

GAO

Report to the Subcommittee on  
Financial Services and General  
Government, Committee on  
Appropriations, U.S. Senate

November 2011

## USER FEES

# Additional Guidance and Documentation Could Further Strengthen IRS's Biennial Review of Fees

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Highlights of [GAO-12-193](#), a report to the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. Senate

## Why GAO Did This Study

The President's fiscal year 2012 budget proposal requests \$13.6 billion to fund the Internal Revenue Service (IRS), including \$204 million in spending funded through user fee collections. Well-designed and well-implemented user fees can reduce taxpayer burden by funding portions of IRS services that provide special benefits to users beyond what is normally provided to the public. As such, GAO was asked to (1) describe the types and amounts of IRS user fees and how IRS collects and uses them, (2) assess how IRS sets and reviews existing user fees, and (3) assess how IRS identifies additional areas where new fees could be justified. GAO reviewed relevant laws, guidance, and literature on user fee design and implementation. GAO reviewed IRS documents and cost estimates and interviewed IRS officials in the Chief Financial Officer's (CFO) office and program divisions.

## What GAO Recommends

GAO recommends that the Commissioner of Internal Revenue take steps to include certain additional fees in IRS's biennial review, improve guidance on estimating costs of user fees, and improve the documentation of assumptions used, factors considered, and decisions made during the setting and reviewing of existing fees. In addition, steps should be taken to provide clear, specific, and direct guidelines for IRS employees and managers to follow in identifying potential new fee opportunities. In written comments, IRS agreed with our recommendations.

View [GAO-12-193](#). For more information, contact James R. White at (202) 512-9110 or [whitej@gao.gov](mailto:whitej@gao.gov).

## USER FEES

### Additional Guidance and Documentation Could Further Strengthen IRS's Biennial Review of Fees

## What GAO Found

Although user fee collections fund less than 2 percent of IRS's budget, fee collections are expected to reach \$309 million in fiscal year 2012 and recently involved nearly 20 million transactions with taxpayers. IRS charges user fees for various activities that include assisting taxpayers in complying with their tax liabilities, clarifying the application of the tax code to particular circumstances, and ensuring the quality of paid preparers of tax returns, among others. In fiscal year 2010, two fees accounted for more than 80 percent of total retained user fee collections:

- **Installment agreements (IA):** Provides taxpayers who cannot pay their full tax liability the option to pay their full tax liability with smaller monthly payments over a period of time for up to 60 months. This service is offered to most taxpayers for \$105 with lower rates for low-income taxpayers and those who opt for a direct debit agreement. This service generated \$198 million, or 68 percent of IRS's total retained user fee collections.
- **Income verification express services (IVES):** Provides 2-business-day processing and electronic delivery of tax return transcripts for users, such as mortgage lenders and other financial market entities, to confirm the income of a borrower (taxpayer) during the processing of a loan application. IRS charged a fee of \$2.25 for each IVES transcript request. This service generated \$40 million, or 14 percent of total retained fee collections.

IRS conducts a review of its user fees biennially (or every 2 years) and has taken steps to improve its estimates of the cost of providing its user fee services, with particular attention to its largest fee. For example, IRS hired a contractor to evaluate, update, and simplify the IA user fee cost estimate. However, for a few of IRS's smaller fee programs, GAO found that IRS omitted fees from its biennial review, did not clearly document assumptions to be used in some cost estimates, and lacked documentation of factors considered in setting some fees. For example, one user fee has not been reviewed or updated since fiscal year 1996, while program managers for another user fee were uncertain about salary assumptions. GAO also found that while officials stated that they consider factors other than cost (such as potential effects on taxpayer compliance and administrative burden) in setting fee rates, they did not thoroughly document these factors or corroborate anecdotal support with analysis. Finally, GAO found that IRS did not fully document final decisions made on fee rates as a result of its biennial review.

IRS has implemented several new user fees in recent years, but it may not be taking full advantage of its process for identifying new user fees. As directed by Office of Management and Budget Circular A-25, IRS's CFO requests that each division review its programs and provide proposals for new user fees on a biennial basis. However, officials in some divisions or offices said that they had no formal solicitation process for employees to suggest new user fee proposals. Further, IRS does not clearly refer staff to consider established guidelines identified in the *Internal Revenue Manual* or other resources when identifying potential new user fees during its biennial review. GAO was unable to determine the extent to which IRS staff considered these guidelines.

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**Abbreviations**

CADE 2	Customer Account Data Engine 2
CFO	Chief Financial Officer
FET	foreign insurance excise tax
FOIA	Freedom of Information Act
IA	installment agreement
IOAA	Independent Offices Appropriation Act
IRS	Internal Revenue Service
IVES	income verification express service
LB&I	Large Business and International
MRF	Miscellaneous Retained Fees
OIC	offer in compromise
OMB	Office of Management and Budget
PFA	pre-filing agreement
PTIN	preparer tax identification number
SB/SE	Small Business and Self-Employed
SEE	special enrollment examination
SFFAS	Statement of Federal Financial Accounting Standards
TE/GE	Tax Exempt and Government Entities
W&I	Wage and Investment

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G A O

Accountability \* Integrity \* Reliability

United States Government Accountability Office  
Washington, DC 20548

November 22, 2011

The Honorable Richard Durbin  
Chairman  
The Honorable Jerry Moran  
Ranking Member  
Subcommittee on Financial Services and General Government  
Committee on Appropriations  
United States Senate

The President's fiscal year 2012 budget proposal requests \$13.6 billion to fund the Internal Revenue Service's (IRS) administration of the tax laws, which includes providing taxpayer services to make voluntary compliance easier and enforcing tax laws to ensure that taxpayers meet their tax obligations. This amount includes \$204 million funded through user fee collections. IRS collects user fees to help offset the costs of providing services to specific beneficiaries, including services that help taxpayers meet their tax obligations, such as installment agreements and offers in compromise, among others.<sup>1</sup> Although user fees fund less than 2 percent of IRS's fiscal year 2012 budget request, fee collections are expected to reach approximately \$309 million in fiscal year 2012 and recently approached nearly 20 million transactions with taxpayers.<sup>2</sup>

Well-designed and well-implemented user fees can fund IRS services that provide special benefits beyond those provided to the general public and thereby reduce the burden on taxpayers not using those services. The Office of Management and Budget (OMB) provides guidance on how executive branch agencies should set and implement user fees through

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<sup>1</sup>An installment agreement is a payment plan that allows a taxpayer to pay his or her full tax liability with smaller monthly payments over a period of time. An offer in compromise is an agreement between IRS and a taxpayer to settle a tax liability for payment of less than the full amount owed.

<sup>2</sup>IRS expects to collect and retain approximately \$309 million in user fees for fiscal year 2012, but it plans to use only \$204 million, as reflected in its budget request. As we discuss later in this report, IRS has permanent authority to obligate and spend user fee collections and can carry forward any unused collections for use in subsequent years.

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Circular No. A-25.<sup>3</sup> Further, the circular and the Chief Financial Officers (CFO) Act of 1990 direct federal agencies to review their user fees every 2 years and make recommendations about the fees charged.<sup>4</sup> The circular also states that each agency should review its programs to determine whether it could charge new fees for its services, noting that if imposing such fees is prohibited or restricted by law, agencies should recommend legislative changes as appropriate.<sup>5</sup>

In response to your request, this report (1) describes the types and amounts of IRS user fees and how IRS collects and uses them, (2) assesses how IRS sets and reviews existing user fees, and (3) assesses how IRS identifies additional areas where new user fees could be justified.

To address these objectives, we reviewed user fee legislation and guidance, agency and budget documents, prior GAO work and other relevant literature on user fee design and implementation characteristics, and cost estimates for user fees that were included in IRS's biennial review process. We also interviewed and obtained written responses from IRS officials in the various divisions and offices who were responsible for overseeing the various user fees. We obtained information about IRS's internal controls for the revenue and volume data we used and determined that the data were sufficiently reliable for the purposes of this report. For further details on our scope and methodology, see appendix I.

We conducted this performance audit from February 2011 through November 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable

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<sup>3</sup>OMB Circular A-25 also states that each agency will review user charges biennially; these reviews will include (1) ensuring that existing charges are adjusted to reflect unanticipated changes in costs or market values and (2) a review of other programs within the agency to determine whether fees should be initiated for government services or goods for which the agency is not currently charging fees.

<sup>4</sup>The CFO Act requires an agency's CFO to review, on a biennial basis, the fees, royalties, rents, and other charges for services and things of value and make recommendations on revising those charges to reflect costs incurred. The CFO Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838, 2843 (Nov. 15, 1990), created section 902 of title 31, United States Code. Also, see OMB Circular A-25, § 8(e).

<sup>5</sup>OMB Circular A-25, § 6.

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basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

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### User Fee Definition and Design Principles

A user fee is a charge assessed to beneficiaries for goods or services provided by the federal government.<sup>6</sup> In general, a user fee is related to some voluntary transaction or request for government goods or services—such as a passport or admission to a national park—above and beyond what is normally provided to the public. Taxes, on the other hand, arise from the government’s sovereign power to raise revenue and need not be related to any specific benefit. Unlike user fees, taxes are generally imposed to raise revenue to fund benefits for the general public, such as national defense.

GAO has published a guide on the principles of effective user fee design.<sup>7</sup> In this guide, we focused on criteria that have often been used to assess user fees and other government collections.

- **Efficiency** is whether the fee ensures that the government is providing the amount of the service that is economically desirable. Efficient fees increase awareness of the costs of government services, creating incentives to reduce costs where possible. In addition, efficient fees act as a measure of the service’s worth while meeting demand for the service.
- **Equity** is the extent to which everyone is considered to be paying a fair share (whether fairness is based on program use or the user’s ability to pay).
- **Revenue adequacy** is the extent to which the fee covers the intended share of service costs, and whether the fee revenue is stable enough to withstand short-term fluctuations in economic activity.

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<sup>6</sup>GAO, *A Glossary of Terms Used in the Federal Budget Process*, [GAO-05-734SP](#) (Washington, D.C.: September 2005).

<sup>7</sup>GAO, *Federal User Fees: A Design Guide*, [GAO-08-386SP](#) (Washington, D.C.: May 29, 2008).

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- **Administrative burden** is the cost of collecting and enforcing the fee, as well as any costs users incur to pay the fee.

These criteria interact and are often in conflict with each other; as such, trade-offs exist when considering among the criteria to design a fee. The weight that different policymakers may place on different criteria will vary, depending on how they value different attributes. To that end, understanding the trade-offs associated with different aspects of a fee's design can provide decision makers with better information and support more robust deliberations about user fee financing.

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## Organization of IRS User Fees

IRS charges user fees for various services that assist taxpayers in complying with their tax liabilities, clarify the application of the tax code to particular circumstances, and ensure the quality of paid preparers of tax returns, among others. IRS is organized into four operating divisions based on types of taxpayers: (1) Wage and Investment (W&I); (2) Large Business and International (LB&I); (3) Small Business and Self-Employed (SB/SE); and (4) Tax Exempt and Government Entities (TE/GE). Each division provides at least one service to taxpayers for which it charges a fee. In addition to these primary operating divisions, IRS has a number of offices, including Chief Counsel, Appeals, Professional Responsibility, and Return Preparer, that also provide services to taxpayers for a fee. Table 1 shows user fee services organized by business division or program office responsible for managing the user fee programs.

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Descriptions of the services and user fees, including fee rates, are included in appendix II.<sup>8</sup>

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**Table 1: Services for Which User Fees Are Charged, by IRS Business Division or Program Office**

<b>Appeals</b>
<b>Advance art determination letters:</b> A statement of value from IRS that can be used to substantiate the value of the art prior to filing the tax return that reports the charitable contribution or the estate or gift tax.
<b>Chief Counsel</b>
<b>Letter rulings and determination letters:</b> Types of written statements from IRS that apply tax law to the taxpayer's specific set of facts on a transaction.
<b>Large Business and International</b>
<b>Competent authority limitation on benefits determination letters:</b> Tax treaty assistance provided to taxpayers related to actions taken by countries that may result in taxation that is contrary to the provisions of a treaty.
<b>Foreign insurance excise tax exemption:</b> An agreement with IRS governed by a tax treaty under which a foreign insurer assumes the responsibility of paying an excise tax on behalf of its domestic insured.
<b>Pre-filing agreements:</b> Examination of specific issues by IRS relating to tax returns before they are filed to resolve issues that are likely to be disputed in audits.
<b>Office of Professional Responsibility</b>
<b>Enrolled actuary:</b> The registration of an actuary who has met certain standards and qualifications and has been approved to perform actuarial services required under federal pension law.
<b>Enrolled agent and retirement plan agent:</b> The registration of a person who has earned the privilege of representing taxpayers before IRS.
<b>Special enrollment examination:</b> A three-part exam tax practitioners must pass to become an enrolled agent and practice before IRS.

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<sup>8</sup>For this review, we focused primarily on user fees included in IRS's fiscal year 2009 review. IRS also charges user fees for requests related to (1) the Freedom of Information Act of 1986 (FOIA), (2) historic easement, (3) reproduction of tax returns, and (4) special statistical studies and compilations. FOIA mandates public access to records of federal agencies unless the information is protected from disclosure. Fee rates for FOIA requests vary depending on the type of requester and the purpose of the request. All collected fees are deposited into the General Fund of the U.S. Treasury. In addition, taxpayers may deduct an amount greater than \$10,000 for the donation of an easement on a building in a historic district by paying a \$500 filing fee to IRS. Collections from the historic easement filing fee are deposited into IRS's Miscellaneous Retained Fees Fund; however, the historic easement fee is not considered a user fee because IRS provides no special benefit or service in exchange for receiving this fee. Lastly, fee collections from the reproduction of tax returns and special statistical studies and compilations user fees are generally treated as offsetting collections and do not flow through IRS's Miscellaneous Retained Fees Fund. Collections related to these user fees amounted to approximately \$6.4 million in fiscal year 2010. Officials indicated that, as of October 1, 2011, the fee for reproduction of tax returns would no longer be treated as offsetting collections and would instead flow through a subfund of IRS's Miscellaneous Retained Fees Fund.

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**Return Preparer Office**

Preparer tax identification number: Identification number required for all paid tax return preparers, including attorneys, certified public accountants, and enrolled actuaries.

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**Small Business and Self-Employed**

**Offer in compromise:** An agreement between IRS and a taxpayer to settle a tax liability for payment of less than the full amount owed.

**Installment agreement:** A payment option or payment plan that allows taxpayers to pay his or her full tax liability with smaller monthly payments over a period of time for up to 60 months.

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**Tax Exempt and Government Entities**

**Letter rulings and determination letters:** Types of written statements from IRS that apply tax law to the taxpayer's specific set of facts on a transaction.

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**Wage and Investment**

**Income verification express service:** Electronic confirmation of a taxpayer's income for lenders.

**U.S. residency certification:** A letter certifying U.S. residency for purposes of claiming benefits under an income tax treaty or exemption from a value-added tax imposed by a foreign country.

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Source: GAO analysis of IRS data.

The CFO has oversight responsibilities for the initial assessment, updates, and collection of user fees. While the CFO does not provide the services for which user fees are charged, it does have the responsibility to ensure that user fees are appropriately collected, deposited, and reported.

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**Authority to Collect User Fees**

IRS derives its authority to charge user fees from either the Independent Offices Appropriation Act (IOAA) or various other specific statutes.<sup>9</sup> Although OMB Circular A-25 states that agencies should recover full costs to the government to the extent permitted by law for providing the service or good,<sup>10</sup> the authority for each fee determines how much of the

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<sup>9</sup>IOAA is codified at 31 U.S.C. § 9701.

<sup>10</sup>According to the circular, full cost includes all direct and indirect costs, but is not limited to salaries and benefits; physical overhead; consulting; material and supply costs; utilities; insurance; travel; rents or imputed rents on land, buildings, and equipment; management and supervisory costs; costs of collecting and enforcing fees; research; establishment of standards and regulation; and imputed costs. OMB Circular A-25, § 6(d)(1).

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costs IRS is required to recover.<sup>11</sup> For example, IRS is directed by the circular to recover full costs for fees authorized by IOAA, unless an exception applies.<sup>12</sup> Agencies, however, may request waivers from OMB to charge less than full cost if the fee would be unduly costly to collect or otherwise justifies an exception.<sup>13</sup> IRS has waivers pending with OMB to charge less than full cost for installment agreements and offers in compromise.<sup>14</sup> According to IRS officials, increasing these fees to full cost could discourage taxpayers from using these services.

In contrast, when IRS is authorized to charge a user fee under a specific statute, the provisions of that statute govern. For example, IRS can charge a reasonable fee for income verification express service and U.S. residency certifications.<sup>15</sup> In some cases, such as with letter rulings and determination letters, minimum rates are specified in the statute. Table 2 shows IRS user fees by authorizing legislation and illustrates that the authority to charge a user fee can be separate from the authority to provide the good or service.

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<sup>11</sup>User fees assessed under specific statutory authority should also be construed consistent with IOAA to the extent possible as part of an overall statutory scheme. Thus, OMB Circular A-25 provides guidance regarding assessments of user charges not only under IOAA but also under other more specific fee statutes to the extent permitted by law—that is, the provisions of a more specific user fee statute take precedence over the circular's guidance and also over the more general provisions of IOAA itself.

<sup>12</sup>OMB Circular A-25, §§4(b), 6(a)(2), 6(c).

<sup>13</sup>If OMB approves an agency's decision to charge less than full cost, an exception is granted for a 4-year period. After the exception period has expired, the agency must submit another request for approval by OMB. OMB Circular A-25, § 6(c)(3).

<sup>14</sup>IRS has charged less than full cost for both installment agreements and offers in compromise since fiscal years 1997 and 2002, respectively. IRS's most recent waivers for installment agreements and offers in compromise expired in March 2010. IRS officials explained that the approval of new waivers was pending because OMB requested additional support from IRS for not charging full cost for these fees, which IRS plans to provide as part of its fiscal year 2011 biennial review.

<sup>15</sup>Unlike IOAA-derived user fees that require full cost recovery, IRS is not required to recover full cost for user fees authorized by specific statutes which permit IRS to charge what it considers to be reasonable, or fair. Income verification express service provides 2-business-day processing and electronic delivery of tax return transcripts for users, such as mortgage lenders and other financial market entities, to confirm the income of a borrower (taxpayer) during the processing of a loan application.

**Table 2: IRS User Fees by Authority to Charge a Fee and Authority to Provide Goods or Services**

User fee type	Authority to charge a user fee	Authority to provide goods/services
<b>IOAA (full cost recovery)</b>		
Installment agreement	31 U.S.C. § 9701	26 U.S.C. § 6159
Offer in compromise	31 U.S.C. § 9701	26 U.S.C. § 7122
Enrolled agent/retirement plan agent	31 U.S.C. § 9701	31 U.S.C. § 330
Enrolled actuary	31 U.S.C. § 9701	29 U.S.C. § 1242
Special enrollment examination	31 U.S.C. § 9701	31 U.S.C. § 330
Preparer tax identification number	31 U.S.C. § 9701	26 U.S.C. § 6109(a)(4)
<b>Specific authority (reasonable cost)</b>		
Letter rulings and determination letters <sup>a</sup>	26 U.S.C. § 7528	26 U.S.C. § 7528
Income verification express service	26 U.S.C. § 6103(p)(2)	26 U.S.C. § 6103(p)(2)
U.S. residency certification	26 U.S.C. § 6103(p)(2)	26 U.S.C. § 6103(p)(2)

Source: GAO.

<sup>a</sup>Includes advance art determination letters, pre-filing agreements, foreign insurance excise tax exemptions, competent authority limitation on benefits determination letters, and Office of the Chief Counsel and TE/GE division letter rulings and determination letters.

## IRS User Fee Collections, Associated Service Volume, and Carryover Amounts Have Increased with Most of the Revenue Used to Fund Taxpayer Services

IRS User Fee Revenue and the Volume of User Fee Services Have Increased in Recent Years

In fiscal year 2010, IRS collected and retained \$290 million in user fees and transferred an additional \$62 million of user fee collections to the U.S. Treasury General Fund (General Fund). Upon collection, user fees are recorded into various IRS financial systems and are deposited either into IRS's Miscellaneous Retained Fees (MRF) Fund for use by the

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agency, the General Fund, or both.<sup>16</sup> The allocation of fees between funds is determined by a formula specified in the Treasury, Postal Service and General Government Appropriations Act of 1995 (1995 Treasury Appropriations Act), which was based on the fees and fee amounts in effect at the time.<sup>17</sup> For example, collections from user fees that existed prior to September 30, 1994, such as enrolled actuary, are divided between IRS's MRF Fund and the General Fund. User fees implemented after September 30, 1994, such as installment agreements, are fully retained by IRS.

Table 3 provides IRS's total retained user fee collections by category for the past 6 fiscal years. Installment agreements have generated the majority of IRS's user fee collections. In fiscal year 2010, they accounted for approximately 68 percent (\$198 million of \$290 million) of IRS's total retained user fee collections. A rate increase implemented in January 2007 resulted in a 55 percent increase (or from approximately \$79 million to \$122 million) in collections from fiscal year 2006 to 2007.<sup>18</sup> According to IRS officials and as shown in table 3, despite the rate increase, taxpayers continued to initiate, restructure, or reinstate installment agreements at similar or higher levels. The second largest contributor to fee collections came from income verification express service, which accounted for approximately \$40 million or 14 percent of fee collections in fiscal year 2010. Fee collections from income verification express service increased significantly from fiscal years 2007 to 2009, which IRS officials

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<sup>16</sup>As specified in IRS's *Internal Revenue Manual* on user fees, the agency generally collects user fees at the time the service is requested. IRS utilizes a variety of collection mechanisms, ranging from checks received at IRS campuses, bank lockboxes, or the IRS National Office, or electronically through Pay.gov.

<sup>17</sup>Congress authorized IRS to retain a portion of its user fee collections to fund operations in the 1995 Treasury Appropriations Act. The amount of user fee collections that IRS was allowed to retain and spend was limited to \$119 million. Pub. L. No. 103-329, title 1, § 3, 108 Stat. 2382, 2388-89 (Sept. 30, 1994). In 2005, the limit was removed as part of the Transportation, Treasury, Housing and Urban Development, the Judiciary, the District of Columbia, and Independent Agencies Appropriations Act, 2006. Pub. L. No. 109-115, div. A, title II, § 209, 119 Stat. 2396, 2439 (Nov. 30, 2005).

<sup>18</sup>From the implementation of the installment agreement user fee in fiscal year 1995 to fiscal year 2006, taxpayers paid \$43 to initiate a new installment agreement or \$24 to restructure or reinstate an installment agreement. Since the fiscal year 2007 fee rate change, taxpayers pay \$105 (or \$52 for direct debit payment) to initiate a new installment agreement or \$45 to restructure or reinstate an installment agreement. Low-income taxpayers pay a reduced fee of \$43 to initiate a new installment agreement.

attributed to the turmoil in the financial and housing markets.<sup>19</sup> Changes in collection amounts can occur because of fee rate changes or because of other factors, such as programmatic changes or economic conditions.

**Table 3: IRS's Total Retained User Fee Collections, Fiscal Years 2005 through 2010**

Dollars in millions						
	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Installment agreement	\$79.0	\$78.8	\$122.1	\$133.2	\$158.0	\$198.5
Income verification express service	N/A	N/A	4.1	8.4	31.8	39.7
Tax Exempt and Government Entities: letter rulings and determination letters	1.3	5.8	19.5	21.3	20.4	27.1
Chief Counsel: letter rulings and determination letters	4.1	8.1	11.2	14.4	16.4	14.0
Offer in compromise	7.1	5.2	5.2	4.2	5.3	5.1
U.S. residency certification	N/A	N/A	2.1	2.8	3.1	2.9
Enrollments <sup>a</sup>	0.8	0.8	1.8	2.5	1.8	2.1
Large Business and International: competent authority limitation on benefits determination letters, foreign insurance excise tax exemptions, and pre-filing agreements	0.6	0.7	1.2	1.0	1.4	1.0
Advance art determination letters <sup>b</sup>	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total</b>	<b>\$92.9</b>	<b>\$99.5<sup>c</sup></b>	<b>\$167.4<sup>c</sup></b>	<b>\$187.6<sup>c</sup></b>	<b>\$238.2</b>	<b>\$290.5<sup>c</sup></b>

Source: GAO analysis of IRS data.

Notes: Because of tiered fee structures and implementation of rate or programmatic changes, the fee rates for each category of user fees cannot be used to calculate the actual volume as reported in table 4. In this table, N/A indicates user fees that had not yet been implemented. This table does not include fee collections from (1) user fees treated as offsetting collections and (2) the preparer tax identification number user fee because IRS began collections in fiscal year 2011.

<sup>a</sup>This category includes fee collections for the enrolled agent, enrolled actuary, and special enrollment examination user fees.

<sup>b</sup>Collections were less than a million.

<sup>c</sup>Figures do not sum to the total because of rounding.

By volume of user fee services, income verification express service topped the list of services provided in fiscal year 2010 with approximately 16 million requests followed by installment agreements with about 3 million requests, as shown in table 4. IRS decreased the income verification express service fee rate from \$4.50 to \$2.25 in fiscal year

<sup>19</sup>IRS officials stated that requests for income verification express service transcripts have increased over the past few years because of the first-time homebuyers credit and property owners who refinanced their mortgages, among other reasons.

2010 because of the increased volume, which lowered the unit cost per income verification express service request. Installment agreement volume has also increased in recent years, despite the fiscal year 2007 fee rate increases.

**Table 4: IRS User Fee Volume, Fiscal Years 2005 through 2010**

In thousands						
	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Income verification express service	N/A	N/A	904	1,856	7,067	16,120
Installment agreement	2,080	2,076	2,035	2,073	2,246	2,900
Tax Exempt and Government Entities: letter rulings and determination letters	68	72	73	72	77	105
U.S. residency certification <sup>a</sup>	N/A	N/A	44	68	79	72
Enrollments	32	15	22	31	38	36
Offer in compromise	48	39	31	28	35	34
Chief Counsel: letter rulings and determination letters	6	6	7	8	11	6
Advance art determination letters	0	0	0	0	0	0
Large Business and International: competent authority limitation on benefits determination letters, foreign insurance excise tax exemptions, and pre-filing agreements	0	0	0	0	0	0
<b>Total</b>	<b>2,234</b>	<b>2,208</b>	<b>3,116</b>	<b>4,136</b>	<b>9,553</b>	<b>19,273</b>

Source: GAO analysis of IRS data.

Notes: Zero denotes volume of less than a thousand. Because of tiered fee structures and implementation of rate or programmatic changes, the fee rates for each category of user fees cannot be used to calculate the actual collections as reported in table 3. In this table, N/A indicates user fees that had not yet been implemented. This table does not include volume for (1) user fees treated as offsetting collections and (2) the preparer tax identification number user fee because IRS began collections in fiscal year 2011.

<sup>a</sup>Volume represents the number of applications received. Because the fee charged is based on the number of certifications provided, which can vary per application, the revenue generated will also vary.

## IRS Can Carry Over Unspent User Fee Revenue

IRS has permanent, indefinite authority to obligate and spend user fee collections. This authority allows the agency independence and flexibility in the use of these funds. IRS can obligate user fee collections for any activity for which it has an appropriation with OMB approval, and it can carry over any unexpended fee collections for use in subsequent years. We have suggested that carryovers are one way agencies can establish reserves to sustain operations in the event of a sharp downturn in user

fee collections or other events.<sup>20</sup> According to IRS, the agency has a reserve of unspent fee collections that can be used for critical needs. The carryover is what is left over after IRS transfers fee collections to supplement its appropriations in order to meet agencywide needs. Table 5 provides information on IRS's MRF carryover balances, which have grown in recent years as fee activity has increased. At the end of fiscal year 2010, \$288 million in fee collections was carried over for use in future fiscal years.

**Table 5: Carryover of IRS Miscellaneous Retained Fees, Fiscal Years 2008 through 2010**

Dollars in millions			
	FY 2008	FY 2009	FY 2010
Unobligated balance carried forward, start of year	\$129	\$70	\$143
New budget authority	188	238	290
Unobligated balance transferred to other accounts	-247	-166	-146
<b>Unobligated balance carried forward, end of year</b>	<b>\$70</b>	<b>\$143</b>	<b>\$288</b>

Source: GAO analysis of the President's Budget Appendix for Treasury and IRS data.

Note: Figures may not sum to total because of rounding.

IRS has used the flexibility afforded by its permanent authority to obligate previously collected user fees to help pay for contingencies such as the damages resulting from the 2006 flood of its headquarters building.<sup>21</sup> More recently, IRS tapped \$89 million in user fee collections to fund its Business Systems Modernization Program for the Customer Account Data Engine 2 (CADE 2) system. According to IRS officials, uncertainty in funding during the spring of 2011 jeopardized activities necessary to roll out the CADE 2 system in preparation for the 2012 filing season. According to IRS officials, the agency has recently set a reserve target amount of \$100 million to provide additional flexibility to address unexpected contingencies. While IRS does not need congressional approval to use additional fee collections for such contingencies, it must obtain approval from the Department of the Treasury and OMB.

<sup>20</sup>GAO-08-386SP.

<sup>21</sup>Treasury Inspector General for Tax Administration, *The Internal Revenue Service Expects to Spend About \$13 Million to Recover From the 2006 Flood of Its Headquarters Building*, 2007-10-113 (Washington, D.C.: July 13, 2007).

## IRS User Fee Collections Fund Taxpayer Services and Agency Operations

IRS uses both annual appropriations from Congress and user fee collections to fund its activities, including those related to taxpayer services, such as prefilling taxpayer education and maintaining taxpayer accounts, and operations support, such as infrastructure and information services. Although its services and operations are primarily funded through annual appropriations, IRS supplements these appropriations with user fee collections, which account for less than 2 percent of IRS's total budget.

In order to supplement its appropriations with user fee collections, IRS transfers its user fee collections from the MRF Fund to its appropriation accounts, as shown in table 6. Once user fee collections are transferred to the appropriation accounts, the user fees and annual appropriations are fungible. In other words, IRS does not track the use of fee collections by user fee program after they have been transferred to the various appropriation accounts.

**Table 6: Transfers from IRS Miscellaneous Retained Fees Fund to IRS Appropriations Accounts, Fiscal Years 2008 through 2010**

Dollars in millions			
	FY 2008	FY 2009	FY 2010
Taxpayer services	\$152	\$127	\$118
Enforcement	13	6	-2 <sup>a</sup>
Operations support	82	33	31
Business systems modernization	0	0	0
Health insurance tax credit administration	0	0	0
<b>Total transfers</b>	<b>\$247</b>	<b>\$166</b>	<b>\$146</b>

Source: GAO analysis of the President's Budget Appendix for Treasury and IRS data.

Note: Figures may not sum to total because of rounding.

<sup>a</sup>Denotes amount of unused fee collections transferred back to IRS's MRF Fund.

According to IRS officials, IRS's appropriation accounts for taxpayer services, operations support, and enforcement provide funding for IRS's user fee programs. For example, the enforcement account funds the installment agreement, offer in compromise, and enrollment-related user fee programs, and the taxpayer services account funds the U.S. residency certification and income verification express service user fee programs. However, the amount of user fee collections that is transferred to these appropriation accounts from the MRF Fund is not directly related to the cost of specific programs or the amount collected from specific fees.

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In contrast, the user fee program for the preparer tax identification number does not receive congressional appropriations and must recover all costs for providing the service through its fee collections. Fee receipts are transferred back to the user fee program to fund all activities related to that fee program. As we mentioned earlier, IRS has the flexibility to determine how to allocate the user fee collections it retains, which is not uncommon among federal agencies.

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## IRS Reviews User Fees Biennially but Does Not Clearly Document Some Processes or Decisions

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### IRS Conducts a Biennial Review of User Fees and Has Taken Steps to Improve Its Cost Estimates

As directed by the CFO Act of 1990 and OMB Circular A-25, IRS conducts a general review of its user fees on a biennial basis. To initiate the biennial review, IRS's CFO issues a memorandum to senior management in relevant business divisions and program offices requesting that they validate the cost of providing services for which they charge a user fee and provide suggestions for new user fees.<sup>22</sup> Based on the cost estimates developed and other considerations, senior management will propose whether to increase, decrease, or keep the current fee rates. These proposals are sent to the CFO and are then compiled and forwarded in a report to the Commissioner for final review and approval.

IRS has made efforts to improve its cost estimation process in support of its user fees, with particular attention given to its largest fee by amount collected. For example, the Treasury Inspector General for Tax Administration's 2006 audit concluded that installment agreement user fee cost estimates were based on incorrect assumptions and contained

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<sup>22</sup>According to IRS's *Internal Revenue Manual*, full cost of user fees should include all direct and indirect costs for providing the good, resource, or service requested. Such costs include personnel costs, overhead costs, and costs to collect the fee, among others.

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calculation errors and unsupported costs. To address these issues, IRS hired a contractor to assess the cost estimate for the fiscal year 2007 biennial review and re-hired the contractor to prepare the cost estimate for the fiscal year 2009 biennial review. For the fiscal year 2011 biennial review, the contractor was hired to simplify the fiscal year 2009 cost estimate. According to officials, IRS does not plan to use the contractor for future biennial reviews.

According to officials, IRS has also taken steps recently to improve the cost estimate for the offer in compromise user fee. For the biennial review in 2009, officials conducted interviews and developed a complex series of spreadsheets to estimate costs of the offer in compromise program. This process, which IRS described as “less precise and more reliant on estimates and averages,” estimated the full cost of the average offer in compromise agreement to be \$2,132. Because the 2009 process was very labor-intensive, IRS assessed other options for gathering the information needed to prepare the cost estimate. As a result of this assessment, IRS simplified its cost estimation process while making it easier to collect information about program costs. The revised fiscal year 2011 review process resulted in an estimated full-cost user fee of \$2,718, an approximate 22 percent increase over that calculated in the 2009 biennial review. According to IRS, the 2009 cost calculations were likely significantly understated, and its 2011 process for capturing offer in compromise costs will yield consistently reliable data going forward.

Based on the biennial review, IRS has also revised fee rates to reflect the updated cost of providing various services, such as income verification express service and Chief Counsel letter rulings.

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## IRS Omitted Some Fees from Biennial Review

IRS has omitted three fees—advance art determination letters, reproduction of tax returns, and special statistical studies and compilations—from its biennial review and contrary to the requirements of the CFO Act.<sup>23</sup> According to an IRS official, the cost estimate used to support the advance art determination letter user fee has not been reviewed or updated since fiscal year 1996 because of very low demand

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<sup>23</sup>According to an IRS official, the fee for special statistical studies and compilations is calculated separately for each request, in general. Thus, costs could be estimated more frequently than biennially. The IRS official added that although the CFO’s office has assisted with these cost estimates in the past, it has not reviewed these fees.

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(fewer than 20 per year from fiscal year 2005 to fiscal year 2010).<sup>24</sup> IRS also omitted from the biennial review the user fees for reproduction of tax returns and special statistical studies and compilations because it interpreted these fees as not being covered by the biennial review requirement.

However, the CFO Act requires IRS to review, on a biennial basis, the fees, royalties, rents, and other charges imposed by IRS for services and things of value it provides.<sup>25</sup> In addition, OMB Circular A-25 provides guidance on conducting a biennial review of user fees regardless of the authorizing statute to the extent permitted by law. Since there is no alternative statutory review process for these fees, they fall under the review requirements of the CFO Act and guidelines of OMB Circular A-25. Furthermore, as articulated in the accounting standards for the federal government, Congress and federal executives need cost information to make decisions about allocating federal resources, modifying programs, and evaluating program performance.<sup>26</sup>

According to IRS, it collected \$6.4 million from these three fees for fiscal year 2010, compared to IRS's fiscal year 2010 total retained user fee collections of \$290 million. Although these fee amounts are small compared to the total amount of user fee collections, regular, substantive fee reviews help ensure that Congress, executive branch agencies, and stakeholders have complete information about both program costs and the alignment between costs and collections. Absent regular reviews, it becomes increasingly likely that fees and costs will become misaligned and that taxpayers could be charged fee rates that do not appropriately reflect the cost of providing the service. However, as outlined in the OMB Circular and our user fee design guide, the benefits achieved from collecting a user fee need to be considered along with the time and costs required to administer and review the fee program. While a comprehensive review of some of these fees every 2 years may not

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<sup>24</sup>OMB Circular A-25 requires the fee to be reviewed every 2 years. Previously, IRS felt that it had met the intent of the circular by reviewing all of its other user fees for letter rulings and determination letters. Since the time of our review, IRS officials said that they have reviewed and updated this cost estimate for the fiscal year 2011 biennial review.

<sup>25</sup>31 U.S.C. § 902(a)(8).

<sup>26</sup>Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Standards and Concepts*, para. 1.

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always be cost-effective given the amount collected from these fees, it may be possible to perform a simplified update during some review cycles.

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### Assumptions Used to Estimate Cost of Some User Fee Programs Were Not Always Correct or Well Documented

According to IRS officials, the CFO's office works closely with business divisions and program offices to develop cost estimates, provides guidance on data to include in the cost estimates, and develops *Internal Revenue Manual* guidelines to document IRS's process for setting and reviewing user fees. In a recent report, we found that IRS set the user fee for the preparer tax identification number in accordance with established guidelines for cost estimation.<sup>27</sup> However, for IRS's smaller user fee programs, we found that data or assumptions used in cost estimates were not always well documented or understood by officials. For example, for the LB&I fees, the fiscal year and data source for some of the fiscal year 2009 cost estimate components were not documented. In another case, we noted some confusion early in the fiscal year 2011 review process from managers in the W&I division about what assumption should be used to estimate the pay increase in the fiscal year 2011 cost estimate. They assumed that they should include a 5 percent pay increase in the fiscal year 2011 cost estimate for the U.S. residency certification fee when the CFO had determined that such an increase should not be included.<sup>28</sup> We also found a calculation error—double counting more than \$6.8 million in direct labor costs—in the cost estimate for the offer in compromise user fee, which the CFO's office did not detect in its review of cost estimates.

According to GAO's cost estimation guide, assumptions used to estimate costs should be documented to include the rationale behind the assumptions and any historical data that support the assumption,<sup>29</sup> and federal accounting standards require documentation of all managerial cost accounting activities, processes, and procedures used to associate

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<sup>27</sup>GAO, *Tax Preparer Regulation: IRS Needs a Documented Framework to Achieve Goal of Improving Taxpayer Compliance*, [GAO-11-336](#) (Washington, D.C.: Mar. 31, 2011).

<sup>28</sup>The CFO's office added that the cost estimates for fiscal year 2011 had not been finalized at the time of our review, and assumptions were subject to change.

<sup>29</sup>GAO, *GAO Cost Estimating and Assessment Guide: Best Practices for Developing and Managing Capital Program Costs*, [GAO-09-3SP](#) (Washington, D.C.: Mar. 2, 2009).

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costs with products, services, or activities.<sup>30</sup> IRS's *Internal Revenue Manual* sections on user fees and managerial cost accounting contain guidelines for developing cost estimates.<sup>31</sup> However, IRS has not provided a documented set of assumptions and decision rules for program managers to follow in estimating costs of user fee program activities for each biennial review. Although it is the responsibility of IRS's business units to develop the cost estimates, supplemental guidance or tools from the CFO's office that provide a crosswalk between the cost estimation guidelines and specific cost estimate assumptions could potentially help staff avoid mistakes that would need to be caught later in the review process. Finally, because these tools could provide more specific instructions on assumptions to be used and documenting data sources, IRS can better ensure consistency of its cost estimates across user fee programs.

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### IRS Does Not Always Document Factors Considered or Decisions Made during Biennial Review of Existing User Fee Rates

In setting user fee rates, IRS officials said they consider taxpayer burden, administrative costs, and potential effects on taxpayer compliance, among other factors, when determining whether to recover full cost. For example, IRS set the U.S. residency certification fee rate at \$35 rather than \$110, the estimated fiscal year 2009 cost of providing the service.<sup>32</sup> Based on anecdotal information, IRS decided that raising the fee rate could discourage taxpayers from applying for the certification, which could result in higher withholding of foreign income taxes and potentially lower income tax revenue to the U.S. Treasury. Similarly, IRS has kept the offer in compromise fee rate at \$150 since the fee's inception in 2003, even though IRS recently estimated that it costs more than \$2,700 to implement the program per user. According to IRS officials, the fee rate has been kept at \$150 to encourage taxpayers who owe taxes to work with IRS and resolve their tax bills.

GAO's user fee design guide outlines important factors to consider when setting user fee rates, including evaluating users' ability to pay and the extent to which the general public and certain individuals benefit from the fee-based program. As described above, IRS officials consider factors

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<sup>30</sup>SFFAS No. 4, para. 71.

<sup>31</sup>IRS, *Internal Revenue Manual* 1.32.19 and 1.32.3.

<sup>32</sup>The \$35 fee covers requests of up to 20 certifications. The fee rate increases for additional certification requests.

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other than cost recovery in setting fee rates. However, we found that IRS has not thoroughly documented these factors, corroborated anecdotal support with data analysis, or studied the effect of user fees on taxpayer behavior. A 2007 report by the National Taxpayer Advocate also found that IRS had not studied the effect of user fees on taxpayer behavior or demand for IRS services. Further, although officials said that changing the offer in compromise fee rate would be costly, IRS has not documented the extent to which changing this fee rate and others would impose additional costs or administrative burden on the agency.

After reviewing fee rates, IRS publishes some of the revised fees in revenue procedures and other documentation.<sup>33</sup> However, IRS's fiscal year 2009 biennial report did not document whether the proposed fee rates discussed in the report had been approved by the IRS Commissioner. For example, in the report, IRS officials proposed a \$5 fee increase from \$35 to \$40 for providing U.S. residency certification. When asked about the disposition of the proposed fee rates presented in the biennial report, officials initially stated that all the proposed fees in the biennial report had been approved and implemented, as appropriate. However, we found documentation that the user fee for U.S. residency certification remained at \$35, which officials later confirmed. IRS officials acknowledged that they used an informal process to decide whether to go forward with the proposed fee increase, which led to miscommunication in determining which fee rate had been implemented.

GAO's standards for internal control in the federal government establish the need for clear documentation.<sup>34</sup> According to these internal control standards, events should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. Moreover, thoroughly documenting decisions and the rationale behind decisions becomes increasingly important as the federal workforce ages and the retirement of senior managers and staff risks the loss of valuable institutional knowledge.

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<sup>33</sup>Revenue procedures are official IRS statements of a procedure that affects the rights and duties of taxpayers and provide instructions concerning an IRS position, such as a change in fee rate. User fees administered by IRS's Office of Chief Counsel, TE/GE division, and LB&I division are published in revenue procedures.

<sup>34</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: Nov. 1, 1999), 15.

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## IRS Has Implemented New User Fees, but the Extent to Which Guidelines Were Used to Assess Potential Fee Opportunities Is Unclear

IRS has implemented several new user fees in recent years. As part of IRS's fiscal year 2005 biennial review, the former IRS Commissioner tasked all business divisions and program offices with identifying potential new user fees to offset processing costs. Through this review, IRS identified several new user fees, including income verification express service and U.S. residency certification, which were implemented in fiscal year 2007. As a result of IRS establishing these new fees, Congress removed the limit on user fee collections that IRS could retain and reduced IRS's annual appropriation by the estimated amount of user fees that would be collected.<sup>35</sup>

Since then, IRS has also identified three new user fees related to return preparers and implemented the first fee, preparer tax identification number, in September 2010. IRS plans to implement the remaining two user fees for competency testing and fingerprinting requirements in fiscal year 2012.<sup>36</sup> According to IRS officials, the return preparer user fee program will be funded exclusively through collections from these three fees.

IRS faces unique challenges in establishing user fees. For example, the National Taxpayer Advocate has noted that user fees may prevent the public from accessing IRS's services because they cannot afford to pay the fee or may discourage people from seeking services that help IRS fulfill its core mission. User fees may also be costly for IRS to administer and divert resources from activities that bring in more tax revenue. On the other hand, user fees can promote an efficient and fair allocation of government resources and ensure that those who are receiving special benefits pay for them.

As directed by OMB Circular A-25, IRS requests business divisions and program offices responsible for implementing user fees to review their programs and provide proposals for new user fees as part of its biennial review.<sup>37</sup> IRS has also developed *Internal Revenue Manual* guidelines to

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<sup>35</sup>Pub. L. No. 109-115, div. A, title II, § 209, 119 Stat. 2396, 2439 (Nov. 30, 2005).

<sup>36</sup>[GAO-11-336](#) discussed IRS's plans for implementing user fees for preparer tax administration number registration, competency testing, and continuing education. Since then, IRS has decided not to establish a fee for continuing education and has decided to establish a user fee for fingerprinting preparers as part of a background check.

<sup>37</sup>Circular, § 8(e).

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assist staff in identifying potential new user fees. However, IRS may not be taking full advantage of its process for identifying new user fees. For example, officials in some divisions or offices said that they had no formal process for soliciting suggestions from employees on new user fee proposals. Although the CFO's biennial review memo refers managers to the *Internal Revenue Manual* when reviewing costs of existing user fees, it does not specifically indicate that these same guidelines or other established design guidelines should be considered when examining new user fees opportunities. We were unable to determine the extent to which IRS staff considered these guidelines, and in our survey of division commissioners, we identified variation in the criteria considered across the operating divisions and offices. If managers are unclear about the process for soliciting user fee proposals or do not receive clear direction on what guidelines to consider when evaluating their programs for new user fees, IRS may be less able to fully engage its staff in evaluating new user fees. As a result, IRS could be missing potential fee opportunities or misallocating resources toward developing fee proposals that are not efficient, equitable, cost-effective, or feasible. The cost and effort involved to clarify its process for soliciting new user fee proposals and to refer staff to established guidelines for identifying and evaluating potential fee opportunities would likely be modest to IRS, since, as table 7 shows, several sources exist for such guidelines.

**Table 7: Selected Guidelines to Consider When Establishing New User Fees**

Source	Selected guidelines
OMB Circular A-25	<p>Does a special benefit exist to an identifiable recipient beyond the general public?</p> <p>Has a review been conducted of all other agency programs to determine whether new fees should be assessed?</p> <p>Does an excise tax already exist for government services that benefit specific individuals? If yes, a new user fee may not be implemented.</p> <p>Have managers of other similar programs been consulted when proposing new fees or modifying existing fees?</p> <p>Has the agency consulted with OMB if it requires legislation to institute new fees?</p> <p>Will the user fee recover the full cost to the agency providing the service?</p>
IRS <i>Internal Revenue Manual</i> 1.32.19	<p>Are benefits voluntary and specific?</p> <p>Can fee payers be identified?</p> <p>Is the fee based on actual cost?</p> <p>Is there a legitimate business case for fee (i.e., fee would further the interests of tax administration, the federal government, or the public)?</p> <p>Can the fee be readily administered (i.e., fee can be easily collected prior to rendering service, and changes and costs needed to administer fee are evaluated)?</p> <p>Is the fee for an activity IRS is already performing?</p> <p>Does implementation of the fee require major data processing changes?</p> <p>What are the public implications of the new fee?</p>
GAO user fee design guide ( <a href="#">GAO-08-386SP</a> )	<p>What is the users' ability to pay?</p> <p>Is a similar service provided by the private sector? If so:</p> <ul style="list-style-type: none"> <li>• Will private producers be subject to unfair competition if the fee is not set to recover the full costs of the service?</li> <li>• Should their charges be a reference point in setting fees?</li> </ul> <p>Does the agency have timely and reliable cost data to link the fee to program costs?</p> <p>Will the fee structure be user specific or systemwide?</p> <ul style="list-style-type: none"> <li>• Is the amount of the fee small or large relative to other costs that the user faces?</li> <li>• Are there numerous different groups of users?</li> <li>• Is the cost variation among the different groups of users large or small?</li> </ul> <p>Does the program have high fixed costs?</p> <ul style="list-style-type: none"> <li>• Is a two-part fee structure, with a flat rate plus a fee based on usage, appropriate?</li> </ul> <p>How frequently will fees be reviewed and updated?</p> <p>What mechanisms will be used to gather stakeholder input?</p>

Source	Selected guidelines
2007 Taxpayer Advocate Service Annual Report to Congress	<p data-bbox="560 464 1523 516">Has IRS researched both the cost of administering the user fee and the effect of the fee on the demand for the specific service in question?</p> <p data-bbox="560 527 1523 579">Has IRS conducted additional research and analysis sufficient to justify the fee and show that:</p> <ul data-bbox="560 590 1523 854" style="list-style-type: none"> <li data-bbox="560 590 1523 642">• The proposed fee will not have a significant negative impact on voluntary compliance or IRS collections or impair IRS's ability to accomplish its mission?</li> <li data-bbox="560 653 1523 705">• The proposed fee will not cost more to administer than IRS could otherwise produce by using the same resources for tax administration?</li> <li data-bbox="560 716 1523 768">• The proposed fee does not apply to services that taxpayers have little choice in obtaining?</li> <li data-bbox="560 779 1523 800">• The proposed fee will not deny basic services to taxpayers who cannot afford them?</li> <li data-bbox="560 810 1523 854">• The services subject to a fee are provided in a reasonably efficient manner so that the fee is not disproportionate to the value received by the service recipient?</li> </ul>

Source: GAO.

## Conclusions

Because of the volume of IRS's user fee transactions with the public, ensuring that user fee rates are properly set, collected, and reviewed is important for taxpayers. As a result of its biennial reviews of user fees, IRS has focused on improving cost estimates related to its most significant fees in recent years. However, we found that (1) some fees were omitted from the biennial review, (2) assumptions used in cost estimates were not always well documented, and (3) factors considered in setting fees and decisions made were not always well documented. It is also unclear the extent to which user fee design guidelines were used to assess new fee opportunities. Given that most of these issues pertained to IRS's smaller fee programs, steps taken to strengthen the review process should not only improve the efficiency of the review but also be cost-effective. Accordingly, we have identified some additional steps, such as clarifying the review guidelines up front, which could potentially decrease the amount of rework needed downstream and be implemented at low cost.

## Recommendations for Executive Action

We recommend that the Commissioner of Internal Revenue take the following five actions to:

- Include certain fees in the biennial review that were previously omitted.
- Develop supplemental guidance or tools that provide more detailed information on data and assumptions to include in cost estimates.

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- Better document the factors considered in setting and reviewing existing user fees.
  - Better document the decisions made in setting and reviewing existing user fees.
  - Provide clear, specific, and direct guidelines for IRS employees and managers to follow in identifying potential fee opportunities.

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## Agency Comments

We provided a draft of this report to the Commissioner of Internal Revenue for his review and comment. In written comments, reprinted in appendix III, the Deputy Commissioner for Operations Support agreed with our recommendations and indicated that IRS plans to implement them during its fiscal year 2013 biennial review of user fees.

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We are sending copies of this report to the Chairmen and Ranking Members of other Senate and House committees and subcommittees that have appropriation, authorization, and oversight responsibilities for IRS. We are also sending copies to the Commissioner of Internal Revenue, the Secretary of the Treasury, and other interested parties. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff members have any questions or wish to discuss the material in this report further, please contact me at (202) 512-9110 or [whitej@gao.gov](mailto:whitej@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Individuals making key contributions to this report are listed in appendix IV.



James R. White  
Director, Tax Issues  
Strategic Issues Team

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# Appendix I: Objectives, Scope, and Methodology

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The objectives of this report were to (1) describe the types and amounts of user fees collected and how the Internal Revenue Service (IRS) collects and uses fees, (2) assess how IRS sets and reviews existing user fees, and (3) assess how IRS identifies additional areas where new user fees could be justified.

To meet these objectives, we reviewed user fee legislation and guidance, agency and budget documents, literature on user fee design and implementation characteristics, and cost estimates for user fees that were included in IRS's biennial review process. We primarily focused on user fees that were included in IRS's fiscal year 2009 biennial review.<sup>1</sup> We also obtained information about IRS's internal controls for the revenue and volume data we used and determined that the data were sufficiently reliable for the purposes of this report. Specifically, we relied on our audit of the aggregated year-end user fee balances and transaction testing for the installment agreement user fee revenue amount, which accounts for the majority of user fee collections and found that the revenue data were sufficiently reliable for our descriptive purposes. Further, we performed a separate analysis to assess the reliability of the user fee volume data by (1) conducting a correlation analysis between the revenue and volume data and (2) using the revenue amount and fee rate to calculate the volume. Based on our analyses, we determined that the volume data were sufficiently reliable for our descriptive purposes.

In addition, we interviewed officials from IRS's Office of the Chief Financial Officer, Office of the Chief Counsel, Large Business and International Division, Office of Professional Responsibility, Return Preparer Office, Small Business and Self-Employed Division, Tax Exempt and Government Entities Division, and Wage and Investment Division, who were responsible for overseeing the user fee programs, and the Taxpayer Advocate Service. We also obtained written responses from the deputy commissioner of each of the user fee programs we selected. Finally, we reviewed prior GAO work on user fees and cost estimation and other relevant literature.

We conducted this performance audit from February 2011 through November 2011 in accordance with generally accepted government

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<sup>1</sup>We also included some discussion about user fees not included in IRS's fiscal year 2009 biennial review, including (1) preparer tax identification number, (2) user fees treated as offsetting collections, and (3) statutorily set user fees.

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auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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# Appendix II: IRS User Fee Descriptions and Amounts

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**Chief Counsel letter rulings and determination letters:** IRS's Chief Counsel issues letter rulings and determination letters for a variety of requests, including but not limited to, (1) advanced pricing agreements, (2) private letter rulings, (3) change in accounting method, and (4) change in accounting period. User fees range from \$150 to \$14,000. IRS publishes updated guidance on obtaining Chief Counsel letter rulings and determination letters and fee amounts in the first Revenue Procedure each year.

**Competent authority limitation on benefits determination letter:** IRS charges a user fee of \$15,000 for taxpayers who request a discretionary determination under a limitation on benefits provision. Revenue Procedure 2006-54 provides guidance on requesting a competent authority limitation on benefits determination letter.

**Enrolled actuary:** An enrolled actuary is an individual who has met certain standards and qualifications set forth by the Joint Board for the Enrollment of Actuaries and has also been approved to perform actuarial services required under the Employee Retirement Income Security Act of 1974. IRS charges a user fee of \$250 for the initial enrollment and for the renewal, which occurs on a triennial basis. Implementing regulations for the enrolled actuary fee are at 26 C.F.R. §§ 300.7 and 300.8 and 20 C.F.R. § 901.11.

**Enrolled agent/enrolled retirement plan agent:** In order to become enrolled to practice before IRS, an individual must submit an application and meet certain standards, pay a user fee of \$30 for the initial enrollment and for renewal every 3 years, and pass the special enrollment examination that is administered by IRS. Similar to attorneys and certified public accountants, enrolled agents and enrolled retirement plan agents are unrestricted as to which taxpayers they can represent and types of tax matters they can handle. Implementing regulations for the enrolled agents and enrolled retirement plan agents fee are at 26 C.F.R. §§ 300.5 and 300.6.

**Foreign insurance excise tax (FET) exemption:** FET is imposed on premiums paid to the foreign insurer. Applicants (which are foreign insurance companies) may apply for a FET closing agreement with IRS under Revenue Procedure 2003-78 certifying that they meet the residency and limitation of benefits articles of the applicable income tax treaty. Through this agreement, the foreign insurer (or applicant) assumes the responsibility of paying the tax, if any, that otherwise would be paid by

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the domestic insured party. Applicants requesting a FET exemption must pay a \$4,000 fee.

**Income verification express service (IVES):** This service provides 2-business-day processing and electronic delivery of tax return transcripts for users, such as mortgage lenders and other financial market entities, to confirm the income of a borrower (or taxpayer) during the processing of a loan application. IRS charges a user fee of \$2.00 for each IVES transcript request.<sup>1</sup>

**Installment agreement (IA):** An IA is a payment option or payment plan that allows a taxpayer to pay his or her full tax liability with smaller monthly payments over a period of time for up to 60 months. Interest and any applicable penalties continue to accrue until the balance is paid in full. To secure an IA, applicants must submit a completed application and pay the applicable user fee. There are three levels of fees applicable to new IAs: (1) \$105 for most taxpayers, (2) \$52 for taxpayers entering into direct debit agreements, and (3) \$43 for taxpayers who qualify for the low-income rate (i.e., taxpayers whose incomes falls below 250 percent of the poverty level). Taxpayers who request reinstatement of an IA must pay a fee of \$45. Implementing regulations for the IA fee are at 26 C.F.R. §§ 300.1 and 300.2.

**Offer in compromise (OIC):** An OIC is an agreement between IRS and a taxpayer to settle a tax liability for payment of less than the full amount owed. When submitting an offer for consideration, taxpayers must make a partial payment unless a waiver applies.<sup>2</sup> Taxpayers may pay the offer amount in a lump sum, in which 20 percent of the offer amount is due when submitting the offer, or in installment payments, in which case the first installment payment is due with the offer (unless the taxpayers qualify for low-income waiver, in which case the 20 percent or installment payment is not applicable). If IRS accepts the offer amount, the user fee

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<sup>1</sup>Prior to October 1, 2011, IRS charged \$2.25 per IVES transcript request.

<sup>2</sup>IRS waives the \$150 fee for applicants who meet the poverty threshold.

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is applied toward the remaining balance due.<sup>3</sup> Implementing regulations for the OIC fee are at 26 C.F.R. § 300.3.

**Pre-filing agreement (PFA):** Taxpayers are subject to the \$50,000 user fee only if they are selected to participate in the PFA program. If taxpayers are selected, IRS will examine specific issues relating to their tax returns before they are filed. The objective of the PFA program is to resolve issues that are likely to be disputed in post-filing audits. Revenue Procedure 2009-14 provides guidance on the PFA program.

**Preparer tax identification number (PTIN):** All paid tax return preparers, including attorneys, certified public accountants, and enrolled agents, are required to apply for a PTIN before preparing any federal tax returns in 2011 and thereafter. Individuals who apply for a PTIN must pay an annual fee of \$64.25. Of that amount, IRS collects \$50 for associated PTIN activities and the remaining \$14.25 is transferred to a third-party vendor responsible for maintaining the registration system. Implementing regulations for the PTIN fee are at 26 C.F.R. § 300.9.

**Special enrollment examination (SEE):** Prior to enrolling as an enrolled agent or enrolled retirement plan agent, individuals must either pass a three-part exam or possess years of past IRS service and technical experience specified in Circular 230 to practice before IRS. IRS charges \$11 per part to oversee the examination. Implementing regulations for the SEE fee are at 26 C.F.R. § 300.4.

**Tax Exempt and Government Entities letter rulings and determination letters:** The Tax Exempt and Government Entities Division issues letter rulings and determination letters for a variety of activities, including but not limited to employee plans and exempt organizations. Depending on the request, fees can range from \$200 to \$25,000.

**U.S. residency certification:** Income tax treaties between the United States and foreign countries can reduce withholding rates for certain types of income paid to U.S. residents. In such cases, U.S. treaty partners may require taxpayers to provide a letter of U.S. residency

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<sup>3</sup>If an offer is accepted under Effective Tax Administration criteria or doubt as to collectibility under special circumstances, the fee will be applied against the amount of the offer, unless the taxpayer requests that it be refunded.

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certification for purposes of claiming benefits under an income tax treaty or exemption from a value-added tax imposed by the foreign country. Applicants requesting such certifications would need to submit a \$35 fee for the first 20 certifications and \$5 for each additional request of 20 certifications thereafter to IRS.

# Appendix III: Comments from the Internal Revenue Service



DEPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

November 10, 2011

Mr. James R. White  
Director, Tax Issues  
Strategic Issues Team  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Mr. White:

Thank you for the opportunity to comment on the draft audit report titled "User Fees: Additional Guidance and Documentation Could Further Strengthen IRS's Biennial Review of Fees." We appreciate the time your team spent reviewing IRS user fees and the biennial review process.

We are pleased that the Government Accountability Office (GAO) recognized our efforts in conducting a biennial review of user fees and striving to improve our cost estimation in order to make sound decisions regarding user fee rates. Additionally, the GAO recognized that the IRS set the Return Preparer user fee in accordance with established cost estimation guidelines. We agree with the recommendations contained in your report to continue to make improvements to our biennial review process, and we will implement them during the fiscal year 2013 biennial review.

We are committed to implementing appropriate improvements to ensure that the IRS maintains sound financial practices. If you have any questions, or would like to discuss our response in further detail, please contact me or a member of your staff may contact Pamela LaRue, Chief Financial Officer, at (202) 622-6400.

Sincerely,

A handwritten signature in cursive script that reads "Beth Tucker".

Beth Tucker  
Deputy Commissioner for Operations Support

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# Appendix IV: GAO Contact and Staff Acknowledgments

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## GAO Contact

James R. White, (202) 512-9110 or [whitej@gao.gov](mailto:whitej@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, Jay McTigue (Assistant Director), Elizabeth Fan, and Susan Sato made key contributions to this report. Doreen Eng, Edward Nannenhorn, Jacqueline Nowicki, Chelsa Gurkin, Melanie Papasian, Neil Pinney, and Andrew J. Stephens also provided valuable assistance.

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