



General Government Division

B-280420

August 4, 1998

The Honorable Daniel Patrick Moynihan  
The Honorable Robert F. Bennett  
The Honorable Christopher J. Dodd  
United States Senate

Subject: Internal Revenue Service: Impact of the IRS Restructuring and Reform Act on Year 2000 Efforts

This letter responds to your May 8, 1998, request that we review the impact of the Senate version of H.R. 2676, the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998, on IRS' Year 2000 efforts. At the time we received your request, the Senate and House had passed versions of the bill. Subsequent to your request, a conference report on the bill was issued, Congress passed the bill, and the President signed the bill into law on July 22, 1998.

The issues raised in your request remain relevant because the effective dates in the act for most of the provisions that we reviewed will require IRS to devote staff resources to implementing them in 1998 and 1999, the same time period in which IRS plans to complete its Year 2000 work. If IRS systems are not made Year 2000 compliant, critical tax processing and collection activities could be seriously jeopardized, resulting in IRS systems failing to operate or generating millions of erroneous tax notices, refunds, interest calculations, and account adjustments.

As agreed with your office, our objectives were to assess whether (1) the effective dates in the Senate bill could affect IRS' ability to achieve Year 2000 compliance as planned; (2) IRS' Year 2000 testing schedule could affect the time frames for developing and implementing tax law changes, such as those in the Senate bill; and (3) specific provisions would present difficult implementation issues, not only in terms of information systems changes but also with regard to changes to IRS' business processes.

BACKGROUND

The most critical issue IRS faces this year and in 1999 is the need to make its computer systems Year 2000 compliant. Because IRS' systems, like many others

in government and the private sector, use two-digit date fields, they cannot distinguish, for example, between 1900 and 2000. Therefore, if unchanged, beginning January 1, 2000, IRS' systems would interpret 2000 as 1900 and thus seriously jeopardize critical tax processing and collection operations. IRS estimates that failure to correct this situation before 2000 could result in millions of erroneous tax notices, refunds, and bills. Accordingly, the Commissioner of Internal Revenue has designated this effort a top priority.

For IRS, the level of effort required to make its information systems Year 2000 compliant is without precedent. IRS must (1) correct applications for 128 mission-critical systems; (2) upgrade hardware and/or systems software for more than 50 mainframes, hundreds of minicomputers/file servers, and over 100,000 personal computers; (3) upgrade telecommunications networks; and (4) ensure that hundreds of external data exchanges are Year 2000 compliant. IRS has established a goal of making all of its systems Year 2000 compliant by January 1999 so that it will have almost a full year to test the ability of its systems to function properly in a Year 2000 compliant environment.

IRS, like many other federal agencies, is extremely vulnerable to the Year 2000 issue due to its widespread dependence on computer systems to carry out its operations. As we recently reported, although IRS has made progress in correcting some of the applications for its mission-critical systems, considerable work remains to make other areas of its information systems infrastructure Year 2000 compliant by January 1999.<sup>1</sup>

To increase their chances of achieving Year 2000 compliance, many private sector firms and government organizations have either limited or suspended information systems changes that are not Year 2000-related unless the changes are absolutely necessary for continued operations. However, IRS must continue making some changes to its information systems—not only changes needed to maintain current systems but also those needed to implement tax law changes, such as those in the act—concurrent with its Year 2000 efforts. To implement any tax law changes, IRS' business organizations determine how specific tax law changes affect manual procedures, business processes, and automated systems. Business requirements for changes to automated systems are then transmitted to IRS' Information Systems (IS) organization. Recognizing the need to coordinate the schedule for IRS' Year 2000 efforts and the implementation of tax law changes that are to take effect in 2000, the Commissioner established a compressed schedule for implementing tax law changes.

In April 1998, as the Senate was debating the bill, the Commissioner provided the Joint Committee on Taxation (JCT) with a listing of 28 provisions that, given their effective dates, could affect IRS' ability to complete its Year 2000 efforts as planned. In addition, IRS classified the effects as small, medium, large, and very large. One provision was identified as infeasible. JCT reviewed IRS' analysis and recommended to the Chairman and Ranking Minority Member of the Senate Finance Committee that some of the

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<sup>1</sup>IRS' Year 2000 Efforts: Business Continuity Planning Needed for Potential Year 2000 System Failures (GAO/GGD-98-138, June 15, 1998).

effective dates be modified to accommodate IRS' concerns. Subsequently, the Senate passed an amendment that extended the effective dates for 10 provisions, including 6 of the 28 about which IRS had expressed concern.

While we were finalizing this letter, on July 22, 1998, the President signed the act. For 4 of the 17 provisions that we reviewed, the act established later effective dates than those that were in the Senate bill that we used for our analysis. For a provision that IRS identified as infeasible, the act changed the requirement to more closely approximate what IRS believed was feasible. Thus, for these five provisions, IRS may have some measure of relief. But for most of the remaining provisions that we reviewed, IRS will have to devote resources to implementing system changes in 1998 and 1999. We plan to continue our monitoring of IRS' Year 2000 efforts and how that progress may affect IRS' ability to implement the provisions of the act that are to take effect in the 2000 filing season.

### RESULTS IN BRIEF

In isolation, an effective date of 2000 for any one of the provisions in the act may not adversely affect IRS' ability to achieve Year 2000 compliance. However, the cumulative impact of (1) many provisions having effective dates of 2000 or before and (2) the compressed schedule for implementing tax law changes that IRS has developed to accommodate its Year 2000 testing efforts could increase IRS' risk of not achieving Year 2000 compliance as planned. However, with the information that is currently available, we are unable to quantify that risk.

IRS' analysis of the impact of effective dates that was done for JCT concluded that IRS' ability to achieve Year 2000 compliance would be affected by provisions that had effective dates before 2000.<sup>2</sup> Accordingly, IRS recommended effective dates of 2000 for several provisions.<sup>3</sup> However, the assumptions that IRS officials used for recommending effective dates of 2000 may not be valid. For example, IRS officials assumed the following about IRS' Year 2000 efforts: (1) IRS will not experience any delays in completing the work that remains for converting applications for 67 of its 128 mission-critical systems, (2) a recently initiated independent verification and validation effort that sampled application code for the 61 mission-critical systems that have already been converted will conclude that the conversion was done correctly, (3) IRS will not need information systems staff for application software work in 1999 to address expanded contingency planning efforts,

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<sup>2</sup>IRS officials said they could meet effective dates of 1999 for some of the provisions by making changes to manual processes, rather than large-scale information systems changes.

<sup>3</sup>For most of the provisions that IRS identified as having at least a medium impact on its Year 2000 efforts, IRS recommended effective dates of January 1, 2000. Other recommended effective dates for provisions having at least a medium impact were July 2000 and January 2001.

and (4) the Year 2000 end-to-end integrated test in 1999<sup>4</sup> will not identify any significant problems that will require application software changes. In the event that any one of these assumptions proves to be incorrect, IRS will need information systems staff in 1999 to do Year 2000 application software work.

In addition to the possibility that IRS' assumptions might not all be valid, IRS' analysis for JCT did not consider the impact of IRS' Year 2000 efforts on the schedule for implementing provisions in the act that would take effect in 2000. Specifically, the time frames for implementing IRS' Year 2000 end-to-end test will reduce the amount of time available to develop business requirements for tax law provisions, make application software changes, and test the requisite changes. IRS officials said that the changes that will be required by the act are not as numerous as the changes that were required by the Taxpayer Relief Act (TRA) of 1997. However, they also said that developing specific business requirements for some provisions, such as the approval process for levies, could be a complex process.

Exacerbating the complex process for developing business requirements will be shorter time frames for finalizing business requirements, making application software changes, and testing the requisite application software changes. Because the final phase of IRS' Year 2000 integrated test is scheduled to begin October 1, 1999, IRS has determined that all systems acceptance testing<sup>5</sup> of tax law changes will have to be completed approximately 3 months earlier than they would be under a normal tax law change cycle—in September 1999 instead of January 2000. Accordingly, business requirements will have to be finalized by February 1999. IRS attempted to meet the February 1998 milestone for the tax law changes that are to take effect in the 1999 filing season but did not. We have reported in the past on IRS' difficulty in managing the development of business requirements for its information systems projects. In the event that business requirements are not finalized by February 1999, IRS faces the risk that application changes made for provisions in the act may not be included in systems acceptance testing. Thus, the first time the tax law changes would undergo testing would be in the final phase of IRS' Year 2000 end-to-end test. If IRS includes a set of untested applications in the final phase of the Year 2000 end-to-end test, this may compound efforts needed to identify the source of any problems that may arise in the final phase of that test.

IRS may encounter difficult implementation issues for some provisions. These specific provisions relate to innocent spouse relief and levies.

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<sup>4</sup>IRS plans to conduct an end-to-end test of certain interlocking applications that need to exchange data to perform their mission-critical tasks. The test is designed to help assure IRS that these applications are correctly performing all date computations using data and system date clocks with January 1, 2000, dates or later. This test is scheduled from February 1999 to December 1999.

<sup>5</sup>IRS' defines systems acceptance testing as testing that assesses whether an application meets the specified user requirements.

CUMULATIVE IMPACT OF EFFECTIVE  
DATES AND TAX LAW CHANGES INTRODUCES  
ADDITIONAL RISK TO IRS' YEAR 2000 EFFORTS

Our review of IRS' analyses and interviews with IRS officials indicated that the cumulative impact of (1) effective dates of 2000 and (2) a compressed schedule for implementing provisions in the act could introduce additional risk to IRS' Year 2000 efforts. However, we were unable to quantify that risk. IRS' April 10, 1998, analysis for JCT expressed the greatest concern about provisions that were to take effect before 2000, and accordingly IRS recommended effective dates of 2000 for various provisions. However, the assumptions that IRS used for recommending such dates may not be valid.

IRS officials said that to accommodate IRS' Year 2000 end-to-end test, business requirements for provisions in the act would have to be finalized in February 1999 to provide enough time for systems acceptance testing of the requisite application software changes before the final phase of the end-to-end test begins. If IRS does not meet the milestones in the compressed schedule, the last phase of the Year 2000 end-to-end test will not include a stable set of previously tested applications. If IRS includes a set of untested application software changes in the final phase of its Year 2000 end-to-end test, this may compound efforts to identify the source of any problems that may arise in the final phase of that test.

IRS' Assumptions About Year 2000  
Workload for 1999 May Not Be Valid

IRS' assumptions regarding the need for information systems staff for Year 2000 application software work in 1999 may not be valid. Specifically, those assumptions did not factor in several different scenarios that could increase the likelihood that information systems staff will be needed for Year 2000 application software work in 1999. To the extent such work is needed, we believe that effective dates of 2000 may introduce additional risk to IRS' completing its Year 2000 efforts as planned.

In its April 10, 1998, analysis for JCT, IRS identified 16 provisions that it believed would have between a medium to a very large impact on IRS' Year 2000 efforts. IRS officials told us that their April 10, 1998, analysis involved "best guesses" based on the time they had available to respond to JCT. IRS submitted a revised list of concerns to the Department of the Treasury on May 27, 1998, that included nine provisions.<sup>6</sup> When asked why some of the provisions that were included in IRS' April 10, 1998, listing were not included in the May 27, 1998, listing, IRS officials said that some of the effective dates

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<sup>6</sup>This list included two provisions from the April 10, 1998, analysis that were identified as having a small impact and the one provision that was identified as infeasible. The remaining six provisions in the May 27, 1998, listing were additions to the April 10, 1998, listing.

had been extended as a result of amendments added in the Senate bill.<sup>7</sup> Enclosure I shows (1) a listing of the provisions that IRS initially assessed as having at least a medium effect on its Year 2000 efforts; (2) the effective dates of those provisions in the Senate bill that was passed on May 7, 1998; and (3) IRS' estimate of when the information systems staff would be needed for making application software changes to the systems affected by the provisions.<sup>8</sup>

As shown in enclosure I, under the effective dates in the Senate bill, IRS will need to make changes to application software for information systems in both 1998 and 1999. IRS officials said they could meet effective dates of 1999 for some of the provisions by making changes to manual processes and minor changes to application software for information systems. On the basis of their staffing estimates for fiscal year 1998, IRS information system officials said that they believe sufficient staff are available to meet the application software work requirements for provisions to take effect in 1999.

IRS officials said that systemic changes to information systems would require effective dates of 2000. Accordingly, IRS' analysis for JCT recommended changing the effective dates for several provisions. IRS' effective date recommendations were based on the conclusion that information systems staff would not be needed for Year 2000 application software work in 1999. However, IRS' conclusion about the availability of information systems staff did not factor in the likelihood of any of the following events that could result in the need for Year 2000 application software changes in 1999:

- Delays occur in completing ongoing conversion work.
- Application errors are identified in an ongoing independent validation of the conversion work IRS has already completed.
- Expanded contingency planning efforts may require some application software changes or other systems changes.
- Application software errors are identified in the Year 2000 end-to-end test.

Between now and January 1999, IRS is scheduled to convert the applications for 67 mission-critical systems—14 systems by July 1998 and 53 systems by January 1999. In the event of conversion delays, IRS may need some staff in 1999 for Year 2000 work. Also, an April 22, 1998, Internal Audit report identified numerous problems that indicated that some application software coding that IRS was reporting as Year 2000 compliant may not

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<sup>7</sup>In light of concerns that effective dates could impair IRS' ability to meet the Year 2000 conversion challenge, Senator Moynihan sponsored an amendment that extended the effective dates for 10 provisions, including 6 that were included in IRS' April 10, 1998, analysis for JCT. For those six provisions, IRS' analysis had identified the degree of impact as follows: one as very large impact, one as large impact, three as medium impact, and one as infeasible.

<sup>8</sup>We have added footnotes to enclosure I to show the effective dates that are included in the act.

have been.<sup>9</sup> As a result of these problems, IRS hired a contractor to review a sample of the application software from the 61 systems that have already been converted. IRS officials said that they do not expect the contractor to find significant problems with the applications that have already been converted. However, if the contractor does identify problems, IRS information system staff would have to do rework on application software that was already considered to be complete. IRS officials said that they expect to have a final report from the contractor in August 1998.

Information systems staff may also be needed to make changes under expanded Year 2000 contingency planning procedures that IRS is developing in response to concerns we raised. These contingency planning procedures were not being considered when IRS developed its April 10, 1998, analysis for JCT. On May 7, 1998, we testified that IRS had a limited contingency planning approach that focused solely on projects that were falling behind schedule.<sup>10</sup> Under this approach, we said that IRS faces the risk to continuity of operations for its core business practices. In responding to our concerns, IRS is expanding its contingency planning efforts. However, it is unclear at this time how this expansion may affect the need for application software or other systems changes.

Finally, information systems staff may be needed to make application software changes to correct any problems identified by the Year 2000 end-to-end test scheduled to be done from February 1999 to December 1999. IRS established its goal of converting all systems by January 1999 so it would have sufficient time to test its systems thoroughly and make corrections as necessary. IRS officials told us that in concluding that it can do work on the provisions in 1999, they assumed that any problems identified in the end-to-end test would not require a significant amount of application software changes. This assumption may not be valid because, according to experiences with Year 2000 conversion efforts reported by other organizations, testing and correcting Year 2000 changes is taking much longer than expected and can consume 50 to 70 percent of the time required for the entire Year 2000 conversion process. IRS officials said that this additional time does not necessarily mean that changes will be needed to IRS' application software. However, as we have said in the past, the software component, which includes both systems software and application software, is the source of most risk in systems development efforts. Therefore, we believe it is likely that the Year 2000 end-to-end test could identify significant problems with application software.

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<sup>9</sup>IRS officials said that Internal Audit concluded, as a result of the problems it found, that IRS would experience problems during the 1998 filing season. IRS officials said that although some problems occurred during the 1998 filing season, they were not significant and IRS had a successful filing season.

<sup>10</sup>IRS' Year 2000 Efforts: Status and Risks (GAO/T-GGD-98-123, May 7, 1998).

Business Requirements for  
Tax Law Changes Will Be Needed  
Earlier Because of Year 2000  
End-to-End Test Schedule

IRS officials have determined that IRS' Year 2000 testing efforts will affect the schedule for developing and implementing tax law changes. IRS officials said that in the final phase of its end-to-end Year 2000 test, between October 1999 and December 1999, IRS plans to test whether certain interlocking applications that are to be implemented in 2000 process data when using data and system date clocks with January 1, 2000, dates or later. To accommodate that schedule, IRS officials have determined that systems acceptance testing of tax law changes—for normal filing season changes and changes required by the act—would have to start no later than June 1999 and be completed by September 30, 1999. The end of the calendar year has been the traditional time frame for completing tests of tax law changes. As a result of this change, the amount of time available for IRS to develop business requirements and complete the other work associated with implementing tax law changes will be reduced. IRS officials said that they plan to begin developing requirements when the legislation is enacted in an attempt to offset this reduction in time.

IRS information systems officials told us that as a result of the Year 2000 test schedule, business requirements for tax law changes to take effect in 2000 would be needed no later than February 1999. Table 1 shows the steps involved in implementing tax law changes, the traditional milestones, and the revised milestones that will have to be met as a result of IRS' Year 2000 end-to-end test schedule.



Table 1: Key Activities Associated With Implementing Tax Law Changes, Traditional Milestones, and Revised Milestones as a Result of Year 2000 Test Schedule

Activity	Traditional milestone	Revised milestone as a result of Year 2000 testing requirements
Business requirements developed	Summer to January	Summer of 1998 to January 1999
Requirements transmitted to Information Systems	February to June	February 1999
Development of applications	March to October	March to July 1999
Systems acceptance testing <sup>a</sup>	Late August to mid-January	Mid-June to September 1999
Final phase of the Year 2000 end-to-end test	N/A <sup>b</sup>	October to December 1999
Implementation	January	January 2000

<sup>a</sup>IRS' systems acceptance testing assesses whether an application meets the specified user requirements.

<sup>b</sup>Not applicable.

Source: IRS data.

As shown in table 1, the first step in implementing tax law changes is to develop business requirements. According to IRS officials, once IS receives the business requirements from the business organizations, such as compliance or customer service, implementation of the system changes normally takes between 6 and 10 months. After IS' programming staff have modified the applications to meet the new requirements, IS staff are to conduct tests to verify that the changes have been made correctly and the systems function properly.

IRS attempted to meet an abridged schedule for business requirements development for the 1999 filing season but was not successful. According to IRS officials, they believe the schedule for the 2000 filing season changes—including those in the act—can be met because the business functions have known about the February 1999 date for some time. IRS officials said that the act will not require as many changes as were required by TRA 1997. However, they also said that the changes required by TRA 1997 involved IRS' front-end tax processing systems, whereas the provisions in the act will primarily affect downstream business processes and manual procedures. Consequently, developing the business requirements for these provisions will be difficult and time consuming, raising

questions about IRS' ability to meet the February 1999 milestone. In addition, we have reported in our previous work on IRS' systems modernization efforts on the many difficulties IRS has had managing the development of business requirements needed to support changes to its systems.

During the June 11, 1998, Executive Steering Committee on Year 2000 and the 1999 filing season, the Commissioner said that business requirements for provisions in the act must be delivered to IS no later than February 1999. IRS officials said that to help ensure that IRS successfully implements the act, no other major tax legislation should be enacted with effective dates of 2000 or earlier.

In the event that business requirements are not delivered by February 1999, IRS faces the risk that application software changes made for provisions in the act may not be included in systems acceptance testing. Thus, the first time those changes would undergo testing would be in IRS' Year 2000 end-to-end test. However, IRS officials said that the goal of the end-to-end test was to test a stable set of previously tested applications with computer system software and hardware using 2000 dates. If IRS includes a set of untested tax law changes in the final phase of its Year 2000 end-to-end test, this may compound efforts needed to identify the source of any problems that may arise in the final phase of the end-to-end test.

#### CERTAIN PROVISIONS MAY POSE DIFFICULT IMPLEMENTATION ISSUES

Certain provisions of the act may pose difficult challenges for IRS to implement. These are the provisions related to innocent spouse relief and levies.

#### Innocent Spouse Provisions

Although, according to IRS, the amount of application software changes needed to implement the innocent spouse provisions would be minimal, we are concerned about adding a significant number of new accounts to IRS' Non-Masterfile (NMF) primarily because of the error-prone process used to establish accounts on the NMF and the resulting effect on providing quality customer service.

When a married couple files a joint federal income tax return, each spouse becomes individually responsible for paying the entire amount of the tax associated with that return. This is known as the joint and several liability standard. Because of this standard, one spouse can be held liable for tax deficiencies assessed after a joint return was filed that were solely attributable to the actions of the other spouse.

Previously, to qualify for innocent spouse relief, the innocent spouse had to meet certain criteria and establish that the understatement of tax liability met certain thresholds. Because of concerns about the effectiveness and fairness of the existing provisions the act allows taxpayers to elect to change the joint and several liability standard to a

proportional liability standard<sup>11</sup> and expands innocent spouse relief by eliminating income tax understatement thresholds.<sup>12</sup>

Under the current process, once an innocent spouse relief request is received and accepted, IRS divides the total assessment and records an assessment for each spouse on the NMF. This stand-alone system was set up to process "exception" cases that IRS' Master File of taxpayer accounts cannot accommodate.<sup>13</sup> Separate systems exist in each of the 10 IRS service centers. Much of the data entry for the NMF is manual, for both creating a new account and for transferring accounts between service centers.

In total, the NMF currently contains about 115,000 accounts. IRS officials said that the system's capacity could be doubled and maybe tripled with minimal trouble. On the basis of our past work, we determined that eliminating the thresholds for qualifying for innocent spouse relief could add another 40,000 or more accounts to the NMF.<sup>14</sup>

Although we recognize that the NMF may have the system capacity to handle these additional accounts, we are concerned about the potential effect on customer service and the increased risk of incorrect notices and inappropriate enforcement action if more accounts are added to the NMF. This concern stems from the known problems with the NMF that make it difficult for IRS employees to adequately service the accounts currently on it and for taxpayers to get reliable information on the accounts. Also, as explained by an IRS task force that recently completed a review of the NMF:

"NMF accounts create serious problems for service center customer service representatives and district office personnel in three primary areas—NMF account identification, NMF access, and NMF awareness. IRS personnel often have difficulty identifying that the account is, in fact, NMF and then in determining which of the ten service centers have control of the account. Because employees are exposed to NMF accounts so infrequently, it is difficult to retain the expertise necessary to provide the expected level of customer service."

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<sup>11</sup>Under proportionate liability, each taxpayer is responsible only for the taxes resulting from his or her individual income, even when such income is reported on a joint return.

<sup>12</sup>Understatements are additional taxes that are due but not shown on the return (i.e., taxes due from unreported income, incorrect deductions, etc). Understatements are usually identified during IRS audits.

<sup>13</sup>Representatives from IRS' office of the Chief Information Officer told us that January 2001 would be the very earliest that it could put these types of accounts on the Master File.

<sup>14</sup>Tax Policy: Information on the Joint and Several Liability Standard (GAO/GGD-97-34, Mar. 12, 1997).

## Levy Provisions

The expanded provisions for providing taxpayers a 30-day notice of, and instituting an approval process for, levies are designed to safeguard the rights of taxpayers during enforcement proceedings. However, because of the potential procedural complexity that the process would introduce, the total number of levies issued—which includes both erroneous and legitimate levies—is likely to decrease. As a result, the resulting revenue collected from levies, including legitimate levies, is likely to decrease.

Under the current system, when IRS determines a taxpayer owes additional taxes due to an understatement on the return, the taxpayer is to be sent a balance-due notice. IRS may also try to contact the taxpayer by telephone. If the taxpayer still does not pay the taxes owed, IRS is to send up to three more notices. If the taxpayer does not pay the tax within 10 days after the last notice has been sent, IRS may levy the taxpayer's wages and other financial assets. IRS uses its information systems in the 10 service centers and at the Automated Collection Sites to review delinquent taxpayers' records to identify potential levy sources (i.e., wages, bank accounts, individual retirement accounts, and other financial resources). If IRS' automated processes identify a levy source, a levy notice is triggered and sent to the financial institution; this is referred to as a systemic levy. In 1997, IRS' automated systems issued over 3 million levies to third parties who potentially held taxpayer assets.

Because "the imposition of levies . . . may impose significant hardships on taxpayers," the Senate Finance Committee stated that taxpayers should be provided additional protection from inappropriate or erroneous levies. Accordingly, the act requires supervisory review of levies when appropriate before they are issued, which may include certification that the amount is owed and due.<sup>15</sup> As an additional protection, the act also requires that taxpayers be given the opportunity for a hearing before their assets are levied.

Under the provisions of the act, the levy process would become more labor intensive and complex than the current levy process. Specifically, IRS employees potentially would need to investigate and certify that levy sources are valid and have a supervisor approve the levy, when appropriate, before any levy notice is sent. Providing taxpayers the opportunity to request a hearing on the proposed levy would also require the need for appeals staff to be involved in the levy process—staff that are not required to be involved in the current process. Given these procedural changes, IRS officials said that development of the business requirements and necessary systems changes for the notice and approval provisions will be a complex process. According to IRS officials, systemic or computer-generated levies could be difficult to implement because many levies would require additional review before being imposed. In addition, IRS officials said that state

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<sup>15</sup>When this report was written, "when appropriate" had not yet been defined. The impact of this provision on IRS' systems and processes would be determined by how "appropriate" is ultimately defined. As shown in enclosure I, the effective date for collection actions initiated under the automated collection system was extended in the act.

programs for levying state tax refunds for federal debts and federal tax refunds for state debts would also be affected.

In summary, the levy provisions provide taxpayers with additional protections. To the extent that the provisions reduce the number of erroneous levies issued, taxpayers will benefit. There is no current information available on the number of erroneous levies issued. In a 1990 report, we estimated that 2.8 percent of levies were erroneous.<sup>16</sup> If 3 million levies were issued, using our estimate, about 84,000 would be erroneous.

To the extent that the provisions result in (1) preventing the issuance of erroneous levies and (2) introducing complexity and additional manual procedures to the levy process, it is likely that IRS will issue fewer levies than it does under the current process. Although levies may not generate revenue for various reasons<sup>17</sup> and IRS does not have complete data on the revenue collected from levies, IRS and JCT officials believe that the revenue loss from issuing fewer levies could be significant.

## CONCLUSIONS

We can not accurately predict, with the information that is currently available, whether IRS will be able to make the systems changes required by the act and successfully make its information systems Year 2000 compliant as planned. The need to make the necessary business process and application software changes for the provisions in the act introduces additional risk to completing IRS' Year 2000 efforts as planned. If IRS has to implement any additional tax law changes beyond those in the act, IRS may face additional risks to (1) completing its Year 2000 efforts as planned and (2) successfully implementing the provisions in the act.

IRS' ability to meet some near-term milestones for its Year 2000 efforts could provide an indicator of the need for Year 2000 application software changes in 1999. Key near-term milestones for IRS' Year 2000 efforts are July 1998 and January 1999—when IRS is scheduled to complete its conversion of applications for 14 and 53 mission critical systems, respectively. A key milestone for developing business requirements for tax law changes to take effect in 2000 will be February 1999. Failure to meet any of these key milestones may indicate that additional legislation, such as modifying the effective dates in the act, would be prudent to reduce the risks of IRS failing to achieve Year 2000 compliance.

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<sup>16</sup>Tax Administration: Extent and Causes of Erroneous Levies (GAO/GGD-91-9, Dec. 21, 1990).

<sup>17</sup>Information returns filed by third parties that identify levy sources, such as an employer or financial institution, may have outdated data. For example, the taxpayer may no longer work for the employer listed on the wage and earning statement, or the taxpayer's bank account may no longer exist.

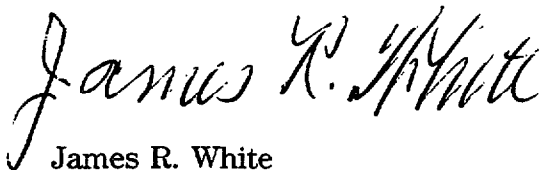
AGENCY COMMENTS AND OUR EVALUATION

We requested comments on a draft of this letter from the Commissioner of Internal Revenue or his designated representative. IRS' Acting Chief Information Officer provided us with comments on June 29, 1998. His comments provided technical clarifications and are incorporated in the letter where appropriate.

SCOPE AND METHODOLOGY

To obtain information on the impact of the effective dates in the Senate bill on the Year 2000 efforts and the associated requirements for application software changes, we interviewed and obtained information from officials at IRS' National Office, including officials from the information systems and compliance organizations. We reviewed IRS' April 10, 1998, analysis of the impacts of effective dates and recommendations for revised effective dates of certain provisions in the Senate bill. We subsequently reviewed the JCT analysis of IRS' recommended dates and a May 27, 1998, memo from IRS to the Department of the Treasury that discussed IRS' concerns with implementing some of the provisions. In determining the difficulties in implementing certain provisions, we used the results of ongoing work on the NMF and previous work on IRS' collection activities. We also compared the content and effective dates for the provisions in the Senate bill that we reviewed to the provisions that were included in the act to identify any differences that could affect the relevancy of the information in this letter. We conducted our review from May 1998 to July 1998 in accordance with generally accepted government auditing standards.

Major contributors to this letter were Sherrie Russ, Assistant Director; Christopher Hess, Senior Evaluator; and Monika Gomez, Evaluator. Please contact me at (202) 512-9110 if you or your staff have any questions.



James R. White  
Director, Tax Policy and  
Administration Issues

Table I.1: Provisions in the Senate Bill, Effective Date Required by the Senate Bill, and Year in Which Work Would Need to Be Done<sup>a</sup>

Provisions of Internal Revenue Restructuring and Reform Act of 1998 that require systems changes	Effective date as required by the Senate bill	Fiscal year(s) in which IRS would have to devote resources to implementing system changes
Innocent spouse <sup>b</sup>	Date of enactment	1998/1999/2000
Suspension of interest and penalties	Taxable years ending after date of enactment	1999/2000
Notices to have name and telephone number of employee to contact <sup>c</sup>	January 1, 2000 <sup>c,d</sup>	1999/2000
Allow taxpayers to designate deposits for payroll periods	Deposits required to be made after the 180th day after date of enactment	1999/2000
Notices to include computation of penalty	Notices issued after the 180th day after date of enactment <sup>e</sup>	1998/1999/2000
Every notice that imposes interest to include detailed computation and citation of the relevant section of the IRS Code	Notices issued after June 30, 2000 <sup>e</sup>	1999/2000
Eliminate interest rate differential on periods of overlapping interest. This may also apply to interest for periods before date of enactment if request made to Secretary of Treasury not later than 12/31/99.	Periods beginning after date of enactment	2000
Prohibit levy if case is in offer-in-compromise related status	Offers-in-compromise pending on or made after December 31, 1999 <sup>c</sup>	1999/2000
Annual Statement for Installment Agreements	Not later than 180 days after date of enactment <sup>f</sup>	1999/2000
30-day notice before IRS levies, liens, or seizes a taxpayer's property	Collection actions initiated after 180 days after date of enactment	1999/2000
Suspend levy collection during refund suit	Unpaid tax attributable to taxable periods beginning after December 31, 1998	1999/2000

Do not impose failure to pay penalty while in installment agreement	Additions to tax for months beginning after December 31, 1999 <sup>c</sup>	1999/2000
Alternatives to written signatures for electronic filing	Date of enactment	1998/1999/2000
Alternatives to Social Security numbers for identifying tax preparers	Date of enactment	To be determined
Release levy immediately upon agreement that amount is currently not collectible	Levies imposed after December 31, 1999 <sup>c</sup>	1999/2000
Waive 10% addition to tax for early withdrawal from IRAs if IRS levies	Levies made after December 31, 1999 <sup>c,9</sup>	1999/2000
Implement approval process for liens, levies, and seizures	Date of enactment, except automated collection system actions initiated before January 1, 2000 <sup>c,e</sup>	1998/1999/2000

<sup>a</sup>These provisions were initially assessed by IRS as having at least a medium effect on its Year 2000 efforts.

<sup>b</sup>The act did not include the Senate amendment providing specific relief for underpayment cases. Underpayment refers to taxes that are identified on the tax return at the time of filing but are not paid.

<sup>c</sup>Dates reflect changes that were included in a Senate amendment sponsored by Senator Moynihan. The purpose of the amendment was to provide effective dates that would allow IRS to implement changes to the tax code but not interfere with the Year 2000 conversion deadline.

<sup>d</sup>This provision was initially assessed by IRS as infeasible to implement. In the act the provision was changed to require that any manually generated correspondence received by a taxpayer from IRS include in a prominent manner the name, telephone number, and unique identifying number of an IRS employee the taxpayer may contact with respect to the correspondence. Any other correspondence or notice received by a taxpayer from IRS must include, in a prominent manner, a telephone number that the taxpayer may contact. The effective date for manually generated notices and other notices is 60 days after the date of enactment. During a telephone or personal contact, an IRS employee must give a taxpayer his or her telephone number and unique identifying number. The effective date for a unique identifying number is 6 months after the date of enactment.

<sup>e</sup>In the act, the effective date for this provision was extended to after December 31, 2000.

<sup>f</sup>In the act, the effective date for this provision was extended to July 1, 2000.

<sup>g</sup>In the act, "levies made after" was changed to "distributions made after." The effective date of the provision was not changed.

Source: IRS' April 10, 1998, JCT analysis; other IRS data; the Senate bill; and the act as signed by the President.

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