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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of The Treasury

Further Improvements Needed In Processing Tax Regulations

IRS and the Treasury have experienced a backlog of tax regulations for over 15 years and the backlog is increasing. These agencies have responded to the problem by (1) revising the regulatory review process, (2) increasing the number of review positions in Treasury, and (3) developing a computerized management imformation system to monitor the agencies' performance. GAO believes that IRS and Treasury can further improve the process by publishing some regulations with limited review and developing the additional management information needed to highlight long-delayed projects and determine whether additional review staff is needed.

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

GENERAL GOVERNMENT
DIVISION

B-209685

The Honorable Donald T. Regan
Secretary of the Treasury

Dear Mr. Secretary:

At the request of the Chairman, Subcommittee on Select Revenue Measures, House Committee on Ways and Means, we have studied the growing backlog of tax regulations. The Chairman made the request because of his concern that Internal Revenue Service (IRS) budget constraints might be contributing to growth in the backlog.

The primary cause of growth in the backlog was an inadequate number of attorneys in the Office of the Assistant Secretary (Tax Policy). Given current procedures in IRS and the Department of the Treasury, the prospects for eliminating the backlog are not good in spite of several recent improvements, including the assignment of additional attorneys to work on tax regulations. Additionally, we believe that IRS and Treasury need to collect data on the amount of attorney staff time dedicated to issuing regulations. With such data--not now available--officials will be better able to determine whether staffing levels are adequate to deal with the existing workload and with the backlog.

Also, we believe that, as IRS and Treasury continue to develop and refine their management information systems, a routine highlighting of long-delayed projects would help make managers more aware of processing problems needing attention. Finally, as a short term measure, we believe that IRS and Treasury should experiment with reduced review before the initial publication of some regulations currently in the inventory. A detailed discussion of the results of our review, conclusions, and recommendations are presented in appendix I.

In comments sent to us on a draft of this report, IRS and Treasury generally agreed with our recommendations to improve the available management information systems for tracking projects but believed that the reduced review of some projects that we suggested would not save much time. The Office of Management and Budget (OMB) in its comments thought some of the management information we suggested gathering was needed but other data related to the time charges by attorneys was not. OMB also felt that our suggestion for changes in review procedures was "an interesting alternative."

As you know, 31 U.S.C. §720 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs within 60 days of the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. Our recommendations to you appear on page 15 of appendix I.

We are sending copies of this report to the Director, Office of Management and Budget; the Commissioner of Internal Revenue; appropriate Senate and House Committees, including the Subcommittee on Select Revenue Measures, House Committee on Ways and Means; and other interested parties.

Sincerely yours,

W. J. Anderson

William J. Anderson
Director

RESULTS OF GAO'S REVIEW OF THE PROCESS USED TO DEVELOP TAX REGULATIONS

Development and issuance of regulations to clarify tax law are the joint responsibility of the Department of the Treasury's Office of Tax Policy (Treasury) and the Internal Revenue Service (IRS). By December 31, 1982, the end-of-year inventory of unpublished regulations had reached 468--a record high. In our review of the regulations process we found that IRS and Treasury were falling behind in handling this growing inventory. We concluded that a bottleneck has existed primarily because the number of attorneys in the Office of the Assistant Secretary (Tax Policy) has not been adequate to deal with the workload.

Since we began our review, IRS and Treasury have taken several actions intended to reduce the regulations backlog. In January 1982, IRS and Treasury began developing a new review process designed to reduce the regulations backlog and, in January 1983, announced refinements to that process. In addition, they have developed a new management information system which provides for better monitoring of the existing workload. Most recently, in May 1983, Treasury announced an increase in the number of attorneys reviewing drafts of regulations.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our review was undertaken at the request of Congressman Fortney H. Stark, Chairman, Subcommittee on Select Revenue Measures, House Committee on Ways and Means. The objective was to determine what could be done to eliminate or reduce the backlog in developing tax regulations.

In the course of our work we reviewed relevant case files and management reports to gain an understanding of how regulations are developed. We discussed selected individual projects, as well as the regulations process as a whole, with appropriate IRS officials, and particularly with the Office of Chief Counsel's Legislation and Regulations Division (L&R) and Employee Plans and Exempt Organizations Division attorneys who have initial responsibility for drafting regulations projects. In the Department of the Treasury, we discussed the growing regulations inventory with top officials in the Office of Assistant Secretary (Tax Policy), and the reviewing attorneys in Tax Legislative Counsel (TLC) and General Counsel's Office. We also had discussions with staff of the Office of Management and Budget and with interested nongovernmental organizations, such as the American Bar Association and the American Institute of Certified Public Accountants.

In addition, we analyzed all regulations projects closed in 1980 and 1981 and about 85 percent of the pending projects which were over 2 years old in March 1982. We have continued to monitor changes in the regulations process and have revised our data as appropriate. We conducted our review in accordance with generally accepted government auditing standards.

REGULATIONS ARE IMPORTANT FOR ORDERLY TAX ADMINISTRATION

A tax regulation is a more specific and/or technical explanation of a particular section of the tax code. Regulations provide guidance to both taxpayers and IRS staff in clarifying and fulfilling the full intent of a particular section of the tax code. Among other things, tax regulations (1) specify filing dates and required filing information, (2) provide needed definitions, (3) give computational examples, (4) provide general explanations, and (5) establish administrative procedures.

The first step in development of regulations is the opening of a "project." IRS and Treasury term each tax code section which requires regulations a project. A project is opened when IRS identifies the need for regulations under a new section of the Internal Revenue Code or when an existing regulation needs to be changed. IRS attorneys in either the Legislation and Regulations or Employee Plans and Exempt Organization Division first develop a draft regulation. After the draft passes through the IRS review process, it is sent to Treasury attorneys in the Tax Legislative Counsel for their review. The TLC-approved draft is then forwarded to the Office of General Counsel and the department's Executive Secretary for departmental clearance. The Treasury-approved draft is returned to IRS and published for public comment. After the comment period IRS revises the draft, which is again reviewed by Treasury. The approved draft then is issued by Treasury as a regulation, published in the Federal Register, and the project is closed. Projects which produce temporary regulations are closed after the first publication.

Regulations are needed in various situations and with different degrees of urgency. For example, IRS and Treasury believed there was an immediate need for regulations following the enactment of the Windfall Profit Tax Act of 1980. To avoid large tax revenue losses, IRS and Treasury issued temporary regulations on the day the act became law. A more common example of a need for a regulation involved a tax credit for increasing research activities. This regulations project, opened as a result of a provision of the Economic Recovery Tax Act of 1981 (ERTA), was needed to define "qualified research expenses" and to determine what research qualified for the tax credit. Without this clarification, for example, insurance companies and accounting firms could not readily determine whether expenditures for actuarial studies or for the development of new accounting procedures qualified.

REGULATIONS PROCESS IS BACKLOGGED AND THE INVENTORY IS GROWING

As of December 31, 1982, the backlog of regulations projects was 468, as compared to 140 in January 1967. Appendix II illustrates how the backlog of tax regulations has grown in the past 15 years and how, historically, the passage of new tax legislation has caused the number of projects to increase. We estimate that, at average annual rates of production, IRS and Treasury would need about 5 years to eliminate the current backlog. However, additional projects resulting from new tax legislation will in all likelihood add to the current number of projects.

Regulations projects are mainly created by: (1) the enactment of new legislation and (2) the need to revise or clarify existing regulations for a particular section of the tax code. The primary reason for the dramatic increase in the number of regulations projects over the past few years has been the enactment of major tax legislation by the Congress. For example, in the 4 months following the enactment of the Tax Reform Act of 1969, 128 projects were created. Similarly, within 4 months following the enactment of the Tax Reform Act of 1976, 190 regulations projects were created. The Economic Recovery Tax Act of 1981 and the recently passed Tax Equity and Fiscal Responsibility Act of 1982 will require at least 90 and 77 new projects, respectively. Moreover, in addition to creating more regulations projects, passage of new legislation often diverts resources from ongoing projects to new regulations projects where guidance is considered critical to implement the law.

Since 1967, IRS has opened an average of 101 regulations projects each year. To date, the number of newly opened projects has ranged from a low of 27 in 1969 to a high of 224 in 1976. Regulations projects are closed when a draft becomes a temporary or final regulation or when a project is considered unnecessary and dropped from the current inventory. Between 1967 and 1982 an average of about 84 projects per year was closed, with closings ranging from 32 in 1969 to 176 in 1977. In 1977, IRS made a special effort to close regulations projects which it considered unnecessary--thus the large number of projects closed that year. In a recent effort, IRS and Treasury closed 46 projects without regulations between November 1982 and January 1983. Appendix III summarizes the opening and closing of projects between 1967 and 1982.

Time to Issue Regulations Varies Widely

The large backlog of regulations and the way they are handled have resulted in (1) many projects which have been pending for several years and (2) a wide variance in the amount of time it took to complete those projects that were issued as regulations. At the end of 1982, IRS still had at least one regulations project pending that was opened in 1964.

Because of the wide variance in complexity, sensitivity, length of regulations, and in the number of taxpayers affected, it is difficult to determine how long it should take to produce a regulation. We discussed the time required to issue regulations with many people who had been involved in tax regulations development including a former IRS Commissioner, a former Assistant Secretary of the Treasury (Tax Policy), three former Directors of L&R, and attorneys involved in the regulations process at IRS and Treasury. The general consensus of the discussions was that, while regulations development time could vary for many reasons, a regulation of ordinary complexity and importance should take about 2 years to develop and issue. One IRS official stated that 2 1/2 years was more reasonable.

There were 83 temporary and final regulations issued in 1980 and 52 in 1981. The average time for completion was 28.8 months for those issued in 1980, and 27.4 months for 1981. In 1980, 41 percent of completed projects took longer than 2 years (34 of 83 total); in 1981, 48 percent of completed projects were similarly time consuming (25 of 52 total). Further comparison is presented in the following table:

Completion Timeframes	Number of regulations projects completed 1980	1981
Within 6 months	18	21
6 months to 1 year	10	2
1 year to 2 years	21	4
2 years to 3 years	5	11
3 years to 4 years	13	2
4 years to 5 years	5	5
over 5 years	11	7
	83	52
Range (in days)	7 to 3,361	2 to 3,541

Several Reasons Contributed to the Delay of Projects

In addition to analyzing the time it takes to issue regulations, we reviewed the backlog to determine why there were so many old projects. After analyzing completed 1980 and 1981 regulations and discussing them with various officials, we looked at all pending L&R projects which were more than 2 years old.[1]

To gain insight into why these projects had not been completed, in March 1982 we interviewed each of the six branch chiefs in L&R regarding their older projects. The branch chiefs cited many reasons why these regulations projects had not been completed. According to the six branch chiefs, the main reasons for the backlog are:

(1) Inadequate staffing at TLC has been a continual problem. TLC's inability to respond in a timely way to the large volume of work coming in from IRS was believed to be due primarily to heavy legislative demands, such as drafting proposed legislation and congressional testimony, which take priority over regulations activity.

(2) Staff turnover both in L&R and in TLC has been a major factor. Most L&R attorneys remain with with IRS for about 4 years, and the TLC attorneys stay about 2 years. Each time an attorney leaves and the projects are reassigned, the new attorney must learn the entire project.

(3) Pending congressional action or a related court case which would have an impact on a pending regulation has caused some projects to be informally suspended awaiting the outcome.

(4) Fundamental policy decisions which must be made before the regulation is issued are delayed. For example, at the time of our review in March 1982 a group of projects dealing with the arbitrage restrictions on tax-exempt bonds was awaiting a basic Treasury policy decision on the proper scope of the arbitrage rules.

CHANGES IN REGULATIONS PROCESS HAVE NOT REDUCED THE BACKLOG

Because the inventory of unissued regulations was growing significantly, IRS and Treasury made substantial changes to the procedures at the beginning of 1982 and announced further refinements of those procedures in January 1983. Even with the

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[1]There were 208 open regulations projects on February 28, 1982, which were begun prior to 1980. Of these 208 projects, 176 were in L&R and 32 in the other IRS division that originates some projects, the Employee Plans and Exempt Organizations Division. Since L&R had most of the inventory, we concentrated on those 176 projects.

changes, the regulations process remains complicated, with numerous levels of review and comment involving several different organizations. The changes to the process have not yet reduced the large backlog.

The Old Process Resulted in Large Inventories at Treasury for Review

Prior to January 1982, the regulations process between IRS and Treasury provided for no routine monitoring of specific regulations projects by either IRS or Treasury and no formal means for resolving policy problems in a timely manner.

When a new regulation was required, the appropriate branch in either L&R or the Employee Plans and Exempt Organization Division,[2] depending upon the subject matter, "opened" a project and assigned it to one of its docket attorneys. The docket attorney prepared a preliminary draft of the regulation. After the draft was approved by a reviewer, copies were forwarded to at least one of IRS' Technical Divisions and to TLC for concurrent review.

IRS standards required Technical to provide its comments within 30 days after receiving the draft. Within this 30-day period, other IRS functions such as Examination, Returns Processing, or Collection would also be asked to provide comments if the project affected their programs. The IRS review standards emphasized that comments should address feasibility, completeness, technical accuracy, and consistency with previously advocated positions.

Within Treasury's TLC, the draft was assigned to a staff attorney for review. Each of the 12 to 14 staff attorneys at TLC was assigned responsibility for particular sections of the tax code. No time frames were established for TLC reviews. Once the attorney completed his review of the draft regulation, it was reviewed by higher level TLC officials.

If neither Technical nor TLC believed significant changes were needed, they could meet with the L&R staff to resolve any

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[2]Since most regulations relate to areas under the jurisdiction of L&R and TLC, we describe the process in terms of their actions. We do not discuss the actions of Employee Plans and Exempt Organization Division, which originates regulations projects in the pension plans and tax exempt organization areas, or International Tax Counsel, which reviews projects related to international issues. However, these organizations use procedures similar to those of L&R and TLC.

minor problems. After agreement had been reached, L&R prepared the "Notice of Proposed Rulemaking" which was circulated for formal approval. The Notice was sent sequentially for approval to several points within IRS: the L&R Division Director, the Assistant Commissioner (Technical), the Chief Counsel and, finally, the Commissioner. Upon the Commissioner's approval, the Notice was forwarded to TLC for approval and then sent to the Assistant Secretary (Tax Policy) for final approval and publication in the Federal Register. One of the purposes of the Notice was to solicit public comments. After evaluating any comments and holding a public hearing if necessary, L&R prepared a draft final regulation, known as a "Treasury Decision." This decision followed exactly the same process as the draft Notice. This entire process, as it existed prior to January 1982, is illustrated in appendix V.

We found that under this regulations process, IRS divisions generally commented on preliminary drafts within their 30-day time frame but that review periods at TLC were frequently protracted. For example, as of December 31, 1981, 68 regulations projects had preliminary drafts of Notices approved by the Technical Division and other IRS divisions but had not been reviewed and commented on by TLC attorneys. The number of months these 68 projects had been with TLC awaiting action was as follows:

Months	Number of Projects
1-6	11
7-12	19
13-24	17
25-36	13
37-48	4
49-60	2
Over 60	2
	68

IRS and Treasury officials pointed out that the higher priority work that TLC attorneys must do resulted in their devoting only a portion of their time to reviewing drafts. Because TLC attorneys do not account for their time by work activity, we requested that they provide us with an estimate of the amount of time they devoted to reviewing regulations projects. The 13 TLC attorneys responding estimated that they spent about 40 percent of their time on this activity. This is equivalent to about 5 full-time attorneys (13 x 40% = 5.2). From 1967 to 1982 this level of effort has yielded an average of 95 projects published each year. This is an overall output of 19 published projects per staff year (95 total published projects/5 staff years = 19 projects per staff year).

TLC attorneys do have other major duties in addition to reviewing regulations for accuracy and policy positions. TLC prepares testimony in the tax area for Treasury officials and prepares and monitors the progress of tax legislation proposed by the Administration. Treasury officials told us that since 1969 there has been a marked increase in the number of appearances by Treasury officials to testify before congressional committees on tax matters. Yet, during the same period, there has been only a small increase in TLC's staff. This contrast is illustrated in the following table which compares the staff attorney positions available in TLC and the number of testimonies prepared by TLC for selected years:

	1969	1970	1981	1982
TLC Attorney Positions[3]	14	14	19	19
Congressional Testimonies	9	7	42	41

This increase, coupled with the 5 major tax laws enacted since 1969, has placed a heavy burden on the TLC staff.

In addition to the increase in testimony and tax legislation that occurred during this time, the regulations process was slowed by a lack of management control over review of drafts which hindered prompt review and resolution of disputes in promulgating regulations. IRS and Treasury officials had recognized this problem prior to our review and, in January 1982, changed the process in an effort to increase the total output of regulations.

The New Process Is Intended To Speed Up the Regulations Process and Reduce the Backlog

In January 1982, IRS and Treasury adopted a new process designed to get regulations issued sooner as well as reduce the backlog. The new process (1) provides for IRS to divide regulations projects into categories--from the simple or routine to the complex--and sets time frames for review by TLC of each project category, (2) limits the number of projects that IRS can forward monthly to Treasury for review, (3) sets a goal of publishing 130 projects per year, and (4) establishes an improved

[3]Includes the Tax Legislative Counsel and his Deputy as well as two Associate Tax Legislative Counsels. In 1981 and 1982 the staff also included one correspondence attorney who was not responsible for working on either tax regulations or tax legislation.

tracking system to monitor the performance of the respective units in Treasury and IRS. In addition, the new procedures provide for a more thorough review within IRS before a draft is sent to TLC. This review is expected to provide the TLC staff with a higher quality draft that should require less review than in the past. Staffing levels in L&R and Employee Plans and Exempt Organization Division are not affected by the agreement.

The following four categories of regulations provide the basic framework of the process:

--Category 1 projects are routine in nature, contain no policy issues and, therefore, require no substantial policy review by Treasury. Because they are neither controversial nor complex, TLC is given 2 weeks in which to review them and offer comments before the draft notice is forwarded to General Counsel and the Executive Secretary for final review prior to publication and solicitation of public comments. If 2 weeks expire and TLC has not responded to a Category 1 project, IRS may forward the draft to General Counsel and the Executive Secretary for final review.

--Category 2A projects contain some policy issues but IRS believes the issues do not require extensive Treasury review. TLC, upon receipt of these projects, is given 30 days to review them.

--Category 2B projects contain policy issues requiring more time for Treasury review. Forty-five days are allowed. TLC may, if needed, use additional time; however, all issues are to be resolved within 135 days from the date IRS first forwards the project to Treasury.

--Category 3 projects are complex and/or contain highly sensitive policy issues. To focus attention on these projects early, the docket attorney in L&R prepares an issue memorandum within 90 days after the date the project is opened. This memorandum is circulated in IRS and Treasury and updated periodically. Upon receipt of a draft of the regulation from IRS, the process requires TLC to review and comment within 60 days and to resolve all outstanding issues within 180 days. However, because of the complexity and/or sensitivity of some projects, an extension of time for TLC review is permitted if IRS and Treasury agree to such an extension.

As of January 31, 1983, IRS estimated that there were 124 projects identified as Category 1's, 263 projects listed as either Category 2A or 2B, and 55 projects classified as Category 3's.

In addition to categorizing the regulations projects and establishing review times for each category, IRS and Treasury under the new process also set 16 as the maximum number of projects per month that IRS could send to Treasury for review. The total was to consist of no more than 6 Category 1 projects, 8 Category 2 projects, and 2 Category 3 projects. Then, in January 1983, IRS and Treasury agreed to change the process by (1) reducing the total number of projects that could be sent to TLC to between 10 and 12 each month (and up to 3 to International Tax Counsel each month) and (2) eliminating the quotas by category. This change was made because the original quota of 16 projects per month proved to be too many for TLC to handle. In addition, the quotas by category did not match TLC's ability to review the projects.

The new process also included another aspect designed to expedite the issuance of regulations--more thorough review within IRS before each project is forwarded to TLC for review. Under the new process, L&R no longer automatically forwards preliminary drafts to TLC; instead, they are forwarded for comment only to selected IRS components. Each IRS division is still given 30 days to comment on the preliminary draft. A revised preliminary draft incorporating their comments is then forwarded to these same divisions. This time the divisions have only 14 days to comment. Once all issues have been resolved within IRS, the revised preliminary draft is approved by the L&R division director and forwarded to the Chief Counsel Review Staff. Upon approval of the Review Staff, the draft is presented at a briefing before top IRS officials. Upon their concurrence, the draft is forwarded to TLC. IRS and Treasury believe that this approach will reduce TLC review time because Treasury will be receiving higher quality drafts than in the past. Appendix VI illustrates this entire process.

OMB's Role in the Regulations Process

An additional requirement that could affect the timeliness with which some tax regulations are issued is the Office of Management and Budget (OMB) review of selected major proposed regulations. Executive Order 12291, signed by the President on February 17, 1981, was intended to reduce the burden associated with future Government regulations issued by all executive branch agencies. It gave OMB the responsibility to minimize the burden of new regulations. While tax regulations are covered under the order, there is an agreement between Treasury and OMB partially exempting them. Under the procedures agreed to by

Treasury and OMB, at least 10 days prior to publication of all regulations except Category 1's in the Notice stage, Treasury provides OMB with a description of the regulation, including any significant policy issues reflected in the regulation. Unless within 10 days OMB indicates a desire to fully review the regulation, Treasury is permitted to publish the regulation.

As of December 31, 1982--nearly 2 years after the issuance of Executive Order 12291--OMB had reviewed three tax regulations projects under the order. During the same period, OMB notified both IRS and Treasury of its interest in three other pending projects.

Management Information System Will Help But Additional Data Needed

In addition to making changes in the regulations process, IRS and Treasury have made and plan other improvements in their management information systems. Computerization of some data which is now manually recorded and a new interface between IRS and Treasury's information systems will give IRS and Treasury expanded capability for monitoring the new regulations process. However, neither L&R nor Treasury currently collect data on precisely how much staff time is dedicated to regulations review, nor are they planning to collect this data. Were they to do so, the new computer system(s) could give managers information that could help them determine what the appropriate staffing levels should be to eliminate the backlog and handle the current workload.

Prior to 1982 under the old process, IRS had the only information system for regulations projects. This system, located in L&R, was the basis for L&R's monthly status report. The system consisted of a manually maintained card file. Each project had its own card which specified the location of the draft and the attorneys responsible for drafting and reviewing the regulation, both in Treasury and IRS. The card also specified the date a project was opened, when a draft was sent to TLC, when it was received, when published, and whether hearings were scheduled. While L&R still prepares its monthly status report from the cards, L&R plans to computerize its manual system.

Since early 1982, Treasury has had limited tax regulations reports on its new management information system known as the Executive Information System (EIS). These reports are designed to provide information on Treasury's overall performance in reviewing and issuing projects forwarded by IRS. However, these are only summary reports and cannot be used to determine the status of individual projects.

To complement this computerized system, L&R is designing its own computerized monitoring system. Scheduled to be operational in early 1984, this system will be comprised of the same data presently collected in the manually maintained card file. It will differ from Treasury's system in that it will include the entire inventory of regulations projects (both those being developed at IRS and those that have been sent to TLC) and thus can be used to monitor the progress of each project. In addition, this system will generate a number of reports, including L&R's monthly status report. It is planned that, in 1984, IRS' system will automatically feed reports into Treasury's; this interface is now being accomplished manually. However, the system is not planned to highlight long-delayed projects to management.

While IRS' planned monitoring system as well as the EIS are substantial improvements over the earlier manual system, neither system in its current or planned form will contain information on the actual time spent by IRS and Treasury attorneys to draft and review each regulations project. This type of information would help managers determine more reliable target dates for issuance of regulations early in the project development stage and estimate what staff levels would be appropriate to handle the workload. This information would also allow managers to better determine the cost of developing a regulations project, and, in retrospect, determine if an appropriate use of staff resources was made.

Preliminary Data on New Process Indicates Further Changes Are Needed

While the new process has only been in effect since January 1982, preliminary indications are not very promising. From February to December 31, 1982, IRS forwarded to TLC 192 regulations projects. Although under the new system 172 projects were scheduled to have been published by December 31, 1982, only 97 (56 percent) of these projects were actually published. Of these 97, 54 were Category 1's, 31 were Category 2's, and 12 were Category 3's.

In 1982, the first year of the new process, 116 projects were published--97 under the new process and 19 before the new process began. Appendix IV shows the annual number of proposed, final, and temporary regulations published since 1967. IRS and Treasury officials believe their original goal of 165 was too high and that a yearly publication of about 130 projects is a more realistic goal. Treasury officials explained that the shortfall was primarily a result of involvement by TLC attorneys in congressional activities, including drafting major tax legislation and numerous testimonies, which absorbed most of the TLC attorneys' time during this period.

Under the new process, staff levels have remained about the same--the work of 60 L&R attorneys has been reviewed by the equivalent of 5 full-time TLC attorneys. The limited information available suggests an average TLC output of 19 published projects per staff year devoted to regulations. Thus, without more staff in TLC devoted to reviewing projects, we see little prospect of completing a sufficient number of projects each year to significantly reduce the backlog.

During our review we discussed with Treasury and IRS officials the need for additional staff in TLC obtained either through hiring additional attorneys or temporarily assigning staff from L&R. Treasury officials said that staff increases were unlikely because additional staff years simply were not available for this purpose, given the limited resources available in the Secretary's office and competing priorities. They also said that Treasury has intentionally kept the TLC staff at a low number in order to assure its high quality and to maintain its close working relations with top Treasury officials.[4]

However, in May 1983, the Assistant Secretary (Tax Policy) announced that the TLC staff would be increased by four attorneys to deal primarily with the regulations backlog.

CONCLUSIONS

The process followed by IRS and Treasury for developing and issuing regulations does not always result in regulations being issued in a timely manner. In addition, recent tax legislation has created the need for even more regulations projects. As a result, the inventory of projects has reached record highs. While the large inventory has prompted IRS and Treasury to make several changes in the regulations process and to increase the TLC staff, early evidence indicates that the changes may not be sufficient to soon reduce the backlog to manageable levels.

The new process is a significant departure from and improvement over the former one in that it requires IRS and Treasury to determine priorities within the different categories of pending regulations projects and to set goals for issuing regulations. Although this new process should help assure that those projects most needed get issued in a more timely manner, IRS and Treasury will need to monitor the process to identify and correct any problems in the new process.

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[4]Several of the officials we talked with told us that, while the TLC staff is small, it is of unusually high quality. The officials described the TLC staff as the best young tax lawyers in the nation. TLC attorneys are generally top graduates of the best law schools who have a few years experience in private practice or government.

In the short term, Treasury should also experiment with publishing proposed Category 1 regulations in the Notice stage for public comment without TLC review. These regulations projects are routine in nature and, in IRS' view, have few, if any, policy implications. This change would enable TLC attorneys to focus on those regulations projects more deserving of their attention. This procedure would serve to immediately shorten processing times for some of the inventory. For example, as of January 31, 1983, there were 124 Category 1 projects in the inventory. Many of these could be published as Notices very quickly if this recommendation were adopted. If no serious degradation in regulations quality results, Treasury should consider extending this procedure to Category 2A regulations as well.

Historically, insufficient management information in both IRS and Treasury has compounded the problem of evaluating the regulations process. This problem will continue to exist because of the lack of a time reporting system. Neither IRS nor Treasury knows how much staff time is invested in any given project, nor if any time is being currently spent on a project. While proposed changes to the system will improve the information available to the managers, the system still will not provide information on time required to develop the regulations.

The yearly goal of publishing 130 projects was not met in the first year of the new process, during which 116 (89 percent) were published. During that year the backlog at Treasury began to grow again as IRS sent Treasury 192 new projects. The recent announcement of plans to add four attorneys to TLC should help to deal with the current workload as well as the backlog. On the basis of the average regulations productivity of TLC staff, if these four attorneys are devoted to reviewing regulations, IRS and Treasury should be able to get about 50 additional projects published in the next year.

While it is clear that sufficient resources have not been available in TLC, with current management information it is difficult to determine what the permanent staff levels for TLC should be. More precise information on the proportion of TLC attorneys' staff time dedicated to regulations and what projects they worked on is needed to decide the proper permanent staffing levels. If such information were available, more informed decisions could be made on (1) whether the temporary positions should be made permanent and (2) whether additional staff beyond the four now planned is needed to eliminate the backlog.

Finally, the new computerized management information systems at IRS and Treasury will provide managers with more timely, better aggregated data on the regulations process than has been the case. We believe that in addition to planned improvements a means of highlighting those regulations which have been delayed for a considerable period of time would help managers decide on appropriate actions to eliminate the current backlog and prevent its recurrence.

RECOMMENDATIONS

We recommend that the Secretary of the Treasury, in consultation with the Commissioner of Internal Revenue:

--Experiment with publishing proposed Category 1 regulations in the Notice stage for public comment without prior Treasury review.

--Refine the management information system in IRS and Treasury to (1) highlight long-delayed projects and (2) provide information on staff time devoted to each project. This additional management information should be used to expedite delayed projects and help assess whether more staff is needed.

AGENCY COMMENTS AND OUR EVALUATION

We sent a draft of this report to OMB, IRS and Treasury for their comments. Appendix VII contains the comments we received from OMB, IRS, and from the Assistant Secretary (Tax Policy) and Assistant General Counsel on behalf of Treasury.

OMB in its comments recognized the need to reduce the tax regulations backlog. It stated that the thrust of our recommendations was worthy of consideration by Treasury and IRS and agreed that publishing some projects in the Notice stage without Treasury review was "an interesting alternative." OMB added that changes to review procedures for regulations containing some policy issues should be evaluated independently of the results of experimenting with publishing proposed non-policy, Category 1 regulations without review.

Treasury and IRS both felt that Treasury review of Category 1 regulations was not significantly delaying processing of the Notices and was helpful in expediting final issuance of these projects. Because no information was available, we could not analyze the staff time required to review the 47 Category 1 projects that were published in the first eight months of 1983. However, we found that the number of Category 2A and 2B projects at Treasury for review has grown from 39 at the beginning of the year to 57 at the end of August. The time TLC attorneys spent on the Category 1 projects could have been used to review those in Categories 2A and 2B.

In experimenting with issuing Category 1 projects in the Notice stage, IRS and Treasury could select two groups of Category 1 projects. One group could be published without TLC review in Notice stage and one group reviewed normally. The agencies could then compare the amount of time spent reviewing the proposed regulations and the time required to issue the final regulations in each group. The experiment could also determine whether the same review attorneys have more substantive projects awaiting review at the same time they are dealing with Category 1 projects. This experiment should enable IRS and Treasury to determine whether review of Category 1 projects in the Notice stage by TLC is necessary.

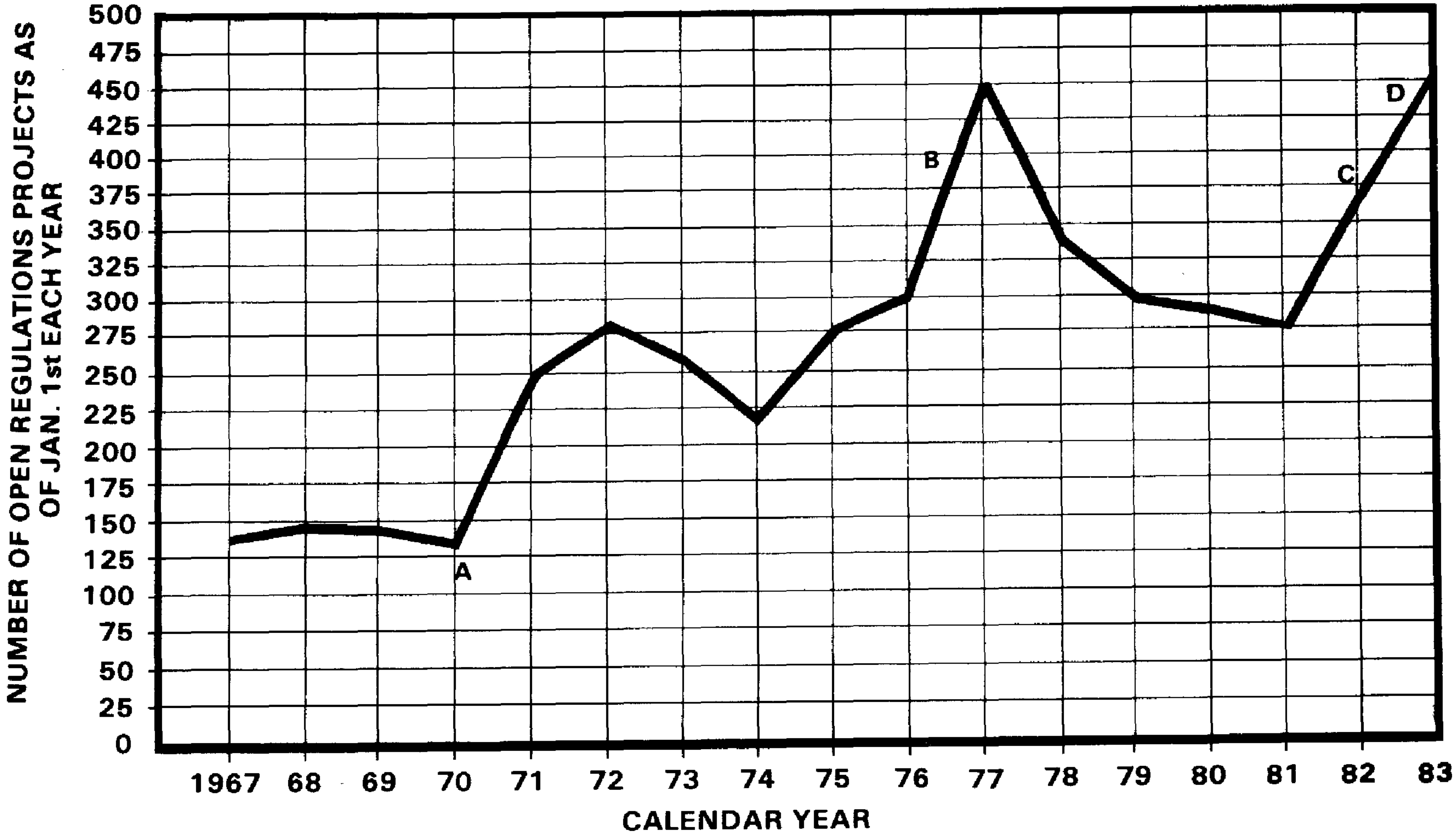
The agencies treated our recommendation on improving the management information system in two parts. All three agencies endorsed our recommendation to use the management information system to identify long delayed projects. Since receiving our draft, IRS has developed a report that provides some limited information on the oldest projects and plans to develop additional information on old projects on their new computerized system.

In commenting on using the management information system to track time charges by attorneys, OMB questioned the usefulness of this recommendation. It felt that because the attorneys have diverse daily activities, reported time worked on individual projects would only be rough estimates. In addition, it thought such time allocations would not differentiate the nature of the work at drafting and the various review levels. For these reasons, OMB did not think the additional information was worth the burden to obtain it. IRS felt that, if a system to report attorney time charges by project could be developed with only minor administrative burden on the attorneys, it would be a constructive innovation. We agree with IRS that the time reporting system, which can be a significant improvement, should be designed to minimize the burden on the already busy TLC and IRS staff attorneys. IRS and Treasury said they will study the feasibility of developing such a system.

In commenting generally on the regulations process, OMB pointed out that less complex tax laws would simplify the regulations required and contribute to reducing the backlog. OMB also commented on their review of regulations, noting that, since February 1981, OMB has reviewed 3 tax regulations projects and has indicated an interest in 3 others. OMB believes it has not hampered the regulations process.

The Assistant General Counsel's comments provided clarification of the role of the Office of General Counsel and the Executive Secretary in the regulations process. The comments also explain in detail how OMB review under the Paperwork Reduction Act could affect the timeliness with which some regulations are issued. The letter notes, however, that no serious difficulties have yet arisen in connection with this OMB review.

HISTORICAL PERSPECTIVE

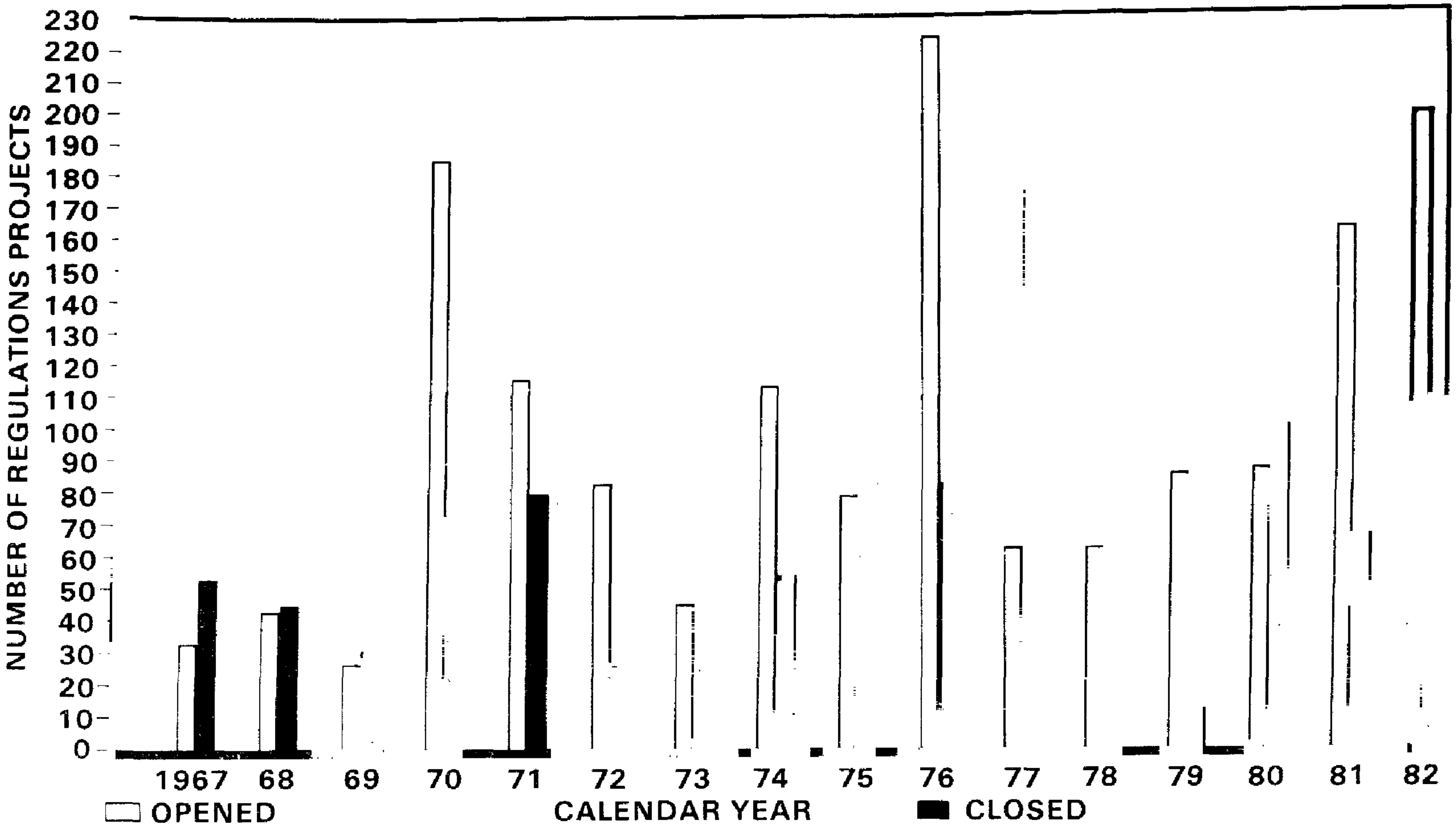


MAJOR TAX LEGISLATION ENACTED

A—Tax Reform Act of 1969 (12/30/69)
B—Tax Reform Act of 1976 (10/4/76)
C—Economic Recovery Tax Act of 1981 (8/13/81)
D—Tax Equity and Fiscal Responsibility Act of 1982 (9/3/82)

APPENDIX II

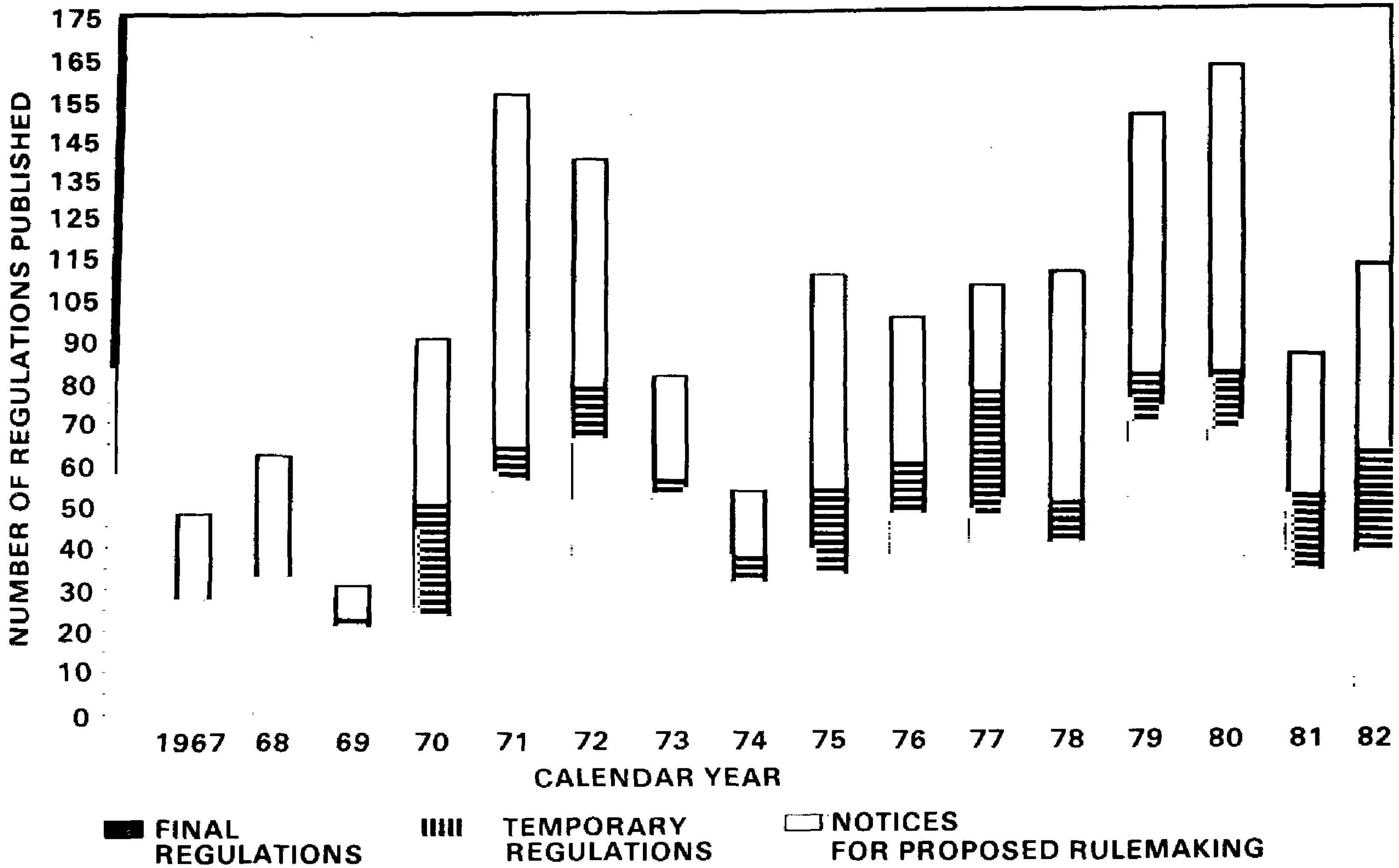
REGULATIONS PROJECTS OPENED & REGULATIONS PROJECTS CLOSED (NOTE a)



(NOTE a) INCLUDES FINAL REGULATIONS AND PROJECTS CLOSED WITHOUT ISSUING REGULATIONS

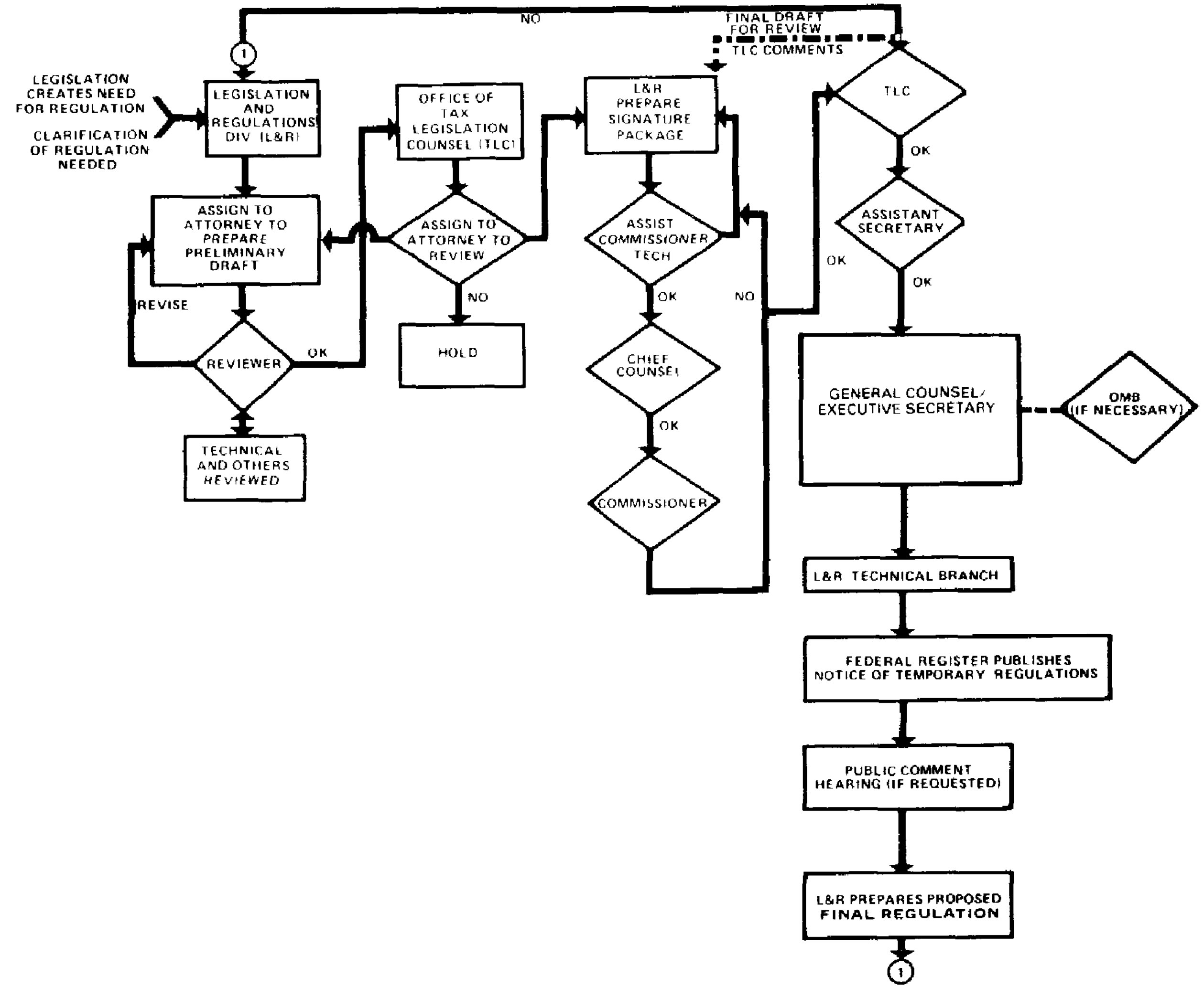
APPENDIX III

PAST ANNUAL REGULATIONS PUBLISHED AS FINAL REGULATIONS, TEMPORARY REGULATIONS AND NOTICES



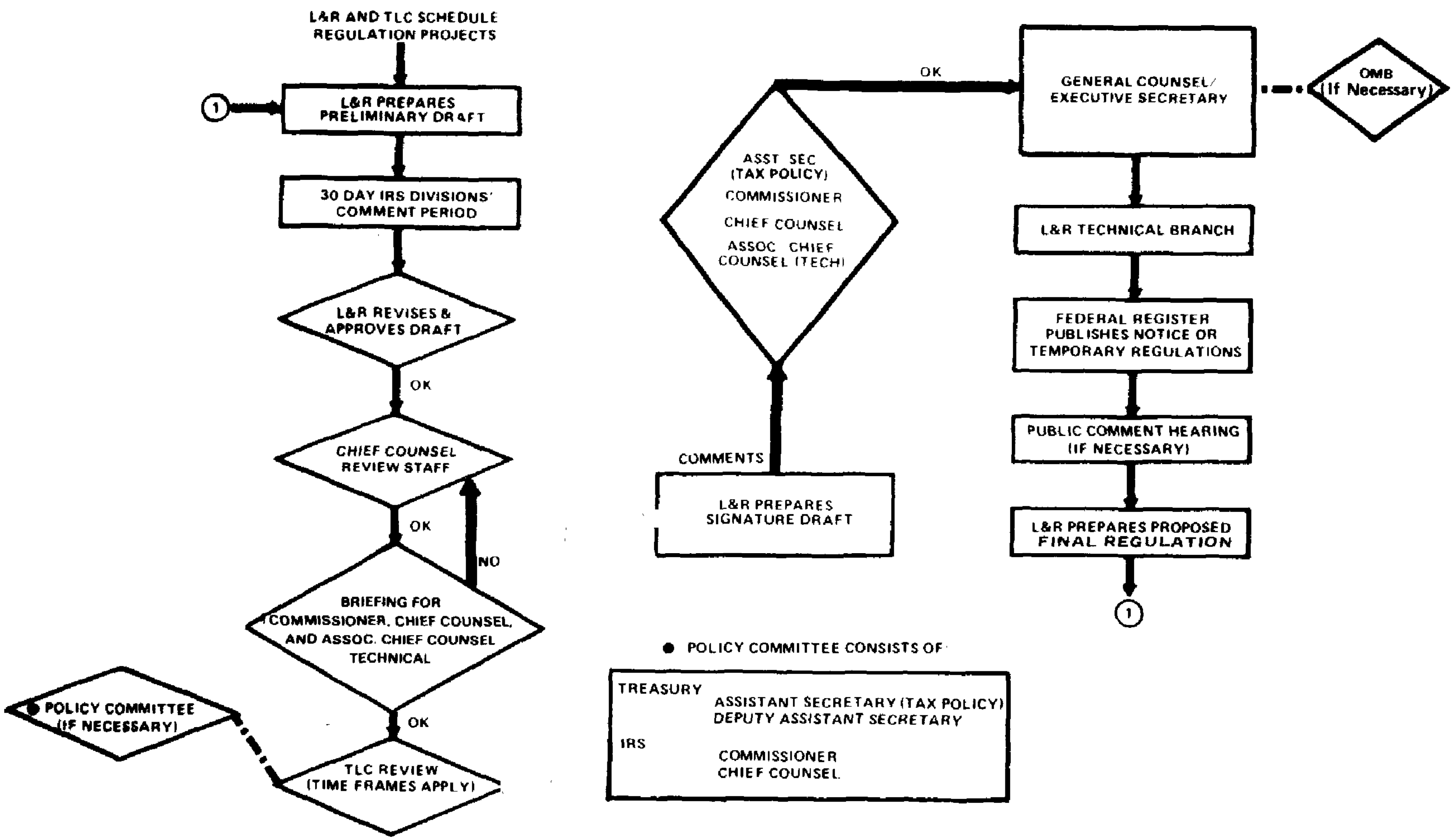
APPENDIX IV

DEVELOPMENT OF TAX REGULATIONS PRIOR TO JAN. 1982 (OLD PROCESS)



APPENDIX V

DEVELOPMENT OF TAX REGULATIONS SINCE JANUARY 1982 (NEW PROCESS)



APPENDIX VI

APPENDIX VII

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

AUG 26 1983

Mr. William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

Thank you for your August 3, 1983 letter requesting the Office of Management and Budget to review and comment on your draft report, "Further Improvements Needed in Processing Tax Regulations."

We recognize the need to reduce the backlog of Internal Revenue Service regulation projects, and view the thrust although not all aspects of the report's two recommendations as worthy of consideration by the Treasury Department and IRS as possible approaches for expediting their reviews of draft regulations. Our specific comments address the recommendations, the effect of tax legislation on regulatory projects, and the OMB/Treasury agreement on reviewing tax regulations.

The first recommendation is to experiment with allowing IRS to publish regulations without prior Treasury Department review that are (a) routine and contain no policy issues, and (b) in the notice of proposed rulemaking stage. These routine type regulations currently are classified in a special category for expedited review by Treasury which permits IRS to publish the rule if Treasury has not responded to the draft sent for their review in 2 weeks (the shortest period for Treasury reviews). Under this recommendation to eliminate the 2-week waiting period, procedural or substantive issues raised during the comment period would still be reviewed by Treasury before the issuance of final regulations. The recommendation is an interesting alternative because it concentrates Treasury reviews on policy issues in the proposed rulemaking stage.

While not explicitly in this recommendation, the report elsewhere states that if no serious degradation in the quality of non-policy regulations results from the recommended experiment, Treasury should consider extending this procedure to regulations that contain some policy issues for which Treasury currently has 30 days to review (p.21). Because policy and non-policy regulations are substantively different, I think any changes in review procedures for policy regulations should be considered independently of experience with non-policy regulations.

2

The second recommendation is for IRS and Treasury to refine their management information systems to highlight long-delayed projects and provide information on legal staff time spent on each regulatory project. The idea of highlighting long-delayed projects seems reasonable. However, I question the utility of requiring staff attorneys to keep track of their time on individual projects. Because the attorneys have diverse daily activities, reported time worked on individual projects would only be rough estimates. Such time allocations also would not differentiate the nature of the work at drafting and various review levels. For these reasons, I do not think the additional information is worth the burden imposed to obtain it.

The report also notes that major new tax legislation enacted by Congress is the main reason for the sharp increase in regulatory projects over the past few years (p.5). While the report recommendations do not address tax legislation, less complex tax laws would reduce the complexity and time required to develop the associated regulations. Thus, simpler tax laws would be a source for lowering the regulatory backlog.

With respect to the report's discussion of OMB's role in the regulatory process, I would like to amplify the nature of the OMB/Treasury agreement to exempt certain IRS regulations from OMB review under Executive Order 12291 (pp. 16-17). All IRS regulations, major and nonmajor, are subject to OMB review, but with different procedures depending on the type of regulation. Regulations that are both major and legislative are automatically subject to OMB review. All other regulations are subject to review if OMB requests to review them within 10 days of receipt of the Treasury description.

Since the executive order was issued in February 1981, OMB has reviewed 3 tax regulatory projects and has notified Treasury of its interest in 3 other pending projects. Of the 3 pending projects, one was subsequently withdrawn by Treasury. Thus, the agreement recognizes the OMB oversight role and at the same time has not hampered the Treasury regulatory process. This is exemplified by the renewal of the agreement earlier this year.

Sincerely,

Christopher DeMuth

Christopher DeMuth
Administrator for Information
and Regulatory Affairs

COMMISSIONER OF INTERNAL REVENUE
Washington, DC 20224

SEP 1 1983

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

This is in response to your letter of August 3, 1983, by which you enclosed for our review and comment a draft report entitled "Further Improvements Needed in Processing Tax Regulations" (GOA/GGD-83-73).

As a general comment, we found the report very thorough, full of food for thought, and one that we will refer to for developing additional ideas for attacking the regulations backlog problem. As the report indicates, we have given the problem a great deal of attention and effort and are constantly making changes to our procedures for improvements. We will, of course, continue these efforts and appreciate the assistance that the report will give.

In accordance with your request, we have previously conveyed to members of your staff comments on technical matters, and we have no comments on the findings and conclusions of your draft report. Our comments on the recommendations are as follows:

(1) Recommendation concerning publishing proposed Category I regulations. While the Category I procedure may not always have been used as fully as was desirable, we believe that the procedure has been working well in the recent past, and is now achieving the intended purpose. Among its merits is that the procedure gives the TLC attorney an opportunity to become familiar with the projects and thus can facilitate the development of the final regulations. It also gives the opportunity for a "quick look" by an attorney who may have been involved in drafting the legislation and thus help avoid potentially embarrassing and time-consuming problems. Further, to eliminate the opportunity for TLC review may have the counter-productive effect of having fewer, rather than more, projects being classified as Category I projects.

Mr. William J. Anderson

(2) Refine the management information system in IRS and Treasury. One of your recommendations was to develop a system to highlight long-delayed projects. We find this suggestion helpful, and since receipt of your draft report have generated within the L&R Division a report that gives the status and other information on our forty oldest cases. This report is not, however, a report on those cases where there has been the longer time lags since the last event of development, e.g., in terms of movement from one office to the other. As you know, we are currently engaged in a project to institute a management information system, using computers, that will contain a great deal of information that will be useful with respect to our regulations program. Long-delayed projects in the sense of time lags between events is one of the pieces of information that can be extracted from this system on an ad-hoc basis. Thus, we believe that with the new computer system and other available means, we will be able to accomplish your recommendation.

You also recommend the gathering of information on staff time devoted to each regulation project. We believe that while there are problems with the suggestion, maintenance of time records would be a constructive innovation as long as the compiliation could be implemented with only minor administrative burden. On the one hand, the disparity in the size of regulations projects would not easily be subject to reconciliation and result in relatively unassessable statistics. Nevertheless, the suggestion has merit and we will study the feasibility and usefulness of a Treasury/IRS computerized system of capturing detailed information on attorney time devoted to regulations.

We will be happy to discuss these comments with you.

With kind regards,

Sincerely,

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

SEP 2 1983

Dear Mr. Anderson:

Thank you for your letter of August 3, 1983, enclosing for our review and comment your draft report (GAO/GGD-83-73) on the processing of tax regulations.

The draft report does an excellent job of describing the tax regulations process and identifying the factors that have created the current regulations backlog. In particular, we agree with your conclusion that in recent years there has been an inadequate number of attorneys on the staff of the Office of Tax Policy's Tax Legislative Counsel, (TLC) to deal with the growing inventory of unpublished regulations. As you point out in your letter, we have taken a number of steps to deal with this problem, including an increase in the size of the TLC staff. Nevertheless, as you are aware, in recent months the congressional tax-writing committees have held an extraordinary number of hearings on proposed tax legislation for which the TLC staff must draft Treasury testimony. It is likely that the schedule of congressional hearings, along with related mark-up sessions and other tax legislative activity, will continue to be very heavy in the coming months. These legislative demands on TLC staff time will continue to limit our ability to devote significant additional time to the review of regulations in the near future. Moreover, any new tax statutes resulting from this legislative activity will add additional regulations projects to the existing backlog.

Your draft report makes two recommendations for change in the tax regulations process. First, you recommend that Treasury experiment with publishing proposed Category I regulations without prior TLC review. We believe that TLC review has not caused undue delays in the publication of Category I regulations. Moreover, the involvement of TLC staff attorneys in the review of proposed Category I regulations materially expedites the issuance of these proposed regulations as final Treasury decisions. Thus, we do not believe that Category I proposed regulations should be published without prior, albeit expedited, TLC review.

We agree with your recommendation that the management information systems in IRS and Treasury should be refined further to highlight long-delayed regulations projects and to provide more reliable information on staff time devoted to

-2-

regulations projects. We currently are working with IRS to identify and complete long-delayed regulations projects. We also are studying the feasibility of keeping more detailed information concerning the manner in which TLC staff attorneys devote their time. We hope that this effort ultimately will enable us to increase the productivity of the TLC staff in reviewing regulations and will assist us in evaluating future needs for additional staff resources in this area.

We would be happy to discuss our comments with you.

Sincerely,

John E. Chapoton
Assistant Secretary
(Tax Policy)

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, D.C. 20548

DEPARTMENT OF THE TREASURY
OFFICE OF THE GENERAL COUNSEL
WASHINGTON, D.C. 20220

SEP 27 1983

Dear Mr. Anderson:

This is in response to your request to the Department of the Treasury for comments on a General Accounting Office draft report entitled "Further Improvement Needed in Processing Tax Regulations" (GAO/GGD-83-73). These comments, which represent the views of the Office of the General Counsel, were prepared in early August but were not transmitted to your office due to an administrative oversight.

We have reviewed the draft report and offer the following comments:

1. Page 3, 6th line from bottom. The following sentence should be inserted immediately after the sentence ending with "for their review":

   The TLC-approved draft is then forwarded to the Office of the General Counsel (OGC) and the Executive Secretary for departmental clearance.

2. Page 14, 1st paragraph. This paragraph should be amended to read as follows:

   Because the are neither controversial nor complex, TLC is given only 2 weeks in which to review them and offer comments before the draft notice is forwarded to OGC and the Executive Secretary for final review prior to publication and solicitation of public comments. If 2 weeks expire and TLC has not responded to a category 1 project, IRS may forward the regulation directly to OGC and the Executive Secretary for final review.

3. Page 16, 6th line from bottom, should be amended by deleting the word "major". This paragraph describes in general terms the current Treasury-OMB Memorandum of Agreement Concerning Executive Order 12291. It incorrectly indicates that only descriptions of "major" regulations are transmitted to OMB. Descriptions of all regulations (with limited exceptions provided for in the Agreement) are provided to OMB. The Agreement specifies that descriptions of Category 1 regulations need not be provided to OMB.

APPENDIX VII

4. Page 17 should be amended by inserting the following paragraphs immediately after the first paragraph:

A second additional requirement that could affect the timeliness with which some tax regulations are issued is OMB review, pursuant to the Paperwork Reduction Act of 1980 (44 U.S.C. 3501 *et seq.*) and 5 CFR §1320.12, of non-notice (temporary or final) regulations which contain recordkeeping, reporting, or disclosure requirements. As noted previously, regulations are needed with different degrees of urgency. In appropriate cases (*e.g.*, where immediate guidance to the public is necessary) the Administrative Procedure Act (5 U.S.C. 553) authorizes the issuance of regulations without notice and public comment and without a 30-day delayed effective date. If such regulations, however, contain recordkeeping, reporting, or disclosure requirements (which are common in tax regulations), the Paperwork Reduction Act and OMB's implementing regulations require that they be submitted to OMB for review and clearance prior to publication. OMB review under the Act may take as long as 90 days.

Unlike Executive Order 12291, neither the Paperwork Reduction Act nor OMB's regulations waives pre-publication review by OMB under circumstances recognized by the Administrative Procedure Act to require the prompt issuance of regulations. Although the Act does provide procedures for expedited OMB review, the statutory requirements for such review are difficult to satisify and probably will not apply to many IRS regulations requiring prompt issuance. Although OMB regulations promulgated pursuant to the Act provide that agencies may request non-statutory expedited processing by OMB, there is no assurance that all such requests will receive a quick review.

Treasury attorneys report that in the short time in which OMB regulations under the Paperwork Reduction Act have been in effect, no serious difficulties have arisen in connection with OMB review of non-notice tax regulations.

5. Appendix V to the draft report should be amended by changing the reference to "Executive Secretaries" to "Executive Secretary".

If you or your staff should have any questions concerning these comments, please contact Richard S. Carro, Special Assistant (Regulatory Affairs) to the General Counsel (566-8464).

Sincerely yours,

Arnold Intrater
Assistant General Counsel
(Administration & Legislaton)

Mr. William J. Anderson
Director
General Government Divison
General Accouting Office
Washington, D.C. 20548

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