff Costs for Audits Closed in Fiscal 1992, as of September 27, 1997

Type of audit	Recommended to cost ratio[a]	Assessed to cost ratio[b]	Collected to cost ratio[c]
Service center	197:1	104:1	59:1
Individual nonbusiness	29:1	14:1	8:1
Individual business	21:1	11:1	5:1
Small corporations	15:1	7:1	4:1
Large corporations	44:1	13:1	10:1
CEP corporations	124:1	24:1	23:1
Other[d]	23:1	8:1	6:1
Total	**50:1**	**16:1**	**11:1**

Note: Table III.2 shows this information by the 30 selected categories.

[a]Includes Examination's direct staff costs but not related indirect costs.

[b]Includes Examination's, Appeals', and Counsel's direct staff costs but not related indirect costs.

[c]Includes Examination's, Appeals', and Counsel's direct staff costs but not Collection's direct staff costs and related indirect costs.

[d]"Other" includes audits of returns for employment, estate, excise, and gift taxes; audits done in IRS training; and audits categorized by IRS as other.

Source: GAO analysis of IRS ERIS data.

The ratios in table 3 should not be used as official measures of results because they do not account for all costs. If costs such as Collection's direct staff costs and IRS' indirect costs could be included, the ratios would be smaller, and the differences by type of audit could change significantly. Direct staff time accounts for about half of all time charged by auditors; much of the remaining time produces indirect costs. The allocation of time could vary by type of audit. For example, service center audits may have a higher proportion of indirect costs given IRS' reliance on automation and nonaudit staff to help the auditors. Further, because individuals tend to pay their additional tax assessments more slowly than corporations (see app. IV), IRS would be likely to incur more costs to collect additional assessments from individuals.

IRS has plans to develop a measure that approximates the least complete ratio of the three ratios. In its 1999 budget submission, IRS reported plans to develop a ratio of the taxes recommended to the audit costs.[16] IRS

[16]IRS also has developed a measure that only tracks collections of recommended assessments to which taxpayers agreed at the closure of CEP audits. Further, IRS has developed a measure of total collections for all enforcement functions but these collections are not linked to the taxes recommended.

officials said the audit cost side of the ratio will come from an activity-based costing model that IRS is developing.

We talked to IRS officials about improving these ratios by capturing more data on the related costs. They said that tracking the direct staff time to collect audit assessments cannot now be done but would be possible if Collection Division staff began to report the time spent on audit-based assessments. These officials said IRS plans to use formulas to allocate indirect costs, such as for administration and rent, of the audit, settlement, and collection activities to the types of audits. They said that the model should, at a minimum, give them a better basis for knowing more about the nature and magnitude of the indirect costs.

Further, we asked IRS about opportunities to more fully report existing data on the revenues generated by audits. Our interviews with IRS officials indicated that measuring and reporting information on taxes assessed and collected from audits, in addition to taxes recommended, would not be costly. Rather, the challenge would be to report these impacts in the most understandable and meaningful way. For example, the officials said amounts collected could be reported in a variety of ways, including by fiscal year of the audit closure, fiscal year of the collection, type of audit, and type of auditor.

Conclusions

In considering the IRS-wide results of the audit function, analyzing and reporting the assessment and collection of amounts recommended provides a more complete picture of revenue impacts than that offered by looking just at recommended amounts. For example, our analyses of audits closed in fiscal year 1992 showed that IRS assessed and collected a fraction of the recommended additional taxes. By disputing recommended taxes, taxpayers substantially reduced the additional taxes that were ultimately assessed. IRS, however, did collect most of the assessed taxes. A closer analysis showed differences by the types of audit. IRS was more likely to assess taxes recommended in simpler audits of individuals than in complex audits of corporations. However, IRS was more likely to collect assessments from the corporations.

We believe that analyses of existing IRS data can offer a fuller, more balanced picture of what happens to additional taxes recommended in audits. If IRS and Congress had access to data and analyses on the assessment and collection of recommended amounts by type of audit, they would have a more informed foundation for discussions and decisions on the audit function. For example, if certain types of audits recommend taxes that tend not to be assessed or collected, IRS may decide to analyze the reasons why and then make improvements to those audits or shift audit resources elsewhere.

Another broad view of audit impacts would involve ratios that compare the direct tax revenues generated with IRS' related costs. Such ratios can be developed with existing data on the direct costs incurred to recommend, assess, and collect additional taxes as a result of the audits. However, such ratios are not yet complete measures of audit results. For example, IRS' data did not include its direct staff costs to collect the additional taxes and its indirect costs for the audit, assessment, and collection activity. Although incomplete as measures, the ratios provide more information on audit impacts compared with solely using data on additional taxes recommended in audits. These analyses could be enriched if IRS had data on its direct collection costs and its indirect costs for the audit, settlement, and collection activities. IRS is developing an activity-based costing model that could help IRS to account for these costs. The analyses could also benefit from IRS having data on the other indirect and marginal effects of audits on tax collections and costs but compiling such data is difficult to do. We are making no recommendations on these indirect and marginal effects because we did not attempt to collect and analyze data on these effects.

Recommendations

We recommend that the Commissioner of Internal Revenue develop meaningful ways to report the results to Congress from tracking, over a reasonable number of future years, existing IRS data on the assessment and collection of additional amounts recommended in specific types of audits closed for each fiscal year. One option for developing reporting formats could be the tables used in this report. The reports would provide fuller measures of the impacts of audits across IRS than those just on taxes recommended.

We also recommend that the Commissioner develop a way to track the direct staff costs of collecting tax assessments associated with specific types of audits. Similarly, the Commissioner also should determine how to account for IRS' indirect costs in auditing returns, settling audit disputes, and collecting audit assessments by type of audits. In analyzing how to account for these indirect costs, IRS may find that the activity-based costing model being developed can serve as a helpful tool.

Agency Comments and Our Evaluation

On April 27, 1998, we obtained comments on a draft of this report during a meeting with officials representing IRS. They included the Assistant Commissioner for Examination and his staff, the National Director for Financial Analysis and his staff, the National Director for Compliance Specialization, and representatives for the National Director of Appeals, the Assistant Commissioner for Collection, and the National Director, Legislative Affairs Division. The IRS Commissioner also documented the comments in a letter dated May 27, 1998 (see app. V).

Both at the meeting and in its letter, IRS agreed to implement our recommendations. For our recommendation on reporting the amounts of recommended taxes that are assessed and collected, IRS said it will annually report to Congress, by fiscal year, the amounts of recommended taxes that are collected. For our recommendation on tracking direct and indirect IRS costs associated with audits, IRS said it will continue to develop the activity-based costing model to track these costs by types of audit.

IRS' letter included an enclosure that provided various technical comments on issues discussed in our report as well as other issues. These comments dealt with issues such as (1) the need to carefully analyze and interpret ERIS data; (2) the challenges of allocating IRS' costs; (3) the value of the activity-based costing model in allocating costs; (4) the ongoing use of ERIS data; (5) IRS' efforts since 1992 to improve the audit and dispute resolution processes; (6) concerns about misinterpretations of the analyses on how much of the recommended tax amounts were settled, assessed, and collected; and (7) the need to analyze new measures. We have made changes and incorporated those comments that had a direct bearing on the information provided in this report.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the House Committee on Ways and Means, the Senate Committee on Finance, and other congressional committees with responsibility for IRS oversight; the IRS Commissioner; the Director of the Office of Management and Budget; the Secretary of the Treasury; and other interested parties. We will also make the report available to others upon request.

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

Sincerely yours,

James R. White
Associate Director, Tax Policy and
Administration Issues

Contents

Tables

Abbreviations

AIMS	Audit Information Management System
CEP	Coordinated Examination Program
ERIS	Enforcement Revenue Information System
IRS	Internal Revenue Service

IRS' Enforcement Revenue Information System

The Enforcement Revenue Information System (ERIS) is an automated data repository, outside the Internal Revenue Service (IRS) enforcement process, that contains IRS data on its enforcement results; these data come from several IRS sources. IRS developed ERIS to track information on the resolution of enforcement cases. Prior to the development of ERIS in 1990, IRS did not have a system that tracked the enforcement results from each fiscal year.

The purpose of ERIS is to account for revenues collected and costs incurred as a result of IRS enforcement activities. In addition, ERIS provides a link to taxes assessed and collected for different types of cases tracked by enforcement activities. ERIS enhances IRS' ability to provide a more complete reporting of enforcement results and forecast enforcement revenues. ERIS also may help IRS manage its enforcement activities better to the extent that it provides more complete reporting of costs and revenues.

ERIS works by integrating data from the various enforcement functions with corresponding Master File data to build a comprehensive enforcement database. It merges data extracted from the Audit Information Management System, Information Reporting Program Case Analysis System, Individual and Business Master Files, Individual Retirement Account Master File, and Non-Master File. Once the data are integrated from various sources, IRS develops a summary database from which comprehensive reports are printed.

Status of Additional Amounts Recommended for Audits Closed in Fiscal Years 1993-1997 Across Seven Types of Audits

Table II.1: Status of Additional Amounts Recommended for Audits Closed in Fiscal Year 1993 Across Seven Types of Audits, as of September 27, 1997

Dollars in millions

		Settlement status of recommended amounts[a]			Collection status		
Type of audit	**Recommended amounts**	**Percent of disputes unsettled**	**Percent not assessed**	**Percent assessed**	**Collected amounts**	**As percent of amount assessed**	**As percent of amount recommended**
Service center	$1,146	0%	23%	77%	$438	50%	38
Individual nonbusiness	2,721	6	31	64	947	55	35
Individual business	1,331	9	32	59	363	46	27
Small corporation	1,292	5	45	50	300	46	23
Large corporation	2,821	13	53	34	623	64	22
Coordinated Exam Program	10,547	43	29	28	2,744	93	26
Other[b]	2,164	7	51	42	606	67	28
1993 Total[c]	**$22,022**	**25**	**35**	**40**	**$6,022**	**68**	**27**

[a]Percentages do not total to 100 percent due to rounding.

[b]"Other" includes audits of returns for employment tax, estate tax, excise tax, and gift tax; audits conducted in IRS training; and audits categorized by IRS as other.

[c]Amounts do not add to total due to rounding.

Source: GAO analysis of IRS ERIS data.

Table II.2: Status of Additional Amounts Recommended for Audits Closed in Fiscal Year 1994 Across Seven Types of Audits, as of September 27, 1997

Dollars in millions

		Settlement status of recommended amounts			Collection status		
Type of audit	**Recommended amounts**	**Percent of disputes unsettled**	**Percent not assessed**	**Percent assessed**	**Collected amounts**	**As percent of amount assessed**	**As percent of amount recommended**
Service center	$830	0%	18%	82%	$353	52%	43%
Individual nonbusiness	3,330	7	23	70	965	41	29
Individual business	1,428	8	25	67	364	38	26
Small corporation	868	6	37	57	247	50	28
Large corporation	1,867	10	40	50	622	67	33
Coordinated Exam Program	12,228	48	26	26	2,994	95	24
Other[a]	2,087	31	35	34	514	72	25
1994 Total[b]	**$22,637**	**31**	**28**	**41**	**$6,059**	**65**	**27**

[a]"Other" includes audits of returns for employment tax, estate tax, excise tax, and gift tax; audits conducted in IRS training; and audits categorized by IRS as other.

[b]Amounts do not add to total due to rounding.

Source: GAO analysis of IRS ERIS data.

Table II.3: Status of Additional Amounts Recommended for Audits Closed in Fiscal Year 1995 Across Seven Types of Audits, as of September 27, 1997

Dollars in millions

		Settlement status of recommended amounts[a]			Collection status		
Type of audit	**Recommended amounts**	**Percent of disputes unsettled**	**Percent not assessed**	**Percent assessed**	**Collected amounts**	**As percent of amount assessed**	**As percent of amount recommended**
Service center	$1,300	1%	16%	83%	$409	38%	31%
Individual nonbusiness	3,599	11	23	66	796	34	22
Individual business	1,730	5	24	70	355	29	21
Small corporation	905	24	33	43	220	56	24
Large corporation	2,460	40	28	32	661	84	27
Coordinated Exam Program	15,406	59	14	27	3,792	91	25
Other[b]	1,783	16	32	52	644	70	36
1995 Total[c]	**$27,184**	**41**	**19**	**40**	**$6,878**	**63**	**25**

[a]Percentages do not total to 100 percent due to rounding.

[b]"Other" includes audits of returns for employment tax, estate tax, excise tax, and gift tax; audits conducted in IRS training; and audits categorized by IRS as other.

[c]Amounts do not add to total due to rounding.

Source: GAO analysis of IRS ERIS data.

Table II.4: Status of Additional Amounts Recommended for Audits Closed in Fiscal Year 1996 Across Seven Types of Audits, as of September 27, 1997

Dollars in millions

		Settlement status of recommended amounts[a]			Collection status		
Type of audit	**Recommended amounts**	**Percent of disputes unsettled**	**Percent not assessed**	**Percent assessed**	**Collected amounts**	**As percent of amount assessed**	**As percent of amount recommended**
Service center	$1,468	1%	16%	83%	$469	38%	32%
Individual nonbusiness	3,379	17	18	65	826	38	24
Individual business	1,633	15	16	69	363	32	22
Small corporation	880	25	27	48	251	60	29
Large corporation	3,135	42	16	41	762	59	24
Coordinated Exam Program	18,093	63	17	20	3,331	92	18
Other[b]	2,183	16	34	50	734	67	34
1996 Total[c]	**$30,771**	**46**	**18**	**36**	**$6,737**	**61**	**22**

[a]Percentages do not total to 100 percent due to rounding.

[b]"Other" includes audits of returns for employment tax, estate tax, excise tax, and gift tax; audits conducted in IRS training; and audits categorized by IRS as other.

[c]Amounts do not add to total due to rounding.

Source: GAO analysis of IRS ERIS data.

Table II.5: Status of Additional Amounts Recommended for Audits Closed in Fiscal Year 1997 Across Seven Types of Audits, as of September 27, 1997

Dollars in millions

		Settlement status of recommended amounts[a]			Collection status		
Type of audit	**Recommended amounts**	**Percent of disputes unsettled**	**Percent not assessed**	**Percent assessed**	**Collected amounts**	**As percent of amount assessed**	**As percent of amount recommended**
Service center	$2,343	2%	6%	92%	$328	15%	14%
Individual nonbusiness	3,544	34	7	60	688	33	19
Individual business	2,107	33	9	58	309	25	15
Small corporation	1,109	43	10	46	290	56	26
Large corporation	3,158	54	10	36	712	63	23
Coordinated Exam Program	16,445	70	7	23	3,512	93	21
Other[b]	2,984	56	6	38	608	53	20
1997 Total[c]	**$31,691**	**55**	**7**	**38**	**$6,447**	**54**	**20**

[a]Percentages do not total to 100 percent due to rounding.

[b]"Other" includes audits of returns for employment tax, estate tax, excise tax, and gift tax; audits conducted in IRS training; and audits categorized by IRS as other.

[c]Amounts do not add to total due to rounding.

Source: GAO analysis of IRS ERIS data.

Detailed Information on Audit Results

Table III.1: Amounts Recommended for Audits Closed in Fiscal Year 1992 Across 30 Audit Subcategories, as of September 27, 1997

Dollars in millions

Subcategory	Total recommended	Settlement status[a]: Percent of disputes unsettled	Settlement status[a]: Percent not assessed	Settlement status[a]: Percent assessed	Collection status: Collected amounts	Collection status: As percent of amount assessed	Collection status: As percent of amount recommended
Service center							
Individual nonbusiness	$1,310.85	0%	24%	76%	$542.06	54%	41%
Individual business	107.98	1	23	76	62.54	76	58
Other	44.80	0	33	67	20.69	69	46
Individual nonbusiness							
1040A TPI < $25,000	373.27	0	21	79	126.41	43	34
Non-1040A TPI < $25,000	237.66	1	25	74	77.77	44	33
TPI $25,000 < $50,000	375.23	1	26	73	135.96	50	36
TPI $50,000 < $100,000	382.25	2	32	66	156.54	62	41
TPI $100,000 and over	1,394.72	7	48	46	397.13	62	28
Individual business							
C-TGR < $25,000	123.00	0	19	81	30.84	31	25
C-TGR $25,000 < $100,000	317.51	1	30	70	84.51	38	27
C-TGR $100,000 and over	760.07	8	38	54	220.21	53	29
F-TGR < $100,000	14.41	0	29	71	7.95	78	55
F-TGR $100,000 and over	75.38	23	30	47	27.77	79	37
Small corporations							
No balance sheet	72.16	5	42	53	16.53	44	23
Assets < $250,000	167.76	6	40	55	38.89	43	23
Assets $250,000 < $1 million	199.65	4	41	55	67.43	61	34
Assets $1 million < $5 million	363.77	7	41	52	123.71	65	34
Assets $5 million < $10 million	197.26	8	46	47	54.56	59	28
Large corporations							
Assets $10 million < $50 million	535.22	10	52	39	146.08	71	27
Assets $50 million < $100 million	288.20	12	47	41	87.67	74	30
Assets $100 million < $250 million	420.94	7	46	47	107.62	55	26
Assets $250 million and over	862.43	5	72	24	188.59	93	22
Foreign corporations	113.80	0	85	15	13.06	79	11
Coordinated Exam Program	13,893.32	39	41	20	2,757.19	97	20
Other returns							
Employment tax	287.03	1	52	48	71.95	53	25

(continued)

Dollars in millions

Subcategory	Total recommended	Settlement status[a]: Percent of disputes unsettled	Percent not assessed	Percent assessed	Collection status: Collected amounts	As percent of amount assessed	As percent of amount recommended
Estate tax	1,161.84	43	28	30	308.84	90	27
Excise tax	213.03	2	39	59	48.98	39	23
Gift tax	172.93	27	51	22	36.44	96	21
Trainee	328.34	11	24	65	166.84	78	51
Other	38.57	3	52	45	12.77	73	33
Total	**$24,833.38**	**26**	**40**	**34**	**$6,137.54**	**72**	**25**

Legend

Assessed = Tax and penalty assessed less related abatements
1040A = Nonbusiness returns filed by individuals
TPI = Total positive income (income reported as a positive on tax return tables)
C-TGR = Form 1040 Schedule C (profit or loss from business) total gross receipts
F-TGR = Form 1040 Schedule F (profit or loss from farming) total gross receipts

[a]Percentages do not total to 100 percent due to rounding.

Source: GAO analysis of IRS ERIS data.

Table III.2 Taxes Recommended, Assessed, and Collected Per Direct Staff Cost for Audits Closed in Fiscal Year 1992 Across the 30 Audit Subcategories, as of September 27, 1997

Subcategory	Recommended to cost ratio[a]	Assessed to cost ratio[b]	Collection to cost ratio[c]
Service center			
Individual nonbusiness	216:1	112:1	61:1
Individual business	120:1	66:1	51:1
Other	93:1	58:1	40:1
Individual nonbusiness			
1040A TPI < $25,000	32:1	22:1	9:1
Non-1040A TPI < $25,000	19:1	12:1	5:1
TPI $25,000 < $50,000	19:1	11:1	6:1
TPI $50,000 < $100,000	20:1	11:1	7:1
TPI $100,000 and over	44:1	16:1	10:1
Individual business returns			
C-TGR < $25,000	20:1	15:1	5:1
C-TGR $25,000 < $100,000	19:1	12:1	4:1
C-TGR $100,000 and over	22:1	11:1	6:1
F-TGR < $100,000	10:1	6:1	5:1
F-TGR $100,000 and over	23:1	10:1	8:1
Small corporation returns			

(continued)

Subcategory	Recommended to cost ratio[a]	Assessed to cost ratio[b]	Collection to cost ratio[c]
No balance sheet	25:1	12:1	5:1
Assets < $250,000	11:1	5:1	2:1
Assets $250,000 < $1,000,000	11:1	6:1	4:1
Assets $1,000,000 < $5,000,000	16:1	8:1	5:1
Assets $5,000,000 < $10,000,000	22:1	9:1	6:1
Large corporations			
Assets $10,000,000 < $50,000,000	26:1	9:1	7:1
Assets $50,000,000 < $100,000,000	36:1	14:1	10:1
Assets $100,000,000 < $250,000,000	46:1	19:1	10:1
Assets $250,000,000 and over	74:1	15:1	14:1
Foreign corporations	108:1	12:1	9:1
Coordinated Exam Program	124:1	24:1	24:1
Other returns			
Employment tax	31:1	13:1	7:1
Estate tax	67:1	18:1	16:1
Excise tax	30:1	17:1	6:1
Gift tax	120:1	22:1	21:1
Trainee	9:1	6:1	4:1
Other	1:1	1:1	0
Total	**50:1**	**16:1**	**11:1**

Legend

1040A = Nonbusiness returns filed by individuals
TPI = Total positive income (income reported as a positive on tax return tables)
C-TGR = Form 1040 Schedule C (profit or loss from business) total gross receipts
F-TGR = Form 1040 Schedule F (profit or loss from farming) total gross receipts

[a]Includes Examination direct staff cost but excludes indirect cost.

[b]Includes Examination, Appeals, and Counsel direct staff cost but excludes indirect cost.

[c]Includes Examination, Appeals, and Counsel staff cost but excludes Collection's direct cost and indirect cost.

Source: GAO analysis of IRS ERIS data.

The Amount of Time IRS Takes to Collect Additional Taxes Assessed After Audits

In developing ratios of the amount of taxes collected to the direct costs for the audit, assessment, and collection activities, we could not include IRS' direct staff costs for the collection activity. We tried various analyses to gain insights on these costs to collect audit-based assessments, but none of our analyses were conclusive. In sum, IRS did not have data that would indicate the significance of these costs.

For example, we found that about 10 percent of the additional taxes collected were collected through the direct involvement of Collection staff. However, IRS' data did not help us to translate this information into the related direct staff costs. Nor did IRS have enough data to allow us to develop formulas for allocating the Collection Division's overall staff costs to the direct staff costs of collecting audit-based tax assessments.

Although our analyses did not help us compute the direct collection costs, we are reporting our results on how long IRS took to collect the audit-based tax assessments. To determine how much time IRS took to collect the tax assessments associated with audits closed in fiscal year 1992, we analyzed ERIS data on the amount of taxes collected from the various types of collection notices. Using IRS manuals, we determined the number of weeks that was to have elapsed between the assessment and each notice.[1] These collections also accounted for amounts that taxpayers paid as a result of the audit before IRS made the official assessment. We analyzed the timing of collections by types of audits.

For audits closed in fiscal year 1992, IRS had collected $6.1 billion of the $8.5 billion in additional assessments, as of September 27, 1997.[2] Although the time taken to do the audits and settle any disputes can be quite lengthy, IRS usually collected any additional taxes from doing the audits prior to or soon after assessment; about 81 percent was collected prior to assessment and within the first 5 weeks after assessment. IRS collects taxes prior to assessment to the extent that taxpayers overwithhold their income taxes, overestimate their quarterly tax payments for the audited tax return, carry over excess tax payments from previous tax returns, or make a payment prior to the additional assessment to prevent the accrual of further interest.

[1]IRS sends up to four notices at 5-week intervals to individual taxpayers. To business taxpayers, IRS is to send up to three notices, with the second notice being sent 5 weeks after the first and the third notice being sent 6 weeks after the second.

[2]We did not analyze how long the remaining $2.4 billion had gone uncollected; nor did we analyze the length of the audit and settlement activities, given our focus on the collection of additional recommended taxes.

Specifically, these analyses showed that IRS collected taxes sooner from corporations than from individuals. IRS collected 95 percent of the taxes from CEP corporations and 92 percent from other large corporations before the assessments or within the first 5 weeks of the assessments. For individuals audited at service centers or district offices, IRS collected about 60 percent of the taxes within these time periods. However, the portion of the taxes that IRS collected after 15 weeks was much higher for individuals than for corporations; staff from the Collection Division become involved after this time. For example, less than 5 percent of the taxes collected from CEP and other large corporations were collected after 15 weeks. About 25 percent of the taxes collected from individuals audited at the service centers and district offices were collected after this period.

Table IV.1 and table IV.2 show the timing of collections of assessed taxes for the various types of audits closed in fiscal year 1992.

Table IV.1: Timing of Collection of Assessed Taxes From Audits Closed in Fiscal Year 1992, as of September 27, 1997[a]

Dollars in millions

Type of audit	Amount collected	Percent collected prior to assessment	Percent collected within 5 weeks after assessment	Percent collected between 5 to 15 weeks after assessment	Percent collected over 15 weeks after assessment
Service center	$625	27%	32%	17%	25%
Individual nonbusiness	894	37	23	16	24
Individual business	371	36	23	13	28
Small corporations	301	54	30	8	9
Large corporations	543	59	33	5	4
Coordinated Examination Program	2,757	62	33	3	1
Other[b]	646	60	18	9	12
Total[c]	**$6,138**	**52**	**29**	**8**	**10**

[a]Percentages do not total to 100 percent due to rounding.

[b]"Other" includes audits of returns for employment tax, estate tax, excise tax, and gift tax; audits conducted in IRS training; and audits categorized by IRS as other.

[c]Amounts do not add to total due to rounding.

Source: GAO analysis of IRS ERIS data.

Table IV.2: Timing of Collection of Assessed Taxes From Audits Closed in Fiscal Year 1992 Across the 30 Audit Subcategories, as of September 27, 1997[a]

Dollars in millions

Subcategory	Tax collected	Percent collected prior to assessment	Percent collected within 5 weeks after assessment	Percent collected between 5 to 15 weeks after assessment	Percent collected over 15 weeks after assessment
Service center					
Individual nonbusiness	$542.06	27%	30%	17%	26%
Individual business	62.54	32	33	17	17
Other	20.69	14	72	6	8
Individual nonbusiness					
1040A TPI < $25,000	126.41	11	19	29	41
Non-1040A TPI < $25,000	77.77	22	20	22	36
TPI $25,000 < $50,000	135.96	28	21	18	32
TPI $50,000 < $100,000	156.54	41	21	14	24
TPI $100,000 and over	397.13	50	26	10	14
Individual business returns					
C-TGR < $25,000	30.84	20	17	19	45
C-TGR $25,000 < $100,000	84.51	26	19	15	40
C-TGR $100,000 and over	220.21	39	24	12	24
F-TGR < $100,000	7.95	61	14	8	17
F-TGR $100,000 and over	27.77	48	34	8	10
Small corporation returns					
No balance sheet	16.53	58	31	3	7
Assets < $250,000	38.89	51	24	10	16
Assets $250,000 < $1 million	67.43	52	28	10	10
Assets $1 million < $5 million	123.71	56	30	7	7
Assets $5 million < $10 million	54.56	52	33	6	9
Large corporation returns					
Assets $10 million < $50 million	146.08	55	34	4	7
Assets $50 million < $100 million	87.67	53	35	9	4
Assets $100 million < $250 million	107.62	65	26	8	2

(continued)

Dollars in millions

Subcategory	Tax collected	Percent collected prior to assessment	Percent collected within 5 weeks after assessment	Percent collected between 5 to 15 weeks after assessment	Percent collected over 15 weeks after assessment
Assets $250 million and over	188.59	59	37	3	2
Foreign corporations	13.06	93	6	0	1
Coordinated Exam Program	2,757.19	62	33	3	1
Other returns					
Employment tax	71.95	40	25	12	23
Estate tax	308.84	80	13	4	3
Excise tax	48.98	52	21	10	18
Gift tax	36.44	69	20	7	3
Trainee	166.84	34	22	18	26
Other	12.77	62	27	5	6
Total[b]	**$6,137.54**	**52**	**29**	**8**	**10**

Legend

1040A = Nonbusiness returns filed by individuals
TPI = Total positive income (income reported as a positive on tax return tables)
C-TGR = Form 1040 Schedule C (profit or loss from business) total gross receipts
F-TGR = Form 1040 Schedule F (profit or loss from farming) total gross receipts

[a]Percentages do not total to 100 percent due to rounding

[b]Amounts do not add to total due to rounding.

Source: GAO analysis of IRS ERIS data.

Comments From the Internal Revenue Service

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

COMMISSIONER

May 27, 1998

Ms. Lynda D. Willis
Director, Tax Policy and
Administration Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Ms. Willis:

Thank you for the opportunity to review and comment on your recent draft report entitled "IRS Measures Could Provide a More Balanced Picture of Audit Results and Costs".

Enclosed are our detailed comments concerning the draft report. Our concerns focus on aspects of the report where we believe careful interpretation of the data from the Enforcement Revenue Information System and the analysis of that data is necessary. We also discuss the challenges of allocating the direct and indirect costs detailed in your report. We do believe though, that the activity-based costing project now under development will address the cost allocation challenges.

We also agree to implement your recommendations. As to recommendation one, we will provide, on an annual basis, to Congress a report detailing by fiscal year Examination's recommended dollars and the collected dollars associated with those recommendations. This report will be based on data provided by the Enforcement Revenue Information System.

As to recommendation two, we will continue development of the activity-based costing project. This project is in the process of building a model that will be able to track business line costs. We anticipate that it will have the capability to track costs to the types of audits.

Further detail regarding the recommendations is provided in the enclosure.

Sincerely,

Charles O. Rossotti

Charles O. Rossotti

Enclosure

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