United States General Accounting Office

GAO

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

December 1998

TAX ADMINISTRATION

IRS' 1998 Tax Filing Season

GAO/GGD-99-21

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-279310

December 31, 1998

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

Dear Chairman Johnson:

This report responds to your request that we assess the Internal Revenue Service's (IRS) performance during the 1998 tax filing season. In addition to providing data on various indicators that IRS uses to measure its filing season performance, we discuss six areas about which you specifically inquired: (1) IRS' efforts to increase the use of electronic filing; (2) IRS' progress in addressing an issue discussed in our reports on the 1996 and 1997 filing seasons involving the use of private banks to process some tax payments;[1] (3) IRS' implementation of the 1997 tax law change dealing with capital gains; (4) the status of IRS' efforts to reduce Earned Income Credit (EIC) noncompliance; (5) the ability of taxpayers seeking assistance to reach IRS by telephone; and (6) other IRS efforts to provide information to taxpayers, such as its World Wide Web site on the Internet and TeleTax (an automated system that provides recorded information on a variety of tax topics). Finally, we discuss IRS' test of a new processing system that has implications for future filing seasons. In March 1998, we testified before the Subcommittee on the interim results of our work.[2]

Results in Brief

IRS has several indicators that it uses to judge the success of a filing season. For the 1998 filing season, those indicators showed that IRS generally met or exceeded its performance goals. Included in IRS' indicators are measures of the timeliness of its processing of refunds, the accessibility of its telephone service, the accuracy with which it processes returns, and the accuracy of assistance it provides over the telephone. Although millions of taxpayers used the services provided by IRS' walk-in sites during the 1998 filing season, IRS did not have meaningful nationwide data for assessing the performance of those sites.

[1] IRS' 1996 Tax Filing Season: Performance Goals Generally Met; Efforts to Modernize Had Mixed Results (GAO/GGD-97-25, Dec. 18, 1996) and Tax Administration: IRS' 1997 Tax Filing Season (GAO/GGD-98-33, Dec. 29, 1997).

[2] Tax Administration: IRS' Fiscal Year 1999 Budget Request and Fiscal Year 1998 Filing Season (GAO/T-GGD/AIMD-98-114, Mar. 31, 1998).

This report addresses several other matters related to the 1998 filing season. For example:

- Although the overall number of individual income tax returns filed in 1998 increased by less than 2 percent from 1997, the number of returns filed electronically, including the number filed over the telephone (i.e., TeleFile), increased at a more robust rate—about 28 percent. According to IRS and our analysis, the increase in electronic filing was due, in part, to (1) a decision by the largest nationwide return preparation company to include electronic filing in its basic return preparation fee and (2) a change in IRS' procedures that made more persons eligible to use TeleFile in 1998.
- Even with the 28-percent increase in electronic filing, about 98.5 million returns (80 percent) were filed on paper in 1998. IRS' most recent survey of taxpayers who were eligible to use TeleFile, but who chose not to, identified one possible step IRS could take to increase the use of that filing alternative. Over 70 percent of the respondents to that survey said that they would have been encouraged to file by telephone if the special tax package they were sent included the tax table. IRS has opposed including the tax table in the package because doing so would increase the size and cost of the package and because taxpayers do not need the table to file by telephone. Although IRS is correct on both counts, it has not conducted a test to determine whether the potential increase in TeleFile use would justify the additional cost of including the tax table in the package.
- IRS uses private banks, known as lockboxes, to process some tax payments submitted with Forms 1040 (U.S. Individual Income Tax Return). As part of that arrangement, IRS requires that taxpayers send their tax returns, along with their payments, to the banks. The government pays the banks several million dollars to sort those returns and ship them to IRS for processing. As we reported in 1997, IRS has inadequate evidence to justify the additional cost associated with having banks handle tax returns.
- The return processing procedures that IRS adopted in implementing a legislative change relating to capital gains led to processing delays and increased taxpayer burden in 1998. IRS plans to revise its procedures for the 1999 filing season. The revisions, if effectively implemented, should alleviate some of the problems encountered in 1998.
- IRS expanded its efforts to ensure that taxpayers filed correct EIC claims in 1998. However, EIC criteria may not have been applied consistently at service centers due to a lack of controls and standardized procedures to ensure that field offices receive timely notification of procedural changes. Also, as we previously reported, IRS could have done more to alert taxpayers to the consequences of falsely claiming the EIC and could have

provided special EIC assistance earlier in the filing season.[3] IRS plans changes in 1999 that partially address these issues, but more can be done.

- The measures that IRS uses to judge the accessibility of its telephone service showed substantial improvement. For example, the level of service, which identifies the percentage of calls that received an answer, increased from 52.6 percent in 1997 to 73.7 percent in 1998. The results of our test of access to IRS' tax assistance telephone number were consistent with IRS' reported increase. IRS took several steps in 1998 that may have contributed to the improved accessibility, including (1) extending the hours during which taxpayers could call IRS and speak to an assistor, (2) expanding its use of voice messaging, and (3) increasing the number of staff available to answer the telephone during peak calling periods.
- Use of IRS' Web site, as measured by the number of "hits," increased by 187 percent this year, while the number of files downloaded from that site increased by about 313 percent. We tested the downloading of forms and publications during the year and consistently found that the process was quick and easy.
- Use of TeleTax decreased about 15 percent during the 1998 filing season. Customer satisfaction surveys show that a majority of the users of TeleTax expressed some dissatisfaction with that service. However, the survey only asked if users were satisfied or dissatisfied; it did not ask any follow-up questions that could be used to determine why a respondent might have been dissatisfied.

We also monitored IRS' test of a new system for processing returns and remittances. Because of problems with the part of the system that processes remittances, IRS has decided to revise the system's implementation schedule and its contingency plan for 1999. We are concerned about the potential impact of the revised schedule on the 2000 filing season and the absence of a contingency plan for 2000, when current systems will no longer work.

Objective, Scope, and Methodology

Our objective was to assess IRS' performance during the 1998 filing season, with particular emphasis on several areas identified in the Subcommittee's request. To achieve our objective, we

- interviewed IRS officials at the National Office; the Midstates, Southeast, and Western Regional Offices; the Georgia, Kansas/Missouri, and Northern

[3] Earned Income Credit: IRS' Tax Year 1994 Compliance Study and Recent Efforts to Reduce Noncompliance (GAO/GGD-98-150, July 28, 1998).

California District Offices; and the Atlanta, GA; Austin, TX; Cincinnati, OH; Fresno, CA; and Kansas City, KS, Service Centers;[4]

- interviewed officials from the two largest national tax return preparation companies;
- analyzed filing-season-related data from various management information systems, such as IRS' Management Information System for Top Level Executives; IRS data on processing errors, including errors involving the EIC and capital gains; and IRS data on alternative filing methods and TeleTax;
- interviewed IRS National Office and service center officials who were responsible for implementing a new system for processing returns and remittances and analyzed reports on a test of that system at the Austin Service Center;
- analyzed IRS data relating to its toll-free telephone assistance and conducted a nonstatistical test of IRS' telephone accessibility during the filing season (see app. I for information on our test methodology and detailed results);
- interviewed officials who were responsible for walk-in assistance sites in IRS' Southeast and Midstates Regional Offices and officials at walk-in sites in Atlanta; Mission, KS; and St. Louis, MO;[5]
- reviewed walk-in site guidance developed by IRS' National Office; the results of walk-in site reviews done by one regional office; and a contractor's report on the results of surveys of walk-in customers done in March, April, and May, 1998;
- analyzed activity data for IRS' forms distribution centers and World Wide Web site and conducted a nonstatistical test of the ability to download files from the Web site;
- interviewed officials from IRS and the Department of the Treasury's Financial Management Service (FMS) (which is responsible for negotiating and administering lockbox contracts) about the use of lockboxes to process Form 1040 tax payments and analyzed cost/benefit data related to lockbox processing;
- interviewed officials from IRS' Taxpayer Advocate's Office about the impact of various filing season activities on taxpayers; and
- reviewed reports by IRS' Office of Internal Audit on filing season activities and a report by Treasury's Inspector General on the use of lockboxes.

[4]Except for Austin, we selected these locations because we had staff available in those areas to do the work. We selected the Austin Service Center because it was responsible for testing IRS' new processing system.

[5]We selected these locations because we had staff available to do the work in those cities.

We did our work from January through October, 1998, in accordance with generally accepted government auditing standards.

IRS Generally Met the Filing Season Goals It Established

Table 1 shows various indicators that IRS used to measure its performance during the 1998 filing season. Those indicators, which we selected from various IRS documents and sources, relate to timeliness, such as the number of days needed to process and issue refunds; quality, such as the accuracy of answers to taxpayers' questions and notices sent to taxpayers; and service accessibility, such as the extent to which taxpayers with tax-related questions were able to reach IRS by telephone.[6] The goals shown in table 1 were set by IRS generally on the basis of historical accomplishments and projected workload. We did not assess the appropriateness of IRS' goals.

Table 1 shows 11 indicators. However, IRS added one indicator, the level of service provided by the taxpayer service telephone system, after planning for the 1998 filing season had been completed and thus did not establish a goal for that indicator. Of the 10 indicators for which IRS had established goals for 1998, IRS met or exceeded the goals for 7 indicators and came close to the goals for the other 3 indicators. Table 1 also shows that for 8 of the 11 indicators, IRS exceeded its performance in 1997. IRS equaled its 1997 performance for one indicator and saw its performance on the other two indicators drop slightly.

[6]IRS also has various workload indicators, such as the number of returns received and refunds issued. Several of those indicators, which generally show a growth in IRS' filing season workload and a growth in taxpayer use of fairly new alternatives, such as electronic filing, direct deposits, and IRS' World Wide Web site, are shown in appendix II.

Table 1: IRS' Performance Goals and Related Accomplishments for the 1997 and 1998 Filing Seasons

	1997[a]		1998[a]	
Indicator	**Goal**	**Accomplishment**	**Goal**	**Accomplishment**
Accuracy of individual income tax returns processed by Code and Edit staff[b]	Process 95% accurately	95% were processed accurately	Process 95% accurately	95.5% were processed accurately
Accuracy of individual income tax returns processed by data transcribers[c]	Process 95% accurately	94.7% were processed accurately	Process 95% accurately	94.2% were processed accurately
Notice accuracy[d]	Provide accurate notices to taxpayers 98.5% of the time	Provided accurate notices to taxpayers 98.3% of the time	Provide accurate notices to taxpayers 98.5% of the time	Provided accurate notices to taxpayers 98.4% of the time
Timeliness of processing tax payments submitted with individual income tax returns[e]	Payments received 4/15/97 through 4/30/97 were to be deposited no later than 4/30/97	All payments received 4/15/97 through 4/30/97 were deposited by 5/2/97	Payments received 4/15/98 through 4/30/98 were to be deposited no later than 4/30/98	All payments received 4/15/98 through 4/30/98 were deposited by 4/30/98
Accuracy of individual income tax refunds on paper returns[f]	Process 99.3% accurately	99.4% were processed accurately	Process 99.3% accurately	99.6% were processed accurately
Timeliness of refund checks for individual income tax returns filed on paper[g]	Issue within an average of 40 days	Issued within an average of 38 days as of 5/97	Issue within an average of 40 days	Issued within an average of 35 days as of 5/98
Timeliness of refunds for individual income tax returns filed electronically[h]	Issue within an average of 21 days	Issued within an average of 15 days as of 5/97	Issue within an average of 21 days	Issued within an average of 15 days
Level of service provided by taxpayer service telephone system[i]	Not applicable[j]	Provided 52.6% level of service	Not applicable[j]	Provided 73.7% level of service
Level of access to taxpayer service telephone system[k]	Provide 60.2% level of access	Provided 71% level of access[k]	Provide 70% level of access	Provided 90.6% level of access
Accuracy of tax law assistance[l]	Answer 92% accurately	95% were answered accurately	Answer 96% accurately	93.6% were answered accurately
Accuracy of processing form orders[m]	Process 96.5% accurately	97% were processed accurately	Process 96.5% accurately	97.3% were processed accurately

Note: Similar tables in our reports on past filing seasons included three indicators that are not included in this year's table. We dropped the indicator "service center individual income tax returns processing productivity" because IRS stopped reporting that measure. We also dropped the indicator "individual income tax returns processing cycle time" because we determined that the refund timeliness measures provide more meaningful information on the timeliness of IRS processing. Lastly, the indicator "level of access to forms-ordering telephone system" was dropped because IRS now includes telephone calls to its forms distribution centers in computing the taxpayer service level of access and level of service indicators.

[a]Data are as of April 1997 and April 1998, unless otherwise noted.

[b]Code and Edit staff are to prepare returns for computer entry by, among other things, ensuring that all data are present on the return and legible. This indicator represents the percentage of "other than full paid," individual income tax returns processed without code and edit errors. Other than full paid returns are those that involve either a refund or an unpaid liability.

[c]This indicator represents the percentage of other than full paid, individual income tax returns processed without transcription errors.

[d]This indicator is based on a sample of returns processing notices addressed to individual and business taxpayers. Among other things, returns processing notices are used to notify taxpayers of missing schedules or forms, missing Social Security numbers, or refunds being delayed or used to offset another liability. IRS compares the printed notice to various data, including information in the taxpayer's master file record and on the taxpayer's tax return. The indicator is calculated by dividing

the number of correct notices reviewed by the total number of notices reviewed. IRS told us that the results for individual and business taxpayers cannot be separated.

[e]Service centers are to deposit payments in a timely manner, generally within 24 hours of receipt. Because of the volume of payments received between April 15 and April 30, IRS suspends the 24-hour requirement during that period. Instead, IRS requires that all payments received during that period are to be deposited by the end of business on April 30. After April 30, the centers are to resume the 24-hour deposit schedule.

[f]This indicator is based on a sample of individual income tax returns filed on paper. The indicator is calculated as the percentage of refunds on those returns that are free of any IRS-caused errors in the name and address field or in the refund amount.

[g]This indicator is based on a sample of paper returns and is an average calculated starting from the signature date on the return to the date the taxpayer should have received the refund, allowing 2 or 3 days after issuance (depending on whether the refund is paid by check or direct deposit) for the refund to reach the taxpayer or the taxpayer's bank account.

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

[i]The level of service indicator is calculated by dividing the number of calls answered by the total call attempts. Calls answered includes the calls to the voice messaging system that were subsequently returned by IRS. Total call attempts is the sum of calls answered, calls abandoned by the caller before receiving assistance, and calls that receive a busy signal. IRS did not track level of service in 1997. We calculated the 1997 level of service using IRS data for that year.

[j]IRS did not establish goals for this indicator because it was selected as an indicator after planning for the 1998 filing season had been completed. Although this indicator did not exist in 1997, we computed the 1997 accomplishment using IRS' data and methodology.

[k]For 1998, the level of access is the sum of the number of calls answered plus the number of abandoned calls divided by the total call attempts (components are defined as in note i above). The 1997 and 1998 accomplishments cannot be compared because IRS changed its calculation method. In 1997, the calculation was the number of calls answered divided by the number of individual callers. In 1998, the denominator was the number of call attempts. Therefore, if one person called five times before reaching IRS, the denominator would have been 1 in 1997 and 5 in 1998.

[l]This indicator measures the accuracy of tax law information provided to taxpayers through the toll-free telephone assistance program. It is based on test calls placed to the telephone assistors.

[m]The accuracy with which forms distribution centers process taxpayers' orders is determined by randomly checking selected taxpayer orders, monitoring telephone calls from taxpayers, and reviewing data transcription of written form requests from taxpayers.

Source: IRS data and GAO analysis of IRS data.

During our reviews of past filing seasons, we assessed the methodology behind some of the indicators in table 1 and validated some of IRS' reported accomplishments. During the 1994 filing season, we examined IRS' methodology for testing the timeliness and accuracy of refunds issued to taxpayers who filed paper returns.[7] We replicated IRS' test at one service center and concluded that it provided a valid measure of refund accuracy and timeliness at that center. We are comfortable with IRS' methodologies for computing the level of access and level of service associated with its taxpayer service telephone system because we have been working with IRS over the past few years to develop these measures. Also, although we have not verified the validity of the data used in those calculations, we have, in several years, done our own tests of accessibility,

[7]Tax Administration: Continuing Problems Affect Otherwise Successful 1994 Filing Season (GAO/GGD-95-5, Oct. 7, 1994).

which produced results that were consistent with IRS' reported results. We discuss the results of our test for the 1998 filing season later in this report.

Our work during the 1990 and 1991 filing seasons provided assurance that IRS' methodology for measuring the accuracy of tax law assistance was reliable.[8] IRS followed the same methodology during the 1998 filing season, except that test calls were made by a contractor rather than by IRS employees. We also have done work in the past to determine the accuracy with which IRS' form distribution centers process taxpayers' orders[9] and to assess a contractor's methodology for testing the performance of IRS' distribution centers.[10] IRS conducted this same test during the 1998 filing season using the contractor's methodology.

IRS Lacked Key Performance Indicators With Which to Measure the Services Provided by Walk-In Sites During the 1998 Filing Season

Among other things, IRS' walk-in sites are to distribute forms, help taxpayers prepare tax returns, resolve account issues detailed in notices to taxpayers, and answer tax law questions. IRS data show that walk-in sites served about 6.2 million taxpayers between January 1 and April 25, 1998. According to IRS' business vision and its walk-in site mission statement, walk-in operations are to provide accessible, high-quality service to the public; reduce taxpayer burden; and ensure compliance with tax laws. However, as noted in our recent report on measuring customer service[11] and confirmed during this review, IRS' walk-in program lacked key performance indicators for quality; timeliness; and service accessibility.[12]

IRS' National Office provided regional offices with some overall management guidance on the walk-in program during the 1998 filing season. However, that guidance did not include specific requirements on how certain items, such as quality, should be measured. To measure

[8]Tax Administration: IRS' 1990 Filing Season Performance Continued Recent Positive Trends (GAO/GGD-91-23, Dec. 27, 1990) and Tax Administration: A Generally Successful Filing Season in 1991 (GAO/GGD-91-98, June 28, 1991).

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

[10]Tax Administration: Increased Fraud and Poor Taxpayer Access to IRS Cloud 1993 Filing Season (GAO/GGD-94-65, Dec. 22, 1993).

[11]Tax Administration: IRS Faces Challenges in Measuring Customer Service (GAO/GGD-98-59, Feb. 23, 1998).

[12]We recognize that a complete evaluation of the walk-in program would involve other factors, such as the comparative costs and benefits of (1) answering tax law questions or resolving account issues at walk-in sites versus over the telephone, (2) return preparation at walk-in sites versus return preparation by community volunteers, and (3) forms distribution at walk-in sites versus community-based locations. An analysis of costs and benefits for these various services was beyond the scope of this review.

quality, the guidance stated that regions should do program reviews and visit sites to ensure that consistent and accurate service was being provided. However, the guidance did not specify what regional officials should be examining during their reviews.

We gathered data about walk-in program reviews at three of IRS' four regions. Two regions did such reviews but conducted the reviews differently; the other region did a pre-filing-season readiness review but did no reviews during the filing season. Even though National Office guidance encouraged that the reviews be "unannounced," one of the two regions that did reviews notified the sites of the visits in advance because, according to a cognizant official, the guidance merely "encouraged" unannounced visits. Therefore, sites in this region may have had time to prepare for the visits and "be on their best behavior." The other region that conducted visits did those visits unannounced, with IRS staff posing as taxpayers.

Regions were not required to report the results of any walk-in site performance reviews to the National Office. Nevertheless, the region that did the unannounced visits and had IRS staff pose as taxpayers reported its results and identified several concerns. Among those concerns were (1) incorrect advice by walk-in site assistors concerning qualification for the EIC and (2) the failure of assistors to probe for information to ensure that they accurately responded to the "taxpayers" questions. The region also expressed great concern about the manner in which many "taxpayers" were treated and said that its observations pointed to the need for basic training in and monitoring of customer service skills. The other region that did reviews did not report its results.

Regarding timeliness, the National Office established taxpayer wait-time goals of 30 minutes for return preparation and 15 minutes for all other issues. Even though the National Office established these goals, it did not have a mechanism for monitoring walk-in sites' performance. For example, the National Office did not require the regions to report wait times; therefore, two of the three regions for which we had information, did not report any wait-time data, and the third reported such data only to the extent that they were observed during performance reviews. Thus, IRS cannot determine if the walk-in program met the wait-time goals of 15 and 30 minutes during the 1998 filing season.

IRS' Internal Audit reviewed the walk-in program for the 1997 filing season and recommended that IRS develop a customer-driven strategy that bases program goals and measures on customer feedback.[13] In response to that recommendation, IRS contracted with a firm to develop and analyze the results of a customer satisfaction survey. The survey was designed to gather information on issues such as the accessibility of IRS' service (e.g., the convenience of walk-in office hours). Due to printing and distribution problems, however, the survey was shipped to walk-in sites too late in the 1998 filing season to provide a complete assessment. According to IRS, most sites did not receive the survey until mid- to late-March 1998.

In a report on the results of walk-in surveys done during March, April, and May, 1998, the contractor said that "Walk-in customers as a whole indicated high overall satisfaction." Of the nine areas that customers were asked to rate, "employee courtesy" and "treating you fairly" scored the highest, while "convenience of office hours" scored the lowest.

According to IRS, it plans to better measure walk-in performance in 1999. It plans to measure customer satisfaction (with a survey starting earlier in the filing season than was the case in 1998), the number of customers served, and customer wait times. The 15- and 30-minute wait-time goals that were in effect in 1998 are to be retained in 1999. Also, according to IRS, quality will be assessed through activities such as regional readiness reviews and program reviews.

Use of Electronic Filing Continues to Increase

As of October 30, 1998, IRS had received 123.1 million individual income tax returns, which was an increase of about 2 percent compared to the same time last year. While the increase in the overall number of returns filed was small, the use of electronic filing increased at a much more robust pace. These increases were consistent with filing patterns in 1997. Even with the increase in electronic filing, about 98.5 million tax returns (80 percent) were filed on paper in 1998.

IRS offers three alternatives to the traditional filing of paper returns. Two of those alternatives involve electronic filing—that is, traditional electronic filing[14] and TeleFile.[15] The third alternative, Form 1040PC (Individual

[13] Taxpayer Walk-In Program for the 1997 Filing Season, IRS Internal Audit, Reference No. 081004, December 22, 1997.

[14] Traditional electronic filing involves the transmission of returns over communication lines through a third party (such as a tax return preparer or electronic return transmitter) to an IRS service center, where the return data are automatically edited and processed. Traditional electronic filing can take several forms. Taxpayers can (1) have their returns prepared by someone else, such as H&R Block, and have the preparer arrange to transmit the return to IRS; (2) take a self-prepared return to an authorized transmitter; or (3) prepare their returns on a computer using certain return preparation software and transmit the return on-line to a third party who then transmits it to IRS.

Income Tax Return-Computer Prepared), provides another way to file on paper.[16] Although IRS has not done the kind of comprehensive analysis needed to fully assess the costs and benefits associated with these alternative filing methods, it assumes that the methods save IRS money by, among other things, significantly reducing the number of errors that IRS has to correct. Traditional electronic filing and TeleFile, for example, include built-in checks that are designed to catch certain taxpayer errors, such as computational mistakes, in advance so that they can be corrected by the taxpayer before IRS takes possession of the return. Also, returns filed electronically bypass the error-prone manual procedures that IRS uses to process paper returns.

As shown in table 2, the use of both electronic filing alternatives increased substantially in 1997 and 1998, while the use of Form 1040PC declined in 1998 after substantial growth in 1997.

Table 2: Number of Individual Income Tax Returns Received, by Filing Type

(Number of returns in thousands)

Filing type	1/1/96 to 11/1/96	1/1/97 to 10/31/97	Percentage change: 1996 to 1997	1/1/98 to 10/30/98	Percentage change: 1997 to 1998
Paper					
Traditional					
Form 1040	60,536	61,413	1.45	61,664	0.41
Form 1040A	18,839	17,427	-7.50	16,440	-5.66
Form 1040EZ	17,167	14,523	-15.40	12,816	-11.75
Form 1040T[a]	253	N/A	N/A	N/A	N/A
Subtotal	**96,795**	**93,363**	**-3.55**	**90,920**	**-2.62**
Form 1040PC	7,042	8,427	19.67	7,533	-10.61
Subtotal	**103,837**	**101,790**	**-1.97**	**98,453**	**-3.28**
Electronic					
Traditional	12,140	14,457	19.09	18,639	28.93
TeleFile	2,840	4,694	65.28	5,963	27.03
Subtotal	**14,980**	**19,151**	**27.84**	**24,602**	**28.46**
Total	**118,817**	**120,941**	**1.79**	**123,055**	**1.75**

Legend: N/A = not applicable.

[a]IRS developed Form 1040T to test a document scanning and imaging system that was eventually terminated in October 1996.

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

[15]Under TeleFile, certain taxpayers who are eligible to file a Form 1040EZ (Income Tax Return for Single and Joint Filers With No Dependents) are allowed to file using a toll-free number on Touch-Tone telephones.

[16]Under the Form 1040PC method, a taxpayer or tax return preparer uses computer software that produces a paper tax return in an answer-sheet format. The Form 1040PC shows the tax return line number and the data (dollar amount, name, etc.) on that line. Only lines on which the taxpayer has made an entry are included on the Form 1040PC.

Traditional Electronic

One barrier to the increase of electronic filing in the past has been its cost—if taxpayers wanted to file electronically, they generally had to pay more than they would pay to file on paper. Two developments in the private sector reduced the significance of cost as a barrier to taxpayers in 1998 and, according to a cognizant IRS official, most likely contributed to the increase in traditional electronic filing. First, the largest nationwide return preparation company revised its fee structure to include electronic filing in the basic return preparation fee. Thus, unlike past years, the decision of a person who used this company to file electronically was not influenced by cost, because it cost the same whether he or she chose to file on paper or electronically. Second, some commercial software packages that were available for use in preparing tax year 1997 income tax returns included, in the cost of the software, the ability to file a return from a personal computer through an on-line intermediary. That form of electronic filing accounted for about 922,000 returns in 1998 compared to about 361,000 in 1997—an 155-percent increase.

Another major barrier to the increase of electronic filing has been the fact that traditional electronic filing is not completely paperless. For example, taxpayers must send IRS their Forms W-2 (Wage and Tax Statements) and Form 8453 (a signature document) after their returns have been electronically transmitted. IRS must then manually input data from these documents and match them to the electronic return.

In 1998, as in the prior two filing seasons, IRS tested the use of digitized signatures at a limited number of locations. In the test, taxpayers used an electronic signature pad in lieu of signing a Form 8453. The electronic signature was attached to the electronic return and both were transmitted to IRS. An IRS official responsible for the program told us that the test will not be conducted in 1999 because previous tests have indicated that the technology can work, if properly implemented, and that taxpayers and preparers liked the option better than using the Form 8453. He also said that some practitioners, especially the larger firms, had voiced a concern about the cost of signature pads, but that they still generally preferred the use of those pads to the burden and cost of storing and shipping paper signature forms.

IRS has announced that it will conduct various alternative signature tests in 1999.[17] In one test, for example, taxpayers will choose a personal

[17] In these tests, as in the digitized signature test, IRS plans to waive the need for participants to send their Forms W-2 to IRS. According to a cognizant IRS official, IRS can waive the submission of W-2s because there is no statutory requirement that these forms be attached to tax returns.

identification number to use when filing electronically through certain tax preparers.

In another move toward eliminating paper, IRS has entered into agreements with two private sector firms that will allow certain taxpayers to pay their income taxes by credit card in 1999. According to IRS, it plans to test the use of credit cards in 1999 and, assuming there are no problems, expand the use of credit cards in 2000.

TeleFile

Taxpayers' use of TeleFile increased by 27 percent in 1998. About one-third of that increase can be traced to a change in procedures that made more persons eligible to use TeleFile in 1998. The rest of TeleFile's increased use cannot be traced to any one particular cause.

In past filing seasons, IRS was unable to accept TeleFile returns from taxpayers whose addresses had changed since their previous filing. IRS could not accept these returns because there was no method within the TeleFile system to update an address and because IRS believed that the risk of fraud would be minimized if it required that a refund check be mailed to the taxpayer's last official address in IRS' records.

For the 1998 filing season, IRS contracted to use the U.S. Postal Services' National Change of Address File to update taxpayers' addresses before the tax package mailing labels were printed. When taxpayers called into TeleFile, they were to confirm that the updated address was correct. If the address was not correct, the taxpayers were ineligible to use TeleFile.

According to IRS, because of the new address update procedure in 1998, it was able to send about 2.5 million TeleFile packages (about 10 percent of the 24.6 million TeleFile packages mailed) to more current addresses than it otherwise would have had in the TeleFile system. About 500,000 of those 2.5 million taxpayers used TeleFile in 1998 (i.e., 500,000 taxpayers who would have been ineligible to use TeleFile without this procedural change).

In an attempt to further increase the use of TeleFile, IRS, in 1999, plans to conduct a joint federal and state TeleFile test in Indiana and Kentucky. After completing the federal portion of TeleFile, these taxpayers are to be given the option to file their state tax returns. If the taxpayers choose to do so, they then are to hear instructions for filing the state return. IRS decided to conduct this federal and state test in response to the results of a survey of TeleFile nonusers in 1997. In responding to the survey, 44 percent of the nonusers said that they might be encouraged to use TeleFile if they could also use it to file their state returns.

In response to the same survey, 72 percent of the TeleFile nonusers indicated that they would be encouraged to use the system if they were able to determine their federal tax before calling TeleFile. This would require including the tax table in the TeleFile package—a step that IRS opposes because it would increase the size of the package by several pages (at an estimated cost of about $1.4 million) and because the table is not needed to file a return using TeleFile (TeleFile computes the tax for the taxpayer on the basis of data that the taxpayer enters into the system).[18] However, given the large percentage of nonusers who indicated that having the table would influence them to use TeleFile, some kind of limited test, similar to what IRS is doing with respect to the filing of state returns, might indicate whether the potential increase in TeleFile use justifies the additional cost of including the tax table in the package.

Form 1040PC

As of October 30, 1998, IRS had received about 7.5 million Forms 1040PC, down 11 percent from the same time in 1997. IRS data show that, in both years, more than 75 percent of these forms were prepared by tax return preparers. According to the largest user of Form 1040PC in the preparer community, the drop in the number of Forms 1040PC may be attributable to the increase in electronic filing. This tax return preparation company was the one referred to previously that included the cost of electronic filing in its return preparation fees in 1998. According to data provided by the firm, more clients chose to have their returns filed electronically in 1998 compared to 1997 and fewer Forms 1040PC were filed.

IRS Still Has Inadequate Evidence to Determine the Most Appropriate Lockbox Procedure

In our reports on the 1996 and 1997 filing seasons, we commented on (1) IRS' use of lockboxes, which are postal rental boxes serviced by commercial banks, to process tax payments submitted with Forms 1040 and (2) IRS' requirement, as part of that arrangement, that taxpayers mail to the banks not only their tax payments but their tax returns. IRS and FMS assume that the use of lockboxes is beneficial to the government because, in general, banks can process the payments and deposit the money to a Treasury account quicker than service centers. This means that Treasury would not have to borrow as much to pay government obligations, thereby avoiding interest charges.

[18]IRS' survey did not solicit information that would explain why taxpayers wanted to be able to determine their federal tax before calling TeleFile. However, one possible reason might be their desire to independently compute their tax liability so that they would have some idea of what to expect before calling TeleFile.

After reviewing information compiled by IRS and FMS in 1998, we continue to believe that IRS has inadequate evidence to determine whether the additional burden that may be caused by having taxpayers separate their returns from their payments outweighs the several million dollars in additional cost associated with having the banks handle those returns. Nevertheless, IRS plans to continue the current lockbox process in 1999.

In our report on the 1996 filing season, we questioned IRS' decision to have taxpayers send both their tax returns and their tax payments to lockboxes.[19] The banks do not need tax returns to process remittances, and the government was incurring several million dollars in additional cost by requiring the banks to receive returns, sort them, and ship them to IRS for processing—even after netting out what it would cost if IRS sorted the returns instead of the banks. IRS believed that the alternative—asking taxpayers to separate their tax payments from their returns and mail each to a different address—would impose a burden on taxpayers. In our opinion, the evidence IRS provided in 1996 on taxpayer burden was not convincing. We recommended that the Commissioner of Internal Revenue either discontinue having returns sorted by the banks, thus reducing the extra cost to the government, or reconsider the decision to have taxpayers send their tax returns to the banks along with their tax payments.

In response to our recommendation, IRS said that it had formed a task force to identify a long-term solution for directing Form 1040 tax payments to lockboxes. In May 1997, the task force recommended that IRS have taxpayers separate their returns from their payments. Despite the task force's recommendation, IRS decided that lockboxes would continue to receive and sort tax returns because of IRS' continuing concern about taxpayer burden. To support its position, IRS cited the results of several focus groups that became available after the task force had completed its work.

In our report on the 1997 filing season, we concluded, after reviewing the results of those focus groups, that IRS still did not have conclusive evidence to support its position.[20] We also questioned the validity of IRS' and FMS' assumption that lockboxes can process remittances and deposit the money to a Treasury account 3 days faster than service centers. That assumption was key to the assertion that it is cost beneficial to have lockboxes process Form 1040 tax payments. We recommended, among

[19]GAO/GGD-97-25.

[20]GAO/GGD-98-33.

other things, that IRS (1) conduct, during the 1998 filing season, the analyses necessary to determine whether there are net savings to the government attributable to the use of lockboxes to process Form 1040 tax payments and (2) collect definitive data on whether taxpayers believe, given the processing cost savings to the government, that it would cause them an unreasonable burden to mail tax returns and tax payments to different locations. We also recommended that IRS take certain steps depending on the results of the analyses.

In an August 1998 report, Treasury's Office of the Inspector General concurred with our findings and also recommended that IRS acquire relevant and reliable comparative cost data on all aspects of the lockbox program to identify the most cost-effective option to use when the current lockbox arrangement expires in 1999.[21]

In 1998, in response to our recommendations and in line with the Inspector General's recommendation, (1) FMS contracted for a study to determine how much time the government saves, if any, by having lockboxes instead of service centers process remittances and (2) IRS included lockbox-related questions in 10 focus groups involving about 100 taxpayers.

FMS Study

To determine how much time the government saves, if any, by having lockboxes instead of service centers process remittances, FMS, in March 1998, contracted for a study that was designed to measure and compare processing time frames. The contractor was to analyze the following three factors: (1) the average mail time to a processing site, (2) the average elapsed time from the receipt of mail at the lockbox or service center to the time receipts were deposited in the bank, and (3) the average time required to convert deposited receipts to funds available in the Treasury account.

Because we did not receive a copy of the contractor's July 1998 report until October 1998, we were only able to partially assess its implications for this report. The study showed that, on average, lockboxes process remittances about 2 days faster than the service centers—1 day less than both FMS and IRS had been assuming in calculating the interest cost avoidance from using lockboxes. The contractor also made several observations about existing processes that, if changed, might reduce service center processing times. For example, the contractor noted that processing times might be reduced if (1) service centers had more reliable

[21] Review of the Effectiveness of Using Commercial Bank Lockboxes for Federal Income Tax Payments, Department of the Treasury, Office of Inspector General, Reference No. OIG-98-097, August 20, 1998.

mail-opening equipment, (2) the strategies at service centers for working on weekends and making deposits on the weekend were consistent, and (3) IRS found some way to better identify envelopes that contained remittances—like the different-colored mailing labels that several states use to distinguish tax returns with payments from returns that involve a refund.

Using the average 2-day timeline variance and data provided by FMS on the then current value of funds rate (5 percent) and the amount of Form 1040 remittances collected by the banks in fiscal year 1998 (about $48.3 billion), we determined that the lockbox processing of Form 1040 remittances resulted in an interest cost avoidance of $19.3 million.[22] In addition, a cognizant FMS official told us that the contractor's study indicated that the timeline variance was actually 3-days during parts of various peak processing periods because of expedited weekend processing by lockboxes. Assuming that the 3-day variance for certain periods is correct and using data provided by FMS, we determined that the amount of interest cost avoidance should be increased by about $1.6 million, for a total of about $20.9 million.[23] Other data obtained from FMS on the number of items handled by the banks (about 11 million) and the banks' charges per item show that the government paid banks about $19.8 million for processing the Form 1040 remittances in fiscal year 1998, of which about $9.7 million was to reimburse the banks for sorting tax returns and shipping them to IRS.

Taken together, and assuming the appropriateness of the 3-day variance for certain weekend processing, FMS' data indicate that the use of lockboxes to process Form 1040 remittances saved the government about $1.1 million in fiscal year 1998 ($20.9 million in interest cost avoidance minus $19.8 million in bank charges). However, the data also indicate that the use of lockboxes could save the government substantially more if the banks were not required to handle tax returns. For example, according to FMS, the $9.7 million paid to the banks for handling tax returns included 74 cents a return for sorting and 13 cents a return for shipping. Two years ago, IRS told us that having service centers sort the returns would cost IRS

[22]FMS used the average variance of 2 days to compute interest cost avoidance. However, looking at each of the 10 service centers and its corresponding lockbox bank separately, the timeline variances reported by the contractor ranged from about 3/4ths of a day to 3-1/2 days. We do not know how much, if at all, the result would have changed if FMS had calculated a separate interest cost avoidance for each of the 10 locations and then summed those 10 calculations.

[23]Although we could confirm that the contractor identified differences between banks and at least some service centers with respect to weekend processing, we did not have time to determine whether the contractor's data supported FMS' decision to use a 3-day variance for certain processing periods.

an average of 37 cents a return—one-half as much as the 74 cents charged by the banks. Thus, assuming that IRS' sorting costs remained at 37 cents a return,[24] having the banks sort and ship 11 million returns in fiscal year 1998 would have cost the government an additional $5.5 million (11 million returns times 50 cents of additional cost per return—that is, 37 cents for sorting and 13 cents for shipping).

IRS Focus Groups

In an attempt to obtain information on taxpayer burden associated with having taxpayers mail their tax returns and tax payments to separate locations, IRS added questions to an existing focus group study. That study, done by a contractor, was originally designed to solicit ideas from taxpayers on ways to improve the Form 1040 tax package. IRS added questions to solicit taxpayers' views on mailing their returns and remittances in separate envelopes. The contractor held 10 focus groups involving about 100 taxpayers who prepared their own federal income tax returns.

Although they provided some evidence of taxpayer concern about burden, these focus groups did not, as we had recommended in 1997, provide "definitive data on whether taxpayers believe, given the processing cost savings to the government, that it would cause them unreasonable burden to mail tax returns and tax payments to different locations." Most important, as noted in our report on the 1997 filing season, although focus groups are useful in providing insight on a particular issue, they are not statistically representative of the population and should not, in and of themselves, provide the basis for far-reaching conclusions. As noted in the contractor's report, its study was "qualitative in nature" and "the hypotheses discussed in this report should be viewed as tentative."

Also, data generated by the focus groups did not provide definitive evidence that taxpayers considered the increased burden associated with using two envelopes unreasonable. The concerns mentioned by participants involved (1) the need to use two envelopes instead of one if they owed money,[25] (2) the need to use an additional postage stamp if they had to use two envelopes, and (3) the possibility that payments and returns would not get linked if they were sent to different places.

[24]We do not know what IRS' per-return sorting costs were in 1998. Although some factors, such as increased salaries and benefits, could have driven those costs up, other factors, such as improved productivity or decreased overhead, could have had the opposite effect.

[25]For persons using a tax package, the two envelopes would be provided by IRS and included in the package. Persons not using a package would have to supply their own envelopes.

It is true that taxpayers would have to use two envelopes instead of one and would have to use an extra stamp, but there is no indication in the contractor's May 1998 summary report that focus group participants were told about the potential savings to the government if taxpayers assumed the additional burden. In that regard, the contractor's report noted that "some taxpayers, who imagined the system would save the IRS time or money, said they would be willing to go along with the new idea if it was properly explained to them." In our opinion, participants should have been told about potential savings rather than having to imagine them.

As for the participants' concern about separating their returns from their payments and the possibility that the two would not get reconnected, there was no indication in the report that participants were told that the current procedure also results in the payment and return being separated. When taxpayers mail their returns and payments to a lockbox, the bank separates the payments from the returns and ships the returns to IRS. The bank then processes the payments while IRS processes the returns.

Given all of the previously mentioned information, we believe that IRS still has not obtained definitive evidence showing that the additional taxpayer burden and costs associated with the use of two envelopes would outweigh the additional costs the government incurs to have banks sort and ship tax returns.

IRS' Plans for 1999

Responsible IRS officials told us that IRS will continue the current lockbox process in 1999. According to the officials, IRS decided to continue the current program because FMS' study was not finalized in time to make changes for 1999 and because IRS continues to believe that asking taxpayers to separate their returns and payments would impose an unreasonable burden. However, in commenting on a draft of this report, IRS said that additional analysis is warranted regarding the efficacy of, and alternatives to, the current arrangement. In that regard, IRS said that it would do a detailed analysis of the costs and feasibility of returning this portion of the remittance processing workload to IRS at some point in the future.

Implementation of Change to Capital Gain Provisions Led to Some Processing Delays and Increased Taxpayer Burden

The Taxpayer Relief Act of 1997 (TRA97) changed the way capital gains are treated for income tax purposes. Before the act, capital gains were taxed at the same rate as other income, up to a maximum of 28 percent. TRA97 created capital gains tax rates ranging from 10 percent to 28 percent, depending on the type of asset, the holding period of the asset, the date of sale, and the individual's income.[26] As a result, taxpayers must now report to IRS more capital gains information than previously required. To implement the new legislation, IRS revised Schedule D (Capital Gains and Losses). That revision increased the number of lines on the Schedule D. The schedule used in 1997 had 19 lines and a 13-line worksheet; the revised schedule had 54 lines.

TRA97 was not passed until August 5, 1997, and some issues related to capital gains were not resolved until early October 1997. Because of the time needed to make the necessary computer software changes, IRS was not prepared to process returns with Schedule Ds until February 13, 1998. Until then, IRS could not accept electronic returns with Schedule Ds, and service centers had to suspend the processing of paper returns with Schedule Ds.

A representative of one of the tax return preparation firms we contacted told us that IRS' hold on accepting electronic returns with Schedule Ds required his firm to develop a software program that would hold electronic returns with Schedule Ds in suspense within its computer system. This firm had over 100,000 electronic returns with Schedule Ds in suspense that had to be transmitted once IRS announced it could process Schedule Ds.

Officials at the 5 service centers we visited said that their inventories of suspended paper returns with Schedule Ds were not very great (fewer than 5,000 at each service center) and were cleared quickly after the software changes were made. According to the officials, the impact was not significant because, historically, most returns with a Schedule D come in later in the filing season.

According to an IRS analysis of a statistically valid sample of tax year 1997 returns filed through August 28, 1998, the percentage of individual income tax returns filed with a Schedule D increased from 13 percent in 1997 to 19 percent in 1998. This increase was partly due to the requirement that all capital gain distributions from mutual funds be reported on Schedule D. In past years, taxpayers with capital gain distributions from mutual funds under $400, and no other capital gains or losses, were not required to

[26]Normal marginal rates for taxable income range from 15 percent to 39.6 percent.

complete a Schedule D. The IRS analysis noted that the number of individual income tax returns filed in 1998 that showed capital gain distributions increased by over 3 million compared to the number in 1997.

IRS estimates that about 1 million taxpayers with capital gains failed to submit a Schedule D during the 1998 filing season. Service centers were instructed to correspond with all taxpayers who claimed capital gains of over $1 but who failed to submit a Schedule D and to suspend the processing of those returns until the Schedule Ds were provided. IRS officials said that they corresponded with all of these taxpayers about the missing Schedule Ds both to educate them about the requirement to attach a Schedule D and because use of the Schedule D and the new capital gain rates could reduce a person's tax liability.

In general, the tax rates on capital gains are lower than the rates on other income. To take advantage of these lower rates, taxpayers must compute their tax using a Schedule D. Because the capital gains tax rates are often lower than the rates on other income, filing a Schedule D usually reduces a taxpayer's liability. However, for taxpayers with a small amount of capital gains, the possible saving is minimal. By requiring everyone to submit a Schedule D, even if they only had $1 in capital gains, IRS created additional work for itself; delayed the processing of some returns and the associated refunds, if any, until receipt of the schedule; and increased taxpayer burden by causing all of these taxpayers to complete a complicated schedule.

We reviewed a proof copy of Schedule D for use during the 1999 filing season, and the form will be virtually the same as the one used in 1998. However, IRS has revised the way it will process returns with missing Schedule Ds for the 1999 filing season. Under its new procedure, IRS will process tax year 1998 returns claiming capital gains even if there is no Schedule D attached. In doing so, IRS will assume a short-term capital gain rate and mail a notice to the taxpayer after the return is processed. The notice is to inform taxpayers that their returns were processed using the short-term rate to avoid any delay, but that they may be able to lower their tax if long-term capital gain rates apply. The mailing is to include a Schedule D, instructions for completing the schedule, and a Form 1040X (amended return). Taxpayers then will have the opportunity to file an amended return if they determine that their tax savings are worth the additional time needed to prepare and file the Form 1040X and Schedule D. IRS' revised procedures should benefit many taxpayers by providing some refunds earlier and by saving them the time associated with completing a

Schedule D if they determine that the tax savings are not significant enough to warrant the effort.

IRS Expanded Its Efforts to Ensure That Taxpayers Filed Correct EIC Claims

The EIC is a refundable tax credit available to low-income, working taxpayers. Congress created the EIC to offset the impact of Social Security taxes and to encourage low-income workers to seek employment rather than welfare. Because of concerns about noncompliance and fraudulent claims, IRS has given increased attention to EIC claims during the past few filing seasons. In 1998, IRS (1) continued validating Social Security numbers (SSN) used in conjunction with EIC claims, (2) conducted in-depth reviews of certain EIC claims, (3) established procedures for denying future EIC claims by taxpayers who were found to have negligently or fraudulently claimed the EIC in 1998, (4) established requirements for paid preparers to exercise due diligence in determining a taxpayer's eligibility for the EIC, and (5) expanded telephone and walk-in assistance for EIC claimants. Two main impetuses were behind this increased activity in 1998—TRA97, which included several provisions relating to the EIC, and a new EIC compliance initiative that Congress began funding in fiscal year 1998.

We discussed IRS' actions in a July 1998 report to the Chairman of the House Committee on Ways and Means and Senator Larry E. Craig.[27] As noted in that report, we believe that IRS could have done more to alert taxpayers to the consequences of falsely claiming the EIC and could have provided special EIC assistance earlier in the filing season. In addition, our review of EIC processing for the 1998 filing season disclosed that IRS does not have controls in place to ensure that field locations receive notification of procedural changes and implement the changes at the same time. The lack of controls leaves open the possibility that criteria were inconsistently applied during the processing of EIC claims in 1998.

Notwithstanding the issues discussed in our previous report and the lack of controls identified during this review, there is evidence to suggest that IRS' efforts have had a positive effect. IRS data on the number of errors identified on returns with EIC claims indicated that although taxpayers and return preparers were still making many errors, the error rate dropped significantly in 1998. For the period January 1 through August 29, 1998, IRS identified 1,992,379 EIC-related errors on 19,393,098 returns—an error rate of 10.27 percent. That error rate compares favorably with 2,655,524 errors on 19,032,043 returns during the same period in 1997—an error rate of 13.95 percent. During the same period, there was also a significant drop in

[27]GAO/GGD-98-150.

the number of errors involving SSNs and other taxpayer identification numbers on EIC returns—600,676 in 1998 compared with 955,542 in 1997.

IRS Continued Validating SSNs

Since 1997, IRS has had the authority to disallow, through its math error program, any deductions and credits associated with an invalid SSN.[28] Under its math error program procedures, if IRS identifies an invalid SSN while processing a return, it can immediately adjust the taxpayer's tax liability; refund; and/or EIC claim. The taxpayer is to receive a notice explaining the change to the return. Taxpayers who receive such a notice can call or write IRS to provide the correct SSN or otherwise resolve the issue. If taxpayers do not respond to IRS' notice, there is to be no further correspondence unless the taxpayers fail to pay any additional tax that was assessed as a result of an IRS change.

As of the end of August 1997, IRS had issued 955,542 math error notices to taxpayers who had claimed an EIC but had not supplied a correct SSN or other identification number for either themselves, their spouses, or their dependents. As of the same point in time in 1998, the number of such notices dropped to 600,676—representing about a 37-percent decrease from 1997. This drop in the number of notices may indicate that fewer taxpayers are attempting to claim an EIC to which they are not entitled. It may also reflect the impact of IRS efforts to alert taxpayers who had used invalid SSNs in prior years of the need to correct those problems before filing their returns in 1998. For example:

- In December 1997, IRS sent notices to about 600,000 taxpayers who had filed returns with an invalid SSN for the "primary" taxpayer.[29] The notice told the taxpayers what to do to correct the situation before filing their returns in 1998.
- IRS also identified about 225,000 EIC-qualifying child SSNs that had been used by more than 1 taxpayer on returns filed in 1997. In December 1997, IRS sent notices to these taxpayers (about 383,000) informing them of the problem and reminding them to file a correct return in 1998.

According to IRS, its analyses of the impact of the notices mailed in December 1997 will not be completed until sometime in 1999.

IRS identified a programming-related problem early in the 1998 filing season that raised concerns that (1) some invalid SSNs were not being

[28]IRS considers an SSN invalid if it is missing from the return or if the SSN and associated name on the return do not match data in the Social Security Administration's records.

[29]The primary taxpayer is the taxpayer filing the return or, on a joint return, the taxpayer listed first.

resolved and (2) EIC eligibility was not being scrutinized in some cases. Efforts to resolve the programming problem revealed that there were no controls in place at the National Office to ensure that service centers receive notification of procedural changes, nor were there any standardized procedures for the service centers to follow to ensure that the functional areas that should receive notification of procedural changes do in fact receive those notifications.

On January 22, 1998, IRS' National Office issued "alert" instructions to the field offices to deal with the programming problem. A cognizant program analyst in IRS' National Office told us that the National Office does not require service centers to respond that they have received or implemented alerts. Representatives we contacted at three service centers told us that the alert was received timely at each of their centers, but each center reported a different date that the alert was received in the branches that were to follow the instructions. The branches received the alert on February 4, March 17, and April 28. Therefore, because not all service center branches had received the instructions at the same time, EIC criteria may not have been applied consistently. IRS did not have data on the extent or impact of this potential problem.

IRS Targeted Certain EIC Claims for In-Depth Review; Results Are Uncertain

In April 1997, IRS published the results of its tax year 1994 EIC compliance study. The study showed that of the $17.2 billion in EIC claimed during the study period, taxpayers overclaimed about $4.4 billion, or about 26 percent. In response to some of the noncompliance problems identified in that study, IRS targeted certain types of EIC claims for in-depth review in 1998.

One form of EIC noncompliance that IRS targeted was the use of a qualifying child's SSN on more than one tax return for the same tax year. As discussed in our recent report on IRS' efforts to reduce EIC noncompliance,[30] IRS allocated staff to audit as many as 140,000 taxpayers who had used about 92,000 duplicate qualifying child SSNs in both tax years 1995 and 1996.[31] According to IRS officials, as of May 16, 1998, about 103,000 of the 140,000 taxpayers had filed tax year 1997 returns, and IRS had frozen their refunds. As of that same date, however, IRS had released 49,000 of the frozen refunds for taxpayers who had responded to IRS'

[30]GAO/GGD-98-150.

[31]The 140,000 taxpayers selected for audit as part of this project were not included in the group of 383,000 taxpayers previously discussed that was sent notices in December 1997 related to duplicate SSN use.

correspondence on these cases but whose conflicting claims for the child(ren) in question were not resolved.[32]

IRS officials told us that the 49,000 refunds were released because IRS (1) did not have enough time to adequately prepare for the start of this project (e.g., get staff assigned, procedures developed, and training done) and (2) had underestimated the volume of contacts it would receive from taxpayers. Although IRS is continuing to investigate these cases, its effectiveness in protecting the revenue has been compromised because it is more difficult (and more costly) to recoup an erroneous refund once it has been released. As of August 21, 1998, according to IRS, it had finished auditing about 81,500 returns under this project and had recommended changes totaling about $63.7 million. As of that same date, audits of another 195,900 returns were ongoing, and 77,100 returns were in inventory but not yet assigned for audit.[33]

The largest source of EIC noncompliance found in IRS' tax year 1994 study related to the eligibility of qualifying children. IRS' study further showed that a large proportion of qualifying child errors occurred in tandem with erroneous claims of head-of-household filing status. In that regard, another area IRS targeted for in-depth review involved EIC claimants who filed as head of household and whose returns contained indications of potential qualifying child problems. IRS data show that IRS had finished auditing about 98,500 returns under this project as of August 21, 1998, and that 75 percent of those audits had resulted in recommended changes totaling about $169.5 million (the other 25 percent resulted in no change to the taxpayers' returns). Also as of August 21, about 232,800 returns were in various stages of audit and about 33,700 returns were in inventory but not yet assigned for audit.

Misreported income also accounted for a significant portion of the EIC noncompliance identified in IRS' tax year 1994 study. Because income level affects the amount of an EIC, IRS was particularly concerned with taxpayers, such as those who are self-employed, whose income cannot be verified through traditional compliance activities, such as matching the amount of income reported on information documents with income reported on tax returns. IRS selected a sample of tax year 1997 returns

[32]Also as of May 16, 1998, IRS had released refunds for 21,000 taxpayers who did not claim the disputed child(ren) for 1997 and another 4,500 taxpayers who, on the basis of audits of their tax year 1996 returns, were entitled to claim the disputed child(ren).

[33]The number of returns in this project exceeds the number of taxpayers previously cited because the project involves multiple tax years—1995, 1996, and 1997.

with self-employment income reported on a Schedule C (Profit or Loss from Business) and held the refunds pending completion of the audits. As of October 1998, according to IRS, some of these audits had not been completed, and IRS had not compiled data on the results of the audits that had been completed.

New Procedures for Negligent or Fraudulent Disregard of EIC Rules Could Have Been Better Publicized

TRA97 provides that taxpayers who fraudulently claimed the EIC beginning with tax year 1997 (i.e., returns filed in 1998) would be denied the credit for the next 10 years, and that those who negligently claimed the credit (through reckless or intentional disregard of the regulations) would be denied the credit for the next 2 years. When taxpayers are found to have filed fraudulently or negligently, they must "recertify" eligibility after the 10-year or 2-year sanction period to claim the EIC again.

During the 1998 filing season, IRS used its Questionable Refund Program and other special projects to identify taxpayers who negligently or fraudulently claimed the EIC. When fraud or negligence is suspected, the refund is to be frozen and an in-depth audit of the return is to be conducted—a process that can take several months to complete. After the audit is completed and it is determined that the taxpayer fraudulently or negligently claimed the EIC, an indicator is to be added to the taxpayer's file to alert IRS that the taxpayer is not entitled to the EIC in subsequent years.

IRS attempted to warn taxpayers about the implication of these new provisions before they filed their returns in 1998 by including a brief statement in the Form 1040 instruction about the possibility that taxpayers may not be allowed to claim the EIC in the future. Although we have no way of knowing how successful that warning was in encouraging better compliance, we believe that the chances for success might have been enhanced if IRS had done a better job of publicizing the warning. In our July 1998 report,[34] we recommended that information regarding the 2-year and 10-year sanctions and the recertification process be prominently published in the Form 1040 EIC instructions and on the Schedule EIC.

In commenting on our recommendation, IRS said that it would include guidance in the tax year 1998 Schedule EIC instructions to advise taxpayers of the 2-year and 10-year sanctions and the need to provide IRS with additional information when they file for the credit in a subsequent year. However, IRS said that it did not intend to revise the Schedule EIC because these issues do not involve the majority of filers. IRS believes that

[34]GAO/GGD-98-150.

providing the information on the schedule may confuse filers who have not had their credit disallowed. Also, according to IRS, taxpayers must go to the instructions to determine if they qualify for the credit before completing the schedule, and IRS' intent is to place the information so that persons using the instructions will easily see it.

In evaluating IRS' comments in our July 1998 report, we said that although inclusion of information in the Schedule EIC instructions would be an improvement, we continued to believe that something should also be added to the schedule. Because one of the purposes of this information is to alert potential EIC claimants to possible repercussions if they make erroneous claims, the information affects more filers than those who have had their EIC claim disallowed. Also, although it is true that taxpayers who choose to compute their own EIC have to use the worksheet in the instructions, taxpayers who choose to have their returns prepared by someone else do not have to use the worksheet and thus might see only the Schedule EIC. A brief, but prominent, cautionary statement added to the Schedule EIC would alert those taxpayers to important information in the instructions that they should read before filing their returns.

IRS Established Requirements for Paid Preparers to Exercise Due Diligence in Determining EIC Eligibility

TRA97 also imposes an $100 penalty on paid tax return preparers who fail to exercise due diligence in determining a taxpayer's eligibility for the EIC. In December 1997, IRS issued specific due diligence requirements and publicized them in mailings to practitioners. Under these requirements, a paid preparer must (1) complete an EIC eligibility checklist or a substitute form that contains the same information; (2) complete the EIC worksheet or keep a paper or electronic record of the EIC computation that includes the computation method and information used; (3) not know or have reason to know that any information used to determine EIC eligibility is incorrect; and (4) retain, for 3 years, a copy of the completed checklist, the worksheet, and a record of how and when the information was obtained and who provided the information.

We did not assess the impact of these due diligence requirements on preparers or taxpayers. However, a representative of one of the tax return preparation firms we contacted told us that it was not difficult to comply with the requirements and that going through the EIC eligibility checklist makes it easier to interview clients to make sure they are entitled to the EIC.

IRS did not institute at a national level specific procedures to monitor compliance with the due diligence requirements during the 1998 filing season, but we know of at least one field office that did some monitoring.

IRS told us that its national-level plans for the 1999 filing season include due diligence monitoring visits to EIC return preparers, but IRS has not yet decided on the procedures for these visits, the number of visits, or the extent to which IRS will target those preparers most likely to be noncompliant.

Expanded Telephone and Walk-In Service for EIC Claimants Could Have Been More Beneficial

In an effort to help taxpayers prepare more compliant EIC claims in 1998, IRS, among other things, expanded telephone access for EIC-related issues to 7 days a week, 24 hours a day. Also, starting on March 7, 1998, IRS provided assistance on 6 consecutive Saturdays (when offices are normally closed) at more than 150 walk-in sites. One of those Saturdays (Mar. 28) was promoted as "EIC Awareness Day."

According to IRS data, 95,000 taxpayers called the EIC assistance lines during the times when IRS' other assistance lines were not available. IRS data also show that walk-in staff helped 2,949 EIC claimants prepare their returns on Saturdays and provided 1,032 others with different types of EIC-related assistance. According to IRS, this is in addition to 185,305 EIC claimants who were assisted on weekdays during the filing season.

Although many taxpayers who were eligible for the EIC were helped by these efforts, we believe more taxpayers could have benefited had IRS implemented its assistance differently. For example:

- IRS did not advertise the 24-hour availability of telephone assistance for EIC-related issues. IRS informed taxpayers of this service only if they received a notice from IRS about a problem with the EIC claims on their tax returns. IRS officials told us that they did not advertise this service because they thought that it would lead to many non-EIC calls during the hours when other assistance lines were closed.[35]
- By March 7, 1998, when IRS first offered Saturday assistance at its walk-in sites, millions of EIC claims had already been filed. IRS said that it did not offer Saturday service earlier in the year because "prior to receiving the appropriation [for the new EIC compliance initiative], we had anticipated having Saturday service for only the last six weeks of the filing season" when, according to IRS officials, demand among all filers is generally higher. Also according to IRS, the date for EIC Awareness Day was selected so that IRS would have adequate time to publicize and provide for quality service to the public.

[35]This should not be a problem in 1999, when IRS plans to offer 24-hour assistance on all of its telephone assistance lines.

In our July 1998 report,[36] we recommended that IRS ensure that customer service efforts aimed at EIC claimants are available earlier in the filing season. IRS agreed with our recommendation and said that it would (1) advertise the availability of 7-days-a-week, 24-hours-a-day telephone assistance (for tax law questions, questions on notices, and other issues) in all tax packages for the 1999 filing season and (2) offer Saturday walk-in service from January 16 to April 10, 1999, with the first 6 Saturdays designated as EIC Awareness Days.

Access to IRS' Phone Systems Improved

During each filing season, millions of taxpayers call IRS to ask questions about the tax law, their refunds, or their accounts and to order forms. The extent to which taxpayers are able to get through to IRS when they call is an important indicator of filing season performance. IRS performance indicators show that taxpayers' ability to reach IRS by telephone increased significantly during the 1998 filing season.[37]

In 1998, IRS used two measures to gauge taxpayers' success in getting through to IRS over the telephone—level of access and level of service.[38] The only difference between the two measures is that "level of access" is computed by including abandoned calls in the number of calls that gained access (i.e., the callers had gained access to IRS' system but subsequently decided, for unknown reasons, to hang up before an assistor came on the line) while "level of service" is computed after deleting the abandoned calls (i.e., although those callers gained access to the system, they were not served).

According to IRS data, as shown in table 3, level of access increased by 26.1 percentage points (from 64.5 percent in 1997 to 90.6 percent in 1998) and level of service increased by 21.1 percentage points (from 52.6 percent in 1997 to 73.7 percent in 1998).[39]

[36]GAO/GGD-98-150.

[37]For purposes of toll-free accessibility, the 1998 filing season was from January 1 to April 18, 1998, and the 1997 filing season was from January 1 to April 19, 1997.

[38]Level of access is defined as the sum of the number of calls answered and the number of calls that are abandoned by the caller before getting assistance divided by total call attempts (which consist of calls answered, calls that are abandoned, and calls that receive a busy signal). Level of service is defined as the number of calls answered divided by total call attempts.

[39]In reporting 1998 telephone data, IRS combined data on six of its toll-free telephone lines—tax law assistance, EIC/refund inquiry, account inquiry, forms ordering, Automated Collection System, and fraud hotline. In reporting 1997 telephone data, IRS did not include one of those six lines—the line for the Automated Collection System. Therefore, to compare IRS' performance during the 2 years, we omitted information for the Automated Collection System from all data calculations and presentations.

Table 3: Accessibility of IRS' Telephone Assistance

Filing season[a]	Call attempts (millions)	Calls abandoned (millions)	Calls answered (millions)	Level of access (percent)	Level of service (percent)
1997	70.2	8.3	36.9	64.5[b]	52.6
1998	48.5	8.2	35.7	90.6	73.7
Change	(21.7)[c]	(.1)	(1.2)	26.1	21.1

[a]Data are for January 1 through April 19, 1997, and January 1 through April 18, 1998.

[b]We calculated the level of access for 1997 by using IRS' current methodology, which is based on the number of call attempts, not the methodology IRS used during 1997, which was based on the number of callers. Therefore, this percentage does not match the percentage shown in table 1 (see table 1, note k).

[c]The significant reduction in call attempts was apparently due, in large part, to the 82-percent decrease in the number of busy signals, which is discussed later in this report.

Source: GAO analysis of IRS data.

During the 1997 and 1998 filing seasons, we conducted tests, using judgmental samples, of the accessibility of one of IRS' toll-free telephone lines—the line taxpayers are to call if they need tax law assistance. The results of those tests also indicated that taxpayers were better able to contact IRS over the telephone in 1998 compared to 1997. Although our test results cannot be projected to all calls made to IRS, we did take steps to ensure that a random calling pattern was used to negate that source of potential bias in our tests.

Results of our test during the 1998 filing season showed a level of access of about 81 percent and a level of service of about 75 percent. Results of a similar test we conducted during the 1997 filing season showed a 51-percent level of access and a 39-percent level of service. Our 1998 test methodology and detailed results are described in appendix I.

Several factors may have contributed to the improved rates of telephone access and service reported by IRS and indicated by our tests. Specifically, IRS (1) extended the hours during which taxpayers could call IRS and speak to an assistor, (2) expanded its use of voice messaging, (3) increased the number of staff available to answer the telephone during peak calling periods so that more calls were answered on the first attempt by the taxpayer, (4) offered taxpayers who were on hold more than 10 minutes the option of leaving a recorded message and receiving a return call, and (5) improved its system of routing calls to available call sites around the country.

Extended Hours of Service

IRS increased the hours of service on the toll-free telephone system to 16 hours a day, 6 days a week.[40] As a result, taxpayers seeking assistance via the toll-free telephone system were able to access that system an additional 46 hours a week in 1998. IRS was not able to provide us with complete data on the number of taxpayers who took advantage of the extended hours of service.

Expanded Use of Voice Messaging

During the 1998 filing season, IRS expanded its use of voice messaging to increase the number of calls answered. As we reported last year, IRS studied several areas of complicated tax law and determined that certain call topics resulted in assistors' spending a significantly longer time per call.[41] As a result of the study, IRS revised its procedures in 1997 so that callers with questions in complex tax areas were automatically connected to a voice messaging system. For the 1998 filing season, IRS added 14 topics to the voice messaging system, increasing the number of topics to 23. In 1998, a recording instructed callers to leave their name, address, telephone number, and the best time for IRS to call them back. The recording stated that an IRS representative would attempt to return the call, at the requested time, within 3 business days.[42]

As was done in 1997, IRS' examination function (Exam) supported the customer service function by detailing staff to answer calls on the voice messaging system. A cognizant official told us that, in total, Exam used about 368 full-time equivalent (FTE) staff years in supporting the customer service function in 1998. IRS estimated that the use of Exam staff in 1998 to support customer service resulted in about $98.7 million in forgone revenue because these staff were not available to audit returns. We did not assess the validity of that estimate.

IRS data show that 1.3 million calls were received by the voice messaging system during the 1998 filing season. Of the calls received, about 400,000 could not be returned because IRS did not have enough information to do so (i.e., the message was not understandable or the taxpayer hung up before providing all of the necessary information). Of the remaining

[40] IRS' standard hours of telephone assistance in 1998 were 7 a.m. to 11 p.m., Monday through Saturday. In 1997, the standard hours of telephone assistance were 7:30 a.m. to 5:30 p.m., Monday through Friday, with assistance on selected Saturdays during the filing season.

[41] GAO/GGD-98-33.

[42] The recording during the 1997 filing season stated that the taxpayer's call would be returned within 2 business days. An IRS official told us that the 2-day standard was not changed for the 1998 filing season but the messaging script was incorrectly changed to 3 days. The cost of re-recording the message to reflect the 2-day standard was not deemed cost-effective, especially since the standard was less than the time frame stated in the message.

900,000 calls, IRS returned about 735,000 (about 82 percent). IRS officials told us that IRS does not plan to use voice messaging to handle complex tax questions during the 1999 filing season because it expects to have sufficient staff to handle all incoming calls. According to the officials, those plans are subject to change if call volumes exceed expectations.

Increased Staffing

To support the extended hours of service previously mentioned, IRS increased staffing for telephone assistance. Additional IRS staff were detailed to answer calls during periods of heavy call volume so that as many calls as possible could be answered on the taxpayer's first attempt to contact IRS. An IRS official projected that through the end of fiscal year 1998, IRS would expend about 8,167 FTEs—an increase of about 18 percent compared with the fiscal year 1997 expenditure of about 6,892 FTEs.

IRS data show that more calls were answered on the first call attempt during the 1998 filing season. The average number of calls each taxpayer had to make before reaching IRS decreased to about 1.1 from about 1.4 during the 1997 filing season.[43] Fewer repeat callers indicates that IRS answered more calls on the first call attempt, thereby reducing the number of times a taxpayer had to call back. That, in turn, reduced the overall demand on IRS' telephone system. IRS telephone data also show a significant reduction in the number of busy signals that taxpayers experienced when attempting to contact IRS during the 1998 filing season. IRS reported about 4.5 million busy signals in 1998 (a busy rate of about 9 percent) compared to about 25 million busy signals in 1997 (a busy rate of about 36 percent).[44] In comparing 1997 and 1998 telephone data, IRS had almost an 82-percent decrease in the number of busy signals.

Taxpayers on Hold Given Callback Option

In another attempt to increase accessibility, IRS offered taxpayers who were on hold waiting for an assistor for more than 10 minutes the option of leaving a message and getting a return call from IRS. IRS used voice messaging to help reduce the call queue and to allow more taxpayers into the telephone system for assistance. An IRS official told us that this change gave taxpayers an option instead of having to wait in the queue and becoming frustrated. IRS did not have any data on the number of callers who took advantage of this option. Although IRS does not plan to automatically direct certain callers to a voice messaging system in 1999, as

[43]The information on average number of call attempts per taxpayer does not include data from the form-ordering telephone line.

[44]The busy signal rate is calculated by dividing the total number of busy signals received by the total number of call attempts.

it did in 1998, it plans to continue to give callers who have been on hold for more than 10 minutes the option to leave a message.

Improved Call Routing System

Changes to IRS' method of routing calls also may have contributed to increased accessibility. In the past, IRS distributed call traffic on the basis of the area code of the originating call. For example, a call site would receive calls from taxpayers in area codes served by a specific service center. According to IRS, routing problems would occur when call traffic exceeded the capacity of the incoming telephone lines at those call sites. When call traffic surged from the area codes that the call site was assigned to answer, it was often difficult to re-route calls to other sites. Re-routing calls required contact with the regional office, the National Office, and the telephone vendor, which caused delays. Under this routing method, the number of busy signals received by callers increased.

During the 1998 filing season, IRS revised its method of distributing calls by changing from area code-based call routing to a nationwide call allocation routing plan. Under that plan, incoming call traffic is routed to all available call sites on a percentage basis, regardless of the area code. Each call site is staffed to answer a percentage of the total call volume, which allows IRS to level off call traffic and balance the demand when there is an unexpected increase. According to IRS, the change to nationwide call allocation routing provides several benefits, such as fewer busy signals, a reduction in the number of call attempts per taxpayer, and increased access to the telephone system.

For the 1999 filing season, IRS plans to further upgrade its call distribution capability with the December 1998 implementation of an intelligent call routing system, known as the Customer Service Call Router, which is to provide (1) instantaneous information on the status of telephone circuits, assistor availability, abandoned calls, and queue times and (2) a real-time capability to route calls. This real-time routing capability should allow IRS to better control call traffic by automatically sending calls anywhere in the nation where call volume is lower and assistors are available.

Taxpayers Used IRS' Web Site and TeleTax Extensively but Expressed Dissatisfaction With TeleTax

Besides the telephone assistance provided by IRS staff, there are other ways that taxpayers can get information from IRS without leaving their homes. Two of the better known methods are IRS' World Wide Web site on the Internet and TeleTax—an automated system that provides recorded information on about 150 tax topics. During the 1998 filing season, the Web site experienced increased use, while the use of TeleTax declined. IRS data show a significant level of customer dissatisfaction with TeleTax, but there are insufficient data to explain the reasons for that dissatisfaction.

Use of Internet Increased During the 1998 Filing Season

According to IRS data, use of its Web site increased in 1998. From January 1 to June 28, 1998, the site had recorded about 412 million "hits," an 187-percent increase from the previous filing season. A hit is recorded each time a user accesses a different page on the Web site. Another indicator of the Web site's use is "files downloaded." Through June 28, 1998, about 29.8 million files (tax forms, publications, regulations, and other documents) were downloaded from the Web site, a 313-percent increase from the same time in 1997. Another useful indicator of the value of IRS' Web site would be the number of returns that are filed using forms that have been downloaded from the Internet. Through various codes imprinted on the forms, IRS tracks the source (such as tax packages, post offices, and IRS walk-in sites) of forms that taxpayers use to file their returns. However, because IRS uses the same code for forms that are downloaded from the Web site as it does for forms that taxpayers download from CD-ROMs and receive from IRS via facsimile, it is not possible to determine to what extent, if at all, IRS' Web site has grown as a source of forms.

We conducted a nonstatistical test to assess the ease and speed with which forms can be downloaded from the Web site. Each weekday from March 30 through April 15, 1998, we attempted to download tax forms at various times of the day. In each case, we were able to download the file quickly and easily. We recognize that an individual's ability to download files depends on the specific hardware and software used, and, therefore, others might have different results from ours.

Taxpayers can also submit tax law questions via E-mail through the Web site. Between January 1 and April 15, 1998, about 82,000 questions were submitted, up from about 44,000 questions for the same period in 1997. IRS conducted a customer satisfaction survey that showed that 95 percent of those responding were satisfied with the timeliness of IRS' response to their E-mail questions. About 75 percent of the respondents said that IRS' response answered their questions, and almost all who responded said that they would use the E-mail service in the future.

IRS Data Indicate a High Level of Taxpayer Dissatisfaction With TeleTax

Taxpayers used TeleTax extensively during the 1998 filing season but to a lesser extent than they did in 1997. IRS data show that from January 1 to April 18, 1998, taxpayers made 37.5 million calls to the TeleTax system versus 44.2 million calls made during the same period in 1997—about a 15-percent decrease.

IRS conducted a survey of selected taxpayers who used TeleTax by playing a recorded message after the taxpayer had finished listening to a TeleTax topic. The survey asked one question: Was the taxpayer completely satisfied, partially satisfied, or dissatisfied with the assistance provided by TeleTax? IRS data from this survey for the 1996 and 1997 filing seasons showed that a majority of the surveyed users expressed some dissatisfaction with the service (the results of the survey for 1998 were not available at the time we completed our audit work for this report). In 1997, for example, about 44 percent of the respondents said that they were dissatisfied with TeleTax, and another 22 percent said that they were only partially satisfied.

The survey did not ask any follow-up questions that could be used to explain why taxpayers were dissatisfied. When we asked officials how IRS uses the survey data, we were told that the data are used to determine the level of taxpayer satisfaction.

IRS officials believe that much of the dissatisfaction with TeleTax stems from difficulties taxpayers are experiencing in accessing the system. In an August 1998 report on the results of its on-line review of the 1998 filing season, IRS' Internal Audit discussed its difficulties in trying to access TeleTax during a test on February 23 and 24, 1998.[45] Internal Audit also discussed problems it encountered after accessing the system, such as difficulty hearing the automated instructions because of static.

IRS plans to improve TeleTax by centralizing the number of system sites and upgrading equipment. According to IRS officials, TeleTax will be moved in 2000 to new equipment that will add several capabilities, such as the option to transfer a call to a live assistor and some interactive scenarios that will enable callers to get information that is specific to their circumstances.

IRS Is Moving Forward With Its New Processing System Without a Contingency Plan for 2000

IRS currently uses the Distributed Input System to process tax returns and the Remittance Processing System to process tax payments. Because both systems are old and are not Year 2000 compliant, IRS plans to replace them at its 10 service centers with 1 integrated system, which is known as the Integrated Submission and Remittance Processing (ISRP) System. Although the system is integrated, each function (return processing and remittance processing) operates independently. The Austin Service Center tested ISRP in 1998. We monitored this test as part of our review of the 1998 filing season because of ISRP's importance in ensuring that IRS can meet the demands of future filing seasons.

[45] On-Line Review of the 1998 Filing Season, IRS Internal Audit, Reference No. 085408, August 7, 1998.

Results of ISRP Test

IRS officials reported the following results during the ISRP test:

- Austin did not process 100 percent of the returns that it received during the 1998 filing season because (1) it did not receive the number of terminals necessary to handle its return volume until after the peak of the filing season and (2) ISRP was not configured to process some forms that accounted for a large volume of Austin's returns until after the filing season ended.
- Austin processed 100 percent of its remittance volume through ISRP, but encountered many system problems that caused processing delays and downtime. The contract contained a requirement that ISRP be able to process 130,000 remittances in 2, 10-hour shifts. Austin was never able to process that number of remittances through ISRP in the allotted time.
- The contract requirement that ISRP operate at a 99-percent level of effectiveness for 30 consecutive days was not met.
- The vendor delayed scheduled delivery of some software on more than one occasion, and, on another occasion, IRS rejected delivered software due to a high failure rate. The delayed and rejected delivery of software required the vendor to add additional deliveries that, as a result, compressed the time that IRS had allocated to test the software.

IRS' Internal Audit reviewed development of the ISRP test and reported its findings in January 1998.[46] Internal Audit concluded that the ISRP project did not follow a disciplined development process. Specifically, the remittance processing function contains significant enhancements, such as an imaging capability and an archiving and retrieval capability. Internal Audit found that IRS had not developed a case to support these enhancements, nor did it analyze whether the enhancements were needed or whether their cost was justified.

Most of the remittance processing problems identified during the test involved the new imaging capability. One significant problem Austin encountered was the imaging equipment's inability to read most of the money orders that Austin received. According to the ISRP project manager, ISRP could not capture an image of many money orders, which represent about 25 to 33 percent of Austin's remittance volume, because the print on the money orders was too light and/or numbers showing the dollar amount were too large. When ISRP cannot capture an image, the record is rejected to an error file. Correction of these errors required going back to the money order to obtain the remittance information and then

[46] Review of the Initial System Development Activities of the Integrated Submission and Remittance Processing System, IRS Internal Audit, Reference No. 082204, January 30, 1998.

manually entering that information. The amount of manual effort required decreased the system's productivity and delayed the processing of remittances.

Another concern with ISRP's remittance processing function is the equipment's need for specialized care that requires trained operators to spend time each day to keep the equipment cleaned and operating properly. Adjustments must be made to the mechanism that transports the documents through the equipment to keep them feeding through and to ensure that the scanner is reading the correct area of the document.

IRS Revised Its ISRP Contingency Plan for 1999 but Has No Contingency Plan for 2000

The problems previously discussed led IRS to revise Austin's original contingency plan for processing remittances. Austin's original contingency plan was to remove the old processing equipment while leaving cables in place to facilitate quick reinstallation of that equipment if it was needed. As a result of the test, IRS has decided that service centers should keep enough of the old equipment fully installed for 1999 so that processing can be switched to the old systems if there are problems with ISRP. However, four centers do not have enough space to house both the old equipment and ISRP.

In part because of the new contingency plan and its impact on space needs, IRS revised its time frame for implementing ISRP. Installation of both the return processing and remittance processing functions of ISRP was to be completed at all service centers by November 1998. In May 1998, IRS revised the implementation schedule for the remittance processing function to delay until August 1999 installation at the four centers that do not have enough space for both the old and new equipment. Until August 1999, the four centers plan to continue using the old remittance processing equipment.

Although the decision to delay implementation of the remittance processing function in four centers may reduce the risk of serious processing problems in 1999, we are concerned about the potential impact in 2000. The four service centers scheduled to receive the remittance processing function in August 1999 were among the top five centers in the volume of remittances processed during the peak of the 1998 filing season (the center with the largest volume—Ogden—is one of the centers where the remittance processing function was installed in 1998). We are concerned that (1) these four centers will receive the remittance processing function so late in 1999 that they will have no experience processing the large volume of remittances that come in at the peak of the filing season and (2) August 1999 is close to the Year 2000 deadline when the old systems will no longer function. IRS has not developed a contingency plan for the processing of remittances beyond the 1999 filing season.

Conclusions

Using various IRS indicators as criteria, the 1998 filing season was generally a success. For example, there were significant gains in the ability of taxpayers to reach IRS over the telephone and in the use of electronic filing. Also, taxpayer use of recent enhancements, such as the ability to obtain information and download forms from IRS' Web site, increased significantly in 1998. Available data also indicate that thousands of taxpayers took advantage of the increased EIC-targeted assistance offered by IRS in 1998, and that IRS' enhanced compliance efforts apparently contributed to fewer SSN- and EIC-related errors in 1998. IRS had to delay processing some returns in 1998 until it had made the programming changes needed to implement new legislation on capital gains, but we saw no evidence that those delays caused undue hardships to taxpayers. It appears, however, that IRS' procedure for processing returns that were filed without a required Schedule D increased taxpayer burden unnecessarily. By suspending the processing of returns until the taxpayers submitted a Schedule D, IRS caused those taxpayers to complete a complicated and time-consuming form even when the capital gain rates would have little, if any, effect on their tax liability. IRS has changed its procedure for 1999, which, if effectively implemented, should reduce the burden for some taxpayers.

Although IRS' data indicate a generally successful filing season, there is one important filing season activity—walk-in assistance—for which IRS lacks meaningful national performance data. For example, although IRS had guidance requiring regional reviews of the service being provided by walk-in sites during the 1998 filing season, the guidance was not specific as to what should be reviewed, and there was no requirement that review results be reported to the National Office. Also, IRS generally did not begin surveying walk-in site customers until mid-March—2-1/2 months after the filing season began. Without meaningful nationwide performance data, IRS cannot determine if the walk-in program is meeting its objectives and goals.

Taxpayers' access to IRS' Web site—or "hits"—increased significantly, but because tax forms downloaded in 1998 were coded the same as forms taxpayers obtained from CD-ROMs or by facsimile, IRS cannot evaluate the actual usefulness of its site in providing taxpayers with the forms they need to file their returns. A separate code would enable IRS to determine how many returns are being filed using forms downloaded from the Web site.

IRS is to be commended for its strides in improving telephone accessibility. There is one aspect of that service, however, that needs particular attention—the high level of taxpayer dissatisfaction with TeleTax. IRS recognizes that there are problems with TeleTax and improvements are planned. Neither we nor IRS know whether those changes are likely to resolve all of the critical problems with TeleTax, because the TeleTax customer satisfaction survey provided no data on why taxpayers were dissatisfied.

The gain in electronic filing is also commendable. But, it is important to note that about 80 percent of the individual income tax returns filed in 1998 were still filed on paper. IRS recognizes the need to continue working to eliminate barriers to electronic filing and plans to conduct various tests in 1999 directed at one of the more significant barriers—the fact that persons using traditional electronic filing still have to send paper to IRS.

One change that IRS has resisted making would involve including the tax table in the TeleFile tax package. We realize that the tax table is not needed to use TeleFile and that its inclusion would add to the program's cost by increasing the size of the TeleFile tax package. However, 72 percent of the respondents to IRS' most recent nonusers survey said that they would be encouraged to use TeleFile if they were able to determine their federal tax before calling TeleFile. We believe that IRS could structure a test that would minimize additional cost by including the tax table in only some TeleFile packages and comparing the filing patterns of persons who received those packages with those who received packages without the tax table. That test should help IRS determine whether the inclusion of the tax table in the TeleFile package would increase the use of TeleFile and whether the extent of that increase would justify the additional cost of including the tax table.

Although there is some evidence that IRS' growing emphasis on EIC noncompliance has had a positive effect, there is much that is still unknown. At the time we completed our audit work, data were not available to assess the effect of the notices IRS mailed in December 1997 or of the various projects IRS had initiated to target specific areas of EIC noncompliance. It was also too early to assess the impact of provisions in TRA97 that authorize IRS to deny EIC claims in subsequent years from persons who were found to have filed fraudulent or negligent EIC claims, because 1999 is the first year that IRS can deny subsequent EIC claims under the provisions. Even then, the full impact of those provisions could not be determined because there is no information on the extent to which knowledge of the provisions deterred persons from filing improper EIC claims. In that regard, we recommended in a previous report that IRS enhance the potential deterrent effect by better publicizing the provisions in the Form 1040 tax package. IRS has agreed to change the Schedule EIC instructions in the package but does not plan to add anything to the schedule itself. We believe that a brief, but prominent, cautionary statement added to the Schedule EIC would alert taxpayers to important information in the instructions that they should read before filing their returns. There is also reason to believe that EIC criteria may not have been applied consistently at all 10 service centers because of a lack of controls to ensure that field locations receive timely notification of important procedural changes.

Since our report on the 1997 filing season and in response to a recommendation in that report, FMS completed a study that supports the assumption that having lockboxes process Form 1040 tax payments saves the government money, although not as much as previously assumed. In light of FMS' study results, we are not suggesting that IRS stop using lockboxes to process those payments. However, because IRS has not developed the kind of definitive data that we recommended in our report on the 1997 filing season, we believe that IRS still lacks the necessary evidence to determine whether the additional burden and taxpayer costs that may be caused by having taxpayers separate their returns from their payments outweigh the additional governmental cost associated with having the banks handle those returns.

Considering the various problems encountered by the Austin Service Center in processing remittances during the test of ISRP in 1998, rollout of the system to other locations could have significant implications for upcoming filing seasons. IRS has developed a contingency plan for the 1999 filing season, when the other nine service centers are to begin processing returns through ISRP and five of the nine are to begin using ISRP for remittances. However, IRS has no contingency plan for the 2000 filing season. We believe that IRS' decision to wait until August 1999 to install ISRP's remittance processing function in the other four centers adds an element of risk to the 2000 filing season that warrants further contingency planning.

Recommendations to the Commissioner of Internal Revenue

We recommend that the Commissioner of Internal Revenue direct the appropriate officials to take the following steps:

- Conduct a test to determine (1) if adding the tax table to the TeleFile package would increase TeleFile use and, if so, (2) whether the increased use would justify the additional cost of including the tax table in the package. The cost of such a test can be minimized if IRS includes the tax table only in the TeleFile packages sent to a representative sample of taxpayers and then compares their filing patterns to the filing patterns of taxpayers who received TeleFile packages without the tax table. If IRS determines, after designing the test, that its cost would be prohibitive, IRS should consider other options for dealing with the issue raised by the TeleFile nonusers.
- Develop controls and standardized procedures to ensure that field locations are notified of procedural changes and implement the changes at the same time.
- In conjunction with IRS' decision to revise the instructions for Schedule EIC to advise taxpayers of the 2-year and 10-year sanctions, add a brief, but prominent, cautionary statement to the Schedule EIC alerting taxpayers that they should read important information in the instructions before filing their returns. We realize that it is too late to make such a change to the Schedule EIC for tax year 1998 and that the first opportunity to make this change will be for tax year 1999.
- To provide a better measure of the extent to which taxpayers are using the Web site, use a separate code to identify forms that have been downloaded from the site.
- Expand future TeleTax customer satisfaction surveys to obtain information on why respondents are dissatisfied.
- Develop a contingency plan for ISRP that provides for the possibility of a systemwide failure of the remittance processing function past 1999.

We are not making a specific recommendation relating to the measurement of walk-in services because we previously made a relevant recommendation in our February 1998 report on measuring customer service.[47] In that report, we recommended that the Commissioner direct the appropriate officials to develop performance indicators that cover the full range of IRS' customer service programs.

[47]GAO/GGD-98-59.

Agency Comments and Our Evaluation

We obtained IRS' written comments on a draft of this report in a December 15, 1998, letter from IRS' Deputy Commissioner Operations (see app. III). We also met with IRS' Chief Operations Officer and other IRS officials who are responsible for the various programs we reviewed on December 4, 1998, to discuss their comments. IRS said that, except for our first and last recommendations regarding TeleFile and ISRP, it generally agreed with the findings and recommendations in our draft report.

IRS did not agree with our recommendation that it conduct a test to determine if adding the tax table to the TeleFile package might increase the use of TeleFile and, if so, whether the increased use would justify the additional cost associated with including the tax table. According to IRS, "while a past survey indicated that some taxpayers might have used TeleFile if they could have determined the tax themselves, the data does not warrant the addition of the tax tables, instructions, and worksheet at a cost of almost $1.4 million." IRS also said that it had not received similar comments from taxpayers in recent years.

IRS' reference to "some taxpayers" in discussing the nonusers survey understates the results of the survey, which showed that a large majority (72 percent) of the nonusers said that they would have been encouraged to use TeleFile if they had been able to determine their federal tax beforehand. Also, IRS' statement that it has not received similar comments "in recent years" is confusing because (1) the 1997 nonusers survey was recent and (2) nonusers did not have an opportunity to provide similar comments in 1998 because IRS did not do a nonusers survey that year.

Although we did not verify IRS' estimate of $1.4 million in additional costs, we recognize that inclusion of the tax table and related materials in all TeleFile packages would be costly. That is why we recommended a test. In our opinion, such a test is needed to determine whether inclusion of the tax table would increase TeleFile use enough to warrant the additional cost.

IRS also said that the addition of the tax table and other material that would be needed for taxpayers to determine their tax liability would increase the complexity of the TeleFile tax package. Although adding the tax table and other material to the TeleFile package would increase the package's size, we see no reason why it would increase TeleFile's complexity. Inclusion of the tax table and other material would give those taxpayers who want to calculate their tax before calling TeleFile the ability to do so; other taxpayers could simply ignore that part of the package.

While we continue to believe that a test is needed, we are sensitive to the potential costs involved and do not want to suggest that a test should be done no matter how costly. At the same time, we believe that efforts to substantially increase the use of TeleFile require that IRS heed the results of the nonusers survey. If, after designing a potential test, IRS determines that the cost of doing the test would be prohibitive, it should consider other options for dealing with the issue raised by the TeleFile nonusers. One option might be to devise a communication/marketing strategy directed at allaying any concerns about TeleFile that would cause taxpayers to want to determine their tax liability themselves before using TeleFile. To acknowledge the possibility that the cost of a test might be prohibitive and that other options might be more feasible, we have revised our recommendation in finalizing this report.

Regarding our recommendation that IRS develop controls and standardized procedures to ensure that field locations are notified of procedural changes and implement the changes at the same time, IRS said that the system used to document and communicate program and procedural changes does not have a feature to notify the originator that an office has accessed the information. IRS said that it will pursue adding such a feature as a future enhancement to the system. IRS also said that as part of its readiness for the 1999 filing season, it will reemphasize to service center directors the importance of ensuring that their field locations expeditiously access program and procedural changes and disseminate and implement all required actions in a timely manner. These actions, if effectively implemented, will meet the intent of our recommendation.

IRS agreed with our recommendation that it add a cautionary statement to the Schedule EIC alerting taxpayers to potential sanctions. IRS said that it would revise the 1999 Schedule EIC to (1) alert taxpayers that they should read the penalties that apply if they improperly claim the EIC and (2) refer taxpayers to the EIC instructions for that information.

IRS also agreed with our recommendation that it use a separate code to identify forms that have been downloaded from IRS' Internet Web site. In our December 4 meeting, IRS officials said that IRS had implemented separate codes for reporting the source of electronically produced forms (i.e., Internet, CD-ROM, and facsimile) in 1996, but had experienced problems with certain off-the-shelf software when producing the CD-ROM for the tax year 1997 forms that resulted in its inability to designate separate codes in 1998. According to the officials, IRS has resolved the source code issue and will have separate source codes for reporting tax year 1998 forms generated by CD-ROM, the Internet, and facsimile.

Regarding our recommendation that IRS expand future TeleTax customer satisfaction surveys, IRS said that the former survey has been discontinued and that the current TeleTax system is scheduled to be replaced beginning in 2000. In conjunction with that replacement, according to IRS officials, IRS intends to reinstate an improved customer satisfaction survey that will include additional questions and the ability to capture taxpayer comments. IRS' decision to discontinue the survey until TeleTax is replaced and an improved survey can be put in place was consistent with the intent of our draft recommendation, so we revised our recommendation to indicate these plans.

IRS disagreed with the last recommendation in our draft report, which called for IRS to develop a contingency plan for ISRP that provides for the possibility of extended downtime of the remittance processing function past 1999. IRS said that it had developed a contingency plan to be used after 1999. In explaining that plan, IRS said that (1) normal disaster recovery procedures will be in place in case of an extended downtime of remittance processing equipment and (2) it will have in place a system to direct payments received to lockbox facilities as needed. We did not receive a copy of IRS' normal disaster recovery procedures in time to analyze them. However, cognizant IRS officials told us that the procedures are service-center specific and focus on the transshipment of work from one center to another, not the movement of work from a service center to a lockbox. They also told us that the procedures did not cover systemwide failures, when transshipment between service centers would be of no value. Regarding the potential use of lockboxes to handle the increased remittance processing workload if the service centers cannot, a cognizant FMS official told us that such a change would require negotiations with the lockboxes. According to the official, no such negotiations had begun as of December 4, 1998.

After considering IRS' comments on our last recommendation, we have retained our recommendation but changed its wording to clarify that our concern centers on the potential for a systemwide failure.

We are sending copies of this report to the Subcommittee's Ranking Minority Member, the Chairmen and Ranking Minority Members of the House Committee on Ways and Means and the Senate Committee on Finance, various other congressional committees, the Secretary of the Treasury, the Commissioner of Internal Revenue, the Director of the Office of Management and Budget, and other interested parties. We will also make copies available to others on request.

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

Sincerely yours,

James R. White
Director, Tax Policy and
Administration Issues

Contents

Contents

Abbreviations

EIC	Earned Income Credit
FMS	Financial Management Service
FTE	full-time equivalent
IRS	Internal Revenue Service
ISRP	Integrated Submission and Remittance Processing
SSN	Social Security number
TRA97	The Taxpayer Relief Act of 1997

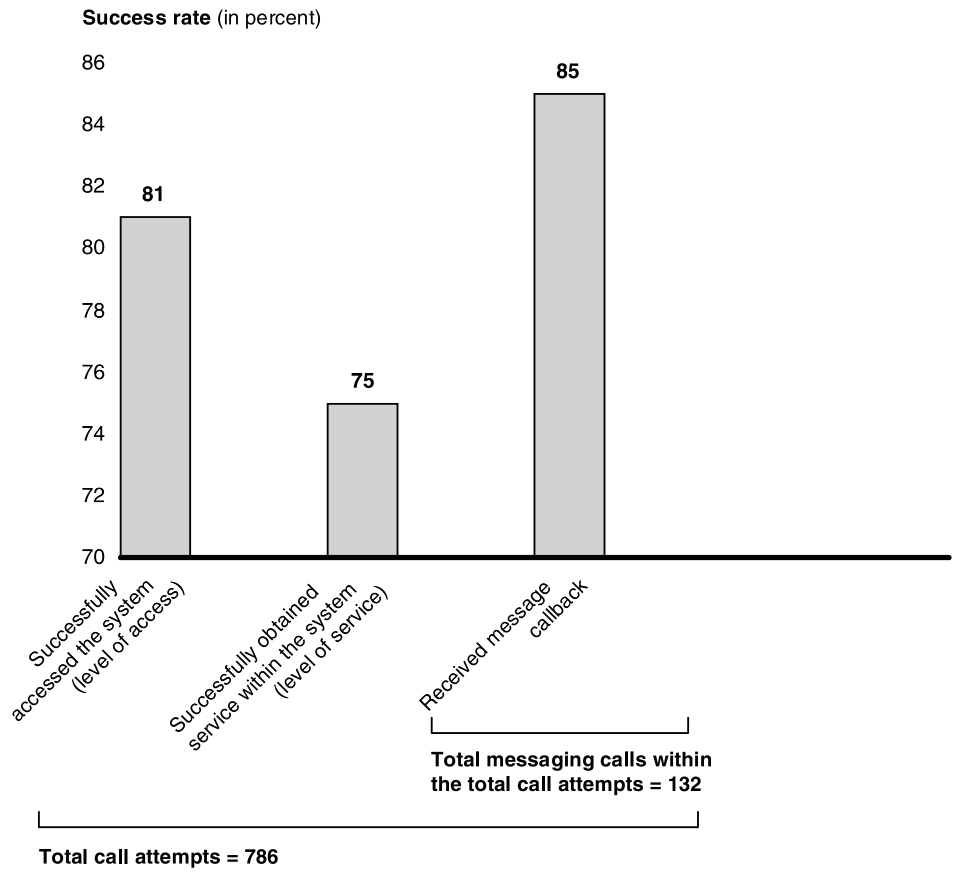
Toll-Free Telephone Accessibility Test

To independently test the accessibility of IRS' toll-free telephone assistance, we conducted a nonprojectable test by making up to six calls per day to IRS' tax law assistance telephone number (1-800-TAX-1040) from four metropolitan areas—Atlanta, GA; Kansas City, KS; San Francisco, CA; and Washington, D.C. We made the calls during the following two periods in 1998: from February 1 through February 26 and from March 30 through April 15. To avoid possible bias, each call attempt was randomly spaced throughout the day from 7 a.m. to 11 p.m. Each attempt to contact IRS consisted of up to five calls that were spaced 1 minute apart. If we received a busy signal, we hung up, waited approximately 1 minute, then redialed. If after four redials (five calls in total) we had not reached IRS, we considered the attempt unsuccessful. In conducting our test, we did not ask questions of the assistors because it was not our intent to assess the accuracy of their answers.

Once in the telephone system, we were either routed to an assistor or to the messaging system, depending on the topic selected from the menu. When routed to an assistor, we (1) abandoned the call if we were on hold for 7 minutes and (2) did not dial again. We considered abandoned calls as successful attempts in computing level of access because we were able to access the telephone system. However, we considered those calls unsuccessful in computing level of service because we did not make contact with an assistor. For calls routed to the messaging system, we left a name and telephone number that had message recording capabilities. If we received a call from IRS within 3 business days, we considered it a successful attempt (call answered) and included it in our calculation of the message callback rate.

For our test, we measured access to IRS' telephone system (level of access), the rate at which calls were answered (level of service), and the callback rate from the messaging system. See figure I.1 for the overall results of our test.

Figure I.1: Results of GAO's Telephone Accessibility Test

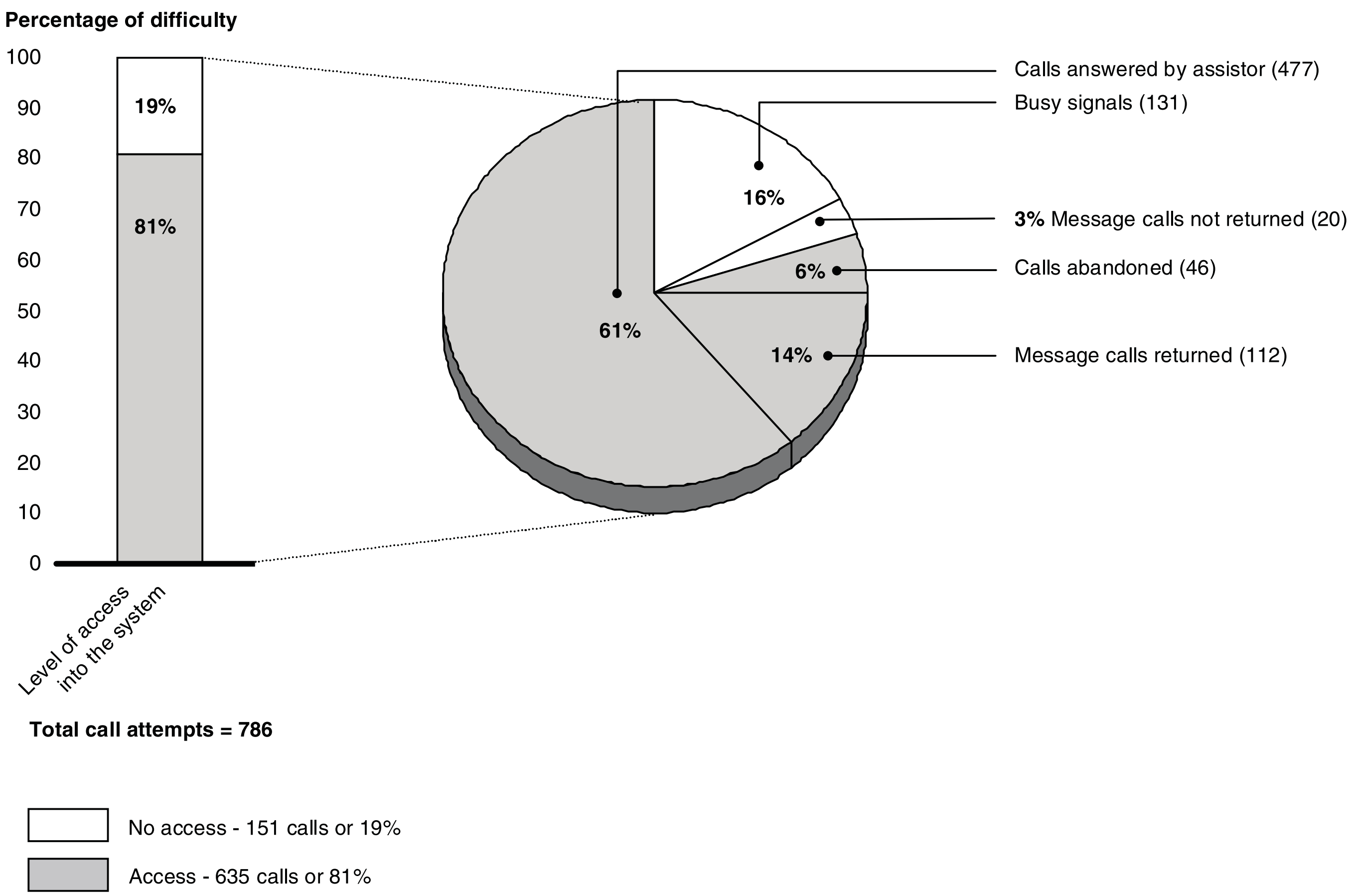


Source: GAO test.

Level of Access

We made a total of 786 call attempts. Of those 786 attempts, 635 resulted in access to the system (an 81-percent level of access). Of the 635 accesses, we reached an assistor 477 times, left a message and received a return call from IRS 112 times, and abandoned the call after being on hold for 7 minutes 46 times. Of the 151 unsuccessful attempts, 131 resulted in busy signals and 20 were calls to the messaging system that were not returned by IRS. These results are depicted in figure I.2.

Figure I.2: Level of Access and Composition

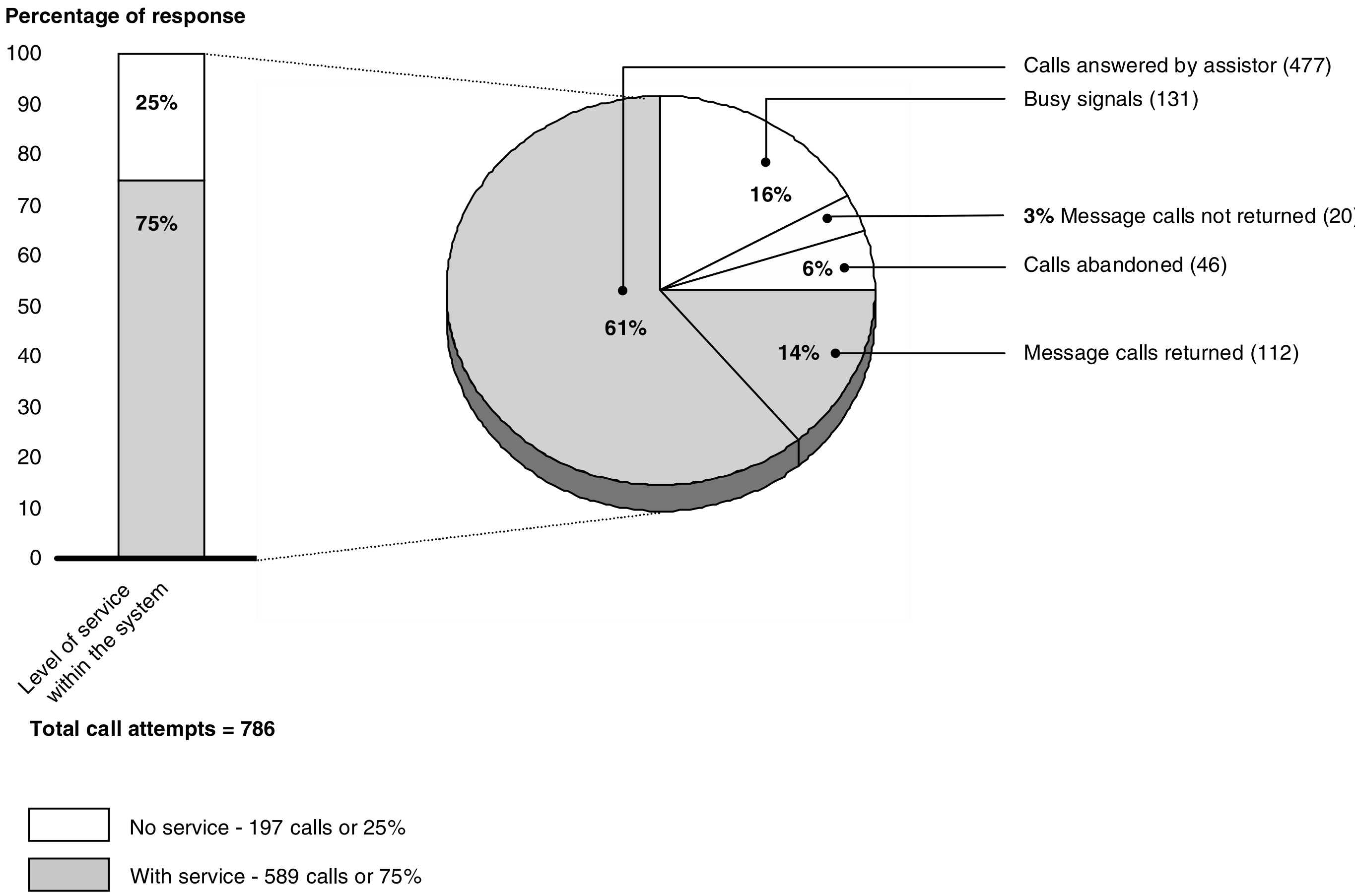


Source: GAO test.

Level of Service

As measured by IRS, the only difference between level of access and level of service is that the former is computed by including abandoned calls in the number of calls that gained access (i.e., the callers had gained access to IRS' system but subsequently decided, for unknown reasons, to hang up before an assistor came on the line), while the latter is computed after deleting the abandoned calls (i.e., although those callers gained access to the system, they were not served). Thus, to compute the level of service from our test, we deleted the 46 abandoned calls that were included in our computation of level of access. As shown in figure I.3, of our 786 call attempts, we either reached an assistor or got a return call from IRS 589 times (a 75-percent level of service).

Figure I.3: Level of Service and Composition

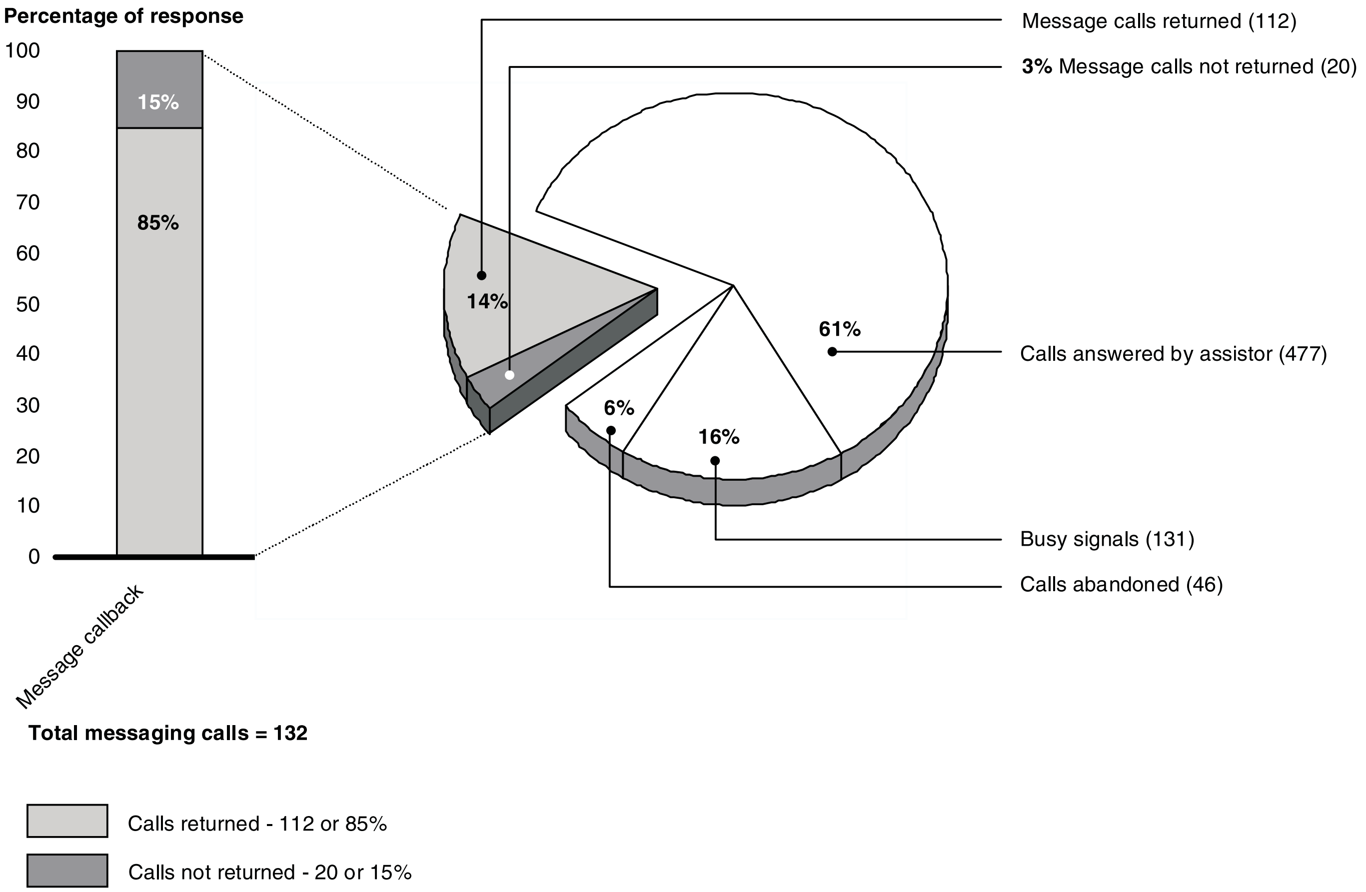


Source: GAO test.

Message Callback Rate

Of our 786 call attempts, 132 were routed to IRS' messaging system. IRS told callers leaving messages that an IRS representative would attempt to return their calls within 3 business days. Of our 132 call attempts that went to the messaging system, 112 resulted in a return call from IRS within 3 business days (a callback rate of 85 percent). That result is depicted in figure I.4.

Figure I.4: Message Callback Rate



Source: GAO test.

IRS Workload Indicators

Indicator	As of date	1997 (thousands)	1998 (thousands)	Percentage change[a]
Individual income tax returns received				
Alternative filing methods:				
Traditional electronic	10/30	14,457	18,639	28.93
Form 1040 PC	10/30	8,427	7,533	-10.61
TeleFile	10/30	4,694	5,963	27.03
Total, all methods	10/30	120,941	123,055	1.75
Refunds sent				
Number	10/30	81,865	82,998	1.38
Amount	10/30	$105,664,000	$112,308,000	6.29
Number of direct deposits	10/30	16,469	19,225	16.73
Amount of direct deposits	10/30	$29,051,000	$34,543,000	18.90
Extension of time to file	5/15	6,548	6,976	6.54
Internet use				
Hits	6/28	143,662	411,758	186.62
Files downloaded	6/28	7,222	29,826	313.00
Tax forms faxed to taxpayers	6/28	671	1,003	49.53
Receipts[b]				
Total number of receipts	8/31	202,855	208,053	2.56
Total amount of receipts	8/31	$1,441,187,407	$1,572,198,961	9.09
Total TeleTax calls	4/18	44,170	37,463	-15.19
Tax law calls	4/18	6,765	7,728	14.22
Refund calls	4/18	37,405	29,735	-20.51
Total toll-free telephone calls[c]	4/18	70,204	48,485	-30.94
Calls answered	4/18	36,910	35,730	-3.20
Busy signals	4/18	24,953	4,535	-81.83
Abandons	4/18	8,341	8,220	-1.45
Taxpayers assisted at walk-in sites	4/25	5,988	6,173[d]	3.10
EIC				
Number of recipients	8/29	19,032	19,393	1.90
Total amount of EIC	8/29	$27,811,508	$29,406,298	5.73

[a]Numbers may not compute to this percentage due to rounding.

[b]Total receipts include remittances from individuals and businesses.

[c]Toll-free telephone calls include calls to the following phone lines: (1) tax law assistance, (2) EIC and/or refund inquiry, (3) account inquiry, (4) form ordering, and (5) fraud hotline.

[d]Included in this number are 82,000 taxpayers served at walk-in sites on Saturdays from March 7 through April 11, 1998. There were about 6.1 million taxpayers served during the weekdays in 1998.

Source: IRS data.

Comments From the Internal Revenue Service

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