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

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IRS' 1996 TAX FILING SEASON

Performance Goals Generally Met; Efforts to Modernize Had Mixed Results





United States
General Accounting Office
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General Government Division

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The Honorable Nancy L. Johnson
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Chairman Johnson:

This report responds to your request that we assess the Internal Revenue Service's (IRS) performance during the 1996 tax filing season. Specifically, we discuss (1) IRS' overall performance during the filing season, including information on changes in 1996 that relate to taxpayer services and the processing of taxpayer refunds, and (2) some of IRS' efforts to modernize its processing activities. In March 1996, we testified before the Oversight Subcommittee on the interim results of our work.¹

Results in Brief

IRS uses various indicators to measure its performance during a particular filing season. On the basis of those indicators alone, the 1996 filing season would be considered generally successful. For example, IRS met or exceeded its timeliness and accuracy goals for processing individual income tax returns and issuing taxpayer refunds, answered more telephone calls from taxpayers seeking assistance than it had planned to answer, and received more returns through alternative filing methods than it had projected. Contributing to the generally successful filing season were improvements in two areas that were the sources of problems in 1995 (i.e., answering taxpayers' telephone calls for assistance and issuing taxpayer refunds).

As compared with the 1995 filing season, IRS received about 119 million fewer telephone calls for assistance and answered about 4 million more calls during the 1996 filing season. That combination of reduced demand and increased service enabled IRS to increase the percentage of calls answered from 8 to 20 percent and to increase the percentage of callers who were eventually able to get through to IRS from 41 to 50 percent. Although these results are much better than last year, there is still considerable room for improvement.

In 1995, IRS delayed about 7 million refunds to allow itself time to verify Social Security Numbers (SSN), with an emphasis on returns claiming the

¹Tax Administration: IRS' Fiscal Year 1996 and 1997 Budget Issues and the 1996 Filing Season (GAO/T-GGD-96-99, Mar. 28, 1996).

Earned Income Credit (EIC).² Although that verification effort had some positive results, there were problems. For example, IRS identified many more missing or invalid³ SSNs than it was able to pursue and eventually released the refunds, after several weeks, without resolving the problems. For the 1996 filing season, IRS revised its procedures to (1) limit the number of delayed refunds to the volume of cases it could review and (2) focus on the cases most in need of review. As a result, IRS delayed many fewer refunds in 1996 than it did in 1995 and avoided the kind of negative press it received in 1995 as taxpayers and tax return preparers reacted to the delays.

Although IRS met its timeliness and accuracy goals for processing returns and refunds during the 1996 filing season, IRS set those goals on the basis of what it expected that it could achieve with the systems and procedures currently in place. Recognizing that much could be done to improve its systems and procedures, IRS has initiated several modernization efforts. Those efforts achieved mixed results in 1996. For example, although a new document scanning and imaging system performed better in 1996 than it did in 1995, the system still was not meeting performance expectations and may eventually cost much more than originally estimated. Also, although the system that allows certain taxpayers to file their returns by telephone worked very well and had a high rate of user satisfaction, only about 10 to 14 percent of those eligible to use the system in 1996 did so.

For all but one of the modernization projects discussed in this report, IRS is taking steps to enhance its efforts. For example, IRS is developing a strategy to increase the use of electronic filing and reassessing its strategy for processing paper returns. The one exception is IRS' use of lockboxes, which are postal rental boxes serviced by commercial banks, to process Form 1040 tax payments. IRS' decision to have taxpayers send not only their payments but also their tax returns to a lockbox and to have the banks sort those returns before sending them to IRS has increased program costs, unnecessarily in our opinion, by about \$4.7 million.

Objective, Scope, and Methodology

Our objective was to assess IRS' performance during the 1996 filing season, including some of IRS' initiatives to modernize its processing activities. To achieve our objective, we

²The EIC is a refundable tax credit available to low-income working families with children and certain taxpayers without children.

³An invalid SSN is one that does not match Social Security Administration records.

- interviewed IRS National Office officials and IRS officials in the Atlanta, Cincinnati, and Kansas City service centers who were responsible for the various activities we assessed;⁴
- interviewed staff from the Department of the Treasury's Financial Management Service (FMS) about the use of lockboxes to process Form 1040 tax payments;
- analyzed filing season related data from various IRS sources, including its Management Information System for Top Level Executives;
- visited four walk-in assistance sites (two in Atlanta and one each in Kansas City, MO, and Mission, KS) to interview staff and taxpayers;
- visited two banks in Atlanta and St. Louis that were being used by IRS as lockboxes to process tax remittances and analyzed cost/benefit data related to IRS' use of lockboxes;
- reviewed data on the results of and costs associated with IRS' decision to allow filers of paper returns to request direct deposits of their refunds;
- reviewed data on IRS efforts to identify and resolve questionable refund claims;
- reviewed computer system availability reports and periodically attended weekly operational meetings held by IRS' Network and Operations Command Center in February, March, and April 1996;
- analyzed IRS' toll-free telephone system accessibility data, telephone activity data for forms distribution centers, and accessibility reports for the IRS system (known as TeleFile) that enables some taxpayers to file their returns by telephone;
- reviewed data compiled by IRS, including the results of a user survey, on the performance of TeleFile; and
- reviewed relevant IRS internal audit reports.

We did our work from January 1996 through September 1996 in accordance with generally accepted government auditing standards. We requested comments on a draft of this report from the Commissioner of Internal Revenue or her designated representative. On November 6, 1996, several IRS officials, including the Assistant Commissioner for Forms and Submission Processing, the National Director for Submission Processing, and the National Director for Customer Service (Planning and Systems), provided us with oral comments. Their comments were reiterated in a November 18, 1996, memorandum from the Acting Chief of Taxpayer Service. IRS' comments are summarized and evaluated on pages 24 and 25. IRS also provided some factual clarifications that we have incorporated in the report where appropriate.

⁴We selected these three service centers because we had staff available to do the work in those cities.

IRS Generally Met Its Filing Season Goals for Fiscal Year 1996

Appendix I has data on 12 indicators that IRS uses to assess its filing season performance.⁵ These indicators relate to workload, such as the number of answered telephone calls from taxpayers who are seeking assistance; timeliness, such as the number of days needed to process returns or issue refunds; and quality, such as the accuracy of IRS' answers to taxpayer questions and the accuracy with which IRS processes individual income tax returns and refunds. As shown in appendix I, IRS met or exceeded 11 of the 12 performance goals for the 1996 filing season and almost met the 12th goal (the number of forms-ordering calls answered).

Two specific aspects of IRS' filing season performance that are of particular interest to taxpayers and that were the source of problems in 1995 are (1) the level of taxpayer service being provided during the filing season, especially the ability of taxpayers to reach IRS by telephone, and (2) the timely issuance of refunds. In 1995, as in the past several years, taxpayers who sought answers to questions about the tax law or their accounts had considerable difficulty reaching IRS by telephone. In 1996, IRS improved its telephone accessibility while, at the same time, it reduced the availability of face-to-face services at its walk-in sites. Also, in 1995, millions of persons had their refunds delayed as a result of new IRS procedures for verifying the SSNs of dependents and EIC-qualifying children. The new procedures were designed to better ensure that persons were entitled to the dependents and EICs they were claiming. In 1996, IRS implemented revised case selection criteria that resulted in many fewer refund delays than in 1995. Sufficient information was not available when we completed our audit work to assess the impact of IRS' revised procedures on the identification and correction of questionable SSNs.

Telephone Accessibility Improved While the Availability of Walk-in Assistance Declined

IRS officials have reaffirmed that service to taxpayers remains a primary goal. However, IRS took steps in 1996 to change the blend of methods that it uses to deliver that service. IRS placed more emphasis on providing telephonic and computer-oriented service (such as a new World Wide Web site on the Internet) while walk-in, face-to-face assistance was deemphasized. As a result, telephone accessibility improved while many walk-in sites either closed or offered a reduced level of service.

Telephone Accessibility Improved

An important indicator of filing season performance is how easily taxpayers who have questions are able to contact an IRS assistor on the telephone (i.e., telephone accessibility). In reports on past filing seasons,

⁵Two other indicators (the number of individual income tax returns received and the number filed through alternative methods) are not included in the appendix but are discussed later in this report.

we discussed the difficulty taxpayers have had in reaching IRS over its toll-free tax assistance telephone line.⁶

Accessibility, as we define it, is the total number of calls answered divided by the total number of calls received. The total number of calls received is the sum of the following: (1) calls answered, (2) busy signals, and (3) calls abandoned by the caller before an assistor got on the line. By our definition, accessibility of IRS' toll-free telephone assistance improved in 1996, although it was still low. From January 1 to April 20, 1996, IRS reported receiving about 114 million call attempts, of which about 23 million were answered—an accessibility rate of 20 percent. For the same period in 1995, IRS reported receiving about 236.0 million call attempts, of which 19.2 million (8 percent) were answered. As the data for 1995 and 1996 indicate, a major reason for the improved accessibility in 1996 was the significant drop in call attempts. IRS attributed that drop to (1) fewer refund delay notices being issued, as discussed in more detail later in this report, and (2) IRS' efforts to publicize other information sources, such as its World Wide Web site on the Internet.

While acknowledging that telephone accessibility is low, IRS believes that accessibility should be measured not only by the percentage of calls answered but also by the percentage of callers who were able to get through to IRS, which IRS refers to as the “taxpayer service level of access.” Accordingly, IRS summarized its toll-free telephone assistance during the 1996 filing season as follows:

“For the period January 1, 1996, to April 20, 1996, IRS received calls made by 46 million callers. IRS answered 23 million calls, or 50% of the callers.⁷ Of the 114 million total call attempts received, 23 million or 20% received an answer. The remaining 91 million attempts, often the result of redials, received a busy signal or were terminated by the callers because they did not want to wait in queue for an assistor. The total number of callers mentioned earlier was determined by discounting for redials. Therefore, the 114 million call attempts equates to 46 million callers. This is an average of 2.5 attempts per caller.”

⁶Tax Administration: Increased Fraud and Poor Taxpayer Access to IRS Cloud the 1993 Filing Season (GAO/GGD-94-65, Dec. 22, 1993); Tax Administration: Continuing Problems Affect Otherwise Successful 1994 Filing Season (GAO/GGD-95-5, Oct. 7, 1994); and The 1995 Tax Filing Season: IRS Performance Indicators Provide Incomplete Information About Some Problems (GAO/GGD-96-48; Dec. 29, 1995).

⁷For the same period in 1995, IRS reported that 41 percent of the callers were able to get through to an assistor.

Availability of Walk-in Assistance Reduced

As IRS' data indicate, the accessibility of IRS' toll-free telephone assistance during the 1996 filing season, whether measured as a percentage of calls or callers, was still not good.

For the 1996 filing season, IRS closed 93 sites that had previously provided walk-in assistance, reduced the operating hours of some of the 442 sites that remained open, and eliminated free electronic filing at many of the sites. According to IRS, the closed sites were selected on the basis of their historical volume of work and their proximity to other walk-in sites. As an indication of the effect of these closures and cutbacks, IRS data showed that (1) walk-in sites served about 2.8 million taxpayers from January 1 to April 20, 1996, which was about 17-percent fewer taxpayers than were served during the same period in 1995, and (2) about 59,000 electronic returns were filed at walk-in sites in 1996, compared with about 104,000 in 1995.

Concerned about the reduction in walk-in service, the House and Senate conference agreement on the Treasury, Postal Service, and General Government appropriation for fiscal year 1997 included a provision that requires IRS to maintain the fiscal year 1995 level of service, staffing, and funding for taxpayer services. While noting that this provision does not mean that IRS should be required to rehire staff or reopen offices, the conference report said that "IRS should be very sensitive to the needs of the taxpayers" who use walk-in sites during the filing season.

Walk-in sites provide various free services, including copies of more commonly used forms and publications, help in preparing returns, and answers to tax law questions. We visited four walk-in sites and asked taxpayers where they would go if the office were closed. Many taxpayers commented that they would go to another IRS office or a professional tax preparer for assistance, and that they would call the toll-free forms-ordering telephone number for forms or pick them up at a library or post office.

As indicated by the persons with whom we spoke, there are other ways taxpayers can obtain the free services offered by walk-in sites, although maybe not as easily. For example, according to IRS, it generally takes from 7 to 15 workdays to receive materials that are ordered by telephone—longer if the materials are not in stock. Persons with access to a computer can download forms from the Internet or the FedWorld computer bulletin board. Free forms are also available at libraries and post offices and through IRS' "fax on demand" service.

Taxpayers who need help in preparing their returns and do not want to pay for that help may be able to take advantage of the tax preparation services offered at sites around the country that are part of the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs. According to IRS, these programs help older, disabled, low-income, and non-English-speaking individuals prepare their basic returns. IRS data for the 1996 filing season indicate that there was an increased demand for services at the VITA and TCE sites. The data showed that although the number of VITA and TCE sites around the country decreased by 513 compared with the 1995 filing season, about 71,000 additional taxpayers took advantage of the service.

Taxpayers who need answers to tax law questions can call IRS' toll-free tax assistance number or IRS' TeleTax system, which has prerecorded information on about 150 topics. From January 1 to April 27, 1996, the number of tax law calls to TeleTax increased by about 11 percent over the same period in 1995 (i.e., 6.9 million in 1996 compared with 6.2 million in 1995).

Still another option for free assistance is IRS' World Wide Web site on the Internet. Among other things, IRS' Web site includes copies of forms, information similar to that on TeleTax, and some interactive scenarios that taxpayers can use to help them answer some commonly asked questions. IRS reported that, as of May 1, 1996, its Web site had been accessed more than 52 million times since January 8, 1996, when it first became available.

Fewer Refunds Delayed in 1996

In 1995, IRS took several steps in an attempt to better ensure that persons were entitled to the dependents and EICs they were claiming. The most visible of those efforts involved the delay of about 7 million refunds to allow IRS time to verify SSNs, with an emphasis on returns claiming the EIC. The delays caused adverse reaction from taxpayers and tax return preparers during the 1995 filing season.

Although IRS' efforts in 1995 and the publicity surrounding those efforts appeared to have had a significant deterrent effect (e.g., according to IRS, 1.5 million fewer dependents were claimed in 1995 than were claimed in 1994), the efforts were not without problems. For example, although IRS identified about 3.3 million returns with missing or invalid SSNs and delayed any related refunds, it was able to pursue only about 1 million of those returns. For those cases it was unable to pursue, IRS eventually released any refunds, after holding them for several weeks, without

resolving the problems. Also, IRS delayed about 4 million EIC-related refunds for taxpayers whose returns had valid SSNs to check for fraudulent use of the same SSN on more than one return. IRS eventually released almost all of those refunds, after several weeks, without doing the checks.

For the 1996 filing season, IRS was more selective in deciding which cases to review and which refunds to delay. IRS tried to limit the number of delayed refunds to the volume of cases it could review and to focus its resources on the most egregious cases. The most significant change for the 1996 filing season was that IRS did not delay EIC refunds on returns with valid SSNs. IRS statistics on the number of refund delay notices sent to taxpayers in 1996, concerning dependent and EIC claims, indicated that IRS delayed far fewer refunds in 1996. As of September 6, 1996, IRS had mailed about 350,000 such notices compared with about 7 million in 1995. Another indicator that fewer refunds were delayed in 1996 is the decrease in the number of “where is my refund” calls to IRS. Taxpayers wanting to know the status of their refunds can call TeleTax and get information through the use of an interactive telephone menu. During the 1996 filing season, as of June 8, 1996, IRS reported receiving 48.2 million such calls, which was a decrease of about 15 percent from the 56.6 million it reported receiving for the same period in 1995.

In contrast to the negative reaction from taxpayers and practitioners during the 1995 filing season, an executive of the largest tax preparation firm told us that IRS generally did a better job in 1996. The executive said that the firm’s clients received refunds quicker and received fewer notices about problems, such as SSN mismatches. Likewise, in March 28, 1996, testimony before the Oversight Subcommittee, a representative of the National Association of Enrolled Agents said the following: “Our members report they have encountered far fewer problems this year compared to last year in the area of refund processing”

IRS Reviewed Fewer Questionable SSNs and Identified Fewer Fraudulent Refund Claims in 1996

As part of IRS’ increased emphasis on verifying SSNs in 1995, the Examination function followed up on about 1 million returns that IRS’ computer, using certain criteria, had identified as having questionable SSNs.⁸ As of June 30, 1996, about 986,000 of those cases had been closed—about 500,000 (51 percent) with no change in tax liability and about 486,000 (49 percent) with changes totaling about \$808 million.

⁸The computers actually identified about 3.3 million problem cases but, as previously noted, IRS was unable to pursue many of them.

In 1996, IRS (1) revised the criteria used to select cases in an attempt to better focus its efforts and (2) identified about 700,000 returns for follow-up, which is about 300,000 fewer than in 1995. Because it takes time for IRS to complete its reviews, information on results was not available at the time we completed our audit work. Thus, we do not know the impact of IRS' reduced level of effort in 1996. However, a decrease in the number of cases reviewed does not necessarily mean that IRS identified less noncompliance in 1996 than in 1995 because only about one-half of the cases reviewed in 1995 were productive. It is possible that IRS' revised criteria, despite generating fewer cases, might have identified more productive cases in 1996.

The SSN verification/refund delay efforts previously discussed were generally directed at identifying and correcting erroneous refunds caused by honest mistakes or negligence. Since the 1970s, IRS has had a Questionable Refund Program (QRP) directed at identifying fraudulent refund schemes.

QRP results for January 1996 through September 1996 showed that IRS had identified 20,521 fraudulent returns (involving claimed refunds of about \$55.4 million) during those 9 months. These results are a significant decline from the 59,241 returns and about \$124.8 million in refunds reported for the first 9 months of 1995. QRP officials attributed the decline to three things. First, and most significant in their opinion, was a staffing reduction that was part of IRS' cost-cutting efforts in anticipation of reduced funding levels. According to the officials, the 10 IRS service centers were allocated a total of about 379 full-time equivalent staff for the QRP in fiscal year 1996 compared with 553 full-time equivalent staff in 1995, which was a decrease of 31 percent. The other two reasons cited by the QRP officials were (1) the impact of enhanced upfront filters in the electronic filing system that prevented bad returns from getting into the system and (2) a decision to focus QRP efforts on certain kinds of cases.

IRS' Efforts to Modernize Its Processing Activities Had Mixed Results in 1996

Although IRS was able to meet its processing goals (such as cycle time,⁹ processing accuracy, and refund timeliness) in 1996, those goals were based on expectations as to what IRS could achieve with the systems and procedures currently in place. In that regard, there is general agreement that much can be done to improve those systems and procedures. IRS has initiated several efforts toward that end, including (1) providing alternatives to the filing of paper returns, (2) using scanning and imaging

⁹Cycle time is the average number of days it takes service centers to process returns.

technology to eliminate the manual data transcription of paper returns, and (3) using lockboxes and direct deposits to expedite the processing of tax payments and refunds, respectively.

Despite IRS' generally successful performance during the 1996 filing season, there are still several concerns centering around IRS' modernization efforts. For example, although more returns were filed using alternatives to the traditional paper form, the number of returns filed through one of those alternatives (electronic filing) fell short of IRS' projections. Also, although a document scanning and imaging system that was intended to streamline parts of IRS' paper-processing operations performed better in 1996, the system still is not meeting IRS' performance expectations and may eventually cost much more than originally estimated. Although data on the results of IRS' use of lockboxes to process Form 1040 tax payments indicate that the government is saving money, those savings are being diminished significantly by the extra cost associated with having taxpayers send not only their payments but also their returns to the lockbox banks. Finally, expansion of the direct-deposit option for refunds to taxpayers who filed a paper return was not as widely received by taxpayers as IRS had anticipated.

Number of Returns Filed Through Alternative Methods Increased but Electronic Filing Falls Short of Projections

As of October 18, 1996, IRS had received about 118.1 million individual income tax returns, which was about 1.5 percent more than the 116.4 million returns received as of the same period in 1995. While the increase in the overall number of returns filed was small, the increase in the number filed through alternative methods was substantially higher than in 1995 (about 50 percent). IRS offers three alternatives to the traditional filing of paper returns (i.e., electronic filing, TeleFile, and Form 1040PC).¹⁰ As shown in table 1, most of the growth in alternative filings was due to TeleFile and Form 1040PC. Table 1 also shows that, of the three alternatives, only electronic filing failed to meet IRS' projections.

¹⁰Under the electronic filing method, return data in electronic format are transmitted over communication lines through a third party (such as a tax return preparer or an electronic return transmitter) to an IRS service center, where the data are automatically edited and processed. Under TeleFile, certain taxpayers who are eligible to file a Form 1040EZ are allowed to file using a toll-free number on Touch-Tone telephones. Under the Form 1040PC method, a taxpayer or tax return preparer uses personal computer software that produces a paper tax return in an answer-sheet format. The Form 1040PC shows the tax return line number and the data (dollar amount, name, etc.) on that line. Only lines on which the taxpayer has made an entry are included on the Form 1040PC.

Table 1: Number of Individual Income Tax Returns Received Through Alternative Filing Methods

| Filing method | Number of returns IRS projected for 1996 filing season | Number of returns filed in 1996 ^a | Number of returns filed in 1995 ^a | Percentage change from 1995 |
|---------------|--|--|--|-----------------------------|
| Electronic | 13,648,400 | 12,139,000 | 11,144,000 | +8.9 |
| TeleFile | 2,497,400 | 2,840,000 | 680,000 | +317.6 |
| Form 1040PC | 4,617,600 | 7,031,000 | 2,912,000 | +141.4 |
| Total | 20,763,400 | 22,010,000 | 14,736,000 | +49.4 |

^aData are as of October 18, 1996, and October 20, 1995.

Source: IRS data.

Electronic Filing

Electronic filing has several benefits. It enables taxpayers to receive their refunds sooner than if they had filed on paper and gives them greater assurance that IRS has received their returns and that the returns are mathematically accurate. The benefit for IRS is that electronic filing reduces processing costs and facilitates more accurate processing. IRS began offering electronic filing in 1986. Since that time, 1995 was the first year that the number of individual income tax returns received electronically decreased from the number received the prior year. IRS attributed that decline to the secondary effects of measures it implemented to combat filing fraud.

IRS took several steps in an attempt to increase the use of electronic filing in 1996. For example, IRS (1) put increased emphasis on the availability of On-Line Filing, a program that allows taxpayers to file their returns, through a third party, via a personal computer-modem link, and (2) extended the period during which returns could be filed electronically by moving the closing date from August 15 (the filing deadline for taxpayers who get one extension to file) to October 15 (the filing deadline for taxpayers who get a second extension).¹¹

Taxpayers' use of electronic filing recovered somewhat in 1996—increasing to about 12.1 million individual income tax returns as of October 18 (about a 9-percent increase). According to IRS, a major contributor to this increase was growth in the Federal/State electronic filing program. Under that program, taxpayers can file both their federal and state income tax returns through one submission to IRS. A taxpayer's

¹¹IRS also eliminated free electronic filing at many of its walk-in sites. However, because only a small number of returns had been filed at walk-in sites in the past, the impact of that action on electronic filing was minimal.

federal and state data are combined into one electronic record that is transmitted to IRS, which, in turn, makes the state portion of the data available to the state. IRS reported that about 3.2 million returns were filed under the Federal/State program in 1996 compared with about 1.6 million in 1995. Some of the increase in electronic filing in 1996 was also due to the steps discussed in the preceding paragraph. According to IRS data, 158,284 taxpayers had used the On-Line Filing option as of October 18, and about 22,000 taxpayers had filed electronically between August 9 and October 18, 1996. Despite the increase in 1996, electronic filings that year were still below the 13.5 million individual returns filed electronically in 1994 and below IRS' projection of about 13.6 million returns in 1996.

A major impediment to the growth of electronic filing is that the method is not completely paperless. Taxpayers must send IRS their W-2s and a signature document (Form 8453) after their return has been electronically transmitted. IRS must then manually input these data and match them to the electronic return.

In an attempt to eliminate the paper associated with electronic returns, IRS tested the use of digitized signatures during the 1996 filing season. The goal of that test was to gauge the willingness of taxpayers and preparers to use an electronic signature pad in place of signing a Form 8453.¹² The electronic signature was attached to the electronic return and both were transmitted to IRS. The test was conducted at three locations (two VITA sites located on military bases and a private, tax return preparation office). According to IRS officials, about 50 percent of the taxpayers who were offered the chance to participate in the test agreed to do so. Given the level of participation in 1996 and positive preparer feedback, IRS plans to expand the test in 1997, but details of that expansion will not be finalized until just before the filing season begins.

Besides eliminating the paper associated with electronic returns, there are other steps IRS could take to increase the use of electronic filing. In October 1995, we reported that without some dramatic changes in IRS' electronic filing program, many of the benefits available from electronic filing could go unrealized.¹³ We recommended that IRS (1) identify those groups of taxpayers that offer the greatest opportunity to reduce IRS' paper-processing workload and operating costs if they filed electronically

¹²Test participants were also granted a waiver from the requirement to submit W-2s. According to an IRS official, tax return preparers were instructed to review the paper W-2s and not prepare electronic returns for taxpayers whose W-2s looked fraudulent.

¹³Tax Administration: Electronic Filing Falling Short of Expectations (GAO/GGD-96-12, Oct. 31, 1995).

and (2) develop strategies that focus on eliminating or alleviating impediments that inhibit those groups from participating in the program. As of October 9, 1996, IRS was finalizing a new electronic filing strategy.

Telefile

TeleFile generally provides the same benefits to taxpayers and IRS as electronic filing. However, TeleFile is more convenient and less costly than electronic filing because the latter requires that taxpayers go through a third party. The increase in taxpayer use of TeleFile in 1996 was due primarily to the program's expansion nationwide. As shown in table 1, IRS received about 2.8 million TeleFile returns in 1996, when TeleFile was available to taxpayers in 50 states, compared with 680,000 in 1995, when Telefile was available in only 10 states. Although most of the increase was due to the program's nationwide expansion in 1996, TeleFile use also showed a significant rate of increase in the 10 states that were in the program in 1995 (from 680,000 returns in 1995 to 804,732 in 1996—an 18-percent increase). A major change that might have contributed to the increase in TeleFile use was IRS' decision to make TeleFile paperless in 1996. Unlike past years, taxpayers did not have to mail their W-2s or a signature document to IRS. Instead of the signature document, taxpayers used a personal identification number that was provided by IRS.¹⁴

IRS' Internal Audit Division reviewed the 1996 TeleFile Program and concluded that management had "effectively prepared for and successfully implemented" the nationwide expansion of TeleFile.¹⁵ For example, Internal Audit noted that (1) its sample of returns filed through TeleFile showed that all tax calculations were correctly computed and that data had been posted accurately to IRS' master file of taxpayer accounts and (2) taxpayer demand for TeleFile during the 1996 filing season was generally met. However, Internal Audit also noted that IRS had not completed a system security certification and accreditation and thus had no assurance that taxpayer data were adequately secured. According to Internal Audit, certification is a comprehensive evaluation of a system's security features; accreditation is a declaration that the system is approved to operate. As of November 21, 1996, according to the TeleFile Project Manager, IRS was working to complete the certification and accreditation.

¹⁴Instead of mailing their W-2s to IRS, taxpayers were required to enter certain data from the W-2s (such as the employer identification number and the amount of taxable wages) into the TeleFile system.

¹⁵Review of the 1996 TeleFile Program, IRS Internal Audit, Reference No. 064401, June 14, 1996.

Internal Audit's evaluation and various statistics compiled by IRS, including the results of an IRS survey of TeleFile users, indicate that TeleFile worked very well in 1996. For example, about 92 percent of the users surveyed by IRS said that they were very satisfied with TeleFile. However, it is important to note that only about 10 to 14 percent of the more than 20 million 1040EZ filers who IRS estimated would be eligible to use the system in 1996 actually used it.¹⁶ IRS did not survey the nonusers because, according to IRS officials, past surveys showed that the most important reason eligible users cited for not using TeleFile was their preference for a paper version. However, those past surveys did not probe into why nonusers preferred paper.

According to the TeleFile Project Manager, IRS plans several changes to TeleFile for the 1997 filing season, which he estimates will increase the participation rate to about 25 percent. For example, he said that eligibility to use TeleFile will be extended to married persons filing jointly and TeleFile users will be able to take advantage of the direct-deposit option that was available to other taxpayers in 1996 (this option is discussed later in this report).

The most significant change for 1997, in terms of its potential impact on taxpayer participation, is IRS' decision to revise the tax package sent to persons eligible to use TeleFile. Instead of sending eligible users a package that also contains a Form 1040EZ and related instructions, in case they choose not to use TeleFile, IRS has decided to send them a much smaller package that contains only the TeleFile worksheet and instructions. Although this action may encourage more persons to use TeleFile and reduce IRS' overall printing and mailing costs, it could be seen as imposing a burden on persons who, for whatever reason, prefer not to use TeleFile and would, in that case, need a Form 1040EZ. It is unclear how taxpayers will react to this change. On the one hand, IRS summaries of three 1040EZ/TeleFile focus groups held in August and September 1996 indicated that focus group participants did not view the noninclusion of Form 1040EZ as a burden because they could easily get a copy, if needed, from their local library or post office. On the other hand, a mail survey that IRS sent to a random number of TeleFile users in 1996 showed that about 28 percent of the respondents thought it was very important that the 1040EZ information be included in the TeleFile package.

¹⁶There was conflicting IRS information on the number of eligible filers, which we were unable to resolve before finalizing the report. However, we are confident that the percentage of use falls somewhere within the range cited.

Form 1040PC

The increase in the use of Form 1040PC during the 1996 filing season resulted, in part, from the largest user's (a tax return preparation firm) rejoining the program after dropping out in 1995. For the 1995 filing season, IRS initially required that preparers provide taxpayers with a specifically formatted legend explaining the Form 1040PC.¹⁷ However, after the 1995 filing season began, IRS decided not to require the specifically formatted legend but to allow preparers to provide any type of descriptive printout that explained each line on the taxpayer's Form 1040PC. According to an executive of the previously mentioned tax return preparation firm, (1) the firm chose not to participate in the program in 1995 rather than comply with the requirement for a specifically formatted legend and (2) IRS' decision to change its requirement came too late for the firm to change its plans. The firm then rejoined the program for the 1996 filing season.

The Form 1040PC was developed to reduce the number of pages that a standard Form 1040 requires, which is a benefit to taxpayers and IRS, and to streamline paper processing. Although use of the Form 1040PC reduces the amount of paper, IRS has not yet realized the full processing efficiencies available from that form. Because of problems encountered with IRS' new document scanning and imaging system, as discussed in the next section of this report, IRS terminated plans to have Forms 1040PC scanned and, instead, is manually keying data from the forms into its computers.

Problems Have Hampered Efforts to Modernize Paper Processing Systems

The Distributed Input System (DIS), which is IRS' primary data entry system for paper tax returns and other paper documents submitted by taxpayers, has been in operation since 1984. Although DIS generally performed without major problems during the 1996 filing season, its age is a source of concern within IRS. IRS had planned to replace DIS with two document scanning and imaging systems. The first replacement system, the Service Center Recognition/Image Processing System (SCRIPS), was implemented nationwide in 1995 and is not yet performing to IRS' expectations at that time. On October 8, 1996, IRS announced that the second planned system, the Document Processing System (DPS), was being terminated.

SCRIPS Is Not Performing to IRS Expectations

IRS experienced significant performance problems with SCRIPS in 1995, which was the system's first year of nationwide operation. Two major problems were significant system downtime and slow processing rates.

¹⁷The legend's purpose was to provide better supporting documentation than was previously available to the taxpayers, and it was to be used as an aid in doing things such as preparing state returns and completing financial aid forms.

IRS made some hardware and software modifications that helped improve the performance of SCRIPS during the 1996 filing season. IRS officials in all five SCRIPS service centers told us that SCRIPS performed significantly better during the 1996 filing season than it did in 1995. Specifically, IRS data for April through June of 1995 and 1996 (the first 3 months for which IRS had comparable data) indicate that system downtime decreased from 791 hours in 1995 to 43 hours in 1996.

Despite the improved performance in 1996, SCRIPS (1) is still not processing all of the forms that it was expected to process and (2) may cost more than originally estimated. In an October 1994 business case for SCRIPS, IRS said that, by 1996, the system would be processing all Federal Tax Deposit coupons and information returns, all Forms 1040EZ, 50 percent of the Forms 1040PC, and 93 percent of the Forms 941 (Employers Quarterly Federal Tax Return). In fiscal year 1996, SCRIPS processed all Federal Tax Deposit coupons and information returns, as expected. However, SCRIPS only processed about 50 percent of the Forms 1040EZ and did not process any Forms 1040PC or Forms 941. In addition, the cost estimate for SCRIPS has increased from \$133 million in October 1992 to a current estimate of \$288 million. Part of the increase is due to the inclusion of certain costs, such as for maintenance, that were not part of the original estimate.

We will be issuing a separate report that has more information on SCRIPS' problems in 1995, its performance in 1996, and IRS' plans for the system in the future.

DPS Terminated

A second scanning system, DPS, was to replace SCRIPS and expand IRS' imaging capability to more complex tax forms. IRS expected DPS to begin handling some of the DIS workload by the start of the 1998 filing season. However, due to concerns about the future of DPS, IRS reassessed its strategy for processing paper tax returns. According to IRS, part of the reassessment involved options, such as outsourcing the processing of some returns and/or acquiring a new manual data entry system to replace DIS. As of September 26, 1996, according to a cognizant IRS official, the reassessment was done but a final decision had not yet been reached. That reassessment took on added importance when IRS announced, on October 8, 1996, that DPS was being terminated. IRS attributed that decision, at least in part, to budgetary concerns and "the need to prioritize investments in systems that have a direct and immediate benefit on improved customer service, such as better telephone access."

The uncertainty of IRS' plans for processing paper returns means that IRS may have to continue to rely on DIS longer than it had originally expected. In a February 1996 report, Internal Audit said that DIS could be required to process forms until 2003.¹⁸ Over the course of the 1996 filing season, various service center officials expressed concern about IRS' ability to adequately maintain and repair the system. Despite their concerns, DIS performed satisfactorily during the filing season. Officials also told us that, until this year, IRS had not kept detailed maintenance records to capture DIS downtime. Thus, an accurate comparison of DIS downtime and system reliability over the years is not possible. We recently began a review of IRS' ability to maintain current operating levels with its existing systems.

Use of Lockboxes to Process Form 1040 Tax Payments Raises Burden, Cost, and Security Issues

IRS envisions that by 2001, most tax payments will be processed by lockbox banks rather than by IRS service centers. The banks process the payments and transfer the funds to a federal government account. The payment and payer information are then recorded on a computer tape and forwarded to IRS for use in updating taxpayer accounts. One reason for using lockboxes is the expectation that tax payments will be deposited faster into the Treasury. Faster deposits mean that the government has to borrow less money to fund its activities and less borrowing means lower interest costs (otherwise known as "interest cost avoidance").

IRS' Testing of Lockboxes to Process Form 1040 Payments

Since 1989, IRS has used lockboxes to process payments sent in with estimated tax returns (Forms 1040ES). For the last several years, IRS has been testing the use of lockboxes to process payments sent in by individuals when they file their income tax returns (Forms 1040). For the 1996 test, IRS sent special Form 1040 packages to specific taxpayers. These packages included (1) mailing instructions and (2) a payment voucher that could be scanned by optical character recognition equipment.

The test packages contained one return envelope with two different tear-off address labels. One label, which was addressed to a lockbox, was to be used for a return with an accompanying tax payment, and the other label, which was addressed to a service center, was to be used for a return with no payment. Taxpayers with payments were instructed to put their returns, payments, and vouchers in the envelope in their tax packages and to affix the label addressed to the lockbox. The bank that serviced the lockbox was to separate the returns from the payments, deposit the payments, record the payment information on a computer tape, sort the

¹⁸Review of the Distributed Input System Transition/Contingency Plan, IRS Internal Audit, Reference No. 062208, February 23, 1996.

returns,¹⁹ and forward the returns and the computer tape to IRS for processing.

IRS had tested another mailing method during the 1994 and 1995 filing seasons. This test involved the use of two envelopes. One envelope was addressed to a service center, and the other envelope was addressed to a lockbox. Taxpayers were instructed to put their tax returns in the envelope addressed to the service center and to put any payments and vouchers in the envelope addressed to the lockbox. The bank was to process the payments and vouchers as previously described.

Lockbox Burden, Cost, and Security Issues

IRS has decided, for the 1997 filing season, to continue testing the two-label method in certain tax packages. According to an IRS official responsible for the lockbox program, IRS will no longer use the two-envelope approach due to the increased taxpayer burden IRS anticipates the approach would cause. She explained that IRS has found, in its studies of taxpayer behavior, that, among other things, taxpayers who participated in the test preferred to keep their remittances and returns together. Because of this, IRS believes that asking taxpayers to split their tax payments from their returns is burdensome.

The studies referred to by IRS, all of which were done by a contractor in 1993 and 1994, included mail and telephone surveys of about 1,900 taxpayers, interviews with 46 individuals, and 5 taxpayer focus groups. We reviewed the contractor's reports and considered the results to be inconclusive as they related to burden. For example, of the people surveyed by mail and telephone who said they remembered what they did in the test, 45.9 percent said that they felt uneasy about mailing their checks and returns in separate envelopes while 41.2 percent said that they did not feel uneasy (the other 12.9 percent did not know). The results of the 46 interviews showed a similar lack of consensus, in our opinion. Several people said that they preferred using one envelope because it was easier or because they were worried about the payments and the tax returns not getting linked if they were sent to two different places.²⁰ But, several other people said that they preferred using two envelopes because they were concerned about the confidentiality of their tax returns or the

¹⁹In some cases, the payment sent in by a taxpayer does not fully satisfy the tax liability reported on the return. Because IRS gives priority processing to those returns, so that it can speed up issuance of a balance due notice to the taxpayer, the banks are to segregate those returns from returns that do not have a balance due.

²⁰It is important to note that, if linkage were a concern, the use of one envelope is not the answer. Even though both the return and payment originally go to the same location (the bank), they are processed at two separate locations (the payment at the bank and the return at the service center), just as they would be under the two-envelope method.

increased risk of their returns getting lost. Even some of those who preferred one envelope expressed concern about the banks' involvement in handling their returns.

Burden is one issue to consider in deciding on the use of lockboxes; cost is another. Information we received from IRS and FMS indicates that having taxpayers send their returns to the lockboxes along with their payments has substantially increased the cost of the lockbox service to the government. During the first 8 months of the 1996 filing season, according to IRS, the lockbox banks had processed about 7 million Form 1040 payments. According to FMS, the government paid the banks an average of \$2.03 per payment in 1996—98 cents to process each payment, 92 cents to sort each accompanying tax return, and 13 cents to ship each return to a service center—and the same fees will be in effect until April 1, 1997.²¹ Fees after that date are subject to negotiation between FMS and the banks. Cognizant FMS staff said that the banks have been charging such a high fee for sorting returns to encourage IRS to stop having the returns sent to the banks.

Service centers process returns received from a lockbox bank in the same manner as they process returns that come directly from taxpayers, with one exception—the returns coming from the bank do not have to be sorted by IRS. According to IRS data, not having to sort the returns saves IRS about 37 cents a return²²—much less than the 92 cents per return being charged by the banks. Thus, assuming a volume of 7 million returns, the government paid about \$6.4 million for a service (return sorting) that it could have done itself for about \$2.6 million, or about \$3.8 million less. Shipping those returns cost the government another \$910,000.

According to FMS, the use of lockboxes to process Form 1040 tax payments enabled the government to avoid interest costs of \$15.7 million in fiscal year 1996.²³ This interest cost avoidance compares with \$1.6 million in

²¹FMS, not IRS, has been paying these fees and will continue to do so in 1997.

²²According to IRS' data, which we did not verify, the 37 cents includes direct labor, benefits, quality assurance, and overhead.

²³FMS, in computing interest cost avoidance, assumed that the lockbox banks were able to deposit tax remittances 3 days faster, on average, than the service centers. Although we did not do sufficient work to validate that assumption, information we obtained during this review, along with related information obtained during reviews of past filing seasons, indicates that the assumption is reasonable.

fiscal year 1995.²⁴ Because these savings result from faster processing of tax payments, having the banks sort and ship the tax returns does not add to the savings and could, by increasing the banks' workload, cause processing delays that would reduce any savings.

In an August 30, 1996, letter to Treasury's Fiscal Assistant Secretary, IRS' Deputy Commissioner acknowledged the high costs associated with having returns sent to lockboxes. In a September 11, 1996, reply, the Assistant Secretary also expressed some concern about the costs associated with the processing of Form 1040 tax payments through lockboxes. The Assistant Secretary said that "[t]he most appealing option from a cost standpoint is the two-envelope concept. This option . . . makes good business sense as tax payments and tax returns are sent to the appropriate place best prepared to handle them."

As a way to lower costs, the Assistant Secretary suggested that IRS explore the possibility of not having the banks sort the returns and have the sorting done by the service centers. We discussed this option with officials in IRS' National Office and at one service center. We were told that it would be difficult for service centers to sort the returns once they had been separated from the payments because the service center would not know if the taxpayer had fully paid his or her tax liability.²⁵ According to the IRS officials, that distinction is important because, as previously discussed, returns involving less than full payment are given priority processing to enable more timely issuance of the balance-due notice to the taxpayer. IRS had considered adding a checkbox on the return for the taxpayer to indicate whether full payment was enclosed with the return. According to IRS, asking taxpayers to check such a box would be another form of burden—although not a significant one.

Security is a third issue that needs to be considered in deciding how to use lockboxes. As previously noted, several individuals who participated in the focus groups and interviews about IRS' use of lockboxes expressed concern that their returns would be lost or their return data would be misused. We did not do a thorough analysis of security at the lockbox banks. However, we reviewed security and processing procedures at 2 of

²⁴In our report on the 1995 filing season (GAO/GGD-96-48), we referred to an interest cost avoidance of \$44.3 million in 1995. That figure related to all tax remittances being processed through lockboxes, including estimated tax payments. The \$1.6 million figure relates just to remittances associated with Form 1040.

²⁵This would also be a problem under the two-envelope method because the return and payment would be separated.

the 10 lockbox banks and found that controls exist to minimize the risk of lost or misused tax data.

IRS' lockbox procedures require that the tax returns be separated from the payment as soon as the envelope is opened. Only personnel who open the envelopes and their supervisors are to have access to the returns. Security cameras are to monitor all of the lockbox processing. The returns are to be bundled and packed into boxes as soon as they are separated from the payment. Each day, the boxes of returns are to be shipped by bonded courier to the service center. Background checks, such as a criminal record check, are to be done on lockbox personnel hired by the bank. These are the same checks that are to be done on IRS service center personnel with the same duties. Bank personnel, like service center employees, are to sign statements of understanding about the confidentiality of the information they will process and the penalties for disclosing any of this information. IRS and FMS lockbox coordinators are to visit the banks to ensure compliance with these procedures and are to submit quarterly reports on the basis of those visits. An FMS staff person who was responsible for IRS' lockbox processing program told us there have been no known incidents of disclosure of taxpayer information from a lockbox bank.

During our visits to the two banks, we observed the security-surveillance cameras in operation and verified that badges were being worn by all personnel and that access to the processing area was controlled by a guard. We also reviewed judgmental samples of personnel files and, for each employee whose file we reviewed, we (1) found that disclosure statements were maintained and (2) saw evidence that background checks had been done.

Use of Direct-Deposit Option Was Not as Widespread as IRS Had Expected

Unlike past years, IRS allowed taxpayers who filed paper returns in 1996 to request that their refunds be deposited directly to their bank account through an electronic fund transfer. IRS included a Form 8888 (Request for Direct Deposit of Refund) in almost all paper tax packages. IRS estimated that about 5 million taxpayers who filed paper returns would request the direct-deposit option and, on average, that the option would enable paper filers to get their refunds 10 days faster than if they had waited for a paper check. IRS also estimated that it would cost about 25-percent less to process a Form 8888 than it costs to mail a paper refund check (20 cents per form v. 27 cents per paper check).

Only about 1.6 million taxpayers took advantage of the direct deposit option. An IRS official said that IRS will retain its goal of about 5 million direct-deposit refunds for the 1997 filing season. IRS has taken a couple of steps to enhance its chances of achieving that goal. Most significantly, it has eliminated the Form 8888. Instead of having a separate form, most of the individual income tax forms will be revised to provide space for the taxpayer to request a direct deposit and to provide the necessary bank account information. Also, as previously noted, TeleFile users will be able to request a direct deposit in 1997.

Conclusions

Was the 1996 filing season a success? The answer depends on one's perspective. From IRS' standpoint, it was a success. IRS met or exceeded all but one of its performance goals and was very close to meeting the other. IRS was able to process individual income tax returns and refunds without any apparent problem, with its aging computer systems having made it through another filing season. From the taxpayer's perspective, the filing season was also successful in many key respects. For example, relatively few refunds were delayed in 1996, unlike 1995 when millions of taxpayers were angered by IRS' decision to delay their refunds while it checked dependent and EIC claims; more taxpayers were given the opportunity to file by telephone and to have their refunds directly deposited into their bank accounts; and IRS' World Wide Web site on the Internet provided a convenient source of information for taxpayers with access to a computer. However, there were some problems in 1996. Although the accessibility of IRS' toll-free telephone assistance improved, taxpayers continued to have problems reaching IRS by telephone, and some taxpayers may have been inconvenienced by the reduction in IRS' walk-in services.

IRS has several efforts under way to modernize the systems and procedures it has used for many years to process returns, remittances, and refunds. These efforts are essential if IRS is to successfully meet the demands of future filing seasons. To date, the results of those efforts have been mixed. IRS has taken steps to enhance its efforts. For example, IRS is (1) expanding eligibility for TeleFile and taking other steps in an effort to increase the use of that filing alternative, (2) working to make electronic filing paperless by broadening its test of digitized signatures, (3) making it easier for taxpayers to request direct deposits of their refunds, and (4) reassessing its strategy for processing paper tax returns.

Even if IRS is successful in increasing the TeleFile participation rate to 25 percent in 1997, that would still leave a large number of eligible users

who choose not to use TeleFile. We believe that IRS' efforts to expand the use of TeleFile could be enhanced if it had more specific information on why eligible users prefer to file on paper. More specifics might help IRS identify barriers to TeleFile use and develop mitigating strategies.

We also question whether IRS' decision to have taxpayers send both their tax returns and their tax payments to lockboxes and to have banks sort those returns adequately considered both the costs to the government and taxpayer burden. Although it is important to minimize taxpayer burden, the evidence we were given was not convincing concerning the amount of burden associated with using two envelopes, especially in light of the extra cost to the government associated with using one envelope (about \$4.7 million during the first 8 months of the 1996 filing season). It is understandable that persons contacted by IRS' contractor, when asked to choose between one or two envelopes, would pick one, because it is easier to put everything into one envelope than to segregate things into two envelopes and pay additional postage. But, it is not clear that those persons considered the use of two envelopes an unreasonable burden. Nor is it clear how those persons might have responded if they were told that the use of one envelope causes the government to spend several million dollars more than it would if taxpayers used two envelopes.

The cost associated with using lockboxes to process Form 1040 tax payments might become less of an issue if the government is able to negotiate bank fees for sorting that are more comparable to the service center costs for that activity. Absent lower fees, an alternative is to continue to have returns sent to the bank but to have the banks ship the returns to the service centers unsorted. That would require IRS to add a checkbox to the return (which would also be required if IRS decided to use two envelopes) but checking a box would likely be perceived by taxpayers as less of a burden than using two envelopes. However, while a reduction in bank fees or a decision to accept returns from the banks unsorted would make the one-envelope method more advantageous, they would not relieve the anxiety expressed by some taxpayers about their returns being lost or misused by bank personnel.

Recommendations to the Commissioner of Internal Revenue

If most eligible TeleFile users do not use the system during the 1997 filing season, as IRS is anticipating, we recommend that the Commissioner of Internal Revenue conduct a survey to determine why, including more specific information on why the nonusers prefer to file on paper, and take steps to address any identified barriers to increased user participation.

If the government is unable to negotiate lockbox fees that are more comparable to service center costs and in the absence of more compelling data on taxpayer burden, we recommend that the Commissioner, for filing seasons after 1997,²⁶ either discontinue having returns sorted by the banks or reconsider the decision to have taxpayers send their tax returns to the banks along with their tax payments.

We are not making any recommendations in this report to address problems with telephone accessibility and electronic filing because we have recently issued separate reports on these topics.²⁷ We will also be issuing a separate report on SCRIPS.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from the Commissioner of Internal Revenue or her designated representative. Responsible IRS officials, including the Assistant Commissioner for Forms and Submission Processing, the National Director for Submission Processing, and the National Director for Customer Service (Planning and Systems), provided IRS' comments in a November 6, 1996, meeting. Those comments were reiterated in a November 18, 1996, memorandum from the Acting Chief of Taxpayer Service. IRS officials also provided some factual clarifications that we incorporated in the report where appropriate.

IRS agreed with our recommendation that it determine why more eligible taxpayers do not use TeleFile, including more specific information as to why nonusers prefer to file on paper. IRS officials told us that by the end of fiscal year 1997, IRS would conduct a focus group study of TeleFile nonusers to determine why they prefer to file on paper and to identify any barriers.

IRS officials said that steps have also been taken to address some concerns identified by past nonuser surveys. IRS believes that taxpayers' preference for paper returns is linked to their familiarity with the form. The TeleFile worksheet that taxpayers had been instructed to fill out and maintain as a record of their filing did not have the same "official" appearance as a tax form. For the 1997 filing season, according to IRS officials, TeleFile users will be instructed to complete a TeleFile Tax Record instead of a worksheet. As described by the officials, the TeleFile Tax Record will

²⁶Our recommendation is directed at filing seasons after 1997 because it is too late for IRS to reconsider its lockbox plans for the 1997 filing season.

²⁷Telephone Assistance: Adopting Practices Used by Others Would Help IRS Serve More Taxpayers (GAO/GGD-95-86, Apr. 12, 1995) and GAO/GGD-96-12.

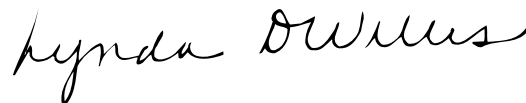
(1) include lines for the taxpayer's name and address, (2) look more like the Form 1040EZ, and (3) be an official document. IRS hopes this change will provide potential TeleFile users with a higher comfort level. IRS officials also said that advertisements and other publicity tools that were used in 1996 will be emphasized again in 1997 to educate the public on the simplicity of using TeleFile.

In commenting on our second recommendation, IRS officials said that IRS, in conjunction with FMS, has formed a task force to identify a long-term solution for 1998 and beyond for directing Form 1040 tax payments to lockboxes. According to the officials, the group has been tasked with (1) identifying options that complement Treasury's goals of increasing the availability of funds and reducing the cost of collecting federal funds, (2) reviewing what is required of lockboxes by IRS to minimize operational and ancillary costs, and (3) making recommendations to management. The group is scheduled to present their findings to management by March 1997. This time frame should provide IRS with information to make a decision on Form 1040 tax payment processing that could be implemented for the 1998 filing season.

We are sending copies of this report to the Subcommittee's Ranking Minority Member, the Chairmen and Ranking Minority Members of the House Committee on Ways and Means and the Senate Committee on Finance, various other congressional committees, the Secretary of the Treasury, the Commissioner of Internal Revenue, the Director of the Office of Management and Budget, and other interested parties.

Major contributors to this report are listed in appendix II. Please contact me on (202) 512-9110 if you have any questions.

Sincerely yours,



Lynda D. Willis
Director, Tax Policy and
Administration Issues

Contents

| | | |
|---|---|----|
| Letter | 1 | |
| Appendix I IRS' Performance Goals for the 1995 and 1996 Filing Seasons and Related Accomplishments | 28 | |
| Appendix II Major Contributors to This Report | 30 | |
| Table | Table 1: Number of Individual Income Tax Returns Received Through Alternative Filing Methods | 11 |

Abbreviations

| | |
|--------|--|
| DIS | Distributed Input System |
| DPS | Document Processing System |
| EIC | Earned Income Credit |
| FMS | Financial Management Service |
| IRS | Internal Revenue Service |
| QRP | Questionable Refund Program |
| SCRIPS | Service Center Recognition/Image Processing System |
| SSN | Social Security Number |
| TCE | Tax Counseling for the Elderly |
| VITA | Volunteer Income Tax Assistance |

IRS' Performance Goals for the 1995 and 1996 Filing Seasons and Related Accomplishments

| Performance indicator | 1995 filing season ^a | | 1996 filing season ^a | |
|--|--|---|--|---|
| | Goal | Accomplishment | Goal | Accomplishment |
| Accuracy of returns processed by Code and Edit staff ^b | Process 93.0% accurately | 94.1% were processed accurately | Process 93.0% accurately | 94.0% were processed accurately |
| Accuracy of returns processed by data transcribers | Process 94.0% accurately | 94.6% were processed accurately | Process 93.0% accurately | 94.2% were processed accurately |
| Service centers' returns processing productivity ^c | Process 9,800 returns per staff year | 10,820 returns were processed per staff year | Process 10,000 returns per staff year | 12,174 returns were processed per staff year |
| Returns processing cycle time ^d | 11 days | Various types of 1040s ranged between 5 and 9 days | 11 days | Various types of 1040s ranged between 8 and 11 days |
| Accuracy of refunds on paper returns | Process 97.0% accurately | 99.5% were processed accurately as of May 1995 | Process 98% accurately | 99.6% were processed accurately as of May 1996 |
| Timeliness of refunds on paper returns ^e | Issue within an average of 40 days | Issued within an average of 36 days as of May 1995 | Issue within an average of 40 days | Issued within an average of 38 days as of May 1996 |
| Timeliness of processing tax payments submitted with returns | Payments received 4/17/95 through 5/2/95 were to be deposited no later than 5/3/95 | All payments received 4/17/95 through 5/2/95 were deposited by 5/3/95 | Payments received 4/15/96 through 5/1/96 were to be deposited no later than 5/1/96 | All payments received 4/15/96 through 5/1/96 were deposited by 5/1/96 |
| Tax assistance telephone calls scheduled to be answered ^f | Answer 16.5 million calls | 19.2 million calls were answered (116% of schedule) | Answer 19.2 million calls | 22.9 million calls were answered (119.5% of schedule) |
| Taxpayer service level of access ^g | Not applicable | Not applicable | Provide 41.4% level of access | Provided 50% level of access |
| Accuracy of tax law assistance | Answer 90% accurately | 90% were answered accurately | Answer 90% accurately | 91% were answered accurately |
| Forms-ordering telephone calls scheduled to be answered ^f | Answer 4.4 million calls | 4.2 million calls answered (95.7% of schedule) | Answer 4 million calls | 3.9 million calls answered (98.3% of schedule) |
| Accuracy of processing form orders | Process 96.5% accurately | 97.2% processed accurately | Process 96.5% accurately | 97.3% processed accurately |

(Table notes on next page)

Appendix I
IRS' Performance Goals for the 1995 and
1996 Filing Seasons and Related
Accomplishments

^aData are as of April 1995 and April 1996, unless otherwise noted.

^bCode and Edit staff prepare returns for computer entry by, among other things, ensuring that all data are present and legible.

^cThe "returns processing productivity" indicator is based on the number of weighted returns processed, which includes all returns whether they were processed manually, through scanning equipment, or electronically. The different types of returns are weighted to account for their differing processing impacts. For example, a paper Form 1040 has a higher weighting factor than a paper Form 1040EZ, which in turn has a higher weighting factor than electronically processed returns.

^dCycle time is the average number of days it takes service centers to process returns.

^eThe "refund timeliness" indicator is based on a sample of paper returns and is calculated starting from the signature date on the return to the date the taxpayer should receive the refund, allowing 2 days after issuance for the refund to reach the taxpayer. As discussed in our report on the 1995 filing season (GAO/GGD-96-48), the 36-day accomplishment cited for 1995 was slightly understated by the exclusion of certain refunds that, according to IRS' standards, should have been included. That issue was not a problem in 1996.

^fThe "calls scheduled to be answered" indicator is the number of telephone calls IRS believes its call sites will be able to answer with available resources. The indicator does not reflect the number of calls IRS expects to receive.

^gThe "level of access" indicator is the number of calls answered divided by the number of individual callers. See pages 4 to 6 for more information on this indicator.

Source: IRS data.

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