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INTERNAL REVENUE SERVICE

Effective Implementation of the Tax Reform Act Led to Uneventful 1988 Filing Season



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The Honorable Lloyd Bentsen
Chairman, Joint Committee on
Taxation

The Honorable Dan Rostenkowski
Vice Chairman, Joint Committee
on Taxation

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

In response to your requests, this report discusses steps the Internal Revenue Service (IRS) took to implement the Tax Reform Act of 1986 in preparation for the 1988 tax return filing season and IRS' success in processing its filing season work load. Another report, on IRS' issuance of regulations and other forms of guidance interpreting the 1986 act, will be issued later.

As arranged with the Committee and Subcommittee, we are sending copies of this report to other congressional committees, the Secretary of the Treasury, the Commissioner of Internal Revenue, and other interested parties. The major contributors to this report are listed in Appendix III.

A handwritten signature in cursive script that reads 'Jennie S. Stathis'.

Jennie S. Stathis
Associate Director

Executive Summary

Purpose

The Tax Reform Act of 1986 amended or repealed over 2,000 subsections of the Internal Revenue Code. These sweeping changes required careful Internal Revenue Service (IRS) preparation for the 1988 tax return filing season, including extensive education of the taxpaying public.

In response to requests from the Joint Committee on Taxation and the Subcommittee on Oversight of the House Committee on Ways and Means, GAO reviewed IRS' implementation of the act and its efforts to provide taxpayer service and process tax returns during the 1988 filing season.

Background

The Tax Reform Act increased IRS' work load during the 1988 filing season compared to 1987. For example,

- 101.8 million individual income tax returns were filed by May 27, 1988, compared to 98.4 million during the comparable period in 1987;
- 21.2 percent of the returns filed as of the end of May 1988 contained errors that had to be corrected before the returns could be processed compared to 19.2 percent in 1987; and
- IRS answered about 20 million calls over its toll-free telephone lines from taxpayers seeking assistance in preparing their tax returns, an increase of about 14 percent over 1987.

IRS also had to hire and train more employees, develop or revise over 200 tax forms and publications and make sure they were available when taxpayers needed them for guidance, and modify computer programs used to process tax returns at each of IRS' 10 service centers.

Results in Brief

IRS did a good job implementing the Tax Reform Act and preparing for the increased work load it expected during the 1988 filing season. IRS mounted an extensive media campaign to inform taxpayers about tax law changes and to encourage them to file early. It hired and trained additional staff to answer taxpayer questions and process tax returns, extensively tested tax forms before distributing them to the public, and tested service center readiness before the filing season began.

Due in large part to IRS' effective preparations, the 1988 tax filing season was uneventful. GAO identified some opportunities for IRS to improve the effectiveness of future filing seasons by revising sections of tax forms that were the source of numerous errors in 1988, tailoring the tax

package mailed to taxpayers to encourage the use of simpler forms, and ensuring that taxpayers have ready access to tax forms and publications. IRS has taken or plans to take steps to address each of these areas.

Principal Findings

Preparations Effective

IRS effectively prepared for the 1988 tax filing season. In particular, IRS

- released many tax forms early for public comment and pretested forms that would be widely used or were significantly changed;
- distributed publications, contacted taxpayer groups, and worked with a public affairs organization to inform taxpayers about tax law changes and to encourage them to file early;
- increased the number of telephone assistors from 3,500 in 1987 to 4,500 in 1988, trained them earlier than in past years, increased the number of telephone lines by 30 percent over 1987, and increased the operating hours of telephone offices; and
- hired additional returns processing staff, reduced service center inventories to the lowest level in 3 years, and conducted extensive readiness checks at all centers. (See pp. 14 to 17.)

Filing Season Uneventful

In terms of IRS' ability to process its work load in a timely manner, the 1988 filing season was a success. IRS met its target date for issuing taxpayer refunds, met its goal of handling the increased volume of calls from taxpayers seeking telephone assistance, and generally did a good job filling taxpayers' orders for forms and publications. Also, service center computers and software worked reliably. (See pp. 18 to 20 and 23 to 25.)

Error Rates Slightly Higher in 1988

IRS statistics as of May 25, 1988, showed that about 21.2 percent of filed returns had one or more errors that had to be corrected before the return could be processed. This rate is 2 percentage points higher than in 1987. According to IRS, more than half of the errors in 1988 were mistakes made by taxpayers when they filled out their returns, such as entering the wrong standard deduction for their marital and/or age category. Many other errors were made by IRS staff when they processed the returns, such as failing to enter certain codes that direct the computer to

take certain actions. In preparing for the 1989 filing season, IRS is modifying tax forms and instructions in an attempt to reduce the frequency of the most common taxpayer errors and plans to emphasize during training those areas where IRS staff made errors. (See pp. 20 and 21.)

Taxpayers Did Not Always File the Simplest Return

The number of taxpayers filing the simpler 1040A and 1040EZ returns increased by 1.2 million in 1988, about 2.9 million less than IRS had projected. Based on a sample of 1,604 returns taken from three IRS service centers, GAO found that about 14 percent of the 1040 filers could have filed 1040A or 1040EZ returns, while about 10 percent of the 1040A filers could have filed 1040EZ returns. GAO projected that it cost IRS an additional \$519,000 to process the more complex returns at the three centers.

GAO concluded that some taxpayers did not file the simplest returns possible because IRS, when mailing out tax packages for the 1988 filing season, relied on filing requirements in place before the Tax Reform Act. IRS officials said they did this because the numerous law changes prevented them from accurately identifying those taxpayers who could file simpler forms. Thus, some taxpayers who could have filed simpler returns under the new law were not provided the simplest return in their tax package. IRS officials said that they plan to adjust for the new law when they mail out tax packages for the 1989 filing season.

Another reason why simpler returns were not filed was provided by representatives of tax preparer groups. Those representatives said that tax preparers sometimes do not use the 1040EZ form because (1) their computer software only produces 1040 forms and (2) preparation of a 1040EZ is complicated by the requirements IRS imposes to process the form on automated equipment. (See pp. 21 to 23.)

Availability of Forms and Publications Improved Later in the Filing Season

Based on tests GAO made at 14 IRS offices, the availability of tax forms and publications improved as the 1988 filing season progressed. After GAO testified in February that certain forms and publications were not available at IRS offices, IRS management directed field offices to follow proper restocking procedures. When GAO rechecked availability in March and April, the situation had improved. According to IRS officials, ensuring the availability of forms and publications is a high priority for the 1989 filing season.

GAO also tested IRS' performance in filling phone orders for tax forms and publications. IRS filled 17 of GAO's 23 test orders in 10 work days or less, the standard IRS sets for itself. Four orders were received in 11 to 15 days, and two orders were never received. IRS is installing an automated phone order system that it believes will improve its performance in future filing seasons. (See pp. 24 and 25.)

Recommendations

GAO is not making any recommendations in this report.

Agency Comments

GAO obtained oral comments from responsible IRS officials on a draft of this report. They suggested some minor technical changes that were incorporated in the final product.

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Abbreviations

GAO	General Accounting Office
IRS	Internal Revenue Service

Introduction

The Tax Reform Act of 1986 made sweeping changes to the Internal Revenue Code. Changes in tax rates, filing requirements, and allowable deductions affected virtually every taxpayer. Successful implementation of the act depended heavily on Internal Revenue Service (IRS) actions to prepare itself and the taxpaying community for the related changes.

We reviewed IRS' implementation of the act and IRS' performance during the 1988 tax return filing season¹ in response to requests from the Joint Committee on Taxation and the Subcommittee on Oversight of the House Committee on Ways and Means. On January 7, 1988, we briefed the Joint Committee on IRS' preparations to implement the act. We testified before the Oversight Subcommittee in February and April 1988 on the filing season.²

With two exceptions, this report summarizes the results of our review. The two exceptions relate to (1) modification and testing of IRS' computer programs, which was discussed in a separate report³ and (2) revision and issuance of regulations and rulings, which will be the subject of a later report.

Impact of the Tax Reform Act

The Tax Reform Act of 1986 amended or repealed over 2,000 subsections of the Internal Revenue Code. These changes had an immediate effect on how taxpayers completed their 1987 tax returns. Changes such as the new requirement that dependents obtain and report social security numbers (affecting 40 million tax returns) and the repeal of the married couple two-earner deduction (affecting 24.6 million tax returns) required extensive education of the taxpaying community and complicated IRS' preparations for the 1988 tax filing season.

In preparing for the filing season, IRS had to

- revise existing tax forms, develop new ones, and provide taxpayers and tax preparers with timely guidance on filing requirements;

¹The 1988 tax return filing season for individual taxpayers filing tax year 1987 returns ran from January 1, 1988, through April 15, 1988. (Some taxpayers filed returns after April 15, however, based on approved extensions.)

²Status of the 1988 Tax Return Filing Season (GAO/T-GGD-88-13, Feb. 23, 1988); The 1988 Tax Return Filing Season (GAO/T-GGD-88-30, Apr. 13, 1988). See appendix I.

³Internal Revenue Service: Computer Readiness For 1988 Filing Season (GAO/IMTEC-88-31, Mar. 31, 1988). See appendix I.

- be ready to assist the 25.3 million people it estimated would request assistance through its toll-free telephone lines—2.8 million more than requested assistance in 1987;
- hire and train enough staff to process the 107.6 million returns it expected to be filed in 1988—a 3.7 million increase over 1987;
- revise computer programs used to process tax returns at IRS' 10 service centers and its National Computer Center; and
- prepare for an estimated increase of 3.2 million errors on tax returns as taxpayers and tax preparers adjusted to changes in forms and filing requirements.

IRS' Efforts to Plan for and Monitor Implementation of the Tax Reform Act

Before enactment of the Tax Reform Act on October 22, 1986, IRS started reviewing each provision of the law to develop an implementation strategy. IRS reviewed each provision to determine

- what technical issues required guidance in the form of regulations, revenue rulings and procedures, notices, and announcements;
- what efforts were needed to educate the public about these new rules;
- how IRS' forms and publications had to be changed; and
- what internal actions were necessary to train IRS employees, revise procedural instructions, and modify and test computer programs.

The end result of that review was an implementation plan containing about 2,000 action items that served to prioritize and guide IRS' implementation of the act. IRS' Legislative Affairs Division, which is located organizationally in the Office of the Commissioner, was responsible for coordinating development of the plan and monitoring its execution by IRS' functional areas.

Besides the Legislative Affairs Division, other IRS groups monitored various aspects of IRS' implementation of the Tax Reform Act and its readiness for the 1988 filing season. In February 1987, IRS established an Executive Steering Committee, composed of executive level staff from IRS' national and field offices. The committee's job was to ensure that the overall planning process was adequate and to elevate issues and concerns about implementation to appropriate officials. In addition, the committee was charged with overseeing IRS' strategy for communicating its tax reform message to employees and the public.

Functioning as a subgroup under the Executive Steering Committee was a second executive team charged with ensuring that IRS was operationally ready for the 1988 filing season. Although IRS has been checking the

readiness of service centers for each filing season since 1985, the 1988 readiness check began earlier and was expanded to cover not only service center operations, but also taxpayer service and forms distribution. The readiness group did its work during the summer and fall of 1987 and issued its final report on November 25, 1987. The report highlighted specific areas that required continued attention, such as the need to (1) closely monitor work load receipts, (2) follow through on developing a new system to measure the quality of assistance provided to taxpayers over toll-free telephone lines, and (3) meet customer demand for tax publications.

IRS' Internal Audit Division staff also did a series of national and local audits to ensure that IRS was ready for the 1988 filing season and that the filing season progressed smoothly once underway. Their reviews focused on taxpayer service; the development of computer software; individual and business income tax processing activities, including an IRS initiative to receive and process electronically filed returns; the tax material distribution program; and taxpayer compliance programs. Although Internal Audit did not identify any problems that would have prevented IRS from implementing the Tax Reform Act, it did identify several areas that needed further attention, such as the instructions provided on tax forms, taxpayer service staffing, and service center processing procedures. The Commissioner of Internal Revenue testified in February 1988 hearings before the House Oversight Subcommittee that IRS had begun taking corrective actions in response to the audit findings.

To obtain an independent view of its implementation plans, IRS contracted with the management consulting firm of Booz-Allen & Hamilton Inc. The firm's task was to identify any significant planning deficiencies that could jeopardize IRS' ability to implement the new law or administer the overall tax system. The final report, issued November 2, 1987, concluded that IRS' planning process was effective and had produced a sound plan overall. The report also noted that IRS still needed to complete a number of actions before the 1988 filing season, and that it must closely monitor execution of the implementation plan.

Objectives, Scope, and Methodology

This report responds to a September 11, 1987, request from the Joint Committee on Taxation and a February 8, 1988, request from the Subcommittee on Oversight, House Committee on Ways and Means. We did our work in two phases.

Our objective in the first phase, from May 1987 through December 1987, was to evaluate IRS' preparations to implement the Tax Reform Act of 1986. We focused on IRS' efforts to

- modify and test computer programs that are used to process tax returns;
- provide written guidance to taxpayers and practitioners in the form of regulations, revenue rulings and procedures, notices, announcements, and the like;
- inform the public about Tax Reform Act changes;
- train its employees; and
- prepare its service centers to process tax returns during the 1988 filing season.

During the first phase, we did work at IRS' National Office in Washington, D.C.; its Detroit, Michigan, and Seattle, Washington, district offices; and its Austin, Texas, and Cincinnati, Ohio, service centers. At the district offices we reviewed IRS' efforts to train taxpayer service staff, while at the service centers we reviewed the testing of computer software, the training of returns processing staff, and other planning for the 1988 filing season. We chose the Detroit and Seattle district offices because of the availability of GAO staff. We chose the Austin and Cincinnati service centers because most of the computer software changes necessitated by the Tax Reform Act were tested at these two locations. At IRS' National Office, we obtained plans to implement the act and periodically reviewed their status. We also coordinated our work with IRS' Internal Audit Division and with the various steering committees that IRS established to implement the act.

To obtain tax preparers' views on IRS' preparations for the filing season, we spoke with representatives of the American Institute of Certified Public Accountants, the American Bar Association, and H & R Block.

Our objective during the second phase of the assignment, from January 1988 through June 1988, was to assess IRS' performance during the 1988 filing season. In so doing, we focused on IRS' ability to handle its filing season work load in a timely manner. We did not assess the quality of IRS' work.⁴ Specifically, we wanted to determine whether

⁴We assessed, as a separate job, the accuracy of IRS' toll-free telephone assistance during the 1988 filing season. A report on our results will be issued later.

- IRS processed returns and issued refunds in a timely manner, and whether service center contingency plans were used effectively to respond to unexpected events;
- mainframe computers at IRS' service centers and the software used to process tax returns operated reliably;
- IRS met the demand for taxpayer assistance at toll-free telephone call sites; and
- tax forms and publications were available at selected over-the-counter distribution sites and provided on a timely basis when ordered by telephone from IRS' centralized distribution centers.

To monitor returns processing performance, we analyzed IRS' management information reports and did on-site work at the Atlanta, Georgia; Austin; Cincinnati; and Fresno, California service centers.⁵ Our work at the service centers included discussing the progress of the filing season with service center staffs, gathering data on returns processing activities, and validating the accuracy of reports generated by IRS' Management Information System for Top Level Executives. We validated the reports by analyzing the source and accuracy of data submitted for the reports by three of the service centers. We also visited the Andover, Massachusetts, service center to determine the extent that staff shortages early in the filing season affected returns processing.

As part of our monitoring of returns processing, we determined whether taxpayers filed the simplest return allowed, i.e., filed a Form 1040A or 1040EZ in lieu of a 1040, or filed a 1040EZ in lieu of a 1040A. To do this, we sampled 1,604 Forms 1040 and 1040A individual tax returns that were filed at the Austin, Cincinnati, and Fresno service centers. We also discussed our results with representatives of the National Association of Enrolled Agents, H & R Block, and the National Federation of Independent Business. Our results are projectable to the three service centers where the returns were filed. Appendix II gives a more detailed description of our sampling methodology.

To determine the reliability of service center mainframe computers and related software, we (1) compared the number of hours scheduled for mainframe computer operation with the actual number of hours the computers were available to users; (2) analyzed management reports to determine the number and seriousness of software errors reported by

⁵Unless otherwise noted, we chose the locations for our field work during this phase of the assignment based on the availability of GAO staff.

service centers; and (3) discussed our results with IRS staff in Washington and the Atlanta, Austin, Cincinnati, and Fresno service centers.

To determine whether IRS accurately projected and met the demand for toll-free telephone assistance, we reviewed IRS' management information reports and interviewed IRS staff who were responsible for providing telephone assistance in Atlanta; Baltimore, Maryland; Cincinnati; Dallas, Texas; Detroit; Richmond, Virginia; and San Francisco, California.

To determine whether tax forms and publications were available at IRS over-the-counter distribution sites, we made a total of 50 visits to 14 of IRS' 678 distribution sites during February, March, and April 1988. During those visits, we compared the site's stock of forms with a list IRS uses to take taxpayer orders. The 14 sites were located in territory covered by IRS' Atlanta, Austin, Baltimore, Cincinnati, Dallas, Richmond, and San Francisco district offices.

To assess the availability of forms and publications from IRS' centralized phone-in order points in Bloomington, Illinois; Fresno; and Richmond; we placed 23 orders over a 4-week period in March and April 1988. An order involved 28 documents, each of which, according to IRS estimates, explained tax law changes that affected 3 million or more taxpayers.

Our work was done in accordance with generally accepted government auditing standards. Responsible IRS officials provided oral comments on a draft of this report. They suggested some minor technical changes that we incorporated in the final product.

IRS Did a Good Job Implementing the Tax Reform Act of 1986 and Preparing for the 1988 Filing Season

Overall, we believe IRS did a commendable job of implementing the Tax Reform Act and of anticipating what might happen during the 1988 filing season. IRS developed a strategy that sought not only to assure timely actions in implementing changes to more than 2,000 subsections of the Internal Revenue Code but also to prepare the public and its own staff for the impact the Tax Reform Act would have on preparing 1987 returns and processing them in 1988.

In implementing the act and preparing for the 1988 filing season, IRS focused on

- letting taxpayers and practitioners know early what the new tax forms would be like,
- developing materials to explain the new tax law changes to taxpayers,
- expanding taxpayer service programs to assist taxpayers, and
- making sure that service centers were ready to accurately process tax returns and certify refunds in a timely fashion.

Providing Early Information on Tax Forms

The Tax Reform Act required changes to 162 existing forms and the development of 48 new forms. IRS released draft copies of many of the forms to get public comment and to provide taxpayers and tax preparers with basic information about new tax law provisions. IRS also pretested those forms that were most widely used or significantly changed by having groups of preparers and taxpayers prepare fictitious returns. Pretested forms included Forms 1040, 1040A, and 1040EZ; Schedule A (Itemized deductions); Form 8606 (Individual Retirement Arrangement contributions); and Form 8598 (Home mortgage interest). IRS then revised forms based on public responses to the drafts and results from the pretests. The requirement for filing Form 8598, for example, was revised based, in part, on public reaction to the form's complexity. That revision significantly reduced the number of taxpayers who had to file the form.

We believe IRS' approach to revising and developing new forms was generally effective. Tax preparers we spoke with were very complimentary about IRS' release of draft forms for public comment. They believed that a few forms, such as the form for computing deductible home mortgage interest, were overly complex, but they did not provide specific details on how the forms might be simplified.

Explaining Tax Law Changes

Because changes are usually more difficult to deal with the first year, IRS launched an extensive campaign to encourage taxpayers to get an early start familiarizing themselves with the 1987 returns and to file their returns as soon as possible. In October 1987, IRS sent a pamphlet to over 90 million taxpayers, alerting them to the new law and urging them to begin thinking early about their taxes. The pamphlet also contained an order blank for a new publication (Publication 920) that explained tax law changes for individuals. Through April 1988, IRS had filled 17.6 million orders for the publication. IRS also held nationwide teleconferences with preparers to explain changes and answer questions.

Overall, IRS developed and distributed 13 new publications to explain various aspects of the new law. Publication 920 for individuals and its companion Publication 921 for businesses were distributed to 22,000 libraries across the country. Publication 1339, which highlighted major new provisions of the law, was mailed to 300,000 practitioners. Other publications were targeted and distributed to special groups. For example, the real estate industry received and circulated Publication 924 on real estate reporting requirements, while the banking industry helped distribute publications on individual retirement arrangements and mortgage interest.

In January 1988, IRS enlisted the Advertising Council¹ to launch a nationwide campaign to urge people to file early. IRS estimates that over 100 million taxpayers were contacted through media materials, such as television and radio spots, billboards, bus cards, and drop-in advertisements. IRS budgeted just over \$1 million for the Advertising Council campaign, which it estimated was supplemented by more than \$25 million in donated advertising time and space in the Nation's media.

Expanding Taxpayer Services

Anticipating that more taxpayers would need help in preparing their 1987 tax returns, IRS made a concerted effort to hire and train more taxpayer service assistors for the 1988 filing season. Although some district offices had early problems hiring additional assistors because of the job market, most offices were able to meet hiring goals by the start of the filing season, putting IRS in a better staffing position than in past years. The number of persons providing assistance over IRS' toll-free telephone lines was increased from 3,500 in 1987 to 4,500 in 1988, and total staffing in the taxpayer service area was increased by about 1,300 staff

¹The Advertising Council is a private nonprofit organization that coordinates public affairs campaigns.

years to a total of 7,245. Classroom training for assistors was provided earlier than past years and assistors were kept on board for extensive on-the-job training. In past years, assistors were trained and then furloughed until the filing season began.

The staffing increase was augmented by an increase in operating hours at taxpayer service offices and an increase in the number of toll-free telephone lines. During the 1988 filing season, each of IRS' seven regions provided toll-free telephone service on Saturdays and some provided service on Sundays. IRS also increased the number of toll-free lines by 30 percent over 1987.

Making Sure That Service Centers Were Ready

In preparing for the 1988 filing season, IRS was concerned about projected increases in the number of returns to be filed and in the number of returns that would be filed with errors. IRS estimated that its 10 service centers would process 107.6 million individual income tax returns during 1988, an increase of 3.7 million returns over 1987, and would need to resolve errors on about 21.7 percent of those returns, an increase of about 2.8 percentage points over 1987.

IRS managers were also concerned that changes in the law might exacerbate a trend towards later filing of tax returns. In 1983, 14 percent of all individual tax returns were filed in January and 34 percent were filed in April. Four years later, in 1987, 4 percent of the returns were filed in January and 39 percent were filed in April. IRS managers were concerned that if the trend worsened and a larger percentage of returns were received in April, the processing of returns and the issuance of refunds could be slowed.

To prepare its service centers for these possibilities, IRS planned to have about 38,000 employees processing returns during the filing season peak, compared to 35,000 in 1987. It also hired and trained returns processing staff early with an eye towards being fully prepared to process returns at the start of the filing season. All of the centers reached their filing season hiring objectives. According to IRS officials, the service center in Andover, Massachusetts, had the most trouble meeting its objective because of a highly competitive job market in that area. The service center eventually achieved its objective, but not until February 1988.

IRS also took several steps to ensure that service center managers were alerted to problems that might occur in implementing the act. National

Office teams visited all 10 centers during 1987 to brief management on the anticipated impact of the act and how to deal with it. Other IRS teams conducted readiness checks at each center and developed contingency plans to address unexpected filing patterns, unacceptable processing delays, or inventory backlogs. Among other things, contingency plans included steps to shift service center staff to areas within the center where problems developed or to shift work loads to other service centers.

To further prepare for the 1988 filing season, the service centers reduced their work load inventories to the lowest level in 3 years. As a result, service centers were in a better position to contend with unforeseen problems that might occur as the filing season progressed. In January 1988, for example, the unpostables inventory, which involves errors that must be resolved before transactions will post to taxpayers' accounts, was 39.9 percent lower than in January 1987.

Conclusions

Given the task of preparing for and implementing a new law as extensive as the Tax Reform Act of 1986, IRS did a good job. It released tax forms for public comment and pretested some forms to minimize complexity. It organized an extensive media campaign to inform the taxpaying community about the act and to encourage them to file early. It hired more taxpayer assistors, hired them earlier, and gave them more training. And it took steps to prepare its service centers through increased and earlier-trained staff, readiness checks, and contingency plans.

The 1988 Filing Season Was Uneventful

IRS' expectations of a larger work load in the 1988 filing season compared to 1987 proved correct. More tax returns and applications for filing extensions were received than in 1987, more returns had errors, more telephone calls were received from taxpayers seeking help in preparing their returns, and millions of orders for forms and publications had to be filled. We believe IRS did a good job in processing that work load in a timely manner.

Returns Processing Progressed Smoothly

IRS received and processed tax returns during the 1988 filing season without major difficulty. As shown in figure 3.1, the pace with which returns were filed and processed was not much different than in 1987. For those returns received by April 15, IRS met its target date for issuing taxpayer refunds by June 1. The June 1 date is important because the Department of the Treasury has to pay interest on any refund paid after then, if the return was filed by April 15.

As of May 27, 1988, IRS had received 101.8 million individual tax returns, up from 98.4 million received by May 29, 1987, but slightly down from the 102.6 million returns IRS had projected by that date. The trend toward later filing of tax returns continued in 1988. About 43 percent of the returns were filed in April or later, up slightly from the 41 percent filed in that time period in 1987.

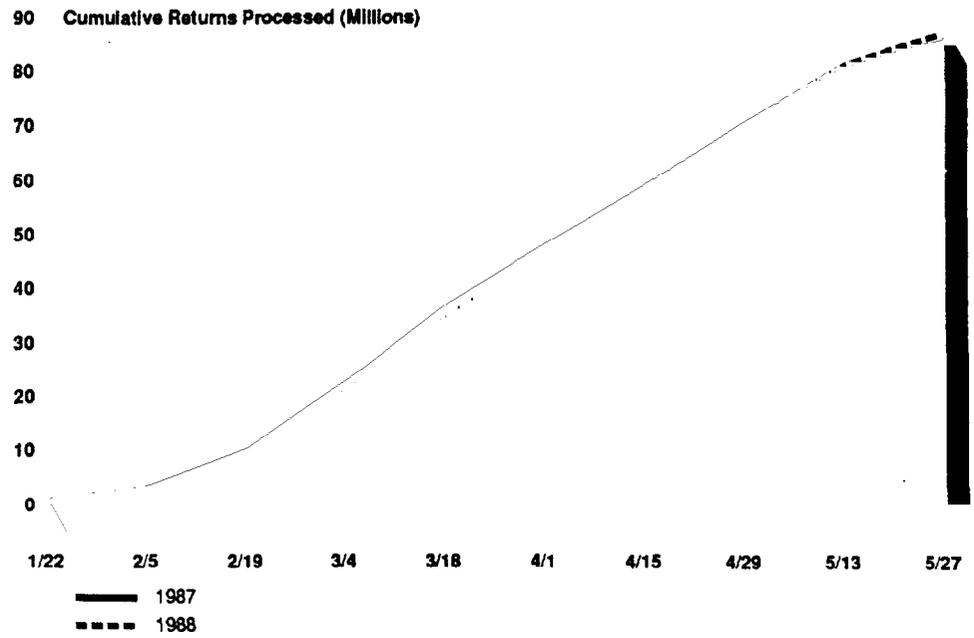
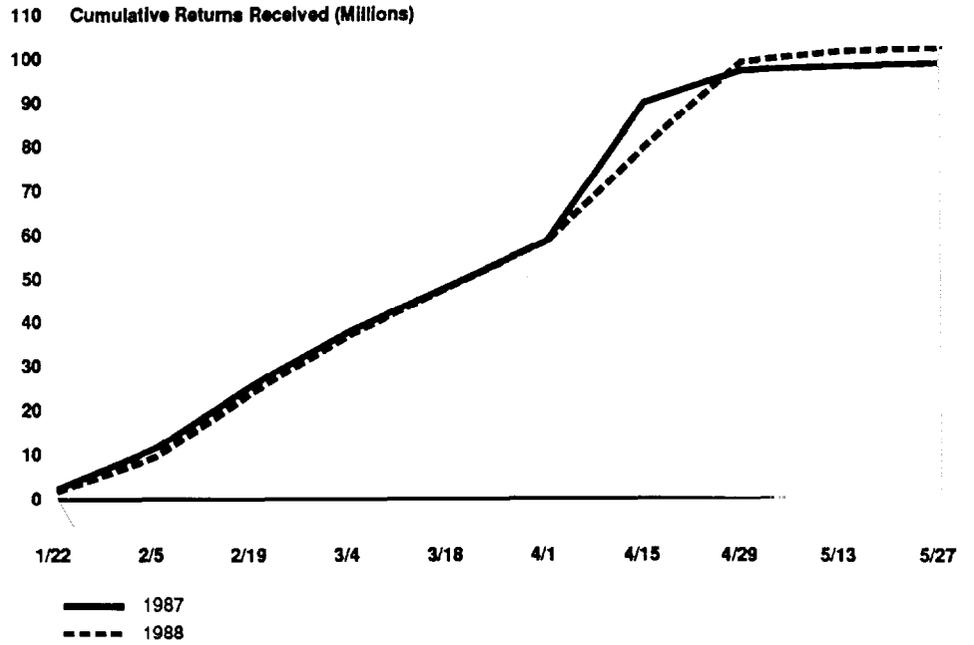
Service Center Computers and Software Worked Reliably

The backbone of IRS' tax processing system is its service center computer system. In September 1987, we reported on the difficulties IRS experienced in processing returns and refunds during the 1985 filing season because of problems with the mainframe computers located at each of IRS' 10 service centers and the software associated with those computers.¹

To determine how well the service centers' mainframe computers supported operations during the 1988 filing season, we compared the number of hours scheduled for the mainframe with the number of hours it was available to users. Between January 1, 1988, and April 30, 1988, the mainframe computers were available 98.1 percent of the time they

¹See our report entitled *Tax Administration: Replacement of Service Center Computers Provides Lessons for the Future* (GAO/GGD-87-109, Sept. 23, 1987) for a detailed discussion of the 1985 problems.

Figure 3.1: Comparison of Individual Tax Returns Received and Processed During the 1987 and 1988 Filing Seasons



Note: Figure 3.1 was developed from information contained in IRS' Management Information System for Top Level Executives.

were scheduled to operate, which was consistent with the 98 percent standard that IRS sets for mainframe availability.

To assess the reliability of the software used to process returns during the 1988 filing season, we analyzed IRS' management reports and visited four IRS service centers. We identified two instances where IRS had caught software errors that could have prevented returns from being processed or could have caused returns to be processed incorrectly. In both cases, IRS took prompt corrective action and there were no work stoppages or slowdowns that could have delayed the processing of taxpayers' returns.

Applications for Extensions to File Increased in 1988

Although more taxpayers requested additional time to file their tax returns in 1988 than in 1987, the increase was less than IRS had projected. IRS automatically grants taxpayers a 4-month filing extension when they apply for the extension before April 15 and pay the estimated tax due. In preparing for the 1988 filing season, IRS projected that it would need to process about 6.2 million applications for extensions, a 34.8 percent increase over the number processed in 1987. IRS expected that more taxpayers would apply for extensions because of the need for additional time to adjust to tax law changes. The actual increase was less than expected, however, as IRS processed 5.6 million applications in 1988, up from the 4.6 million processed in 1987, but less than the 6.2 million projection. Processing the additional applications did not disrupt service center operations because IRS had anticipated the additional work load.

Error Rates Were Slightly Higher in 1988 Than in 1987

IRS statistics as of May 25, 1988, showed that about 21.2 percent of filed returns had one or more errors. This compared with a 19.2 percent rate as of May 27, 1987.²

Errors are caused either by taxpayers or by IRS personnel who process tax returns. Errors cause additional IRS processing and may delay the issuance of refunds. If undetected, errors may cause erroneous information to be entered to taxpayer accounts and require correspondence between IRS and taxpayers at some later date.

²These error rates include mistakes such as addition errors, omitted tax information, or data transcription errors that would prevent a service center from being able to process a return without first correcting it. The figures do not include mistakes that would prevent a return from posting to a taxpayer account, such as an erroneous social security number, or errors in allowable deductions that would be detected when a tax return is examined at a later date.

IRS attributed about 54.5 percent of the errors to mistakes made by taxpayers when they filled out their tax returns. The three most common taxpayer errors, according to IRS statistics, involved the taxpayers' failure to (1) enter the correct standard deduction for their marital and/or age category, (2) claim or accurately compute earned income credits, and (3) indicate on line 4 of Form 1040EZ whether they could be claimed as a dependent on another person's return. According to IRS officials, such errors indicate that some taxpayers were confused by sections of the tax forms or instructions. A member of IRS' Tax Forms Coordinating Committee said the Committee is changing parts of the tax forms and instructions in an attempt to reduce the frequency of these errors in 1989.

IRS attributed 35.8 percent of the errors to mistakes made by returns processing staff. Most of these errors occurred when data transcribers failed to properly enter tax information for computer processing or when other returns processing staff did not enter codes that direct the computer to take certain actions. The three most common errors occurred because returns processing staff failed to properly code or enter information on (1) taxpayer dependents, (2) taxpayer withholding, and (3) taxpayer age or blindness. IRS officials said they plan to cover problem areas when they train returns processing staff for the 1989 filing season.

According to IRS, the remaining 9.7 percent of the errors involved conditions, such as returns on which the taxpayers reported wages but no withheld taxes, that are identified for further analysis as a result of computerized consistency checks. Although classified as errors, further analysis might prove otherwise.

Many Taxpayers Did Not File the Simplest Return Possible

In preparing for the 1988 filing season, IRS projected that about 4.1 million more taxpayers would be able to file the simpler Forms 1040A and 1040EZ.³ Of that increase, IRS attributed about 3.2 million to tax law changes, such as the loss of income averaging, the loss of the deduction

³In general, taxpayers who have taxable income less than \$50,000 can file form 1040A if they derive income only from wages, salaries, tips, interest, dividends and/or unemployment compensation; claim only Individual Retirement Arrangement adjustments to income and/or earned income tax credits; and do not itemize deductions. Single taxpayers with taxable income under \$50,000 can file form 1040EZ if they do not itemize and if they derive income only from wages, salaries, tips, or interest of not more than \$400.

for working married couples, the increase in the standard deduction, and reductions in certain allowable itemized deductions. IRS encourages taxpayers to fill out the simplest return possible, telling them they will probably save time. It is less costly for IRS to process Forms 1040A and 1040EZ because returns processing staff can process them faster than Form 1040.

IRS statistics show that the number of 1040A and 1040EZ filers increased by only 1.2 million in 1988, about 2.9 million less than IRS had projected. IRS' statistics also show that the number of 1040 filers increased by 2.1 million.

To determine whether more taxpayers could have filed simpler returns, we sampled 1,604 Form 1040 and 1040A returns at three service centers. We estimate that about 14 percent⁴ of the 1040 filers could have filed a Form 1040A or 1040EZ, while about 10 percent of the 1040A filers could have filed a Form 1040EZ. Based on IRS' estimates of the cost to process different types of returns, we project that it cost IRS an additional \$519,000 to process the more complex returns at the three service centers.

Our discussions with IRS officials in the Returns Processing and Accounting Division surfaced two reasons why taxpayers may not have filed the simplest form. First, IRS mailed packages of tax forms to individual taxpayers for the 1988 filing season based on the forms they filed in 1987. Thus, some taxpayers, particularly those who were eligible to file simpler returns because of Tax Reform Act changes, may not have filed a simpler return because it was not included in their tax package. According to the officials, Tax Reform Act changes were not considered in deciding which forms to mail to taxpayers because the large number of changes prevented them from accurately predicting those taxpayers who could file simpler returns. They said that information on returns filed in 1988 will allow them to take Tax Reform Act changes into account when they mail out tax packages for the 1989 filing season.

A second reason suggested by IRS officials for taxpayers not filing the simplest return related to returns prepared by tax preparers. IRS officials expressed the belief that because preparers use computer software that produces 1040 returns they are inclined to file Form 1040 for their clients even if a simpler form could be used.

⁴The potential sampling errors for our estimates are presented in appendix II.

To determine whether more tax preparers than individuals failed to file the simplest return possible, we compared the returns in our sample that were filed by the two groups. Our comparison showed that about the same percentage of tax preparers and individuals who filed 1040 returns could have filed simpler returns (15 percent of the preparers vs. 13 percent of the individuals). However, a higher percentage of preparers who filed 1040A returns could have filed 1040EZ returns (19 percent of the preparers vs. 6 percent of the individuals).

Representatives of the National Association of Enrolled Agents and the National Federation of Independent Business, who represent groups of tax preparers, provided several reasons for the difference. They said most of their clients are required to file 1040 returns and, as a result, they do not buy computer software to prepare 1040EZ returns. Also, because IRS uses optical character recognition equipment to read tax information directly from 1040EZ returns, preparers must use IRS' forms (many preparers prefer to supply their own forms) and print information on the form according to specific IRS requirements. According to the representatives, many tax preparers believe it is less trouble to use Forms 1040 or 1040A.

IRS Met Toll-Free Telephone Level of Service Goals

Most taxpayers who seek help from IRS in preparing their tax returns do so by telephone. IRS' statistics show that as of April 23, 1988, the last day for which IRS compiled this information for the 1988 filing season, assistants at its 32 call sites answered about 20 million calls from taxpayers during the filing season, or about 62 percent of the 32.1 million calls received since the first of the year. The number of calls answered was about 14.4 percent higher than last year but 6.7 percent less than IRS had expected. Using its formula for converting the total number of calls coming into the call sites (including those resulting in busy signals) to an estimate of taxpayer demand for telephone service, IRS determined that about 23.7 million taxpayers called for assistance through April 23, 1988. Comparing that to the number of calls answered, IRS determined that its cumulative level of service through April 23, 1988, was 84.7 percent.⁵ The result is consistent with IRS' objective of 85 percent and is above the 77.8 percent level of service IRS says it achieved in the 1987

⁵IRS uses "level of service" to measure its responsiveness to taxpayers who call for assistance. It defines level of service as the ratio of the number of calls answered to an estimate of taxpayer demand for assistance. To estimate taxpayer demand, IRS adjusts its call statistics to avoid double counting those taxpayers who call several times before reaching IRS. Thus, taxpayer demand for assistance is less than the total number of calls IRS receives. We plan to report on the formula IRS uses to compute level of service at a later date.

filing season. Figure 3.2 shows the week by week level of service achieved by IRS for the 1986, 1987, and 1988 filing seasons.

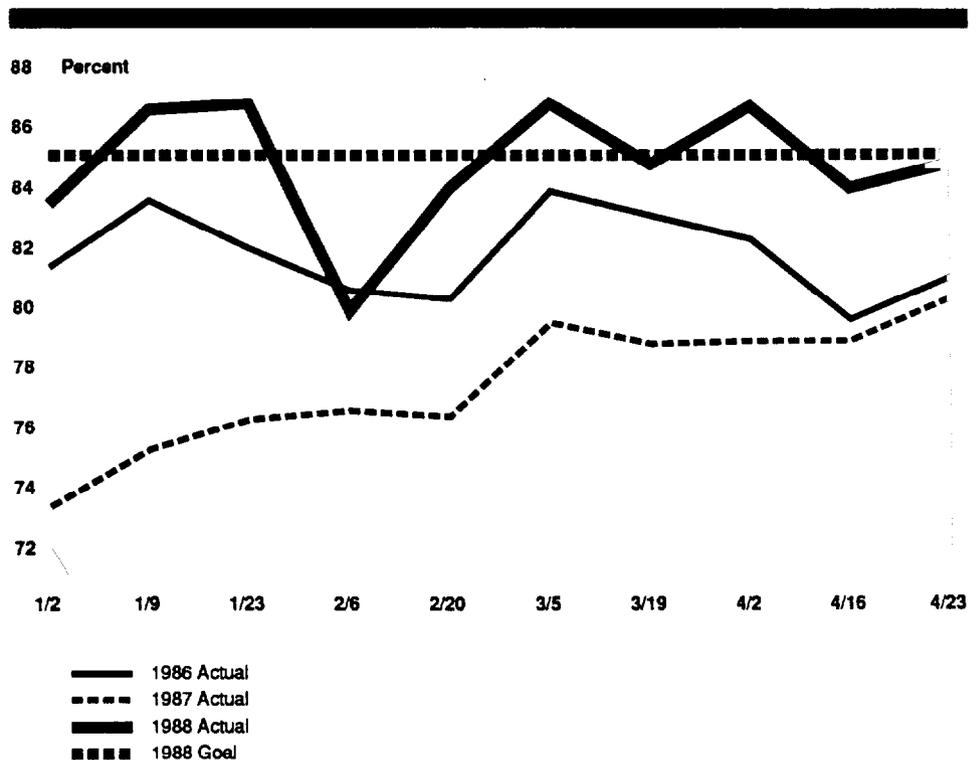
This information relates only to IRS' ability to answer the phone when it rang at one of its call sites. It does not relate to IRS' ability to correctly answer the question posed by the caller. We will be reporting separately on that issue.

Forms and Publications Were Generally Available to Taxpayers

In light of IRS' efforts to encourage taxpayers to file early, it was important that necessary forms and publications be readily available. Taxpayers could either obtain those documents in person at over-the-counter distribution sites or order them by mail or phone.

On February 23, 1988, we testified before the Subcommittee on Oversight, House Committee on Ways and Means, that some of the 233 forms and publications on an IRS ordering list were not available at the six

Figure 3.2: Level of Toll-Free Telephone Service Provided During the 1986, 1987, and 1988 Filing Seasons



Note: Figure 3.2 was developed from data contained in IRS' Management Information System for Top Level Executives.

over-the-counter distribution sites we had visited. Following our testimony, IRS' National Office issued a directive that field offices follow proper restocking procedures. When we rechecked the availability of forms and publications at five of the six locations during a 4-week period ending April 13, we found the situation had improved. The number of out-of-stock documents ranged between 0 and 21 during this period, compared to a range of 11 to 41 in February. Most of the other distribution sites we visited in March and April showed a similar improvement during the period of our visits.

Many taxpayers also order forms and publications by mail or telephone. As of June 3, 1988, according to IRS statistics, its three central distribution centers and one backup center had filled over 99 percent of the 24.3 million mail and phone orders placed since October 1, 1987.

To get an indication of IRS' performance in filling phone orders, we placed 23 phone orders for documents explaining tax law changes that IRS estimated would affect 3 million or more taxpayers. IRS advises taxpayers that they can expect to receive documents within 7 to 10 work days after receipt of an order. We received 17 of our 23 orders in 10 work days or less and 4 orders in 11 to 15 work days. We never received the other two orders involving a total of 52 documents. In addition, 11 of the 21 orders we received were missing a total of 20 documents, about 3.6 percent of the 563 total documents included in the 21 orders. IRS officials were not able to determine why two orders had not been filled nor why 20 documents were missing from the other orders. IRS is in the process of installing an automated phone order system, however, and believes that problems associated with what has previously been a manual order-taking operation will be resolved.

Officials in the forms distribution area told us that IRS plans to place a high priority on making forms and publications available to taxpayers during the 1989 filing season. We are planning additional work to assess IRS' 1989 performance in this area.

Conclusions

The changes and uncertainties caused by the Tax Reform Act of 1986 increased the potential for significant problems during the 1988 filing season. In terms of IRS' ability to handle the increased work load in a timely manner, that potential went unrealized. Returns were processed, refunds were issued, telephones were answered, and computers ran relatively trouble free. A few problems occurred, but they were relatively minor. Our review pointed to three areas where improvements seemed possible—revising sections of tax forms that caused high error rates, tailoring tax packages mailed to taxpayers to encourage the use of simpler forms, and better ensuring the availability of forms and publications. Because IRS is addressing each of these areas, we are making no recommendations.

Summary of GAO Work Regarding IRS' Implementation of the Tax Reform Act and Its Performance During the 1988 Filing Season

1. Status of the 1988 Tax Return Filing Season, testimony before the Subcommittee on Oversight, House Committee on Ways and Means (GAO/T-GGD-88-13, Feb. 23, 1988).

Results:

- IRS did a good job in trying to prepare its employees and the taxpaying public for the 1988 filing season.
- Telephone assistance has been meeting taxpayer demand in terms of quantity, but preliminary IRS and GAO results indicate that IRS assistors need to improve the accuracy of their responses to taxpayer questions.
- Preliminary work at walk-in offices indicates a high level of taxpayer satisfaction with IRS service.
- Some forms and publications have been unavailable to taxpayers at certain over-the-counter distribution sites. IRS statistics show that about 98 percent of phone order requests for forms and publications have been filled.
- Members of the tax preparer community have mixed views on the adequacy of written guidance IRS has issued to help taxpayers and preparers interpret the Tax Reform Act of 1986. They believe that the lack of some guidance and the complexity of other guidance are causing problems for taxpayers and IRS.
- Early in the filing season, returns processing is proceeding smoothly and service center inventories are at levels IRS considers manageable.

2. Internal Revenue Service: Computer Readiness For 1988 Filing Season (GAO/IMTEC-88-31, Mar. 31, 1988).

Results:

- As of February 1, 1988, IRS had finished modifying and testing computer software to be used in the 1988 tax filing season.
- The capacity of mainframe computers used to process tax returns at IRS service centers should be sufficient for the 1988 filing season.
- Old communications processors should prove reliable in 1988.

**Appendix I
Summary of GAO Work Regarding IRS'
Implementation of the Tax Reform Act and
Its Performance During the 1988
Filing Season**

3. The 1988 Tax Return Filing Season, testimony before the Subcommittee on Oversight, House Committee on Ways and Means (GAO/T-GGD-88-30, Apr. 13, 1988).

Results:

- GAO test calls to IRS' telephone assistance call sites have shown little improvement in the accuracy of IRS' answers since we testified in February 1988.
- IRS has not encountered any unusual problems in processing tax returns so far in 1988.
- Since our February 1988 testimony, the availability of forms and publications at over-the-counter distribution sites has improved.
- Taxpayers we interviewed are generally satisfied or very satisfied with assistance provided at IRS' walk-in offices.

Sampling Methodology for Measuring Whether Taxpayers Filed the Simplest Form

The primary objective of our sample was to estimate the number of individual tax returns that could have been filed on simpler forms at the Austin, Cincinnati, and Fresno Service Centers in the 1988 filing season. We also were interested in whether the tax returns that could have been filed using simpler forms were prepared by paid preparers.

We randomly chose individual tax returns (1040s and 1040As) filed between January 2, 1988, and April 29, 1988, in the three service centers. The tax returns were sampled from IRS' 1988 Taxpayer Usage Study sample.¹ We stratified our sample by (1) service center; (2) type of tax return filed (1040 or 1040A); (3) whether or not the tax return was signed by a paid preparer; and (4) whether or not the return was filed after March 11, 1988. We isolated the time period in which the return was filed because IRS selected returns differently for the Taxpayer Usage Study after March 11.

Table II.1 shows the number of returns sampled at each service center for each strata.

Table II.1: Number of Returns Sampled

	Service Center		
	Austin	Cincinnati	Fresno
1040s signed by paid preparer and filed on or before 3/11/88.	61	82	73
1040s signed by paid preparer and filed after 3/11/88.	65	67	62
1040s not signed by paid preparer and filed on or before 3/11/88.	69	97	71
1040s not signed by paid preparer and filed after 3/11/88.	55	44	57
1040As signed by paid preparer and filed on or before 3/11/88.	124	85	105
1040As signed by paid preparer and filed after 3/11/88.	33	20	28
1040As not signed by paid preparer and filed on or before 3/11/88.	149	104	89
1040As not signed by paid preparer and filed after 3/11/88.	27	13	24
Totals	583	512	509

¹The Taxpayer Usage Study involves an annual sample of individual income tax returns taken as they are received during the filing season. The study highlights selected characteristics of the sampled returns, such as the number of returns filed with preaddressed labels, the number of refund returns, and the number of returns filed by paid preparers.

**Appendix II
Sampling Methodology for Measuring
Whether Taxpayers Filed the Simplest Form**

We reviewed each tax return chosen in our sample and determined, using IRS' criteria, whether it could have been filed on a simpler tax form. The work was done at each of the three service centers.

We projected our sample results to the universe of individual tax returns filed at the three service centers using weights that we computed from data obtained from IRS officials. (See table II.2). Each weight given in table II.2 shows the number of cases that one case in our sample represents in the universe. Tables II.3 and II.4 illustrate the precision of our projections based on a 95 percent confidence level.

**Table II.2: Weights Used in Projecting
GAO Sample Results to the Universe of
Individual Income Tax Returns
(Forms 1040 and 1040A)**

	Service Center		
	Austin	Cincinnati	Fresno
1040s signed by paid preparer and filed on or before 3/11/88.	19,279	19,768	15,562
1040s signed by paid preparer and filed after 3/11/88.	43,000	40,403	51,629
1040s not signed by paid preparer and filed on or before 3/11/88.	11,942	11,268	8,592
1040s not signed by paid preparer and filed after 3/11/88.	24,727	46,795	24,263
1040As signed by paid preparer and filed on or before 3/11/88.	2,694	2,871	2,219
1040As signed by paid preparer and filed after 3/11/88.	7,788	7,600	9,000
1040As not signed by paid preparer and filed on or before 3/11/88.	7,235	7,462	6,090
1040As not signed by paid preparer and filed after 3/11/88.	22,556	34,692	26,625

**Appendix II
Sampling Methodology for Measuring
Whether Taxpayers Filed the Simplest Form**

Table II.3: Confidence Limits for 1040 and 1040A Projections

Simplest form that could have been filed	Actual Form Filed			
	1040		1040A	
	Number in millions	Percent	Number in millions	Percent
1040				
Universe estimate	17.1	85.7		
Lower limit	15.5	83.2	•	•
Upper limit	18.7	88.3	•	•
1040A				
Universe estimate	2.0	10.0	5.0	90.3
Lower limit	1.5	7.8	4.4	88.3
Upper limit	2.6	12.2	5.8	92.6
1040EZ				
Universe estimate	.8	4.2	.5	9.7
Lower limit	.3	1.6	.3	6.5
Upper limit	2.6	12.8	.8	12.8

Note: The actual number of returns filed and the percentage of returns in each category are projected to fall within the upper and lower limits with 95 percent certainty.

Table II.4: Confidence Limits for 1040 and 1040A Projections Categorized by the Type of Filer

Simplest form that could have been filed	Actual Form Filed							
	1040				1040A			
	Filed by a paid preparer		Filed by a taxpayer		Filed by a paid preparer		Filed by a taxpayer	
	Number in millions	Percent	Number in millions	Percent	Number in millions	Percent	Number in millions	Percent
1040								
Universe estimate	10.7	85.0	6.4	86.9				
Lower limit	9.8	81.5	5.6	83.7	•	•	•	•
Upper limit	11.8	88.6	7.1	90.2	•	•	•	•
1040A								
Universe estimate	1.2	9.9	.8	10.3	1.2	81.2	3.8	93.6
Lower limit	.8	6.9	.5	7.3	.9	77.5	3.4	90.5
Upper limit	1.7	12.9	1.1	13.4	1.5	88.6	4.3	96.8
1040EZ								
Universe estimate	.6	5.1	.2	2.8	.3	18.8	.3	6.4
Lower limit	.2	1.9	.1	1.0	.2	13.9	.1	3.2
Upper limit	1.7	13.8	.8	11.2	.4	23.9	.4	9.7

Notes: Values in table II.3 cannot be added to obtain values in table II.2 because the square root of variances is not additive.

The actual number of returns filed and the percentage of returns in each category are projected to fall within the upper and lower limits with 95 percent certainty.

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