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

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TAX ADMINISTRATION

Continuing Problems Affect Otherwise Successful 1994 Filing Season

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

Dear Mr. Chairman:

This report responds to your request that we assess the Internal Revenue Service's (IRS) performance during the 1994 tax filing season. Specifically, we discuss the processing of individual income tax returns and related refunds and the accessibility that taxpayers have to IRS.

To assess IRS' progress in managing the annual tax filing season and providing taxpayers with service and information, we present trend data on various filing season activities and inventories in appendix I.

Results in Brief

The 1994 filing season was successful in many respects. The number of returns filed increased after an unexpected decline in 1993, and more taxpayers used alternatives to the traditional paper filing method. According to IRS data and our review at 1 of IRS' 10 service centers, tax refunds were generally processed accurately and issued in a timely manner, and IRS improved the accuracy of its returns processing, thus reducing the amount of rework. IRS' computers generally worked well with minimal downtime. On the basis of tests done by us and IRS, taxpayers looking for tax forms and publications at IRS walk-in sites could reasonably expect to find them, and taxpayers calling IRS' toll-free telephone assistance with tax law questions could generally expect to get accurate answers.

However, there were some significant problems.

- The number of IRS-detected fraudulent refund claims continued the steady increase that has troubled IRS for the past several years. Through the first 6 months of 1994, IRS had identified twice as many fraudulent claims as it had during the same period in 1993. What remains unclear is (1) how much of that growth is due to increased fraudulent activity versus improved IRS monitoring and (2) how much additional fraud might be going undetected.
- The ability of taxpayers to reach IRS by telephone has been a problem for several years and has degraded even further in 1994. Using IRS data, we determined that (1) only about 20 percent of the calls to IRS' toll-free

telephone assistance and 50 percent of the calls to IRS' forms distribution centers were being answered and (2) only 13 percent of the calls to IRS' TeleFile system were getting through during the peak period.
- The Earned Income Credit (EIC) was the source of many errors by taxpayers and tax practitioners in preparing returns. Those errors, along with errors by IRS staff in following IRS procedures for handling EIC claims, increased IRS' error resolution workload and delayed taxpayers' receipt of benefits.

Objective, Scope, and Methodology

Our objective was to assess IRS' performance during the 1994 filing season. Specifically, we focused on IRS' ability to (1) process income tax returns and refunds accurately and efficiently and (2) provide taxpayers access to forms, information, and electronic filing methods.

To achieve our objective, we

- validated the results of 1 service center's test of the accuracy and timeliness of refunds by reviewing 853 randomly selected refunds;
- analyzed filing season-related data from IRS' Management Information System for Top Level Executives and IRS data on processing errors, including those involving the EIC;
- reviewed IRS reports on refund fraud;
- reviewed computer system availability reports and attended weekly operational meetings held by IRS' National Office Command Center;
- assessed the availability of tax materials by visiting 10 walk-in sites;
- tested taxpayers' access to ordering forms and publications from IRS' 3 tax material distribution centers by placing phone calls to those centers;
- analyzed IRS' toll-free telephone system accessibility data, telephone activity data for area distribution centers, and telephone accessibility reports for the TeleFile system;
- compiled trend data for various indicators of IRS' filing season performance; and
- interviewed IRS National Office officials and IRS officials in the Atlanta; Cincinnati; Fresno, CA; and Kansas City, MO, Service Centers responsible for the various activities we assessed.

We did our work from January through August 1994 in accordance with generally accepted government auditing standards. With the exception of the refund accuracy rate and refund timeliness measure, we did not test and verify statistical data provided by IRS. We discussed our findings and conclusions in an exit conference attended by cognizant IRS officials,

including the National Director for Submission Processing, the Assistant Commissioner for Taxpayer Services, the Director for Taxpayer Service Design and Review, and the Chief of the Publishing Distribution Section. Their comments are presented and evaluated on page 15. Other changes resulting from their comments were made in the body of the report as appropriate.

IRS' Successful Processing of Returns in 1994 Marred by Continuing Problems With Refund Fraud and the EIC

There were many positive aspects of the 1994 filing season. After an unexpected drop in individual income tax return filings in 1993, the number filed in 1994 went up, although not as much as IRS had originally anticipated; and more of those returns were filed through alternative methods like electronic filing. IRS' computer systems generally performed well with intermittent problems causing only minor delays. IRS also exceeded its accuracy and timeliness goals for processing refunds and its accuracy goal for processing returns and took positive steps to improve its processing of tax receipts. However, there were some problems. The EIC continued to be a leading source of errors by taxpayers and tax practitioners in preparing returns, thus contributing to IRS' error resolution workload; and the number of fraudulent refund claims identified by IRS continued to grow at a troubling pace.

Taxpayers Filed More Returns in 1994

As of September 9, 1994, IRS had received 113.4 million individual income tax returns, compared to 112.7 million for the same period in 1993.

In planning for the 1994 filing season, IRS had expected to receive 117.5 million individual returns—a projection that was based on historical growth rates. As shown in figure I.1 in appendix I, in the several years preceding 1993, the number of individual income tax returns filed increased consistently from year to year. However, there was an unexpected reduction in the number of returns filed in 1993.

Because of the drop in the number of filers, IRS' Research Division analyzed the shortfall in 1993 individual income tax returns. IRS determined that the major causes of this shortfall were (1) the IRS Reduce Unnecessary Filings program,[1] (2) a drop in interest rates that reduced the

[1]The purpose of the Reduce Unnecessary Filings program is to identify and contact taxpayers who filed a federal income tax return the prior year even though they may not have been required to do so. IRS sends each taxpayer a notice, worksheet, and instructions for taxpayers to use in determining whether they should file a federal return. In 1993, IRS sent 1 million notices that it determined resulted in 744,000 fewer taxpayers filing returns. In 1994, IRS sent 1.4 million notices; IRS will not know how many fewer taxpayers filed until later in 1994.

income levels of certain taxpayers below filing requirement thresholds, and (3) the 1992 change in withholding rates that apparently left some individuals with an unanticipated balance due and who then did not file a return.

On the basis of its analysis of the 1993 filing season, which was not completed until the spring of 1994—well into the 1994 filing season, IRS revised its projection model and dropped the expected 1994 filings to 114.5 million from the original 117.5 million. We did not review or test the assumptions IRS used to revise its projection model and, therefore, cannot comment on the reasonableness of the adjustment. As of September 9, however, the number of filings was still 1.1 million short of IRS' revised expectations.

Use of Alternative Filing Methods Generally Increased

Although the overall number of individual filers has not significantly increased, taxpayer use of the various alternative filing methods generally increased in 1994. IRS offers three types of filing alternatives to the traditional paper return: electronic, TeleFile, and 1040PC. Electronic and TeleFile use increased in 1994; 1040PC use declined slightly.

In 1994, 13.5 million individual income tax returns were filed electronically—up from 12.3 million in 1993. As shown in figure I.2 in appendix I, this continues the consistent growth in electronic filing since it became available nationwide in 1990.

Under TeleFile, certain taxpayers who are eligible to file a Form 1040EZ are allowed to file using a toll-free number on touch-tone telephones. In 1993, TeleFile was available to taxpayers in 1 state, and about 149,000 taxpayers used the system. IRS expanded the availability of TeleFile to 7 states in 1994, and the number of users grew to about 519,000. In 1995, IRS plans to expand TeleFile to all or parts of three more states and to double the number of telephone lines. IRS expects to further expand the system in 1996 and make it available nationwide in 1997.

Under the 1040PC method, a filer uses personal computer software that produces tax returns in an answer-sheet format. The 1040PC shows the tax return line number and the data (dollar amount, name, etc.) on that line. Only lines on which the taxpayer has made an entry are included on the 1040PC. IRS received about 4.8 million 1040PC returns in 1993, but only about 4.2 million in 1994. IRS attributes the decline to a delay by a major return preparer in submitting its 1040PC software for IRS approval. The

decline might also be attributed to problems with the 1040PC that were discussed during a September 1993 meeting of the Internal Revenue Commissioner's Advisory Group. As reported in the September 3, 1993, issue of the Daily Tax Report, those problems involved taxpayers' inability to interpret the 1040PC and use it as an aid in doing such things as (1) preparing state tax returns and (2) completing financial aid forms for children. IRS officials told us that steps have been taken to address these problems. In the future, 1040PC software packages will be required to provide the taxpayer with a legend explaining the lines on the 1040PC or a printed copy of the full return.

Computer Systems Generally Performed Well

IRS' computer systems generally performed well during the 1994 filing season. However, some systems problems occurred that had operational impacts, such as downtime for IRS employees and short delays in refunds for taxpayers.

Systems problems caused the computer systems at various locations to be unavailable to IRS personnel for generally short periods of time (less than 12 hours). According to IRS problem assessments, this limited downtime usually had a minimal impact on IRS' overall operations. However, in 1 instance, a problem with the Automated Underreporter System at 1 service center caused IRS to lay off 270 temporary employees for about 1 week. IRS officials attributed this event to systemic problems in the software provided by the vendor.

IRS had some intermittent systems problems that affected taxpayers. For example, one problem caused tax returns that were electronically filed at one service center on February 1, 1994, to not be processed on time. IRS estimated that the problem caused about a 1-week delay in processing those refunds.

Refund Timeliness and Accuracy Goals Met

Two of IRS' goals are to issue individual income tax refunds within an average of 40 days and with at least a 98-percent accuracy rate. IRS reports show that each of the 10 service centers met the timeliness goal, and the average issuance time for all 10 centers was 36 days. Also according to IRS data, 8 of the 10 centers met or exceeded the accuracy goal; the other 2 centers' accuracy rates were within 1 percent of the goal. The average accuracy rate for all service centers was 98.6 percent.

IRS measures refund accuracy by reviewing samples of nonelectronically filed returns with a refund due to the taxpayer. It compares the taxpayer's name, address, and refund amount on the tax return with the same information on IRS' master file, which is used to generate the refund check. By comparing this information, IRS can determine if an error was made and who made the error. IRS uses the same sample to measure refund timeliness. IRS computes the number of days from the return's signature date to the date the taxpayer would have received the refund, allowing 2 days after issuance for the refund to reach the taxpayer.

For the 1994 filing season, we examined the methodology IRS uses in measuring refund accuracy and timeliness. Using IRS criteria for testing accuracy and timeliness, we replicated its test at one service center using its four cluster samples. We selected and compared the results from a random sample of 853 refunds out of the service center's 3,693 refunds used for its test.

We agreed with 98.6 percent of the service center's results. The 1.4-percent difference consisted of instances where service center personnel overlooked errors that our review caught. On the basis of these results, we concluded that the test conducted at one service center provides a valid measure of that service center's accuracy and timeliness of refunds.

Revenue Processing Procedures Enhanced

In an effort to improve check processing and deposit tax receipts more timely, IRS (1) tested the use of lockboxes[2] and (2) required each of the service centers to develop procedures for depositing revenues. Establishing lockboxes was not a new procedure for IRS. It has been using lockboxes for estimated tax payments since 1989.

Lockbox Tests

To assess taxpayers' willingness to use different procedures for mailing tax payments associated with their returns, IRS conducted three lockbox tests during the 1994 filing season. For each test, IRS sent special Form 1040 packages to selected taxpayers. These packages included (1) mailing instructions that were different for each of the three tests and (2) a payment voucher that could be scanned by optical character recognition equipment.

[2]A lockbox is a postal rental box serviced by a commercial bank where persons mail payments. The bank processes the payments and transfers the funds to a federal government account. The payment and payer information is then recorded on a computer tape and forwarded to IRS where the tape is used to update taxpayers' accounts on IRS' master file.

- One test package contained a return envelope with two different tear-off address labels—one label addressed to the lockbox was to be used for a return with a tax balance due, while the other label addressed to the service center was to be used for a return with a refund due to the taxpayer. Taxpayers with balance-due returns were instructed to include the return, payment, and voucher in one envelope and to affix the label addressed to the lockbox. The bank that serviced the lockbox separated the return from the payment, deposited the payment, recorded the payment information on a computer tape, and forwarded the return and the computer tape to IRS for processing.
- Another test package used two envelopes—one addressed to the service center, the other addressed to the lockbox. All taxpayers were instructed to send only the return in the envelope addressed to the service center. However, taxpayers who owed a balance were to use the second envelope to send their payments and vouchers to the lockbox. The bank processed the payment and voucher as described above.
- The third test package also contained two envelopes. This test was no different from the other two-envelope test, except that these envelopes were postage paid. Thus, taxpayers incurred no expense by separating their returns from their payments and mailing them to the two addresses.

On the basis of preliminary results of the three tests, IRS has decided to continue testing the two-label and two-envelope methods nationwide during the 1995 filing season. IRS plans to initiate some type of lockbox collection process nationwide in 1996.

Service Center Deposits

One measure of service center efficiency is the speed with which they deposit tax receipts. In response to our past recommendations,[3] IRS required each service center to provide a plan on how they would expedite the identification and depositing of large dollar remittances during the peak filing season. Service centers were required to give priority handling to mail in oversized envelopes because IRS had determined that a high proportion of those envelopes contained large tax payments. However, because service centers were not required to separately track the amounts extracted from oversized envelopes, IRS could not determine the actual impact of this priority handling.

In another effort to expedite deposits, IRS also required that all tax payments received with individual tax returns around the April 15th filing deadline be deposited by May 2, 1994. Nine of the 10 service centers met

[3]Tax Administration: Delayed Tax Deposits Continue to Cause Lost Interest for the Government (GAO/GGD-93-64, Mar. 22, 1993).

the goal; the other center was 1-day late. Service centers processed and deposited more tax payment revenues from individuals than in the previous year. Between April 15 and May 2, 1994, service centers deposited $41.5 billion compared to $36.2 billion during the same time period in 1993.

Return Processing Accuracy Improved

In 1993, IRS began using a new system to measure the accuracy of its returns processing activity. The measure is derived from the Computer Assisted Pipeline Review (CAPR), which is a complete review of all returns identified by service centers' computers as having math or other errors needing resolution before processing at the service centers can be completed. CAPR information identifies who was responsible for the error—service center staff or taxpayers, which includes tax practitioners—and what part of the return was in error.

IRS had separate accuracy goals for the two service center groups that are primarily responsible for processing returns. The Code and Edit Section, whose staff review returns to ensure that all data are present and legible, had an accuracy goal of 94.4 percent in 1994. The goal for the Transcription Section, whose staff enter data from the returns into the computer, was 94.1 percent. As of the end of June 1994, according to IRS data

- the Code and Edit Sections in the 10 service centers had achieved a combined accuracy rate of 95.3 percent, up from 94 percent for the same period in 1993 and
- the Transcription Sections in the 10 centers had achieved a combined accuracy rate of 95.8 percent, up from 94.9 percent for the same period in 1993.

IRS also measures the extent to which taxpayers or their representatives make errors in filling out their returns. That data, also as of the end of June 1994, showed an accuracy rate of 94.2 percent, well above IRS' goal of 88.3 percent.[4]

Although these rates indicate that taxpayers correctly filed and IRS accurately processed the great majority of returns, CAPR data show that the EIC continues to cause particular problems for taxpayers and tax practitioners.

[4]All accuracy goals apply to paper returns filed by taxpayers who either were due a refund or did not pay the full amount of tax owed at the time of filing (i.e., other than full-paid returns). The majority of returns IRS receives are other than full paid. IRS limits the goals to paper returns because electronic returns do not go through the service centers' manual review and data entry processes.

The EIC Continues to Be a Source of Many Errors

As of July 2, 1994, 14.4 million taxpayers had received over $14.9 billion in EIC benefits—an increase compared to the 13.6 million taxpayers who had received almost $12.8 billion at the same point in time in 1993.

The EIC continues to be a source of many mistakes by taxpayers and tax practitioners in preparing returns, which, in turn, increases IRS' error resolution workload. Data from CAPR showed that in both 1993 and 1994, EIC-related mistakes were among the top errors made by taxpayers and tax practitioners when preparing returns. Other IRS data showed that IRS found a total of about 1 million Schedule EIC errors in 1994 and that taxpayers and practitioners had particular difficulty in figuring the amount of earned income and the basic credit and in determining "qualified" children. While acknowledging the many errors associated with the EIC, IRS officials noted that more than 90 percent of the over 14 million Schedule EICs filed in 1994 were processed without change.

In an effort to reduce errors and better ensure that only qualified taxpayers received the EIC, IRS changed its procedures in 1993 by requiring taxpayers to submit a completed Schedule EIC with their returns when claiming the credit. However, in 1994, some taxpayers who claimed the credit did not submit the Schedule EIC. CAPR data showed that staff in the service centers' Code and Edit Sections sometimes overlooked that taxpayers had not included the required Schedule EIC. According to IRS, when taxpayers do not include the proper schedules, the Code and Edit Section should send a notice instructing the taxpayer to submit the schedule in order for the credit to be granted and the return to be processed. When the Code and Edit Section overlooks the missing schedule, it is up to other departments to catch the error and correspond with the taxpayer. This delays the processing of the return, which then causes the eligible taxpayer a delay in receiving the benefit.

In another effort to reduce errors, IRS officials said that IRS will make a greater effort in 1995 to encourage taxpayers to allow IRS to compute their EIC.

Continuing Increase in Fraudulent Refund Claims

As we have discussed in past reports and testimonies and as shown in table I.4 in appendix I, the number and dollar amount of IRS-detected fraudulent refund claims, on both electronic and paper returns, have been

steadily increasing over the past several years.[5] That trend continued in 1994. By the end of June 1994, IRS had identified 58,828 returns involving fraudulent refunds, twice as many as had been identified during the first 6 months of 1993. Of that total, 34,713 were paper returns and 24,115 were electronic returns. What is unclear is (1) how much of this growth is due to increased fraudulent activity rather than an improvement in fraud detection and (2) how much additional fraud might be going undetected.

In an effort to better control filing fraud, IRS has taken several steps. For example, IRS has (1) added additional up-front computer checks in an attempt to prevent fraudulent returns from entering the electronic filing system, (2) added staff to its fraud detection teams in the service centers in an attempt to detect more fraudulent returns, (3) initiated studies in an attempt to better understand the fraudulent schemes confronting IRS, and (4) engaged the services of the Los Alamos National Laboratory in an attempt to improve IRS' ability to identify fraudulent refund claims through the use of artificial intelligence and thus reduce expensive manual screening procedures. Also, at the request of the House Committee on Ways and Means and its Subcommittee on Oversight, the Secretary of the Treasury, in April 1994, established an interagency task force to investigate refund fraud.

Additional steps are planned for 1995. For example, IRS has tightened the standards for electronic return originators—individuals and firms that are authorized to submit returns electronically. Among other things, new applicants will be required to submit fingerprints that can be used to obtain a criminal records check from the Federal Bureau of Investigation. Although it is unclear how such a procedure would work, IRS' intent is consistent with a recommendation in our December 1992 report that IRS seek access to National Crime Information Center data for the purpose of checking the backgrounds of persons applying to be electronic return originators. IRS has also announced that it will be taking additional steps to ensure that taxpayers claiming refunds use the proper taxpayer identification number.

In 1994, as in 1993, almost all of the fraudulent returns identified by IRS involved EIC claims. One of the studies undertaken by IRS in 1994 in an attempt to better understand fraudulent schemes involved a sample of

[5]Tax Administration: IRS Can Improve Controls Over Electronic Filing Fraud (GAO/GGD-93-27, Dec. 30, 1992); Tax Administration: Increased Fraud and Poor Taxpayer Access to IRS Cloud 1993 Filing Season (GAO/GGD-94-65, Dec. 22, 1993); Tax Administration: Electronic Filing Fraud (GAO/T-GGD-94-89, Feb. 10, 1994); and IRS Automation: Controlling Electronic Filing Fraud and Improper Access to Taxpayer Data (GAO/T-AIMD/GGD-94-183, July 19, 1994).

about 1,000 returns that were electronically filed in January 1994 and that claimed the EIC. As part of its study, IRS contacted return preparers, taxpayers, and employers to confirm income, filing status, and the existence of dependents. As of September 1, 1994, IRS was still analyzing the study results.

Recent expansion of the EIC under the Omnibus Budget Reconciliation Act of 1993 is expected to make about 6 million more persons eligible for the credit and could encourage even more attempts to defraud the system in 1995. Those legislative changes expanded eligibility for the EIC and increased the maximum credit amount.

Taxpayers Continue to Have Problems Reaching IRS by Telephone

Taxpayers call IRS during the filing season for a variety of reasons. As we reported in the past, taxpayers have had problems reaching IRS by telephone to get answers to their questions.[6] That problem worsened in 1994. Not only did the accessibility of IRS' toll-free telephone assistance decline, but taxpayers calling IRS to order forms and taxpayers trying to use the TeleFile system also had problems getting through.

Toll-Free Accessibility Continued to Decline

A key indicator of filing season performance is how well IRS serves taxpayers who call toll-free telephone assistance to ask questions about their account, the tax law, or IRS procedures. Our analysis of IRS' data on the toll-free telephone system shows that accessibility during the 1994 filing season was lower than in 1993 while accuracy of answers to tax law questions remained the same. Accessibility decreased primarily because of an increase in the number of calls received while the number of calls answered remained fairly constant.

As in our reviews of previous filing seasons, we measured accessibility using information on actual calls from IRS' Telephone Data Report. We computed accessibility by dividing the total number of calls answered by the total number of calls received, which we defined as the sum of (1) calls answered, (2) busy signals, and (3) calls abandoned by the caller before an assistor got on the line.

For the period from January 2, 1994, through April 30, 1994, IRS received 87.9 million calls and answered 18.6 million calls—an accessibility rate of

[6]Tax Administration: A Generally Successful Filing Season in 1991 (GAO/GGD-91-98, June 28, 1991); Tax Administration: IRS' 1992 Filing Season Was Successful but Not Without Problems (GAO/GGD-92-132, Sept. 15, 1992); and Tax Administration: Increased Fraud and Poor Taxpayer Access to IRS Cloud 1993 Filing Season (GAO/GGD-94-65, Dec. 22, 1993).

21 percent. This rate indicates that about four out of five calls were not answered.[7] As shown in figure I.3 in appendix I, the 1994 accessibility rate continued a downward trend since 1989 and was 3 percentage points below last year. On the other hand, IRS' accuracy rate on answers to tax law questions during the 1994 filing season was 89 percent, the same rate as in 1993 and 26 percentage points higher than in 1989.[8]

Demand for telephone assistance has increased in recent years. Despite this trend, IRS' fiscal year 1995 budget request included a decrease of about 40 staff years at the toll-free call sites. If demand continues to increase, this reduction in resources could exacerbate the accessibility problem.

Accessibility to Forms Varied

Taxpayers can obtain tax forms, instructions, and publications through telephone and mail orders placed with 1 of 3 IRS distribution centers or by visiting 1 of IRS' over 600 walk-in sites. Over 90,000 banks, post offices, and libraries also stock the more commonly used forms and instructions. During the 1994 filing season, we conducted two limited tests of the level of service IRS provides to taxpayers seeking copies of tax forms and publications.[9] Taxpayers were likely to find tax materials they needed if they visited a walk-in site, but they had to be persistent to order materials over the telephone.

Test of Toll-Free Form Ordering System Disclosed Telephone Accessibility Problems

In one test, we placed calls to each of IRS' three area distribution centers that provide tax materials to walk-in sites and fill taxpayers' telephone and mail orders.[10] These were toll-free telephone calls but the toll-free telephone number for ordering forms is different from the toll-free number taxpayers call when they have a tax law or account question. Each day, except Sunday, during a 2-week period in March 1994, we placed calls to the distribution centers from Washington, D.C.; Mission, KS; and San Francisco. We did not order any materials; our intention was to test access to the telephone order system. If we received a busy signal when making a call, we waited 1 minute after hanging up and then redialed. If after 9 redials (10 calls in total) we had not gotten through, we considered the attempt unsuccessful.

[7]The number of calls received includes multiple attempts by the same taxpayer to access the system. Thus that number does not represent the number of taxpayers calling IRS for assistance. IRS is working to develop a system that will enable it to better measure its performance in terms of the number of taxpayers served.

[8]To measure accuracy, IRS test callers place anonymous calls to assistors and score their answers to various tax law questions.

[9]The tests were conducted during selected periods in March 1994 and reflect conditions at those times.

[10]The area distribution centers are in Richmond; Bloomington, IL; and Sacramento, CA.

Of 100 attempts to contact a distribution center, 75 were successful on the first try; 9 were successful after one redial; 11 were successful after 2 or more redials; 3 were aborted after 9 unsuccessful redials; and 2 (both placed from Washington, D.C., on a Saturday) were aborted after we let the phone ring for 2 minutes without receiving either a busy signal or an answer. Our 100 attempts to contact a distribution center required a total of 175 calls. Of those 175 calls, we succeeded in getting through to an IRS representative 95 times—a 54-percent accessibility rate.

This result is consistent with data in IRS' Telephone Activity for the Area Distribution Centers report. Using the actual number of busy signals and abandons from that report, we calculated an accessibility rate of 53 percent for the first half of 1994. We used the same method to calculate this rate as we did to calculate the accessibility rate for toll-free telephone assistance.

While not disputing the accuracy of our 54-percent computation, IRS officials responsible for forms distribution activities said that they think the more meaningful result of our test was that 84 percent of our attempted contacts were successful after only one or two calls.

Walk-in Sites Stocked Required Forms

In the second test of forms and publications accessibility, we visited 10 IRS walk-in sites in 6 states and Washington, D.C., during the week of March 21, 1994, to see whether they had the 101 tax forms, instructions, and publications that all walk-in sites were required to stock for the 1994 filing season. Of the 10 sites, 5 had all of the required items; 4 were missing 1 item each; and 1 was missing 4 items. We made follow-up visits during the next week to the five sites that were missing items and found that the site missing four items and three of the sites missing one item had received a new stock of those items. The other site missing one item received new stock of the item before the filing deadline of April 15.

The results of our test of walk-in sites during the 1994 filing season were better than the results from the last time we conducted such a test in February 1992. At that time, we visited 10 different sites and found that no site had all of the required items; 4 sites were missing 1 item; and 6 sites were missing between 2 and 5 items.

TeleFile System Overloaded

IRS mailed 4.7 million TeleFile tax packages to taxpayers in the 7 states participating in the program in 1994. IRS had projected that almost 519,000

returns would be filed through TeleFile in 1994. As of mid-April 1994, IRS had received TeleFile returns in line with its projection.

The number of TeleFile returns might have been higher if the system were better able to handle the volume of calls. Using IRS data, we computed a TeleFile accessibility rate of 13 percent for the period January 13 through February 10, 1994, the peak period for TeleFile. We divided the total number of successful connections by the total number of calls received, which we defined as the sum of successful connections (about 547,000) and busy signals (about 3.8 million). There is no way to know how many individual taxpayers these busy signals represented or how many of them might have used TeleFile had they been able to get through.

For the 1995 filing season, IRS will be expanding TeleFile to 3 more states and plans to double the number of phone lines to 288. IRS expects that the additional telephone lines will help handle the increased demand. IRS will not test the use of a voice signature in 1995, which should shorten the length of some calls and thus also help to increase IRS' capacity. To further reduce busy signals, IRS plans to publicize the best times to reach the TeleFile system. Also in 1995, IRS expects to learn how many different phone numbers have been used to try to access the TeleFile system. This information may help IRS better estimate the number of taxpayers trying to use TeleFile to file their returns.

Conclusions

A successful filing season requires that IRS effectively manage various programs. IRS achieved many of its goals for processing tax returns and assisting taxpayers and, in many respects, had a successful 1994 filing season. However, there continue to be some serious problems.

Once again this year, the incidence of detected refund fraud has increased significantly. While that trend is troubling in and of itself, even more troubling is the uncertainty as to how much fraud might be going undetected. As IRS continues to add more controls and increase its fraud detection capabilities, it continues to find more fraud.

The EIC continues to be a problem area for IRS and taxpayers. It is the source of many of the errors made by taxpayers and tax practitioners in preparing returns, and almost all of the refund fraud cases identified by IRS involve the EIC. That situation may only worsen in 1995 as more people become eligible to claim the credit.

Taxpayers continue to experience considerable difficulty reaching IRS over the telephone, and those difficulties appear to be widening. According to IRS data, taxpayers in 1994 had problems not only accessing IRS' toll-free telephone assistance but also contacting IRS to order forms and publications and to file their returns. An inability to contact IRS by telephone can heighten taxpayer frustration and contribute to a negative view of IRS.

We are not making any recommendations to address these significant problems because (1) there are several efforts already underway and planned—such as the review being conducted by Treasury's Fraud Task Force and IRS' plan to increase the number of telephone lines for TeleFile—that should have a positive effect on these issues and (2) we have other work underway, which is specifically targeted at those issues and may help us better identify root causes.

Agency Comments and Our Evaluation

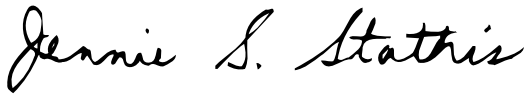
We met with IRS officials on September 26, 1994, to discuss a draft of this report. Except as noted below, they agreed with the matters discussed in the report. In some cases, they provided additional information on events that occurred in 1994 and IRS' plans for 1995. We incorporated those comments where appropriate in the body of the report.

IRS officials disagreed with our methodology for computing telephone accessibility. They said that we focused on the number of calls rather than the number of callers, thus overlooking the fact that many callers could be using features, such as automatic redial, that enable persons to continuously redial until they get through—thus inflating the real demand for IRS assistance. Although we agree that the number of callers trying to reach IRS would be less than the number of calls being made, IRS does not yet have a viable way to measure accessibility based on the number of callers. We have been working with IRS to develop a better measure of telephone accessibility. Until then, we will continue using the measure we have used in the past—the percent of incoming calls that are answered.

We are sending copies of this report to various congressional committees, the Secretary of the Treasury, the Commissioner of Internal Revenue, the Director of the Office of Management and Budget, and other interested parties.

Major contributors to this report are listed in appendix II. Please contact me on (202) 512-5407 if you have any questions.

Sincerely yours,



Jennie S. Stathis
Director, Tax Policy
and Administration Issues

Contents

Abbreviations

CAPR	Computer Assisted Pipeline Review
EIC	Earned Income Credit
IRS	Internal Revenue Service

Trends in Filing Season Performance Indicators

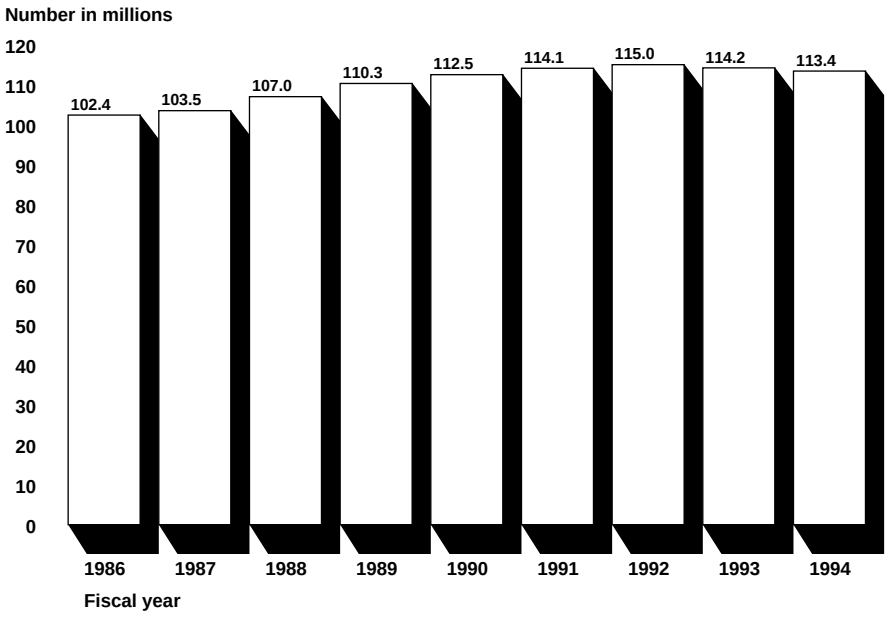
This is our ninth report on IRS' tax filing season for the House Ways and Means Oversight Subcommittee. We first reviewed IRS' performance during the 1985 filing season. In 1985, a combination of insufficient computer capacity, inefficient software, and inadequate training played a major role in creating returns processing backlogs and document control problems. As a result (1) more refunds were delayed in 1985 than in the past and interest payments on late refunds increased substantially, (2) many taxpayers had to file duplicate returns to expedite receipt of their refunds, (3) many erroneous taxpayers notices were issued, (4) correspondence and other inventories increased, (5) the number of telephone calls from taxpayers grew, (6) overtime costs increased, and (7) the productivity of service center personnel declined significantly.

Since then, IRS' service centers have acquired more computer hardware; and computer programs that took many hours to run in 1985 are now running more efficiently. IRS also improved its procedures for dealing with computer-related problems and implemented ways that taxpayers could file returns that bypass the labor intensive and error-prone paper processing system. IRS also established the National Office Command Center in 1986 to coordinate and monitor the resolution of hardware and software problems. The command center helps ensure that problems are addressed in a timely manner and helps identify problems involving multiple locations.

As a result of these changes, IRS' filing season performance has generally improved over the past several years. Receipts of unpostables, error resolution, and adjustments/correspondence cases have decreased (see tables I.1, I.2, and I.3),[11] refund timeliness has increased, receipts of returns on other than paper have increased along with the overall increase in the number of returns received (see figs. I.1 and I.2), and telephone tax law accuracy has increased (see fig. I.3). However, not all of the trends are positive. The number of detected fraudulent refunds has increased dramatically (see table I.4), and telephone accessibility has decreased by 37 percentage points since 1989 (see fig. I.3).

[11]The introduction of new technology has also helped reduce the volume of these receipts. Because of up-front validity checks, for example, returns filed electronically are much less likely to contain errors than returns filed on paper and thus less likely to necessitate correspondence and/or adjustments.

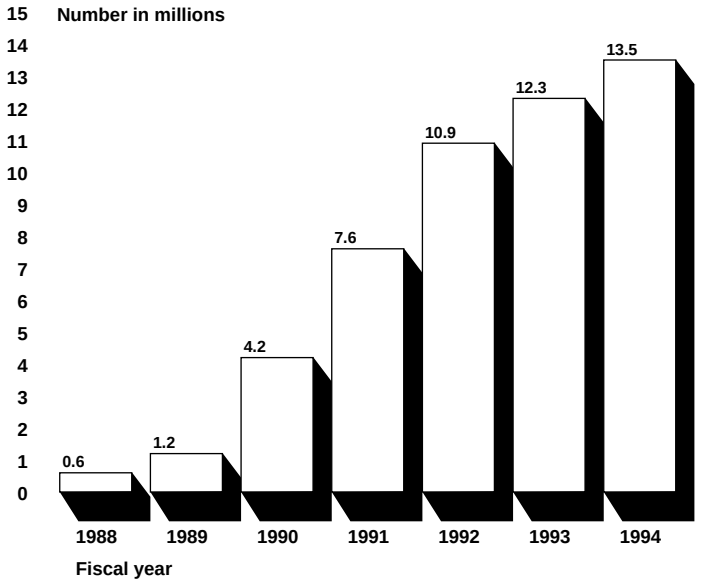
Figure I.1: Number of Individual Income Tax Returns Filed in Fiscal Years 1986 Through 1994



Note: Data for 1994 are for the period January 1 to September 9, 1994. IRS estimates that 114.5 million individual income tax returns will be filed by the end of fiscal year 1994.

Source: Data for 1986 through 1993 are from IRS annual reports. Data for 1994 are from IRS' Management Information System for Top Level Executives.

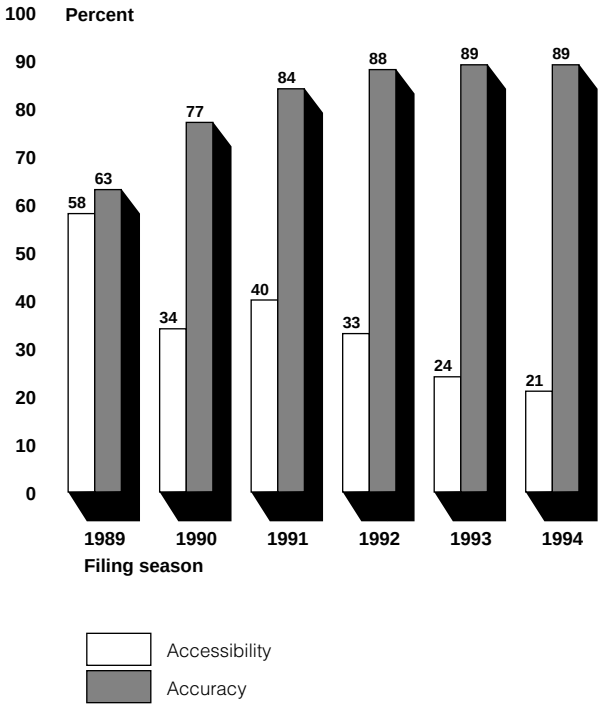
Figure I.2: Number of Individual Income Tax Returns Filed Electronically in Fiscal Years 1988 Through 1994



Note: 1990 was the first year electronic filing was available nationwide.

Source: Data for 1988 through 1993 are from IRS annual reports. Data for 1994 are from IRS' Management Information System for Top Level Executives.

Figure I.3: Comparison of Toll-Free Telephone Accessibility and Accuracy During the 1989 Through 1994 Filing Seasons



Source: IRS' Management Information System for Top Level Executives and IRS' Telephone Data Reports.

Table I.1: Unpostable Receipts for Individual Tax Returns in Calendar Years 1986 Through 1994

Number in millions

Calendar year	Number received
1986	12.7
1987	10.4
1988	11.5
1989	9.8
1990	8.6
1991	7.1
1992	5.8
1993	5.7
1994[a]	4.0

[a]Data as of September 9, 1994.

Source: IRS' Management Information System for Top Level Executives.

Table I.2: Error Resolution Receipts for Individual Tax Returns in Calendar Years 1988 Through 1994

Number in millions

Calendar year	Number of returns sent to Error Resolution
1988	24.7
1989	22.0
1990	21.4
1991	19.7
1992	21.0
1993	19.6
1994[a]	17.7

Note: Comparable data for 1986 and 1987 were not available.

[a]Data as of September 9, 1994.

Source: IRS' Management Information System for Top Level Executives.

Table I.3: Adjustments/ Correspondence Receipts in Calendar Years 1986 Through 1994

Number in millions

Calendar year	Number received
1986	14.2
1987	11.7
1988	11.6
1989	11.6
1990	11.1
1991	10.5
1992	11.0
1993	10.2
1994[a]	8.0

Note: IRS had computer problems in 1985 that caused problems in processing returns and refunds. The large number of adjustments/correspondence receipts in 1986 compared with the following years reflects, at least in part, one of the consequences of those problems.

[a]Data as of September 9, 1994.

Source: IRS' Management Information System for Top Level Executives.

Table I.4: Number of Detected Fraudulent Refunds in Calendar Year 1986 Through 1994

	Paper		Electronic		Totals	
Calendar year	Returns	Refunds claimed	Returns	Refunds claimed	Returns	Refunds claimed
1986	4,856	$ 9,921,350	0	$ 0	4,856	$ 9,921,350
1987	4,363	12,713,058	0	0	4,363	12,713,058
1988	3,622	30,464,242	68	133,925	3,690	30,598,167
1989	3,326	7,244,981	67	350,459	3,393	7,595,440
1990	5,302	15,897,539	411	1,192,054	5,713	17,089,593
1991	5,422	32,273,983	5,746	10,656,046	11,168	42,930,029
1992	12,244	33,165,648	12,725	33,626,516	24,969	66,792,164
1993	51,883	82,764,145	25,957	54,000,206	77,840	136,764,351
1994[a]	34,713	410,781,541[b]	24,115	50,772,345	58,828	461,553,886
Total	**125,731**	**$635,226,487**	**69,089**	**$150,731,551**	**194,820**	**$785,958,038**

[a]Data as of June 1994.

[b]This figure includes two returns claiming refunds totalling about $350 million.

Source: IRS data.

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