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[Use of Minicomputers for Internal Revenue Service Tax Return Preparation]. February 23, 1978. 5 pp.

Report to Anita F. Alpern, Internal Revenue Service: Assistant Commissioner (Planning and Research); by Johnny C. Finch, Assistant Director, General Government Div.

Contact: General Government Div.

Concern over the difficulties that average taxpayers encounter in completing their income tax returns, as well as a continuing interest in improving productivity and effective resource utilization, led the Internal Revenue Service (IRS) to test the use of minicomputers to fully prepare some taxpayer returns. The tests established that the use of minicomputers is reliable, practical, and popular with the taxpayers, the IRS, and the news media. While demonstrating that minicomputer return preparation is feasible, the tests did not evaluate some important effects that minicomputer preparation would have on costs and benefits; for example, the tests did not estimate the costs or benefits of implementing a nationwide, large-scale, and long-range program. The IRS should establish conditions and circumstances under which individual tax returns will be prepared, including some of the following policy considerations: the type of returns that IRS will prepare, the maximum level of adjusted gross income to qualify for the program, other possible program restrictions, the degree and type of publicity needed, and ways to deliver the service to the public. (RRS)



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT
DIVISION

FEB 23 1978

Miss Anita F. Alpern
Assistant Commissioner
(Planning and Research)
Internal Revenue Service
Department of the Treasury

Dear Miss Alpern:

The Joint Committee on Taxation asked GAO to undertake a review of the Internal Revenue Service's (IRS') taxpayer services activities. As part of this work we have reviewed the design and outcome of IRS' testing over the past five years of the use of mini-computers to prepare tax returns. We also reviewed the design of the 1978 filing season test.

Based on our work we suggest that:

- Before any future tests are conducted, IRS should examine its return preparation policy and clearly establish the conditions and circumstances under which individual returns will be prepared.
- The design of any future tests should include estimates of the number of taxpayers that will use the service, and the costs and benefits that a nationwide, large-scale and long-range tax preparation program would have for the IRS, taxpayers, and private tax preparers.

BACKGROUND

prior to 1953 some individuals required to file income tax returns had IRS prepare a return for them. As the demand for preparation service increased, IRS officials became concerned over the amount of resources being devoted to this effort. Taxpayers were also

concerned with the long lines that formed at IRS offices, especially toward the end of the filing season, which resulted in a considerable waiting period.

In 1953, IRS adopted a policy which it termed "self-help." Under this policy, IRS assistance was to be limited to educating taxpayers in the preparation of their own returns. However, in 1972 the policy was changed to provide return preparation for taxpayers who requested that IRS prepare their returns. This policy change only served to confirm the de facto policy in existence since 1953 of preparing returns if time and resources were available. In 1977, IRS prepared about 1.6 million returns.

FEASIBILITY OF RETURN PREPARATION
USING MINI-COMPUTERS ADEQUATELY
DEMONSTRATED

Concern over the difficulties average taxpayers encounter in completing their returns as well as a continuing interest in improving productivity and effective resource utilization, led IRS to test the use of mini-computers to fully prepare some taxpayer returns. The tests have established that mini-computer preparation of 1040A returns is feasible and practical.

The return preparation process followed during the tests was as follows. Only those taxpayers eligible to file a 1040A return participated in the test. Those selected met with IRS employees trained to use a computer terminal. The terminal was connected to a mini-computer programmed to prompt the IRS employee as to the information needed from the taxpayer. The terminal screen was situated so that the taxpayer could not see the questions or the answers. As the information was entered it was stored in the computer. Once all the needed information was stored, the computer did the necessary analysis, checked for tax credits, made the required computations, and immediately provided the taxpayer with a typed return that was both mathematically and technically correct. The taxpayer had only to sign the return before filing.

The tests established that the use of mini-computers is reliable, practical, and popular with the taxpayers, IRS, and the news media. However, IRS continues to test mini-computer preparation of 1040A returns. One reason for the continued tests is IRS' concern about the impact that providing higher quality service would have on its resources.

TEST SHORTCOMINGS

While demonstrating that mini-computer return preparation is feasible, the tests did not evaluate some important effects that a mini-computer preparation program would have on costs and benefits. For example, the tests did not estimate the costs or benefits of implementing a nationwide, large-scale, and long-range program. The specifics of these shortcomings are discussed below.

National Aspects

IRS is concerned that changes in its return preparation policy could have major resource implications as well as significant social and economic ramifications. For example, IRS could be called on to prepare significantly more returns than the 1.6 million prepared in 1977, especially if, as expected, the electronic transmission between mini-computers and service centers reduces the waiting time for refunds from 6 weeks to 1 week. On the other hand, an extensive return preparation industry now exists and its members can be expected to react negatively to a government financed competitor.

Even though IRS has recognized these implications of its increased entry into the return preparation market, it has not projected the potential demand such a program would generate considering its ease, accuracy, reduced refund waiting time, widespread public acceptance, and favorable media exposure. In our April 1, 1976, report on taxpayer services, we reported that about 58 percent of lower income taxpayers needed full tax return preparation. ^{1/} We also reported that while 74 percent of this group was aware that IRS would prepare their returns, only 4 percent sought IRS help. Given the advantages discussed above, many taxpayers who did not previously seek IRS assistance might decide to do so.

Without an estimate of demand, IRS cannot confidently predict the amount and cost of personnel, office space, and equipment necessary to avoid the problems experienced before 1953. Neither is IRS acquiring the information needed to estimate the program's social and economic impact.

^{1/}"Internal Revenue Service Assistance to Taxpayers in Filing Federal Income Tax Returns" (GGD-76-49).

Large-Scale Aspects

To date, IRS has estimated the costs and benefits of using mini-computers through limited-scale testing. But several of the costs and benefits may be sensitive to the degree of use. For example, the capital costs per return of purchasing or leasing terminals, printers, optical scanners, key punchers, memory capacity, etc., are lessened the more the equipment is used. Conversely, total program costs are increased as the number of returns prepared increases.

Neither did IRS test the effect that the mini-computer would have on service center processing of remittance returns. Thus, IRS was not able to capture cost data or determine the benefits (such as reduced coding and editing) that would be gained through mini-computer preparation of these returns.

Other benefits such as reducing review time or reducing the number of audits may also be affected by the size of the program. Because IRS' tests have not addressed these points, we question the usefulness of the cost and benefit estimates made to date.

Long-Range Aspects

Other costs and benefits of using mini-computers can only be estimated when the evaluation covers more than one year. Although IRS has conducted several tests, the long-range aspects of the program have not been estimated.

Private industry has found that using mini-computers in successive years cuts costs. Savings are possible by automating those entries on the return that usually do not change from year to year--such as name, address, social security numbers, exemptions--thereby reducing both preparation time and the probability of error.

Repeat use may also ease the taxpayers' record preparation burden and reduce their tax liability by enabling them to benefit from certain tax provisions. Efficiency of employees (more use of address labels, fewer errors, better training) and equipment (better verbiage, additional displays, error correction loops) may also increase over time. Although IRS has tested mini-computers in the same place for more than one year, the tests did not measure long-range effects.

OBSERVATIONS

While the 1978 test may provide some additional insight into the long-range and other aspects of the mini-computer program it does little to address most of the questions raised by our review--questions which should be answered to adequately decide the policy issue. To answer these questions, we suggest that IRS first establish the conditions and circumstances under which individual tax returns will be prepared. In this regard, some of the considerations that should be included are;

- the type of returns that IRS will prepare, i.e., Form 1040 only, or Form 1040 with Schedule A and B or some other combination;
- the maximum level of adjusted gross income to qualify for the program, i.e., less than \$20,000, or less than some other higher level;
- other possible program restrictions such as limiting it to taxpayers who are over 65 years of age, retired, or handicapped;
- the degree and type of publicity needed to inform those who qualify for the program; and
- ways to deliver the service to the public such as by telephone or using mobile vans to reach the elderly or disabled.

Once these questions have been resolved, a 1979 filing season test should be conducted to identify the future costs and benefits of the program IRS proposes to implement, taking into account the questions raised by our review. After the additional test is completed, IRS, the Administration, and the Congress should have the basic information needed to adequately discuss the policy implications of having IRS prepare more taxpayers' returns.

Sincerely yours,



Johnny Finch
Assistant Director