United States General Accounting Office

GAO

Report to Congressional Requesters

March 2001

TAX ADMINISTRATION

IRS Can Help Taxpayers Reduce the Need for Tax Abatements

GAO

Accountability * Integrity * Reliability

GAO-01-328

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United States General Accounting Office
Washington, DC 20548

March 30, 2001

The Honorable William M. Thomas
Chairman, Committee on Ways and Means
House of Representatives

The Honorable Amo Houghton
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

In fiscal year 1998, the Internal Revenue Service (IRS) abated—or, reduced—2.3 million tax assessments (totaling $3.6 billion) on individual income tax returns because of an error made by the taxpayer, IRS, or third party in determining the tax to be assessed.[1] Making and then abating tax assessments imposes costs on taxpayers as well as on IRS. Avoiding the errors that led to the assessments would also avoid the need for abatements, reducing costs in time and money for taxpayers and IRS.

Given your interest in reducing these costs to individual taxpayers and IRS, you asked us to (1) describe the nature of the errors that led to the abated income tax assessments, such as who made the error and what the error involved; (2) quantify the costs to IRS; (3) describe the costs incurred by taxpayers to correct these errors; and (4) determine what IRS could do to reduce the errors that led to these abated tax assessments. To answer these questions, we analyzed IRS data from a random sample of 486 abatements made in fiscal year 1998 because of errors made in the tax assessed against individual taxpayers. We analyzed IRS data on the costs and consulted with IRS officials about options for avoiding the errors.

[1]IRS made 2.5 million tax abatements to individual tax returns in fiscal year 1998, totaling $5.5 billion. Not all abatements arise from errors with tax assessments. For example, a taxpayer can carry back a net operating loss to an earlier tax year to abate a correct assessment. Because we focused on abatements of tax assessments created from errors, we excluded abatements due to these carry backs as well as for substitute returns IRS prepares using income information from third parties and debt discharges, such as bankruptcy, that are used to offset correct assessments for the tax year in question.

Results in Brief

The errors that led to 2.3 million individual income tax assessments being abated in fiscal year 1998 had two features that stood out.[2] First, taxpayers made the errors in an estimated 86 percent of the abated assessments. Second, the errors for about half of the abated assessments involved exemption claims, usually in reporting names and Social Security numbers (SSN) for dependent exemptions.

Abating tax assessments can be costly. According to IRS officials, IRS' costs to record, collect, and abate the 2.3 million income tax assessments are in the tens of millions of dollars each year. IRS was unable to provide data on which to develop more reliable cost estimates in time for this report. Individual taxpayers also incur costs to get assessments abated, but the amount is unknown. The types of taxpayer costs can also vary with the number of IRS contacts and degree of documentation provided to get the abatement.

IRS has taken two steps intended to reduce exemption errors leading to the abated tax assessments but could take additional steps. In one step, IRS revised tax return instructions on claiming exemptions for tax year 2000. For example, IRS added a statement that the names and SSNs used on tax returns had to match those recorded at the Social Security Administration. For name and SSN errors that continue to be made, IRS changed its procedures in January 2001 to try to correct some of the errors during returns processing before taxes are assessed. However, IRS has not changed its procedures for correcting the most common type of exemption error—errors in claiming dependent exemptions.

Under current procedures, IRS corrects dependent exemption errors after the tax assessment through its abatement process. IRS verifies these corrections by checking the names and SSNs used on previous tax returns as well as contacting taxpayers for additional information if necessary. IRS could do these checks and contacts earlier during returns processing. Doing so would eliminate some steps currently used to assess and abate taxes, reducing burden on taxpayers. The effects of earlier checks and contacts on IRS' overall costs are not known.

[2]Over a hundred million assessments of individual income taxes are recorded for each tax year. Because abatements made in a fiscal year involve assessments from various tax years, which IRS does not track, we do not know the percent of all tax assessments made in a given tax year that are abated.

After our audit work was completed, an IRS official told us that IRS was considering doing checks for dependent exemption errors and taxpayer contacts during returns processing in order to avoid assessing additional taxes. Considering these checks and contacts is worthwhile because a large number of taxpayers could potentially benefit. However, as noted above, the effects on IRS' overall costs are not known. Because IRS did not provide us with details or documentation on how or when decisions would be made, we are recommending that IRS determine whether the costs and benefits justify implementing these checks and taxpayer contacts during returns processing.

Finding ways to reduce the remaining 1.1 million assessments that are abated due to nonexemption errors will be challenging. These remaining abated assessments involve a variety of errors that occur infrequently. Because little is known about these errors and because of the potential benefits to a large number of taxpayers, we are recommending that IRS determine whether research to identify the causes of the errors and possible solutions is justified.

Background

An assessment is a formal bookkeeping entry in which IRS records the amount of tax, penalty, or interest charged to a taxpayer's account each tax year. An assessment establishes the taxpayer's liability and IRS' right to collect. Taxpayers essentially assess themselves when they report these taxes on their tax returns. IRS may add to or subtract from tax amounts reported when its returns processing or enforcement programs identify errors. Taxpayers also may file an amended return or otherwise notify IRS of errors, which can change the amount assessed.

An abatement is a formal bookkeeping entry to record a reduction of tax, penalty, or interest assessments on a taxpayer's account. Abatements reduce the amounts that taxpayers owe and that IRS has a right to collect. Section 6404 of the Internal Revenue Code authorizes IRS to abate an assessment under certain conditions. For example, IRS can abate an assessment because of errors made. A taxpayer can make an error on the original tax return, such as not claiming a deduction. Or, IRS may assess incorrect tax amounts when auditing a return or matching income reported by taxpayers with income reported by third parties (such as employers) on payments made to the taxpayers.

Both taxpayers and IRS can initiate abatements. Taxpayers can request an abatement by filing an amended tax return (e.g., Form 1040X), by filing an IRS Form 843 (Claim for Refund and Request for Abatement), or by calling

or writing to IRS. IRS can also initiate abatements. When, for example, an IRS auditor finds evidence that a taxpayer overstated the tax liability on a return, this evidence could lead to an abatement, depending on the results from the rest of the audit.

Scope and Methodology

To fulfill our objectives, we reviewed a stratified, random sample of 486 individual taxpayer abatements made in fiscal year 1998 due to errors by taxpayers, IRS, or third parties.[3] Our sample includes abatements in which taxpayers elected to change their filing status or basis for deductions when the original assessment also changed. If a taxpayer had multiple abatements, we studied only the abatement that was drawn into our sample.

We obtained the final sample of 486 abatements by first drawing a stratified sample of 500 abatements from a population of 2,351,194 abatements for individual taxpayers who had at least one abatement in 1998 associated with an error in the assessment. After reviewing the 500 IRS case files, we removed 14 sampled abatements that did not contain these errors, such as abatements due to net operating loss carry backs, debt discharges, and substitute returns. On the basis of our final sample, we estimated that the total population of 1998 abatements based on errors was about 2.3 million with a value of about $3.6 billion.

Each abatement could be associated with more than one error. For each error, we collected information on which line item on the return was in error. For example, an error could involve lines for the primary taxpayer's SSN, a tax exemption, or a tax deduction. To the extent possible, we also collected information on whether taxpayer, IRS, or third-party actions led to an error. Because so many of the errors related to exemptions, we collected more information, such as whose exemption (taxpayer, spouse, dependent) was in error and what information was missing or incorrect.

To develop data about IRS' costs to abate tax assessments made due to errors by taxpayers, IRS, or third parties, we used IRS' abatement files to identify the type and frequency of IRS activities associated with the recording, collecting, and abating of these assessments. We then talked to

[3]We focused on fiscal year 1998 because more recent data were not available when we began our work, and we had fiscal year 1998 data from our previous work. See *Tax Administration: IRS' Abatement of Assessments in Fiscal Years 1995-1998* (GAO/GGD-99-77, June 4, 1999).

IRS officials about the unit costs of these activities and the magnitude of the overall costs for all activities. These officials represented IRS' Wage and Investment Division, IRS' Chief of Operations and IRS units that record, collect, or abate assessments, such as those that process or examine tax returns. We attempted to develop more reliable cost estimates but IRS was unable to provide sufficient data in time for including in this report.

To describe the types of taxpayer costs, we recorded the types of activities associated with each sampled abatement case. We discussed these activities with IRS officials to understand the potential impacts on costs. On the basis of this work, we summarized the range of activities and of time (in calendar days) that taxpayers faced to get the tax assessments abated. We did not have enough information to compute taxpayers' costs.

After our analysis, we sought feedback from IRS officials at the National Office on our sample results and the costs. We sought IRS documentation and views on options for reducing the number of assessments that involved exemptions and that were abated due to errors. We also sought views on these options from officials of four professional associations—the American Institute of Certified Public Accountants, National Association of Enrolled Agents, National Association of Tax Practitioners, and National Society of Accountants.

Because we selected the probability sample following random selection procedures, each estimate is surrounded by a 95-percent confidence interval. For example, the estimate that 86 percent of the abatements is due to taxpayer errors is surrounded by a 95-percent confidence interval of +/- 3 percentage points. This shows that we are 95-percent confident that the percentage of taxpayer errors in the actual population is between 82 and 89 percent. All percentage estimates have sampling errors of +/- 6 percentage points or less, unless otherwise noted. Estimates on numbers of abatements have sampling errors of +/- 6 percent or less of their values unless otherwise noted.

We did work at IRS offices in Washington, D.C., and New Carrollton, MD, as well as IRS' Kansas City Service Center because of our staff's proximity. We did our work from November 1999 through December 2000 in accordance with generally accepted government auditing standards. We discussed our draft report with representatives of the IRS Commissioner on March 23, 2001. IRS officials agreed that our recommendations had merit and said they would review ways to implement them. Their written comments arrived too late to be reprinted in this report.

Abated Assessments Usually Resulted From Taxpayer Errors on Exemption Claims

We traced most abated income tax assessments in fiscal year 1998 to individual taxpayer errors. These errors usually involved claims for tax exemptions for the taxpayers, spouses, or dependents. Taxpayers usually erred by not providing any information or by providing inaccurate information. With exemption claims, these errors usually involved SSNs for dependent exemptions.

Taxpayers Made Most of the Errors When Reporting Tax Return Data

We estimated that 86 percent[4] of the 2.3 million abated assessments arose from taxpayer errors, and 6 percent arose from IRS errors. Sources for the remaining errors were third parties or could not be determined due to insufficient data in IRS' abatement case files.

We further analyzed how the errors were made. For taxpayer errors, about 74 percent of the abated tax assessments were associated with taxpayers not correctly reporting an item on the tax return; and about 22 percent were associated with taxpayers omitting the item from the return.

For IRS errors associated with abated tax assessments, most of the errors occurred when the IRS unit that processes tax returns did not accept valid information from these returns. Third-party errors[5] generally arose due to errors in the Social Security Administration database used by IRS to validate names and SSNs related to the exemption claims.

Tax Exemption Errors Accounted for Half of the Abated Assessments

For fiscal year 1998, an estimated 50 percent of errors that led to the 2.3 million abated tax assessments involved exemptions claimed on income tax returns for taxpayers, spouses, or dependents. The remaining abated assessments involved errors with many other types of claims at much lower percentages. The next two most frequent errors—Schedule A deductions (e.g., real estate taxes) and the other income line on the tax return—each accounted for around 10 percent.

Of the exemption errors, we estimated that about 96 percent involved dependent exemptions; and the rest involved exemptions for the spouse of

[4]Since we used a random, probability sample, all results are subject to sampling error. Unless otherwise indicated, all sample estimates are surrounded by 95-percent confidence intervals of less than +/- 6 percentage points.

[5]We only attributed errors to third parties when we found conclusive evidence of their mistakes.

the primary taxpayer filing the tax return.[6] For dependent exemptions, about 32 percent of the errors were missing SSNs; and about 50 percent were incorrect SSNs.[7] The remaining errors involved the names of the dependents or could not be determined due to insufficient data.

These errors in names and SSNs occurred in many ways. For example, in one instance, an exemption for a dependent was disallowed because the taxpayer used the spouse's SSN instead of the dependent's. Other dependent exemption errors either occurred because no SSN was reported, SSNs were transposed, or an SSN was reported as a progression of numbers (i.e., 123-456-789). Examples also included a taxpayer who used the same SSN for two different dependents and a taxpayer who used the last four digits of an SSN for two dependents. Other errors related to the dependent's last name not matching SSA records and a spousal exemption disallowed because the spouse's last name did not match SSA data.

The exemption errors were not limited to a type of taxpayer. An estimated 256,000 or more taxpayers with incomes below $25,000 made such errors as well as about 107,000 taxpayers with incomes over $100,000. Most exemption errors came from individuals who had no business income, but about 47,000 taxpayers who had business income made exemption errors.[8]

IRS Costs for Abating Tax Assessments Could Be Substantial

IRS did not track its costs to record, collect, and then abate the 2.3 million tax assessments that were made due to errors by taxpayers, IRS, or third parties. IRS agreed that these overall costs could be substantial, totaling at least tens of millions of dollars annually. IRS was unable to provide accurate cost data for developing more reliable estimates in time for this report. However, IRS agreed that having such accurate cost information is important and plans to develop it.

[6]Our sample did not include any abated tax assessments with exemption errors for the primary taxpayer. IRS has procedures to find and correct these types of errors.

[7]The estimate of 32 percent is surrounded by a 95-percent confidence interval of +/- 8 percentage points. The estimate of 50 percent is surrounded by a 95-percent confidence interval of +/- 9 percent.

[8]The estimate of 256,000 is surrounded by a 95-percent confidence interval of +/- 78,000; the estimate of 107,000 taxpayers by an interval of +/- 52,000; and the estimate of 47,000 taxpayers by an interval of +/- 17,000.

We identified three broad activities—recording, collecting, and abating the tax assessments—associated with IRS' costs. Table 1 shows the frequencies of these broad activities.

Table 1: IRS Activities Associated With Individual Income Tax Assessments Abated in Fiscal Year 1998 Due to Errors by Taxpayers, IRS, or Third Parties

Numbers in thousands

Activity	Frequency of abated assessments	Percent of abated assessments
Record	1,304	56
Collect	609 [a]	26
Abate	2,308	100
Total	[b]	[b]

Note: The sample percentage estimates in this table are surrounded by 95-percent confidence intervals of less than +/- 6 percentage points. The frequency intervals are surrounded by these 95-percent confidence intervals: 1,304 +/- 122; 609 +/- 72; and 2,308 +/- 30.

[a]Only includes collection actions that are attributable solely to the abated tax assessment.

[b]Column is not totaled because some abated assessments had more than one type of action.

Source: GAO analysis of IRS activities in our sample cases.

IRS' Recording Costs

IRS incurred additional costs to record an estimated 1.3 million of the 2.3 million tax assessments abated due to errors. In such cases, IRS did more work to make additional tax assessments. IRS' usual costs include those to record the tax assessment originally reported on the tax returns. The additional costs would have been avoided if the errors and additional assessments had not been made. The other 1 million tax assessments did not incur additional recording costs.

Various IRS units can be involved in recording increases or decreases to the original tax assessment reported on the tax return. IRS' processing units can increase the original assessment because of more obvious errors, such as invalid SSNs. IRS post-processing units also can make additional tax assessments that will be recorded. For example, when the taxpayer files an amended tax return or third-party reports indicate that a taxpayer did not report all income, IRS' adjustment units can increase the assessment. IRS' examination units can increase assessments during audits when taxpayers do not provide documents to support their tax return.

The cost to record tax assessments is higher when a post-processing unit does the work to create an assessment. The greatest cost is associated with examination units because their auditors have higher pay grades,

audit more complex cases, and need more time to work cases compared to nonaudit staff.

IRS' Collection Costs

IRS attempted to collect an estimated 609,000 of the 2.3 million abated tax assessments. IRS could have avoided the associated collection costs if the tax assessment, which was abated because of errors, had not been made. For the portion that was abated of the other 1.7 million tax assessments, IRS did not take collection action.

The process for collecting any unpaid assessment has three steps. The process starts with a series of computer-generated notices demanding payment or information to otherwise resolve the unpaid assessment. If the unpaid assessment is not resolved, IRS might try to call the taxpayer through its Automated Collection System. If still unresolved, IRS might assign a field collector to visit the taxpayer. The costs of the collection activity increase substantially with each step. For example, each notice costs a fraction of what a field collector visit costs.

IRS' Abatement Costs

IRS also incurred additional costs to abate the 2.3 million tax assessments. Abatements involve three types of costs, as described below.

First, IRS incurs costs to process abatement requests. These costs are relatively low compared to later steps. Abatement requests include formal claims (Form 1040X or Form 843) and informal requests when taxpayers call or write IRS requesting abatements. Compared with informal requests, formal claims are more costly because of the extra costs to record them on IRS' masterfile of taxpayer accounts to show the pending formal request.

Second, IRS incurs costs to make and record the abatement decision. Some abatement decisions are made in IRS examination units while the bulk are done in nonexamination units. The unit cost of abatements made in examination units is higher because, among other reasons, they use higher-graded (or paid) staff.

Third, IRS incurs costs for some abatements when issuing a refund check that otherwise would have been unnecessary. This check is for tax amounts overpaid by individuals because of the assessment made in error.

Taxpayer Costs Are Not Known, and the Types of Costs Can Vary

Taxpayers also incurred costs when tax assessments were made and then abated. However, the amount is currently unknown. IRS' abatement files lacked sufficient information on taxpayers' activities, efforts to contact IRS, and time spent in order to estimate taxpayer costs. Further, taxpayers usually do not record and maintain such information. As part of its multiyear effort to estimate taxpayer compliance burdens, IRS is designing a methodology intended to estimate taxpayer costs for abatements and other post-filing activities.[9]

Although we could not measure the costs to taxpayers, we were able to estimate the number of taxpayers involved in two actions that imposed some level of burden.[10] For both types of actions, taxpayers incurred costs in time and money, especially if they used a paid preparer. Of the 2.3 million abated assessments,

- an estimated 609,000 involved IRS contacts with taxpayers to collect an assessment before it was abated, of which the vast majority were IRS notices; and
- an estimated 575,000 involved amended tax returns that taxpayers filed to correct errors and request the tax abatements.

The amount of variation in taxpayer costs also cannot be quantified currently. Taxpayer costs can vary, depending on the actions and time required to correct the error and abate the tax assessment. Taxpayer actions could include finding the error, gathering documents to support the abatement, communicating with IRS, providing any requested documentation, and responding to IRS notices. Contacts with IRS could be as inexpensive as a toll-free telephone call or as costly as paying the fees of tax professionals to work with IRS.

In terms of calendar time required, most abatements we reviewed took 3 months or less to be approved, but some took much longer. At one extreme in our sample, IRS notified a taxpayer through a collection notice that it had assessed additional taxes after disallowing a dependent exemption while processing the tax return. The taxpayer called IRS to provide the dependent's correct SSN. After verifying the SSN, IRS made

[9] *Tax Administration: IRS Is Working to Improve Its Estimates of Compliance Burden* (GAO/GGD-00-11, May 22, 2000).

[10] A taxpayer could have been involved in just one or both of these actions.

the abatement 21 days after the date of the collection notice. At the other extreme in our sample, IRS disallowed two dependent exemptions, assessed additional tax, and sent a collection notice. The taxpayer eventually provided sufficient documents to support the exemptions and justify the abatement. However, the abatement took 493 days from the date of the first collection notice. During this time, IRS sent multiple correspondence and collection notices to the taxpayer about the unpaid assessment and abatement request.

IRS files also showed variation in the amount of taxpayer documentation and number of IRS contacts required for abatements. In another case from our sample, multiple exchanges between IRS and a taxpayer took 245 days from the first collection notice to the abatement. IRS had notified the taxpayer that an additional tax form was needed, and the taxpayer's representative returned the completed form to IRS showing no additional tax due. About 1 month later, IRS sent its version of the form showing additional tax due followed by four subsequent bills. The taxpayer hired a second representative who wrote IRS, sent documents, and faxed a form showing no additional tax due. IRS assigned the case to an IRS office that resolves difficult cases. The second representative faxed another copy of the form to this office to get the tax assessment abated.

IRS Has Taken Steps to Reduce Some Exemption Errors but Could Take Other Steps

IRS has taken steps to avoid exemption errors or correct certain types of exemption errors earlier during returns processing rather than through the abatement process. However, IRS has not taken other steps that could potentially correct more errors earlier. If the errors were not made or were corrected earlier, IRS would not create tax assessments that need to be abated, which could reduce taxpayer and IRS costs. We focused on reducing exemption errors because, as discussed earlier, they accounted for half of the 2.3 million assessments that were abated in fiscal year 1998.

Avoiding Exemption Errors

After reviewing our data on the number of exemption errors that lead to abatements, IRS took a step intended to prevent some of the errors. For tax year 2000 returns, IRS revised tax return instructions to state that (1) the name and SSN entered on the tax return should agree with the Social Security card to avoid losing the exemption as well as tax benefits, such as the Earned Income Credit and (2) taxpayers should call the Social Security Administration to resolve any discrepancy. IRS made the revisions because a test of expanded SSN matching for spouse exemptions claimed on joint tax returns revealed errors with the names and SSNs of the spouses. IRS officials believe that these revisions will help reduce such

errors, but the actual effects will not be known until after tax year 2000 returns are processed.

Correcting Remaining Exemption Errors Earlier

IRS recently decided to revise its procedures during returns processing in an effort to correct some of the remaining exemption errors earlier. However, the largest category of exemption errors, errors with the dependent exemption, will not be corrected by the revisions.

These revised procedures involve IRS' math-error program. About one million of the exemption-related tax assessments were created during returns processing through IRS' math-error program. In this program, IRS uses computers to find arithmetic errors on tax returns as well as errors in reporting SSNs, exemptions, and certain other items. When it finds math errors on paper returns, IRS processes the return,[11] assesses the tax, and contacts the taxpayer to disclose the reason for the additional tax assessment and to request payment. Afterward, IRS uses its abatement process to correct any errors and eliminate the tax assessments.

Further changes to the math-error program could help to correct errors earlier and avoid assessing taxes that will be abated. Specifically, after IRS' computerized processing detects exemption errors, computerized checks of previous tax returns could help to correct simple errors, such as transposed SSNs or misspelled or changed names. IRS now does these checks after returns processing when abatements are requested. To notify taxpayers of the corrections and need to avoid such errors, IRS could send so-called "soft notices"—notices that do not ask taxpayers to provide information or pay additional taxes. If the name or SSN were changed or missing, IRS could suspend processing and contact taxpayers. In effect, this would treat paper returns the same as electronic returns. As noted earlier, IRS does not accept electronic returns with math errors. If the contacts do not resolve the errors or if more effort is required, IRS could

[11]For electronically filed tax returns, IRS has chosen to reject the returns rather than process them and assess taxes for errors. IRS officials said taxpayers could refile the return electronically after correcting the error or file a paper return with or without the correction.

continue its practice of disallowing the exemptions and assessing additional taxes.[12]

After we shared the results of our work with IRS, IRS decided to change its procedures, effective January 28, 2001, to correct name and SSN errors with claims for spousal exemptions earlier. IRS officials decided to do the checks for correcting these errors during returns processing. Before disallowing exemptions and assessing additional taxes, IRS staff are to check spouses' names and SSNs on tax returns against IRS and Social Security Administration computer data in an attempt to correct the errors.

Recently, an IRS official told us that IRS is considering taking two other steps to correct exemption errors during returns processing. The first step would be doing earlier checks for erroneous dependent exemptions. The second step would be to contact taxpayers for any type of exemption error that had not been corrected by the checks. This same official said that IRS had concerns about the time and costs to contact taxpayers during returns processing in order to correct exemption errors. However, IRS did not provide any documentation or details on how or when decisions about these earlier checks and contacts would be made.

Considering steps to correct exemption errors earlier is worthwhile because of the potential benefits to a large number of taxpayers. While neither the benefits to taxpayers nor the costs to IRS can be quantified, some information is known. First, IRS already abates almost all tax assessments created through the math-error program for exemption errors in missing or inaccurate names or SSNs. According to our analysis, IRS abated at least 87 percent of the additional tax assessments for name or SSN errors in exemptions claimed on tax year 1997 returns.[13] In deciding whether to approve abatements requested by taxpayers, IRS checks previous tax returns and contacts taxpayers, as needed. Since abatements are requested for almost all of these assessments, IRS is already doing the checks and contacts.

[12]IRS does checks and contacts in other enforcement programs before assessing additional tax. For example, audits of tax returns entail checks of documentation and written or face-to-face contacts with taxpayers about errors before assessing any additional taxes.

[13]Our analysis of the math-error program for tax year 1997 showed that during fiscal year 1998, IRS abated 71 percent of the 983,000 assessments related to disallowed dependent exemptions. By analyzing previous math-error programs, we calculated that another 16 percent of these assessments was abated during fiscal year 1999; and a smaller percentage was likely abated in fiscal year 2000.

Second, although taxpayers' costs have not been quantified, correcting the exemption errors earlier could reduce the costs that taxpayers incur to correct errors through abatements. To the extent that the earlier checks correct the errors, fewer taxpayers would be contacted. Even if contacted, taxpayers would likely have an easier time finding or compiling records or working with tax representatives because the errors would be found sooner. Some taxpayers (about 26 percent of the cases we reviewed) would no longer face IRS collection actions. The extent to which taxpayer costs would be reduced could be influenced by, among other factors, how many exemption errors continue to be made after IRS clarified its instructions for claiming exemptions.

In discussing taxpayer burdens, representatives we interviewed from four groups of tax professionals generally favored the idea of doing the checks and contacts earlier to avoid tax assessments that have to be abated. They said that taking care of the errors earlier would reduce taxpayer burden, particularly when the errors lead to a series of written and telephone contacts to get the taxes abated.

Third, IRS could reduce annual operating costs by correcting exemption errors earlier rather than later through abatements. We could not estimate the amount of operating cost savings because available data did not allow us to quantify the costs associated with exemption errors separately from the costs for other types of errors. Even so, by correcting errors earlier, IRS would no longer incur costs to record and collect the tax assessments that would be abated. Nor would IRS incur some of the costs of making abatements, including the costs of processing abatement requests or issuing refunds after abatements are granted. Other costs savings could occur from using lower paid staff, rather than audit staff, to make the checks and contacts earlier.

Whether IRS would have overall cost savings depends on the costs to implement the earlier checks and contacts. These one-time costs would offset IRS' operating cost savings to some extent. Implementation costs could include, if needed, new equipment, computer programming, moving equipment or staff, and training. IRS did not have data on the magnitude of these one-time costs.

Researching Nonexemption Errors

Finding ways to reduce the remaining 1.1 million assessments that are abated due to nonexemption errors will be challenging. As discussed earlier, these remaining abated assessments involve a variety of errors that occur infrequently. Since little is known about these errors or their causes,

a promising first step towards reducing the errors would be to do research on their causes and on ways to avoid the errors.

Doing research on the nonexemption errors has the potential to benefit a large number of taxpayers. However, research also incurs costs, which we did not attempt to estimate. Such costs would depend on the design, scope, and depth of the studies.

Conclusions

Approximately one million taxpayers per year, as well as IRS, incur costs to abate tax assessments created due to exemption errors. Avoiding the errors, or correcting them earlier, could reduce the burden on taxpayers of complying with tax laws.

IRS has taken one step intended to help taxpayers avoid these errors—revising instructions for claiming exemptions. In another step, aimed at correcting some exemption errors that continue to be made, IRS decided to do checks of name and SSN errors for spousal exemption claims during returns processing.

In addition, IRS is considering implementing earlier—during returns processing—checks for dependent exemption errors and taxpayer contacts if the checks do not correct exemption errors. Considering doing such checks and contacts earlier is worthwhile. While the cost savings to IRS are not known, a large number of taxpayers could benefit. However, IRS did not provide us with any details or documentation about how or when decisions would be made.

Little is known about how to reduce nonexemption errors that lead to assessments being abated. Because over one million taxpayers were burdened by such assessments, research to reduce the errors is worth considering.

Recommendations

Regarding name and SSN errors, we recommend that the Commissioner of Internal Revenue make a determination on whether the costs and benefits justify implementing earlier—during returns processing—(1) checks for dependent exemption errors and (2) taxpayer contacts, as needed, for the remaining errors in any type of exemption claim.

Regarding the nonexemption errors that lead to assessments that are later abated, we recommend that the Commissioner of Internal Revenue determine whether research to identify causes and solutions is justified.

Agency Comments

We discussed our draft report on March 23, 2001, with IRS officials from Wage and Investment who were representing the IRS Commissioner. They agreed to implement both of our recommendations. First, they said that IRS would review the costs and benefits of doing checks and contacts during returns processing for dependent exemption errors. Second, they said that IRS would review available data on nonexemption errors to determine the merits of researching their causes, and solutions. IRS was unable to provide written comments in time for inclusion in this report.

We are sending copies of this report to Representative Charles B. Rangel, Ranking Minority Member, House Committee on Ways and Means; Representative William J. Coyne, Ranking Minority Member, Subcommittee on Oversight, House Committee on Ways and Means; and Senator Charles E. Grassley, Chairman, and Senator Max S. Baucus, Ranking Member, Senate Committee on Finance. We also are sending copies to the Honorable Paul H. O'Neill, Secretary of the Treasury; the Honorable Charles O. Rossotti, Commissioner of Internal Revenue; the Honorable Mitchell E. Daniels, Jr., Director, Office of Management and Budget; and other interested parties. Copies of this report will be made available to others upon request.

If you have any questions concerning this report, please contact Tom Short or me at (202) 512-9110. Key contributors to this work are listed in appendix I.

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Appendix I: GAO Contacts and Staff Acknowledgements

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Acknowledgements

In addition, Royce Baker, Larry Dandridge, Thomas Venezia, James Fields, Anne Rhodes-Kline, Sam Scrutchins, Thomas Bloom, and Rodney Hobbs contributed to this report.

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