

GAO

Report to the Subcommittee on
Oversight, Committee on Ways and
Means, House of Representatives

March 2008

INTERNAL REVENUE SERVICE

Fiscal Year 2009 Budget Request and Interim Performance Results of IRS's 2008 Tax Filing Season





Highlights of [GAO-08-567](#), a report to the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

The Internal Revenue Service (IRS) has ambitious goals to improve enforcement, improve taxpayer service, increase research, and continue investing in systems modernization. The President's 2009 proposed budget is a roadmap for how IRS intends to achieve these goals. IRS's 2008 filing season performance, along with the performance of paid preparers who help taxpayers, is a key indicator of the tax system's impact on taxpayers.

GAO was asked to (1) assess how the budget request allocates resources compared to prior years, (2) determine the status of systems modernization efforts, (3) assess filing season performance, and (4) assess IRS's ability to identify paid preparers. GAO compared the budget request to prior years, updated our previous reporting, compared IRS's filing season performance to prior years and goals, and interviewed IRS officials.

What GAO Recommends

GAO recommends that IRS extend return on investment (ROI) analyses to major enforcement programs for future budget requests and develop a plan to require a single identification number for paid preparers, including the feasibility of options, their benefits and costs, and usefulness for enforcement and research on paid preparer behavior. Due to the short time frame for GAO's report, IRS officials said they were unable to respond to our recommendations.

To view the full product, including the scope and methodology, click on [GAO-08-567](#). For more information, contact James R. White at (202) 512-9110 or whitej@gao.gov.

INTERNAL REVENUE SERVICE

Fiscal Year 2009 Budget Request and Interim Performance Results of IRS's 2008 Tax Filing Season

What GAO Found

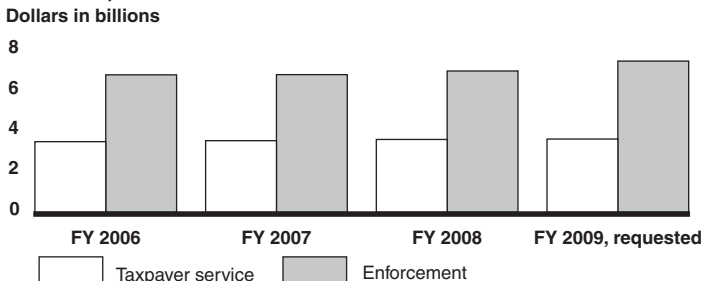
The President's fiscal year 2009 budget request of \$11.4 billion for IRS is 4.3 percent more than its 2008 enacted budget and includes increases of 7 percent for enforcement and less than 1 percent for taxpayer service. IRS is proposing a number of new enforcement initiatives, and deserves to be commended for providing ROI analyses to support them. Although the budget request for IRS provides performance measure data, it does not provide ROI for programs or activities other than the new initiatives. IRS included 16 legislative proposals and if none is enacted, IRS would not need the associated \$23 million in 2009. Similarly, if IRS were to fall behind in its hiring efforts related to its nonlegislative initiatives, not all the associated funding would be needed for 2009.

The request for IRS systems modernization is more than \$40 million less than the fiscal year 2008 enacted amount. IRS said that the proposed funding level will allow it to continue developing and delivering its primary modernization projects, but it did not provide details on how specific projects or benefits to taxpayers would be affected. Although IRS has experienced significant management and technical weaknesses, it has made progress and addressed some, but not all, of GAO's numerous recommendations.

So far this filing season, IRS has processed 51.2 million income tax returns and issued 46.5 million refunds worth \$122.7 billion. Because of increased call volume that IRS expects due to the recently passed Economic Stimulus legislation, IRS is planning to shift hundreds of collections staff to telephones with an estimated revenue loss of up to \$681 million.

Because of the lack of a single identification number, IRS has limited ability to identify paid preparers. This complicates tax law enforcement and limits IRS's ability to conduct research on how paid tax preparers affect taxpayer compliance. According to IRS officials, requiring a single identification number could improve the situation but IRS has not analyzed the usefulness or cost of options to do so.

Funding for IRS Enforcement and Taxpayer Service Programs and Related Support Functions, Fiscal Years 2006-2009



Source: GAO analysis of IRS data.

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United States Government Accountability Office
Washington, DC 20548

March 13, 2008

The Honorable John Lewis
Chairman
The Honorable Jim Ramstad
Ranking Member
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Financing of the federal government depends largely on the Internal Revenue Service's (IRS) ability to effectively administer the tax laws. The President has requested \$11.4 billion in program dollars to fund IRS's fiscal year (FY) 2009 operations, including \$11.1 billion for service to taxpayers and tax law enforcement. Although the exact mix is unknown, effective tax administration requires a balance of service and enforcement.

In response to congressional concerns, in 2007 IRS published strategies for reducing the tax gap and improving taxpayer service.¹ IRS most recently estimated the net tax gap—the difference between the taxes owed and eventually paid—at \$290 billion in tax year 2001. The tax gap strategy emphasized the need to address both intentional evasion and unintentional taxpayer errors and recognized that enforcement efforts should be combined with taxpayer service because both affect compliance. The taxpayer service strategy—known as the Taxpayer Assistance Blueprint—committed IRS to making decisions about taxpayer services based on an understanding of taxpayers' needs, preferences, and behaviors, as well as the cost of services, with the goal of improving compliance. The two strategies, together with the 2009 budget request for IRS, emphasize that the foundation for improving enforcement and service is (1) increased research on the nature and causes of taxpayer noncompliance and how enforcement and service affect compliance, and (2) continued investment in modernized information systems, including IRS's Business Systems Modernization (BSM) program. The budget is a roadmap for how IRS intends to allocate resources in order to improve enforcement, improve

¹IRS, *Reducing the Federal Tax Gap* (Washington, D.C.: Aug. 2, 2007); and IRS, *The 2007 Taxpayer Assistance Blueprint* (Washington, D.C.: 2007).

taxpayer service, increase research, and continue investing in modernized information systems.

IRS provides much of its service to taxpayers during the annual tax filing season, making filing season performance a key indicator of overall performance. Two challenges for this year's filing season are (1) the late passage of changes related to the alternative minimum tax (AMT) and other tax laws, and (2) recent passage of the Economic Stimulus Act of 2008.² Both create additional, unanticipated workload for IRS.

In addition to IRS, paid preparers provide service to many taxpayers; preparers prepared 78 million returns, or 61 percent, during the 2006 filing season. In the past, we have documented problems and recommended that the Commissioner of Internal Revenue conduct research to determine the extent to which paid preparers live up to their responsibility to file accurate and complete tax returns based on information they obtain from their customers.

Based on your request, our objectives related to the President's proposed budget for IRS were to (1) assess how the budget request allocates resources for enforcement, service, research, and systems modernization compared to prior years and the rationales for differences, including for new initiatives; and (2) determine the status of IRS's efforts to develop and implement its BSM program, particularly its Customer Account Data Engine (CADE). Related to the interim results of the filing season, our objectives were to assess IRS's (1) development of a strategy to inform taxpayers about changes in filing requirements due to recently enacted AMT legislation; (2) performance compared to goals and prior years' performance, including factors affecting performance; and (3) ability to identify paid preparers and track their performance.

To meet these objectives, we did the following. We based our budget work, in part, on comparisons of enacted and requested budgets for IRS, reviews of other documents, and interviews with IRS officials. For our BSM work, we relied primarily on our reviews of BSM expenditure plans. We based our filing season work primarily on comparisons of IRS's actions related to the AMT to best practices and of performance to prior years' and current goals, analysis of performance and other data, and interviews with IRS officials. We used different time periods depending on the

²Pub. L. No. 110-166 (2007) and Pub. L. No. 110-185 (2008).

available information. We conducted this performance audit from December 2007 through March 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. For a more detailed discussion of our scope and methodology, see appendix I.

Results

On February 29, 2008, we briefed your staff on our preliminary observations of our reviews of the 2009 budget request for IRS and 2008 filing season performance. This report transmits updated materials we used at the briefing, which are reprinted in appendix II.

In summary, we made the following major points:

- The President's 2009 budget request for IRS of \$11.4 billion is 4.3 percent more than the FY 2008 enacted budget and represents an increase of 7 percent for enforcement and less than 1 percent for taxpayer service, consistent with longer-term trends. The enforcement increase reflects initiatives that address a small percentage of the \$290 billion net tax gap. We have previously reported on 3 of 16 legislative initiatives which are estimated to raise about \$34 billion over 10 years. We have (1) suggested that Congress consider an idea for reducing securities capital gains noncompliance, (2) supported the notion that payments to corporations be reported on information returns, and (3) described ways to mitigate the compliance costs of proposals related to these information returns and to other information returns associated with credit and debit card payments. If none of the legislative initiatives is enacted, IRS would not need the associated \$23 million in 2009. Similarly, if IRS were to fall behind in its hiring efforts related to its nonlegislative initiatives, not all the associated funding would be needed for 2009. In general, we commend IRS for including more information this year on its new initiatives and for including return on investment (ROI) information for all new nonlegislative initiatives. Although the budget request for IRS provides performance measure data, it does not provide ROI for programs or activities other than the new initiatives.
- The budget request for IRS's BSM was reduced by over \$40 million from last year's enacted amount. IRS said that the proposed funding level will allow it to continue developing and delivering its primary

modernization projects, but it did not provide details on how plans to deliver specific projects or benefits to taxpayers would be affected. IRS's initial efforts to modernize its information systems encountered significant management and technical weaknesses. IRS has made significant progress in implementing management controls and capabilities and addressing our recommendations in recent years. However, some of our recommendations have not been fully addressed. For example, we recently reported that IRS has yet to take certain actions to address our recommendation to fully revisit the vision and strategy for BSM, including developing long-term plans for completing the program.³ In our report, we also noted, among other things, that BSM project phases were not all completed on schedule and within cost during 2007 and that future releases of CADE and Account Management Services continue to face risks and challenges. Finally, we recommended that IRS complete a plan with specific time frames for implementing initiatives supporting its information technology human capital strategy, and IRS agreed.

- IRS's efforts to develop a communication plan about delays in processing certain AMT-affected returns adhered to many communication strategy best practices. IRS began processing all AMT-affected returns on February 11, 2008, about 4 weeks after the filing season began.
- IRS data show that, as of February 29, IRS processed 51.2 million individual income tax returns (79 percent filed electronically) and issued 46.5 million refunds worth \$122.7 billion. IRS expects to process more than 20 million returns due to the recently passed Economic Stimulus legislation. IRS has achieved processing efficiencies, but we have reported that IRS could achieve even more.⁴ Early in the filing season, IRS's telephone performance was comparable to last year. However, because of the anticipated increased call volume associated with the Economic Stimulus legislation, IRS expects the assistor level of service to drop from 82 percent down to 74 percent, a level which will decrease taxpayers' ability to get through and speak with an assistor. In addition, IRS has estimated the revenue foregone by

³GAO, *Business Systems Modernization: Internal Revenue Service's Fiscal Year 2008 Expenditure Plan*, [GAO-08-420](#) (Washington, D.C.: Mar. 7, 2008).

⁴GAO, *Tax Administration: 2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and Increase Tax Compliance Should Be Evaluated*, [GAO-08-38](#) (Washington, D.C.: Nov.15, 2007).

shifting hundreds of collection staff to answering taxpayer calls about their economic stimulus checks to be up to \$681 million.

- IRS faces limitations in identifying individual paid preparers and monitoring their performance. Because they now prepare over 60 percent of all individual income tax returns, paid preparers are a key part of tax administration. IRS requires that paid preparers identify themselves on all income tax returns they prepare by entering their Social Security Number (SSN) or Preparer Tax Identification Number (PTIN). If the preparer has a partnership or an employer, then the preparer must also include the Employer Identification Number (EIN) of the partnership or employer on the return, in conjunction with an SSN or PTIN. However, according to IRS officials, many preparers do not sign tax returns with the required identifying number or numbers. Because processing returns is a priority for IRS, it accepts returns even if preparers' information is not provided on returns. Because preparers have the choice between two numbers and may be required to use a third as well, IRS officials said that confusion is created for preparers and IRS faces challenges in enforcing the signing requirement. The limitations in identifying preparers complicate enforcement because IRS cannot systemically match tax returns with preparers in order to detect patterns of noncompliance. Furthermore, IRS officials said this is an impediment to research on preparer compliance, its causes, and possible solutions. Several IRS officials with responsibility for preparer compliance said that requiring a single identifying number could improve preparer compliance with signing requirements, but that IRS has not evaluated the usefulness or costs of implementing such a requirement.

Conclusions

IRS should be commended for including ROI analyses of new initiatives in the FY 2009 budget justification. Because IRS has ambitious plans to improve enforcement, improve taxpayer service, increase research, and continue investing in modernized information systems, resource allocation decisions are more important than ever. Being able to make resource allocation decisions, based in part on ROI analysis, even with its limitations, could increase the chances that IRS's ambitious goals are met.

Because of the important role of paid preparers in administering the U.S. tax system, better information about preparer behavior and their contribution to taxpayer compliance could ultimately help reduce the large tax gap. A first step toward better information would be improving IRS's ability to identify paid preparers.

Recommendations for Executive Action

We recommend that the Commissioner of Internal Revenue

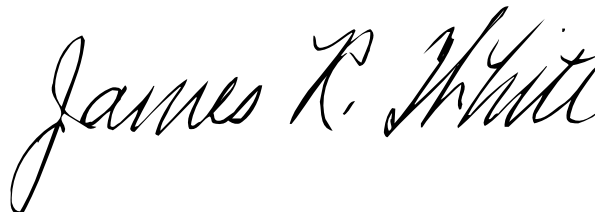
- extend the use of ROI in future budget proposals to include major enforcement programs, and
- develop a plan to require a single identification number for paid preparers, including the feasibility of options, benefits and costs of those options, as well as their usefulness for enforcement and research on paid preparer behavior.

Agency Comments

In commenting on a draft of this report, IRS officials said that, due to the short time frame for GAO's report, they did not have time to fully analyze the recommendations and, therefore, were unable to respond to them at the time. They provided technical comments, and we made those changes where appropriate.

We are sending copies of this report to the Chairmen and Ranking Members of other Senate and House committees and subcommittees that have appropriation, authorization, and oversight responsibilities for IRS. We are also sending copies to the Commissioner of Internal Revenue, the Secretary of the Treasury, the Chairman of the IRS Oversight Board, and the Director of the Office of Management and Budget. Copies are also available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions or wish to discuss the material in this report further, please contact me at (202) 512-9110 or at whitej@gao.gov. Contact points for our offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.



James R. White
Director, Tax Issues
Strategic Issues

Appendix I: Scope and Methodology

To assess the President's 2009 budget request for IRS, we reviewed IRS's congressional budget justifications and supplementary documents to (1) identify trends in spending and staffing from FYs 2006 through 2008, and (2) assess information on the tax gap and spending initiatives to determine how they were justified. We based our assessment on a comparative analysis of funding, reviews of documentation, and interviews with IRS officials. Our analysis of the BSM program was based primarily upon previous work and the results of our detailed review of the FY 2008 BSM expenditure plan.

To assess IRS's filing season performance related to processing, telephones, face-to-face assistance, and its Internet Web site, we obtained and analyzed information on IRS's development of a communication strategy for the AMT and determined how well it adhered to communication best practices; obtained performance and production data, which we compared to annual goals and prior years' performance looking for trends and the factors that significantly affected performance; reviewed regulations and reports; and interviewed IRS officials.

Our filing season and budget audit work was done primarily at IRS's National Office and its operating divisions, including the Large and Mid-Size Business operating division in Washington, D.C; the Small Business/Self-Employed operating division in New Carrollton, Md.; and the Wage and Investment operating division headquarters and Joint Operations Center in Atlanta, Ga. We also interviewed officials at the IRS Oversight Board in Washington, D.C. Additionally, we reviewed relevant external documentation and our reports as well as those of the Treasury Inspector General for Tax Administration.

We previously assessed IRS budget and filing season performance data for reliability. For example, we considered filing season performance measures and data that cover the quality, accessibility, and timeliness of IRS's services to be objective and reliable based on that work. Since the data sources and procedures for producing this year's budget and filing season data have not significantly changed from prior years, we determined that the data were sufficiently reliable for the purposes of this report. To the extent possible, we corroborated information from interviews with documentation and data and where not possible, we report the information as attributed to IRS officials. We have determined that the estimates for cost savings come from competent sources and are reasonable. Data limitations are discussed where appropriate.

We conducted this performance audit from December 2007 through March 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Updated Slides from the February 29, 2008 Briefing

Fiscal Year 2009 Budget Request and Interim Performance Results of IRS's 2008 Tax Filing Season

**Update to February 29, 2008 Briefing
To the Subcommittee on Oversight,
House Committee on Ways and Means**

1

FY 2009 Budget Request – Objectives

- Our objectives were to
 - assess how the President’s budget request for IRS allocates resources for enforcement, service, research, and systems modernization compared to prior years and the rationales for differences, including for new initiatives; and
 - determine the status of IRS’s efforts to develop and implement its Business Systems Modernization (BSM) program, particularly its Customer Account Data Engine (CADE).
 - We based our budget work, in part, on comparisons of enacted and requested budgets for IRS, reviews of other documents, and interviews with IRS officials. We based our BSM work primarily on our reviews of BSM expenditure plans.
-

Interim Results of IRS's 2008 Filing Season – Objectives

- Our objectives were to assess IRS's
 - development of a strategy to inform taxpayers about changes in filing requirements due to recently enacted tax law changes, including to the alternative minimum tax (AMT);
 - performance compared to goals and prior years' performance, including factors that affect performance; and
 - ability to identify paid preparers and track their performance.
 - We based our work primarily on comparisons of IRS's actions related to the AMT to best practices and of performance to prior years' and current goals, analysis of performance and other data, and interviews with IRS officials. We used different time periods depending on the available information.
-

Budget Request and Interim Results of IRS's 2008 Filing Season – Results in Brief

- The President's budget request for IRS of \$11.4 billion is 4.3 percent more than the FY 2008 enacted budget and shows an increase of 7 percent for enforcement and less than 1 percent for taxpayer service.
- All of IRS's nonlegislative initiatives show an anticipated return on investment (ROI), and we commend IRS for this. ROI varied from \$0.40 to \$11.40 on the dollar; to us, IRS justified resource allocations using ROI and other factors, such as the need to provide examination coverage.
- IRS did not include such ROI information about other key elements of its budget; doing so would provide decision makers with more information about resource allocations.

Budget Request and Interim Results of IRS's 2008 Filing Season – Results in Brief

- We have previously reported on 3 of the 16 legislative initiatives that are estimated to raise about \$34 billion over 10 years.
 - We have (1) suggested that Congress consider an idea for reducing securities capital gains noncompliance, (2) supported the notion that payments to corporations be reported on information returns, and (3) described ways to mitigate the compliance costs related to these information returns and to other information returns associated with credit and debit card payments.
 - If none of the legislative initiatives is enacted, IRS would not need the associated \$23 million in 2009.
- Similarly, if IRS were to fall behind in its hiring efforts related to its nonlegislative initiatives, not all the associated funding would be needed for 2009.

Budget Request and Interim Results of IRS's 2008 Filing Season – Results in Brief

- For IRS's BSM program, the request is over \$40 million less than last year's enacted amount. IRS told us that this funding level will allow it to continue developing and delivering its modernization projects, but it did not provide details on how its plans or benefits to taxpayers would be affected.
- Early results show that IRS's filing season performance is comparable in some areas to last year's. However, because of the anticipated increased call volume associated with the recently passed Economic Stimulus package, IRS expects to provide lower telephone service and has begun shifting hundreds of collection staff to answering taxpayer calls about their economic stimulus checks. IRS estimates the foregone collections revenue due to this shift to be up to \$681 million.

Interim Results of IRS's 2008 Filing Season – Results in Brief

- IRS faces limitations in identifying individual paid preparers and monitoring their performance, a situation that can complicate enforcement and research on preparer compliance, its causes, and possible solutions. Several IRS officials said that requiring a single identifying number could provide some benefits.

FY 2009 Budget Request - Overall Comparisons of Program Dollars

Table 1: Request Compared to Last Year's Enacted Budget

Program	FY 2008 (in thousands) enacted	FY 2009 (in thousands) requested	Percentage change
Taxpayer service	\$3,612,833	\$3,636,230	0.6
Enforcement	6,997,226	7,487,209	7.0
BSM	267,090	222,664	-16.6
Health insurance tax credit	15,235	15,406	1.1
Total	\$10,892,384	\$11,361,509	4.3

Note: Dollar amounts include amounts for operations support.

Source: GAO analysis of IRS data.

FY 2009 Budget Request - Overall Comparisons of Full-Time Equivalents

Table 2: IRS Full-Time Equivalents (FTE)

Appropriation	FY 2008 enacted	FY 2009 requested	Percentage change
Taxpayer Service (see below)	31,218	30,792	-1.4
Enforcement (see below)	47,349	49,792	5.2
Operations Support (see below)	12,181	11,989	-1.6
BSM	358	333	-7.0
Health Insurance Tax Credit	17	16	-5.9
Total	91,123	92,922	2.0

Percentage of staff that are managers or executives remained around 9 to 9.5 percent between FY 2006 and FY 2008.

Note: The decline in taxpayer services, including operations support, reflects 91 FTEs in efficiency savings and 207 FTEs in electronic filing savings. The increase in enforcement, including operations support, includes 1,431 additional revenue agents and 582 extra revenue officers.

Source: GAO analysis of IRS data.

FY 2009 Budget Request – Justification for New Initiatives

- Because of our recommendations from last year, IRS included more information on new initiatives in the FY 2009 proposed budget.
 - We commend IRS for including ROI measures and projections for all nonlegislative new initiatives in its budget request.
 - The budget request has explicit sections on initiative summary, implementation plan, expected benefits, and ROI.
 - IRS's ROI calculations have limitations that reflect the challenges of estimating ROIs. For example, they do not include benefits of improved voluntary compliance. For the research initiative, the ROI does not measure the longer-term benefits of being able to develop better strategies to combat noncompliance and reduce burden on compliant taxpayers.

FY 2009 Budget Request - Justification for New Initiatives

- Four of the five nonlegislative enforcement initiatives in FY 2009 were revisions of FY 2008 initiatives, with more total funds requested and with generally more informative justifications than last year.
- ROI for FY 2011 varied from \$0.40 to \$11.40 on the dollar, and IRS officials said elements beyond ROI, such as the need to provide examination coverage to different segments of the taxpaying population, factored into judgments about resource allocation.
- A \$51 million National Research Project (NRP) initiative's ROI of \$.40 per \$1 applies only to research audits and, as already noted, does not fully capture the initiative's value. The request funds research studies of the reporting compliance of taxpayers such as corporations in order to develop more effective enforcement programs.

FY 2009 Budget Request - Justification for New Initiatives

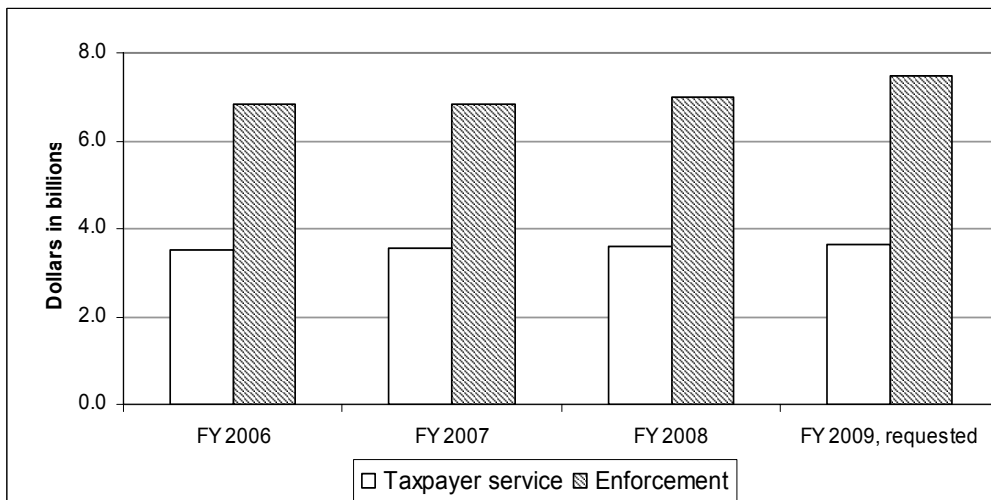
- The National Research Program's ROI does not quantify
 - updates to IRS's system to target individual tax returns for examination, intended to increase examination efficiency;
 - updates to the tax gap estimate for corporations and partnerships, for example; and
 - IRS and Treasury use of NRP data to identify compliance-related legislative recommendations (e.g., securities sales basis reporting).
- We are waiting for data from IRS to estimate the compliance benefits from using the NRP results to update IRS's enforcement programs.

FY 2009 Budget Request - Justification for New Initiatives

- Hiring enough staff for the initiatives will be challenging for the Large and Mid-Size Business (LMSB) and Small Business/Self-Employed (SB/SE) divisions.
 - For instance, the new initiatives call for adding 1,431 revenue agents in addition to those who must be replaced through attrition, a high number relative to past years.
 - IRS divisions have previously hired large numbers of staff in a short time due to specific budget initiatives, but officials reported that hiring gradually over time would reduce challenges.
 - If IRS were to fall behind in its hiring efforts, not all of the associated funding would be needed for 2009.

FY 2009 Budget Request - Balance between Taxpayer Service and Enforcement

Figure 1: Comparison of Funding for Taxpayer Service versus Enforcement



Enforcement increased 10.0 percent between FY 2006 and FY 2009.

Taxpayer assistance increased 3.7 percent between FY 2006 and FY 2009, a decrease in real terms.

Source: GAO analysis of IRS data.

FY 2009 Budget Request - Balance between Taxpayer Service and Enforcement

- Although the budget request for IRS provides performance measure data, it does not provide ROI for programs or activities other than the new initiatives.
 - The Government Performance and Results Act of 1993 focuses on holding federal agencies accountable for the results of federal spending and aims for a clear link between the process of allocating resources and the expected results to be achieved with those resources.
 - ROI analyses provide a common measure for managers and Congress helpful for making resource allocation decisions.
 - Without measures such as ROI, IRS does not have a measure of program results in comparable units that shows the trade-offs among alternative allocations of resources.

FY 2009 Budget Request - Balance between Taxpayer Service and Enforcement

- Analytic data, such as ROI, can help answer questions such as the following:
 - Does increasing taxpayer service or enforcement have a more significant effect on compliance?
 - For taxpayer services, what are the implications, if any, of the fact that it is significantly less expensive for IRS to interact with taxpayers through the Internet or over the telephone than at walk-in sites (as shown on slide 17)?
 - For enforcement, what are the implications, if any, of the fact that correspondence audits are sometimes more productive than field audits (as shown on slide 18)?

FY 2009 Budget Request - Balance between Taxpayer Service and Enforcement

Comparing the costs of various taxpayer service options helps decision makers with funding choices.

Table 3: Cost of Providing Taxpayer Service

Service	Estimated cost-per-contact
Answering tax law questions via e-mail	\$52.51
Providing assistance at walk-in sites	28.73
Answering correspondence	24.97
Providing assistance by assistors via toll-free telephones	19.46
Providing assistance through VITA sites	12.01
Providing assistance by automation via toll-free telephones	0.71
Providing assistance such as downloads and searches on IRS's Web site	0.13

Note: IRS reported that these estimates do not fully allocate all indirect overhead and support costs. We have reported that because of long-standing limitations in IRS's cost accounting capability, cost data at this detailed level have not been audited (see, for example, GAO-07-310 and 07-247). From our perspective, it would be important to know more about the indirect and support costs to see if they might significantly change the cost estimates.

Source: IRS data.

FY 2009 Budget Request - Balance between Taxpayer Service and Enforcement

Table 4: Field versus Correspondence Audits, FY 2006

Type and size of return	Number of returns examined		Recommended additional tax (dollars in thousands)		Average recommended additional tax (dollars)	
	Field	Correspondence	Field	Correspondence	Field	Correspondence
Total individual income tax returns	302,785	981,165	\$5,433,084	\$7,612,137	\$17,944	\$7,758
Nonbusiness returns with TPI of \$100,000 or more	56,717	110,122	3,115,679	3,514,184	54,934	31,912
Business nonfarm returns with TPI of \$100,000 or more	54,716	34,515	1,410,954	961,681	25,787	27,863

Correspondence audits brought in more additional tax per return than field audits for business nonfarm returns with total positive income (TPI) of \$100,000 or more.

Source: IRS data.

FY 2009 Budget Request - Balance between Taxpayer Service and Enforcement

- Developing ROI information beyond IRS's FY 2009 new initiatives will be a challenge.
 - IRS recognizes that additional research may be needed to provide data for ROI analyses.
 - Developing ROI estimates for taxpayer service is a particular challenge because of a lack of data on the impact of taxpayer service on compliance.
 - IRS's Taxpayer Assistance Blueprint includes a proposal to conduct research with the goal of measuring the ROI for taxpayer service.
-

FY 2009 Budget Request – Enforcement Increase

- The FY 2009 enforcement increase reflects initiatives that address a small percentage of the \$290 billion net tax gap.

 - The budget request for IRS includes five nonlegislative enforcement initiatives that would cost about \$338 million in FY 2009 and are expected to raise about \$2 billion of direct revenue annually starting in 2011.
 - The amount of indirect revenue from changes in voluntary compliance is harder to measure than the direct revenue effects of IRS's enforcement programs, but the budget request says "it is estimated to be at least" \$6 billion annually as a result of deterring noncompliance.

 - Examination coverage for corporations with assets of \$10 million or more will increase from a planned 6.6 percent for FY 2008 to 6.8 percent for FY 2009, which was the actual FY 2007 percentage, and to 7.59 percent and 7.32 percent for FYs 2010 and 2011, respectively.
-

FY 2009 Budget Request – Enforcement Increase

- The budget request shows that 16 legislative initiatives budgeted at \$23 million for FY 2009 would raise about \$36 billion in revenue over 10 years; if none is enacted, IRS would not need the \$23 million.
 - Twelve of the 16 legislative initiatives remain from the FY 2008 proposed budget.
 - Three of the 16 would raise about \$34 billion of the \$36 billion over 10 years; for various reasons this is more than the administration's FY 2008 estimate of about \$27 billion for similar proposals.

FY 2009 Budget Request – Enforcement Increase

- We have reported on three proposals.
 - In 2006 we suggested that Congress consider an idea for reducing securities capital gains noncompliance.
 - In 1991 we supported the notion that payments to corporations be reported on information returns.
 - In 2007 we described ways to mitigate the compliance costs related to these information returns and to other information returns associated with credit and debit card payments.

FY 2009 Budget Request – Specific Taxpayer Service Decreases

- The FY 2009 budget request for IRS does not include any taxpayer service initiatives that increase 2009 funds over the 2008 enacted amount.
 - IRS officials told us they expect the number of tax returns prepared by IRS taxpayer assistance centers to increase despite a \$31 million reduction in funding for the category covering these centers and outreach; they said that the number of returns would not decline because much of the \$31 million in 2008 was being used for long-term investments that would not be duplicated in 2009.
 - A \$7.7 million decrease in funding for the Taxpayer Advocate is designed to offset an unexpected funding increase in FY 2008 that is being used to lower the Advocate's outstanding caseload.

FY 2009 Budget Request – Specific Taxpayer Service Decreases

- The \$8 million reduction in Volunteer Income Tax Assistance (VITA) resulted from the \$8 million provided in FY 2008 for 2 years not being used in 2008 and still being available through FY 2009.
 - Since the program being funded--providing matching grants to volunteer tax preparer organizations--was ramping up in 2008 to be operational in 2009, another \$8 million was not needed for 2009; according to IRS officials, the \$8 million was not used in 2008 because it only became available after the filing season.
 - IRS is expecting to see large, but unquantified, growth in VITA returns.
 - There were 11,922 VITA and Tax Counseling for the Elderly sites with 76,000 volunteers in FY 2007.

FY 2009 Budget Request – Background on BSM

- As previously noted, the budget for the BSM program was significantly reduced from the enacted FY 2008 budget.

Table 5: BSM Funding Differences, FYs 2008 and 2009 (in thousands)

Project	FY 2008 enacted	FY 2009 budget request
Customer Account Data Engine	\$58,500	\$58,800
Accounts Management Services	28,983	26,158
Modernized e-File	55,802	25,000
Filing & Payment Compliance	0	0
Core Infrastructure	39,150	32,000
Architecture, Integration, and Management	35,100	35,000
Management Reserve	4,310	2,300
Subtotal capital investments	\$221,845	\$179,258
BSM labor	44,000	42,052
Subtotal program request	\$265,845	\$221,310
Maintaining current levels	1,245	1,354
Total BSM budget request	\$267,090	\$222,664

Source: IRS data.

FY 2009 Budget Request – Background on BSM

- IRS's BSM program was initiated in 1999. It involves the development and delivery of a number of modernized tax administration, internal management, and core infrastructure projects that are intended to provide improved and expanded service to taxpayers as well as IRS internal business efficiencies.
- To date, about \$2.3 billion has been appropriated for BSM.
- The budget request for IRS's BSM was reduced by over \$40 million from last year's enacted amount. When we asked about the impact of this reduction on its operations, IRS told us that the proposed funding level will allow it to continue developing and delivering its primary modernization projects, but did not provide details on how plans to deliver specific projects or benefits to taxpayers would be affected.

FY 2009 Budget Request - BSM Projects

Key tax administration systems include

- Customer Account Data Engine (CADE)--Intended to replace the Individual Master File (IMF) and allow daily transaction processing rather than current weekly batch processing provided from current IMF.
 - CADE has demonstrated potential to significantly improve service to taxpayers through streamlined and more efficient processing. Direct deposit refunds 3.5 days faster and paper refunds up to 7 days faster than legacy system.
- Account Management Services (AMS)--Intended to allow IRS employees and taxpayers to access, validate, and update taxpayer accounts on demand.
 - As an initial step, AMS allows IRS customer service representatives to perform on-line address changes to CADE accounts.

FY 2009 Budget Request - BSM Projects

- Modernized e-File (MeF)--Allows electronic filing of many business returns. Plan for providing future capability for electronic filing of virtually all returns.
 - Provides electronic filing of federal and state tax forms, including for large corporations and tax-exempt organizations; over 2.2 million returns/extensions have been accepted since launch. Accepts large attachments in Portable Document Format (PDF), thus eliminating the need for separate submission by mail. Has successfully processed large partnership forms with over 500,000 documents.

FY 2009 Budget Request - BSM Challenges

- IRS's initial efforts to modernize its systems had significant management and technical weaknesses and, as a result, projects were routinely experiencing cost increases and schedule delays.
 - The seriousness of these weaknesses led us to place the modernization program on our high-risk list in 1995.
 - We review the program regularly as part of our BSM expenditure plan reviews and have noted that IRS has made significant progress in implementing management controls and capabilities and addressing our recommendations in recent years.
-

FY 2009 Budget Request - BSM 2008 Expenditure Plan Findings

- However, some of our recommendations have not yet been fully addressed. For example, in our review of IRS's BSM expenditure plan for FY 2008, we reported that IRS
 - was still not performing postimplementation reviews on its projects, and
 - had yet to take certain actions to address our recommendations to fully revisit the vision and strategy for BSM, including developing long-term plans for completing the program.

FY 2009 Budget Request - BSM 2008 Expenditure Plan Findings

- We also noted that
 - project phases were not all completed on schedule and within cost during 2007, and
 - future releases of CADE and AMS continue to face risks and challenges.
- We recommended that IRS complete a plan with specific time frames for implementing initiatives supporting its IT human capital strategy, and IRS agreed.

Interim Results of IRS's 2008 Filing Season – Alternative Minimum Tax Processing Delays

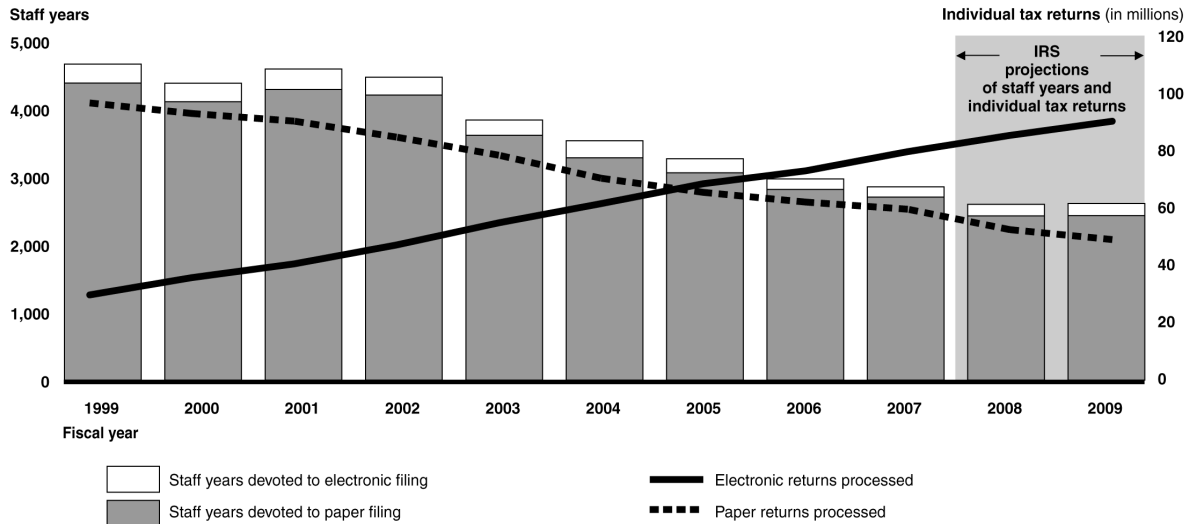
- IRS's efforts to develop a communication plan about delays in processing certain AMT-affected returns adhered to many communication strategy best practices.
 - IRS updated some systems and processed a majority of returns including many AMT-affected returns, without any processing delays.
 - IRS began processing all AMT-affected returns on February 11, about 4 weeks after the filing season began.
 - Many taxpayers facing AMT-affected processing delays did not file a return until after February 11.
 - A small number (74,000) of electronically filed returns were rejected because they could not be processed before February 11 due to AMT.
-

Interim Results of IRS's 2008 Filing Season – Returns Processing

- The volume of returns processed and refunds issued and IRS's processing performance are comparable to last year. According to IRS data, as of February 29, IRS
 - processed 51.2 million individual income tax returns, with nearly 79 percent filed electronically. The volume of electronically filed returns is up 6.2 percent over last year; and
 - issued 46.5 million refunds, worth \$122.7 billion, with 81 percent being directly deposited into taxpayers' accounts (up 6 percent over last year).
 - As of February 28, 2.5 million returns were processed through the Free File Program, up 12 percent from last year. IRS does not allow financial products, such as Refund Anticipation Loans (RALs), to be offered through the Free File Program.
 - IRS expects more than 20 million returns to be processed in 2008, due to the requirements of the economic stimulus program (in addition to the more than 130 million returns processed in a normal year).
-

Interim Results of IRS's 2008 Filing Season-- Returns Processing

Figure 2: Number of Individual Income Tax Returns and IRS Staff Years for Individual Paper and Electronic Processing, FYs 1999 – 2009



Source: GAO analysis of IRS data.

Interim Results of IRS's 2008 Filing Season - Increasing Efficiencies in Returns Processing

- Compared to paper returns, electronic filing
 - Reduces IRS's costs by reducing staff devoted to processing. In 2007, IRS used 1,811 (39 percent) fewer staff years for processing tax returns than in 1999 for savings estimated by IRS to be \$85 million.
 - Improves service to taxpayers because of more accurate returns and faster refunds.
- As of March 5, 14.3 million returns were posted to CADE with nearly the same number of refunds totaling \$23 billion. Because CADE processes returns and refunds more quickly, it can help minimize the need for RALs and the high interest rates associated with these short-term loans.

Interim Results of IRS's 2008 Filing Season - Increasing Efficiencies in Returns Processing

While IRS has achieved efficiencies, in large part, from increases in electronic filing, in prior reports we have said that IRS could achieve additional efficiencies by

- mandating electronic filing for paid preparers who file a certain number of returns and/or mandating bar coding for paper returns prepared on a computer, and
- transcribing all information from the remaining paper tax returns.

Doing the above would make all tax return information available electronically for enforcement, which is not now the case.

Interim Results of IRS's 2008 Filing Season - Telephone Assistance

Table 6: IRS Telephone Assistance Volume in the First Weeks of the Filing Seasons, 2007 and 2008

Telephone assistance	2007 Actual	2008 Actual
Total calls ^a	16,027,716	15,378,372
Answered by IRS assistors (percentage)	6,538,436 (41%)	6,295,549 (41%)
Answered by automated menu of recordings (percentage)	9,489,280 (59%)	9,082,823 (59%)

Source: GAO analysis of IRS data.

^a Total calls (i.e., calls answered by assistors and automation) are based on actual counts, from January 1 to February 24, 2007, and January 1 to February 23, 2008. FY 2007 Actual includes 241,880 TETR assistor and automated calls answered.

Interim Results of IRS's 2008 Filing Season - Telephone Assistance

Table 7: IRS Telephone Assistance Performance in the First Weeks of the Filing Seasons, 2007 and 2008

Telephone performance--access	2007 Actual	2008 Actual	2008 Plan (to date)
Assistor level of service (percentage of taxpayers who wanted to talk with an assistor and actually got through and received service) ^a	80.9%	78.6%	80.7%
Average speed of answer (number of minutes spent waiting in queue to speak with an assistor) ^a	4.6	5.7	4.8
Taxpayer disconnects (when taxpayer hangs up while waiting on assistance) ^a	12.9%	14.8%	N/A
IRS disconnects (when IRS hangs up on a taxpayer waiting on assistance) ^a	1.3%	2.7%	N/A
Telephone performance--accuracy^b			
Accounts customer accuracy rate estimates ^c	91.97%	93.96%	N/A
Tax law customer accuracy rate estimates ^c	87.05%	87.18%	N/A

Source: GAO analysis of IRS.

Note: N/A means that IRS did not set goals for these measures.

^a Assistor level of service, average speed of answer, and taxpayer and IRS disconnects are based on actual counts from January 1 to February 24, 2007, and January 1 to February 23, 2008.

^b According to IRS, these measures are based on a representative sample estimated at the 90 percent confidence interval for January 2007 and 2008. The margin of error for the 2007 and 2008 estimates is less than 2.4 percentage points.

^c The percentage of calls in which telephone assistors provided accurate answers for the call type and took the appropriate action.

Interim Results of IRS's 2008 Filing Season - Telephone Assistance

- IRS expects substantially increased telephone demand related to the economic stimulus legislation.
 - IRS will be establishing a new automated line (1-866-234-2942) for taxpayers with questions about stimulus payments. Taxpayers without a filing requirement will hear a recorded message with the option to route to an assistor.
 - Because of the increased demand, IRS expects its assistor level of service to drop from 82 percent (the 2008 goal) down to 74 percent—the lowest level since 2002, depending on taxpayer behavior and IRS's ability to steer them to other means of assistance and information. This lower level would decrease taxpayers' ability to get through and speak with an assistor.
-

Interim Results of IRS's 2008 Filing Season - Telephone Assistance

- IRS has begun shifting hundreds of Automated Collection System (ACS) staff from collections work to answering taxpayer calls about their economic stimulus checks.
- IRS started sending economic stimulus notices to taxpayers the week of March 3rd and needed additional phone staff that same week.
- To accommodate the shift, IRS stopped sending out some ACS notices several weeks ago.
- IRS considered alternatives to ACS staff including contracting out, using other IRS staff, or using Social Security Administration or other federal staff but decided they were infeasible. For example, contracting out was not feasible because of insufficient time to negotiate the contract and conduct background checks and training.
- IRS estimated that the revenue foregone by shifting ACS staff from collections work to economic stimulus work to be up to \$681 million.

Interim Results of IRS's 2008 Filing Season - Web Site Assistance

Table 7: IRS Web Site Use for Filing Seasons 2007 and 2008

Uses	2007	2008
Visits ^a	74,186,798	82,612,754
Downloads ^b	24,429,718	24,842,830
Searches ^b	20,248,240	21,782,375

Source: GAO analysis of IRS data.

^a Web site visits are from January 1 to March 2, 2007, and January 1 to March 1, 2008. A visit begins when a visitor views his or her first page from the server IRS.gov, and ends when the visitor leaves the site. Visits are not counts of the numbers of unique individuals who have accessed the site.

^b Web site downloads and searches are from January 2007 and 2008.

Interim Results of IRS's 2008 Filing Season - Face-to-Face Assistance

Table 8: Assistance Provided at IRS Taxpayer Assistance Centers and Volunteer Sites

	2007	2008
Return preparation contacts at IRS taxpayer assistance centers ^a	NA	85,604
Returns prepared at volunteer sites ^b	1,084,051	1,199,307

Source: GAO analysis of IRS data.

^a IRS data for 2007 are not comparable to 2008, because IRS changed how it counts numbers of returns being prepared at taxpayer assistance centers from counting the number of returns prepared to counting the number of taxpayers who returns they prepared. The time periods covered are December 31, 2006 to February 24, 2007, and January 1, 2008 to February 23, 2008.

^b Returns prepared at volunteer sites from October 1, 2006 to March 4, 2007, and October 1, 2007 to March 3, 2008.

IRS is expecting increased demand at its taxpayer assistance centers and volunteer sites, including VITA, as a result of the economic stimulus legislation.

Interim Results of IRS's 2008 Filing Season - IRS's Ability to Identify Paid Preparers

- IRS has limited ability to identify paid preparers and match them with the returns they prepared.
- Paid preparers prepared 78 million individual tax returns during the 2006 filing season, or 61 percent of all individual returns. Because paid preparers assist the majority of taxpayers, they are a potentially significant part of efforts to reduce taxpayer noncompliance and reduce the tax gap.
- IRS requires that paid preparers identify themselves on all income tax returns they prepare by entering their Social Security Number (SSN) or Preparer Tax Identification Number (PTIN). If the preparer has a partnership or employment arrangement, then the preparer must also include the Employer Identification Number (EIN) of the partnership or employer on the return, in conjunction with an SSN or PTIN.

Interim Results of IRS's 2008 Filing Season - IRS's Ability to Identify Paid Preparers

- According to IRS officials, many preparers do not sign tax returns with the required identifying number or numbers. However, because processing returns is a priority for IRS, it accepts returns even if preparers' information is not provided on returns.
 - Because preparers have the choice between two numbers and may be required to use a third as well, IRS officials said that this creates confusion for preparers and IRS faces challenges in enforcing the signing requirement.
 - According to IRS officials, one possible improvement would be to require a single identification number for each paid preparer. However, these officials also noted that there would be a range of options, for example, about how much data IRS would collect from preparers when obtaining the number. IRS does not have estimates of the usefulness of the various options or the costs of developing such a system.
-

Interim Results of IRS's 2008 Filing Season - IRS's Ability to Identify Paid Preparers

The limitations in identifying preparers complicate enforcement because IRS cannot systemically match tax returns with preparers in order to detect patterns of noncompliance.

- According to IRS officials,
 - IRS obtains much information on paid preparers from audits of taxpayers. Identifying problems with paid preparers through audits can be labor intensive and complicated because it is difficult to identify and track paid preparers this way.
 - Without a single identification number, lists of returns prepared by a particular preparer may be incomplete.

Interim Results of IRS's 2008 Filing Season - IRS's Ability to Identify Paid Preparers

- Early in last year's filing season, IRS detected paid preparers filing fraudulent telephone excise tax refund (TETR) claims. IRS
 - detected amounts over a threshold for the TETR claims made by taxpayers,
 - pulled those returns and identified patterns, such as many refunds going to one address, using its Electronic Fraud Detection System (EFDS),
 - took action, including audits, to investigate these claims and determined whether a paid preparer was involved, and
 - manually looked for patterns of fraudulent claims associated with particular paid preparers.
 - Although labor intensive, IRS officials said that detecting TETR related preparer fraud was easier than for many other types of noncompliance because of the simplicity of determining useful thresholds.
-

Interim Results of IRS's 2008 Filing Season - IRS's Ability to Identify Paid Preparers

- Beyond complicating enforcement, IRS officials said that the limited ability to identify paid preparers is also an impediment for research about the influence that paid preparers have on taxpayer compliance.
- The Director of IRS Research noted that without an unduplicated count of return preparers it is difficult to do research on how different types of paid preparers contribute to taxpayer noncompliance or engage in fraud themselves.
- Without such research about paid tax preparers, IRS is less able to understand the influence that paid preparers have on taxpayer behavior and is less able to target outreach, education and enforcement efforts on problem preparers.

Conclusions

-
- IRS should be commended for including ROI analyses of new initiatives in the FY 2009 budget justification. Because IRS has ambitious plans to improve enforcement, improve taxpayer service, increase research, and continue investing in modernized information systems, resource allocation decisions are more important than ever. Being able to make resource allocation decisions, based in part on ROI analysis, even with its limitations, could increase the chances that IRS's ambitious goals are met.
 - Because of the important role of paid preparers in administering the U.S. tax system, better information about preparer behavior and their contribution to taxpayer compliance could ultimately help reduce the large tax gap. A first step toward better information would be improving IRS's ability to identify paid preparers.
-

Recommendations

- The Commissioner of Internal Revenue should
 - extend the use of ROI in future budget proposals to include major enforcement programs, and
 - develop a plan to require a single identification number for paid preparers, including the feasibility of options, benefits and costs of those options, as well as their usefulness for enforcement and research on paid preparer behavior.

Agency Comments

- In commenting on a draft of this report, IRS officials said that, due to the short time frame for GAO's report, they did not have time to fully analyze the recommendations and, therefore, were unable to respond to them at the time. They provided technical comments, and we made those changes where appropriate.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

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Staff Acknowledgments

In addition to the contact person named above, Shea W. Bader, Crystal M. Bernard, Michael Brostek, James Cook, John H. Davis, Carlos E. Diz, Sarah A. Farkas, Charles R. Fox, Leon H. Green, Brent Greene, Carol M. Henn, Robyn T. Howard, Lawrence M. Korb, David Lewis, Paul B. Middleton, Karen V. O'Connor, Sabine R. Paul, Cheryl M. Peterson, Neil A. Pinney, Jesus Ramoz, and Joanna M. Stamatiades made key contributions to this report.

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