

United States General Accounting Office

**GAO**

Report to the Acting Assistant  
Commissioner (Collection), Internal  
Revenue Service

March 1989

**TAX  
ADMINISTRATION**

**Improving IRS'  
Business Nonfiler  
Program**



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

General Government Division

B-229469

March 8, 1989

Mr. Paul M. Harrington  
Acting Assistant Commissioner (Collection)  
Internal Revenue Service

Dear Mr. Harrington:

On May 24, 1988, we issued a report entitled Tax Administration: IRS Could Reduce the Number of Unproductive Business Nonfiler Investigations (GAO/GGD-88-77). In that report, we made a number of recommendations for improving the business nonfiler program. After completing this assignment, we received additional data on business nonfilers from the state of California and IRS. On the basis of our analysis of these data, we believe additional improvements to the business nonfiler program can be made.

## Results in Brief

California state employment tax information could be helpful in IRS' business nonfiler program. Using this information, we analyzed 100 business nonfiler cases that IRS closed without securing returns or collecting any taxes because the businesses said that they were not liable for employment taxes. Our analysis showed that

- 21 of the businesses did pay wages during the period under investigation and owed approximately \$243,000 in federal employment and withholding taxes, and
- 79 of the businesses had provided information to California showing that they did not pay wages during the periods under investigation.

Our sample is not projectable because of its small size. However, the sample results indicate that California state employment tax information could be helpful to IRS to (1) verify businesses' statements about their employment tax liabilities and (2) expedite closure of nonfiler investigations that have little or no federal employment tax liability.

Another opportunity for improvement concerns eliminating the mailing of Publication 393, "Federal Employment Tax Forms," to known invalid addresses. This publication contains various employment tax forms that, among other things, should remind the business of its filing responsibilities in the event it employs workers. We were not able to quantify the extent and cost of the problem. However, our review of 14 nonfiler investigations closed "unable to locate" showed that IRS, because of a

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computer code, mailed Publication 393 to all 14 businesses even though IRS investigators determined the mailing addresses were no longer valid.

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## **IRS Could Use California State Tax Data to Verify Business Statements About Employment Tax Liability**

IRS has agreements to exchange tax information on individual businesses with state employment departments and other state taxing agencies. While IRS recognizes that state employment tax data are useful for locating delinquent businesses, IRS generally does not use such information to verify taxpayer statements about their employment tax liability or to determine the potential tax liability of employers who fail to file employment tax returns.

To test the benefits of using state employment tax information, we requested through IRS tax information from California's Employment Development Department on 201 randomly selected California businesses that IRS had identified as potential nonfilers of quarterly and annual employment tax returns (Forms 941 and 940). IRS had closed these 201 nonfiler investigations without obtaining returns or collecting any taxes because the businesses said they did not pay wages during the periods in question.

California did not have any employment tax records on 101 of the businesses, but our analysis of the tax records that California provided IRS on the other 100 businesses showed that California state employment tax information could be used to verify statements business representatives make about their tax liability as well as to estimate the businesses' potential federal employment tax liability. Under IRS procedures, nonfiler investigations may be closed without further verification when businesses say they have no tax liability. For example, the Internal Revenue Manual says that, in general, nonfiler investigations should be closed if the business responds that no return and no taxes are due or that the business did not begin operations until after the return period.

However, for 21 of the 100 businesses for which California state tax information was obtained, the state information contradicted the businesses' statements of no employment tax liability. State employment tax returns filed with California showed that the businesses were liable for 31 delinquent federal employment tax returns because they paid wages during the return periods under investigation. For example, in one of the sample cases, IRS had closed two quarterly tax return delinquencies as "not liable" because the business said that it had paid no wages during the periods in question. However, state return information showed the

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business paid wages in both of the delinquent quarters that amounted to \$26,500.

To estimate the federal tax liabilities of the 21 businesses, we applied a tax estimation formula used by IRS' San Francisco District to the wages shown on the state employment tax return. Using that formula, we estimate that the 21 businesses owed federal taxes amounting to about \$243,000.

In addition to identifying erroneous taxpayer statements, California employment tax records could have been used by IRS to more expeditiously close 79 investigations on which we obtained state tax information. IRS investigators could have closed these 79 investigations more expeditiously if they had the state tax information at the time of their investigations since the state tax information showed the businesses did not pay wages during the periods under investigation. Specifically, the state tax records showed that

- 15 of the businesses went out of business before the periods under investigation;
- 44 of the businesses did not file state tax returns or pay wages for the periods under investigation, and the state information showed the business had no federal employment tax liability; and
- 20 of the businesses filed state tax returns showing zero wages paid for the periods under investigation or had previously notified the state that they had no employees for the period under investigation.

For example, on one of the sampled investigations, IRS was seeking quarterly employment tax returns for two quarters: the fourth quarter of 1984 and the first quarter of 1985. IRS sent notices, tried to telephone, and finally visited the business owner only to learn that the business closed before these periods. IRS could have closed this investigation much earlier and without the numerous attempts to contact the taxpayer had it sought information from California since the state had records showing that the business went defunct in September 1984 and thus owed no federal employment taxes.

IRS San Francisco District Collection Division officials reviewed our sample cases and agreed with our conclusions. IRS San Francisco District investigators said they have found California state employment tax information to be very reliable when they have used it. They said that if IRS obtained the information on a regular basis and made it available at the initiation of a delinquency investigation, the information would be of

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great value to them. They said that such information would help them (1) more quickly determine the potential federal employment tax liability, (2) establish priorities for their nonfiler investigations, and (3) identify and counter false taxpayer statements of no liability.

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## Recommendation

We recommend that you direct IRS collection staffs in the California district offices to use California state employment tax information in business nonfiler investigations and explore similar opportunities for using other states' tax information in the business nonfiler program.

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## IRS Could Avoid Mailing Information to Invalid Addresses

IRS mails Publication 393 to business addresses that investigators have already determined to be invalid. That is, the investigator was unable to locate the business at the address recorded on IRS' master file, and the Postal Service had no forwarding address for the business.

When IRS determines that a business is no longer required to file employment tax returns because, for example, it does not have employees, it sends the business Publication 393. Publication 393 contains various employment tax forms that (1) should remind the business of its filing responsibilities in the event it again employs workers and (2) provide the business the proper form for correcting information erroneously submitted on previously filed employment tax returns.

To avoid generating unproductive delinquency investigations, IRS deletes filing requirements when businesses file final returns, notify IRS that they have closed, or no longer have employees. Similarly, IRS will suspend the filing requirements for businesses that it could not locate in employment tax return delinquency investigations. IRS records this status information on its computers and uses one computer code for deletions and another for suspensions. Both codes generate a third code that identifies the business as one that should receive Publication 393. This code, however, does not distinguish between deletion and suspension cases and, for suspension cases, results in the publication being mailed to invalid addresses.

We analyzed 14 quarterly employment tax return delinquency investigations that were closed "unable to locate" to determine if they would be sent Publication 393. Our analysis showed that the computer code indicating that the businesses would be mailed Publication 393 was on the business master file of all 14 businesses. Publication 393, therefore, would automatically be mailed to the business addresses that were on

the master file even though IRS investigators had already determined they were invalid.

In 1986, IRS sent out approximately 800,000 Publication 393s to businesses that had been subjected to nonfiler investigations. IRS does not know how many Publication 393s were sent to businesses whose employment tax filing requirements were suspended because the businesses could not be located as opposed to those whose filing requirements were deleted. Without this information, we cannot readily estimate how much the erroneous mailings are costing IRS.

However, it appears that all businesses identified in the nonfiler program as "unable to locate" would be mailed Publication 393. IRS' National Office computer services officials said that the computer code that causes the publication to be mailed is part of a national computer program and affects all IRS district offices.

IRS' National Office computer services officials said that reprogramming to distinguish between businesses that are no longer liable for employment tax returns and those that IRS was unable to locate would probably not be very difficult or costly.

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## Recommendation

We recommend that you direct the appropriate collection staff to work with computer services staff to correct the computer coding problem so that Publication 393 is not mailed to invalid addresses.

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## Objectives, Scope, and Methodology

Our objectives were to determine if state employment tax information would be more useful in IRS' business nonfiler investigations and to determine if IRS was sending Publication 393 to known invalid addresses.

To determine if state tax records would benefit business nonfiler investigations, we requested and analyzed state employment tax information on 201 randomly selected businesses from California that IRS had identified as potential nonfilers. To determine if IRS was sending Publication 393 to known invalid addresses, we analyzed master file transcripts of 14 business nonfiler investigations that were closed "unable to locate." We did our work at the IRS National Office in Washington, D.C.; Western Region and San Francisco District Offices in San Francisco, California;

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Fresno Service Center in Fresno, California; Oakland Automated Collection System Call Site in Oakland, California; and the California Employment Development Department in Sacramento, California. We did our field work during the period September 1987 through January 1988 in accordance with generally accepted government auditing standards.

We discussed the report's findings and recommendations with officials in your office. They generally agreed with the opportunities to improve the business nonfiler program. They said that they will examine how to obtain California state employment tax data on a regular and, if possible, automated basis to assist in business nonfiler investigations. They further said that they plan to determine what specific changes are needed to correct the problem of mailing Publication 393 to invalid addresses.

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We appreciate the support and cooperation of your staff during this review. Major contributors to this report are listed in the appendix. If you have any questions regarding this information, please phone Gerald Stankosky on 272-7904.

Sincerely yours,



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# Major Contributors to This Report

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