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GAO

Fact Sheet for the Chairman, Committee on the Budget, House of Representatives

July 1990

# BUDGET ISSUES

# Effects of the Fiscal Year 1990 Sequestration on the Internal Revenue Service



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GAO

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General Government Division

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The Honorable Leon Panetta
Chairman, Committee on the Budget
House of Representatives

Dear Mr. Chairman:

In your January 2, 1990, request, you asked us to study the effects of the fiscal year 1990 sequestration on the operations of the Department of Health and Human Services and four or five other federal departments. The Committee later requested that we include the Internal Revenue Service (IRS) as one of the other agencies. This fact sheet presents information on the sequestration at IRS and is one of a series of case studies responding to your request.

## Results in Brief

IRS was required to sequester $46 million of its original fiscal year 1990 appropriation of about $5.5 billion. IRS administers four sequestrable appropriation accounts; only two of them were sequestered. The Processing Tax Returns account was reduced by 1.3 percent, or about $25 million, and the Investigations, Collection, and Taxpayer Service account was reduced by 1.3 percent, or about $21 million. IRS' remaining two accounts, Examination and Appeals and Salaries and Expenses, were unaffected because their fiscal year 1990 appropriations were below the post-sequester levels mandated under the sequestration.

Even after the sequestration, IRS received about a 6 percent increase in obligational authority over fiscal year 1989. Despite this increase, IRS determined after the fiscal year began that it had about $463 million less than it needed to meet its operating requirements. The sequestration accounted for about 10 percent of that shortfall. IRS attributed the rest to unfunded increases in compensation and benefit costs, the need to absorb the 1990 general pay increase for federal employees, additional program funding needs, and a reduction of funds for IRS' share of the federal government's escalation of the war on drugs.

IRS curtailed hirings and promotions, cut back support services, and reduced some programs in response to its total shortfall, not just in response to the sequestration. As a result, IRS could not isolate the impact of the sequestration from the impact of its overall shortfall. Treasury's Office of Tax Analysis estimated that these cutbacks will result in a combined $700 million revenue loss in fiscal years 1990 and 1991.

## Background

The Balanced Budget and Emergency Deficit Control Act of 1985, as amended by P.L. 100-119, establishes deficit targets leading toward a balanced, unified budget by fiscal year 1993. Each year, the Office of Management and Budget (OMB) is required to submit an initial report on August 25 and a final report on October 15 projecting the fiscal year deficit. If OMB projects a deficit in excess of the target amount plus $10 billion, the President must issue a sequester order to reduce budgeted amounts sufficiently to reach the deficit target level. In its August and October reports, OMB identifies the amount of the total reduction required to meet the year's deficit target, the percentage reduction required in defense and nondefense accounts, and the sequester base[1] and sequestration amount for each of those accounts.

The 1985 act, as amended, set the fiscal year 1990 deficit target at $100 billion. The August 1989 OMB report estimated a $116.2 billion deficit, exceeding the target by $16.2 billion; the October 1989 report slightly reduced the overall estimate to $116.1 billion. Both reports would have required a sequestration of 4.3 percent in defense accounts and 5.3 percent in nondefense accounts subject to sequestration. Sequestration of this magnitude was never implemented, however, because of the enactment of the Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239).

That act, approved on December 19, 1989, reduced the mandatory sequestration amount to 130/365 of the original $16.1 billion requirement. This change effectively reduced sequestration requirements to $5.7 billion, or 1.5 percent in defense accounts and 1.4 percent in nondefense accounts. OMB responded to this legislation with a "Revised Final Sequester Report," published on December 27, 1989, that sequestered the lower amounts.

Ultimately, however, not all agency accounts were reduced by 1.5 or 1.4 percent because of rules that apply when the sequestration precedes approval of appropriation acts. When OMB issued its final sequester report on October 15, most agencies were operating under continuing budget resolutions. As required by law, therefore, OMB calculated the sequester base using fiscal year 1989 appropriation amounts adjusted upward for inflation and pay costs. If actual fiscal year 1990 appropriations differed from the sequester base, the percentage actually sequestered varied. If, for example, the agency's actual appropriation for a

[1] The sequester base for a fiscal year is the account appropriation for that year or, if there is no appropriation, the previous year's appropriation adjusted for inflation and pay costs. To calculate the sequester amount for each account, OMB applies the sequester percentage to the sequester base.

particular account was less than the sequester base for that account minus the sequestration amount, the account was not to be sequestered. If the agency's actual appropriation for an account was greater than the sequester base for that account, the account was to be reduced by the original sequestration amount. Agencies are not required to sequester more than the amount originally designated by OMB.

## Objectives, Scope, and Methodology

As the Committee requested, our objectives were to identify (1) how IRS' resources were reduced by the sequestration and (2) what impact the sequestration had on IRS' ability to fulfill its mission.

To determine how IRS resources were reduced by the sequestration, we analyzed data on IRS' appropriation accounts that we obtained from OMB's October 1989 sequester report, the Budget of the United States Government for fiscal year 1991, and IRS' Finance Division.

To identify the sequestration's impact on IRS' ability to carry out its mission, we relied primarily on the results of prior work we did on the impact of IRS' fiscal year 1990 funding shortfall. We testified on that work in March 1990, before the Oversight Subcommittee of the House Committee on Ways and Means.[2] For that testimony, we gathered data from officials in three IRS regions and the National Office on the specific impacts of the shortfall on their 1990 operations. As agreed with the Committee, we did not verify agency statements regarding the sequestration's impact.

## Only Two of IRS' Four Sequestrable Accounts Were Reduced

IRS was required to sequester a total of $46 million from two of its four operating accounts, or 0.8 percent of the agency's $5.5 billion fiscal year 1990 appropriation.[3] IRS sequestered about $25 million from its Processing Tax Returns account and about $21 million from its Investigations, Collection, and Taxpayer Service account. The remaining two accounts, Salaries and Expenses and Examination and Appeals, were not sequestered because the final appropriations for those accounts fell below the amount of the sequester base minus the sequestration. IRS' accounts and final sequestration amounts are discussed in appendix I.

[2] IRS' Budget Request for Fiscal Year 1991 and Status of the 1990 Tax Return Filing Season (GAO/T-GGD-90-26, Mar. 22, 1990)

[3] The President's budget for fiscal year 1991 shows appropriations for six IRS accounts. Four were subject to the sequestration, and two were exempt. The two exempt accounts, with appropriations totalling $6 2 billion, fund Earned Income Tax Credit payments and interest on refunds.

## Impact of the Sequestration Cannot Be Separated From the Impact of IRS' Total Fiscal Year 1990 Shortfall

In fiscal year 1990, after the sequestration, IRS received about a 6 percent increase in obligational authority over fiscal year 1989. In spite of that increase, IRS determined that it had about $463 million less than it needed to meet its operating requirements. Unfunded increases in salary and benefit costs ($270.2 million) and the need to absorb the 1990 general pay increase ($103.0 million) accounted for a much larger part of IRS' shortfall than did the sequestration ($46.2 million). A funding reduction pursuant to P.L. 101-164 to support the government's war on drugs and management's decision to spend additional funds on various activities, such as the distribution of forms and publications and the processing of currency transaction reports, accounted for the rest of the shortfall.

IRS took a series of cost cutting actions to cover its fiscal year 1990 shortfall. IRS continued a hiring freeze begun in fiscal year 1989, curtailed promotions, and cut back support services. IRS also made some program cuts that led to curtailed service to the public and others that, according to Treasury's Office of Tax Analysis, were expected to reduce combined fiscal year 1990 and 1991 revenues by $700 million. Because the sequestration accounted for only 10 percent of the total shortfall, IRS officials told us that they could not differentiate the impact of the sequestration on program results from the impact of other shortfall components. Appendix I gives more details on IRS' fiscal year 1990 shortfall.

As requested by the Committee, we did not obtain written comments on this fact sheet from IRS or other interested parties. However, we discussed the contents of this fact sheet with IRS officials, who agreed with the facts presented.

As agreed with the Committee, unless you publicly announce the contents of this fact sheet earlier, we will not distribute it until 30 days from its date. At that time, we will send copies to the Director of the Office of Management and Budget, the Director of the Congressional Budget Office, and other interested parties. Copies will also be made available to others upon request. Fact sheets for the other departments selected for this study will be transmitted to you upon completion.

Major contributors to this fact sheet are listed in appendix II. If you or your staff have any questions, please call me at 275-6407.

Sincerely yours,

Jennie S. Stathis

Jennie S. Stathis
Director, Tax Policy and
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**Abbreviations**

| | |
|---|---|
| IRS | Internal Revenue Service |
| OMB | Office of Management and Budget |

# Implementation and Impact of Sequestration at IRS

## How IRS Sequestered Its Budget Accounts

As shown in table I.1, IRS was required to sequester $46 million: about $25 million, or 1.3 percent, of its Processing Tax Returns account and about $21 million, or 1.3 percent, of its Investigations, Collection, and Taxpayer Service account. The reduction in these two accounts is actually 1.3 percent rather than the 1.4 percent used in OMB's sequester report because IRS' appropriations were larger than the sequester base. According to sequestration rules, agencies are not required to sequester more than the dollar amount designated in OMB's report. The remaining two accounts were not sequestered because the actual appropriations for those accounts fell below the amount of the sequester base minus the sequestration.

**Table I.1: IRS' Appropriations and Sequestration Amounts**

Dollars in thousands

| | OMB Sequester Report | | | Fiscal year 1990 budget actions | | |
|---|---|---|---|---|---|---|
| **Account** | **Sequester base** | **1.4 percent sequestration** | **Post-sequestration amount** | **Fiscal year 1990 adjusted appropriation[a]** | **Actual sequestration amount** | **Sequestration as a percent of appropriation** |
| Salaries and expenses | $90,431 | $1,266 | $89,165 | $72,241 | $0 | 0 |
| Processing tax returns | 1,807,710 | 25,308 | 1,782,402 | 1,944,504 | 25,308 | 1.3 |
| Examination and appeals | 2,009,730 | 28,136 | 1,981,594 | 1,907,813 | 0 | 0 |
| Investigations, collection, and taxpayer service | 1,491,687 | 20,884 | 1,470,803 | 1,622,953 | 20,884 | 1.3 |
| **Total** | **$5,399,558** | **$75,594** | **$5,323,964** | **$5,547,511** | **$46,192** | **0.8** |

[a]Pursuant to P.L. 101-164, about $2.4 million was rescinded from IRS' fiscal year 1990 appropriations before the sequestration was implemented. This fiscal year 1990 adjusted appropriation was used to calculate the actual sequestration amount.

Sources: Sequester base from OMB's Revised Final Sequester Report; fiscal year 1990 appropriations and actual sequestration amounts from the President's fiscal year 1991 budget.

## Sequestration's Impact on IRS Operations

Even after the sequestration, IRS' obligational authority for fiscal year 1990 was about 6 percent higher than in fiscal year 1989. Table I.2 shows IRS' obligational authority for fiscal years 1988 through 1990.

**Table I.2: IRS' Obligational Authority for Fiscal Years 1988 to 1990**

Dollars in thousands

| | Fiscal year | | | Percent change fiscal years | |
|---|---|---|---|---|---|
| | 1988 | 1989 | 1990 | 1988-1989 | 1989-1990 |
| Appropriation amount | $5,058,880 | $5,194,880 | $5,549,938 | 2 7 | 6 8 |
| Other obligational authority | | | | | |
| Offsetting collections | 24,971 | 31,977 | 44,578 | | |
| Unobligated balances | 38,051 | 20,101 | 11,686 | | |
| Transfers in or (out) | 0 | (140) | (1,557) | | |
| Sequestration amount | 0 | 0 | (46,192) | | |
| Other reductions | 0 | 0 | (2,427)[a] | | |
| **Total obligational authority** | **$5,121,902** | **$5,246,818** | **$5,556,026** | **2.4** | **5.9** |

[a]P L 101-164 rescinded approximately $7 4 million from IRS' budget to help finance the government's war on drugs and appropriated an additional $5 million to support IRS enforcement of federal tax law violations and money laundering related to illegal narcotics activity The net effect was a reduction of approximately $2 4 million

Source President's budgets for fiscal years 1990 and 1991

In spite of the increase in obligational authority, IRS experienced a funding shortfall of $463 million in fiscal year 1990, as shown in table I.3. Sequestration accounted for about 10 percent of the shortfall while increased labor costs accounted for 81 percent.

**Table I.3: IRS' Fiscal Year 1990 Funding Shortfall**

Dollars in millions

| Source of shortfall | | Amount |
|---|---|---|
| Increased labor costs | | |
| Increased salary costs | $196 5 | |
| Increased benefit costs | 73 7 | |
| Absorbing 1990 pay increase | 103 0 | |
| Total | | $373 2 |
| Sequestration | | 46.2 |
| Additional program needs | | |
| Tax forms distribution | 11 9 | |
| Currency transaction reporting | 10.9 | |
| A-76 restoration | 8 1 | |
| Electronic filing | 3 8 | |
| Internal audit | 1 7 | |
| Total | | 36 4 |
| Rescission for the war on drugs | | 7.4[a] |
| **Total shortfall** | | **$463.2** |

[a]As part of the same law that rescinded approximately $7 4 million, IRS received an additional $5 million That money was not available to help offset the shortfall because it was legislatively earmarked for IRS' anti-drug efforts

Source IRS Finance Division

In response to its funding shortfall, IRS did a significant amount of reprogramming and took a series of cost saving actions. For example, IRS reprogrammed funds from such areas as transportation, equipment, and supplies to compensation, benefits, and rent. In addition to reprogramming, IRS continued a hiring freeze begun in fiscal year 1989; limited promotions and position upgrades; cut back training, travel, and other support services; and reduced funds for information systems. Because of the hiring freeze, IRS delayed implementing seven of the nine revenue initiatives that Congress authorized as part of IRS' fiscal year 1990 budget. These revenue initiatives were intended to increase staff in IRS' Examination, Collection, Appeals, and International programs.

IRS Finance Division officials said the decisions to delay implementing the revenue initiatives and to continue the hiring freeze were directly linked to the costs associated with the sequestration and the absorption of the 1990 general pay increase. Treasury's Office of Tax Analysis estimated that these two actions will result in a combined $700 million revenue loss over fiscal years 1990 and 1991.

We discussed the impact of IRS' total shortfall with officials in IRS' National Office and Central, Midwest, and Western regions. Our inquiries showed that field offices had to eliminate all but the most essential training. For example, some officials told us that employees were not getting industry-specific, computer, and other technical training necessary to do their jobs effectively. We were also told that insufficient money to relocate employees left positions unfilled and that budget reductions hindered the acquisition and use of space and equipment.

Funding shortages also led to some program adjustments. For example, IRS reduced the number of toll-free telephone lines, making it more difficult for taxpayers to get through to IRS with their tax law questions during the 1990 filing season. This year, one out of three callers reached an assistor; the rest got a busy signal or hung up after being put on hold. Last year, two out of three callers reached an assistor. At the Kansas City Service Center, the shortfall contributed to delays in IRS' responses to taxpayer correspondence. Service Center officials also told us about cutbacks in various service center compliance programs, including those that involve (1) the use of information returns to identify persons who have underreported their income and (2) the audit of simple issues through correspondence with the taxpayer.

IRS completed its mid-year financial review and released a new set of operating guidelines in April 1990. Subject to the availability of funds, these guidelines eased several of the cost controls placed on field and National Office operations. For example, available funds identified during the financial reviews can now be used to release promotion restrictions and the hiring freeze for clerical staff and to restore cuts made to taxpayer telephone service and the underreporter program. As IRS continues to monitor its fiscal condition, it may add other cost controls or further relax those still in place.

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