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Report to Designated Congressional Committees

March 1994

TAX POLICY AND ADMINISTRATION

1993 Annual Report on GAO's Tax-Related Work

GAO/GGD-94-82

GAO

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General Government Division

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The Honorable Daniel P. Moynihan
Chairman, Committee on
Finance
United States Senate

The Honorable John Glenn
Chairman, Committee on
Governmental Affairs
United States Senate

The Honorable Dan Rostenkowski
Chairman, Committee on
Ways and Means
House of Representatives

The Honorable John Conyers, Jr.
Chairman, Committee on
Government Operations
House of Representatives

This report is submitted in compliance with 31 U.S.C. 719(d) and summarizes our work on tax policy and administration during fiscal year 1993. It contains appendixes that highlight (1) agency actions taken on our recommendations as of December 31, 1993; (2) recommendations we made to Congress before and during fiscal year 1993 that have not been acted upon; and (3) assignments for which we were authorized access to tax information under 26 U.S.C. 6103(i)(7)(A)(i).

Key Recommendations for Tax Policy and Administration

In recommendations to Congress and the administration, we suggested actions that could be taken to improve compliance with the tax laws, increase accounts receivable collections, enhance the effectiveness of tax policies and incentives, simplify the tax system, strengthen the Tax Systems Modernization program, and improve management of the Internal Revenue Service (IRS).

Improve Compliance With Tax Laws

To reduce the gap between what taxpayers owe and what they voluntarily pay—estimated at $127 billion in 1992[1]—IRS must improve voluntary

[1]IRS has updated its tax gap estimate for 1992 but has not yet, as of February 1994, released this figure publicly. In a December 1993 speech, IRS' Deputy Commissioner indicated that the revised estimate would be between $135 billion and $150 billion.

compliance. IRS' data showed that voluntary compliance for small corporations plummeted from 81 percent in 1980 to 61 percent in 1987 (the latest year for which data were available), while individual compliance stayed at about the mid-80-percent level. If IRS is to effectively target its efforts toward increasing compliance and reducing the tax gap, it needs reliable data on the nature of noncompliance, and it must clarify what data it needs from taxpayers to ensure higher levels of compliance.

In the past fiscal year, we recommended a number of ways to help increase the level of voluntary compliance. In the near future, we plan to report on issues concerning the effectiveness of IRS' large corporation examination program.

- **Business Computer Matching.** IRS' most recent compliance data showed that small corporations in 1987, and sole proprietors in 1988, overstated their deductions by $40 billion. We suggested that IRS could better detect such noncompliance by using computer matching rather than, as is its current practice, relying on audits of business books and records. We recommended that IRS test the feasibility of "reverse matching," comparing certain expenses small businesses deduct on their tax returns with the same expenses they report on information returns. IRS has agreed to test reverse matching, particularly in connection with wages reported on Form W-2 (GAO/GGD-93-133, Aug. 13, 1993). (See p. 50.)
- **Compliance Measurement.** For about 30 years, the Taxpayer Compliance Measurement Program (TCMP) has been IRS' primary means of gathering information on taxpayer compliance. In 1991, IRS began making plans to redesign TCMP due to concerns about TCMP's cost, burden to taxpayers, and timeliness. We reported that neither cost nor taxpayer burden justified the proposed changes to TCMP and recommended that IRS delay any changes until a satisfactory substitute could be found that would result in consistent measurement nationwide, objective selection of returns for audit, and statistical details on noncompliance. IRS agreed with our recommendation and plans to redesign TCMP to meet these and other criteria presented in our report (GAO/GGD-93-52, Apr. 5, 1993). (See p. 42.)
- **Tax-Exempt Bond Oversight.** The volume of long-term, tax-exempt bonds doubled between 1968 and 1990, while the amount of forgone federal tax revenues grew proportionately, exceeding $20 billion in 1990. We recommended that IRS improve its oversight of compliance with tax-exempt bond requirements by redirecting its enforcement program to (1) test current market compliance, (2) make better use of information collected from bond issuers, and (3) reassess staffing levels and locations. We also recommended that IRS develop and implement a plan for more

effective use of resources to promote voluntary compliance in the tax-exempt bond industry. In addition, we suggested actions that Congress could take to encourage voluntary compliance, such as adoption of penalties targeting specific types of noncompliance or modification of present disclosure prohibitions. IRS agreed that tax-exempt bond oversight was inadequate and has begun making changes in concert with our recommendations (GAO/GGD-93-104, May 10, 1993). (See p. 45.)

- **Real Estate Tax Deductions.** IRS audits indicated that individuals overstated their real estate tax deductions by an estimated $1.5 billion in 1988, resulting in a loss of nearly $300 million in federal income taxes for that year. To improve voluntary compliance, we recommended that IRS clearly define user fees, special assessments, and rebates in Form 1040 instructions and that it work with local governments to revise their real estate tax bills to designate user fees and special assessments as "nondeductible." Further, we suggested that IRS auditors routinely check local records and that IRS negotiate agreements with local governments to share data on taxpayers' real estate payments. Since we completed our review, IRS has taken steps, such as improving the instructions on deducting real estate taxes, to implement our recommendations (GAO/GGD-93-43, Jan. 19, 1993 and GAO/T-GGD-93-46, Sept. 21, 1993). (See p. 35.)
- **Information Returns on Forgiven Debt.** Until recently, the Federal Deposit Insurance Corporation (FDIC) and the Resolution Trust Corporation (RTC), unlike most other federal agencies, were not required to submit information returns to IRS and taxpayers when forgiving debts of taxpayers. Our study indicated that substantially more taxpayers reported forgiven debt as income when an information return was filed, and we recommended that Congress require FDIC and RTC file information returns on forgiven debt exceeding $600. In response to our recommendation, Congress enacted a legislative provision requiring such returns. The Joint Committee on Taxation estimated that this requirement would generate $484 million over 5 years (GAO/GGD-93-42, Feb. 17, 1993). (See p. 37.)
- **Transfer Pricing.**[2] In March 1993, we testified that 72 percent of foreign-controlled corporations did not pay U.S. income taxes in 1989, compared to 59 percent of U.S.-controlled corporations. The data for 1987, 1988, and 1990 show similar differences. However, these percentages changed when we examined data related to the largest corporations. For corporations with $250 million or more in assets, 30 percent of foreign-controlled corporations did not pay U.S. income taxes, compared to 33 percent of U.S.-controlled corporations. By adjusting corporate income under the authority of section 482 of the Internal Revenue Code,

[2] Transfer prices are prices companies charge other related companies for goods and services transferred on an intercompany basis.

IRS continues to try to prevent corporations from underpaying their income taxes through improper use of transfer pricing—prices companies charge related parties for goods and services transferred on an intercompany basis. We concluded, however, that enforcement of the transfer pricing regulations would remain difficult for IRS because of the growing influence of international forces on the U.S. economy and the subjective judgments required by the current transfer pricing regulations (GAO/T-GGD-93-16, Mar. 25, 1993; GAO/GGD-93-112FS, June 11, 1993; and GAO/GGD-92-89, June 15, 1992). (See p. 41.)

- **Reporting Net Operating Loss Carryover.** Although no one knows the exact amount of net operating loss carryover that corporations have accumulated to offset future tax liability, our work suggested that it is large and growing. Using IRS data, we estimated this carryover for two-thirds of all corporations and found that it grew from $160 billion to $246 billion in 1989—an increase of 54 percent. We recommended that IRS clarify its instructions on net operating loss deductions and that it require corporations to annually report their carryover amounts, thereby enabling IRS to use the reported amounts to track the validity of corporate net operating loss deductions. IRS has agreed to take action on these recommendations (GAO/GGD-93-131, Sept. 23, 1993). (See p. 90.)
- **Money Laundering.** We reported on actions taken by states to combat money laundering. We noted that the Internal Revenue Code requires persons engaged in a trade or business who receive cash payments of over $10,000 to file a report with IRS but that these reports are not available to state law enforcement agencies. We recommended that Congress amend the IRS disclosure laws to allow states access to these reports (GAO/GGD-93-1, Oct. 15, 1993). (See p. 30.)

Increase Accounts Receivable Collections

In recent years, IRS has placed increasing emphasis on collecting delinquent taxes, but the results have not been encouraging. Collections of overdue taxes in the past 5 years have not changed much. They have declined yearly since 1991. As discussed in our report on high risk federal government management areas, several factors, such as inadequate records, an antiquated and inefficient collection process, and ineffective staff allocation practices, have hindered IRS' collection efforts (GAO/HR-93-13, Dec. 1992). (See p. 22.)

In fiscal year 1993 reports, we suggested some changes to improve the collection process. In October 1993, we reported on ways IRS could better manage a growing category of delinquent accounts considered "currently

not collectable." We plan to report in the near future on IRS' expanded use of programs to compromise delinquent tax debts.

- **Modern Collection Techniques.** We studied private sector and state collection techniques to determine what changes IRS could make to improve its delinquent tax collections. We recommended that IRS restructure its collection program to (1) support earlier telephone contact with delinquent taxpayers, (2) develop detailed information on delinquent taxpayers for customized collection procedures, (3) test the use of private collection companies, and (4) identify ways to increase cooperation with state governments. IRS agreed in principle with our recommendations and has tests currently pending or underway to determine whether it should fully adopt our recommendations. For example, IRS said its emphasis would be on early telephone contact and resolving accounts much sooner as new technology and new organizational designs are implemented (GAO/GGD-93-67, May 11, 1993). (See p. 28.)
- **Collection Staff Deployment.** Although IRS' delinquent taxpayer workload has continued to grow, productivity of collection staff has varied at different field locations. Currently, IRS' staff allocation system does not use marginal productivity measurements to adjust staff levels at various field locations. We recommended that IRS develop a plan to better deploy its collection staff to maximize the assessment and collection of taxes and, as a last resort, reconsider its policy against transfer of collection staff among field offices. IRS recognized that the collection staff deployment issue needed to be addressed and has begun to use staffing strategies for matching staff to workload needs. IRS is continuing to explore possibilities for improving resource allocations such as redirecting work to other locations to address uneven staffing (GAO/GGD-93-97, May 5, 1993). (See p. 24.)

Enhance Effectiveness of Tax Policies and Incentives

Congress continues to seek equitable ways to reform the current tax system and, in doing so, possibly increase tax revenues and reduce the budget deficit. At the same time, it often adopts tax incentives and preferences to promote certain social policy goals. Hundreds of billions of dollars in revenues are forgone because of incentives and preferences. Forgone revenues from these tax expenditures are expected to increase faster than the economy will grow. In 1993, we provided Congress with information on the costs and benefits associated with various tax policies and incentives. In 1994, we are continuing to study how these provisions could be scrutinized and the revenues forgone controlled.

- **Value-Added Tax**. For several years, a federal value-added tax (VAT) has been discussed as an option that the United States might use to reduce the budget deficit, reform the current federal tax system, or fund new programs. We analyzed the organizational structure and administration that such a tax might require in the United States. We concluded that the costs of administering a VAT would vary according to the complexity of the proposed system. Using one set of assumptions, we estimated that a single-rate, broad-based tax effective in 1995 would cost the government between $1.2 and $1.8 billion annually to administer. These costs could rise significantly if the VAT were structured to include multiple rates and exemptions. We also concluded that it would take between 18 and 24 months to put a VAT into operation and would cost about $800 million for initial taxpayer education, staff training, and computer system development (GAO/GGD-93-78, May 3, 1993). (See p. 80.)
- **Industrial Development Bonds.** Tax-exempt industrial development bonds are issued by state and local governments to finance private manufacturing facilities. The interest on these bonds is tax exempt because the activities financed are thought to produce public benefits. We reported, however, that the issuers generally do not have requirements for achieving public benefits and that our review of projects in three states showed only limited public benefits. Overall, we questioned whether the benefits provided by these bonds were worth the $2 billion in tax revenues estimated to be forgone annually. We suggested that Congress might wish to reconsider extending the program or, alternatively, specify requirements for greater achievement of public benefits (GAO/RCED-93-106, Apr. 26, 1993). (See p. 78.)
- **Corporate Consumption Tax.** In an attempt to eliminate the perceived inefficiencies and complexities of the current method of taxing U.S. businesses, legislation has been proposed to replace the current corporate income tax and the employer's share of the Federal Insurance Contributions Act (FICA) payroll tax with a consumption tax, the uniform business tax (UBT). Under an income tax, corporations are allowed a deduction for depreciation of plant and equipment representing the loss in value over time. In contrast, consumption taxes in general—and UBT in particular—would allow the immediate deduction of all investment spending. The corporate income tax also allows a deduction for wages and interest, whereas under the UBT the deduction would not be allowed. We reported on the advantages and disadvantages of the UBT as to savings and investment, distribution of corporate profits, composition of trade, tax progressivity, and administrative costs (GAO/GGD-93-55, May 11, 1993). (See p. 82.)

- **Puerto Rico and the Section 936 Tax Credit.** Section 936 of the Internal Revenue Code primarily affects Puerto Rico and subsidiaries of U.S. companies that operate there. Under this provision, income earned by U.S. firms from operations in U.S. possessions is effectively exempted from federal corporate income taxes. To aid congressional deliberations on proposals to modify or replace section 936, we examined its economic impact on Puerto Rico and the firms currently taking advantage of section 936. We reported on issues related to Puerto Rico's economic development—industry concentration, income and employment levels—that might be affected by revision of section 936. We also summarized data on distribution of tax benefits, employment, and compensation among section 936 manufacturing firms (GAO/GGD-93-109, June 8, 1993). (See p. 84.)
- **Long-Term Care Insurance.** Few individuals purchase insurance to cover long-term care (medical, social, and support services provided over an extended period of time to people in nursing homes or in the community who are dependent on others for assistance) despite the fact that the population is aging and there are increasing strains on the Medicaid system. Recently, many alternatives have been proposed to increase the incentive to purchase such insurance. We reported on the different tax treatments presented by these proposals and showed how the related tax incentives would affect the price of the insurance (GAO/GGD-93-110, June 22, 1993). (See p. 86.)
- **Home Equity Financing.** Home equity financing, estimated to represent about 12 percent of all housing debt, or $357 billion in 1991, grew at an average annual rate of about 20 percent between 1981 and 1991. In contrast, total nonhousing consumer debt had an annual growth rate of about 4 percent. We identified several factors that played a role in the growth of housing debt, especially home equity debt, including rising home values, changes in banking laws, and lenders' aggressive marketing campaigns. We also found that the elimination of the tax deductibility of interest expenses for many forms of consumer debt, but excluding mortgage debt, contributed to the continuing growth of home equity financing (GAO/GGD-93-63, Mar. 25, 1993). (See p. 73.)

Simplify the Tax System

Simplification remains critical to reducing taxpayer burden and encouraging greater voluntary compliance. We identified some changes to help simplify several aspects of our relatively complex U.S. tax system.

- **Tax Forms.** We reviewed certain commonly used IRS forms, publications, and notices for conformity with current legal requirements and IRS

guidance. Although we did not find any discrepancies with these requirements, we identified numerous changes that could be made to improve the clarity and usefulness of these documents to taxpayers. IRS agreed with most of our suggestions, and it is changing its documents accordingly (GAO/GGD-93-72, Apr. 30, 1993). (See p. 71.)

- **Dependent Exemption.** In a review of taxpayer compliance in claiming the dependent exemption, we concluded that the rules for claiming dependent exemptions are too complex and burdensome for many taxpayers to comply with. We suggested that Congress consider simplifying the rules by substituting a residency test similar to that used in the Earned Income Tax Credit program. We also recommended that IRS resolve operational problems in its computer matching program, enabling IRS to cost-effectively implement a 100-percent computer matching program to identify erroneous dependent claims (GAO/GGD-93-60, Mar. 19, 1993). (See p. 39.)
- **Earned Income Tax Credit.** We reported that the earned income tax credit increased the progressivity of the tax system by offsetting payroll taxes and reducing the average federal income tax rates of the low-income workers who receive the credit. Although recent changes in the law have made it simpler to determine eligibility for the credit, IRS introduced a complex new schedule in an effort to reduce erroneous credit payments. We concluded that the new schedule is overly complicated and that most of the necessary information could be included on the tax return itself. Further, because we found that IRS credit processing procedures are inconsistent in the treatment of taxpayers who claim the credit but fail to file complete information, we recommended that IRS adjust its procedures to ensure that all taxpayers receive equitable treatment. Finally, we recommended that IRS expand its efforts to inform low-income workers about the tax credit by sending explanatory notices to all nonfiling workers who had earned income (GAO/T-GGD-93-20, Mar. 30, 1993 and GAO/GGD-93-145, Sept. 24, 1993). (See p. 75.)

Strengthen the Tax Systems Modernization Program

Tax Systems Modernization (TSM) is a long-term multibillion dollar program through which IRS is to replace its antiquated data processing system with a modern system using state-of-the-art electronic methods for receiving, processing, storing, and retrieving tax information. We have reported that systems modernization is the most pressing issue facing IRS (GAO/OCG-93-24TR, Dec. 1992). (See p. 53.) In 1993, we monitored the progress of TSM and identified certain issues. At the request of several congressional committees, we are continuing to follow IRS' modernization program.

- **Modernization Progress.** We testified that because of the numerous complex business and technical changes that IRS is undertaking with its modernization program, strong technical leadership under a chief systems architect is critical to successful implementation. We noted that although IRS had made progress with some interim systems, other new systems were experiencing schedule delays that are not expected to be completed until newer replacement systems are operational. We recommended, therefore, that these projects be reevaluated in light of the schedule delays. We also reported that IRS has progressed slower than expected in completing steps that are basic to successful modernization, such as planning for business changes that take advantage of new technology, developing detailed security and telecommunications requirements, and addressing the major human resource implications of the new computer systems (GAO/T-GGD-93-4, Feb. 3, 1993; GAO/IMTEC-93-1, Feb. 24, 1993; GAO/T-IMTEC-93-3, Mar. 30, 1993; GAO/T-IMTEC-93-6, Apr. 27, 1993; and GAO/T-GGD-93-24, Apr. 27, 1993). (See pp. 53, 94 and 96.)
- **Electronic Filing Marketing.** IRS' electronic filing program benefits IRS and taxpayers by reducing handling costs while allowing faster and more accurate processing of returns and refunds. IRS' marketing of the electronic filing program has focused on attracting more tax preparers, but only approximately 12 percent of all individual returns were filed electronically in 1992. To broaden the use of electronic filing, we recommended that IRS devise a marketing plan that directs appropriate attention to other segments of the population. In response to our recommendations, IRS developed an electronic filing strategy with 21 initiatives to broaden use of electronic filing (GAO/GGD-93-40, Jan. 22, 1993). (See p. 32.)
- **Electronic Filing Fraud.** Electronic filing significantly reduces the time it takes to issue a refund to a taxpayer—on average, from 5 weeks for taxpayers who file paper returns to 2 weeks for taxpayers who file electronically. However, because this speed leaves IRS with as little as 2 days to investigate and stop a refund, the program is particularly vulnerable to fraud. We assessed IRS' controls to prevent electronic filing fraud and recommended additional controls. Since our report, IRS has improved its computer checks to identify questionable electronic returns and has established special procedures for handling electronic returns submitted by first-time filers (GAO/GGD-93-27, Dec. 30, 1992). (See p. 32.)

Improve Management of IRS

IRS manages systems that affect the lives of millions of taxpayers every day. These operations should be run in a manner to ensure fair and equitable treatment for all taxpayers. IRS is burdened with manual

processes and inaccessible information. Technical modernization should allow IRS to use resources more productively, speed up tax processing, and reduce costs. We recommended several ways to improve management of IRS operations.

- **1992 Financial Statement Audit.** We reported on IRS' financial statements, which IRS prepared for the first time on its fiscal year 1992 operations. We were unable to express an opinion on the reliability of these statements because critical supporting information was not available. IRS did not design its existing systems to provide meaningful and reliable information to use in reporting on its operations. Its internal controls were insufficient to safeguard assets, provide a reasonable basis for determining compliance with laws and regulations, or ensure that there were no material misstatements in the financial statements (GAO/AIMD-93-2, June 30, 1993 and GAO/AIMD-93-3, Aug. 4, 1993). (See p. 64.)
- **Controls Over Computer Systems and Equipment.** As a part of our review of IRS' 1992 financial statements, we examined the controls over IRS' computer systems, equipment, and software. IRS' computer systems contain confidential information on all U.S. taxpayers, and we found that IRS did not sufficiently monitor the activities of its staff to ensure protection of taxpayer data. Further, we reported that IRS' inventory records were unreliable for managing and reporting on its computer equipment and hardware (GAO/AIMD-93-34, Sept. 22, 1993 and GAO/AIMD-93-24, Aug. 5, 1993). (See pp. 66 and 97.)
- **Tax Deposit Delays.** IRS continues to lose millions of dollars of interest payments each year because of delays in depositing individual income tax payments. We believe that IRS needs to aggressively seek faster ways to deposit tax payments. We recommended that IRS collect data to help it develop strategies for identifying and rapidly depositing large tax payments (GAO/GGD-93-64, Mar. 22, 1993). (See p. 55.)
- **Federal Tax Deposit System.** The federal tax deposit (FTD) system collects payment and tax data separately. This creates problems because it is difficult to match the accounting information on the tax returns to the payment data on the FTD coupons. The Department of the Treasury is automating the FTD process. We recommended that these automation efforts be closely monitored to ensure that the new automated system can collect the accounting and payment data together (GAO/AFMD-93-40, Apr. 28, 1993). (See p. 61.)
- **Social Security Tax Accounts.** We reported that the taxpayer identity data IRS collects each year to process tax returns would help the Social Security Administration (SSA) identify the correct accounts to which to credit workers' social security taxes. We recommended that IRS and SSA

jointly study the extent to which SSA could better match workers' earnings to correct social security accounts by using IRS taxpayer data (GAO/HRD-93-42, Mar. 29, 1993). (See p. 99.)

We do our work on tax policy and administration matters pursuant to 31 U.S.C. 713, which authorizes the Comptroller General to audit IRS and the Bureau of Alcohol, Tobacco, and Firearms. GAO Order 0135.1, as amended, prescribes the procedures and requirements that must be followed in protecting the confidentiality of tax returns and return information made available to us when doing tax-related work. This order is available upon request.

Copies of this report are being sent to the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Commissioner of Internal Revenue. Copies will also be sent to interested congressional committees and to others upon request.

Major contributors to this report are listed in appendix VIII. If you or your colleagues would like to discuss any of the matters in the report, please call me on (202) 512-5407.

Jennie S. Stathis

Jennie S. Stathis
Director, Tax Policy and
Administration Issues

Contents

Abbreviations

ADP	automated data processing
CFO	chief financial officers
EIC	earned income credit
ETEP	Employment Tax Examination Program
FDIC	Federal Deposit Insurance Corporation
FICA	Federal Insurance Contribution Act
FTD	federal tax deposit
GSA	General Services Administration
HUD	U.S. Department of Housing and Urban Development
IRS	Internal Revenue Service
NOL	net operating losses
OBRA	Omnibus Budget Reconciliation Act
PHA	Public Housing Authorities
RTC	Resolution Trust Corporation
SSA	Social Security Administration
TCE	Tax Counseling for the Elderly
TCMP	Taxpayer Compliance Measurement Program
TMAC	Treasury Multiuser Acquisition Contract
TSM	Tax Systems Modernization
UBT	uniform business tax
USDA	U.S. Department of Agriculture
VAT	value-added tax

Summaries of Tax-Related Products Issued in Fiscal Year 1993 by Subject Matter

Accounts Receivable and Collection Activities

Compliance

General Management

Taxpayer Assistance

Tax Policy

Tax Systems Modernization

Other

Accounts Receivable

Internal Revenue Service Receivables

GAO/HR-93-13, 12/92

GAO identified IRS' accounts receivable inventory as an area of high risk vulnerable to waste, fraud, abuse, and mismanagement. This was one of a series of reports, made available to the President-elect, congressional leadership from both parties, and appropriate Cabinet-level designees, identifying 17 federal programs selected because they had weaknesses in internal controls or in financial management systems.

GAO reported that IRS had an accounts receivable inventory totaling about $111 billion at the end of September 1991. IRS estimated that nearly 75 percent of that amount cannot be collected because either the records are inaccurate and taxpayers do not actually owe the money, IRS cannot locate the taxpayers, or the taxpayers cannot pay. That leaves almost $30 billion that IRS has estimated as potentially collectible.

IRS based these estimates on its record of success at collecting delinquent taxes. If IRS were to improve its ability to collect, it could recoup more of the unpaid debt. Yet, IRS collections have actually declined, dropping by 5 percent in fiscal year 1991. Meanwhile, reported delinquent tax debts—the accounts receivable inventory—continue to grow and age.

GAO identified several obstacles that have interfered with IRS' ability to collect unpaid taxes: (1) IRS' records are inaccurate and insufficient; (2) IRS' collection process is lengthy, antiquated, rigid, and inefficient; (3) IRS has had difficulty balancing collection efforts with the need to protect the taxpayer—an objective embodied in legal restrictions on IRS' efforts; (4) IRS' decentralized structure tends to blur lines of responsibility and accountability; (5) IRS does not have enough information to allocate staff effectively; and (6) staffing varies dramatically among districts and is independent of collection needs.

GAO has made numerous recommendations to IRS over the years to improve its collection efforts, and IRS has responded to some of them. But, in GAO's judgment, more needs to be done. Many areas remain to be addressed. Among other actions, IRS should (1) gather more and better data and use that data as a basis for decisions, (2) shorten and improve its debt collection process, and (3) remove organizational impediments to

collections and determine the appropriate size and mix of collection staff. Further, GAO said that Congress could reassess the issue of the appropriate balance between the need to protect taxpayers and the need to collect delinquent tax debts.

Related GAO Product(s)

GAO/T-GGD-90-19, 02/20/90; GAO/GGD-90-80, 04/13/90; GAO/GGD-90-85, 06/20/90; GAO/GGD-90-111FS, 07/30/90; GAO/GGD-90-102, 07/31/90; GAO/T-GGD-90-60, 08/01/90; GAO/T-GGD-91-2, 10/18/90; GAO/GGD-91-4, 12/21/90; GAO/GGD-91-36, 03/13/91; GAO/T-GGD-91-17, 03/20/91; GAO/GGD-91-45, 04/16/91; GAO/IMTEC-91-30, 06/18/91; GAO/T-GGD-91-20, 06/25/91; GAO/T-GGD-91-54, 07/09/91; GAO/GGD-91-94, 08/28/91; GAO/T-GGD-91-65, 09/12/91; GAO/GGD-91-89, 09/30/91; GAO/GGD-92-45FS, 01/30/92; GAO/GGD-92-29, 02/18/92; GAO/T-GGD-92-23, 03/17/92; GAO/GGD-92-6, 03/26/92; GAO/T-IMTEC-92-13, 04/02/1992; and GAO/T-GGD-92-26, 04/02/1992

Improved Staffing of IRS' Collection Function Would Increase Productivity

GAO/GGD-93-97, 05/05/93

At the request of the Chairman, Subcommittee on Oversight, Committee on Ways and Means, GAO reported on (1) the growth of the delinquent account and delinquent return workload, (2) how IRS has deployed its collection staff to meet this workload, and (3) the results of collection function activities by location.

GAO noted that IRS has been faced with a continually growing workload of delinquent taxpayers but has not allocated its collection field staff to maximize collections by ensuring that each field office has the appropriate number of staff. Productivity has varied greatly over time and among IRS offices. For example, dollars collected per staff year ranged from a low of about $136,000 to a high of over $836,000 during the 5 years ending September 30, 1991. In addition, some field offices have had almost no backlog of delinquent cases, while others individually had over 60,000 delinquent accounts that were not being processed at the end of fiscal year 1991 because of insufficient staff.

Although IRS recognizes that some offices have staffing imbalances, GAO said that IRS has not identified the full extent of the imbalances because it has not used staff productivity measures in determining the most appropriate allocation of staff.

Recommendation(s)

The Commissioner of Internal Revenue should direct the Assistant Commissioner for Collection to develop a plan for (1) ensuring that the collection staff in field offices is balanced to maximize the assessment and collection of delinquent taxes; (2) providing a means for the collection function to assess the impact of planned future technological, strategic, and organizational changes on collection staffing needs and, if appropriate, modifying its plan on the basis of that assessment; and (3) identifying strategies for transferring collection employees to other functions as a means of eliminating staffing imbalances.

GAO also recommended that IRS reconsider its decision not to transfer collection staff among field offices and consider the benefits to the federal government of the additional collections that will result from balancing workload and staffing.

Action(s) Taken and/or Pending

IRS is expected to issue a final Collection Resource Allocation Study Group report by 1994. IRS is currently consolidating regional office responses to

GAO's recommendations. IRS' collection function has already included provisions to implement some of the recommendations in its fiscal year 1994 Financial and Operating Plan.

Related GAO Product(s)

GAO/GGD-92-6, 03/26/92

IRS Significantly Overstated Its Accounts Receivable Balance

GAO/AFMD-93-42, 05/06/93

As a part of its audit of IRS' fiscal year 1992 financial statements pursuant to the Chief Financial Officers Act of 1990 (P.L. 101-576), GAO reviewed IRS' accounts receivable. GAO's analysis showed that (1) the gross accounts receivable balance IRS reported for June 30, 1991, was overstated by as much as $39.4 billion and (2) about two thirds of what was owed was not likely to be collected. Because the composition of IRS' gross receivables changed little during the next 3 months, GAO believed that an overstatement also existed in the balance IRS reported for September 30, 1991.

GAO said that IRS overstated it gross receivables primarily because it included duplicate and insufficiently supported assessments that it had recorded as a part of its efforts to identify and collect taxes due. GAO noted that these and many other erroneous assessments were not valid receivables.

GAO also said that IRS estimates regarding the collectibility of its receivables were unreliable. IRS' June 1991 estimate did not involve any substantive analysis of collectibility, and the methodology IRS used to develop its September 1991 estimate was also flawed even though it involved a more extensive analysis.

GAO believes that some taxpayers may perceive that IRS' efforts to collect taxes are not equitable because of the disparity between IRS gross receivables and amounts expected to be collected, thereby affecting voluntary compliance with the tax laws. GAO noted that more reliable information on receivables could allow IRS to more effectively allocate resources, determine staffing levels, and measure enforcement and collection performance.

Recommendation(s)

The Commissioner of Internal Revenue should ensure that IRS' accounting system development efforts meet its financial reporting and other financial needs, by requiring, as a minimum, approval of related system designs by IRS' Chief Financial Officer. In addition, IRS should (1) identify which assessments should be in the receivables balance, including only valid receivables in the balances reported in IRS' financial statements and (2) modify its methodology for assessing the collectibility of its accounts receivables.

Action(s) Taken and/or Pending

IRS generally agreed with GAO's recommendations and plans to take appropriate action to implement them. For example, IRS was (1) planning to assign full responsibility for the entire revenue accounting system function to its Chief Financial Officer, (2) evaluating its assessments and excluding certain ones from the accounts receivables, and (3) conducting a statistical study of its accounts receivable to determine their collectibility. GAO plans to evaluate these efforts as a part of its fiscal year 1993 audit of IRS' financial statements.

Related GAO Product(s)

GAO/AFMD-93-40, 04/28/93; GAO/AIMD-93-2, 06/30/93; and GAO/AIMD-93-24, 08/05/93

New Delinquent Tax Collection Methods for IRS

GAO/GGD-93-67, 05/11/93

In response to a request by the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, GAO reported on the options available to IRS to enhance its collection of delinquent federal taxes. Specifically, GAO examined whether IRS could strengthen its tax collection programs by adopting private sector or state collection techniques.

GAO found that IRS' ability to collect delinquent taxes has been hampered by self-imposed and external constraints. For example (1) because of convention, IRS has generally followed a lengthy and rigid three-stage collection process that begins with a series of written notices, or bills, sent to delinquent taxpayers over a period of about 6 months followed by telephone calls and ends with visits to delinquent taxpayers; (2) because of legal restrictions, IRS handles all aspects of delinquent tax collection itself and does not evaluate or reward its collection staff on the basis of collection performance; and (3) because of inadequate information systems, IRS pursues delinquent accounts without knowing whether the amounts recorded in the accounts are valid receivables and with only limited knowledge about the characteristics of the delinquent taxpayers.

GAO noted that (1) although IRS and state tax departments currently cooperate in many tax administration projects, only about 10 percent of these projects are directly related to tax collection; (2) IRS may have opportunities for expanding cooperative projects with states that are directly related to collecting delinquent federal taxes; and (3) based on GAO's survey of states, more than half of the states with an opinion about participating in joint tax collection projects with IRS would consider engaging in such projects if they were compensated.

GAO concluded that since IRS competes with private collection companies and state governments for payments from debtors, IRS should adopt collection strategies that are more effective than its current approaches, including (1) early telephone contact with delinquent taxpayers, (2) customized handling of delinquency cases, (3) expanded use of cooperative efforts with state governments, and (4) use of private collection companies.

GAO also concluded that, for IRS to enhance its collection of delinquent federal taxes, certain external and internal changes would have to occur.

Matter(s) for Congressional Consideration	Congress may wish to consider revising current tax law to allow IRS to use collection performance in determining compensation and rewards for its collection staff as long as other criteria, such as fair and courteous treatment of taxpayers, are also considered.
Recommendation(s) to IRS	The Commissioner of Internal Revenue should (1) restructure IRS' collection organization to support earlier telephone contact with delinquent taxpayers and determine how to use current collection staff in earlier, more productive phases of the collection cycle; (2) develop detailed information on delinquent taxpayers and use it to customize collection procedures; (3) identify and implement ways to increase cooperation with state governments in collecting delinquent taxes. GAO also recommended that the Commissioner allow the Assistant Commissioner (Collection) to use private collection companies, on a test basis, to support IRS' collection efforts as permitted by current law.
Action(s) Taken and/or Pending	IRS has requested additional resources devoted to increasing the use of telephone contact with delinquent taxpayers. As IRS implements new technology and new organizational designs, its emphasis will be on contacting taxpayers by telephone earlier than current methods allow. IRS plans to extend the hours at its Automated Collection System call sites, establish call sites in the service centers for prenotice contact on large dollar cases, and extend telephone assistance hours for taxpayers requesting installment agreements and other accounts receivable related work. No further IRS action was taken on the other GAO recommendations, nor was any legislative action taken as of December 31, 1993.
Related GAO Product(s)	GAO/T-GGD-90-19, 02/20/90; GAO/GGD-92-23, 12/10/91; and GAO/IMTEC-92-63, 09/21/92

Compliance

Money Laundering: State Efforts to Fight It Are Increasing but More Federal Help Is Needed

GAO/GGD-93-1, 10/15/92

In response to a request from the Chairman of the Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, GAO identified (1) actions taken by states to combat money laundering and (2) actions taken by the federal government to assist the states.

Federal efforts over the past 20 years to curtail money laundering operations and identify and locate income derived from criminal activity have developed into an approach using legislation and requiring reporting of large currency transactions. In 1970, the Bank Secrecy Act was enacted and required individuals, banks, and other financial institutions to report large foreign and domestic financial transactions to the Department of the Treasury. In 1984, section 6050I was added to the Internal Revenue Code and required certain persons engaged in a trade or business who receive more than $10,000 in cash payments in a single transaction or series of related transactions to file a report on an IRS Form 8300.

Although a growing number of states have recognized the importance of attacking money laundering as a means of reducing the profitability of crime, their efforts vary considerably. Only a few states use both legislation and financial transaction reports as federal law enforcement agencies do. Most states make only limited use of the Bank Secrecy Act data available from Treasury.

Although IRS Form 8300 provides the same basic information as the Bank Secrecy Act reports, the Internal Revenue Code does not allow disclosure of the data to entities other than federal agencies for law enforcement purposes.

Recommendation(s) to Congress

Congress should amend the disclosure provisions of the Internal Revenue Code to give the Secretary of the Treasury permanent authority to disclose to federal agencies information reported on IRS Form 8300 and to allow states access to the data on the same basis as federal law enforcement agencies.

Recommendation(s) to the Department of the Treasury

If IRS Form 8300 information is made available to the states, Treasury should make it available to states on magnetic media ready for computer processing, as are Bank Secrecy Act data.

Action(s) Taken and/or Pending

The Commissioner of Internal Revenue generally agreed with our recommendations to Congress and said that if the disclosure provisions were amended, IRS would work closely with Treasury to provide access to the states. In January 1993, H.R. 22 was introduced in the House of Representatives. This bill, among other things, would permit state access to the form 8300 data and also authorize access by non-Treasury federal agencies, since this authority expired in November 1992. As of December 31, 1993, no further action had been taken.

Opportunities to Increase the Use of Electronic Filing and Better Control Fraud

GAO/GGD-93-27, 12/30/92 and GAO/GGD-93-40, 01/22/93

Most individual income tax returns are filed on paper. Electronic filing is an alternative to that system—returns are sent to IRS over telephone lines and are processed by computer, thus eliminating labor-intensive manual processing steps and reducing the number of errors. About 11 million taxpayers filed their income tax returns electronically in 1992.

The feature of electronic filing that appears to be most appealing to taxpayers is the ability to get quicker refunds. These expedited refunds come at a price, however. Taxpayers must pay a third party to prepare and/or electronically transmit the returns and pay an additional fee if they want to get their money even faster through a refund anticipation loan provided by a financial institution. According to IRS, about 74 percent of the electronic returns filed in 1992 through April 1 involved refund anticipation loans.

IRS' approach to promoting the electronic filing program has focused on attracting more preparers and transmitters. That approach has led to a steady increase in the number of taxpayers filing electronically. Nonetheless, about 90 percent of all individual income tax returns filed in 1992 were not filed electronically.

GAO issued a report in January 1993 on opportunities to increase the use of electronic filing. Given the benefit of electronic filing to both IRS and taxpayers, GAO said that IRS needed to develop a strategy for making electronic filing more appealing and more available to a broader segment of the population, such as those who are not expecting a refund or who are unwilling to pay the costs associated with going through a preparer or transmitter. GAO also said that IRS, in developing such a plan, needed to address various operational issues that, if effectively resolved, could enhance the appeal of electronic filing and help IRS more fully realize the benefits available through this technology.

The most serious operational issue discussed by GAO was the need for IRS to deal with an ever-increasing incidence of electronic filing fraud. In a separate report on that subject, issued in December 1992, GAO said that IRS had improved its controls in 1992 but that additional controls were needed to further reduce IRS' vulnerability.

Recommendation(s)

To broaden the electronic filing of individual income tax returns, the Commissioner of Internal Revenue should (1) identify market segments and specify national strategies for attracting those segments to electronic filing, including strategies to encourage employers and financial institutions to provide electronic filing services to their employees and customers, (2) assess the feasibility of enabling taxpayers to file electronically through their personal computers and provide broader access to electronic filing at IRS field offices and other convenient locations, and (3) determine which forms and schedules might be added to the list of documents that can be filed electronically to broaden the accessibility of electronic filing.

The Commissioner of Internal Revenue should also ensure that various operational issues discussed in the January 1993 report are resolved. With specific reference to electronic filing fraud, GAO made several recommendations to the Commissioner including the following: (1) seek approval to allow Criminal Investigation staff access to National Crime Information Center data for the purpose of checking the background of electronic filing applicants; (2) identify electronic filing preparers/transmitters on IRS computer files so that past year electronic filing participants who did not pay taxes or file returns can be included in the annual suitability screening process; (3) follow through on plans to develop improved computer checks for identifying questionable electronic returns in time for the 1993 filing season; (4) classify electronic returns from first-time filers as questionable returns for further investigation, and delay processing those returns until the validity of the filer can be established; (5) require that preparers/transmitters obtain at least two pieces of identification from electronic filers before transmitting their returns, and retain the pieces of identification with taxpayers' records; and (6) until electronic filing paper documents are no longer required, follow established procedures for warning and suspending preparers/transmitters who do not submit timely paper documents, and discontinue issuing refunds until the associated electronic return can be matched with a corresponding taxpayer signature document.

Action(s) Taken and/or Pending

IRS generally agreed with GAO's recommendations. IRS did not agree, however, that it should discontinue issuing refunds until the electronic return could be matched with a corresponding signature document. IRS believed that doing so would defeat the purpose of electronic filing and adversely affect the program's primary selling point—being able to get refunds faster.

In response to GAO's other recommendations, IRS had taken several steps as of December 1993. Among other things, IRS (1) developed an electronic filing strategy that contained 21 initiatives for broadening the use of electronic filing including initiatives that would enable individual taxpayers to file directly with IRS, expand access to free electronic filing at IRS locations, and establish electronic filing sites in public-access buildings; (2) added more forms and schedules to the list of those that taxpayers will be able to file electronically in 1994; (3) instructed each of its district offices to check with their respective states on the availability of the National Law Enforcement Telecommunications System for background checks of electronic filing applicants; (4) improved its computer checks in 1993 and planned further improvements in 1994; and (5) established special procedures for handling electronic returns submitted by first-time filers that gave IRS staff more time to assess the validity of those returns before issuing the refunds.

Overstated Real Estate Tax Deductions Need to Be Reduced

GAO/GGD-93-43, 01/19/93 and GAO/T-GGD-93-46, 09/21/93

In a report to the Chairman, Subcommittee on Private Retirement Plans and Oversight of the IRS, Senate Committee on Finance, and in subsequent testimony before the Subcommittee on Select Revenue Measures, House Ways and Means Committee, GAO discussed the issue of overstated real estate tax deductions among individual taxpayers. GAO reviewed IRS' random compliance audits of individuals and contacted 171 local governments that collected $100 million or more in real estate taxes.

GAO found that IRS audits showed individuals overstated their 1988 real estate tax deduction by an estimated $1.5 billion nationwide. This level of noncompliance resulted in an estimated $300 million federal income tax loss for 1988 and about $400 million for 1992. However, GAO found that the level of noncompliance and resulting tax loss were much greater. IRS audits detected only an estimated $37 million (29 percent) of $127 million in overstated deductions in three locations.

The overstated deductions arose from taxpayers deducting Montgomery County, Maryland, user fees and not reporting New Jersey and Minnesota real estate tax rebates. The reasons for such noncompliance included (1) inadequate IRS instructions on what to deduct or report and (2) confusing real estate tax bills that did not clearly distinguish taxes from user fees.

Matter(s) for Congressional Consideration

Congress may want to consider legislation that would require states to annually send IRS and taxpayers an information return on any cash rebates for real estate tax payments.

Recommendation(s) to IRS

The Commissioner of Internal Revenue should (1) include rules on the tax deductibility of user fees and reporting of rebates in tax return instructions and consider ways, such as an optional worksheet, to help taxpayers calculate the real estate tax deduction; (2) work cooperatively with local governments to revise their real estate tax bills to identify user fees, label these charges as not tax deductible, and notify taxpayers that the local government may report the deductible tax to IRS; (3) notify examiners to check local records on user fees and state records on rebates to verify real estate tax deductions; and (4) negotiate agreements with local governments on their sharing of data on real estate tax payments by individuals, and use the data in IRS' enforcement programs.

Action(s) Taken and/or Pending

IRS has improved its instructions on deducting real estate taxes and drafted changes to the tax return to clarify that taxpayers should not deduct user fees. IRS also has notified its examiners to better check support for the deduction. Finally, IRS has been working with local governments on revisions to their bills. On a separate track, Congress has been considering legislation to require (1) IRS to clarify its rules and the tax return, (2) IRS to help local governments determine what is deductible, and (3) local governments to clarify their bills, using federal funds.

Information Returns Can Improve Reporting of Forgiven Debts

GAO/GGD-93-42, 02/17/93

In a report to the Chairman, Subcommittee on Private Retirement Plans and Oversight of the IRS, Senate Committee on Finance, GAO measured the impact of information returns on individual taxpayers' reporting of income from having their debts forgiven. GAO tested a random sample of debts forgiven by the Federal Deposit Insurance Corporation (FDIC). The test covered 1986—when FDIC filed information returns on its forgiven debts, and 1989—the most recent year for which FDIC did not file these returns when GAO did its test.

GAO found 1 percent voluntary compliance in reporting income from FDIC-forgiven debts when the taxpayers had no information returns compared to 48 percent when they had information returns. Moreover, by computer matching the information returns and pursuing potential noncompliance, IRS determined that another 20 percent failed to report their forgiven debt income and owed taxes for 1986, while another 12 percent did not owe taxes. The match found another 20 percent who may have underreported forgiven debt income but IRS did not pursue these potential underreporters largely because of limited resources. For those 1986 cases that were pursued, IRS generated an estimated $37 in recommended taxes for every $1 that IRS spent. For those cases in which IRS had complete records, 83 percent of the taxpayers had paid these recommended taxes.

When FDIC did not file information returns for 1989, an estimated $78 million in federal income taxes were lost. FDIC's forgiven debts totaled $2.2 billion in 1989 and increased to over $8.4 billion by 1991. This 1991 total would rise to $10.9 billion if the Resolution Trust Corporation's (RTC), whose forgiven debts approximated FDIC's, were included.

If Congress extends information reporting to debts forgiven by FDIC and RTC, taxpayers with debts forgiven by FDIC or RTC will be subject to more IRS scrutiny than those whose debts are forgiven by private lending institutions (e.g., banks and savings and loans). The amount of debt forgiven by these institutions has doubled to $40 billion from 1985 to 1990. Because loans in the FDIC samples came from banks and were selected randomly, taxpayers' compliance in reporting this $40 billion would likely be similar to the 1-percent compliance GAO found for FDIC's debts that were forgiven but not covered by information returns.

Recommendation(s) to Congress	To improve taxpayer compliance in reporting forgiven debt, Congress should require FDIC and RTC to issue information returns on forgiven debts that exceed $600.
Matter(s) for Congressional Consideration	If FDIC and RTC information reporting on forgiven debts proves to be cost effective, Congress also may wish to explore whether extending similar information reporting to other institutions is warranted.
Action(s) Taken and/or Pending	In August 1993, Congress extended information reporting to debts forgiven by FDIC, RTC, and certain private financial institutions. Further, in September 1993, Congress considered a legislative proposal to extend such reporting to all financial institutions.
Recommendation(s) to IRS	If Congress extends information reporting, IRS should use the information returns on forgiven debts in its enforcement programs.
Action(s) Taken and/or Pending	As of December 31, 1993, IRS was developing a system for processing and matching the information returns to be filed, starting in tax year 1994.

Erroneous Dependent and Filing Status Claims

GAO/GGD-93-60, 03/19/93

In a report to the Chairman, Senate Committee on Finance, GAO reviewed the compliance of individuals in claiming dependent exemptions and filing status. GAO analyzed IRS' most recent compliance audits of individuals for 1988 to determine the extent and causes of noncompliance and to identify ways to improve compliance. According to IRS' audits, taxpayers erroneously claimed exemptions for an estimated 9 million dependents for 1988, improperly lowering their taxable income by an estimated $17 billion. Also, an estimated 3 million taxpayers claimed the wrong filing status.

According to GAO estimates, the primary source (73 percent) of erroneous dependent claims for 1988 was the taxpayer's failure to meet the dependent support test. Of those not meeting this test, taxpayers either did not (1) provide the necessary financial support or (2) have adequate records to show whether they provided the support. GAO found that the support test was complex because it required detailed records and difficult financial analyses. After analyzing four options, GAO found only one that eliminated the complexity of the support test by replacing it with a residency test. Under this test, taxpayers can claim dependents who lived with them for at least 6 months, if they meet other dependency tests.

If the support test were replaced, complexity would not be reduced for taxpayers claiming head of household filing status. These taxpayers would still have to meet a maintenance test, which is nearly as complex as the support test. IRS data showed that the head of household accounted for an estimated 82 percent of all filing status errors in 1988.

Even if Congress simplified these tests, IRS could do more to detect any remaining erroneous dependent claims. For 1988, IRS matched about 3 percent of dependents' Social Security numbers (SSN) to identify dependents who were claimed on more than one tax return or did not meet income and age requirements. If IRS had a 100-percent matching program for 1988, IRS could have generated an estimated $751 million in tax revenues at a cost that ranges between $45 million to $60 million. A 100-percent matching program coupled with the simpler rules would address an estimated 4.3 million (71 percent) of the 6.1 million erroneous dependent claims.

Matter(s) for Congressional Consideration	Congress should consider enacting legislation that would substitute a residency test for the dependent support test if the dependent lives with the taxpayer. If this legislation is enacted, Congress also should consider eliminating the household maintenance test for filing as head of household status.
Recommendation(s) to IRS	The Commissioner of Internal Revenue should correct the operational problems in IRS' limited matching program and implement a 100-percent computer matching program to identify erroneous dependent claims.
Action(s) Taken and/or Pending	In 1993, Congress considered but did not enact this legislation. IRS had not acted on this recommendation as of December 31, 1993.

Updated Information on Transfer Pricing

GAO/T-GGD-93-16, 03/25/93 and GAO/GGD-93-112FS, 06/11/93

In testimony before the Senate Committee on Governmental Affairs, GAO provided information on transfer pricing issues facing IRS. GAO found that for each year from 1987 through 1990, about 72 percent of foreign-controlled corporations did not pay U.S. income taxes, compared to about 59 percent of U.S.-controlled corporations. Also, the dollar amounts at issue between IRS and taxpayers had remained large. For example, on September 30, 1992, at least $14.4 billion of proposed section 482 adjustments to income had been protested to IRS' Appeals Division and were awaiting resolution. IRS' recent experience in sustaining section 482 cases through Appeals and in litigating them had been difficult.

In a report to Senator Byron L. Dorgan, GAO followed up its testimony statement that 207 (or 30 percent) of the 693 very large foreign-controlled corporations did not pay U.S. income taxes in 1989 as compared to 1,555 (or 33 percent) of the 4,650 very large U.S.-controlled corporations. In the group of very large corporations—those with assets of $250 million or more—GAO found that 102 foreign-controlled corporations (or 15 percent) and 362 U.S.-controlled corporations (or 8 percent) paid less than $100,000 in income taxes.

Related GAO Product(s)

GAO/GGD-92-89, 06/15/92

IRS' Plans to Measure Tax Compliance Can Be Improved

GAO/GGD-93-52, 04/05/93

In a report to the Chairmen of the Senate Committee on Finance and House Committee on Ways and Means, GAO analyzed IRS' plans to revamp its program for statistically measuring taxpayer compliance—the Taxpayer Compliance Measurement Program (TCMP). In addition to this analysis, GAO interviewed users of TCMP data and analyzed the TCMP audit cases.

GAO found that TCMP audit data have benefited many users. IRS uses TCMP data to measure compliance and objectively select returns for audits. Congress and federal agencies use TCMP data for policy analysis, revenue estimating, and research. Even so, GAO found that IRS had planned changes that would have reduced the value of TCMP data.

IRS had planned to (1) audit about 50-percent fewer tax year 1992 returns (25,000 rather than 54,000), which would reduce the precision of any detailed estimates; (2) no longer require auditors to examine every line on the return, which would lead to gaps in data on noncompliance; and (3) change the number and makeup of the taxpayer groups, which would preclude consistent comparisons with previous measures.

GAO concluded that these proposed changes did not appear justified. Implementing these proposed TCMP changes would be premature and would hamper IRS' ability to achieve its strategic objectives for the 1990s. IRS planned these changes because it believed that TCMP costs too much, is overly intrusive on compliant taxpayers, and produces untimely data. GAO agreed that these were valid but not significant problems given TCMP's benefits. As a result, GAO believes that IRS should defer its proposed changes until IRS develops an adequate replacement for TCMP.

Recommendation(s)

The Commissioner of Internal Revenue should not implement the three proposed changes and ensure that any proposed changes to TCMP produce data that (1) consistently measure nationwide compliance, (2) allow IRS to objectively select returns for audit and allocate audit resources, (3) provide statistical details on noncompliance in support of existing enforcement programs, and (4) meet the needs of various users.

Action(s) Taken and/or Pending

IRS agreed to not implement its three changes and to redesign TCMP to meet GAO's four criteria. However, to finish the redesign, IRS had to postpone the

next TCMP until tax returns are filed for 1994. As of December 31 1993, IRS appeared to be on track to meeting this time frame.

Recurring Tax Issues Tracked by IRS' Office of Appeals

GAO/GGD-93-101, 05/04/93

In a report to the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, GAO discussed the most prevalent issues appealed by taxpayers and how often those issues had been appealed in the past.

GAO found that, as of September 30, 1992, an IRS database contained about 12,000 disputed issues with $99 billion in proposed income adjustments awaiting Office of Appeals resolution. Fourteen Internal Revenue Code sections accounted for about 45 percent—or 5,279—of those issues and 57 percent—or $56 billion—of the proposed adjustment amount. Issues related to these 14 code sections accounted for an average of 44 percent of all issues resolved by Appeals during fiscal years 1991 and 1992, 52 percent of the proposed adjustment amounts, and 59 percent of the proposed adjustment amounts sustained by Appeals.

Improvements for More Effective Tax-Exempt Bond Oversight

GAO/GGD-93-104, 05/10/93

In a report to the Chairman of the Subcommittee on Human Resources and Intergovernmental Relations, House Committee on Government Operations, GAO assessed IRS' efforts to oversee compliance with tax-exempt bond requirements.

GAO found that IRS' principal tax-exempt bond enforcement effort, the Expanded Bond Audit Program, had concentrated almost exclusively on possible noncompliance cases that were identified by others and that were a part of an alleged surge in abusive bonds issued in anticipation of the stricter requirements in the Tax Reform Act of 1986. IRS recognized that its tax-exempt bond oversight efforts needed to be improved and had, therefore, begun some initiatives during the period studied and will take more initiatives on the basis of the GAO report. GAO also concluded that Congress could take actions to enhance IRS' ability to deter abusive uses of tax-exempt bonds.

GAO found that several areas merited particular attention to improve IRS' tax-exempt bond oversight. IRS' near-total concentration on bond abuses predating the 1986 Tax Reform Act hampered its understanding of current compliance problems and IRS had not used tax-exempt bond return information to monitor issuers' compliance. In addition, IRS' plan for improving its tax-exempt bond oversight, while a positive step, did not provide a clear direction for integrating tax-exempt bond efforts throughout IRS.

GAO also found that the basic sanction for tax-exempt bond noncompliance available to IRS—collecting taxes on interest earned by bondholders—is inadequate to deter noncompliant behavior by those who are most responsible for abusive transactions. That is, this sanction applies to the innocent purchasers of the bond but not to the bond's issuer and the specialists the issuer relies on to provide legal, financial, and other services. This aspect of the sanction is contrary to the commonly accepted theory that to provide the best deterrence, a penalty should be targeted to those responsible for the noncompliance. Legislation would be needed to develop better targeted penalties.

IRS' ability to deter abusive use of tax-exempt bonds could be further enhanced by bringing market forces to bear against abusers. To do so, GAO said that Congress may wish to explore options for modifying the present tax information disclosure prohibitions. If IRS could, in some way, disclose

limited information about the results of its tax-exempt bond enforcement activities, market participants would be in a better position to make judgments about the potential consequences of doing business with specific parties.

Matter(s) for Congressional Consideration

Congress may want to consider options to enhance tax-exempt bond voluntary compliance: (1) adoption of other penalties for specific kinds of noncompliance and (2) whether permitting the disclosure of some tax-exempt, bond-related tax information, with appropriate safeguards, would improve overall compliance incentives in the industry.

Recommendation(s) to IRS

GAO recommended that the Commissioner of Internal Revenue (1) partially redirect existing Expanded Bond Audit Program efforts to include active testing of current market compliance, (2) identify and make better use of information to detect noncompliance and direct enforcement efforts, (3) provide final guidance for tax-exempt bond enforcement, and (4) reassess program staffing levels and locations and training needs in light of the program's future.

GAO also recommended that the Commissioner develop and implement a plan to guide efforts throughout IRS to make more effective use of resources to promote voluntary compliance in the tax-exempt bond industry and test the use of the penalty for promoting abusive tax shelters in tax-exempt bond enforcement.

Action(s) Taken and/or Pending

As of December 31, 1993, Congress had not considered alternative penalties or revised disclosure provisions for tax-exempt bonds.

IRS generally agreed to implement or consider most of the recommendations contained in GAO's report. For example, IRS transferred responsibility for tax-exempt bonds to the Employee Plans and Exempt Organizations Division. In addition, IRS plans to (1) audit four bond issuances by non-exempt organizations in each of its seven district offices, (2) increase the number of examiners for tax-exempt bonds, (3) provide specialized training to examiners, (4) develop audit guidelines on tax-exempt bonds, (5) achieve significant levels of audit coverage, (6) increase effective use of tax-exempt bond information, (7) develop an action plan to implement this revised tax-exempt bond program, and

(8) consider whether legislative changes are needed to improve the IRS' ability to enforce tax-exempt bond provisions.

IRS Activities to Increase Compliance of Overseas Taxpayers

GAO/GGD-93-93, 05/18/93

In a report to the Chairman, Senate Committee on Finance, GAO discussed actions IRS had taken since 1986 to improve the tax compliance of American taxpayers living overseas.

GAO found that IRS had taken several steps to encourage compliance by these taxpayers, including (1) reducing taxpayer burden, (2) increasing taxpayer education, and (3) continuing its enforcement efforts. In spite of these efforts, IRS still could not measure the full extent of overseas noncompliance because it had limited information about Americans living overseas.

In three overseas enforcement initiatives that GAO studied, IRS did not collect significant additional federal tax revenues. Among the possible reasons for this were that (1) nonfilers had incomes below the minimum level required for filing a U.S. tax return, or (2) their U.S. tax liability was negligible after the foreign earned income exclusion and the foreign tax credit were taken into account. The revenue costs related to the exclusion of income earned abroad were estimated to be $7.9 billion for fiscal years 1992 through 1996.

IRS planned to continue its efforts to educate taxpayers who live overseas about filing requirements and to consider additional options for simplifying filing and reducing the burden of filing from overseas locations. In addition, IRS had begun several projects to develop better information about Americans living overseas. These projects might ultimately allow IRS to better target its enforcement activities.

Information Reporting of Interest Payments Can Improve Voluntary Compliance

GAO/GGD-93-55R, 07/22/93

In correspondence to Senator Arlen Specter, GAO discussed the issue of sending information returns to individual taxpayers. Specifically, GAO addressed this issue in the context of interest income that banks also may report to the taxpayers on a separate, year-end statement.

GAO reported that Congress specifically required this separate mailing of information returns that would only report the income. The added visibility of a separate mailing is more likely to increase taxpayer compliance than bank statements containing other information unrelated to taxes.

In addition, GAO's analysis uncovered many examples in which information reporting increased the taxpayers' compliance. For example, in the absence of information reporting, individuals voluntarily reported between 15 to 75 percent of the income they received (depending on the type of income). In contrast, individuals who received information returns voluntarily reported between 85 to 99 percent of their income (again depending on type of income). GAO concluded that the use of a separate mailing was worthwhile.

Computer Matching Could Identify Overstated Business Deductions

GAO/GGD-93-133, 08/13/93

In a report to the Chairman, Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, GAO tested whether IRS could further use information returns that small businesses (sole proprietorships and small corporations) already had filed. IRS does not computer match these returns with business tax returns (i.e., "reverse match") to detect any overstated deductions or unfiled information returns. IRS attempts to detect such noncompliance through audits.

To determine the feasibility of a reverse match, GAO analyzed 189 IRS compliance audits of businesses at two IRS service centers in which IRS had detected overstated tax deductions for one of four expenses—wages, rents, pension plan contributions, and services. GAO analysis included 73 audits of small businesses that overstated wage deductions. GAO also analyzed IRS' databases on all recent compliance audits to determine the extent that all small businesses overstated these four deductions and two others—interest and bad debts—that had potential for a reverse match.

GAO found that a reverse match was feasible to identify businesses that overstate wage deductions or do not file all required Forms W-2. GAO found that such matching would have identified 52 of the 73 small businesses in our sample that overstated wage deduction in either tax years 1987 or 1988. Also, such matching would have identified all 12 of the 73 businesses that failed to file information returns on wages they paid.

Reverse matching for the other five types of deductions GAO reviewed is less feasible because of various factors. For example, businesses are required to issue information returns on various payments to individuals and sole proprietors but not to corporations. Thus, amounts that businesses deducted for services would not necessarily match amounts they reported on information returns. GAO believes these limitations can be reduced, if not overcome, as IRS modernizes its computer operations. Addressing other limitations, such as the reporting gap between tax returns and information returns, would require legislative or regulatory changes. Given the $40 billion in overstated deductions from just small businesses, significant benefits would likely emerge from expanding reverse matching beyond wages to include services and other deductions GAO reviewed. However, the costs for businesses to file more information returns would have to be considered.

Recommendation(s)

The Commissioner of Internal Revenue should do a limited test of a reverse matching program for wages, and, if this proves to be cost effective, the Commissioner should develop a full-scale program.

If Congress expanded information reporting to cover service payments to corporations or forgiven debts, the Commissioner should do a limited test of reverse matching programs for these deductions. If they prove cost effective, a full-scale program should also be developed.

When implementing Tax Systems Modernization (TSM), IRS should consider what actions are necessary to overcome the limitations to reverse matching programs for other deductions, such as pensions, rents, and interest.

Action(s) Taken and/or Pending

IRS agreed to test reverse matching for wages in exploring ways to use information returns and tax returns as well as other information. IRS also agreed to explore ways to overcome the limitations to reverse matching, particularly as TSM progresses. As of December 31, 1993, IRS was taking action on all recommendations.

General Management

Implementation of IRS Employee Suggestions

GAO/GGD-93-22, 11/24/92

In response to a request from the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, GAO reviewed IRS' employee suggestion awards program. Specifically, GAO determined whether IRS was making cash awards to employees for suggestions but not implementing the approved suggestions, thereby failing to take advantage of potential savings offered. The IRS' employee suggestion program encourages employees to suggest ways to improve operations and gives cash and other awards if the suggestions are adopted.

GAO found that IRS does not routinely monitor or document the implementation of approved suggestions on an IRS-wide basis. Therefore, it was not practical to determine the extent that approved suggestions were being implemented throughout IRS. However, GAO did test the process in three IRS offices and found that almost all approved suggestions were implemented.

IRS recognizes that the suggestion program has problems and is taking steps to strengthen the program. These problems include lack of management support, poor training for personnel who administer the program, inadequate publicity, and untimely evaluation of suggestions.

Critical Issues Facing IRS

GAO/OCG-93-24TR, 12/92 and GAO/T-GGD-93-4, 02/03/93

In December 1992, GAO issued a series of transition reports discussing major policy, management, and program issues facing Congress and the new administration. One of those reports dealt with IRS. In a similar report issued 4 years before, GAO had discussed four issues facing IRS—the need to (1) modernize the agency's outdated and inefficient tax-processing system, (2) strengthen human resources, (3) collect $30 billion in delinquent taxes, and (4) reduce the $114 billion tax gap.

In its 1992 report, GAO noted that those four areas still required the new Commissioner's priority attention as did five others (1) ongoing efforts to change the way IRS does business, (2) strategic business process, (3) financial management, (4) management of criminal investigation resources, and (5) the need to respond to calls for a consumption tax. GAO said that two themes cut across all these issues—the need to foster and manage change and the need for effective communication.

More details on the issues surrounding delinquent taxes were provided in a related report (See p. 22.)

In testimony before the Subcommittee on Treasury, Postal Service, and General Government of the House Committee on Appropriations, GAO discussed three of the five issues—systems modernization, tax delinquencies, and the tax gap. GAO said that the three issues were interrelated. IRS would be better able to collect delinquent taxes and reduce the tax gap if its employees had on-line access to essential information when needed—the basic goal of the modernization effort. GAO discussed (1) IRS' slow progress in completing steps, such as finalizing decisions on how it will structure its operations and developing system and data standards to guide software development, that are critical to the modernization effort; (2) the impact of inadequate records, an antiquated and inefficient collection process, and ineffective staff allocation practices on IRS' collection efforts; and (3) the need for IRS to improve voluntary compliance by, among other things, rethinking its enforcement approach and ensuring that it has reliable data with which to effectively target its efforts.

Related GAO Product(s)

GAO/HR-93-13, 12/92

Status of Progress in Correcting Selected High-Risk Areas

GAO/T-AFMD-93-1, 02/03/93

In testimony before the Subcommittee on Oversight, House Committee on Ways and Means, GAO discussed seven areas within its high-risk program and several crosscutting issues that affect these and other problem areas throughout the government. Specifically, GAO focused on program weaknesses, agency corrective actions, and recommendations for future actions by Congress, the administration, and agency officials in areas involving several government organizations, including IRS.

IRS is responsible for routine tax collection and for pursuing delinquent payments. Although IRS routinely collects about a trillion dollars each year, its efforts to collect delinquent taxes have been inefficient and unbalanced. As a result, billions of dollars in taxes remain uncollected, representing a serious loss of revenue for the government.

GAO said that several problems have interfered with IRS' ability to collect unpaid taxes. Specifically, (1) IRS' records are inaccurate and insufficient; (2) its collection process is lengthy, antiquated, rigid, and inefficient; (3) it has had difficulty balancing collection efforts with the need to protect the taxpayer; (4) its decentralized structure tends to blur lines of responsibility and accountability; and (5) it does not have enough information to allocate staff effectively.

Although IRS has begun to develop some much needed information on the accounts receivable inventory, taken a step toward establishing a unified collection strategy by appointing an accounts receivable executive officer, and included collection goals in its strategic planning process, GAO said that many areas have yet to be addressed. These include gathering more and better data and removing organizational impediments to collections. Further, GAO said that Congress could revisit the issue of the appropriate balance between the need to protect taxpayers and the need to collect delinquent tax debts.

Delayed Tax Deposits Continue to Cause Lost Interest for the Government

GAO/GGD-93-64, 05/22/93

In a report to the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, GAO provided updated information on a 1990 report about the timeliness of IRS deposits of tax payments.

IRS data for 2 of its 10 service centers showed that the 2 centers averaged 6.2 days to deposit the $5.2 billion in tax payments they received with individual tax returns during the peak period (between April 15 and May 4, 1992)—the time of year when IRS receives the heaviest volume of returns with tax payments. GAO estimated that the government could have earned $2.4 million in additional interest income if the $5.2 billion had been deposited within 24 hours of receipt—the time service centers normally take to make deposits at other times of the year. The lost interest was considerably less than the $8.8 million GAO reported for the same two centers in 1990, but most of the reduction was due to lower interest rates rather than faster processing of tax payments.

GAO recommended in 1990 that IRS assess various options for reducing the time it takes to deposit large tax payments. In GAO's opinion, IRS' National Office did not provide the strong leadership necessary to effectively respond to that recommendation.

The Department of the Treasury has a cash management strategy that, if successfully implemented, could speed up deposits. Under this strategy, which IRS did not expect to fully implement before 1996, tax payments would be sent directly to banks instead of IRS' service centers. In the interim, IRS needs to more aggressively seek faster ways to deposit tax payments. One opportunity identified by GAO involved requests for extensions to file. IRS data for the two service centers showed that taxpayers who requested extensions sent payments along with those requests that were, on average, about four times greater than the payments that accompanied regularly filed returns.

Recommendation(s)

The Commissioner of Internal Revenue should direct the Assistant Commissioner for Returns Processing to (1) expedite deposits of tax payments submitted with applications for filing extensions starting with the 1994 filing season and (2) require that service centers collect data during the 1993 peak period to identify the type of mail having the largest tax payments and the number of tax payments received at various dollar

levels. IRS should then use the data to develop strategies for identifying and rapidly depositing large tax payments.

Action(s) Taken and/or Pending

In 1993, two of IRS' service centers collected data that showed mail in oversized envelopes is more likely to contain larger tax payments. GAO has been told that all 10 service centers will be required to prioritize the handling of such mail in 1994. As for payments accompanying applications for filing extensions, IRS said it would test an alternative way to process the payments but has determined that the earliest the process can be tried would be 1995.

Related GAO Product(s)

GAO/GGD-90-120, 08/31/90

Collection and Exchange of Data by IRS and the U.S. Customs Service

GAO/GGD-93-33R, 04/06/93

In a letter to the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, GAO presented information resulting from general observations of IRS and Customs officials about their collection and exchange of data. The information, presented in matrix form, covered

- the type of data each agency collected,
- the extent of data sharing between the agencies,
- the type of data that officials in one agency would like from the other, and
- the barriers to additional data sharing.

Examples of Waste and Inefficiency in IRS

GAO/GGD-93-100FS, 04/27/93

In a fact sheet to the Chairman of the Subcommittee on Oversight of the House Committee on Ways and Means, GAO documented examples of waste, inefficiency, and abuse in IRS. Those examples came from prior GAO reports and reports prepared by IRS' Internal Audit Division and the Department of the Treasury's Office of Inspector General, various studies and other documents prepared by and for IRS, and congressional hearings.

GAO noted that (1) many of the examples derived from IRS' antiquated computer systems, fragmented organizational structure, and inefficient work processes and (2) IRS was doing things, such as modernizing its systems and reassessing the roles and responsibilities of its various organizational components, that should alleviate many of the problems discussed in the fact sheet.

Related GAO Product(s)

GAO/T-GGD-92-34, 04/30/92

IRS' Budget Request for Fiscal Year 1994

GAO/T-GGD-93-23, 04/28/93

The administration's fiscal year 1994 budget request for IRS was for 116,060 full-time equivalent staff years and $7.4 billion—about $284 million and 792 staff years more than IRS' fiscal year 1993 authorization. The budget called for large increases for Tax Systems Modernization (TSM) and for 11 compliance initiatives involving such things as collecting delinquent taxes, increasing international tax compliance, and increasing audit coverage. The increases were offset, in part, by decreases due to anticipated productivity savings from automation.

In conjunction with hearings on this budget request held by the Subcommittee on Oversight, House Committee on Ways and Means, GAO prepared a statement for the record that made the following points:

- More than half of the TSM increase was for synchronized deployment of four automated systems. GAO questioned the appropriateness and timing of this request because much remained to be done before IRS would be able to develop and approve a detailed deployment plan.
- GAO believed that the goals of some of the 11 initiatives could be achieved without more staff. IRS could collect more delinquent taxes, for example, by changing collection processes and reallocating existing resources.
- IRS might have trouble delivering on some compliance initiatives because of its continuing need to redirect resources to offset labor cost shortfalls. If estimated productivity savings proved unrealistic, for example, IRS' base operations would be eroded in 1994 and at least some of the growth intended through the initiatives might go unrealized as resources are diverted to stem that erosion.
- The budget included no allowance for additional staff to implement expected tax law changes in 1993. Such changes could increase IRS' taxpayer service workload and, without any increase in resources, exacerbate IRS problems in meeting taxpayer demand for telephone assistance. As of March 28, 1993, IRS was only answering about 24 percent of the calls it was receiving.
- Operating efficiencies are available through TSM and changes in the way IRS does business. As a part of that discussion, GAO suggested some changes affecting IRS' regional offices and discussed some IRS initiatives to streamline its operations.

Action(s) Taken and/or Pending

IRS' appropriation, as enacted on October 29, 1993, provided for $51 million less than the administration had requested—$35 million less for enforcement and $16 million less for information systems.

Related GAO Product(s)

GAO/T-GGD-91-17, 03/20/91; GAO/T-GGD-92-34, 04/30/92; and GAO/GGD-93-76, 05/11/93

IRS Can Improve the Federal Tax Deposit System

GAO/AFMD-93-40, 04/28/93

In a report to the Secretary of the Treasury, GAO presented the results of its evaluation of IRS' current procedures for collecting the necessary accounting and payment data for the payments made through the Federal Tax Deposit (FTD) system. The FTD system collects taxes paid by private sector businesses and governmental entities and accounts for over 80 percent of IRS' tax receipts. The report assesses the efforts that IRS and Treasury's Financial Management Service have underway to modernize this process.

Because the FTD system is a paper-based system that separates the payment and related accounting data, opportunities for numerous errors exist in the process. Resolving such errors is both time consuming and costly to the IRS and taxpayers. Also, the current process costs Treasury about $145 million annually because of a 1-day delay in funds availability to the Treasury. Recognizing that automating the system can provide substantial savings, the Treasury in 1986 began to automate the FTD system and speed up collecting tax revenues by 1 day. IRS has developed several prototype systems that (1) automate this process, (2) address several systemic problems, and (3) allow same-day fund availability to the Treasury.

Yet, the candidate systems for national application do not address the business problem of separately reporting accounting and payment data. However, because of the potential for about $145 million in annual savings, GAO said it might be beneficial to proceed with one or more of these models provided a nationwide system can be implemented by IRS' current target date of 1994. But if a full-scale implementation continues to be delayed, as it has been virtually since the project began, and the projected cash management savings would be further delayed, GAO said that the best course of action would be to incorporate concurrent reporting of tax payment and the related accounting data with current initiatives. After discussing the issue with GAO, Treasury officials said that they had made significant changes in the project's direction, including a commitment to test concurrent reporting of accounting and payment data. Treasury plans to do the necessary analyses to decide whether to pursue the cash management savings first or to bring both components on at the same time to reduce taxpayer confusion.

Recommendation(s) to the Secretary of the Treasury

The Secretary of the Treasury should direct the Commissioners of the Internal Revenue Service and the Financial Management Service to monitor the revised FTD automation efforts.

Related GAO Product(s)

GAO/GGD-90-102, 07/31/90

Management of IRS' Information Systems Management Resources

GAO/GGD-93-37R, 05/25/93

At the request of the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, GAO began an assessment of how IRS' Information Systems Management organization managed its resources. That organization had about 4,400 authorized positions and a budget of $294 million for fiscal year 1993.

GAO discussed various events that had transpired or were in process that bore on the issues covered by this request. Those events included (1) IRS' development and substantive implementation of an action plan in response to a subcommittee inquiry about allegations of abuse in the use of computer resources; (2) an October 1992 reorganization of Information Systems Management's systems development activities; (3) an ongoing study, begun in September 1992, of IRS' ability to deliver projects that employ advanced systems development technologies and methods; and (4) an Internal Audit study, completed in August 1992, that disclosed, among other things, a need to improve management and control of software development resources, budgets, and costs.

Because it would take several months to properly evaluate these actions, GAO agreed with the Chairman's office to terminate this assessment.

Examination of IRS' Fiscal Year 1992 Financial Statements

GAO/AIMD-93-2, 06/30/93 and GAO/T-AIMD-93-3, 08/04/93

In a report to Congress, GAO presented the results of its audit of Principal Financial Statements IRS prepared pursuant to the Chief Financial Officers (CFO) Act of 1990 (P. L. 101-576). The act also authorized GAO to do an audit of these statements. GAO was unable to express an opinion on the reliability of these statements because critical supporting information was not available. And, where information was available, GAO found that it was generally unreliable.

The significant matters that GAO noted in its audit related to revenue, tax accounts receivable, property and equipment, management of operating funds, computer controls, seized assets, and reports required by the Federal Managers' Financial Integrity Act. GAO found that IRS' internal controls over each of these areas did not (1) effectively safeguard assets, (2) provide a reasonable basis for determining material compliance with relevant laws and regulations, and (3) ensure that there were not any material misstatements in the Principal Financial Statements. In addition, GAO was unable to test all significant controls because of the limitations on data availability.

Further, GAO could not test compliance with many laws that it wanted to test because of the ineffective internal controls and limitations on the availability of data.

In subsequent testimony before the Senate Committee on Governmental Affairs, the Comptroller General discussed the (1) results of GAO's financial statement audits at IRS and the Customs Service and (2) the need to accelerate governmentwide financial management reform through the full and effective implementation of the CFO Act of 1990.

The Comptroller General said that GAO's financial audits showed that (1) serious financial problems exist at the Department of the Treasury and the Department of Defense, which he discussed before the same Committee in his July 1, 1993, testimony (GAO/T-AIMD-93-1); and (2) this demonstrated a need to prepare and audit annual financial documents. He noted that through the CFO Act's pilot financial statement audits, IRS and Customs have improved their financial reporting and the quality of the underlying financial and program performance data.

The Comptroller General further noted that Congress has a better idea of how these organizations are actually functioning. Regarding IRS, for

example, he said that Congress now has reliable estimates of IRS' receivables and the related collectible amount, which are tens of billions of dollars less than what had been reported by the agency in the past.

Related GAO Product(s)

GAO/GGD-92-81BR, 04/17/92; GAO/HRD-92-81, 09/01/92; GAO/T-GGD-93-20, 03/30/93; GAO/AFMD-93-40, 04/28/93; GAO/AFMD-93-42, 05/06/93; GAO/GGD-93-109, 06/08/93; and GAO/AIMD-93-24, 08/05/93

IRS Information Systems: Weaknesses Increase Risk of Fraud and Impair Reliability of Management Information

GAO/AIMD-93-34, 09/22/93

As a part of its audit of IRS' fiscal year 1992 financial statements, GAO reviewed computer controls. In a report to the Commissioner of Internal Revenue, GAO discussed weaknesses in general controls over IRS' computerized information systems. General controls affect the overall effectiveness and security of computer operations as opposed to being unique to any specific computer application. They ensure (1) that the organizational structure, operating procedures, software security features, and physical projections are designed to ensure that only authorized changes are made to computer programs; (2) that access to data is appropriately restricted; and (3) that backup and recovery plans are adequate to ensure the continuity of essential operations. Such controls are critical to IRS' ability to safeguard assets, maintain the confidentiality of taxpayer data, and ensure the reliability of financial management information.

GAO identified two areas of significant weakness in the general controls over IRS computer systems that have increased the risk of fraud and diminished the reliability of IRS' financial management information:

- IRS did not adequately restrict access to taxpayer data to only those computer support staff who needed it and did not adequately monitor the activities of thousands of employees who were authorized to read and change taxpayer files. As a result, IRS could not be certain that the confidentiality and accuracy of this data were protected and that the data were not manipulated for purposes of personal gain. GAO reported that IRS internal reviews have identified instances where IRS employees (1) manipulated taxpayer records to generate unauthorized refunds, (2) accessed taxpayer records to monitor the processing of fraudulent returns, and (3) browsed taxpayer accounts that were unrelated to their work, including those of friends, relatives, neighbors, and celebrities.
- Controls did not ensure that IRS used only authorized versions of its computer programs. This is a systemic problem that permits programmers to introduce unauthorized software changes either inadvertently or deliberately and, thus, increases the risk that taxpayer and other data may not be processed as intended by management policies.

GAO also noted that (1) in case of an unexpected interruption in operations at its primary computer center, IRS' ability to maintain taxpayer accounts on a current basis may be impeded and (2) IRS has not yet tested the effectiveness of its recently revised disaster recovery plan.

Recommendation(s)

GAO made several recommendations regarding controls over (1) employees access to computer programs and taxpayer data files and (2) centrally and locally developed computer programs.

Action(s) Taken and/or Pending

IRS generally agreed with GAO's recommendation and has taken or plans to take corrective action. For example, IRS said that (1) it is revising written guidelines, strengthening management reviews, and enhancing audit trail systems to better report employees activities and (2) it has formed a team to identify needed controls, is testing off-the-shelf computer software that contains program version controls, and is strengthening documentation and scheduling requirements for locally developed computer processes. IRS also provided some details regarding its efforts to strengthen its disaster recovery capabilities.

Related GAO Product(s)

GAO/AFMD-93-40, 04/28/93; GAO/AFMD-93-42, 05/06/93; GAO/AIMD-93-2, 06/30/93; and GAO/AIMD-93-24, 08/05/93

Taxpayer Assistance

Information on Tax Counseling for the Elderly Program

GAO/GGD-93-90BR, 04/08/93

In a report to the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, GAO provided information about IRS' grants for the Tax Counseling for the Elderly (TCE) program. Under this program, nonprofit organizations provide volunteer-assisted free tax counseling for the elderly. This report discusses how (1) grant funds are awarded under the TCE program, (2) funds were spent by the five largest grantee organizations, and (3) IRS oversees the use of grant funds.

To be eligible for a grant, an organization must have nonprofit status, volunteer coordination experience, and tax expertise. IRS awards grant funds to all organizations that apply and meet the eligibility criteria, although the organizations generally receive less than they request. In 1992, IRS granted $3 million to 58 organizations.

IRS requires that at least 70 percent of grant funds be used as reimbursement to volunteers for out-of-pocket expenses incurred in training or providing tax assistance to the elderly. The remaining 30 percent of grant funds may be used for administrative expenses, such as advertising the program to the elderly, telephone costs, and supplies needed by volunteers. Before fiscal year 1992, the limit on administrative expenses was 25 percent. IRS records of grantee expenditures in fiscal year 1991 indicate that the five largest grantee organizations spent the funds received in accordance with these guidelines.

IRS requires all grantees to submit monthly or quarterly expense statements and requires independent audits of grantees who receive more than $25,000 in federal funds. IRS district offices are responsible for reviewing the quality of TCE return preparation, and IRS service centers maintain statistics, including accuracy rates, on the tax returns prepared under the TCE program. The TCE program has an intricate system of reporting on program activities and fund disbursement that, if properly implemented, provides reasonable level of certainty that grant funds are used for expenses directly related to providing assistance to the elderly.

IRS' Test of Tax Return Filing by Telephone

GAO/GGD-93-91BR, 04/26/93

In 1992 and 1993, IRS tested the filing of the simplest individual income tax return (Form 1040EZ) by using a push-button telephone. The test, known as TeleFile, was limited to taxpayers in Ohio who met certain eligibility requirements. At the request of the Chairman of the Senate Committee on Governmental Affairs, GAO reviewed the results of this test in 1992 and changes to the test for 1993.

IRS' evaluation of TeleFile test results in 1992 and GAO's assessment of those results indicated that filing by telephone can be a viable alternative to the filing of paper returns for the millions of taxpayers who would otherwise file a Form 1040EZ. IRS' test in 1992 showed that telephone filing is technically feasible and that taxpayers who used it liked it. Taxpayers are not required to pay to use TeleFile and can access the system 7 days a week, 24 hours a day without leaving home. Also, TeleFile users can get their refunds faster, and their burden is reduced by having fewer computations to make. For IRS, TeleFile results in more accurate returns that are less costly to process.

The biggest change in the test for 1993 was that some users, instead of having to send in a paper document with their signature, had a voice recording taken, which served as their signature.

Security poses the biggest potential obstacle to expansion of TeleFile. Despite the presence of several controls, GAO said that TeleFile security was being compromised because of taxpayer identifying information, such as Social Security numbers and personal identification numbers, needed to file a return over the telephone, was printed on the label on the outside of the tax package mailed to eligible taxpayers, and thus easily accessible to others. IRS was aware of this problem and was considering alternatives to correct it.

Implementation of IRS Actions in Corresponding to Taxpayers

GAO/GGD-93-38R, 04/27/93

Taxpayers write to IRS on a variety of matters, such as to send a payment, request that a penalty be abated, or provide information in response to an IRS notice. IRS sends interim letters to taxpayers to advise them when the matter in question cannot be resolved within 30 days. In a letter to the IRS, the Subcommittee expressed concern that the correspondence was inappropriate for the situation, citing cases in which the taxpayer had sent payments to IRS, but IRS' interim response did not acknowledge the payments but instead contained language thanking the taxpayers for their "inquiry." In its reply to the Subcommittee, IRS said it agreed with the subcommittee's concern and was taking immediate action to change the interim letter. GAO found that the problem had not been solved, primarily because IRS directed only one of several service center functions that correspond with taxpayers to correct its procedures. Also, GAO found that IRS staff who prepared the corrected letters did not choose appropriate language when composing the letters on IRS' computerized letter writing system. GAO plans to study this problem in more depth as part of a broader review of IRS correspondence issues it is doing for the Subcommittee.

Selected IRS Forms, Publications, and Notices Could Be Improved

GAO/GGD-93-72, 04/30/93

In response to a request from the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, GAO reported on the accuracy of some commonly used IRS forms, publications, and notices. Specifically, GAO examined 17 selected forms and publications to see if they conformed with current legal requirements as stated in the Internal Revenue Code and Treasury Regulations and 21 notices for consistency with the purposes established by IRS guidance. GAO also looked for consistency with IRS revenue rulings, revenue procedures, and other IRS documents, including other forms and publications.

GAO did not identify any instances in which the forms, publications, and notices did not conform with legal requirements or IRS guidance. However, GAO did identify some changes that could be made to improve the understandability and usefulness of these printed products to taxpayers. Generally, GAO suggested changes that were directed toward the use of more specific language, consistent terminology, and inclusion of appropriate references to other forms and publications.

The report also discusses the usefulness of taxpayer assistance telephone numbers that IRS provides on these printed products. The taxpayer assistance telephone numbers provided on the tax forms and publications that GAO reviewed were those of IRS taxpayer offices that should be able to respond to taxpayer' questions and related matters. The notices reviewed generally included the telephone number of an IRS service center, district office, or toll-free taxpayer call site.

IRS agreed to address most of GAO's suggestions and said that the changes either already have been made or will be incorporated in future versions of the IRS documents.

Tax Policy

Small Tax-Exempt Insurance Companies

GAO/GGD-93-11R, 02/08/93

Congress has provided tax relief under Internal Revenue Code section 501(c)15 to small, local insurance companies that provide insurance to rural and farm communities. GAO reviewed this provision to determine if its intent was still being met and in a letter to the Acting Commissioner of Internal Revenue presented the results of that study.

GAO said that the Tax Reform Act of 1986 expanded the provision under which a property or casualty insurance company could qualify for this tax-exempt status. The 1986 provision provided tax-exempt status to mutual and stock companies that have no more than $350,000 in net or direct written premium income. This change made it possible for a company with sizable investment income to be tax exempt if it has a small premium income.

GAO found, for the most part, that the insurance companies qualifying for the tax exemption since 1986 were generally small companies that seem to be the types of organizations Congress intended to assist under section 501(c)15. In a few isolated instances, companies had earned large amounts of investment income tax free under the revised section 501(c)15. Because GAO found few companies with substantial investment income, little revenue appeared to have been forgone.

Many Factors Contributed to the Growth in Home Equity Financing in the 1980s

GAO/GGD-93-63, 03/25/93

At the request of Congressman William J. Coyne, GAO reviewed (1) the use of home equity financing, including both home equity loans and home equity lines of credit and (2) the effect of the Tax Reform Act of 1986 on the use of home equity and other types of consumer financing.

GAO said that while total housing debt and nonhousing consumer debt increased at average annual rates of 6 and 4 percent between 1981 and 1991, the use of home equity financing increased by 20 percent. GAO reported that several factors played a role in the growth in housing debt, particularly home equity debt. These factors included rising home values, changes in banking laws, and lenders' aggressive marketing campaigns for home equity financing. In addition, the Tax Reform Act of 1986 contributed to the continuing growth and popularity of home equity financing with the elimination of the tax deductibility of interest expenses from many types of consumer debt, but not mortgage debt.

Although information on home equity financing usage was available from surveys of borrowers and lenders, GAO reported that no conclusions could be reached from the data concerning changes in consumer behavior due to increased availability of home equity financing during this period. This was because the data did not clearly indicate whether the existence of home equity financing allowed borrowers to (1) finance something they would not have otherwise done or (2) finance something they would have done anyway, freeing resources for other uses.

GAO also reported that while home equity financing was tax-preferred due to interest deductibility, there were disadvantages to using it. For example, when borrowers use home-based debt, there is the potential for losing the home if they default. In addition, unlike other types of consumer financing, there are costs associated with obtaining home equity financing, such as application processing fees.

If there is congressional concern about the amounts or uses of home equity financing, GAO gave several options that Congress could consider: (1) eliminate the tax deductibility of interest paid on home equity financing and (2) limit the amounts of deductible home equity financing or further limit the total amount of mortgage debt eligible for the interest deduction. While these options could possibly alleviate congressional concerns, they also raise enforcement difficulties. For example, the elimination of interest deductibility on home equity financing would be

difficult for IRS to monitor. Under current reporting requirements to IRS, interest on home equity financing and other mortgage debt are reported as a single line item on individual tax returns, thus making it very difficult to differentiate between different types of mortgage debt. A more feasible option may be for Congress to introduce a cap on deductible mortgage interest. This would allow IRS to use existing information reporting systems for enforcement purposes.

Earned Income Tax Credit: Design and Administration Could Be Improved

GAO/T-GGD-93-20, 03/30/93 and GAO/GGD-93-145, 09/24/93

In testimony before the Subcommittees on Select Revenue Measures and Human Resources, House Ways and Means Committee, and in a report to Senator Bill Bradley, GAO assessed the design of the earned income credit (EIC), a tax credit available to low-income workers with qualifying children. GAO wanted to know if the EIC was achieving its objectives and whether IRS is continuing to encounter problems in administering the credit. Specifically, GAO evaluated (1) how the benefits of the credit are distributed among taxpayers; (2) the extent to which the credit offsets the payroll tax incurred by qualifying taxpayers; and (3) how the credit affects recipients' work incentives, especially those of single parents. The administrative issues that GAO was asked to examine included how IRS was attempting to ensure that the maximum number of qualifying recipients receive the credit without unduly increasing the number of illegitimate claims.

The tax credit was created in 1975 with the objective of providing assistance to low-income workers who maintained households and had dependent children they claimed as exemptions. In its first year, 6.2 million families claimed the credit. By 1988, 11.1 million families were receiving the credit, and almost 14 million received it for tax year 1991.

The EIC is a refundable tax credit payable to a qualifying household if income is below a cap ($22,370 in 1992) and if the household contains at least one qualifying child. Any credit amount that exceeds tax liability is paid to the recipient. The credit is based on a percentage of earnings (17.6 percent in 1992) up to $7,500 of earned income. When income is between $7,500 and $11,850, the credit is a constant amount ($1,324 in 1992). For income above $11,850, the credit is reduced (at a rate of 12.57 percent in 1992) as income rises, until it disappears at the cap ($22,370 in 1992).

GAO concluded the credit increased progressivity of the tax system for recipients. In 1988, the credit offset about half of the payroll taxes for low-income workers who qualified for the credit and almost offset these taxes for qualified workers in the credit's lowest income range. By 1994, the credit is expected to nearly offset payroll taxes for the average low-income recipient. Those workers who received the credit and are below the poverty line have their overall federal tax burden substantially reduced, while those qualified workers who are above the poverty line have their taxes reduced somewhat. However, because only 18 percent of

low-income filers qualify for the credit, the overall effect on tax progressivity for low-income households is much less.

GAO also concluded that overall work incentives built into the design of the credit negatively affected the average annual hours worked by credit recipients. GAO estimates that in 1988 recipients probably worked about 2.1 percent fewer hours as a result of the credit. Wives were more responsive to the credit since their hours worked fell more than husbands and single female parents. GAO projections based on the credit rates for tax year 1994 contained in the Omnibus Budget Reconciliation Act of 1990 (OBRA) suggest that the size of these responses may increase as the credit becomes larger by 1994.

GAO found that some IRS administrative problems have been solved but that others remain. Some of these problems can be resolved by improving IRS' returns processing procedures; others may require legislative changes to make the credit more administrable.

GAO said that the act's simplifications reduced the importance of filing status and dependency tests as problems for the IRS. However, additional credits and interactions between these credits and other provisions in the code were introduced by the act, which along with IRS' new schedule EIC, have added to the complexity of the credit.

Even with the act's changes, IRS still faces the dilemma of either denying the credit to potentially eligible workers or giving the credit to potentially ineligible workers. Trying to balance these forces can lead to inconsistent treatment of filers. For example, the returns processing procedures IRS has instituted since the act may still allow certain filers who provide incomplete information to receive the credit. However, other filers who also provide incomplete information may not receive the credit or may receive it after much delay, although they appear qualified on the basis of tax return information. In addition, while IRS has greatly expanded its outreach effort for the EIC, it still does not use information it has on nonfilers that could substantially improve this effort.

Recommendation(s)

The Commissioner of Internal Revenue should (1) modify the tax return to capture all of the requisite qualification information, (2) send notices that explain credit requirements to nonfilers with low earned incomes, and (3) modify returns processing procedures to ensure that all potentially eligible taxpayers who submit similar information are treated consistently.

Action(s) Taken And/or Pending

IRS and Treasury disagreed with GAO's recommendation to modify the tax return to capture the relevant qualification information. Because some of the additional information would be added to the current space for dependent information, IRS was concerned that the burden on non-EIC taxpayers would be increased. IRS also believed that adding more information to the tax return would make that return more complex.

IRS agreed with GAO's recommendation to send notices about the EIC to nonfilers. IRS said that a work group is looking at GAO's proposal and studying other ways to reach all individuals who may be eligible for the credit and are not receiving it.

IRS disagrees that taxpayers potentially eligible for the credit are treated inconsistently. IRS contends that taxpayers who file a schedule EIC are treated consistently within that group and that taxpayers eligible for the credit and do not file a schedule EIC but show similar qualifying information on their tax returns are treated consistently within their class of filers.

Related GAO Product(s)

GAO/T-92-26, 02/19/92

Industrial Development Bonds: Achievement of Public Benefits Is Unclear

GAO/RCED-93-106, 04/22/93

The federal government forgoes revenue, estimated by the Joint Committee on Taxation, at over $2 billion in 1991, because of the tax-exempt status of small issue industrial development bonds. The bonds, issued by state and local governmental authorities, are intended to help finance the creation or expansion of manufacturing facilities. Because these bonds are considered to generate public benefits, the Internal Revenue Code exempts the interest investors earn on the bonds from federal income taxes. The authorizing provision for issuing these bonds expired on June 30, 1992, and at the time of GAO's review, the President had proposed extending the provision permanently.

In a report to the Chairman of the Subcommittee on Intergovernmental Relations, House Committee on Government Operations, GAO presented the results of its review of the use and benefits of small issue industrial development bonds for manufacturing. Specifically, GAO determined the extent to which (1) public benefits were achieved through the use of these bonds; (2) the bonds were subject to default; and (3) the bonds were paid off early, thus removing the Internal Revenue Code use restrictions so that the projects could subsequently be used for purposes other than manufacturing.

GAO said that these industrial development bonds were being used for their intended purpose of financing manufacturing facilities. However, contrary to claims that these bonds were achieving public benefits, such as (1) creating jobs, (2) assisting economically distressed areas, (3) fostering start-up companies, and (4) keeping manufacturing firms in the country, GAO found that it was unclear whether the bonds significantly achieved these benefits. Of the 68 projects financed with industrial development bonds in the 3 states we reviewed, only 16 of the projects were located in economically distressed areas, 7 involved start-up companies, and 1 might have moved to another country had it not received industrial bond financing.

Additional concerns that these bonds were subject to high rates of default or that they were paid off early were not confirmed by GAO's study. In the three states GAO reviewed, the bonds seldom defaulted, which may be attributed to safeguards in the issuance process to ensure that the developers were creditworthy and that the projects were financially sound. Similarly, GAO said that few bonds were paid off early, and there was no evidence that projects were subsequently used for

nonmanufacturing purposes. When early payment of the bonds occurred, GAO found that usually the company refinanced the debt or had become financially able to pay it off.

Matter(s) for Congressional Consideration

Given the questions that surround whether these industrial bonds are achieving the public benefits attributed to them and because of the tax revenue forgone, Congress may wish to consider not renewing the provision authorizing issuance of these industrial bonds. If, however, Congress does extend the provision, it may wish to specify requirements to better direct these bonds toward achieving public benefits that would not occur from alternative investment of the money. For example, GAO suggested that Congress may wish to provide requirements that would direct small issue industrial development bonds to economically distressed areas or to start-up companies.

Action(s) Taken and/or Pending

On August 10, 1993, Congress enacted the Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66) which, among other things, permanently extended the Industrial Development Bond provision. No further action had been taken as of December 31, 1993.

Related GAO Product(s)

GAO/RCED-91-50, 03/29/91; and GAO/RCED-92-247R, 07/24/92

Value-Added Tax: Administrative Costs Vary With Complexity and Number of Businesses

GAO/GGD-93-78, 05/03/93

For several years a federal value-added tax (VAT) has been discussed as an option that the United States might use to reduce the budget deficit, reform the current federal tax system, or fund new programs. In its earlier work on the VAT, GAO found a major gap in the literature pertaining to how a VAT might be administered in the United States and how much it might cost. GAO thus initiated this review to provide Congress with this information. Specifically, GAO's objectives were to (1) identify the processes and structure for administering a VAT, (2) estimate the costs of administering a basic VAT in the United States, (3) consider how alternative designs affect administrative costs, and (4) discuss the transition necessary to implement a VAT.

A single-rate, broad-based VAT would promote economic neutrality among goods and services, minimize compliance burdens for the taxpayer, and minimize administrative costs. For its basic VAT, GAO assumed that (1) IRS would administer the tax in cooperation with Customs and the Federal Reserve System; (2) all goods and services would be taxed except for difficult to tax sectors, such as financial intermediaries, whole life insurers, and pre-existing buildings, including residential housing; (3) nearly all businesses would be subjected to the tax and would file monthly or annually depending upon the gross receipts of the business; and (4) businesses with gross receipts above $25,000 would be required to file and pay electronically.

The costs of administering a VAT would vary according to the complexity of the tax. Exemptions and multiple rates, such as the ones foreign countries use to address concerns of the burden on low-income consumers, would significantly increase the complexity, resulting in higher costs of administration. A single-rate, broad-based VAT in 1995 would cost the government between $1.22 billion and $1.83 billion annually, depending on the number of taxpayers subjected to the tax. If the VAT were structured to include exemptions and multiple rates, the administrative costs could be as much as $700 million higher. GAO estimated that reducing the number of businesses from 24 to 12 million would reduce the administrative costs from $1.83 billion to $1.41 billion; with only 9 million taxpayers, the estimated costs would be further reduced to $1.22 billion.

For transition to a VAT, about $800 million would be needed for taxpayer education, staff training, and computer system development. Optimally, 18 to 24 months would be required to properly prepare for a VAT.

Related GAO Product(s)

GAO/GGD-90-50, 03/21/90

Implications of Replacing the Corporate Income Tax With a Consumption Tax

GAO/GGD-93-55, 05/25/93

In a report to Congressman Bill Archer, GAO discussed the advantages and disadvantages of replacing the corporate income tax with a broad-based consumption tax. The report reviewed the impact of such a change on its effects on (1) economic efficiency and equity, (2) tax administration costs, and (3) tax compliance costs. In particular, the report evaluated the likely effects of replacing the corporate income tax and the employer's share of the Federal Insurance Contribution Act payroll tax with the Uniform Business Tax (UBT).

GAO found that the UBT closely resembled a consumption-type, value-added tax (VAT) because it allowed businesses to deduct investment expenditures but not wages and interest. Under an income tax, corporations are allowed a deduction for depreciation of plant and equipment representing the loss in value over time. In contrast, consumption taxes in general—and the UBT in particular—allow the immediate deduction of all investment spending. The corporate income tax also allows a deduction for wages and interest expense, while the UBT does not. Thus, replacing the corporate income tax and a portion of the payroll tax with the UBT would likely increase taxes on wage income and decrease taxes on capital income.

Increased taxes on wage income could reduce the labor supply of some workers, most likely those who work part time or those deciding whether to enter the labor force. Reducing taxes on capital income would increase investment demand. Whether the increase in investment demand would actually lead to greater investment would depend on whether additional domestic or foreign saving would be generated to finance the investment. Most, but not all, studies of the effects of income taxes on domestic saving find the effect to be small. If additional domestic saving or foreign saving does generate additional investment, the average level of worker productivity and real wages may increase.

Some advocates of VATs maintain that border tax adjustments—taxing imports and exempting exports from tax—favor domestic production and can improve the trade deficit. Although this may appear to be the case from the perspective of a particular company or industry, it does not apply to the economy as a whole. Substituting the UBT or a VAT for the corporate income tax affects the trade balance to the extent that national saving increases by more or less than investment.

The current corporate income tax has been criticized as favoring investments financed with debt over those financed with equity because interest payments are deductible and dividend payments are not. Replacing the corporate tax with the UBT would eliminate the current bias, but create a bias in favor of financing investment from undistributed profits. Under the proposal, undistributed profits would not bear any income tax until shareholders sold their shares and realized a capital gain. In contrast, dividends and interest would be taxed under the personal income tax when received.

The replacement of the corporate income tax and the employer's share of the payroll tax with the UBT would likely make the tax system less progressive, but how much less is uncertain. There is considerable debate about whether the corporate tax results in lower income for shareholders, lower income for owners of capital in general, lower wages for workers, or higher prices for consumers. If the current corporate tax is effectively paid by workers or consumers, the switch to the UBT would not affect the distribution of income substantially, although the lowest income groups could pay somewhat higher taxes. However, to the extent that the current corporate tax reduces capital income, the switch to the UBT would make the tax system less progressive.

GAO found that moving from the current income tax to the UBT would not necessarily lower either administration or compliance costs of the tax system. While both types of costs could decrease for corporations, some noncorporate businesses could pay both the income tax and the UBT. Their compliance costs could rise, and their additional returns would have to be processed and examined, thereby increasing administrative costs.

Puerto Rico and the Section 936 Tax Credit

GAO/GGD-93-109, 06/08/93

In a report to the Chairman, Senate Committee on Finance, GAO provided information relevant to Congress' consideration of proposals to revise the Internal Revenue Code section 936 tax credit, which primarily affects Puerto Rico and subsidiaries of U.S. companies that operate there. GAO's report provided background information, addressed issues concerning estimating the effects of alternatives to the section 936 tax credit, and discussed the possible multiplier effects of section 936 firms on the Puerto Rican economy. The report also summarized information relating to changes in the Puerto Rican economy since 1971 and to the distribution of tax benefits, employment, and compensation among section 936 manufacturing firms.

Regarding the effects of alternatives to the section 936 tax credit, GAO said a key question was the impact on Puerto Rico's economic development. The impact of changing section 936 on Puerto Rico's economic development and growth depended on how the change would affect the use of Puerto Rico's resources, both resources employed directly by section 936 firms as well as resources employed indirectly through Puerto Rican suppliers. The effect of changing section 936 on the employment of Puerto Rico's resources depended on how the tax change affects firms' location decisions and whether the resources would be otherwise employed.

GAO also said that although some firms might consider relocating, the kind of detailed information on firms, including firms that may move to Puerto Rico, necessary to estimate the effects of the proposed tax changes on firms' location decisions did not exist.

Although data were not available to estimate the effects of proposed tax changes on firm's location decisions, the report provided data on the distribution of tax benefits, employment, and compensation among section 936 firms. Average tax benefits per employee were $24,300 while average wages paid, including estimated fringe benefits, were $22,800. For some industries, in particular the chemical industry and its pharmaceutical component, average tax benefits considerably exceeded wages paid. The average tax benefits per chemical industry employee were $69,800 in 1989, and average compensation was $32,900. The section 936 tax benefits were concentrated in capital-intensive firms. Given the characteristics of these firms, GAO said that the effect of these firms on the Puerto Rican economy

might not be proportional to their capital investments in Puerto Rico or to the tax credits they received.

On the topic of possible multiplier effects of section 936 firms on the Puerto Rican economy, GAO said that in an economy with high persistent unemployment like Puerto Rico's, investment undoubtedly produced a multiplier effect. GAO was, however, unable to find estimates of a multiplier that took into account the possibility of alternative employment for Puerto Rico's resources and the adjustments that would occur in response to price changes resulting from firms' location decisions. GAO said the magnitude of the multiplier effect depended on whether the resources would have been employed otherwise and that it was likely that some portion of those who would lose employment due to a change in section 936, either from reduced operations of firms directly benefiting from section 936 or firms indirectly benefiting, would find alternative employment. The relatively high level of education in the Puerto Rican labor force combined with the below average unemployment rate for the well educated suggested such a result.

Summary of Related Action(s)

Congress revised the section 936 tax credit in the Omnibus Budget Reconciliation Act of 1993. The Joint Committee on Taxation expects the revisions to reduce forgone federal revenues by $3.75 billion from 1994 through 1998.

Related GAO Product(s)

GAO/GGD-92-72BR, 05/04/92

Long-Term Care Insurance: Tax Preferences Reduce Costs More for Those in Higher Tax Brackets

GAO/GGD-93-110, 06/22/93

Long-term care insurance policies charge a premium that is, in part, a payment by policyholders to offset the current risk of requiring long-term care and, in part, an addition to a reserve that prefunds future insurance. Although IRS has ruled on certain issues related to such insurance, it has not specifically addressed many policyholder tax issues. As a result, some uncertainty exists about the current tax treatment of long-term care insurance. For example, the part of long-term care insurance premiums that funds current or prefunds future medical care benefits may or may not qualify for the medical and dental expense deduction. In addition, benefits paid from such policies could be included in taxable income but—to the extent they are used to pay medical expenses—may be deductible under the medical and dental expense deduction.

In response to a request from the Chairman of the House Committee on Energy and Commerce, GAO compared how alternative tax treatments common to several proposals to increase the incentive to buy long-term insurance would affect the cost of such insurance. GAO said that many of the alternatives being proposed would clarify the tax treatment of payment from long-term care insurance policies and long-term care riders to life insurance policies. Other proposals would liberalize tax treatment either by allowing long-term care insurance premiums to be deductible or payments from policies to be tax exempt so that individuals or groups would have more incentive to buy long-term care insurance.

GAO noted that although current tax practice regarding long-term care insurance is ambiguous, it closely resembled the life insurance or annuity approach. Because investment income is not taxed, the annual premium for long-term care insurance costs less than it would if such earnings were taxed as accrued. For example, a 40-year-old customer in the 28-percent tax bracket realizes a 20-percent reduction in the annual premium resulting from exempting investment income. Interest accumulation is more important in calculating annual premiums for younger customers, so that the gain from exempting interest is much smaller for a 65-year-old about to retire, who would only realize an 8-percent reduction in the annual premium.

While not discussing each alternative proposed, GAO did examine generic types such as pension, life insurance, and health insurance, and showed how the related tax incentives would affect the price of long-term care insurance depending upon (1) the age and tax bracket of the consumer

and (2) whether the coverage is employer provided or individually purchased. GAO noted the following:

- One important alternative approach would move the tax treatment of long-term care insurance to a pension model by allowing individuals to deduct premiums paid for long-term care insurance or, if such insurance were provided by employers, exclude premiums from taxable income, thus lowering the annual effective cost of such insurance.
- Some proposals by treating long-term care insurance as accident and health insurance for tax purposes and thereby significantly reducing the overall cost of such insurance, provide the most generous income tax treatment because they would allow deducting premiums and exempting both investment income and distributions from taxable income.

GAO concluded that because most proposals provided favorable income tax treatment, they primarily would benefit those in the highest tax brackets who also tend to earn above-average incomes.

Related GAO Product(s)

GAO/GGD-90-31, 01/29/90; and GAO/HRD-92-14, 12/26/91

Public Housing: Low-Income Housing Tax Credit as an Alternative Development Method

GAO/T-RCED-93-54, 06/17/93 and GAO/RCED-93-31, 07/16/93

In testimony before the Subcommittee on Housing and Community Development, House Committee on Banking, Finance and Urban Affairs and in a report to that Subcommittee and the Subcommittee on Housing and Urban Affairs, Senate Committee on Banking, Housing and Urban Affairs, GAO provided the results of its work on the low-income housing tax credit program as an alternative to the public housing program in developing public housing. GAO's work was mandated in the National Affordable Housing Act of 1990 (P.L. 101-625).

The tax credit and public housing programs involve different methods of using federal funds for developing low-income housing: (1) the public housing program provides direct grants from the Department of Housing and Urban Development (HUD) to public housing authorities (PHA) who are the primary developers and managers of publicly controlled housing for low-income households, and (2) the tax credit program provides federal tax credits to low-income housing developers. The programs also differ in the level of federal involvement: while HUD selects and works closely with the PHAs that receive public housing development grants, there are few federal requirements for the development of projects with tax credits.

GAO compared the two programs in terms of (1) tenant and project characteristics, (2) costs to the federal government, and (3) public housing authorities' administrative experiences when developing each type of project. GAO reviewed nine PHAs nationwide that completed projects through both programs between 1989 and 1991.

Regarding characteristics, GAO said that the PHAs used the tax credit program to serve different types of tenants and to develop different types of projects other than the public housing development program. Most of the public housing units were used for families with children and were scattered through predominantly middle-income neighborhoods. However, the authorities used the greater flexibility offered them with tax credits to develop more concentrated housing for the elderly as well as families in a variety of low- and middle-income neighborhoods. In addition, GAO said the tax credit projects needed federal operating funds, such as Section 8 housing subsidies, to serve tenants with incomes as low as those tenants in public housing projects.

Although HUD grants covered virtually all of the costs of developing the public housing projects, tax credits only generated enough cash to pay for

a little more than half of the costs for developing the tax credit projects. GAO estimates at one PHA showed that if tax credits were used to serve households as poor as those in the PHA's public housing project the federal government would have to spend more per unit than it did for the public housing project.

GAO said that PHAs had to overcome certain administrative obstacles to use each of the programs: The four PHAs that GAO visited said that the greatest obstacle with the public housing program was the multitude of HUD regulations and procedures; while with the tax credits, it was finding other funding sources, such as commercial loans, to cover development costs beyond those covered by the tax credit. GAO noted that (1) at least two of the PHAs were able to develop housing quicker with the tax credit and (2) PHAs said that, with so few funds available through the public housing program, the tax credit was a valuable tool for developing additional low-income housing.

Related GAO Product(s)

GAO/T-RCED-90-73, 04/12/90 and GAO/RCED-90-203, 08/14/90

Corporate Taxes: Many Benefits and Few Costs to Reporting Net Operating Loss Carryover

GAO/GGD-93-131, 09/23/93

In a report to the Chairman, Subcommittee on Oversight, House Committee Ways and Means, GAO estimated the total amount of past net operating losses (NOL) that corporations had accumulated through 1989. GAO's estimate relied on a methodology that IRS' Research Division had developed just for small corporations in 1987. GAO applied this methodology to data reported by all corporations for 1989, which allowed estimates for about two thirds of the corporations.

No one knows the exact amount of NOL carryover that corporations have accumulated to offset future tax liability through NOL deductions. GAO's work suggested that the NOL carryover amount is not only large and growing but could be larger than existing data allowed us to identify. For over two thirds of all corporations, the estimated carryover of $160 billion in 1985 increased to $246 billion in 1989—or 54 percent in current dollars. Over this time, total receipts (i.e., the amount of gross receipts and other forms of positive income before deductions) for the corporations covered by GAO's estimate grew from $0.95 trillion to $1.25 trillion (32 percent).

GAO found that IRS' instructions on the NOL deduction amounts that corporations should report were incomplete and confusing. As a result, three out of four corporations reported NOL deductions even when they had no taxable income or reported more NOL deductions than taxable income. These corporations mistakenly reported their NOL carryover amounts as NOL deductions. Accordingly, GAO used these misreported amounts to estimate corporate NOL carryover.

While neither of these reporting mistakes improperly reduced their 1989 taxable income, NOL deductions can have a major impact on taxes. For example, corporations reduced their tax liability by claiming $39 billion in NOL deductions for 1989.

IRS' Research Division recommended that corporate tax returns be modified to report NOL carryover. GAO believed that the benefits of this procedure outweigh the costs. GAO said that knowing the amount of the NOL carryover would (1) improve revenue estimates of proposed tax law changes, (2) improve voluntary compliance in reporting NOL deductions, and (3) allow IRS to do limited compliance checks. IRS estimates that the added costs and burdens from requiring this reporting and processing the data would be minimal.

Recommendation(s)

The Commissioner of Internal Revenue should (1) revise instructions on reporting NOL deductions to clarify amounts that can be deducted and to clearly define NOL carryover and (2) require corporations to annually report their NOL carryovers and use the reported amounts to track corporate NOL deductions.

Action(s) Taken and/or Pending

IRS had begun taking actions on GAO's recommendations. As of December 31, 1993, IRS had drafted clearer instructions and added a new space on the income tax return on which corporations should report their NOL carryover.

Tax Systems Modernization

IRS' Use of Consultants to Do the TMAC Price/Technical Trade-Off Analysis

GAO/IMTEC-93-4BR, 10/23/92

In a briefing report to the Chairman of the Senate Committee on Governmental Affairs, GAO presented the results of its review of IRS' use of outside consultants to conduct a second price/technical trade-off analysis for the Treasury Multiuser Acquisition Contract (TMAC) procurement. This analysis was performed between November 1991 and February 1992, after the General Services Administration Board of Contract Appeals ruled that IRS' earlier analysis was inadequate.

TMAC was a 1-year contract awarded in 1991, with annual renewal options for up to 6 years, to provide up to 3,200 minicomputers, 50,000 workstations, printers, networking hardware and software, an integrated office automation system, and computer maintenance and other services to support IRS' Tax Systems Modernization (TSM) program.

The Chairman asked GAO to determine (1) the extent to which IRS identified and evaluated sources of expertise available within the government to do the analysis before contracting with the outside consultants and whether these actions were consistent with the Federal Acquisition Regulation, (2) whether the analysis was done properly, and (3) the level of oversight and assistance that the General Services Administration (GSA) has provided IRS on major TSM procurements after a Delegation of Procurement Authority was issued by GSA.

GAO said that IRS' use of outside consultants to perform the price/technical trade-off analysis was not inconsistent with the procurement regulation. While prohibiting agencies from contracting for services that are readily available within the government, the regulation does not require agencies to take any specific actions, such as a comprehensive review, to determine the availability of such in-house services. IRS' Assistant Commissioner for Procurement said that he chose to use consultants because he believed (1) they could complete the analysis quicker than in-house sources and thereby avoid additional delay in awarding the contract and (2) the credibility of the analysis would be enhanced if a new team and new methodology were used to do it. While IRS did not do a review to determine the availability of expertise within the government, IRS officials said that

they could not have done the analysis as quickly as the consultants. However, IRS has taken steps to make greater use of in-house expertise on future procurements that may involve price/technical trade-offs.

GAO also said that (1) the price/technical trade-off analysis used a methodology that appeared reasonable and (2) IRS was furnishing GSA with information on the status and progress of IRS' acquisition efforts, and GSA was providing technical assistance upon request.

Related GAO Product(s)

GAO/IMTEC-90-24, 01/12/90; GAO/IMTEC-92-7, 10/28/91; GAO/IMTEC-92-27, 03/13/92; and GAO/IMTEC-92-14R, 05/28/92

Program Status and Comments on IRS' Portion of President's Request for Fiscal Year 1993 Supplemental Funds and Fiscal Year 1994 Budget Request

GAO/T-IMTEC-93-1, 02/24/93; IMTEC/T-93-3, 03/30/93; and GAO/T-IMTEC-93-6, 04/27/93

In several testimonies before the Subcommittee on Treasury, Postal Service, and General Government, Committee on Appropriations and the Subcommittee on Oversight, Committee on Ways and Means, GAO discussed the funding aspects of IRS' Tax Systems Modernization (TSM) program. Specifically, GAO (1) commented on IRS' portion of the President's request for supplemental funds for fiscal year 1993, (2) discussed IRS' proposed fiscal year 1994 budget request for TSM, and (3) provided its views on actions the Subcommittee could take to help ensure TSM's success.

The fiscal year 1993 supplemental request was for $148.4 million to buy computer and telecommunications equipment for 12 projects; $41 million of that request was earmarked for IRS' Tax Systems Modernization (TSM) program. Of the $41 million, about $15.7 million was for two short-term TSM projects and $25.3 million was for telecommunications improvements in preparation for TSM projects. GAO said that IRS should reevaluate all of the short-term projects because they were experiencing schedule delays to the point where their completion was expected about the same time that the replacement TSM systems would be starting operations. The remaining $107.4 million was primarily to support IRS' current information processing operations.

IRS requested $717 million for its fiscal year 1994 budget—a net increase of $145 million over fiscal year 1993. GAO had concerns about the appropriateness and timing of about $83 million of the increase. Also, GAO noted that IRS' funding requests were not based on reliable cost and benefit estimates, and, as a result, GAO had no confidence in IRS' $23 billion cost estimate for the entire TSM program.

GAO also talked about one of the most critical issues facing the IRS—managing the expensive TSM program. GAO made the following observations:

- While IRS had made progress in implementing several interim TSM systems such as electronic filing, other interim systems being developed had experienced significant problems and delays, calling for a reevaluation of their costs and benefits.
- TSM's success as expressed in terms of cost, benefits, and timing, was at risk unless a number of problems were resolved soon. For example,

business studies that could significantly affect TSM remained unfinished, the program lacked a firm management and technical foundation, and much more had to be done with regard to the program's human resource implications.

GAO suggested that the Subcommittee consider having IRS take certain actions to address these problems before releasing fiscal year 1994 appropriations and take other actions before considering IRS' budget request for fiscal year 1995.

Summary of Related Action(s)

In IRS' 1994 Appropriations Act (P.L. 103-123, dated Oct. 28, 1993) Congress adopted GAO's suggestion by including language prohibiting the expenditure of 1994 funds on TSM until the Commissioner of Internal Revenue reported to the House and Senate Committees on Appropriations concerning the implementation of TSM. The request for fiscal year 1993 supplemental funds was not approved by Congress.

Related GAO Product(s)

GAO/IMTEC-90-13, 02/08/90; GAO/OCG-93-24TR, 12/92; and GAO/T-GGD-93-4, 02/03/93

Achieving Business and Technical Goals in Tax Systems Modernization

GAO/T-GGD-93-24, 04/27/93

In testimony before the Subcommittee on Treasury, Postal Service, and General Government of the House Committee on Appropriations, GAO (1) talked about how Tax Systems Modernization (TSM) is changing the way IRS does business and (2) highlighted issues related to IRS' management of TSM.

As examples of how automation is changing the way IRS does business, GAO cited automated filing (like electronic filing) and IRS' Corporate Files On-Line project, through which taxpayers' account information is quickly made available to IRS employees. While noting the benefits from these initiatives, GAO also pointed to some significant limitations.

One theme highlighted in GAO's testimony was the need for an experienced chief systems architect at IRS' executive level to concentrate on the technical aspects of TSM and provide technical leadership. This individual would be responsible for TSM's technical design and compatibility and help make critical decisions that balance business needs with technology.

Related GAO Product(s)

GAO/OCG-93-24TR, 12/92; GAO/GGD-93-27, 12/30/92; GAO/GGD-93-40, 01/22/93; and GAO/T-GGD-93-4, 02/03/93

IRS Lacks Accountability Over Its ADP Resources

GAO/AIMD-93-24, 08/05/93

As a part of its audit of IRS' fiscal year 1992 financial statements, GAO reviewed IRS' accountability over its automated data processing (ADP) equipment and software. In a report to the Commissioner of Internal Revenue, GAO said that IRS has invested hundreds of millions of dollars in these resources, which are critical to the agency's processing and accounting for tax data. GAO noted that IRS is in the early stages of a Tax Systems Modernization effort that it projects, through the year 2008, will result in expenditures of about $23.1 billion, $8.9 billion of which is for ADP hardware and software, thus making it especially important for IRS to have reliable information to properly manage and accurately report on these assets.

GAO reported that despite recent improvement efforts, IRS' ADP inventory records were unreliable for managing and reporting on these assets because IRS had not instituted basic controls to ensure that information maintained by its ADP inventory system was current and accurate. Specifically, GAO said that IRS (1) had not developed procedures to ensure that acquisitions and disposals were accurately recorded on a timely basis; (2) did not effectively perform physical inventories; and (3) did not properly value ADP resource, primarily because, for many items, IRS used unrealistic estimates instead of actual costs.

Recommendation(s)

The Commissioner of Internal Revenue should (1) ensure that data maintained by IRS' ADP inventory system meets management and reporting needs; (2) provide that any software purchases, development, or modifications related to this system are subject to review and approval; and (3) develop and implement standard operating procedures that incorporate controls to ensure that inventory records are accurately maintained.

Action(s) Taken and/or Pending

IRS generally agreed with GAO's recommendations and plans to take corrective actions to develop standards and requirements and institute appropriate controls to ensure the integrity of financial management information contained in the ADP inventory system.

Related GAO Product(s)

GAO/AFMD-93-40, 04/28/93; GAO/AFMD-93-42, 05/06/93; and GAO/AIMD-93-2, 06/30/93

Time Tables for Critical Planning Documents

GAO/AIMD-93-81FS, 09/30/93

In a fact sheet to the Chairman of the Senate Committee on Governmental Affairs, GAO provided information on the (1) critical planning and system development products that IRS needs to successfully implement its Tax Systems Modernization (TSM) program and (2) estimated or actual completion dates for these products and the frequency with which they were updated.

GAO categorized the TSM planning and system development products into two broad categories—summary documents and technical supporting products.

Summary documents set forth IRS' strategic goals and vision for tax administration in the next century and describe the approach for achieving these goals. They are high-level documents and are generally used to guide and oversee the modernization efforts by senior IRS management and Congress.

Technical supporting products supplement the summary documents and are used to manage the TSM program. They are the detailed plans and tools used by IRS to direct and manage the various TSM projects and activities and include (1) an acquisition plan, (2) a security architecture, and (3) an integrated project schedule.

Other

IRS Tax Identity Data Can Help Improve SSA Earnings Records

GAO/HRD-93-42, 03/29/93

Each year, millions of workers pay Social Security taxes on earnings that cannot be credited to their Social Security accounts because the Social Security Administration (SSA) does not have sufficient information to identify the correct accounts for these earnings. As a result, the workers to whom these uncredited earnings belong may not receive the full Social Security benefits to which they are entitled. Despite SSA's efforts to address this problem, the number of reports and the amount of uncredited earnings continues to grow.

The Chairman of the House Committee on Ways and Means asked GAO to determine whether IRS has information that would allow SSA to identify the owners of uncredited earnings. Specifically, the Chairman asked about an IRS process that collects additional taxpayer identification information as a condition for mailing out income tax refunds. In addition, GAO developed information on the possibility of SSA using IRS data files to help identify spouses who never reported surname changes to SSA.

In its report to the Chairman, GAO said that through routine tax administration activities, IRS obtains taxpayer identity data that could help SSA resolve uncredited earnings recorded in its suspense file. In GAO's opinion, this information, which is required by IRS as a condition for paying tax refunds, has the potential to greatly benefit SSA resolution efforts. IRS reports show that over 776,000 taxpayers responded to its requests about the identity question to obtain a release of their refunds. Because IRS did not retain the taxpayer responses, however, GAO was unable to estimate the potential suspense file resolution value to SSA.

GAO noted that spousal names from certain joint tax returns would also help SSA credit earnings to workers' accounts. GAO said that IRS data could be helpful when SSA's crediting problems relate to unreported changes in surnames. Using this data, GAO estimated that SSA could resolve about 79,000 uncredited earnings cases, valued at $556 million for tax year 1989 alone.

Recommendation(s) to IRS and SSA

The Commissioners of SSA and IRS should do a joint study evaluating the extent to which additional uncredited earnings reports can be resolved by

using data taxpayers send to IRS to obtain the release of their tax refunds. SSA should also use the spousal name information IRS currently provides to SSA to supplement ongoing efforts to resolve unidentified earnings cases.

Action(s) Taken and/or Pending

SSA and IRS generally agreed with our recommendations. While SSA agreed to do a joint study, its primary concern was whether IRS could electronically transmit to SSA the taxpayer responses about their identity. SSA believes that manually handling a workload of this size could be a substantial effort and impact heavily on administrative costs. IRS agreed to assist SSA if such a study were conducted.

Regarding disclosing tax data, IRS and SSA noted that there were legal restrictions that had to be addressed. While recognizing that the Internal Revenue Code limits disclosure of tax data, GAO noted that the code also authorizes IRS to disclose information returns under certain conditions. One condition deals with having an effective returns processing program. Thus, while the disclosure issue needs to be fully considered, the type of information discussed in this report has, historically, been considered disclosable.

With regard to the GAO's recommendation concerning the exchange and use of spousal names from tax returns, SSA said it would work with IRS to obtain spousal name information. IRS said that SSA can access this information already from the Individual Master Ferret File it provides SSA. Therefore, GAO suggested that SSA use this IRS data file to supplement its current resolution efforts.

1992 Annual Report on GAO's Tax-Related Work

GAO/GGD-93-68, 03/31/93

This report was prepared in compliance with a legislative requirement and contains information on GAO's tax policy and administration-related work during fiscal year 1992. It includes (1) summaries of tax-related products issued in fiscal year 1992; (2) summaries of tax-related products issued before fiscal year 1992 with open recommendations to Congress; (3) descriptions of legislative actions taken in fiscal year 1992 in response to GAO recommendations; (4) a listing of recommendations to Congress that were open as of December 31, 1992; (5) a listing of recommendations GAO made in fiscal year 1992 to the Commissioner of Internal Revenue; and (6) brief descriptions of assignments for which GAO was authorized access to tax data in fiscal year 1992.

GAO reported that (1) IRS had taken, or planned to take, action on most of the tax-related recommendations GAO made during fiscal year 1992 and (2) congressional committees and Members of Congress used GAO products in overseeing tax administration operations, considering tax policy issues, and enacting legislation.

Trends for Certain IRS Programs

GAO/GGD-93-102FS, 05/26/93

In a fact sheet addressed to the Chairman, Subcommittee on Regulation and Government Information, Senate Committee on Governmental Affairs, GAO provided trend data for (1) some mission-related indicators, such as voluntary compliance and net revenue collections, that IRS has traditionally used; (2) three of IRS' key enforcement programs—examination, collection, and information returns; and (3) IRS' taxpayer service and returns processing activities. For these same programs and activities, the fact sheet also includes information on (1) recent developments within IRS relating to performance measures and (2) gaps in IRS' management information that were identified in some of GAO's previous work.

The trends included in the fact sheet are generally for fiscal years 1986 through 1991. For several of the more important indicators, such as staffing, obligations, and overall workload, the trends go back to fiscal year 1981.

Most of the indicators included in the fact sheet relate to resources (such as staffing), workload (such as the number of tax returns filed), and output (such as the number of audits completed) as opposed to program results or program impact. This type of focus reflects the level of development of performance measurement at IRS as well as most other government agencies.

In recognition of the need for results/impact-oriented indicators, IRS has started to develop performance measures for its three strategic objectives: (1) increasing voluntary compliance, (2) reducing taxpayer burden, and (3) improving quality-driven productivity and customer satisfaction. IRS also plans to measure how its component parts contribute to accomplishing its mission. Rather than developing performance measures in each of IRS' functional areas, such as Examination and Collection, IRS is developing performance measures for its core business systems. These core business systems encompass what IRS believes are its major business processes and cut across functional lines. For example, the core business system called "ensuring compliance" incorporates work that is currently being done by Examination and Collection as well as IRS' other compliance functions.

Related GAO Product(s)

GAO/T-GGD-92-26, 04/02/92; and GAO/GGD-92-125, 08/13/92

Net Farm Income: Primary Explanations for the Difference Between IRS and USDA Figures

GAO/GGD/RCED-93-113, 06/03/93

In a report to Senator J. Robert Kerrey, GAO discussed what it believed to be the primary explanations for the difference between IRS' and the U.S. Department of Agriculture's (USDA) net farm income figures. In 1989, the most recent year for which comparable data were available, IRS showed net farm income at $4.2 billion, while USDA reported it at $49.9 billion—a difference of $45.7 billion.

GAO identified the following five primary explanations for the difference in these figures: (1) IRS and USDA figures were developed from two different populations, (2) USDA's net farm income figures included noncash income items that were excluded from IRS' figures, (3) IRS and USDA reported some sales of livestock in a different manner, (4) IRS and USDA accounted for depreciation in a different manner, and (5) IRS' net farm income figures were understated because some tax filers erroneously reported farm incomes and expenses.

GAO pointed out that data users must exercise caution when using either agency's aggregate figures to portray the financial condition of U.S. farms. This is necessary because dependence on any one figure could present a misleading picture of the financial conditions of different groups within the farm sector. For instance, in 1989, individual tax filers reported an aggregate net farm loss of $214 million on their tax returns. However, this aggregate figure did not reflect the fact that the only groups of individual tax filers reporting overall net farm losses were those with adjusted gross incomes of less than $10,000, of $15,000 to $20,000, or of $200,000 or more.

Summaries of Tax-Related Products Issued Before Fiscal Year 1993 With Open Recommendations to Congress as of December 31, 1993

Congress May Wish to Consider (1) Directing the Secretary of Transportation to Monitor the Effects of Increasing the Tax-free Limit on Transit Benefits and Taxing Parking and (2) Using This Information to Determine if Additional Legislative Changes Are Desirable

GAO/RCED-92-243, 09/08/92

In a report to congressional requesters, GAO examined the role tax policy plays in commuting decisions. GAO specifically focused on (1) contrasting the tax treatment of mass transit and parking benefits, (2) describing how current tax treatment influenced commuter behavior, (3) assessing whether proposed tax law modifications might encourage mass transit use, and (4) identifying alternative efforts to discourage drive-alone commuting and encourage mass transit use.

GAO reported that, on the whole, federal tax law favors employer-provided parking over employer-provided transit benefits, thus encouraging driving rather than taking mass transit to work. Parking benefits were completely tax exempt for the employee, while transit benefits were taxable income to the employee if the monthly value exceeded $21. GAO said that the difference in the tax treatment of parking and transit benefits reduces the cost of commuting by auto relative to taking mass transit and thereby encourages people to drive to work.

Bills that were pending before Congress would, among other things, increase the tax-free limit for employer-provided transit benefits up to $100 per month and/or begin taxing parking benefits. Employers that provided the increased benefit would effectively lower the cost of riding transit for those who received the benefit. GAO said that while such proposals could increase transit ridership, the size of the potential increase is unknown mainly because it is unclear how many additional employers would offer the benefit or how many employees would take advantage of it.

Some proposed changes in the tax law would treat the value of employer-provided parking that exceeds $145 or $160 per month as a taxable fringe benefit. GAO found that while these tax policy changes could effectively raise the cost of driving for commuters in some cities and might discourage them from driving alone, relatively few drivers would be affected because most parking benefits are worth less than $145 per month.

GAO reported that other efforts to discourage drive-alone commuting and encourage mass transit use were under way at the federal, state, and local levels. For example, (1) employers in some areas will be required by the federal Clean Air Act Amendments of 1990 to reduce drive-alone commuting by employees and (2) some areas have restricted the number of parking places available.

Matter(s) For Congressional Consideration

It is unclear how effective legislative changes in the tax treatment of transportation benefits would be in discouraging drive-alone commuting and encouraging greater reliance on mass transit. Because of the lack of this information, Congress may wish to consider including language in such legislation to direct the Secretary of Transportation to monitor the effects of increasing the tax-free limit on transit benefits and taxing parking. Congress may wish to use this information to determine if additional legislative changes are desirable.

Action(s) Taken And/or Pending

As of December 31, 1993, no congressional action had been taken directing the Secretary of Transportation to monitor the effects of increasing the tax-free limit on transit benefits and taxing parking.

Related GAO Action(s)

The Energy Policy Act of 1992 (P.L. 102-486, dated Oct. 24, 1992) includes provisions to increase the tax-free limit on transit benefits from $21 per month to $60 per month. It also treats the value of employer-provided parking that exceeds $155 per month as a taxable fringe benefit. These actions could encourage greater use of mass transit.

Related GAO Product(s)

GAO/RCED-93-25, 11/13/92

Congress Needs to (1) Clarify the Rules for Classifying Workers Along the Lines That GAO Recommended in Its 1977 Report, by Amending the Law to Exclude From the Common Law Definition of "Employee" Certain Classes of Workers and (2) Consider Legislation to Improve Independent Contractor Compliance Through Withholding and/or Improved Information Reporting

GAO/GGD-92-108, 07/23/92 and GAO/T-GGD-92-63, 07/23/92

At the request of Senators Max Baucus and David Pryor and Congressman Doug Barnard, Jr., GAO reviewed the tax effects of IRS' Employment Tax Examination Program (ETEP). This program focuses on small business compliance with the common law rules for classifying workers as either "employees" or "independent contractors" (self-employed individuals who provide services).

GAO issued its report and testified at a hearing before the Subcommittee on Select Revenue Measures, House Committee on Ways and Means. In both the report and testimony, GAO said the common law rules for classifying workers remain unclear and subject to conflicting interpretations as GAO described in its 1977 report entitled Tax Treatment of Employees And Self-Employed Persons by the Internal Revenue Service: Problems and Solutions. Since then, no final action has been taken to clarify the common law rule.

GAO also reported that independent contractor compliance continued to be a concern. As early as 1979, GAO concluded that noncompliance among self-employed workers, such as independent contractors, was serious enough to warrant tax withholding on payments to them. Since the mid-1970s, IRS studies have documented the lower level of compliance of independent contractors compared to employees. IRS estimated that self-employed individuals (including independent contractors) would underpay $20.3 billion in 1992 taxes by not reporting income.

Because of the continual high tax noncompliance of independent contractors, IRS began the nationwide ETEP in 1988. IRS planned to reduce this noncompliance by requiring businesses to treat misclassified independent contractors as employees subject to withholding taxes. GAO reported that 6,900 ETEP audits through December 1991 proposed assessments of $468 million and reclassified 338,000 workers as employees. Since fiscal year 1989, IRS data have shown that 90 percent of ETEP audits have found misclassified workers.

GAO found that while the classification rules still need clarifying, IRS could use approaches in addition to ETEP to help improve independent contractor compliance. For example, IRS could require businesses to (1) withhold taxes from payments to independent contractors and (2) improve compliance in filing information returns on payments to independent contractors. GAO concluded that either approach should help collect more of the taxes owed through means other than retroactive tax assessments under ETEP. While GAO acknowledged that both approaches would increase the burden on independent contractors and businesses that use them, GAO believed that both approaches have merit.

GAO reported on the pros and cons of each approach. For example, GAO said withholding provides the cornerstone of employees' tax compliance, as well as a gradual and systematic method to pay taxes. GAO also reported that withholding has several administrative problems that need to be resolved—such as ensuring that the tax withheld approximates the tax due.

GAO's second approach—improving information reporting—would shift emphasis to the clearer laws on information returns. IRS' data show that independent contractors reported 97 percent of the income that appears on information returns. Without these returns, contractors reported only 83 percent. GAO assessed eight options for strengthening information reporting, itemizing the various pros and cons of each. GAO largely identified the options through past and ongoing work.

Recommendation(s) to Congress

Congress needs to clarify the rules for classifying workers along the lines that GAO recommended in its 1977 report by amending the law to exclude certain classes of workers from the common law definition of "employee." Congress also should consider legislation to improve independent contractor compliance through withholding and/or improved information reporting.

Action(s) Taken and/or Pending

As GAO completed its report, H.R. 5011—the Employment Tax Improvement Act of 1992—was introduced to revise employment tax procedures and improve information reporting along with the compliance of independent contractors. This bill included many of GAO's eight options as well as others. No further action had been taken as of December 31, 1993.

Related GAO Product(s)

GAO/GGD-89-107, 09/25/89; GAO/GGD-91-94, 08/28/91; and GAO/GGD-77-88, 11/21/77

Congress Should Explore the Level of Tax Evasion With the Responsible Federal Agencies and Affected Industries. If Evasion Is Sufficiently High, Congress Should Consider Moving the Collection of Excise Taxes to the Point at Which Gasoline First Leaves the Refinery or Is First Imported

GAO/GGD-92-67, 05/12/92

In response to a request from Congressmen Downey and McGrath, GAO studied federal motor fuel excise tax compliance and administration. This report discussed (1) the lack of information to determine motor fuel excise tax compliance, (2) the effect of recent legislation on compliance, (3) the effectiveness of IRS programs in promoting compliance, and (4) state initiatives that could be adapted to bolster federal motor fuel excise tax collections.

GAO found that no reliable statistical information was available to estimate the current level of fuel tax evasion. IRS had recognized this problem and was investigating alternative methods for estimating motor fuel excise tax evasion. Although government and private officials involved in the motor fuel distribution and tax system agreed that the legislative changes that have taken effect over the last 5 years have reduced some forms of motor fuel excise tax evasion, disagreements existed about the extent of the reductions.

Because the level of evasion was unknown, GAO could not assess the effectiveness of IRS compliance programs. IRS was working with the Federal Highway Administration and selected states to determine whether joint enforcement efforts could improve compliance with motor fuel excise taxes. IRS was also developing a database containing information on all firms authorized to deal in tax-free motor fuel. The database was to be used by IRS and states in examining compliance and by terminal operators to determine whether firms they do business with are properly registered with IRS and thus eligible to purchase fuels tax-free.

GAO found that the applicability of states' compliance initiatives to federal motor fuel excise tax enforcement was difficult to gauge because of differences between state and federal taxes and collection systems. IRS was considering shifting the motor fuel excise tax collection point to the refinery level, which would be similar to New York State's collection point. GAO concluded that moving the collection point would reduce the number of liable firms and should help minimize the potential for evasion. Industry members, however, disagreed about the desirability of such a move.

Regardless of what the actual level of gasoline tax evasion may be, GAO found strong arguments suggesting that refinery-level taxation could curb evasion more than the current collection scheme. For example:

- Gasoline would change hands fewer times between production and taxation, resulting in larger volume transactions.
- Refiners are presumed to be financially more sound and to maintain better records than other parties in the distribution chain.
- The tax would be imposed on fewer taxpayers, thereby reducing the universe for IRS' examination efforts.

A key question, however, is whether refinery-level tax collection imposes competitive disadvantages. The American Petroleum Institute argued that the cost disadvantages would make the petroleum distribution system less efficient or more reliant on foreign imports. For example, increasing carrying costs for gasoline before it was marketed would create a disincentive to store gasoline, which could result in spot shortages.

GAO concluded that the differences in competitive costs that could be created by moving the point of taxation to the refinery would likely vary on average between 2 cents per barrel (.0005 cents per gallon) for U.S. competitors and 4 cents per barrel (.001 cents per gallon) between U.S. and foreign competitors. GAO did not know whether such cost difference could have a significant effect on competition. In contrast, depending on how extensive evasion is in a particular market, tax-paying firms could face a 14.1 cent per gallon disadvantage compared to tax-evading firms.

Matter(s) for Congressional Consideration

Congress should explore the level of tax evasion with the responsible federal agencies and affected industries. If evasion is sufficiently high, Congress should consider moving the collection of gasoline excise taxes to the point at which gasoline first leaves the refinery or is first imported.

Action(s) Taken and/or Pending

As of December 31, 1993, no congressional action had been taken.

Congress Should Clarify the Law by Expressly Authorizing IRS to Use Administrative Offsets. Congress May Also Want to (1) Specify the Procedural Protections to Be Afforded Taxpayers When IRS Uses the Offset Mechanism and (2) Consider Whether Tax Compliance Should Be Made a Prerequisite to Awarding Federal Contracts

GAO/T-GGD-92-23, 03/17/92

In testimony before the Subcommittee on Oversight, House Committee on Ways and Means, GAO discussed two issues: (1) a component of the accounts receivable—tax delinquencies of federal contractors—and (2) the status of the 1992 tax return filing season.

GAO said that over one quarter of the 26,000 federal contractors it reviewed were delinquent on IRS' records for either the payment of taxes or the filing of tax returns. IRS' records showed that the contractors owed $773 million as of July 1991.

GAO pointed out that the 1986 Tax Reform Act required federal agencies to report information on federal contracts starting in 1987. But Treasury regulations were not finalized until December 1989, and the first submission of usable information was not made until July 1991. GAO found that IRS had not developed procedures to fully use the information received and had no procedure to ensure that all required information was properly reported.

GAO found that IRS had not fully used contract payments as a means to collect delinquent taxes. In those cases in which IRS used contract information, IRS either administratively offset contract payments or levied the payments due the contractor. IRS preferred the administrative offset because it remains in effect until the delinquency is satisfied, whereas a levy applies only to the amount due the contractor at the time the levy is received. A levy has to be reissued to remain in effect. GAO stated that it was unclear whether IRS has the authority to administratively offset contractual payments and suggested that Congress consider clarifying this issue by expressly authorizing administrative offsets of contractual payments.

GAO also pointed out that making tax compliance a prerequisite for awarding federal contracts had potential for preventing and collecting delinquencies. However, current procurement and tax laws preclude denying a contract solely because the contractor has a tax delinquency,

and tax law precludes IRS providing tax compliance information to the contracting agency.

Matter(s) for Congressional Consideration

Congress should clarify the law by expressly authorizing IRS to use administrative offsets. Congress may also want to (1) specify the procedural protections to be afforded taxpayers when IRS uses the offset mechanism and (2) consider whether tax compliance should be made a prerequisite to awarding federal contracts.

Recommendation(s) to IRS

IRS should (1) establish a mechanism to ensure that federal agencies and the General Services Administration's Federal Procurement Data Center report all required information on federal contracts; (2) work with the other federal agencies, including the Department of Defense, to ensure that all required information is shared; and (3) complete the project it has under way to provide guidance to its own staff on how to use federal contract information.

Action(s) Taken and/or Pending

Although there has been no congressional actions on these recommendations, IRS revised its procedures regarding offset and levy in May 1992 to require the use of levies. Under the levy procedures, taxpayers are afforded the protections not provided for under administrative offset. IRS is also investigating the use of an interactive compliance alert response system that would allow for compliance checks prior to awarding contracts and disbursing payments.

IRS developed a review instrument to learn what problems may exist in reporting by federal agencies. IRS intends to use the results of this review to develop solutions, including outreach efforts with other federal agencies. IRS has requested a system change to help ensure that information is shared with all agencies that need it. This change is expected to be completed by January 1994.

Congress Should Clarify the Internal Revenue Code to (1) Specifically Provide IRS Authority to Withdraw a Notice of a Lien When It Is in the Best Interests of the Taxpayer and the Government and (2) Eliminate the Uncertainty Over Whether Taxpayers Should Be Given 21 Days to Correct an Erroneous Levy Under Section 6332(c)

GAO/GGD-92-23, 12/10/91 and GAO/T-GGD-92-09, 12/10/91

In a report to the Chairman, Subcommittee on Private Retirement Plans and Oversight of the IRS, Senate Committee on Finance, GAO assessed IRS' implementation of the 1988 Taxpayer Bill of Rights. GAO also testified on its findings at a Subcommittee hearing held December 10, 1991.

GAO found that IRS had implemented all 21 provisions of the Taxpayer Bill of Rights. GAO focused on seven key provisions and concluded that these provisions had generally been successfully implemented. Despite IRS' general success, GAO found that there were certain shortcomings. Specifically, GAO said that some taxpayers eligible to use the Taxpayer Assistance Order Program may be unaware of the program. Further, although IRS sends copies of a taxpayer's rights guide known as Publication 1, it does not emphasize to taxpayers the importance of reading the publication when contacting them before conducting an audit interview. GAO also said that IRS is inconsistent in notifying taxpayers when it cancels installment agreements, depending upon whether agreements are monitored by service centers or district offices. Finally, GAO pointed out issues that it believes need to be clarified in the Internal Revenue Code to facilitate IRS' implementation of the act.

Matter(s) for Congressional Consideration

Congress may wish to consider clarifying the Internal Revenue Code to (1) specifically provide IRS authority to withdraw a notice of a lien when it is in the best interests of the taxpayer and the government and (2) eliminate the uncertainty over whether taxpayers should be given 21 days to correct an erroneous levy under section 6332(c).

Recommendation(s) to IRS

The Commissioner of Internal Revenue should take several actions to improve implementation of the Taxpayer Bill of Rights. These actions include

- developing testing procedures to determine whether IRS employees successfully identify and manage taxpayers' hardship situations and, when

hardships exist, initiate applications for assistance on the taxpayer's behalf;
- emphasizing the importance of reading Publication 1 when contacting taxpayers by telephone or through correspondence before taxpayers have an audit interview; and
- developing standard procedures for district offices to use when advising taxpayers that their installment agreements are subject to cancellation.

Action(s) Taken and/or Pending

In October 1992, Congress passed the Revenue Act of 1992, which, among other things, contained a provision giving IRS authority to withdraw a notice of a lien when it is in the best interest of the taxpayer and the government. On November 3, 1992, however, the act was vetoed by the President and as of December 31, 1993, no further action had been taken.

IRS agreed with GAO's recommendations and has taken or plans to take action to implement them. For example, IRS is

- developing test questions to evaluate whether IRS employees successfully recognize taxpayers eligible for Taxpayer Assistance Orders,
- revising its audit notification letter to emphasize that taxpayers should read Publication 1 before an audit interview, and
- developing standard procedures for district offices to use when advising taxpayers that their installment agreements are subject to cancellation.

Congress May Wish to Extend the Offset Authority for Expenses IRS Incurred in Undercover Operations, Which Expired on December 31, 1991, and Revise Current IRS Reporting Requirements

GAO/GGD-91-106, 07/03/91

This report responded to section 3301 of the Crime Control Act of 1990. Section 3301 required that GAO study IRS undercover investigative operations that were done using the authority provided in section 7608(c) of the Internal Revenue Code of 1986. This authority exempts IRS undercover operations from certain laws and allows IRS to use the proceeds from the undercover operation to offset necessary and reasonable expenses incurred in the operation. The Crime Control Act required that GAO evaluate (1) IRS' use of the proceeds in these operations, (2) the operations' results, and (3) IRS' financial audits of the operations.

GAO reported that IRS had made limited use of the offset authority, which was due to expire on December 31, 1991. From November 1988 through May 1, 1991, IRS had approved the use of the offset authority in only 19 of its undercover operations—less than 5 percent of the total undercover operations initiated for the same period.

The 19 undercover operations using the offset provision had produced about $545,000 in income. In regards to the income earned, approximately $121,000 was used to offset operational expenditures, $269,000 had not yet been offset against expenditures, and about $155,000 had been returned to the general fund. IRS reported that as of May 1, 1991, undercover operations using the offset provision had resulted in the seizure of over $207 million in cash and significant amounts of drugs, including cocaine and heroin, and 75 convictions.

GAO noted that identifying a direct cause and effect relationship between the financing mechanism provided by the offset authority and the results of a given investigation was difficult, if not impossible, because many variables came into play. However, GAO concluded that the additional funds made available through the use of the offset provision allowed IRS to either undertake more investigations than it could without those funds or to expand the range of activities for each investigation.

GAO raised questions about IRS' control over funds. None of the operations involving the offset provision had met the statutory criteria requiring a detailed financial audit. In some cases, IRS Internal Audit might not have

sufficient access to all the information needed to do a thorough audit because it did not have complete access to information on investigations done under the control of a grand jury. Thirteen of the 19 operations using the offset authority were grand jury cases.

Further, GAO believed that IRS' use of Internal Audit to audit undercover operations using the offset provision should not be limited to those operations meeting a specific dollar threshold. IRS' use of Criminal Investigation Division employees to do audits of offset operations in which activity fell below the prescribed dollar thresholds raised questions of organizational independence, a general standard for government auditing. GAO said that such questions could be avoided by having Internal Audit do all the audits. In addition, the sensitivity of the activities being undertaken and the exemption of the expenditures from normal controls over appropriated funds increased the need for the audits to be done by an independent entity.

GAO also said that Congress' understanding of the use and results of undercover operations involving the offset provision could be enhanced if IRS' reports to Congress contained additional details and were more timely.

Matter(s) for Congressional Consideration

Should Congress decide to extend the offset authority, it might also wish to revise the current IRS reporting requirements. GAO said that (1) expanding the information IRS is required to include in its annual reports to Congress and (2) requiring IRS to report the results of its detailed financial audits after the covert phase of the operation, instead of when the operation is closed, could provide Congress with more timely and complete information on undercover operations involving offsetting. Such reporting should not jeopardize undercover agents' safety or the success of criminal proceedings.

Recommendation(s) to IRS

The Commissioner of Internal Revenue should direct the Chief Inspector to ensure that Internal Audit expands its financial audits to include all undercover operations involving offsetting, regardless of the amount of expenditures or proceeds.

Action(s) Taken and/or Pending

The offset authority expired on December 31, 1991, thereby rendering our recommendations moot. As of December 31, 1993, this authority had not been reinstated.

Congress Should Consider Modifying the Targeted Jobs Tax Credit Program to Require Employers Using the Program to Take Special Actions That Benefit Members of the Targeted Group

GAO/HRD-91-33, 02/20/91

In 1977, Congress established the Targeted Jobs Tax Credit Program to induce employers to favor certain disadvantaged individuals facing barriers to employment. Over the past 10 years, employers had claimed an estimated $4.5 billion in tax credits under the program. Yet, little information was available on the employers using the program or the workers hired under it.

In a report to two subcommittees of the House Committee on Education and Labor, GAO provided descriptive information on employers using the program and the individuals for whom the tax credits were claimed. GAO discussed (1) the extent to which employers made specific efforts to identify, hire, or retain eligible workers; and (2) differences in participants' earnings before and after their involvement in the program.

This tax credit program is intended to increase employment opportunities for members of the targeted groups by providing a financial incentive to employers to recruit, hire, and retain target group members. GAO found that nearly half of the 60 employers it interviewed had made some special effort to do so. The other half had taken advantage of the tax credit without making special efforts to hire members of the targeted groups.

GAO also determined that work experiences had a positive impact on participants' earnings. GAO did not find any substantial differences, however, in earnings changes resulting from participants' work experience when compared with the experience of other workers who were eligible for the program but did not participate.

GAO's analysis of data from 13 states indicated that (1) retail stores and restaurants were the primary users of the tax credit program in 1988 and (2) most of the hirings under the program that year involved youths who were hired to fill entry-level jobs requiring minimal skills and paying low wages.

Matter(s) for Congressional Consideration

If Congress wishes a higher proportion of employers using the Targeted Jobs Tax Credit Program to take special actions that benefit members of the targeted groups, it could modify the program by imposing new

requirements. For example, program requirements might involve employer outreach efforts to eligible populations, prescreening to determine eligibility before the hiring decision, or providing additional training or supervision to eligible workers to increase the likelihood of retention.

Action(s) Taken and/or Pending

No legislative action had been taken on this matter as of December 31, 1993.

Congress Should Consider Revising the Criteria for Tax Exemption if It Wishes to Encourage Nonprofit Hospitals to Provide Charity Care and Other Community Services

GAO/HRD-90-84, 05/30/90 and GAO/T-HRD-90-45, 06/28/90

In a report to and testimony before the House Select Committee on Aging, GAO discussed the role of nonprofit hospitals in providing (1) acute medical care to indigents and (2) other community services, such as health education and screening. Private nonprofit hospitals, which account for about one half of the nation's hospitals, are exempt from federal taxation if they meet certain tests established by IRS. Until 1969, the test for tax-exempt status included specific reference to providing services to those unable to pay. Since then, IRS has not required such care as long as the hospital provides benefits to the community in other ways.

GAO analyzed the distribution of uncompensated care among hospitals in five states to assess the role of nonprofit hospitals in supplying such care. GAO found that

- nonprofit hospitals provided a smaller share of their states' uncompensated care than they provided of general hospital services;
- uncompensated care expenses were not distributed equally among the nonprofit hospitals but were disproportionately concentrated in large urban teaching hospitals;
- among the rest of the nonprofit hospitals, the tendency was for those hospitals with the greatest ability to finance charity care to have the lowest rates of uncompensated care; and
- about 57 percent of the nonprofit hospitals in the five states incurred charity care costs that amounted to less than GAO's estimate of the value of the hospitals' tax exemptions.

GAO noted that (1) some hospitals' goals did not focus on the health needs of the poor or underserved in their community, (2) physician staffing and charity admissions policies discouraged indigent admissions except in emergency cases, and (3) nonprofit hospitals were more likely than investor-owned hospitals to offer community services but were equally likely to charge patients for those services and more likely to recover their costs.

Matter(s) for Congressional Consideration

Currently, there are no requirements relating hospitals' charitable activities for the poor to tax-exempt status. If Congress wishes to encourage nonprofit hospitals to provide charity care to the poor and

underserved and other community services, it should consider revising the criteria for tax exemption. Criteria for exemption could be directly linked to a certain level of (1) care provided to Medicaid patients, (2) free care provided to the poor, or (3) efforts to improve the health status of underserved portions of the community.

Action(s) Taken and/or Pending

Although several bills to establish charity care standards for tax-exempt hospitals have been introduced, none were enacted as of December 31, 1993. IRS, however, revised and strengthened its examination guidelines for examining large multientity exempt hospital systems and increased its tax-exempt hospital examination activities since GAO reported on the issue.

Congress Should Consider Restricting the Use of Low-Income Housing Tax Credits Generally to Areas Where Vacancy Rates Are Low for Suitable Units Renting at or Below the Area's Fair Market Rents

GAO/T-RCED-90-34, 02/27/90 and GAO/RCED-90-168, 06/19/90

In response to a request from the Chairman of the Subcommittee on HUD/Moderate Rehabilitation Investigation, Senate Committee on Banking, Housing and Urban Affairs, GAO provided information on the financial implications of combining subsidies under the Department of Housing and Urban Development's (HUD) Section 8 Moderate Rehabilitation Program and the Department of the Treasury's Low-Income Housing Tax Credit Program. In February 1990, GAO testified on one of those projects. In June 1990, GAO reported on eight specific housing projects.

GAO reported that (1) developers for the eight projects realized cash proceeds that exceeded their costs for acquiring and rehabilitating the properties by 11 to 34 percent and (2) developers generated the proceeds by selling their ownership interests in the projects, along with the related tax credits, and combining them with mortgage loans secured by moderate rehabilitation rental subsidies.

GAO said that (1) by combining rehabilitation subsidies and tax credits, developers received more assistance than needed to ensure the projects' financial viability or to compensate them for their limited financial risk, (2) the use of both programs was questionable because the projects were located in areas with ample vacant units and with rents generally well below the established rents for the eight projects, and (3) it would have been more economical to rely on existing rental housing subsidized by certificates and/or vouchers under HUD's Certificate and Voucher Programs rather than developing the eight projects GAO reviewed.

GAO noted that Congress and HUD had taken steps to better control subsidies under the Moderate Rehabilitation and Tax Credit Programs. Those changes (1) limited the amount of subsidies allowable and the way they could be used, (2) placed greater responsibility on state credit-allocation agencies, and (3) prohibited the use of tax credits in conjunction with the Section 8 program.

Matter(s) for Congressional Consideration

Congress may wish to consider restricting the use of tax credits generally to areas where vacancy rates are low for suitable units renting at or below the area's fair market rents. Congress could further require that any

deviation from this policy by a state credit-allocation agency be documented and subject to review by an authorized representative of the federal or state government.

Action(s) Taken and/or Pending

The Omnibus Budget Reconciliation Act of 1990 required (1) the Secretary of the Treasury and HUD's Inspector General to jointly conduct a study on the combined use of the low-income housing tax credit and the Section 8 Moderate Rehabilitation Program funds and (2) states to develop tax credit allocation plans that would include priorities for targeting the credits. State allocation plans include this new targeting requirement, thereby providing a basis for GAO to assess whether this alternative action responds to the recommendation. Low-income housing tax credits were made permanent on August 10, 1993, with the signing of the Budget Reconciliation Act of 1993.

Summary of Related Action(s)

HUD revised its program policies and guidelines to require that when projects are to receive tax credits in conjunction with HUD subsidies, HUD must consider the value of the tax credit and adjust accordingly the amount of other subsidies awarded to the project. In addition, HUD revised its program policies to target housing subsidies to geographic areas with low unit vacancies.

Congress May Wish to Periodically Reconsider the Preferential Tax Treatment Given to Interest That Is Earned on Life Insurance and Deferred Annuity Contracts, Weighing Social Benefits Against Revenue Forgone

GAO/GGD-90-31, 01/29/90

In a report to the Chairmen of the Senate Committee on Finance and the House Committee on Ways and Means, GAO responded to section 5014 of the Technical and Miscellaneous Revenue Act of 1988. Section 5014 called for GAO to report on (1) the effectiveness of the revised tax treatment of life insurance products in preventing the sale of life insurance primarily for investment purposes and (2) the policy justification for, and the practical implications of, the current tax treatment of earnings accruing on the cash surrender value of life insurance and annuity contracts in light of the Tax Reform Act of 1986.

Under current law, interest earned on life insurance and deferred annuity contracts, commonly referred to as "inside buildup," is not taxed as long as it accumulates within the contract. By choosing not to tax the interest as it is earned, the federal government forgoes an estimated $5 billion in tax revenue each year. Also, as a result of this preferential tax treatment, there are incentives to design life insurance and annuity products that are targeted more toward generating investment income than toward providing insurance protection.

GAO found that recent changes in the definition of life insurance had reduced the sales of single-premium policies but said it was more difficult to evaluate the effect on other investment-oriented life insurance products.

GAO noted that the most convincing policy justification for the current tax treatment of accrued interest is that it lowers the cost of providing insurance and retirement income protection. Even if more is spent on life insurance and annuity protection as a result of this tax preference, it is not clear that the revenue loss is justified. In addition, although borrowing against the cash value of life insurance is not taxed, it reduces the protection afforded beneficiaries. As a result, the current tax treatment, which allows the borrowing of life insurance accrued interest without tax, appears inconsistent with (1) the goal of fostering increased protection and (2) the tax treatment of similar products, such as Individual Retirement Accounts and 401(k) plans.

Recommendation(s) to Congress

Because the pattern of policy usage as well as the type of products offered can change, Congress may wish to periodically reconsider its policy decision to grant preferential tax treatment to inside buildup, weighing the social benefits against the revenue forgone. If Congress decides not to tax inside buildup, it should eliminate tax-free borrowing of life insurance proceeds. Any borrowing of those proceeds should be considered a distribution of interest income. To offset the advantages of accruing interest income without tax, a penalty provision needs to be added to the regular tax. Since repayment of the amount borrowed restores the death benefits, any amount that is taxed when it is borrowed should be tax deductible if subsequently repaid.

Action(s) Taken and/or Pending

As of December 31, 1993, no legislative action had been taken.

Congress Should Repeal Internal Revenue Code Section 809 Dealing With Policyholder Dividends Paid by Life Insurance Companies and Designate What Portion of These Dividends Consists of Distributed Earnings

GAO/GGD-90-19, 10/19/89 and GAO/T-GGD-90-03, 10/19/89

In a report to the Chairmen of the Subcommittees on Health and on Select Revenue Measures, House Committee on Ways and Means, and in testimony before the Select Revenue Measures Subcommittee, GAO discussed (1) the effect of section 809 of the Internal Revenue Code on the income tax split between stock and mutual life insurance companies and within the mutual segment itself and (2) alternative methods of taxing mutual life insurance companies. Congress enacted section 809 to make the taxation of mutual companies more parallel to that of stock companies.

GAO found that section 809 imposed taxes that (1) were higher for the mutual companies as a whole in years when their earnings were low and vice versa, (2) were regressive on the basis of company income because averages for all mutual companies dictated each firm's taxes, and (3) depended disproportionately on the behavior and performance of the larger mutual companies. GAO also found that for 1984 through 1987, the mutual stock split in taxes produced by the section 809 approach was consistent with the mutual stock split in income.

After examining various alternatives, GAO concluded that the most equitable approach would be to repeal section 809, allow mutual life insurance companies to deduct all policyholder dividends in determining corporate taxable income, and tax policyholders on the earnings part of certain dividends.

Recommendation(s) to Congress

Congress should repeal section 809 and designate what portion of policyholder dividends paid by life insurance companies consists of distributed earnings. For administrative reasons, companies would pay the tax as a proxy for individual policyholders.

Action(s) Taken and/or Pending

GAO's proposal and a number of others have been part of the ongoing discussion about the tax treatment of mutual life insurance companies. However, as of December 31, 1993, no legislative action had been taken.

Legislative Actions Taken in 1993 on GAO Recommendations

Congress Should Amend the Internal Revenue Code to Allow HUD Temporary Access to Federal Tax Data to Validate Its Cost-Benefit Analysis of Using Tax Data to Identify Subsidized Households' Misreporting of Income

GAO/HRD-92-60, 07/17/92

In response to a request from the Chairman, Subcommittee on Housing and Urban Affairs, Senate Committee on Banking, Housing and Urban Affairs, GAO did a study to determine whether the Department of Housing and Urban Development (HUD) has sufficient internal controls to ensure that families in federally subsidized public and Section 8 housing accurately reported their income. GAO found that HUD lacks sufficient information to ensure that federally subsidized housing units are occupied by needy, low-income families and that those living in such units are paying correct rents. Public housing agencies and management agents cannot effectively verify the accuracy of most subsidized households' self-reported wage, interest, and dividend income.

GAO's computer match of approximately 175,000 HUD-subsidized households' records (less that 4 percent of such records) with federal tax data revealed that in 1989, 21 percent of the matched households may have understated their incomes to HUD by $138 million. This would have resulted in potential excess federal subsidies of $41 million. In regards to households that may have understated their incomes, 63 percent reported no wage, interest, or dividend income in 1989.

Recommendation(s) to HUD

To gain access to tax data, HUD should (1) incorporate in its assisted housing information systems appropriate data safeguards and (2) conduct a cost-benefit analysis of using tax data to identify subsidized households' misreporting of income and report the results to Congress.

Recommendation(s) to Congress

When HUD's centralized public housing information system is fully operational and data safeguards are in place, Congress should amend the Internal Revenue Code to allow HUD temporary access to federal tax data to validate its cost-benefit analysis. If HUD's use of tax data is indeed cost beneficial, Congress should further amend the Internal Revenue Code to broaden and make permanent HUD's access to federal tax data, including its use in the Section 8 program when that program's centralized management information system becomes fully operational.

Action(s) Taken and/or Pending	The Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66, effective Aug. 10, 1993), grants HUD temporary access to federal tax data for income verification under certain housing assistance programs in section 13404. HUD plans to upgrade its automated systems, including appropriate safeguards for tax data, in late 1994.

Congress Should Consider Revising the Current Tax Law to Provide for Amortization of Purchased Intangible Assets, Including Goodwill, Over Specific Statutory Cost Recovery Periods

GAO/GGD-91-88, 08/09/91

One of the oldest controversies between taxpayers and IRS is the extent to which taxpayers can deduct the price they pay for intangible assets, such as customer or subscription lists. The general rule is that the cost of an intangible asset can be amortized over its useful life. Purchased goodwill and other intangible assets without determinable useful lives, however, are not amortizable. Taxpayers are supposed to determine the specific useful life for each intangible asset separately. The taxpayer's determination of useful life is questioned only when IRS performs an audit. IRS frequently contends that many intangible assets are in fact purchased goodwill and not amortizable. However, taxpayers assert that the assets are not goodwill, the determined useful lives are accurate, and the intangible assets are eligible for amortization.

The opportunities for disputes between taxpayers and IRS intensified during the 1980s, when business acquisition activity increased and led to a growth in the reported value of intangible assets from about $45 billion in 1980 to $262 billion in 1987. As a result, billions of dollars of potential tax deductions and, therefore, tax revenues were affected by decisions on whether tax deductions for intangible asset costs were permitted.

In response to a request from the Joint Committee on Taxation, GAO provided information on the types of deductible intangible assets, the asset values and useful lives claimed, and the industries affected. GAO also explored various proposals for revising intangible asset tax rules, which had not significantly changed since 1927.

GAO analyzed tax data IRS gathered in 1989 on all of its unresolved, or open, purchased intangible asset cases. Taxpayers in nine industry groups had claimed deductions for 175 types of purchased intangible assets that they identified as different from goodwill and valued at $23.5 billion. In 70 percent of the cases in which taxpayers claimed that intangible assets had a determinable useful life, IRS claimed that the assets were in fact goodwill and not amortizable. In total, IRS proposed adjustments of about $8 billion on the basis of its evaluation of the value, useful life, or classification of intangible assets. The final outcome of these cases will depend on IRS' or the courts' interpretation of facts related to each asset.

GAO concluded that disagreements between taxpayers and IRS over which intangible assets may be amortized would continue unless changes were made in the current rules. GAO said that the current tax treatment of goodwill and similar intangible assets failed to recognize the economic benefits that wasting intangible assets contribute over time. These assets are consumed over time even if a precise period cannot be determined. Denying amortization deductions does not result in an accurate determination of taxable income since expenses are not properly matched to income generated. Recognition of these economic benefits over time for tax purposes could be accomplished, according to GAO, by establishing specific statutory cost recovery periods for purchased intangible assets similar to those used for tangible assets.

Matter(s) for Congressional Consideration

Congress should consider revising the current tax law to provide for amortization of purchased intangible assets, including goodwill, over specific statutory cost recovery periods.

Action(s) Taken and/or Pending

The Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66, dated Aug. 10, 1993) revised the tax law to, among other things, allow taxpayers to amortize certain purchased intangible assets, including goodwill, over 15 years.

Related GAO Product(s)

GAO/NSIAD-88-56BR, 12/28/87 and GAO/T-GGD-92-1, 10/02/91

Congress Should Make Several Tax-Related Changes to the Debt Collection Act to Help Alleviate the Government's Credit Management Problems

GAO/AFMD-90-12, 04/16/90

At the request of Congressman John R. Kasich, GAO reviewed the efforts of selected federal agencies, including IRS, to implement the Office of Management and Budget's nine-point credit management program. That program's nine points include such things as (1) screening loan applicants, (2) reporting to consumer reporting agencies, (3) using collection firms, (4) offsetting federal income tax refunds, and (5) writing off delinquent debts. GAO focused on selected programs at the five primary credit agencies—the Small Business Administration and the departments of Agriculture, Housing and Urban Development, Education, and Veterans Affairs.

GAO noted the progress agencies had made over the past several years in certain credit management areas. GAO also cited some problems. For example, agencies were not always (1) checking to see if loan applicants were delinquent in paying taxes or (2) reporting closed-out debts to IRS as income to the debtor.

Recommendation(s) to Congress

Because of the magnitude of the government's credit management problems, Congress should amend the Debt Collection Act in a number of ways. The tax-related changes would involve (1) screening loan applicants to determine credit worthiness and ability to repay and to determine if the applicants owe delinquent debts to the federal government, including IRS; (2) referring all appropriate debts to IRS for the purpose of offsetting delinquent debtors' tax refunds; and (3) reporting closed-out debts to IRS as income to the debtor.

Congress should legislatively direct the Secretaries of Housing and Urban Development and Veterans Affairs and the Administrators of the Farmers Home and Small Business Administrations, in coordination with IRS, to test the use of consent forms for obtaining and using tax information in the loan-making process. The affected agencies could designate selected programs, including those with guaranteed loans, for participation in the test. Congress should also require IRS to disclose address information to agencies pursuing debt collection activities under authorities in addition to the Federal Claims Collection Act.

Action(s) Taken and/or Pending

Congress implemented some of GAO's recommendations to improve the government's credit management. The Emergency Unemployment Compensation Act of 1991 (P.L. 102-164, dated Nov. 15, 1991) provides permanent authority for collecting nontax debts by reducing debtors' tax refunds; the Cash Management Improvement Act Amendments of 1992 (P.L. 102-589, dated Nov. 10, 1992) requires the referral of debts to IRS for the purpose of offsetting delinquent debtors' tax refunds; and the Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66, dated Aug. 10, 1993) requires the applicable financial entities to report discharged debts to IRS as income to the debtor.

Listing of Open Recommendations to Congress Before and During Fiscal Year 1993

Listing of Recommendations Made in Fiscal Year 1993 to the Commissioner of Internal Revenue and to Other Agency Heads

Accounts Receivable and Collection Activities

Compliance

Chronological Listing of GAO Products on Tax Matters Issued in Fiscal Year 1993

Tax Systems Modernization: IRS' Use of Consultants to Do the TMAC Price/Technical Trade-off Analysis (GAO/IMTEC-93-4BR)	10/23/92
Money Laundering: State Efforts to Fight It Are Increasing But More Federal Help Is Needed (GAO/GGD-93-1)	10/15/92
Implementation of IRS Employee Suggestions (GAO/GGD-93-22)	11/24/92
IRS Can Improve Controls Over Electronic Filing Fraud (GAO/GGD-93-27)	12/30/92
Internal Revenue Service Receivables (GAO/HR-93-13)	12/92
Internal Revenue Service Issues (GAO/OCG-93-24TR)	12/92
Overstated Real Estate Tax Deductions Need to Be Reduced (GAO/GGD-93-43)	01/19/93
Tax Administration: Opportunities to Increase the Use of Electronic Filing (GAO/GGD-93-40)	01/22/93
Status of Tax Systems Modernization, Tax Delinquencies, and the Tax Gap (GAO/T-GGD-93-04)	02/03/93
Government Management: Status of Progress in Correcting Selected High-Risk Areas (GAO/T-AFMD-93-1)	02/03/93
Review of Tax-Exempt Insurance Companies (GAO/GGD-93-11R)	02/08/93
Tax Administration: Information Returns Can Improve Reporting of Forgiven Debts (GAO/GGD-93-42)	02/17/93
Tax Systems Modernization: Comments on IRS' Portion of President's Request for Fiscal Year 1993 Supplemental Funds (GAO/T-IMTEC-93-1)	02/24/93
Tax Administration: Erroneous Dependent and Filing Status Claims (GAO/GGD-93-60)	03/19/93
Tax Administration: Delayed Tax Deposits Continue to Cause Lost Interest for the Government (GAO/GGD-93-64)	03/22/93
International Taxation: Updated Information on Transfer Pricing (GAO/T-GGD-93-16)	03/25/93
Tax Policy: Many Factors Contributed to the Growth in Home Equity Financing in the 1980s (GAO/GGD-93-63)	03/25/93
IRS Tax Identity Data Can Help Improve SSA Earnings Records (GAO/HRD-93-42)	03/29/93
Earned Income Credit: Effectiveness of Design and Administration (GAO/T-GGD-93-20)	03/30/93
Tax Systems Modernization: Program Status and Comments on IRS' Portion of President's Request for Fiscal Year 1993 Supplemental Funds (GAO/T-IMTEC-93-3)	03/30/93
1992 Annual Report on GAO's Tax-Related Work (GAO/GGD-93-68)	03/31/93
IRS' Plans to Measure Tax Compliance Can Be Improved (GAO/GGD-93-52)	04/05/93
Collection and Exchange of Data by the IRS and the U.S. Customs Service (GAO/GGD-93-33R)	04/06/93
Information on Tax Counseling for the Elderly Program (GAO/GGD-93-90BR)	04/08/93
Industrial Development Bonds: Achievement of Public Benefits Is Unclear (GAO/RCED-93-106)	04/26/93
IRS' Test of Tax Return Filing by Telephone (GAO/GGD-93-91BR)	04/26/93
Examples of Waste and Inefficiency in IRS (GAO/GGD-93-100FS)	04/27/93
Implementation of Actions Involving IRS Correspondence in Responding to Taxpayers (GAO/GGD-93-38R)	04/27/93
Tax Administration: Achieving Business and Technical Goals in Tax Systems Modernization (GAO/T-GGD-93-24)	04/27/93
Tax Systems Modernization: Comments on IRS' Fiscal Year 1994 Budget Request (GAO/T-IMTEC-93-6)	04/27/93
IRS' Budget Request for Fiscal Year 1994 (GAO/T-GGD-93-23)	04/28/93
IRS Can Improve the Federal Tax Deposit System (GAO/AFMD-93-40)	04/28/93

(continued)

Selected IRS Forms, Publications, and Notices Could Be Improved (GAO/GGD-93-72)	04/30/93
Value-Added Tax: Administrative Costs Vary With Complexity and Number of Businesses (GAO/GGD-93-78)	05/03/93
Recurring Tax Issues Tracked by IRS' Office of Appeals (GAO/GGD-93-101)	05/04/93
Improved Staffing of IRS' Collection Function Would Increase Productivity (GAO/GGD-93-97)	05/05/93
IRS Significantly Overstated Its Accounts Receivable Balance (GAO/AFMD-93-42)	05/06/93
Improvements for More Effective Tax-Exempt Bond Oversight (GAO/GGD-93-104)	05/10/93
Implications of Replacing the Corporate Income Tax With a Consumption Tax (GAO/GGD-93-55)	05/11/93
New Delinquent Tax Collection Methods for IRS (GAO/GGD-93-67)	05/11/93
IRS Activities to Increase Compliance of Overseas Taxpayers (GAO/GGD-93-93)	05/18/93
Review of the Internal Revenue Service's Information Systems Management Organization (GAO/GGD-93-37R)	05/25/93
Trends for Certain IRS Programs (GAO/GGD-93-102FS)	05/26/93
Net Farm Income: Primary Explanations for the Difference Between IRS and USDA Figures (GAO/GGD/RCED-93-113)	06/03/93
Tax Policy: Puerto Rico and the Section 936 Tax Credit (GAO/GGD-93-109)	06/08/93
International Taxation: Taxes of Foreign- and U.S.-Controlled Corporations (GAO/GGD-93-112FS)	06/11/93
Public Housing: Projects Developed With Low-Income Housing Tax Credit Differ From Traditional Public Housing Development Projects (GAO/T-RCED-93-54)	06/17/93
Long-Term Care Insurance: Tax Preferences Reduce Costs More for Those in Higher Tax Brackets (GAO/GGD-93-110)	06/22/93
Examination of IRS' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-2)	06/30/93
Public Housing: Low-Income Housing Tax Credit as an Alternative Development Method (GAO/RCED-93-31)	07/16/93
Information Reporting of Interest Payments Using IRS Form 1099-INT (GAO/GGD-93-55R)	07/22/93
Financial Management: First Financial Audits of IRS and Customs Revealed Serious Problems (GAO/T-AIMD-93-3)	08/04/93
IRS Lacks Accountability Over Its ADP Resources (GAO/AIMD-93-24)	08/05/93
Tax Administration: Computer Matching Could Identify Overstated Business Deductions (GAO/GGD-93-133)	08/13/93
Improving Compliance With Real Estate Tax Deductions (GAO/T-GGD-93-46)	09/21/93
IRS Information Systems: Weaknesses Increase Risk of Fraud and Impair Reliability of Management Information (GAO/AIMD-93-34)	09/22/93
Corporate Taxes: Many Benefits and Few Costs to Reporting Net Operating Loss Carryover (GAO/GGD-93-131)	09/23/93
Tax Policy: Earned Income Tax Credit: Design and Administration Could Be Improved (GAO/GGD-93-145)	09/24/93
Tax Systems Modernization: Time Tables for Critical Planning Documents (GAO/AIMD-93-81FS)	09/30/93

Listing of Assignments for Which GAO Was Authorized Access to Tax Data in Fiscal Year 1993 Under 26 U.S.C. 6103(i)(7)(a)(i)

Subject matter	Objectives
IRS' Actions to Implement the "One Stop Service" Initiative	To assess the quality and consistency of the assistance IRS provides to individual taxpayers nationwide.
IRS' Consolidated Statement of Financial Position on September 30, 1993	To (1) determine extent of financial management and internal control problems needing correction, (2) identify needed audit procedures to opine on fiscal year 1993 financial statements, (3) assist IRS in preparing appropriate financial statements, and (4) analyze available data maintained on IRS operations to attest to the adequacy of such data.

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