

GAO

Report to the Ranking Minority
Member, Subcommittee on Oversight,
Committee on Ways and Means, House
of Representatives

April 2007

INTERNAL REVENUE SERVICE

Interim Results of the 2007 Tax Filing Season and the Fiscal Year 2008 Budget Request





Highlights

Highlights of [GAO-07-673](#), a report to the Ranking Minority Member, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

The Internal Revenue Service's (IRS) tax filing season performance is a key indicator of how well IRS serves taxpayers. This year's filing season was expected to be risky because of tax system changes, including the telephone excise tax refund (TETR). IRS's fiscal year (FY) 2008 budget request shows its spending proposal for taxpayer service, enforcement, and Business Systems Modernization (BSM). The request includes initiatives to reduce the tax gap, the difference between what taxpayers owe and what they voluntarily pay on time. IRS recently estimated the net tax gap to be \$290 billion in 2001. GAO was asked to (1) describe IRS's 2007 filing season performance, (2) determine how IRS's proposed FY 2008 budget compares to prior years', provides information on how proposals may impact the tax gap, justifies new spending, and whether there are opportunities to reduce or reallocate resources, and (3) evaluate the status of IRS's efforts to develop and implement BSM.

What GAO Recommends

GAO is not making any new recommendations, but notes relevant past recommendations, their implementation status, and where our previous work has identified opportunities for additional savings.

www.gao.gov/cgi-bin/getrpt?GAO-07-673.

To view the full product, including the scope and methodology, click on the link above. For more information, contact James R. White at (202) 512-9110 or whitej@gao.gov.

INTERNAL REVENUE SERVICE

Interim Results of the 2007 Tax Filing Season and the Fiscal Year 2008 Budget Request

What GAO Found

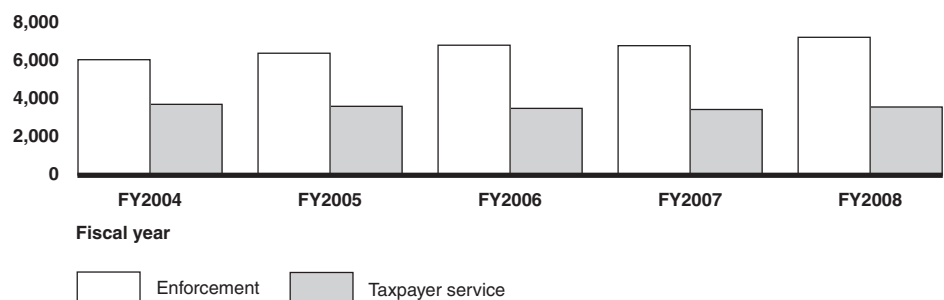
Despite initial concerns about this year's filing season being high risk due to increased workload from TETR and other tax system changes, early data suggest that the impact has been minimal because anticipated volume has not materialized. IRS has processed over 63 million returns, most filed electronically. However, one of IRS's key tax return processing systems became operational two months behind schedule, resulting in slower posting of returns and delayed refunds for several days for millions of taxpayers.

IRS's 2008 budget request of \$11.6 billion would increase spending by 5.6 percent and continue a trend since 2004 of shifting overall spending toward enforcement. The proposed budget provides limited information on the impact of proposed initiatives on the tax gap. Expected direct enforcement revenue to be gained is small—less than 1 percent of the net tax gap. The indirect effect of the initiatives on voluntary compliance is unknown although some research suggests that the indirect effect might be larger than the direct effect. Further, justifications for selected taxpayer service and enforcement initiatives varied. While documents for some initiatives had useful detail for assessing them, others lacked this information. For example, the initiative to determine the impact of taxpayer service on compliance lacked details such as a problem statement, a research approach, and how IRS determined needed resources. While GAO has been supportive of this kind of research, without a more detailed justification GAO cannot comment on specifics of the proposal. GAO is continuing to assess the justifications. IRS may be able to deliver taxpayer service more cost effectively, but its study of taxpayer service delivery options is several months behind schedule; in March 2007, the IRS Commissioner testified that the report will be issued soon.

Despite progress made in implementing BSM projects and improving modernization management controls and capabilities, significant challenges and serious risks remain, and IRS has more to do to fully address our prior recommendations.

Funding for IRS Enforcement and Taxpayer Service Programs and Related Support Functions, Fiscal Years (FY) 2004-2008

Dollars in millions



Source: GAO analysis of IRS data.

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United States Government Accountability Office
Washington, DC 20548

April 3, 2007

The Honorable Jim Ramstad
Ranking Minority Member
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Ramstad:

Effective tax administration requires a balance of taxpayer service and tax law enforcement. To provide enforcement and taxpayer service in fiscal year (FY) 2008, the Internal Revenue Service (IRS) has requested an \$11.6 billion¹ operating level budget with about 63 percent going for enforcement activities and 31 percent for taxpayer service (including operational support). The remaining request includes funding to develop and implement modernized information systems.

IRS provides much of its services to taxpayers during the annual tax return filing season, making filing season performance a key indicator of how well IRS is serving taxpayers. In past reports and testimonies, we said that IRS has made significant progress improving taxpayer service since passage of the IRS Restructuring and Reform Act of 1998 (RRA 98).² Improvements include increased electronic filing, better access to IRS's telephone assistants, and more accurate answers to taxpayers' questions. However, we have also described taxpayer service challenges such as the quality of assistance at walk-in and volunteer sites where taxpayers get face-to-face assistance. Moreover, the Commissioner of Internal Revenue stated that this year's filing season is high risk for several reasons, including challenges in implementing the new telephone excise tax refund

¹ The \$11.6 billion includes \$11.1 billion in new appropriated funds and \$0.5 billion in other funds.

² See, for example, GAO, *Tax Administration: IRS Improved Some Filing Season Services, but Long-term Goals Would Help Manage Strategic Trade-offs*, [GAO-06-51](#) (Washington, D.C.: Nov. 14, 2005), *Internal Revenue Service: Assessment of the Interim Results of the 2006 Filing Season and Fiscal Year 2007 Budget Request*, [GAO-06-615T](#) (Washington, D.C.: Apr. 6, 2006), and *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings*, [GAO-07-27](#) (Washington, D.C.: Nov. 15, 2006).

(TETR), split refund option (refunds can now be directly deposited to up to three separate accounts), and several tax law extensions that passed late in 2006.

Although IRS has increased revenue collected through its enforcement programs in recent years, enforcement continues to be included on our list of high-risk federal programs.³ This is due, in part, to the persistence of a large tax gap.⁴ IRS estimated the gross tax gap to be \$345 billion for tax year 2001. After late payments by taxpayers and revenue brought in by IRS's enforcement efforts, the resulting net tax gap is estimated to be \$290 billion.

Another high-risk challenge is IRS's ongoing Business Systems Modernization (BSM) program, a multibillion-dollar, highly complex effort that involves the development and delivery of a number of modernized information systems that are intended to replace the agency's aging business and tax processing systems. The program is critical to supporting IRS's taxpayer service and enforcement goals and reducing the tax gap. We recently reported that despite progress made in implementing BSM projects and improving modernization management controls and capabilities, significant challenges and serious risks remain, and further program improvements are needed, which IRS is working to address.⁵

In light of the challenges IRS faces, you asked us to assess IRS's 2007 tax filing season performance, FY 2008 budget request, and the status of the BSM program. Our objectives were to (1) describe IRS's 2007 tax filing season performance for returns processing and taxpayer assistance including the impact of tax system changes, such as the TETR, split refund option, and several tax law extensions that passed late in 2006, (2) assess IRS's proposed FY 2008 budget and compare it with prior years' spending and staffing and determine what information it provides on the impact of proposals on the tax gap, how new spending initiatives are justified, and whether there are opportunities to reduce or reallocate resources, and (3) evaluate the status of IRS's efforts to develop and implement BSM.

³ GAO, *High-Risk Series: An Update*, [GAO-07-310](#) (Washington, D.C.: January 2007).

⁴ The tax gap is an estimate of the difference between what taxpayers pay in taxes voluntarily and on time and what they should pay under the law.

⁵ GAO, *Business Systems Modernization: Internal Revenue Service's Fiscal Year 2007 Expenditure Plan*, [GAO-07-247](#) (Washington, D.C.: Feb. 15, 2007).

On March 15, 2007, we briefed your staff and staff of the Subcommittee Chair on the preliminary observations of our review. This report transmits the updated materials we used at the briefing, which are reprinted as appendix I.

In summary, we made the following major points:

- Despite initial concerns and IRS's characterization of this year's filing season as high risk, early data show that tax systems changes have not had a significant effect on filing season operations or performance. In particular, TETR-related requests and telephone calls have been far less than IRS planned. As of March 16, 2007, IRS has processed 63.5 million individual income tax returns, with 69 percent including TETR requests. The number of returns filed electronically is 5 percent greater than this time last year. Also, IRS is achieving its goals for telephone service. However, there are areas of concern. In early March, the latest release of the Customer Account Data Engine (CADE), one of IRS's key tax return processing systems, became operational—2 months behind schedule. As a result of the delay, IRS has had slower processing times and delayed refunds for up to several days for millions of taxpayers. This delay may have a more serious impact on IRS's ability to deliver future releases of CADE, because it caused contention for key resources, but it is too early to know. Taxpayers' use of the Free File program (an alliance of companies that offer free return preparation and electronic filing on their Web sites to eligible taxpayers) is 5.5 percent below last year at this time.
- IRS's 2008 budget request would increase spending, particularly for enforcement. The \$11.6 billion requested total operating budget is an increase of \$608.8 million (5.6 percent) over the FY 2007 continuing resolution level. IRS proposes spending \$7.2 billion for enforcement (including operational support), an increase of 6.5 percent, continuing a trend since 2004 of shifting a greater proportion of overall spending toward enforcement as compared to taxpayer service. IRS's budget request includes initiatives and legislative proposals to address the tax gap. There is limited data in IRS's request on the expected impact of the proposals on the gap. The expected direct enforcement revenue to be gained is small compared to the size of the tax gap. For example, IRS expects to yield about \$699 million in FY 2010, or about ¼ of 1 percent of the tax year 2001 net tax gap from additional enforcement staffing. However, the indirect effect on voluntary compliance is unknown. Several research studies by economists, while subject to data limitations, suggest that indirect revenue might exceed direct revenues gained. We asked for supplementary documents on six initiatives to better understand their expected benefits and costs. The documented justifications for those

initiatives varied in the depth of useful information they provided. We continue to assess the justifications for the initiatives and whether IRS could cost effectively provide additional information that could be useful for the Congress and others as they assess IRS's budget request. IRS identified savings in the 2008 budget request, but other savings opportunities may exist. For example, IRS may be able to change the mix of services provided—such as giving taxpayers more options for help by e-mail or its Web site in place of more costly telephone or walk-in operations—but its study to identify cost-effective service delivery methods is several months behind schedule.

- IRS continues to make progress in implementing BSM projects and meeting cost and schedule commitments, but two key projects—CADE (discussed above) and Modernized e-File (a new electronic filing system)—experienced significant cost overruns during 2006. Future BSM project releases face serious risks, which IRS is working to mitigate. For example, delays in deploying the latest release of CADE have resulted in contention for key resources and will likely impact the design and development of the next two important releases, which are scheduled to be deployed later this year. IRS has made significant progress in implementing our prior recommendations and improving its modernization management controls and capabilities. However, critical controls and capabilities related to requirements development and management and post implementation reviews of deployed BSM projects have not yet been fully implemented. In addition, more work remains to be done by the agency to fully develop a long-term vision and strategy for completing the BSM program, including establishing time frames for consolidating and retiring legacy systems.

Scope and Methodology

To assess IRS's filing season performance for processing, telephones, face-to-face assistance and its Internet Web site, we obtained and analyzed IRS's performance and production data and compared it to annual goals and prior years' performance. Our work also included direct observations of key filing season operations, and interviews with IRS officials and other external stakeholders.

To assess IRS's 2008 budget request, we reviewed IRS's congressional budget justifications and supplementary documents to (1) identify trends in spending and staffing from FYs 2004 through 2008, (2) assess information on the tax gap and selected spending initiatives to assess the information provided to justify the request, and (3) identify areas of potential opportunities for savings and efficiencies. Our assessment is

based on a comparative analysis funding, expenditures, and other documentation and interviews with IRS officials.

Our filing season and budget audit work was done primarily at IRS's National Office and its operating divisions including the Large and Mid-Size Business operating division in Washington, D.C; Small Business/Self-Employed operating division in New Carrollton, Md; and Wage and Investment Division operating division headquarters and Joint Operations Center and call site in Atlanta, Ga. We also interviewed officials at the IRS Oversight Board in Washington, D.C. Additionally, we reviewed relevant external documentation and our reports and reports of the Treasury Inspector General for Tax Administration.

Our analysis of the BSM program was based primarily upon the results of our detailed review of the FY 2007 BSM expenditure plan that we issued in a recent report.⁶

In past work, we assessed IRS's budget and filing season performance data. We considered filing season performance measures and data that cover the quality, accessibility, and timeliness of IRS's services to be objective and reliable based on our prior work. Since the data sources and procedures for producing this year's budget and filing season data have not significantly changed from prior years, we determined that the data were sufficiently reliable for the purposes of this report. To the extent possible, we corroborated information from interviews with documentation and data and where not possible, we report the information as attributed to IRS officials. We have determined that the estimates for cost savings and Web site performance come from competent sources and are reasonable. Data limitations are discussed where appropriate. We performed our work from December 2006 through March 2007 in accordance with generally accepted government auditing standards.

Agency Comments

In commenting on a draft of this report, IRS officials emphasized that the budget's initiatives and legislative proposals will result in additional direct and indirect revenue and, ultimately, increase compliance. It also reported that it will soon release its strategic plan for taxpayer service delivery,

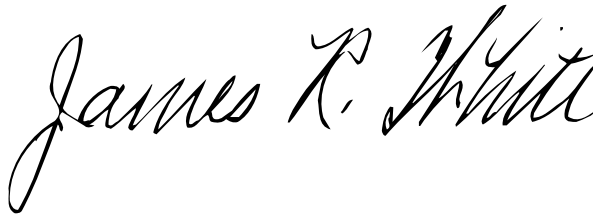
⁶ [GAO-07-247](#).

which will serve as the foundation for future decisions for service improvements and efficiencies.

We are sending copies of this report to the Chairmen and Ranking Minority Members of other Senate and House committees and subcommittees that have appropriation, authorization, and oversight responsibilities for the IRS. We are also sending copies to the Commissioner of Internal Revenue, the Secretary of the Treasury, the Chairman of the IRS Oversight Board, and the Director of the Office of Management and Budget. Copies are also available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or you staff have any questions or wish to discuss the material in this briefing further, please call me at (202) 512-9110 or at whitej@gao.gov. Contact points for our offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in Appendix II.

Sincerely yours,

A handwritten signature in black ink that reads "James R. White". The signature is written in a cursive style with a large, prominent initial "J".

James R. White
Director, Tax Issues
Strategic Issues Team

Appendix I: Updated Briefing Slides from the March 15, 2007, briefing to the Subcommittee on Oversight, House Committee on Ways and Means



Interim Results of IRS's 2007 Tax Filing Season Performance and Fiscal Year 2008 Budget Request

Update of March 15, 2007 Briefing To the Subcommittee on Oversight, House Committee on Ways and Means

1



Review Objectives

- What is IRS's 2007 filing season performance for returns processing and taxpayer assistance including impacts of tax system changes, such as the telephone excise tax refund (TETR), split refund option (refunds can be directly deposited to up to three separate accounts), and several tax law extensions that passed late in 2006?
 - How does IRS's proposed FY 2008 budget compare with prior years' spending and staffing and what information does it provide on how proposals may impact the tax gap, how new spending initiatives are justified, and opportunities to reduce or reallocate resources?
 - What is the status of IRS's efforts to develop and implement its Business Systems Modernization (BSM) program?
-



Background

-
- IRS's primary filing season operations include processing electronic and paper individual income tax returns and issuing refunds as well as providing taxpayer service through its toll-free telephone operations, Web site, and face-to-face assistance.
 - Taxpayers can electronically file their returns by using a paid tax preparer, commercial tax preparation software, or the Free File program. The Free File program, accessible through IRS's Web site, is an alliance of 20 companies that have an agreement with IRS to provide free on-line tax preparation and electronic filing on their Web sites for taxpayers below an adjusted gross income ceiling (\$52,000 in 2007).
 - While it is always a massive undertaking, the IRS Commissioner characterized this year's filing season as high risk for three reasons: the TETR, split refund option, and tax law extender provisions.
 - IRS estimated that over 180 million individuals and businesses are eligible for the TETR. Individuals, businesses, and tax-exempt organizations that paid the excise tax on long-distance telephone service after February 28, 2003 and before August 1, 2006 are eligible to request the refund. Individuals who do not have tax filing obligations, but paid the tax, can request the refund on Form 1040EZ-T (Request for Refund of Federal Telephone Excise Tax).



Background

- Individuals can request a standard TETR amount ranging from \$30 to \$60 depending on the number of exemptions they are eligible or they can use Form 8913 (Credit for Federal Telephone Excise Tax Paid) to claim the tax paid.
- Taxpayers have 3 years to file an amended tax return to request TETR. Individuals who have no tax filing obligation can file a 1040 EZ-T within 3 years to request TETR without filing an extension.
- Prior to the 2007 filing season, taxpayers could have their refunds directly deposited into one account. Beginning in 2007, to encourage savings, taxpayers are allowed to directly deposit their refunds into up to three accounts.
- The Tax Relief and Health Care Act of 2006 signed into law in December 2006 extended some provisions that expired at the end of calendar year 2005. These changes include extensions of three tax deductions: (1) state and local sales tax, (2) higher education tuition and fees, and (3) educator expenses.



Background

- The most recent (tax year 2001) estimated gross tax gap—the difference between what taxpayers pay voluntarily and on time and what they should pay under the law—is \$345 billion. IRS estimated that it would recover \$55 billion of the 2001 tax gap through late payments and enforcement actions, leaving a net tax gap of \$290 billion.
- IRS's BSM program is a multibillion-dollar, high-risk, highly complex effort to develop and deliver modernized information systems that are intended to replace the agency's aging business and tax processing systems. The program is critical to supporting IRS's taxpayer service and enforcement goals and reducing the tax gap.
- IRS's new tax return processing system, the Customer Account Data Engine (CADE), is the cornerstone of IRS's modernization efforts. CADE is being introduced through a series of releases and is intended to fully replace IRS's antiquated Individual Master File system of taxpayer accounts by 2012.



Interim Results of IRS's 2007 Filing Season – Returns Processing

The volume of returns processing and refund issuance is comparable to last year.

According to IRS data, as of March 16, 2007, compared to the same time last year IRS

- processed 63.5 million returns compared to 62.7 million returns, and
- issued 55.2 million refunds for \$139.3 billion compared to 56.3 million refunds for \$134.0 billion.

According to IRS officials, the agency is meeting most processing goals and performance is comparable to last year.



Interim Results of IRS's 2007 Filing Season – Returns Processing

The growth rates for electronic filing and direct deposits are up from the same period last year.

As of March 16,

- Over 77 percent of all individual income tax returns or 49.3 million were filed electronically, up 5.3 percent over the same time last year, an increase over the previous years' growth of 2.2 percent, and
- 76.2 percent of refunds were directly deposited into taxpayers' accounts, up 5.8 percent over the same time last year. Direct deposits are faster and more convenient for taxpayers than mailing paper checks.

We previously reported that state mandates for electronic filing of state tax returns also encourage electronic filing of both state and federal tax returns.¹ Last year, electronic filing of federal returns increased 27 percent for the three states (NY, CT & UT) with new 2006 mandates. This year, state mandates are likely to continue to show a positive effect on federal electronic filing because, with the addition of West Virginia, 13 states now have state mandates.

¹ GAO, *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings*, GAO-07-27 (Washington, D.C.: Nov. 15, 2006).



Interim Results of IRS's 2007 Filing Season – Returns Processing

Compared to processing paper returns, electronic filing:

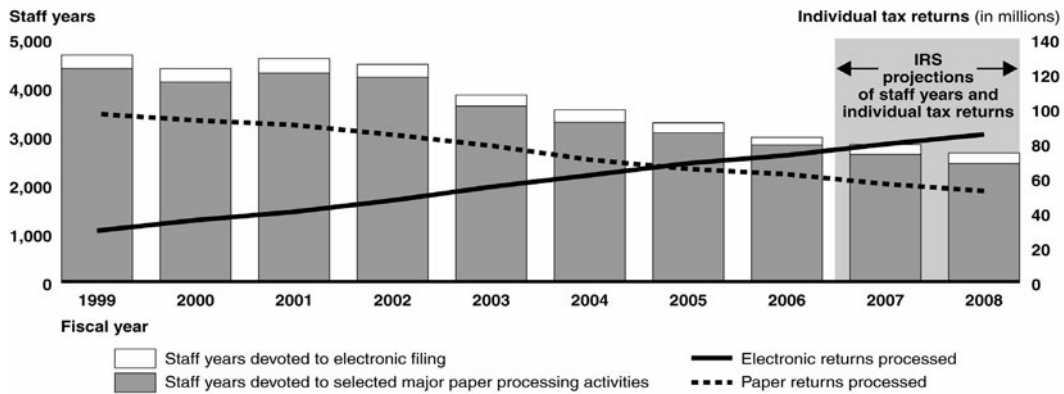
- reduces IRS's costs by reducing staff devoted to processing. In 2006, IRS used almost 1,700 (36 percent) fewer staff years for processing tax returns than in 1999, which IRS estimates to have saved the agency \$78 million in salary, benefits, and overtime, and
- improves service to taxpayers, not only by a more accurate return, but also by a faster refund



Interim Results of IRS's 2007 Filing Season – Returns Processing

As electronic filing grows, resources devoted to processing continue to decline.

Figure 1: Number of Individual Returns and IRS Staff Years for Individual Paper and Electronic Processing, FYs 1999 – 2008



Source: GAO analysis of IRS data.

Notes: Staff years and FTEs are units of measurement that are often used interchangeably. An FTE is the equivalent of one person working full-time for 1 year with no overtime. As noted in the figure, staff years for paper filing are for selected major activities only. Also, 2007 projections do not include 1040EZ-T.



Interim Results of IRS's 2007 Filing Season – Returns Processing

Early data show that the tax system changes have not had a significant impact on returns processing operations because the volume IRS anticipated has not materialized.

- As it does every filing season, IRS planned and prepared extensively for tax system changes which minimized problems.
- IRS anticipated a significant volume of TETR claims to process, which IRS has not received to date. While all taxpayers who paid the tax are eligible, of those who filed as of March 10, 68.7 percent have claimed TETR. Additionally, of those who do not otherwise have tax obligations, approximately 312,000 have asked for a refund (2.5 percent of the 12.4 million IRS expected by this time). Both IRS's CADE and legacy systems are processing TETR requests made on the 1040 and 1040EZ-T forms.
- IRS also anticipated an increased workload from split refunds that has not yet materialized. As of March 24, about 61,000 taxpayers, out of the 3.8 million IRS expected for the filing season, chose the split refund option to directly deposit their refund in more than one account. According to IRS, split refunds cost more to process, reducing the agency's savings from direct deposit. Further, two large tax software packages do not offer split refunds.
- IRS delayed processing a small number of returns (compared to total filing population) claiming tax extender provisions until February 3 until it completed changes to its tax processing systems to accommodate the provisions.



Interim Results of IRS's 2007 Filing Season – Returns Processing

The latest release of CADE became operational in early March, 2 months behind schedule because of problems identified during testing. IRS had originally planned to post 33 million taxpayer returns to CADE. However, as a result of the delay of that release of CADE,

- IRS estimates that CADE will post about 12.5 million fewer returns. Thus, returns processing has been slowed for millions of taxpayers who would have been eligible for their returns to be posted on CADE, because of the longer posting times for the legacy system versus CADE, and
- refunds for millions of those CADE-eligible taxpayers were delayed by 1-5 days for direct deposit and 4-8 days for paper checks.

The setback may have a more serious impact on IRS's ability to deliver expanded functionality of future versions of CADE, thus delaying the transition to the new processing system (discussed further in the BSM section of this briefing).

IRS did not plan to process returns with split refunds on CADE this year because of IRS's concerns about having enough time to complete the programming for the current release of CADE after passage of the legislation.



Interim Results of IRS's 2007 Filing Season – Returns Processing

IRS made several changes in the Free File program

- IRS and the Free File Alliance agreed to provide services to taxpayers with an average gross income of \$52,000 or less which equates to about 95 million or 70 percent of all taxpayers. Under the agreement, companies are not allowed to offer refund anticipation loans and checks, or other ancillary products to free file participants.
- While all 19 companies participation in the free file program allow for TETR requests, 3 of the 19 companies offer form 1040 EZ-T requests.

Taxpayers' use of the Free File program continues to decline

- As of March 8, 2.5 million returns were filed via free file (down 5.5 percent from the same time last year). As of March 10, just under half requested TETR.



Interim Results of IRS's 2007 Filing Season – Telephone Assistance

Call volume to IRS's toll free assistance is less than planned and last year's volume.

Table 1: IRS Telephone Assistance Volume in the First Weeks of the Filing Seasons, 2006 and 2007

Telephone assistance	2006 Actual	2007 Actual	2007 Plan^a
Total calls ^b	19,201,258	18,460,273	20,584,114
Answered by IRS assistors (percentage)	7,677,406 (40.0%)	7,474,521 (40.5%)	8,182,026 (39.7%)
Answered by automated menu of recordings (percentage)	11,523,852 (60.0%)	10,985,752 (59.5%)	12,402,088 (60.3%)

Source: GAO analysis of IRS data.

^a 2007 plan is IRS's year-to-date plan to monitor performance toward annual goals.

^b Total calls (i.e., calls answered by assistors and automation) are based on actual counts from January 1 to March 4, 2006 and March 3, 2007.



Interim Results of IRS's 2007 Filing Season – Telephone Assistance

The assistor level of service peaked in 2003 at 87 percent. This year, IRS is meeting its goals, including for assistor level of service, but goals are lower than last year's actual performance.

Table 2: IRS Telephone Assistance Performance in the First Weeks of the Filing Seasons, 2006 and 2007

Telephone Performance-access	2006 Actual	2007 Actual	2007 Plan ^a
Assistor level of service ^{b c}	83.8%	82.4%	81.1%
Average speed of answer (in minutes) ^{c d}	3.1	4.4	4.6
Taxpayer disconnects ^{c e}	9.0%	12.7%	14.7%
IRS disconnects ^f	462,303	137,926	N/A
Telephone Performance-accuracy^g			
Accounts customer accuracy rate estimates ^h	92.7% +/-0.7%	92.9% +/- 0.9%	N/A
Tax law customer accuracy rate estimates ^h	90.2% +/-1.0%	88.7% +/- 1.5%	N/A

Source: GAO analysis of IRS.

Note: N/A means that IRS did not set goals for these measures.

^a 2007 plan is IRS's year-to-date plan to monitor performance toward annual goals.

^b Assistor level of service is the percentage of taxpayers who wanted to talk with an assistor and actually go through and received service.

^c Assistor level of service, average speed of answer, and taxpayer disconnects are based on actual counts from January 1 to March 4, 2006 and March 3, 2007.

^d The number of minutes a taxpayer waits in a queue to speak with an assistor.

^e When a taxpayer hangs up before receiving assistance.

^f An IRS disconnect occurs when IRS disconnects callers due to long wait times. Based on actual counts for January 1 through March 4, 2006 and March 3, 2007.

^g Based on a representative sample estimated at the 90 percent confidence interval for January and February 2006 and 2007.

^h The percentage of calls in which telephone assistors provided accurate answers for the call type and took the appropriate action.



Interim Results of IRS's 2007 Filing Season – Telephone Assistance

Tax systems changes have had minimal impact on IRS's telephone operations.

- TETR-related calls are a small fraction of what IRS expected. Of the 6.8 million TETR-related calls IRS expected between January 1 and March 3, it received over 326,000 calls (or 4.8 percent) for TETR assistance.² TETR-related calls were 1.8 percent of total calls received by IRS to date.
- IRS prepared for TETR by hiring about 650 FTEs with the expectation that those hires would be used to cover anticipate attrition in 2008 and trained to handle account calls and paper inventory should the demand for TETR not materialize. Because TETR call volume has not materialized, TETR hires are allowing IRS to focus more on processing paper correspondence, such as amended returns, at call sites.
- For split refunds, IRS anticipated about 7,000 calls (compared to the 70 million total calls it receives each year).
- For tax provision extenders, IRS anticipated that the affected taxpayers would be a small portion of total taxpayers and determined questions on extenders would be a part of general tax law calls.

²We are in the process of obtaining additional information to evaluate IRS's projections of TETR.



Interim Results of IRS's 2007 Filing Season – Telephone Assistance

IRS has surplus space at call sites and is reviewing options for reducing excess capacity.

- Last year, IRS determined that because of excess capacity, it has the potential to close several call sites without negatively affecting taxpayer service even at peak times, but had no plans to do so. As a result, we recommended that IRS plan to consolidate call sites.
- IRS is reviewing the feasibility and costs of different options to decrease excess capacity should issue a report in FY 2008.



Interim Results of IRS’s 2007 Filing Season – IRS’s Web Site Assistance

Use of IRS’s Web site increased during initial filing season months compared to last year and data show that the site is performing well.

Table 3: IRS Web Site Use in the First Weeks of the Filing Seasons, 2006 and 2007

Uses	2006	2007	Percentage Change
Visits ^a	66,571,225	72,978,709	9.6%
Downloads ^a	21,609,956	24,429,718	13.0%
Searches ^a	35,917,428	41,434,606	15.4%
Where’s My Refund ^b	17,732,356	21,656,492	22.1%

Source: GAO analysis of IRS data.

^a Web site visits and searches and downloads from January and February 2006 and 2007. Downloads are from January 2006 and 2007. A visit begins when a visitor views their first page from the server IRS.gov, and ends when the visitor leaves the site. Visits are not counts of the numbers of unique individuals who have accessed the site.

^b For January 1 through March 11, 2006 and March 10, 2007.

- According to independent evaluations, such as Keynote and the American Consumer Satisfaction Index, IRS’s Web site is scoring high compared to other government agencies, non-profits, and private sector firms for customer satisfaction and compared to other government agencies for average download time.
- IRS added a state deduction calculator feature this filing season, which IRS wants to use as a new standard for other on line calculators.



Interim Results of IRS's 2007 Filing Season – Face-to-face Assistance

Taxpayers are using IRS's walk-in sites less and using volunteer site return preparation services more.

- As of March 10, the total taxpayer contacts at IRS's 401 walk-in sites declined to 1.8 million (down 4.7 percent) from the same period last year. IRS has devoted 9 percent fewer FTEs compared to last year for walk-in assistance (down from 176 to 160 FTEs). IRS continues to limit return preparation by setting income limits that approximate the amount for claiming the Earned Income Tax Credit (less than \$39,000) and in some cases, requiring appointments as it has done since 2003. IRS has prepared about 6,700 (5.3 percent) of the over 126,000 1040EZ-T forms it expected to be prepared at the sites.
- As of March 11, the number of returns prepared at over 11,700 volunteer sites has increased to just over 1.3 million returns (up over 8 percent), including 33,600 1040EZ-T forms. IRS did not develop 1040EZ-T projections for volunteer sites.



Interim Results of IRS's 2007 Filing Season – Face-to-face Assistance

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- We and the Treasury Inspector General For Tax Administration (TIGTA) have raised concerns about the quality of assistance at walk-in and volunteer sites for years.³
 - For IRS's walk-in sites, as of March 10, tax law and accounts assistance accuracy rates were 74 and 85 percent respectively as measured by IRS. IRS's goal for tax law accuracy is 78 percent. In 2007, IRS is collecting data to set a goal for accounts accuracy for 2008. IRS prepared over 125,000 returns and schedule at walk-in sites, but it lacks information on the accuracy of that assistance.
 - For volunteer sites, IRS is conducting several types of reviews. As of March 2, for a small non-statistical sample IRS is reporting a 69 percent accuracy rate for return preparation, compared to the goal of 55 percent. In contrast, TIGTA's results, using similar methods, show a 60 percent accuracy rate. Available IRS and TIGTA data is limited, not statistically based, and therefore cannot be projected to all sites.

³ See GAO, *Tax Administration: IRS Improved Some Filing Season Services, but Long-term Goals Would Help Manage Strategic Trade-offs*, GAO-06-51 (Washington, D.C.: Nov. 14, 2005) and TIGTA, *Taxpayer Service is Improving, but Challenges Continue in Meeting Expectations*, Reference No. 2006-40-052 (Washington, D.C.: Feb. 17, 2006).



IRS's FY 2008 Budget Request

Requested funding would increase spending particularly for enforcement.

- IRS is requesting \$11.6 billion total program operating level for FY 2008, an increase of \$608.8 million or 5.5 percent over the FY 2007 continuing resolution level and 11 percent over the FY 2004 enacted level.⁴
 - When adjusted for inflation, requested 2008 funding would be a 0.5 percent increase since 2004.
 - IRS plans to spend a total of \$7.2 billion for enforcement and \$3.6 billion for taxpayer service (increases of 6.5 and 3.8 percent respectively over the 2007 continuing resolution levels) and continuing a trend since 2004 of shifting the portion of overall spending toward enforcement as compared to service, as shown in figure 2.
 - The request would provide over 56,500 FTEs for enforcement and about 35,200 FTEs for taxpayer service (an increase of 0.7 percent and a decrease of 3.74 percent, respectively, compared to the FY 2007 enacted levels).⁵

⁴ The \$11.6 billion includes \$11.1 billion in appropriated resources and \$0.5 billion in other resources, including such funds as user fees and funds available for obligation over multiple years. Continuing resolution data is based on assumptions prior to Congress passing IRS's FY 2007 budget and is the best available as IRS was unable to provide updated data in time for this briefing.

⁵ IRS provided updated FTE data based on its enacted FY 2007 budget.



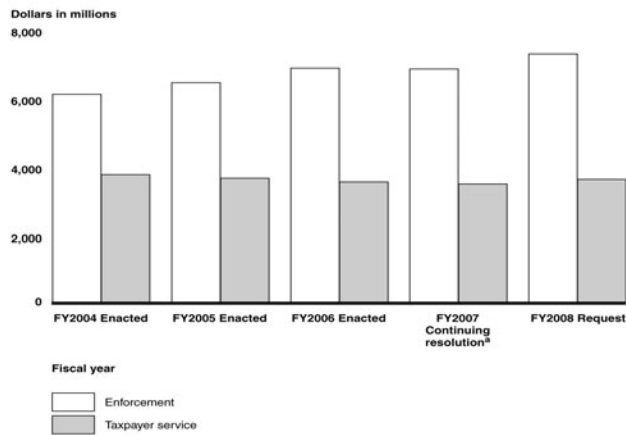
IRS's FY 2008 Budget Request

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- At FY 2008 requested levels, since 2004, total spending for enforcement would increase by 19.4 percent while spending for service would decrease by 3.8 percent.
 - IRS proposes to fund 92,814 FTEs, a 0.29 percent decrease compared to the FY 2007 enacted level.
 - Between FYs 2004 and 2008 (requested), total FTEs would decline 6.3 percent, from 99,055 to 92,814.
 - The decline in FTEs is due, in part, to reduced staffing devoted to paper return processing, which is part of taxpayer service. As noted earlier, IRS used almost 1,700 (36 percent) fewer staff years for processing tax returns in 2006 than in 1999.



IRS's FY 2008 Budget Request

Figure 2: Funding for IRS Enforcement and Taxpayer Service Programs and Related Support Functions, FYs 2004-2008



Source: GAO analysis of IRS data.

^a These data, based on assumptions prior to Congress passing IRS's fiscal year 2007 budget, are the best available on total taxpayer service and enforcement spending in 2007 as IRS was unable to provide updated data in time for this briefing.



IRS's FY 2008 Budget Request

Proposed spending could help address the tax gap but there is limited information on impact.

- To help address the tax gap, the budget request proposes additional revenue-producing initiatives, non revenue-producing initiatives, and legislative proposals.
 - The expected direct revenue to be gained from revenue-producing initiatives and legislative proposals is small compared to the size of the tax gap. Direct revenue includes the additional dollars generated through increased enforcement efforts, such as through audits or collections.
 - Additional enforcement staffing to be hired for these initiatives is expected to yield about \$699 million in direct revenue in FY 2010, about ¼ of 1 percent of the tax year 2001 net tax gap.
 - Of the 16 legislative proposals on tax gap reduction, 7 are related to expanded information reporting. The legislative proposals are estimated to produce \$1.9 billion in additional revenue in FY 2010.
 - In 2010, the total estimated increased revenues from both the revenue-producing initiatives and legislative proposals, about \$2.6 billion, is about 0.9 percent of the 2001 net tax gap.



IRS's FY 2008 Budget Request

Increased enforcement could have indirect revenue effects that exceed direct revenue, but indirect effects are not known or addressed in the budget.

- Indirect revenue of enforcement includes the additional revenue generated due to targeted taxpayers' increased voluntary compliance in subsequent years and the deterrent effect of enforcement on the larger population. Widespread agreement exists that IRS enforcement programs have indirect revenue effects through increases in voluntary tax compliance.
 - Several research studies by economists, while subject to data limitations, suggest that indirect revenue might exceed direct revenues gained.⁶
 - The precise magnitude of the indirect effects of enforcement is not known given challenges in measuring compliance; developing reasonable assumptions about taxpayer behavior; and accounting for factors outside of IRS's actions that can affect taxpayer compliance, such as changes in tax law.
 - That the impact of increased enforcement and legislative proposals on the tax gap is small is consistent with our previous statements which noted that no single approach—such as increased enforcement efforts—is likely to fully and cost effectively address noncompliance.
 - The tax gap has multiple causes and spans different types of taxes and taxpayers.
 - Multiple approaches are needed to reduce the tax gap, including providing IRS additional enforcement authority and tools and simplifying the tax laws.

⁶For citations of research studies, see GAO, *Tax Compliance: Multiple Approaches Are Needed to Reduce the Tax Gap*, GAO-07-488T (Washington, D.C.: Feb. 16, 2007).



IRS's FY 2008 Budget Request

Justifications of new spending initiatives vary in depth of useful information provided.

- To better understand IRS's initiatives and their expected benefits and costs, we asked for supplementary documentation on selected new spending initiatives:
 - Improve tax gap estimates, measures, and noncompliance detection: \$41.0 million; 258 FTEs
 - Improve compliance for large multinational businesses: \$26.2 million; 158 FTEs
 - Improve compliance among small businesses and self-employed taxpayers: \$73.2 million; 485 FTEs
 - Critical upgrades to IT infrastructure: \$60 million; 0 FTEs
 - Research effects of taxpayer service on compliance: \$5 million; 8 FTEs
 - Expand volunteer income assistance: \$5 million; \$46 FTEs



IRS's FY 2008 Budget Request

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- For the six initiatives we reviewed, the budget request and supplementary documents varied in the detail provided to justify new spending initiatives, for example:
 - Documents for the IT infrastructure initiative included information on the extent of the problem to be addressed by new spending, including its impact on employee performance. However, the documents supporting expanding volunteer income tax assistance had no such information, such as, for example, evidence of how current spending levels result in some groups of taxpayers not receiving needed services.
 - Beyond the general, half-page description in the budget request, IRS lacked documentation to justify the initiative to research the effects of taxpayer service on compliance, such as potential research questions or methodologies. While we have been supportive of this kind of research, without more detailed documentation we cannot comment on specifics of the proposal, such as the proposed research approach and how IRS determined needed resources.
 - We continue to assess the documentation for the initiatives and whether IRS could cost effectively provide additional useful information for Congress and others as they consider the appropriate level of funding for IRS.



IRS's FY 2008 Budget Request

IRS's request shows savings, but other savings opportunities may exist.

- As it has in prior years, IRS identified millions in savings; based on its past history of reporting achieving those savings, we have no reason to believe those savings will not materialize.
- We have suggested that Congress mandate electronic filing for certain paid preparers. Much of IRS's proposed savings continue to result from efficiencies from electronic filing.
- IRS may be able to better identify the mix of taxpayer service delivery methods to best meet taxpayer needs more cost effectively. IRS's comprehensive study of taxpayer service delivery options is several months behind schedule. In his March 20, 2007, testimony, the Commissioner of IRS said the report will be released soon.
- We and TIGTA have long reported that IRS has faced challenges in managing and improving the quality of services provided by volunteer organizations. If IRS is unable to ensure that quality is up to an acceptable level, it might need to rethink its funding for these in the future.
- GAO has done past work related to some of the budget's information reporting proposals and suggested them as options for reducing the tax gap.⁷

⁷For citations of our past reports, see GAO-07-488T.



Status of BSM

Additional progress made in BSM implementation, but challenges and risks remain.

- IRS continues to make progress in implementing BSM projects and meeting cost and schedule commitments, but two key projects experienced significant cost overruns during 2006—CADE and Modernized e-File. According to IRS, the cost overrun for Modernized e-File was due in part to upgrading infrastructure to support the electronic filing mandate for large corporations and tax exempt organizations which was not in the original projections or scope.
- Future BSM project releases continue to face significant risks and issues, which IRS is addressing. Delays in deploying the latest release of CADE have resulted in continued contention for key resources and will likely impact the design and development of the next two important releases, scheduled to be deployed later this year. The potential for schedule delays, coupled with reported resource constraints and expanding complexity of CADE, increases the risk of scope problems and the potential for deferring planned functionality to later releases. Maintaining alignment between the planned releases of CADE and the new Accounts Management Services project—intended to deliver improved customer support—is also a key area of concern because of the functional interdependencies. The agency recognizes the potential impact of these project risks and issues on its ability to deliver planned functionality within cost and schedule estimates, and has developed mitigation strategies to address them.



Status of BSM

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- IRS has made further progress in addressing high-priority BSM program improvement initiatives during the past year, including efforts related to hiring and training 25 entry-level programmers to support CADE development.
 - IRS has made significant progress in implementing our prior recommendations, including improving its modernization management controls and capabilities and developing an updated modernization vision and strategy. However, critical controls and capabilities related to requirements development and management and post implementation reviews of deployed BSM projects are not yet fully implemented.
 - IRS has more to do to fully address our prior recommendation of developing a long-term vision and strategy for completing the BSM program, including establishing time frames for consolidating and retiring legacy systems.

Appendix II: GAO Contact and Staff Acknowledgments

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Staff Acknowledgment

In addition to the contact person named above, Amy Dingle, Charles R. Fox, Carol Henn, Timothy D. Hopkins, Ronald W. Jones, Matthew Kalmuk, Varflay Kessely, Jennifer McDonald, Paul B. Middleton, Sabine R. Paul, David A. Powner, Cheryl Peterson, Neil Pinney, and Joanna Stamatiades made key contributions to this report.

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