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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

GENERAL GOVERNMENT
DIVISION

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MAY 17 1976

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Mr. Kenneth Back, Director
Department of Finance and Revenue
District of Columbia Government

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Dear Mr. Back:

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We have completed our review of the Department of Finance and Revenue's (DFR) administration of self-assessed taxes. The review resulted in reports to the Congress, and the Mayor and District Council regarding the followup on individuals who do not file income tax returns; withholding District and State income taxes from military pay; and management of the District's voluntary taxpayer compliance program.

Some observations which were not included in these reports are summarized in this letter. Our observations were discussed with Department officials. Generally, they agreed that these matters appeared to have potential for improving tax administration and should be further developed, as resources permit.

ESTABLISHING A PENALTY FOR
NONFILING WHEN ADDITIONAL
TAX IS NOT OWED

Using the Federal/State Tape Exchange Program (TEP), DFR has identified and followed up on many individuals who were due tax refunds but did not file District tax returns. For fiscal years 1973 and 1974, about \$100,000 was refunded to such persons as a result of TEP followup by DFR. We were told that although most of these individuals were required to file District returns, no penalties were assessed because they did not owe the District more taxes than was withheld during the tax year.

Section 311.1 of Title 16 D.C. Rules and Regulations regarding the penalty for failure to file required returns states that:

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" * * * unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as the tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate. For purpose of this section, the amount of tax required to be shown on the return shall be reduced by the amount of any part of the tax which is paid on or before the date prescribed for payment of the tax * * *" (underscoring supplied)

Under this regulation the penalty for failure to file a tax return is computed on the amount by which the nonfiler's tax liability exceeded his tax withholding (or other prepayments). When withholding exceeds tax liability there is no penalty assessable under the regulation.

Individuals who do not file tax returns required by law impede the effective and efficient administration of the District's tax program. Under TEP, these individuals show up as potential nonfilers and compliance resources must be used to obtain their returns and ascertain their tax status. Using available information, we estimated that it may have cost the District a total of about \$25,000 in fiscal years 1973 and 1974 to follow up on nonfilers who subsequently received refunds. This cost was about 25 percent of the total amount refunded to them.

A person who does not file a required return on his own volition has not complied with the individual income tax law, and, in our opinion, should be required to at least pay for the added administrative cost caused by the nonfiling. The District should consider the feasibility of establishing a penalty which would apply to nonfilers who do not owe additional tax.

TAX REGISTRATION SHOULD BE A PREREQUISITE TO DOING BUSINESS IN THE DISTRICT

DFR relies on information obtained from sources inside and outside the District Government to discover firms doing business in the District without having registered for sales, withholding, or franchise taxes.

Within the District Government, DFR receives information from agencies such as the Departments of Economic Development and General Services, the Armory Board and the Recorder of Deeds. DFR matches the information against its registration records to identify those firms that have not registered for taxes. Then DFR must followup with the firms to find out why they are not registered.

Data was not available on the effort expended by DFR to use information obtained from District departments and agencies, however, DFR personnel said that the use of such information was largely responsible for the discovery in fiscal year 1974 of about 500 unregistered businesses.

DFR could eliminate much of the present effort to follow up on such businesses if, as a general policy, the businesses were required to furnish proof of tax registration before they could receive licenses, occupancy permits, or other authorization to do business in the District. This is presently required of street vendors. DFR should consider proposing that this requirement apply to all requests by businesses for authorization to operate in the District.

POSSIBILITIES FOR INCREASED BENEFITS
FROM DFR/IRS AUDIT COOPERATION

In February 1963, the District and IRS entered into an agreement providing for cooperation in tax administration. As it pertains to audit, this agreement has led to an exchange of audit findings and the District's use, to a limited extent, of the IRS audit selection system for the individual income tax.

DFR provided us with the following data on the results of the audit exchange program for fiscal years 1974 and 1975.

	<u>Fiscal Year</u>	
	<u>1974</u>	<u>1975</u>
District returns adjusted on basis of IRS findings	3,196	2,782
District revenue from adjustments	\$359,039	\$358,969

IRS sends the District copies of all the Federal audit adjustments notices pertaining to individuals and businesses having District addresses. About 60 percent of these notices result in adjustments to District tax. The following summary shows action taken by DFR on IRS individual income tax audit adjustments during fiscal years 1974 and 1975.

Disposition:

Did not apply to District residents	1,076
Findings did not apply under District's tax law	917
Returned to IRS (insufficient information)	298
District's statute for audit adjustment had expired (3 years) when received from IRS	431
Adjustments already made on basis of District audit	1,130
District returns adjusted	<u>5,978</u>
Total	<u>9,830</u>

In the above statistics, there are two categories that appeared to us to warrant the attention of DFR. They involved (1) 431 adjustments lost because according to law the District has only 3 years after tax returns are filed to make audit adjustments (the 3-year period had passed when the IRS adjustments were received), and (2) 1,130 adjustments that pertained to taxpayers whose returns DFR already had audited and adjusted.

The latter statistic indicates that about 10 percent of District taxpayers whose Federal returns are audited by IRS are also audited by DFR. We could not determine the extent to which audit duplication was warranted because detailed information on the results of the IRS and DFR audits of District taxpayers' returns was not available to us. DFR officials stated that some audit duplication is unavoidable.

Although DFR officials may be correct in stating that it would not be possible to eliminate all duplicative audits, additional effort may be warranted to insure that unnecessary duplication is avoided. We believe that DFR should explore with IRS the feasibility of regularly exchanging information identifying taxpayers whose returns are to be audited and the planned scopes of the audits.

Regarding IRS audit adjustments that DFR cannot use because the District's 3-year statute for adjusting returns has expired, DFR should explore with IRS ways in which the District could receive notification of IRS audit adjustments in time to prevent the expiration of the statute. DFR also should discuss with Corporation Counsel whether there is sufficient justification to propose modification of this law to provide for automatic extension of the 3-year period when a District taxpayer's Federal return is selected for audit. DFR audit personnel said that they believe that such a change in the law would be very beneficial to the District.

TAXPAYER INFORMATION
AND ASSISTANCE

We had two general observations pertaining to the District's tax information program.

We noted that DFR had not developed generalized tax education material for inclusion in the regular curriculum of District high schools. Many District schools now receive Federal tax education packages from IRS. DFR should supplement the Federal material with information on District taxes. District schools seem to us a logical place to begin a program designed to achieve increased public awareness of the District's tax structure and its relationship to the District Government's programs.

The other observation we had pertains to taxpayer assistance provided District residents by commercial tax return preparers and by various public interest groups. We believe these organizations might be able to help the District improve its tax information program. Therefore, the Department should consider regularly soliciting information from these groups on problems they note in the course of providing assistance to District taxpayers.

Copies of this letter are being sent to the Mayor, City Council, Office of Budget and Management Systems, D.C. Auditor, and the Office of Municipal Audit and Inspection.

We appreciated the cooperation given us by Department personnel during our review. We would be pleased to meet with you to discuss further any of the matters contained in the letter and we would appreciate being informed of actions taken on them.

Sincerely yours,

F. Medico
Frank Medico
Assistant Director