28643

REPORT BY THE U.S.

# General Accounting Office

## Compilation Of GAO's Work On Tax-Related Activities During 1983

This report, required by Public Law 95-125, summarizes the results of GAO's work on tax-related activities for 1983 Among other things, the report discusses open recommendations to the Congress from reports issued during and before 1983 It also discusses recommendations to the Commissioner of Internal Revenue during 1983, as well as actions taken or proposed by IRS in response to those recommendations

GAO/GGD-84-81
JUNE 27, 1984

Request for copies of GAO reports should be sent to

U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md 20760

Telephone (202) 275-6241

The first five copies of individual reports are free of charge Additional copies of bound audit reports are $3 25 each Additional copies of unbound report (i e., letter reports) and most other publications are $1 00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis Check should be made out to the "Superintendent of Documents".

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

GENERAL GOVERNMENT
DIVISION

B-137762

The Honorable Dan Rostenkowski
Chairman, Committee on
Ways and Means
House of Representatives

The Honorable Robert Dole
Chairman, Committee on
Finance
United States Senate

The Honorable Robert Dole
Chairman, Joint Committee
on Taxation
Congress of the United States

The Honorable Jack Brooks
Chairman, Committee on
Government Operations
House of Representatives

The Honorable William Roth, Jr.
Chairman, Committee on
Governmental Affairs
United States Senate

This is our annual report for 1983 on our work in the tax area. The report is submitted in compliance with section 4 of Public Law 95-125 and consists of the following enclosures:

(1) Open recommendations to the Congress from reports issued during 1983.

(2) Open recommendations to the Congress from reports issued before 1983.

(3) Recommendations to the Commissioner of Internal Revenue during 1983 and actions taken and/or proposed by the Internal Revenue Service (IRS).

(4) A listing of reports on tax matters issued during 1983.

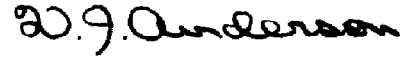
(5) A listing of testimonies given on tax matters by GAO officials before various committees of the U.S. Congress during 1983.

(6) Scope and subject matter of tax-related jobs initiated pursuant to Public Law 95-125 during 1983.

(7) GAO order relating to safeguarding tax returns and return information and procedures followed when undertaking reviews at the IRS and the Bureau of Alcohol, Tobacco and Firearms.

We are pleased to report that IRS has taken, or plans to take, action on most of our recommendations made during 1983. We look forward to continuing to work closely with the Congress in its oversight of tax matters and to assist it in considering our legislative recommendations.

We would be glad to discuss any of the matters included in the enclosures if you, your colleagues, or staffs believe it would be beneficial.



William J. Anderson
Director

## OPEN RECOMMENDATIONS TO THE CONGRESS FROM REPORTS ISSUED DURING 1983


| | Page |
|---|---|
| Congress Should Adopt A Tax Treatment Which Better Recognizes Changes In Some Electric Cooperatives | 2 |
| Legislative Change Needed To Enable IRS To Assess Taxes Voluntarily Reported By Taxpayers In Bankruptcy | 4 |

CONGRESS SHOULD ADOPT A TAX TREATMENT WHICH BETTER RECOGNIZES CHANGES IN SOME ELECTRIC COOPERATIVES

GAO/GGD-83-7
B-207753
1-5-83

## Summary of Finding

Under section 501(c)(12) of the Internal Revenue Code, electric cooperatives are provided tax exempt status and are permitted to earn substantial untaxed income from nonmember sources, which subsidizes cooperative members' cost of electricity. This exemption was initially granted over 60 years ago when electric cooperatives were generally small, struggling associations which primarily distributed electricity to sparsely populated rural areas. Since that time, however, the operations of many cooperatives and the environment in which they do business have changed substantially.

Today many electric cooperatives are still small associations which continue to need assistance in order to provide electricity to rural areas at rates comparable to those charged in urban areas. Others, however, have substantially changed in character or have progressed to the point where they closely resemble their taxable counterparts. Yet, unlike other federal assistance programs which can be directed to those organizations having a continuing need for assistance, all electric cooperatives continue to benefit from tax exemption. Under the broad requirements of the law, tax exemption applies across-the-board to all electric cooperatives.

IRS, in administering the tax exemption requirements, has tried to recognize the changes in electric cooperatives. However, it has experienced difficulties because of the broad nature of the law. Therefore, the Congress needs to consider alternatives to the present tax treatment of electric cooperatives and adopt a treatment which would better recognize the changes in their operations and the environment in which they operate. As a framework for the Congress' consideration, we proposed alternatives to the present law which would (1) modify electric cooperatives' nonmember income allowance, or (2) eliminate that allowance, and/or (3) apply tax rules already applicable to other types of cooperatives. These alternatives, which would have an estimated revenue impact ranging from $2 million to $45 million, are by no means all inclusive.

Recommendation

We recommended that the Congress, using the alternatives we provided as a guide, establish a tax treatment which better addresses electric cooperatives' present operating environment.

Action taken and/or pending

None

LEGISLATIVE CHANGE NEEDED TO ENABLE IRS TO ASSESS TAXES VOLUNTARILY REPORTED BY TAXPAYERS IN BANKRUPTCY

GAO/GGD-83-47
B-211231
6-20-83

## Summary of finding

The Bankruptcy Reform Act provides qualified debtors with certain protections from creditors--including IRS. The act restricts IRS' authority in many cases to assess, collect, or recover a claim against an individual or a business during bankruptcy proceedings. Administratively, this restriction has caused problems for IRS because it requires IRS to process returns from bankrupt taxpayers manually rather than through its automated processing system. During fiscal year 1982, these additional processing steps cost IRS an estimated $500,000.

## Recommendation

We recommended that the Bankruptcy Act be amended to allow assessment of the taxes that bankrupt taxpayers report on their returns. Allowing IRS to assess--but not collect--these taxes would still protect bankrupt taxpayers, but at less cost to IRS than is presently being incurred.

## Action taken and/or pending

None

## OPEN RECOMMENDATIONS TO THE CONGRESS FROM REPORTS ISSUED BEFORE 1983


| | Page |
|---|---|
| Mandatory Tax Withholding Recommended For Agricultural Employees | 2 |
| Self-Employment Income Reported For Credit Toward Social Security Benefits Although Tax Not Paid | 3 |
| Need For Legislative Solution To The Problem Of Determining Whether An Individual Is An Employee Or Self-Employed | 4 |
| Need For Change In Law To Provide FICA-SECA Offset | 7 |
| Need To Change Requirement That Government Must Purchase Seized Property At A Sale At The Minimum Bid Price | 9 |
| Changes Needed In The Tax Laws Governing The Exclusion For Scholarships And Fellowships And The Deduction Of Job Related Educational Expenses | 10 |
| Employee Stock Ownership Plans Should Be Established For The Benefit Of Employees | 12 |
| Need For Congress To Ensure That The Treasury And Justice Departments Develop A Streamlined Legal Review Process For Criminal Tax Cases | 14 |
| Taxation Of The Life Insurance Industry Needs To Be Updated | 16 |
| Congress Should Amend The Internal Revenue Code To Require Sponsors Of Terminating Pension Plans To Obtain An IRS Review Of Participant Protection Requirements Before Plan Dissolution | 19 |
| Changes To The Disclosure Provisions Of The Internal Revenue Code Could Improve Verification Of Welfare Recipients' Income And Assets | 20 |
| Key Issues Affecting State Taxation Of Multijurisdictional Corporate Income Need To Be Resolved | 21 |

MANDATORY TAX WITHHOLDING RECOMMENDED FOR AGRICULTURAL EMPLOYEES

GGD-75-53
B-137762
3-26-75

Summary of finding

Both the federal government and agricultural employees would benefit from a system of mandatory withholding of federal income tax from wages earned by agricultural employees. Withholding federal income taxes from agricultural wages would ease problems of agricultural employees by placing them on a pay-as-you-earn basis similar to other wage earners, lessen IRS collection problems, and reduce revenue loss from unreported agricultural wages.

Recommendation

We recommended that the Congress revise chapter 24 of the Internal Revenue Code of 1954, as amended, to include remuneration received as agricultural wages in the federal income tax withholding system.

Action taken and/or pending

On April 7, 1981, H.R. 3104, a bill which would have accommodated our recommendation, was introduced and referred to the Subcommittee on Social Security, Committee on House Ways and Means. However, no further action was taken on it.

On April 12, 1983, H.R. 2492 was introduced. The bill, if enacted, would amend the Internal Revenue Code to subject agricultural labor to withholding for income tax purposes and, thus, would fully adopt our recommendation. The bill was referred to the House Ways and Means Committee, where action is pending.

SELF-EMPLOYMENT INCOME REPORTED FOR CREDIT TOWARD SOCIAL SECURITY BENEFITS ALTHOUGH TAX NOT PAID

B-137762
8-9-73
and
GGD-77-78
8-8-77

## Summary of finding

IRS reports to the Social Security Administration the amount self-employed persons designate on their income tax returns as self-employment income even though such persons may not have paid the applicable self-employment social security tax. The self-employed person thus receives credit toward social security benefits even if that person has not made the required contribution.

## Recommendation

We recommended that the Congress amend section 205(c) of the Social Security Act (42 U.S.C. 405(c)) to prohibit a person from receiving credits toward social security benefits if that person has not paid the required tax on self-employed income.

## Action taken and/or pending

In May 1978, the Chairman of the Ways and Means Oversight Subcommittee introduced H.R. 12565, the Self-Employment Tax Payments Act of 1978, which contained the substance of our recommendation. However, no action was taken on the bill.

In September 1979, the Chairman of the Ways and Means Oversight Subcommittee reintroduced the bill, which was renumbered as H.R. 5465 and was referred to the Subcommittee on Social Security. No further action has been taken since that time.

NEED FOR LEGISLATIVE SOLUTION TO THE PROBLEM OF DETERMINING WHETHER AN INDIVIDUAL IS AN EMPLOYEE OR SELF-EMPLOYED

GGD-77-88
B-137762
11-21-77

## Summary of finding

We determined that there is a need for a legislative solution to the problem of determining whether an individual is an employee or self-employed independent contractor. One of the reasons IRS, employers, accountants, lawyers, and other advisors have difficulty making these determinations is that the common law rules relied upon to define employee and self-employed are general and open to broad and inconsistent interpretation. As a result, IRS often disagrees with an employer's determination that an individual is an independent contractor. When this occurs the following can happen:

--Employers can be retroactively assessed employment taxes for those years not subject to the statute of limitations.

--Double taxation can occur when the employer and employee pay income and social security taxes on the same income.

--Self-employment (Keogh) retirement plans established by individual taxpayers can be declared invalid with all contributions and income earned thereon becoming taxable in the current year.

## Recommendations

We recommended that the Congress amend section 3121 of the Internal Revenue Code to exclude separate business entities from the common law definition of employee in those instances where they

--have a separate set of books and records which reflect items of income and expenses of the trade or business,

--have the risk of suffering a loss and opportunity of making a profit,

--have a principal place of business other than at a place of business furnished by the persons for whom he or she performs or furnishes services, and

--hold themselves out in their own names as self-employed and/or make their services generally available to the public.

In addition, we recognized that there may be some situations where a worker is able to meet some but not all of the above criteria and still have a valid basis for being considered self-employed. In these circumstances some type of common law criteria should be applied but not unless there is evidence that the worker's situation tends toward being one of a self-employed individual.

Accordingly, we recommended that the Congress amend section 3121 of the Internal Revenue Code to require separate business entities to meet three of the four criteria noted in the previous recommendation before using common law criteria to determine employment status. If the independent contractor cannot meet at least three of the criteria, we recommended that he or she be considered an employee.

To avoid unnecessary burdens on those businesses that elect to or must obtain the services of independent contractors, we further recommended that the Congress amend the Internal Revenue Code to provide that, with the exception of fraud, IRS cannot make retroactive employee determinations in those cases where businesses (1) annually obtained a signed certificate from the persons they classify as self-employed stating that they meet all separate business entity criteria and (2) annually provided IRS with the name and the employer identification or social security number of all such certificate signers. The certificate should be signed by the contractor under penalty of perjury and in a form approved by the Secretary of the Treasury.

Action taken and/or pending

In September 1979, the Select Revenue Measures Subcommittee of the House Ways and Means Committee cleared H.R. 5460, which would have (1) provided five "safe harbor" tests for determining whether a worker is an independent contractor or an employee and (2) instituted a 10 percent withholding rate on all independent contractors. No further action was taken on the bill.

However, on September 18, 1980, the Chairman, House Ways and Means Committee, introduced H.R. 8156 prohibiting IRS from issuing regulations on reclassifying independent contractors as employees until January 1, 1984. The Congress subsequently enacted the bill but changed the expiration date to June 30, 1982.

In January 1981, the Senate Finance Committee Chairman introduced S.8, a bill containing the same five safe harbor tests as H.R. 5460 but not containing the withholding requirement. However, no action was taken during 1981.

During the second session of the 97th Congress, several bills were introduced relating to the classification of workers as either employees or self-employed for Federal tax purposes. For example, S. 2369 was introduced by the Chairman of the Senate Finance Committee on April 14, 1982, as the Independent Contractor Tax Classification and Compliance Act of 1982. This bill would have eased the problems associated with classifying workers as employees or independent contractors and would have strengthened information reporting and penalties with respect to independent contractors. A similar bill, H.R. 6311, was introduced in the House on May 6, 1982. Neither S. 2369 nor H.R. 6311 required withholding. An earlier House bill, H.R. 5867, introduced on March 17, 1982, as the Independent Contractor Tax Act of 1982, would have provided alternative standards for determining whether individuals are not employees for purposes of the employment taxes and would also have provided a 10 percent withholding requirement on payments made to independent contractors.

On April 26, 1982, in testimony on S. 2369 before the Subcommittee on Oversight of the Internal Revenue Service, Senate Finance Committee, we reiterated the need to clarify the rules for determining employer-employee relationships. We pointed out that while there were some differences between S. 2369 and our recommendations on the worker classification issue, the proposed legislation would accomplish the overall purpose of clarifying the circumstances under which a worker should be classified as an employee or an independent contractor.

The Tax Equity and Fiscal Responsibility Act of 1982 (Public Law 97-248), which was enacted on September 3, 1982, dealt with part of the independent contractor issue by defining salespersons who are licensed real estate agents and individuals who are direct sellers as self-employed for federal income and employment tax purposes under certain conditions. The act also indefinitely extended the moratorium on IRS reclassification action from July 1, 1982, until such time as the Congress enacts legislation concerning the classification of workers as independent contractors or employees.

No further action was taken during 1983.

NEED FOR CHANGE IN LAW TO PROVIDE FICA-SECA OFFSET

GGD-77-88
B-137762
11-21-77

## Summary of finding

When IRS determines that an individual is an employee instead of an independent contractor, it assesses the employer for social security taxes that should have been withheld from amounts paid even though the employee had paid self-employment social security taxes. As a result, social security taxes are frequently collected twice on the same income.

Unless the statute of limitations has expired, IRS is precluded by the Internal Revenue Code from reducing the social security tax assessed under the Federal Insurance Contributions Act by any social security taxes the employees have paid under the Self-Employment Contributions Act. This is because the self-employment tax was technically paid in error and the employees could seek refunds of the tax payments. Generally, however, they have not sought to recover such payments.

## Recommendation

We recommended that the Congress amend section 6521 of the Internal Revenue Code to authorize IRS to reduce the employees' portion of social security taxes assessed against employers by an appropriate portion of the self-employment social security taxes paid by reclassified employees for the open statute years.

## Action taken and/or pending

In December 1979, H.R. 5460 was reported to the House Ways and Means Committee. This bill would have provided criteria for determining independent contractor status and required withholding on compensation paid to certain independent contractors. Such provisions would have reduced the potential for controversy between IRS and taxpayers regarding the determination of who is an independent contractor but would not have obviated the need for offset authority, such as we recommended. No action was taken on the bill.

During the second session of the 97th Congress, several bills were introduced relating to the worker classification issue. However, none of the bills addressed the need for offset authority, such as we recommended. On April 26, 1982, we testified on S. 2369 before the Senate Finance Committee's Subcommittee on Oversight of the Internal Revenue Service. During the hearing, we pointed out that the proposed bill would not eliminate the need for IRS reclassifications and retroactive tax assessments and that problems associated with those actions

would continue to exist. We proposed that some further legislative and administrative changes would be needed, particularly to reduce the potential for double taxation in the event of reclassification. In this regard, we reiterated the need for legislation to allow FICA-SECA offset.

The Tax Equity and Fiscal Responsibility Act of 1982 reduced the employer's liability by providing that an employer would be liable for only 20 percent of the worker's share of FICA tax that should have been withheld if the employer erroneously treated the worker as a nonemployee for social security tax purposes. Although this provision reduces the employer's social security tax obligations, it does not fully resolve the FICA-SECA offset issue. No further action was taken on this issue during 1983.

NEED TO CHANGE REQUIREMENT THAT GOVERNMENT MUST PURCHASE SEIZED PROPERTY AT A SALE AT THE MINIMUM BID PRICE

GGD-78-42
B-137762
7-31-78

Summary of finding

The government may be required to purchase seized property which may not be in its best interest. This is because section 6335(e)(1) of the Internal Revenue Code provides that:

> " * * *if no person offers for such property at the sale the amount of the minimum price, the property shall be declared to be purchased at such price for the United States * * *."

It is possible that seized property has a saleable value but that it would not be in the government's best interest to purchase it. For example, the property may require a substantial investment to repair or clear the title before it can be used or resold. Under such circumstances, the law should be clarified to give IRS the option of either buying the property for the government or returning it to the taxpayer.

Recommendation

We recommended that the Congress amend section 6335(e)(1) of the Internal Revenue Code to provide that if no person offers to purchase property at a sale at the minimum bid price, the property shall be declared to be purchased at such price for the United States or released back to the taxpayer if IRS determines it is not in the best interest of the government to purchase the property. Such a determination would have to be made by IRS prior to the sale on the basis of criteria developed by the Commissioner of Internal Revenue.

Action taken and/or pending

None

CHANGES NEEDED IN THE TAX LAWS GOVERNING THE EXCLUSION FOR SCHOLARSHIPS AND FELLOWSHIPS AND THE DEDUCTION OF JOB RELATED EDUCATIONAL EXPENSES

GGD-78-72
B-137762
10-31-78

## Summary of finding

Section 117 of the Internal Revenue Code, pertaining to the exclusion of scholarships and fellowships, and Treasury regulations section 1.162-5, pertaining to the deduction of job related educational expenses, are difficult to understand and sometimes confusing. As a practical matter, it is virtually impossible for IRS or the courts to apply the many tax computation rules of these two provisions in an even-handed manner because the rules make taxability depend upon innumerable precise factual determinations not relevant to considerations of ability to pay. The rules are focused more on refining the definition of net taxable income than on according equal treatment to taxpayers similarly situated.

The result is that taxpayers who protest deficiencies on the basis of disallowing the exclusion under section 117 or the deduction under regulations section 1.162-5 are often propelled to pursue their cases through the administrative appeals process and through litigation quite as much by a sense of personal injustice as by a wish to minimize taxes.

The courts, confronted with a large volume of educational tax litigation considered trivial and time consuming, have expressed impatience with the legal uncertainties created by section 117 and regulations section 1.162-5. Judges frequently have recommended that section 117 be amended to clarify the tax status of educational grants where the element of compensation is present to some extent. Judges have also criticized the bias of the educational expenses deduction regulations in favor of teachers and professors.

## Recommendation

We recommended that the Congress amend section 117 of the Internal Revenue Code and add a new educational expense deduction section. We proposed specific legislative language for each.

## Action taken and/or pending

On several occasions, the Congress has provided, on a temporary basis, that National Research Service Awards should be treated as excludable scholarships or fellowship grants. For example, the Tax Equity and Fiscal Responsibility Act of 1982 extended the exclusion for National Research Service Awards through the end of 1983. While the action related to certain

awards being treated as excludable scholarship or fellowship grants under section 117 of the Internal Revenue Code, it did not fully encompass either of our recommendations.

EMPLOYEE STOCK OWNERSHIP PLANS SHOULD BE ESTABLISHED FOR THE BENEFIT OF EMPLOYEES

HRD-80-88
B-199055
6-20-80

## Summary of finding

The Employee Retirement Income Security Act of 1974 requires that Employee Stock Ownership Plans, as tax-qualified plans, be established and operated exclusively for the benefit of participants and their beneficiaries. Our analysis of Plan transactions showed that most were not being operated in the best interest of participants. Specifically, one or more of the following problems that could affect participants' benefits were present in each of the closely held company plans reviewed.

--The companies sold or contributed company stock to their Plans at questionable prices. These were based on appraisal valuations which lacked independence and/or did not properly consider relevant factors, such as earning capacity, book value, comparability with similar companies, and marketability. If the transactions in company stock were for more than fair market value, they (1) were prohibited transactions under the act of 1974 and subject to an excise tax, (2) could mislead participants about the value of their Plan account, and (3) could increase the amount on which participants would ultimately pay income tax.

--Participants were not assured of a market for company stock distributed by the Plan. The act requires that Plans invest primarily in employer securities, but regulations do not generally require the employer to repurchase stock distributed to participants.

--Participants generally were not permitted to vote or direct the voting of company stock allocated to their Plan accounts. Rather, a Plan committee usually appointed by the employer voted the Plan company stock without formal direction from the participants.

## Recommendation

We recommend that the Congress enact legislation to

--provide that full and unrestricted voting rights be passed to Plan participants for all employer stock allocated to their accounts; and

--require Plan provisions for redeeming, at fair market value, all company stock distributed by the Plan.

Action taken and/or pending

None

NEED FOR CONGRESS TO ENSURE THAT THE TREASURY AND JUSTICE DEPARTMENTS DEVELOP A STREAMLINED LEGAL REVIEW PROCESS FOR CRIMINAL TAX CASES

GGD-81-25
B-201235
4-29-81

Summary of finding

IRS seeks to promote voluntary compliance with the tax laws by treating taxpayers in an equitable manner and by achieving a balanced criminal tax enforcement program aimed at deterring would-be violators. However, the current legal review process requires that cases be reviewed consecutively by three separate groups of government attorneys--IRS' District Counsel, the Justice Department's Tax Division, and the cognizant U.S. attorney. This process does not promote IRS' goals because it is time consuming and unnecessarily duplicative. Each year, many taxpayers learn that legal reviewers have declined to prosecute them after they have been subjected to the trauma of a lengthy investigation. Moreover, the impact of successfully prosecuted cases is lessened because the cases often are several years old before they are brought to the public's attention and before the government can collect past due taxes, penalties, and fines.

The present sequential, postinvestigative legal review process continues to exist despite its time consuming and duplicative nature and IRS' recognition that the Criminal Investigation Division (CID) needs legal assistance during, rather than after, its investigations. Although the existing legal review process for criminal tax cases clearly needs to be revised, especially in light of concern over increased federal spending and efforts by the executive and legislative branches to balance the federal budget, the best means for doing so is not clear. The process can be restructured in various ways. However, any modification should (1) provide a means through which CID can obtain needed legal assistance during its investigations, (2) improve timeliness and eliminate any unnecessary duplication and costs, (3) ensure that criminal tax cases receive a high quality, independent legal review before they are prosecuted, and (4) safeguard the legal rights of taxpayers.

Our analyses of sample cases and discussions with various federal officials and private sector attorneys enabled us to formulate several alternative approaches to revising the present legal review process. Each alternative has advantages and disadvantages, as well as cost implications; some have more merit than others. For example, one alternative would have District Counsel attorneys carry out ongoing, rather than post investigative, legal reviews. That alternative has merit because it would reduce delays in the present legal review process while safeguarding taxpayers' legal rights. CID's productivity would

increase as attorneys, through early involvement in the investigative process, identify problem cases and/or help ensure efficient development of good cases. Two important IRS goals--equitable treatment of taxpayers and voluntary compliance--would be more effectively promoted. Also, annual recurring cost savings of up to $2.63 million could be realized through the elimination of a postinvestigative review level because fewer District Counsel attorneys would be needed.

Recommendation

We recommended that the Congress ensure that the Treasury and Justice Departments develop a streamlined legal review process for criminal tax cases and that any revised system realizes potential cost savings while safeguarding taxpayers' legal rights.

Action taken and/or pending

In December 1981, the Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs, asked Justice and IRS to specify what actions have been taken in response to our recommendation. In their responses, Justice and IRS described a series of actions they had taken to streamline the review process. Given that, the Subcommittee decided to defer consideration of a hearing on the issue. The Subcommittee believed that some time would be needed to assess the utility of the actions taken by the agencies in response to our report.

On September 16, 1982, the Senate Appropriations Committee, in its report accompanying IRS' 1983 appropriation bill, responded to our recommendation by suggesting that IRS and the Justice Department develop a streamlined legal review process which would prevent duplicate oversight of criminal tax cases. No action was taken by the agencies during 1983 in response to the Appropriation Committee's suggestion. However, the substance of the recommendation was included in the August 31, 1983, report of the President's Private Sector Survey (Grace Commission) on Cost Control in the Federal Government.

TAXATION OF THE LIFE INSURANCE INDUSTRY NEEDS TO BE UPDATED

PAD-81-1
9-17-81

Summary of finding

The income of U.S. life insurance companies is taxed under the Life Insurance Company Income Tax Act of 1959 which was tailored to fit the life insurance industry at that time. When the act was passed, for example:

--The industry was dominated by mutual companies (cooperative ventures) that represented only about 11 percent of the total number of companies in business but held 75 percent of industry assets and sold 63 percent of U.S. life insurance.

--The predominant product sale was whole life insurance (a life insurance policy for the whole of life payable at death) which generated large reserves and investment income.

--The rate of inflation in the U.S. was low (0.8 percent annually compared to recent rates of 10 percent and more), and earnings rates on investments were much lower than current taxes.

The Congress considered the structure of the industry in 1959 and provided special features in the Act that recognized

--the competitive balance between mutual and stock companies (mutual companies, unlike stock companies, do not have stockholders);

--the importance of fostering the survival of small life insurance companies that were by far the largest in number of companies doing business; and

--the long-term nature of life insurance business (life insurance contracts span many years).

In the last 20 years many changes have taken place in the industry, not only in its structure but also in the products it offers. Moreover, the economic environment in which life insurance companies operate has also changed. These changes include the following:

--The balance in the industry has shifted, and mutual companies no longer dominate, though they are still a major factor in the industry.

--The lines of business life companies write have shifted from whole life to term and group insurance. (Term life coverage is for a specified number of years and expires without cash value if the insured survives, and group insurance provides coverage to many insureds under a single policy.)

--The growth in the pension line of business and tax deferred annuities (money on which income tax is deferred until a payment is made) has increased dramatically but has yet to peak.

--Policy loan provisions have induced unanticipated demands on life company assets in recent years.

--Interest rates have risen sharply, primarily because of inflationary pressures.

Because of these changes, we concluded that the Life Insurance Company Income Tax Act of 1959 needs to be updated.

Recommendations

We recommended that, primarily due to changes in the insurance industry structure, its product offerings, and the effects in the inflation, Congress should consider changing the sections in the 1959 Act dealing with:

--the method by which the reserve deduction, that portion of current income necessary to meet future obligations, is calculated (Section 805);

--the definition of taxable income (Section 802 (b)); and

--the method for approximating those reserves that are computed on a preliminary term basis. (Under a preliminary term basis, a company adds less to its reserves during the early years of a policy and then makes up for the deficiency in later years. The company may elect to compute these reserves either exactly or approximately). (Section 818(c).)

In addition, we identified six more provisions of the act that merit further consideration by the Congress. These provisions deal with the following issues:

--deferred annuities (section 805(e)),

--the definition of a life company (section 801(a)),

--the deduction for investment expenses (section 801(c)(1)),

--the definition of assets (section 805(b)(4), and

--the use of modified coinsurance for tax avoidance (section 820).

Action taken and/or pending

The Tax Equity and Fiscal Responsibility Act (TEFRA) provided for changes in the taxation of life insurance companies on a "stopgap" basis for the taxable years 1982 and 1983. TEFRA included a provision adopting one of the alternatives included in our "Reserve Deduction" recommendation.

It also adopted the principle in one of our major recommendations dealing with "Reserve Revaluation", but substituted $19 instead of our suggested $15 per thousand dollars of risk allowance in revaluing reserves for permanent insurance years. Based on this change, we estimated that this particular recommendation would result in additional annual tax revenue of $220 million, an amount corroborated by revenue estimates of the Joint Committee on Taxation.

Two of the six additional provisions which we suggested needed congressional consideration were also the subject of legislative changes in TEFRA. The first was the matter of deferred annuities where the legislation, among other things, included penalties for early distributions. The second was the matter of modified coinsurance, in which section 820 dealing with the issue, was repealed with a very large revenue savings effect for the government.

With the life insurance company taxation provisions of TEFRA having expired, Congress is now considering entirely new legislation. Bills have been passed in both the House of Representatives (HR 1470) and the Senate (S.1982). These bills which are awaiting action by the House and Senate Conferees, reflect our recommendations on taxable income and reserve revaluation.

CONGRESS SHOULD AMEND THE INTERNAL REVENUE CODE TO REQUIRE SPONSORS OF TERMINATING PENSION PLANS TO OBTAIN AN IRS REVIEW OF PARTICIPANT PROTECTION REQUIREMENTS BEFORE PLAN DISSOLUTION

HRD-81-117
B-203672
9-30-81

## Summary of finding

On the basis of our anlaysis of pension plan terminations for 1977, we found that plan sponsors for about two-thirds of reported terminating plans were not requesting IRS reviews at the time of termination because such reviews are not mandatory under the Internal Revenue Code. Termination actions were not being reported to the Pension Benefit Guaranty Corporation, which is responsible for insuring participants' benefits. Thus, at the time of termination there is no assurance that, for many such plans, the participants are adequately protected as required by the Employee Retirement Income Security Act and the Internal Revenue Code.

## Recommendation

We recommend that the Congress amend the Internal Revenue Code to require sponsors of terminating pension plans to obtain an IRS review of participant protection requirements before plan dissolution.

## Action taken and/or pending

None

## CHANGES TO THE DISCLOSURE PROVISIONS OF THE INTERNAL REVENUE CODE COULD IMPROVE VERIFICATION OF WELFARE RECIPIENTS' INCOME AND ASSETS

HRD-82-9
B-203669
1-14-82

### Summary of finding

Underreporting of income and assets by recipients of benefits from needs based programs results in hundreds of millions of dollars in improper payments each year. Current requirements and practices for verifying program eligibility are not adequate to prevent such payments. Verification requirements vary widely but generally are extremely vague or overly restrictive. Furthermore, some federal laws and regulations preclude the use of information which, if available, would significantly enhance the verification process.

Financial data, such as interest and dividend income, in IRS' Information Return Processing File would be useful in verifying income and assets in welfare programs. Because of the concerns about individual privacy, however, exchange of these data is prevented by the Tax Reform Act of 1976.

### Recommendation

We recommended that the Congress amend the Internal Revenue Code to permit disclosure of:

--Data on individual wages, net earnings from self-employment, and payments of retirement income maintained by SSA to federal, state, and local agencies administering federally funded needs-based programs, whenever comparable data are not available at the state level.

--IRS Information Return Processing File data on sources and amounts of unearned income to federal, state, and local agencies administering federally funded needs-based programs.

### Action taken and/or pending

References to these recommendations were made in the report of the President's Private Sector Survey (Grace Commission) on Cost Control in the Federal Government and in the CBO/GAO Analysis of the Grace Commission's Major Proposals for Cost Control issued on February 24, 1984. Provisions relating to our recommendations were included in H.R. 2163, which was approved by the House of Representatives and referred to the Senate on July 12, 1983. The bill was reported out of the Senate Finance Committee on November 15, 1983, and placed on the Senate calendar, where action is now pending.

KEY ISSUES AFFECTING STATE TAXATION OF MULTIJURISDICTIONAL CORPORATE INCOME NEED TO BE RESOLVED

GAO/GGD-82-38
B-202972
7-1-82

Summary of finding

At present, state taxation of multijurisdictional corporate income is administratively unwieldy. Forty-five separate political jurisdictions attempt to equitably divide the income of often complex and geographically dispersed taxable entities, and each jurisdiction formulates its own specific rules for determining how much of an entity's total income is attributable to operations in that jurisdiction. The resulting lack of uniformity is extensive.

The problems of nonuniformity are even more critical today than they were when the special House subcommittee issued the Willis report in 1964 extensively documenting the lack of uniformity in interstate tax provisions. The issues have become more complex and controversial as the number of corporations has grown, and certain states have expanded their taxing efforts to take foreign operations into account.

The issues which have developed in recent years have broad policy implications potentially affecting international tax policy. Furthermore, the issues are at the center of the long-standing constitutional debate over the balance between state soveignity and Congressional Commerce Clause Powers. Moreover, lack of uniformity among the states causes problems for states and corporate taxpayers. The problems--higher return preparation costs, potential overtaxation or undertaxation, and numerous disputes--result in a tax system which is unduly uncertain, inefficient, and often inequitable.

Recommendation

None. While we made no recommendation, we concluded that the key issues affecting state taxation of multijurisdictional corporate income need resolving. In the almost 20 years since the House subcommittee issued its report, little progress has been made to increase the uniformity with which states tax corporate income. The states have made some voluntary efforts, but substantial nonuniformity still exists.

The Supreme Court has attempted to deal with some the issues affecting state taxation of multijurisdictional corporate income. For example, the Court recently ruled that a state can take into account a corporation's worldwide income when taxing that corporation. But, in the past the Court has also recognized the inherent limitations of the judicial approach to solving the interstate and international policy issues and has

acknowledged that the Congress is the appropriate body to resolve such issues.

The Congress appears to be in the best position to fully evaluate the multiple factors and assess the arguments surrounding the policy issues involved in state taxation of multistate and multinational corporate income, especially foreign source income. Also, because the Congress can fully consider the states' rights and foreign policy issues, it can best devise a comprehensive solution which adequately and fairly balances the competing interests of the states and corporate taxpayers.

Action taken and/or pending

In response to concerns of foreign governments and U.S. and foreign-based multinational corporations, the President directed the Secretary of Treasury to form a special working group on unitary taxation to recommend solutions to the problems resulting from state taxation of multinational corporate income. The working group was formed in October 1983 and consists of representatives from states, corporations, and key interest groups. In November 1983, we made an extensive presentation before the task force of the working group based on issues covered in our report on state taxation and in a related report on federal taxation of multinational corporations (GGD-81-81, September 30, 1981). The working group plans to issue its recommendations during 1984.

Since 1965, bills covering interstate corporate taxation have been introduced in every session of the Congress, including the current one. Each of the 33 bills introduced has contained income tax provisions. However, primarily because of state opposition, none of the bills have become law.

The two identical bills now before the Congress, S. 1225 and H.R. 2918, are similar to other bills introduced in the last several sessions of Congress. These two bills would prohibit states form using the worldwide combined reporting method when taxing multinational corporations and would restrict states from taxing a greater portion of a corporation's foreign source dividends than the federal government effectively taxes. Congressional action on these bills is expected after the special working group on unitary taxation makes its recommendations.

## RECOMMENDATIONS TO THE COMMISSIONER OF INTERNAL REVENUE DURING 1983


| | Page |
|---|---|
| IRS Needs To Provide More Guidance On The Member Income Requirement Affecting Tax Exemption For Electric Cooperatives | 2 |
| IRS Should Find The Least Costly Means Of Collecting Needed Management Information On Problem Tax Preparers | 4 |
| IRS Needs To Better Insure That Tax Examiners Consider Tax Law Complexity When Deciding Whether To Assert Penalties Against Tax Preparers | 5 |
| Inadequate Guidelines Have Hampered Administration Of The Preparer Penalty For Willful Misconduct | 6 |
| IRS' Automated Collection Procedures Should Be Modified To Avoid Violating The Protection Afforded Taxpayers By The Bankruptcy Code | 7 |
| With Better Management Information IRS' Efforts Against Abusive Tax Shelters Could Be Improved | 8 |
| IRS Needs To Give More Attention To Public Information Reporting By Tax-Exempt Private Foundations | 11 |
| IRS' Installation of Check-Sorting Equipment Offers Advantages To The Government | 13 |
| Faster Deposits Of Tax Receipts Collected By IRS Field Offices Would Improve Cash Management | 14 |
| Greater Use Of The Federal Tax Deposit System Would Increase Interest Earnings | 15 |
| Less Review Would Improve Processing Of Tax Regulations | 16 |
| Lack Of Adequate Management Information Has Hindered Tax Regulations Issuance | 17 |

IRS NEEDS TO PROVIDE MORE GUIDANCE ON THE MEMBER INCOME REQUIREMENT AFFECTING TAX EXEMPTION FOR ELECTRIC COOPERATIVES

GAO/GGD-83-7
B-207753
1-5-83

## Summary of finding

Many electric cooperatives' operations and service areas have changed since the tax exemption laws were enacted. IRS has tried to address these changing conditions in administering the tax exemption provisions of the Internal Revenue Code. IRS' compliance program centers on the requirement that 85 percent or more of a cooperative's income be collected from members. But even this has proven difficult for IRS to administer and for electric cooperatives to comply with. IRS has not provided sufficient guidance for cooperatives to properly compute and determine the percentage of gross income collected from members as opposed to nonmembers and for IRS to monitor compliance with the law.

Electric cooperatives are supposed to determine their compliance with the member income requirement as part of their annual filing of exempt organization returns. However, in addition to inadequate guidance, the exempt organization return lacks the format and instructions necessary to properly compute the 85 percent member income test.

## Recommendations

We recommended that the Commissioner of Internal Revenue:

--Provide more complete guidance to assist electric cooperatives and other section 501(C)(12) organizations in complying with the 85 percent member income requirement of the law and to assist IRS examiners in determining compliance with this requirement. At a minimum, such guidance should address those issues that affect the computation of member and nonmember income.

--Direct the Tax Forms Coordinating Committee to examine the need for revisions to the exempt organization return (Form 990) and/or the need to include a supplementary schedule to provide the format for section 501(C)(12) organizations to properly account for their member and nonmember income and compute the percentage of gross income collected from members.

## Action taken and/or pending

IRS agreed to inquire into the specific issues raised concerning the computation of member income to ascertain whether

additional guidance is needed. In January 1984, IRS issued a notice of proposed regulations relating to electric cooperatives covered under section 501(C)(12) of the Internal Revenue Code of 1954. These regulations are intended to provide necessary guidance to those electric cooperatives making a determination of their exempt status under 501(C)(12) and will affect such cooperatives and their members.

IRS also agreed to assess whether changes in the Form 990 format and/or an illustrative example are required. IRS said that these changes would be contingent on whether the final amendments to the regulation dictate a need for such changes.

IRS SHOULD FIND THE LEAST COSTLY MEANS OF COLLECTING NEEDED MANAGEMENT INFORMATION ON PROBLEM TAX PREPARERS

GAO/GGD-83-6
B-203494
1-6-83

## Summary of finding

Since tax preparer penalties enacted by the Tax Reform Act of 1976 went into effect in January 1977, IRS has dealt firmly, fairly, and effectively with preparers who only partially identified themselves on tax returns. Through penalty assessments, educational efforts, development and use of tolerance levels, and dialogue with industry representatives, IRS has been very successful in getting those preparers who provide some but not all of the identification data required on tax returns to more fully comply with disclosure requirements of the law. That success may prove short lived because, due to budget constraints, IRS had to stop collecting certain data on return preparers in January 1982.

Because of the lack of adequate information, it is not clear whether IRS has been as successful in dealing with the more troublesome tax preparers who do not identify themselves on returns they prepare and/or do not keep required records. Available evidence indicates that there are a number of such preparers. However, the overall extent of the problem is unknown. Thus, IRS needs to gather and analyze data on these preparers with a view toward determining the extent of the problem and the relative effectiveness of its compliance enforcement activities.

## Recommendation

We recommended that the Commissioner of Internal Revenue identify and implement the least costly means of collecting needed management information on the preparer population and on preparer penalties. In this regard, the Commissioner should consider using IRS' Taxpayer Compliance Measurement Program for collecting some of the needed data

## Action taken and/or pending

IRS agreed to include questions concerning the amounts and types of penalties imposed on individual return preparers during Phase III, Cycle 8, of the Taxpayer Compliance Measurement Program Survey. The computer generated checksheet containing these questions was implemented in February 1984.

## IRS NEEDS TO BETTER INSURE THAT TAX EXAMINERS CONSIDER TAX LAW COMPLEXITY WHEN DECIDING WHETHER TO ASSERT PENALTIES AGAINST TAX PREPARERS

GAO/GGD-83-6
B-203494
1-6-83

### Summary of finding

On the basis of general guidelines issued by IRS headquarters, IRS examiners began asserting penalties against paid preparers for negligent misconduct in October 1977. These guidelines provided that, in determining whether to assert this penalty, IRS examiners were to take into account the complexity of the return at issue and the frequency and materiality of errors made. However, those instructions were not supplemented with specific description of what constitutes a complex issue and did not contain specific criteria defining the terms frequency and materiality. Consequently, preparers began complaining that examiners were asserting the penalty on an inconsistent basis.

As a result, IRS reevaluated its guidelines and subsequently made a strong effort to further clarify what exactly constitutes negligent misconduct. This should help assure application of this penalty on a more consistent basis. However, IRS still needs to resolve persistent confusion over the question of how examiners ought to take tax law complexity into account when making penalty assertion decisions. Otherwise, examiners would have to continue relying heavily on subjective judgement in determining whether a particular provision of the law is or is not complex.

### Recommendation

We recommended that the Commissioner of Internal Revenue identify additional means through which to better ensure that examiners take tax law complexity into account when making penalty assertion decisions.

### Action taken and/or pending

IRS revised training materials on the return preparers penalties by incorporating guidelines to assure that examiners take tax law complexity into account when making penalty assertion decisions. The revision was completed in January 1983.

INADEQUATE GUIDELINES HAVE HAMPERED ADMINISTRATION OF THE PREPARER PENALTY FOR WILLFUL MISCONDUCT

GAO/GGD-83-6
B-203494
1-6-83

## Summary of finding

IRS' administration of the penalty for willful misconduct has been hampered by inadequate guidelines. Examiners have been required to make decisions as to whether penalties ought to be asserted by taking into account the complexity of returns and the frequency and materiality of errors but have been afforded only general guidance as to what constitutes willful misconduct. Moreover, IRS has made little effort to clarify guidelines relating to the $500 penalty for willful misconduct. As a result, preparers have continued to complain that IRS has assessed this penalty in an inconsistent fashion. The lack of specific guidelines, together with minimal documentation in case files, has limited IRS' ability to assess the effectiveness of its efforts to detect and deter preparers who willfully understate taxpayers' tax liabilities.

## Recommendation

We recommended that the Commissioner of Internal Revenue publish guidelines better defining the circumstances under which the willful misconduct penalty ought to be asserted. By so doing, IRS would better ensure consistency in the application of this penalty, while also alerting preparers to the situations in which they should expect to be penalized for this serious violation.

## Action taken and/or pending

In January 1983, IRS revised its training material on return preparers' penalties by incorporating guidelines which better defined the circumstances under which the willful misconduct penalty should be applied.

| IRS' AUTOMATED COLLECTION PROCEDURES SHOULD BE MODIFIED TO AVOID VIOLATING THE PROTECTION AFFORDED TAXPAYERS BY THE BANKRUPTCY CODE | GAO/GGD-83-47<br>B-211231<br>6-20-83 |
|---|---|

Summary of finding

The Bankruptcy Reform Act provides qualified debtors with certain protections from creditors--including IRS. The act restricts IRS' authority in many cases to assess, collect, or recover a claim against an individual or a business during bankruptcy proceedings. Administratively, this restriction has caused problems for IRS because it requires IRS to process returns from many bankrupt taxpayers manually rather than through its automated processing system. During fiscal year 1982, these additional processing steps cost IRS an estimated $500,000 in administrative expenses. Even if assessment restrictions are eliminated so that IRS can process returns of bankrupt taxpayers through the automated system, modifications must be made to bypass automated collection procedures that violate collection restrictions placed on the IRS by the Bankruptcy Reform Act.

Recommendation

We recommended that, for purposes of better assuring that the protections afforded by the act are realized, IRS should modify its automated collection system to stop collection notices from being sent routinely to bankrupt taxpayers once the reported taxes have been assessed.

Action taken and/or pending

The IRS fully concurred with our recommendation to modify its collection procedures. In this regard, a request for data services was approved for a computer program change to suppress the issuance of demand (collection) notices until after the lifting of the automatic stay on all tax assessments during bankruptcy proceedings. Completion of this program change is scheduled for August 1984. It is being implemented as part of the major computer reprogramming effort associated with the Service Center Replacement System.

WITH BETTER MANAGEMENT INFORMATION IRS' EFFORTS AGAINST ABUSIVE TAX SHELTERS COULD BE IMPROVED

GAO/GGD-83-63
B-212165
8-25-83

Summary of finding

Since March 1981, IRS has taken several administrative actions designed to improve its performance in completing examinations of tax returns involving abusive tax shelters. For example:

--IRS has adopted an innovative "must work" approach in dealing with potentially abusive tax shelters. Simply stated, once an apparent abusive tax shelter is identified, an IRS examiner must begin an examination. As a result, however, IRS has examined a large number of returns and has devoted increasing amounts of examiners' time to the problem. This has led to a significant administrative burden on the examiners.

--IRS has also revised procedures and devised standards to expedite processing of tax shelter returns. In addition, IRS has updated portions of program guidelines and formed centralized support units in districts having large volumes of tax shelter examinations.

--In dealing with the existing case backlog, IRS implemented a new policy called the "out-of-pocket expenses" approach for those tax shelter cases initiated before 1981. This approach allowed taxpayers to deduct their investment in the initial year of the shelters as settlement. Thus, the theory was that taxpayers would not receive artificial benefits from their participation in abusive tax shelters; rather they would receive only a dollar deduction for each dollar invested.

On the legislative front, the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) gave IRS several enforcement tools, such as injunction and penalty authority, intended for use against promoters of abusive tax shelters.

Despite innovative approaches and close attention by IRS top management, as well as the Congress, the number of abusive shelter returns have continued to grow and problems have occurred in program operations. Therefore, IRS should monitor the results of these recent administrative and legislative changes to make sure they are having the intended effect and, if they are not, to expeditiously take corrective actions, as appropriate. To do this, IRS needs improved management information on two levels--strategic and operational.

On the strategic level, IRS should collect and appropriately aggregate better management information on the current size of the problem and the estimated revenue loss caused by tax shelter abuse. With such information, IRS' strategic planners would be in a better position to gauge current trends and predict future ones. They would then be able to make the best possible strategic decisions on how to allocate IRS' limited resources in the future.

On the operational level, IRS should monitor how well the "must work" approach, with its resulting demands on IRS' limited resources, is working in the new situation. IRS would also need to assure itself that the levels of administrative burden on tax shelter examiners are easing and that old cases are being settled as expected under the "out-of-pocket expenses" approach. With better management information on case processing times and program workload, IRS should be better able to assure itself that operations are running efficiently or, if they are not, take administrative action as needed.

Better management information on operations would be important also for strategic planners. If past problems are not being solved or if new ones arise, IRS planners should consider making strategic changes, such as modifying the must work approach, or seeking further legislative relief.

Recommendations

We recommended that the Commissioner of the Internal Revenue develop such management information as is appropriate and necessary to more accurately gauge the current size of the problem of abusive tax shelters and the impact IRS is having on noncompliance in this regard.

We also recommended that the Commissioner develop such management information as is appropriate and necessary (1) for determining whether TEFRA and administrative changes have eliminated the cause of past problems, such as the uncompleted examination case backlog and administrative burden on examiners, and (2) for identifying as early as possible any other obstacles to effective and efficient program operations. If, in implementing this recommendation, IRS finds that the "must work" approach is still resulting in administrative difficulties, we further recommended that the Commissioner:

--reassess the goal of expeditiously examining every abusive shelter which is identified, in light of this goal's impact on IRS' examination plan,

--if this goal is found to be no longer attainable, formulate criteria for deciding which abusive tax shelters are most in need of examination, and

--make more extensive use of centralized support staffs and computer, rather than manual, systems to further free examiners from clerical and administrative tasks.

Action taken and/or pending

IRS generally agreed with our recommendations. In this regard, IRS said it is modifying its management information system data base to produce reports that are intended to enable IRS to evaluate its tax shelter program. IRS expects to complete this action by June 30, 1984. IRS said it is also analyzing its management information data base reports to clearly identify current trends and characteristics in the tax shelter program

In order to eliminate administrative difficulties resulting from the "must work" approach to abusive tax shelters, IRS has already taken steps to:

--allocate resources to stop tax shelters in mid-stream by changing program guidelines,

--monitor by October 1984, current selection criteria for tax shelter and partnership returns and change the criteria, if necessary, when modifications can be made, and

--implement by July 1984, the new flow-through investor procedures for service center examinations support units.

IRS NEEDS TO GIVE MORE ATTENTION TO PUBLIC INFORMATION REPORTING BY TAX-EXEMPT PRIVATE FOUNDATIONS

GAO/GGD-83-58
B-211258
9-26-83

## Summary of finding

Private foundations are required by the Internal Revenue Code to make extensive public disclosures on returns filed with IRS. This information on grant making programs, investments, and foundation managers is useful to the Congress and the public for monitoring foundation activities, and to grant seekers for identifying those foundations most likely to fund their proposals. In effect, the disclosures made on foundation returns--990PF and 990AR--cause private foundations to be accountable for their actions to the Congress, IRS, and the public. Additionally, the public information is necessary for IRS to administer the revenue laws.

Currently, private foundations generally comply well with certain tax administration reporting requirements which IRS, through its enforcement efforts has shown, are important. On the basis of a review of 51 information items, we estimated that about 92 percent of the 990PF and 99 percent of the 990AR returns reported all the information identified by the three service centers we visited as necessary for efficient administration of the tax exemption law.

However, IRS has devoted less attention to the public information reporting requirements, and, consequently, most foundations do not make full information disclosures on their returns. In contrast, on the basis of a review of 19 key information items, we estimated that about 41 percent of the 990PF returns and 94 percent of the 990AR returns did not completely respond to certain public information reporting items. To assure that the public's information needs for oversight and grant seeking purposes are met, IRS needs to make administrative changes to better enforce those tax exemption reporting requirements.

## Recommendations

To improve private foundation compliance with the Internal Revenue Code's public information reporting requirements, we recommended that the Commissioner of Internal Revenue adopt a systematic enforcement approach which combines an appropriate mix of increased service center correspondence and examinations to secure better foundation compliance.

We also recommended that the Commissioner:

--Adopt changes to the Internal Revenue Manual illustrating the (1) public information reporting requirements as an examination objective and (2) responsibility of examiners to secure compliance with those requirements.

--Develop the management information needed for monitoring the effectiveness of the overall compliance approach adopted and determine periodically whether any changes to that approach are necessary. In accomplishing this objective, the Commissioner should consider (1) incorporating additional reporting items in the management information system to monitor the amount and types of noncompliance, such as incomplete public information reporting found by examining agents, (2) including incomplete public information reporting as a noncompliance item in future Taxpayer Compliance Measurement Programs, and (3) using service center correspondence statistics.

--Establish procedures for assessing the incomplete reporting penalty in those instances when IRS, through its overall approach, is unable to secure a foundation's voluntary compliance with tax administration or public information reporting requirements; and for revoking a foundation's tax-exempt status when necessary.

Action taken and/or pending

IRS agreed that a systematic enforcement approach was necessary and has taken steps to implement all of our recommendations. For example, to provide better guidance to examiners, in July 1983 IRS issued Internal Revenue Manual provisions relating to the examiners' responsibilities in determining compliance with filing requirements listed on forms 990AR and 990PF returns.

In addition, to monitor the types of compliance, IRS incorporated into its management information system for fiscal year 1984 a revised listing of Exempt Organization Principal Issue Codes, which identifies issue being raised during an examination.

In October 1983 IRS announced its plans to assess penalties against exempt organizations and private foundations that fail to file complete annual returns. IRS intends to assess penalties under Internal Revenue Code section 6652(d) on 1983 and subsequent forms 990PF when, after being notified, an organization does not comply or give a reason for failure to file a complete return.

IRS' INSTALLATION OF CHECK-SORTING EQUIPMENT OFFERS ADVANTAGES TO THE GOVERNMENT

GAO/GGD-84-14
B-208617
11-21-83

Summary of finding

During fiscal year 1982, IRS deposited about $139.6 billion in commercial and Federal Reserve banks. Because most taxes are paid by check, the time it takes a depositary to sort and collect funds on checks is a key factor governing when funds are made available to the Treasury.

IRS believes check sorting will increase the availability of funds to the Treasury and is testing the feasibility of such operation. We see some additional advantages:

--IRS may be able to extend its deposit cutoff times at depositaries, and

--IRS' cost to install check-sorting equipment could be offset by reduced check-processing costs at Federal Reserve banks.

We expressed the view that IRS should consider all factors when deciding whether to install check-sorting equipment at its service centers.

Recommendation

We recommended that evaluations of whether to install check-sorting equipment at IRS service centers also consider (1) the potential interest earnings associated with extending the service centers' deposit times, (2) the costs and benefits derived from increased use of Federal Reserve banks as depositaries, and (3) the cost offsets to be gained through decreased check-processing costs for Federal Reserve depositaries.

Action taken and/or pending

IRS agreed with our recommendation and formed a working group made up of representatives from IRS, the Bureau of Government Financial Operations, the Office of Management and Budget, and the Federal Reserve Board to study a decision model for the procurement of check-sorting equipment at all IRS service centers. IRS stated that the factors cited in our recommendation would be considered in the decision process. The study is expected to be completed in June 1984.

FASTER DEPOSITS OF TAX RECEIPTS COLLECTED BY IRS FIELD OFFICES WOULD IMPROVE CASH MANAGEMENT

GAO/GGD-84-14
B-208617
11-21-83

## Summary of finding

IRS procedures required field offices to forward their tax receipts to district offices for processing and deposit. We estimated that over a one-year period, the time delays associated with sending field office tax receipts to district offices in IRS' North Atlantic and Central Regions resulted in foregone interest of about $1.3 million.

## Recommendation

We recommended that IRS, in conjunction with the Bureau of Government Financial Operations, reduce the deposit time for field office tax receipts. Allowing field offices to deposit receipts directly into local banks and/or mail tax receipts to designated bank lockboxes were two alternatives that could be considered in implementing this recommendation.

## Action taken and/or pending

IRS agreed with our recommendation and stated that it was preparing an implementation plan to centralize all remittance processing activities in its 10 service centers to accelerate availability of deposits. Implementation of this plan has been set for June 30, 1985. We agreed that centralization would expedite remittance processing, but we thought that additional time would be saved if field offices were given direct deposit authority. Accordingly, we expressed the belief that IRS should review its centralization decision to determine whether it could further reduce field and district office deposit time.

GREATER USE OF THE FEDERAL TAX DEPOSIT SYSTEM WOULD INCREASE INTEREST EARNINGS

GAO/GGD-84-14
B-208617
11-21-83

Summary of finding

The Federal Tax Deposit (FTD) system was established to expedite the availability of tax receipts to the Treasury by requiring that certain tax deposits be made to Treasury accounts at authorized financial depositaries. Preprinted cards--known as FTD cards--accompany such deposits.

Because some taxpayers send their payments to IRS instead of to financial depositaries, the government is losing the opportunity to earn millions in interest. We estimated that, in fiscal year 1981, about $2.3 million in foregone interest was associated with IRS' processing of about $1.3 billion in payments that were sent to the two service centers included in our review instead of to financial depositaries. Inasmuch as other IRS locations received payments and were required to follow similar processing procedures, we believe foregone interest during fiscal year 1981 could have exceeded $10 million on the $9.2 billion that all 10 IRS service centers received.

Recommendations

We recommended that the Commissioner of Internal Revenue:

--Require taxpayers to send all payments accompanied by FTD cards, including those payments with corrected cards, directly to financial depositaries.

--Develop a system that will enable IRS to make more informed decisions on whether to impose penalties on individuals who are not sending FTD payments to authorized depositaries.

Action taken and/or pending

IRS converted its FTD processing system to process documents which could be used for all types of taxes required by regulation to be paid to authorized depositaries. Taxpayers have been instructed to send all payments, including those with entity changes directly to authorized depositaries per the instructions in the FTD coupon book mailed on December 16, 1983.

Also, IRS said that it is designing a universal FTD form and that the FTD mailout responsibility is being transferred from the Bureau of Government Financial Operations to IRS. Both actions, which are scheduled to be completed by June 1984, are intended to enhance IRS' ability to enforce regulations concerning direct payments to authorized depositaries.

LESS REVIEW WOULD IMPROVE PROCESSING OF TAX REGULATIONS

GAO/GGD-84-12
B-209685
12-1-83

Summary of finding

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 Treasury staff, early evidence indicated that the changes may not be sufficient to soon reduce the backlog to manageable levels.

We found that Treasury should experiment with publishing some proposed regulations for public comment without review in Treasury. These regulations projects are routine in nature and, in IRS' view, have few, if any, policy implications. This change would enable Treasury 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 as well as enable Treasury attorneys to devote more of their time to the most important projects.

Recommendation

We recommended that the Secretary of the Treasury, in consultation with the Commissioner of Internal Revenue, experiment with publishing some proposed regulations for public comment without prior Treasury review.

Action taken and/or pending

Treasury disagreed with this recommendation and consequently plans to take no action.

LACK OF ADEQUATE MANAGEMENT INFORMATION HAS HINDERED TAX REGULATIONS ISSUANCE

GAO/GGD-84-12
B-209685
12-1-83

Summary of finding

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.

While it is clear that sufficient resources have not been available in Tax Legislative Counsel, current management information makes it difficult to determine what the permanent staff levels for Treasury should be. More precise information on the proportion of Treasury attorney's 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 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.

Recommendation

We recommended that the Secretary of the Treasury 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.

Action taken and/or pending

Treasury and IRS agreed with this recommendation. They told us that they are studying (1) ways to implement the system to highlight the long-delayed projects and (2) the feasibility of developing a time reporting system for their staffs. For

example, IRS' UNIVAC Automated System, which is scheduled to be implemented in June 1984, should enable IRS to identify all projects with extensive time lags in a particular status by capturing time frames for each phase of the processing of every case.

As to gathering staff time, IRS said that although a program has been developed for including attorney time in the automated data base, IRS intended to advise the Assistant Secretary (Tax Policy) that such a system would be useful only if Treasury also maintained this information with regard to its attorneys. Accordingly, IRS did not intend to institute such a system until such time as Treasury institutes a program for gathering this data. On January 13, 1984, IRS prepared a letter advising Treasury of its plans. Treasury is now considering this matter.

## A LISTING OF REPORTS ON TAX MATTERS ISSUED DURING 1983

| Title | Date |
|---|---|
| Legislation Needed to Improve Administration of Tax Exempt Provisions for Electric Cooperatives (GAO/GGD-83-7) | 1/5/83 |
| IRS' Administration of Penalties Imposed on Tax Return Preparers (GAO/GGD-83-6) | 1/6/83 |
| Legislative Change Needed to Enable IRS to Assess Taxes Voluntarily Reported by Taxpayers in Bankruptcy (GAO/GGD-83-47) | 6/20/83 |
| Self-Employed Fiscal Year Taxpayers Can Receive an Advantage Compared to Self-Employed Calendar Year Taxpayers at the Social Security Trust Fund's Expense (GAO/HRD-83-45) | 6/30/83 |
| Compilation of GAO's Work on Tax Administration Activities During 1982 (GAO/GGD-83-89) | 8/12/83 |
| With Better Management Information IRS Could Further Improve its Efforts Against Abusive Tax Shelters (GAO/GGD-83-63) | 8/25/83 |
| Computer Technology at IRS: Present and Planned (GAO/GGD-83-103) | 9/1/83 |
| Public Information Reporting by Tax-Exempt Private Foundations Need More Attention by IRS (GAO/GGD-83-58) | 9/26/83 |
| Follow-Up of Guam's Administration of its Income Tax Program (GAO/GGD-84-11) | 10/26/83 |
| Expediting Tax Deposits Can Increase the Government's Interest Earnings (GAO/GGD-84-14) | 11/21/83 |
| Further Improvements Needed In Processing Tax Regulations (GAO/GGD-84-12) | 12/1/83 |

## A LISTING OF TESTIMONIES GIVEN ON TAX MATTERS BY GAO OFFICIALS DURING 1983

| GAO Official | Congressional Committee | Subject Matter | Date |
|---|---|---|---|
| William J. Anderson, Director, General Government Division | Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations | Federal Efforts To Define and Combat the Tax Haven Problem | 4/12/83 |
| Authur J. Corazzini, Deputy Director, Program Analysis Division | Subcommittee on Select Revenue Measures, House Ways and Means Committee | Taxation of the U.S. Life Insurance Industry | 5/10/83 |
| Johnny C. Finch, Associate Director, General Government Division | Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations | Efforts To Enforce Tax Exempt Private Foundation Reporting Requirements | 5/11/83 |
| Harry S. Havens, Assistant Comptroller General For Program Evaluation | Senate Finance Committee | Taxation of the U.S. Property/Casualty Insurance Industry | 6/13/83 |
| Johnny C. Finch, Associate Director, General Government Division | Subcommittee on Oversight, House Committee on Ways and Means | The Operations and Activities of Private Foundations | 6/28/83 |
| Johnny C. Finch, Associate Director, General Government Division | Committee on Ways and Means, House of Representatives | House Bill 3475, Tax Law Simplification and Improvement Act of 1983 | 7/25/83 |
| John F. Simonette, Associate Director, Accounting and Financial Management Division | Subcommittee on Oversight of the Internal Revenue Service, Senate Finance Committee | Offset of Federal Tax Returns | 9/16/83 |



ENCLOSURE V

## SCOPE AND SUBJECT MATTER OF TAX RELATED JOBS INITIATED PURSUANT TO PUBLIC LAW 95-125 DURING 1983

| Subject matter | Objective/scope | Month started |
|---|---|---|
| Volunteer Taxpayer Assistance | To examine the interrelationships among the various providers of taxpayer assistance.<br><br>To determine the similarities and differences between the kinds of assistance provided and types of taxpayers served by the various providers.<br><br>To determine whether there are ways IRS can better use other groups to provide assistance.<br><br>To determine the extent to which the IRS should focus its efforts on particular kinds of assistance and target groups. | January |
| Administration of Windfall Profit Tax on Alaskan North Slope Crude Oil | To review IRS' efforts to administer the Windfall Profit Tax on Alaskan North Slope Crude Oil, particularly such issues as wellhead pricing, tariffs, and ocean transportation costs. | February |
| Occupational Taxes | To develop a methodology for measuring the occupational tax compliance rate and the revenue lost through noncompliance.<br><br>To identify those occupational taxes which appear to cost the federal government more than the revenue they generate. | February |

| Subject matter | Objective/scope | Month started |
|---|---|---|
| Occupational taxes (continued) | To identify potential alternative methods for administering occupational taxes. | February |
| Further Tax Withholding | To identify the major pockets of noncompliance involving nonreporting or underreporting where further withholding might be applicable. | February |
| | To determine the feasibility of assessing the potential costs and revenue and compliance benefits associated with applying further withholding versus using other compliance enforcement methods. | |
| | To develop alternative approaches for reviewing the withholding area and prepare the necessary documentation for initiating the first review. | |
| Costs and Revenue Benefits of Further Tax Withholding | To identify major pockets on noncompliance involving nonreporting or underreporting where further with holding might be applicable. | February |
| | To determine feasibility of assessing potential costs, revenue, and compliance benefits associated with applying further withholding versus using other compliance enforcement methods. | |
| Unreported Illegal Income | To evaluate IRS' efforts to detect, investigate, and tax unreported income from illegal activities. | March |

| Subject matter | Objective/scope | Month started |
|---|---|---|
| Unreported Illegal Income (continued) | To identify specific issues and problems warranting a more detailed review. | March |
| IRS' Automation Activities | To assess how well IRS is planning and managing its automation initiatives so that new equipment and improved systems are adopted in the most economical, effective, and and efficient way possible. | March |
| IRS' Administration Of Tax Exempt Organization Unrelated Business Income Tax | To determine whether IRS has an efficient and effective system to identify unrelated business income and ensure the collection of taxes due.<br><br>To determine whether IRS' administration of the unrelated business income tax provision of the Code results in consistent tax treatment among exempt organizations.<br><br>To determine whether the Code provisions and implementing IRS regulations (1) contain sufficient criteria regarding what constitutes unrelated business income to foster payment of the tax and facilitate IRS administration, and (2) prevent exempt organizations from benefiting from unrelated business activities and tax avoidance. | March |
| IRS' Payment of Interest | To assess the potential impact of the Tax Equity and Fiscal Responsibility Act of 1982 on interest costs. | May |

| Subject matter | Objective/scope | Month started |
|---|---|---|
| IRS' Payment of Interest (continued) | To determine whether IRS can take certain administrative actions to improve its returns processing procedures, thereby reducing the number and amount of interest payments. | May |
| Tax Treaty/Tax Haven Abuse | To identify those income tax treaties or pending treaties that do not appear to contain adequate provisions to prevent abuse by persons<br><br>To analyze the adequacy of Treasury's approach to negotiating or modifying those treaties.<br><br>To determine the extent to which the use of these treaties is monitored by IRS and the respective countries. | June |
| Chief Counsel Activities | To evaluate the effectiveness of the Office of Chief Counsel and how well it is managed. | June |
| IRS' Economy and Efficiency Efforts | To determine what economy and efficiency related studies and programs have been performed by IRS.<br><br>To identify potential IRS programs and activities which warrant further review. | June |
| Data Exchanged by IRS and States | To evaluate the extent of federal use of state data to ensure that IRS is taking full advantage of such data. | July |

| Subject matter | Objective/scope | Month started |
|---|---|---|
| Data Exchanged by IRS and States (continued) | To evaluate the extent of state use of federal data to ensure that federal tax data is being used effectively.<br><br>To determine what other state data is available for federal use as well as other federal data states could use.<br><br>To determine ways to improve the efficiency of the exchange process, especially through better use of automation and program management improvements. | July |
| Computer Based Support for the Information Returns Program | To determine whether the IRP computer-based systems contain sufficient internal controls to ensure accurate and reliable data processing.<br><br>To determine whether the current IRP computer-based systems and document matching methods are as efficient and effective as possible or whether alternative computer methodologies would be more efficient and effective.<br><br>To determine the potential impact that the Tax Equity and Fiscal Responsibility Act of 1982 will have on the existing IRP computer-based systems regarding capacity to process additional information returns. | September |

| Subject matter | Objective/scope | Month started |
|---|---|---|
| IRS' Unrelated Business Income Examination Process | To determine how efficiently and effectively IRS uses its examination process to administer and assure compliance with the unrelated business income tax provisions of the Internal Revenue Code. | October |
| State Refund Reporting | To review the impact of Section 313 of the Tax Equity and Fiscal Responsibility Act of 1982 on state and local governments. | October |
| IRS' ADP Initiatives | To determine the impact of IRS' ADP initiatives on the effectiveness and productivity of the returns processing system.<br><br>To determine if ADP initiatives are being managed and coordinated effectively to ensure that they are (1) directed toward common objectives, (2) effectively integrated, and (3) in consonance with IRS' long range or strategic plans. | November |
| IRS' Written Communication With Taxpayers | To determine the extent to which unclear written communications may be contributing unnecessarily to the demand for IRS assistance.<br><br>To determine whether and how IRS can clarify its communications with taxpayers. | December |

| Subject matter | Objective/scope | Month started |
| --- | --- | --- |
| IRS' Tax Gap Study | To determine whether IRS' estimates of the tax gap are reliable enough for the Congress to use in both designing tax legislation and in preparing and overseeing the budget.<br><br>To determine the potential for closing the tax gap. | December |

ENCLOSURE VII

GAO FORM-379 (Aug 72)
United States
General Accounting Office
Operations Manual

# Order

0135.1

AUDITS OF THE INTERNAL REVENUE SERVICE AND THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS INVOLVING ACCESS TO TAX RETURNS AND TAX RETURN INFORMATION

August 25, 1980

GAO NOTE:

This order is being revised to incorporate additional access authority given to GAO in the Tax Equity and Fiscal Responsibility Act of 1982. Section 358 of the Act authorizes GAO access to tax returns and return information in the possession of any Federal agency when GAO is auditing a program or activity of the agency which involves the use of tax information. Furthermore, under certain circumstances, GAO is permitted access to tax information that a Federal agency could have requested for nontax administration purposes.

Distribution C, N, R, and S

Initiated by General Government Division

ENCLOSURE VII

GAO FORM-379A (Aug. 72)

RECORD OF CHANGES

| CHANGE NO. | DATE OF CHANGE | DATE ENTERED | INITIALS OF PERSON ENTERING CHANGE |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |

August 25, 1980

0135.1

TABLE OF CONTENTS

| Appendix Figure | Paragraph | Title | Page |
|---|---|---|---|
| | TABLE OF CONTENTS | | 1 |
| | 1. | Purpose, Scope, and Applicability | 1 |
| | 2. | Supersession | 1 |
| | 3. | References | 1 |
| | 4. | Delegation of Authority | 2 |
| | 5. | Initiating Audits | 2 |
| | 6. | Designation of GAO Officials Having Access to Tax Returns and Tax Return Information | 3 |
| | 7. | Safeguard Requirements | 3 |
| | 8. | Disclosure Accounting | 4 |
| | 9. | Annual Report | 5 |
| APPENDIX 1. | DISCLOSURE ACCOUNTING FOR TAX RETURNS AND TAX RETURN INFORMATION OBTAINED WHEN DOING AUDITS OF THE INTERNAL REVENUE SERVICE AND THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS | | |
| | 1. | Purpose | 1 |
| | 2. | Background | 1 |
| | 3. | What Is To Be Recorded | 2 |
| | 4. | Implementing Procedures | 2 |
| | | a. Disclosures to GAO by IRS and ATF | 2 |
| | | b. Disclosures to GAO by Others | 3 |
| | | c. Requests for Tax Information Made of GAO by Others | 3 |
| Figure A1-1. | Disclosure Control Document | | 4 |
| APPENDIX 2. | CONDITIONS UNDER WHICH GAO WILL ACCEPT FROM THE CONGRESS NAMES OF TAXPAYERS SUSPECTED OF INCORRECT REPORTING OF INCOME WHEN AUDITING IRS' ADMINISTRATION OF THE TAX LAWS | | |
| | 1. | Statement of Principle | 1 |
| | 2. | Work Done Under GAO Authority | 1 |
| | | a. Receipt of Names from Tax Writing Committees and Appropriate Oversight Committees or Subcommittees | 1 |
| | | b. General Operating Procedures | 2 |
| | 3. | Work Done Under Committee Authority | 2 |

GAO FORM - 378 (Aug 72)

United States
General Accounting Office
Operations Manual

# Order

0135.1

August 25, 1980

**Subject:** AUDITS OF THE INTERNAL REVENUE SERVICE AND THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS INVOLVING ACCESS TO TAX RETURNS AND TAX RETURN INFORMATION

1. PURPOSE, SCOPE, AND APPLICABILITY. This order:

a. Provides for delegation of authority, assignments of responsibility, and establishes policies and procedures in carrying out GAO audits of the Internal Revenue Service (IRS) and the Bureau of Alcohol, Tobacco and Firearms (ATF).

b. States policies and procedures that are designed to preclude the unauthorized disclosure of tax returns and tax return information coming into the custody of the U.S. General Accounting Office (GAO) or its employees.

c. Establishes minimum standards governing the transmission, custody, and disclosure of tax returns and tax return information, consistent with the provisions of sections 4424 and 6103 of the Internal Revenue Code.

d. Applies to all GAO organizational elements.

NOTE. References throughout this order to the safeguarding of tax returns and tax return information means the safeguarding of information so as to preclude disclosure of tax returns and tax return information in any form which would enable association with or identification of a particular taxpayer. Nothing in this order shall be construed as authorizing disclosure, dissemination, release, handling, or transmission of tax returns and tax return information contrary to the specific provisions of any law.

2. SUPERSESSION. This order supersedes GAO Order 0135.1, Audits of the Internal Revenue Service and the Bureau of Alcohol, Tobacco and Firearms
* Involving Access to Tax Returns and Tax Return Information, June 27, 1978.

* NOTE. Asterisks have been used to indicate the new or revised information.

3. REFERENCES.

a. Public Law 95-125.

b. 31 U.S.C. 67.

c. 26 U.S.C. 7213 and 7217.

Distribution C, N, R, and S Initiated by General Government Division

d. 18 U.S.C. 1905.

e. Sections 4424 and 6103 of the Internal Revenue Code.

4. DELEGATION OF AUTHORITY.

a. In accordance with the provisions of subsection (d)(3) of section 117 of the Accounting and Auditing Act of 1950 (31 U.S.C. 67) as added by Public Law 95-125, the Comptroller General of the United States will once every 6 months designate in writing the name and title of each officer and employee of GAO who is to have access to tax returns and tax return information, or any other IRS or ATF information in a form which can be associated with or otherwise identify, directly or indirectly, a particular taxpayer.

b. Authority is hereby delegated to the Director, General Government Division (GGD), to make such interim designations in writing of additional persons who are to have access to the information described above as might become necessary in connection with any audit. As in the case of designations made by the Comptroller General, each written designation made by the Director, GGD, or a certified copy thereof, shall be delivered promptly to the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, the Joint Committee on Taxation, the Committee on Government Operations of the House of Representatives, the Committee on Governmental Affairs of the Senate, the Commissioner of IRS, and the Director of ATF.

c. The authority hereby delegated to the Director, GGD, may be redelegated to the Associate Director in charge of tax administration audits.

5. INITIATING AUDITS. The following policies and procedures will apply to audits of IRS and ATF for which access to tax returns or tax return information is required:

a. A tentative assignment authorization (GAO Form 100) will be prepared by the tax administration group approximately 45 days before the planned initiation of audit work at IRS or ATF. This preliminary work authorization will be forwarded to the Comptroller General together with an appropriate letter for his signature, notifying the Joint Committee on Taxation of the audit as required by the provisions of subsection 6103(i)(6)(B) of the Internal Revenue Code.

b. The signed letter will be hand-carried to the secretary of the Chief of Staff of the Joint Committee on Taxation and evidence of receipt obtained showing date and time of delivery.

c. Except where unusual circumstances warrant otherwise, notice of the contemplated audit will be provided to the Commissioner of IRS or the Director of ATF, as appropriate, by furnishing them a copy of the Comptroller General's letter after delivery to the Joint Committee on Taxation.

d. Upon expiration of 30 days after delivery of the Comptroller General's notice to the Joint Committee without Committee objection or upon receipt of an affirmative response from the Committee to such notice, a letter will be forwarded to the Comptroller General for signature making request of the Commissioner of IRS or the Director of ATF as provided in subsection 6103(i)(6)(A) of the Internal Revenue Code, for access to the tax returns and tax return information required for purposes of the audit.

e. GAO and IRS or ATF will then follow the procedures agreed upon regarding the liaison activities that apply in the conduct of GAO audits, and the GAO staff making the audits will complete final assignment authorizations (GAO Form 100) in accordance with normal GAO policies and procedures.

6. DESIGNATION OF GAO OFFICIALS HAVING ACCESS TO TAX RETURNS AND TAX RETURN INFORMATION.

a. The Comptroller General will, at least every 6 months, designate in writing the name and title of each officer and employee of GAO who shall have access to tax returns and tax return information for the purpose of carrying out audits authorized by Public Law 95-125 and section 6103 of the Internal Revenue Code. The Associate Director in charge of tax administration activities shall be responsible for forwarding to the Comptroller General through the Director, GGD, the names of GAO officers and employees whom the Comptroller General should designate every 6 months. The Associate Director of the General Government Division responsible for tax administration activities shall be responsible for delivering to the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, the Joint Committee on Taxation, the Committee on Government Operations of the House of Representatives, the Committee on Governmental Affairs of the Senate, the Commissioner of IRS, and (when appropriate) the Director of ATF certified copies of the lists of GAO officers and employees authorized access.

b. The Director, GGD, shall be responsible for making interim additions or deletions to the list of GAO officers and employees authorized to have access to tax returns and tax return information and for advising the committees and officials set forth in paragraph 6a of such interim additions or deletions.

7. SAFEGUARD REQUIREMENTS. The policies and procedures established to preclude the unauthorized disclosure of tax returns and tax return information coming into the custody of GAO depends upon the alertness, reliability, and discretion of every individual who receives tax returns and tax return information. The importance of effective security and of the position of trust imposed upon each individual who has possession, access, or control of such
* information is indicated by (1) the criminal penalties imposed by 18 U.S.C. 1905
* and 26 U.S.C. 7213 which provide for a maximum penalty not to exceed $5,000
* and/or imprisonment of not more than 5 years and, (2) the authority for obtaining
* civil damages under 26 U.S.C. 7217.

a. Access to and Dissemination and Control of Tax Returns and Tax Return Information. The following principles and requirements will be adhered to in GAO:

(1) Access to tax returns and tax return information shall be limited to those employees of GAO designated by the Comptroller General

or his designee as having a need for such returns and information in connection with the carrying out of their official duties. No person shall be entitled to knowledge or possession of, or access to, tax returns and tax return information solely by virtue of his office or position.

(2) A listing of individuals designated by the Comptroller General or his designee will be provided to the Commissioner of Internal Revenue or to the Director of the Bureau of Alcohol, Tobacco and Firearms, and to others as required by law.

(3) Tax returns and tax return information shall not be disseminated to or discussed with or in the presence of unauthorized persons.

(4) Any person who has knowledge of the loss or possible compromise of any tax return or tax return information shall promptly report the circumstances to the Comptroller General or his designee who SHALL TAKE APPROPRIATE ACTION FORTHWITH, INCLUDING ADVICE TO THE INTERNAL REVENUE SERVICE OR THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS, AS THE CASE MAY BE.

b. Physical Control Over Tax Returns and Tax Return Information. Representatives of the General Accounting Office designated by the Comptroller General or his designee shall be responsible for maintaining, as a minimum, control over tax returns and tax return information consistent with security requirements maintained by the Internal Revenue Service and the Bureau of
* Alcohol, Tobacco and Firearms. The Internal Revenue Service requirements
* in this regard are set forth in the Service's Physical and Document Security
* Handbook.

(1) When documents cannot be personally transmitted between authorized recipients, the transmittal of tax returns and tax return information and related working papers shall be transferred by registered mail with a return receipt to be signed by a designated representative who is authorized access to tax returns and tax return information.

(2) Tax returns and tax return information and related working papers including computerized files shall be stored under the sole control of designated employees who are authorized access to tax returns and tax return information. When copies of tax returns and tax return information and related working papers are no longer needed, they shall be destroyed under the supervision of a designated representative who is authorized access to tax returns and tax return information. GAO shall NOT retain custody of original tax returns except by special arrangement made with the Commissioner of Internal Revenue or his designee.

(3) Computer files containing tax return information shall be protected against disclosure to unauthorized personnel when being processed at non-IRS or non-GAO computer facilities. The following safeguards should be adhered to:

(a) ALL processing phases shall be monitored by onsite designated employees who are authorized access to tax returns and tax return information.

(b) ALL output resulting from processing shall be received by designated employees at the end of processing.

(c) ALL files, reports, and related items shall be secured before and after processing in accordance with paragraph 7b(2).

(d) ALL undesired computer listings and reports shall be properly disposed of by designated employees.

(e) No tax information shall be left in computer memory at the end of processing.

c. General. The Comptroller General or his designee will cooperate with the Commissioner of Internal Revenue and the Director of the Bureau of Alcohol, Tobacco and Firearms, in implementing any additional control or safeguard deemed necessary to provide security of tax returns and tax return information in the possession of GAO.

8. DISCLOSURE ACCOUNTING. In accordance with the provisions of section 6103(p)(3) and (4) of the Internal Revenue Code, the Director, GGD, shall be responsible for establishing and implementing an appropriate system
* of standardized records to record any GAO request and subsequent receipt and
* authorized disclosure of tax returns and tax return information in accordance with rules and procedures established by the Secretary of the Treasury. This procedure appears as appendix 1 to this order.

9. ANNUAL REPORT.

a. The GGD Associate Director responsible for tax administration activities shall be responsible for preparing the annual report on audits of IRS and ATF required in accordance with section 4 of Public Law 95-125. The annual report will be submitted by the Comptroller General to the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, the Joint Committee on Taxation, the Committee on Government Operations of the House of Representatives, and the Committee on Governmental Affairs of the Senate as soon as possible after the close of of each calendar year.

b. Upon compilation of the appropriate information needed for the annual report, the Associate Director shall forward it for transmittal from the Comptroller General.

2 Appendixes:
1. Disclosure Accounting for Tax Returns and Tax Return Information Obtained When Doing Audits of the Internal Revenue Service and the Bureau of Alcohol, Tobacco and Firearms
2. Conditions Under Which GAO Will Accept from the Congress Names of Taxpayers Suspected of Incorrect Reporting of Income when Auditing IRS' Administration of the Tax Laws

# APPENDIX 1. DISCLOSURE ACCOUNTING FOR TAX RETURNS AND TAX RETURN INFORMATION OBTAINED WHEN DOING AUDITS OF THE INTERNAL REVENUE SERVICE AND THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

## 1. PURPOSE.

a. This appendix implements paragraph 8 of this GAO Order 0135.1, Audits of the Internal Revenue Service and the Bureau of Alcohol, Tobacco and Firearms Involving Access to Tax Returns and Tax Return Information, approved by the Comptroller General. The subject paragraph provides that the Director, General Government Division (GGD), shall be responsible for establishing and implementing an appropriate system of standardized records to record any GAO request and subsequent receipt of tax returns and tax return information in accordance with the rules and procedures established by the Secretary of the Treasury.

b. The procedures described below apply to all GAO organizational elements that undertake work in the tax administration area pursuant to GAO Order 0135.1.

## 2. BACKGROUND.

a. Section 117 of the Accounting and Auditing Act of 1950 (31 U.S.C. 67), as added to by Public Law 95-125, authorizes GAO to make audits of the Internal Revenue Service (IRS) and the Bureau of Alcohol, Tobacco and Firearms (ATF). Section 6103(i)(6) of the Internal Revenue Code authorizes IRS and ATF to disclose tax returns and tax return information to designated GAO officers and employees for the purpose of and to the extent necessary in making these audits. Section 6103(b) of the Internal Revenue Code defines return, tax returns, and tax return information.

b. These laws also place several recordkeeping requirements on GAO. Among these, GAO is to maintain records of its accesses to tax returns and tax return information provided by (1) IRS and ATF and (2) such other agencies, bodies, or commissions that are subject to GAO audit under section 6103(p)(6) of the Internal Revenue Code. GAO is also to maintain records of any requests it receives for tax returns or tax return information.

(1) Section 6103(p)(4)(A) of the Code requires GAO to--

"establish and maintain, to the satisfaction of the Secretary, a permanent system of standardized records with respect to any request, the reason for such request, and the date of such request made by or of it and any disclosure of return or return information made by or to it; * * *."

(2) Section 6103(p)(6)(B)(i) of the Code requires GAO to--

"maintain a permanent system of standardized records and accountings of returns and return information inspected by officers and employees of the General Accounting Office under

subsection (i)(6)(A)(ii) and shall, within 90 days after the close of each calendar year, furnish to the Secretary a report with respect to, or summary of, such records or accountings in such form and containing such information as the Secretary may prescribe, * * *."

3. WHAT IS TO BE RECORDED.

a. The primary purpose of the disclosure provisions of section 6103 of the Code is to insure that an audit trail exists whenever IRS discloses to anyone any tax information in any form which can identify an individual taxpayer. IRS is responsible for determining when a disclosure occurs and for documenting each disclosure. GAO will rely on IRS determinations and recordings as they pertain to disclosures by IRS to GAO. The IRS records therefore will be the basis for GAO's standardized records in these instances.

b. When carrying out audits pursuant to section 6103(p)(6) of the Code, GAO will use as a basis for its records the determinations and recordings implemented by the entity under audit pursuant to disclosure procedures issued by IRS.

4. IMPLEMENTING PROCEDURES. To meet these requirements, the following procedures are established.

a. Disclosures to GAO by IRS and ATF.

(1) All disclosures will be recorded by job code.

(2) Authorized GAO personnel at the location where the disclosure is made will arrange with the IRS Disclosure Officer to obtain a copy of each IRS record of disclosure to GAO. IRS personnel are responsible for preparing these records generally on IRS Forms 5466 and 5466A. A copy of the IRS records should be obtained on a daily basis.

(3) The copies of IRS Forms 5466 and 5466A and/or other appropriate IRS records will be used by GAO staff for DAILY posting to GGD Form 4, GAO Disclosure Control Document. (See figure A1-1.) A separate disclosure control document must be kept by each GAO work location for each job. The copies of IRS Forms 5466 and 5466A and/or other appropriate IRS records should be retained as support for the GGD Form 4. MONTHLY, each work location will forward a copy of the GGD Form 4 showing the month's postings to the GGD Associate Director responsible for tax administration reviews. If no disclosures were made during the month, so advise the Associate Director. If the IRS Disclosure Officer at a particular IRS location where GAO is working, requests a copy of the monthly form, it can be provided.

(4) GGD Form 4 and the supporting IRS disclosure documents will be maintained in a separate folder at each work location until job completion. At the end of the job, the complete folder will be sent to the GGD Associate Director responsible for tax administration.

(5) Similar procedures will be used for work performed at ATF.

b. Disclosures to GAO by Others.

(1) Any other authorized agency, body, or commission, as a condition for receiving returns or return information from IRS, must under section 6103(p)(4) of the Internal Revenue Code, establish and maintain to the satisfaction of the Secretary, a permanent system of standardized records with respect to any request, the reason for such request, and the date of such request made by or of it, and any disclosure of return or return information made by or to it. To accumulate data needed to meet our reporting responsibilities when undertaking any audit pursuant to section 6103(p)(6)(A) of the Code, we will use the disclosure forms prepared by the entity under audit and follow the procedures set forth above for disclosures by IRS and ATF.

(2) Using the information produced as a result of these procedures, the GGD Associate Director responsible for tax administration reviews will prepare and forward to the Director, GGD, all appropriate material necessary for the Director to furnish to the Secretary of the Treasury the report required by section 6103(p)(6)(B) of the Code.

c. Requests for Tax Information Made to GAO by Others.

(1) By law, GAO cannot disclose any tax return or return information to anyone except Congressional Committees when acting as their agents pursuant to section 6103(f) of the Code and the Secretary of the Treasury pursuant to section 6103(p)(6) of the Code. Any requests made pursuant to such sections should be directed to the GGD Associate Director responsible for tax
* administration reviews who will be responsible for accounting for such requests
* pursuant to the requirements of section 6103(p)(4)(A) of the Code.

(2) Nevertheless, others could request such information from GAO. Whenever any such request is made of any GAO employee, the employee should immediately refer the requester to the GGD Associate Director responsible for tax administation reviews, explaining that all such requests must be made to the GGD Associate Director. The GGD Associate Director will deny such requests and be responsible for accounting for such requests pursuant to the requirement of section 6103(p)(4)(A) of the Code.

0135.1
Appendix 1

August 25, 1980

FIGURE A1-1. DISCLOSURE CONTROL DOCUMENT

GGD Form 4
(12-77)

U.S. GENERAL ACCOUNTING OFFICE

TAX ADMINISTRATION
DISCLOSURE CONTROL DOCUMENT

GAO OFFICE: _____

JOB TITLE: | JOB CODE:

| WORK-PAPER INDEX | DATE OF DISCLOSURE | IRS LOCATION (REGIONAL OFFICE, DISTRICT OFFICE, SERVICE CENTER, ETC.) | TYPE OF DOCUMENT (TAX RETURN, DATA PROCESSING RUN, CORRESPONDENCE, ETC.) | NUMBER OF TAXPAYERS ON DISCLOSURE FORM |
|---|---|---|---|---|
| | | | | |
| | | | | |
| | | | | |

August 25, 1980

0135.1
Appendix 2

APPENDIX 2. CONDITIONS UNDER WHICH GAO WILL ACCEPT FROM THE CONGRESS NAMES OF TAXPAYERS SUSPECTED OF INCORRECT REPORTING OF INCOME WHEN AUDITING IRS' ADMINISTRATION OF THE TAX LAWS

1. STATEMENT OF PRINCIPLE.

a. GAO does not believe it would be consistent with the law providing for its audits of tax administration to investigate and report on the tax status of specific taxpayers identified for GAO by others. The legislative history of Public Law 95-125, as exemplified by the following quotes from House Report No. 95-480, is clear that GAO is not to concern itself with the returns of individual taxpayers:

> "The purpose of the legislation is to resolve * * * the right of the GAO to gain access to records necessary to perform regular audits of the Service. * * *
>
> "[The legislation] scrupulously safeguards the privacy and integrity of income tax returns and information from unauthorized disclosure. * * *
>
> * * * * *
>
> "In performing an audit of IRS, [GAO] would not be concerned with the identity of individual taxpayers nor * * * would [GAO] impose [its] judgment upon that of IRS in individual tax cases. [GAO] would examine the individual transactions on a sample basis and only for the purpose of evaluating the effectiveness of IRS' operations and activities."

b. To assure full compliance with the spirit of the law, GAO audits of the way IRS administers the tax laws will normally be based on a random sampling from appropriate universes of tax returns and return information rather than preselection of individual tax returns. The circumstances and procedures under which GAO will accept from committees and Members of Congress the names of taxpayers suspected of incorrectly reporting income, expenses, or deductions on their tax returns are set forth in the guidelines stated in the paragraphs below.

2. WORK DONE UNDER GAO AUTHORITY. When GAO initiates a review pursuant to Public Law 95-125 and section 6103(i)(6) of the Internal Revenue Code, tax returns and return information will be obtained by sampling from appropriate universes.

a. Receipt of Names from Tax Writing Committees and Appropriate Oversight Committees or Subcommittees.

(1) If the House Ways and Means Committee, Senate Finance Committee, Joint Committee on Taxation, or committees or subcommittees having a jurisdictional interest in the administration of the tax laws

have knowledge of possible incorrect reporting of income, expenses, or deductions on tax returns by specific taxpayers and want to provide the names of such taxpayers to GAO for audit purposes, GAO will first suggest that they turn the information over directly to the Internal Revenue Service. If these committees still want to turn the names of such taxpayers over to GAO, GAO will accept them upon receipt of a letter signed by the Chairman of these committees or subcommittees or the Chief of Staff of the Joint Committee on Taxation.

(2) GAO will not accept the names of taxpayers for audit purposes from any other congressional committee or Member. GAO will advise other committees and Members that they should send the names directly to the Internal Revenue Service.

b. General Operating Procedures.

(1) GAO may analyze the tax returns and return information provided to it by the tax writing committees, the Joint Committee on Taxation, or comittees or subcommittees having a jurisdictional interest in the administration of the tax laws to gain a better understanding of the issues involved in an ongoing or planned review GAO might make of the way IRS administers the tax laws.

(2) GAO will not intentionally incorporate any names or information so provided into any samples it draws to carry out its audits of IRS' administration of the tax laws. However, if such names are selected as part of a random sampling of appropriate universes, GAO will analyze the circumstances of that taxpayer in the same way it would for all taxpayers so selected.

(3) GAO will not report or disclose to anyone outside of IRS or GAO the names of taxpayers included in its samples or any information on sampled taxpayers. Nor will GAO advise anyone who provided it names of taxpayers any information obtained by GAO about those taxpayers.

(4) The disclosure restrictions cited above are consistent with the December 15, 1977 conclusion of the GAO General Counsel that:

> "* * * except when we act as agents of a committee or subcommittee pursuant to section 6103(f)(4), we do not believe that section 6103 authorizes us to disclose to a committee or subcommittee of Congress any tax return or return information obtained during the course of a self-initiated audit of IRS."

3. WORK DONE UNDER COMMITTEE AUTHORITY.

a. When designated by the House Ways and Means Committee, Senate Finance Committee, or the Joint Committee on Taxation pursuant to section 6103(f)(4) of the Internal Revenue Code, GAO can accept the names of taxpayers from such committee(s) and report back information on such taxpayers to those

August 25, 1980

0135.1
Appendix 2

committees. GAO can do the same when designated by other committees acting pursuant to a concurrent resolution or resolution by either House under the provisions of section 6130(f)(4) of the Internal Revenue Code.

b. However, even in these cases it is GAO policy to encourage the above-mentioned committees to provide the names of specific taxpayers directly to the Internal Revenue Service if there is any suspicion on the committees' part that the taxpayers have possibly incorrectly reported income, expenses or deductions.



*U.S. GOVERNMENT PRINTING OFFICE : 1984 0-421-843/266

28643

**AN EQUAL OPPORTUNITY EMPLOYER**

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON D.C. 20548

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE $300

POSTAGE AND FEES PAID
U.S. GENERAL ACCOUNTING OFFICE

**THIRD CLASS**