United States General Accounting Office

GAO

Report to the Honorable
Margaret Milner Richardson,
Commissioner of Internal Revenue

May 1996

INTERNAL REVENUE SERVICE

Results of Nonfiler Strategy and Opportunities to Improve Future Efforts

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United States
General Accounting Office
Washington, D.C. 20548

General Government Division

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May 13, 1996

The Honorable Margaret Milner Richardson
Commissioner of Internal Revenue
Department of the Treasury

Dear Mrs. Richardson:

This report discusses the results of our review of IRS' Nonfiler Strategy and opportunities for improving any similar future efforts. We did this review under our basic legislative authority.

The report contains recommendations addressed to you. As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Reform and Oversight not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Secretary of the Treasury; the Director, Office of Management and Budget; and interested committees and subcommittees. We will make copies available to others upon request.

Please call me at (202) 512-9110 if you or your staff have any questions about the report. Other major contributors to this report are listed in appendix II.

Sincerely yours,

Natwar Gandhi
Associate Director, Tax Policy
and Administration Issues

Executive Summary

Purpose

At the beginning of fiscal year 1993, the Internal Revenue Service (IRS) had an inventory of about 10 million known individual and business nonfilers. IRS estimated that the amount of unpaid taxes on nonfiled individual income tax returns for 1992 alone was more than $10 billion. Concerned about this noncompliance, IRS implemented a strategy in fiscal year 1993 to bring nonfilers into the system and keep them there. GAO, under its basic legislative authority, reviewed IRS' strategy to (1) assess the results and (2) determine whether opportunities existed to improve any future nonfiler efforts.

Background

IRS identifies potential nonfilers primarily by matching data on information returns, such as wage and withholding statements from employers, with data on filed income tax returns. When the matched data show income but no corresponding tax return, a potential nonfiler is identified. IRS then decides what type of action to take, if any. Depending on the facts of the case and available resources, IRS' decision can range from doing nothing to conducting a detailed investigation.

The Commissioner of Internal Revenue, in October 1993 congressional testimony, cited three goals that IRS established to help achieve the objective of the Nonfiler Strategy: (1) use a combination of outreach and enforcement to improve taxpayer compliance and the identification of nonfilers, (2) eliminate the backlog in IRS' inventory of nonfiler investigations by the end of fiscal year 1994 so that IRS can work individual nonfiler cases promptly, and (3) improve the way IRS directs its enforcement resources in working nonfiler cases so that it can employ the most effective techniques on different types of cases to achieve the highest return on its resource investment. The Strategy was to be in effect for fiscal years 1993 and 1994.

To achieve its review objectives, GAO interviewed officials and reviewed procedures and results at IRS' National Office, three regional offices, four district offices, two service centers, and a compliance center. Because a major part of the Strategy involved the use of staff from IRS' Examination function to help investigate nonfiler cases, GAO randomly selected a total of 140 cases completed in fiscal years 1993, 1994, and 1995 by Examination staff at the four district offices visited. GAO's sample results are not projectable.

Results in Brief

IRS took several positive steps to achieve the goals of the Nonfiler Strategy. Among other things, the Examination function deployed staff to work on nonfiler cases; other IRS functions increased their emphasis on nonfiler activities; and IRS eliminated old cases from inventory, established cooperative working arrangements with states and the private sector, and implemented a refund hold program.

According to IRS, the Nonfiler Strategy was generally a success. Among other things, IRS (1) reduced the size of the nonfiler inventory; (2) eliminated unproductive cases, which allowed it to focus enforcement resources more effectively; and (3) increased the number of returns secured from individual nonfilers. However, the results of the Strategy are less conclusive when compared with the Strategy's goals. IRS achieved its goal of reducing the backlog of nonfiler investigations, but there is insufficient information with which to judge IRS' success in achieving its other two goals. For example, it is unclear how much, if at all, voluntary taxpayer compliance improved as a result of the Strategy, and the absence of comprehensive cost data makes it difficult to assess return on investment.

GAO identified several areas where opportunities existed to improve any future IRS effort directed at nonfilers. Those opportunities relate to (1) the time it takes IRS to make telephone contact with nonfilers; (2) the use of higher graded staff to perform tasks that might be effectively done by lower graded staff; and (3) procedures for dealing with recidivists—i.e., nonfilers who are brought into compliance and then become nonfilers again.

Principal Findings

Was the Nonfiler Strategy a Success?

According to IRS, the Nonfiler Strategy was a success for several reasons. By purging old cases and redirecting staff from the Examination function to help work nonfiler cases, for example, IRS was able to reduce its nonfiler inventory. The use of Examination staff, along with such things as the establishment of cooperative working arrangements with states and the private sector and implementation of a refund hold program, also helped IRS increase the number of returns secured from individual nonfilers. Under the refund hold program, IRS held refunds claimed by certain individuals who had a prior year's return that was more than 1 year overdue until they either filed the overdue return or explained why there was no filing requirement. (See pp. 15 to 17.)

Compared to the goals of the Strategy, however, the results are less conclusive. It is unclear how much, if at all, voluntary taxpayer compliance improved as a result of the Strategy. For example, of the nonfilers who were brought into compliance in 1993, 38 percent had not filed a tax year 1993 return by August 1995—16 months after the returns were due. IRS does not know how that rate of recidivism compared to past years. IRS also does not have the comprehensive cost data necessary to assess its return on investment. Some cost data, such as the number of Examination and Collection staff years spent on nonfiler work, were available but not enough to determine overall cost. IRS said that it never intended to measure the Strategy's success by cost. In GAO's opinion, however, comprehensive cost data are important if management is to make informed decisions on the nature and extent of future nonfiler efforts. (See pp. 17 to 23.)

Assessment of the results of the Nonfiler Strategy was made more difficult by the general absence of many measurable goals (targets) against which to compare the results. For example, IRS did not have a goal for the number of delinquent returns it wanted to secure during the Strategy or the number of nonfilers it wanted to bring into compliance. IRS agreed that it did not have many specific targets but pointed out that it had several indicators that were designed to show positive or negative trends in results. GAO agrees that it is useful to track trends, but such an exercise is more meaningful if there are goals against which to compare those trends. (See p. 22.)

Opportunities to Improve Future Nonfiler Efforts

In reviewing the Nonfiler Strategy, GAO identified three areas where opportunities existed to enhance any future nonfiler initiatives: (1) the time that elapses before IRS attempts to contact a nonfiler by telephone, (2) the staffing of future nonfiler initiatives, and (3) recidivists.

Telephone Contact With Nonfilers

IRS officials have said that the faster they can act to obtain delinquent returns and related taxes, the more likely that the action will be successful. At the time of GAO's review, however, IRS did not send a first notice to an individual nonfiler until about 1 year after the return was due, and cases that IRS considered to have high potential were not assigned for telephone contact with the nonfiler until several notices had been sent—about 1-1/2 years after the return was due.

IRS has efforts underway to shorten by several months the time before the first notice is sent. As a result of those efforts, IRS expects to move up first contact with certain nonfilers to November of the year the return was due. Besides shortening the time before issuance of the first notice, resolution of nonfiler cases might also be enhanced by more timely telephone contact with the nonfiler after issuance of the first notice—something IRS is trying to do, through an Early Intervention Project, in cases involving delinquent tax payments. As of July 1995, IRS management had under consideration several recommendations by an IRS business reengineering team, some of which were directed at shortening the notice process. (See pp. 25 to 27.)

Staffing of Future Nonfiler Efforts

During each of the 2 years of the Nonfiler Strategy, IRS' Examination function had about 18,000 revenue agents and tax auditors. To help work nonfiler cases, IRS redirected a significant number of those staff (about 4,000 staff years in total during the 2 years) from their regular audit duties. According to IRS data, of the time charged by revenue agents and tax auditors to nonfiler cases that had been closed in fiscal years 1993 and 1994, about 66 percent was charged by GS-11 revenue agents, and another 14 percent was charged by revenue agents above the GS-11 level. When not working on nonfiler cases, revenue agents at those grade levels generally audit complex returns filed by individuals and returns filed by corporations.

GAO is not questioning IRS' staffing decisions for the Nonfiler Strategy. Given the importance of the Strategy and available resources at the time, IRS may have had no other viable option. However, it appears, on the basis of GAO's case reviews and discussions with IRS staff in four district offices, that future nonfiler efforts could be just as effective without IRS relying as much on higher graded revenue agents.

Although Examination managers and staff GAO interviewed in four district offices had several positive things to say about the Nonfiler Strategy and Examination's role in it, a common theme expressed by many of them was that much of the nonfiler case work was the kind of work that could be done by lower graded staff. Options suggested by district office personnel for staffing future nonfiler efforts included (1) using more tax auditors or service center tax examiners instead of revenue agents and (2) making greater use of paraprofessionals or administrative staff. In many of the cases GAO reviewed, for example, Examination's success in securing delinquent returns seemed to be due, in large part, to the agents' and auditors' persistence in contacting nonfilers by telephone and in following up with nonfilers when they missed an appointment or when returns or information they had promised to mail were not received. Because it did not appear that the person making the phone calls needed any special auditing skills, it would seem that IRS could achieve the same result by using paraprofessionals or other lower graded staff, leaving higher graded staff more time to audit. (See pp. 27 to 30.)

Recidivists

In July 1995, the Deputy Commissioner of Internal Revenue approved a strategy for dealing with recidivists—nonfilers who are brought into compliance and then fail to file again in later years. The strategy calls for such things as expediting cases by eliminating some notices. However, the strategy says nothing about revising the language in the notices that will be sent. If IRS plans to send recidivists fewer notices than it sends other nonfilers and to revise other procedures relating to the handling of recidivist cases, the language of the remaining notices may no longer be appropriate for those cases. An IRS official responsible for the nonfiler program acknowledged that if IRS decides to send fewer notices to recidivists, it may need to revise the wording of those notices. It is important that IRS make that determination in a timely manner because of the long process involved in approving and making the computer programming changes needed to revise a notice. (see pp. 30 to 31.)

Recommendations

To better assess the results of future nonfiler efforts, if any, and provide a better foundation for deciding about subsequent efforts, GAO recommends that the Commissioner of Internal Revenue (1) establish measurable goals and (2) develop comprehensive data on program costs.

To enhance any future IRS efforts directed at nonfiling, GAO recommends that the Commissioner of Internal Revenue do the following:

- Revise procedures to provide for more timely telephone contact with nonfilers in line with the reengineering team's recommendations. In that regard, IRS should consider whether the Early Intervention Project, which includes, among other things, earlier telephone contact with taxpayers whose taxes are delinquent, should be extended to nonfilers.
- Consider the feasibility and appropriateness of assigning more nonfiler work to lower graded professional staff, paraprofessionals, and administrative staff. In considering its options, IRS might want to solicit input from district managers and staff who worked on the Nonfiler Strategy.
- Determine, if IRS decides to send fewer notices to recidivists, whether the language of the remaining notices should be revised.

Agency Comments

GAO obtained comments on a draft of this report at a meeting with IRS officials on December 4, 1995. Those comments were expanded on in memoranda dated December 11, 1995, and February 12, 1996. (See pp. 23 and 32.)

IRS officials took strong exception to the "extremely negative tone" of GAO's draft report. They said that the draft focused almost exclusively on criticisms of the Strategy without fully acknowledging its accomplishments and that an uninformed reader would likely judge the Strategy a failure when, in IRS' view, it was generally a success. In response to those comments, GAO revised this summary and chapter 2 of the report to give more prominence to the Strategy's positive aspects and to recognize IRS' position on the Strategy's success. However, although IRS is confident that the Strategy was a success, GAO could not reach the same conclusion given the statistical data available and the absence of measurable goals and comprehensive cost data.

IRS agreed with GAO's recommendation on revising the notices sent to recidivists but took issue with the other recommendations in GAO's draft. In response to IRS' comments and to clarify its intent in some cases, GAO revised the wording of the recommendations.

IRS took most exception to GAO's recommendation about the staffing of future nonfiler efforts. IRS said that the decision to assign nonfiler cases to higher graded Examination employees was a management decision based on the view that maintaining the viability of the nonfiler program outweighed possible short-term productivity losses in other areas.

It was not GAO's intent to second-guess IRS' staffing decisions for the Nonfiler Strategy but rather to suggest that IRS consider other options in staffing any future nonfiler initiatives. GAO revised its recommendation to give IRS more flexibility in deciding how to staff future nonfiler efforts. After seeing the revision, IRS said that it would, in the future, "consider using appropriately graded employees, if available."

Contents

Abbreviations

ACS	Automated Collection Site
IRS	Internal Revenue Service
SFR	Substitute for Return
TDI	Taxpayer Delinquency Investigation

Introduction

Section 6012 of the Internal Revenue Code requires individuals, businesses, and other taxable entities with income over a certain threshold amount to file income tax returns. While most individuals and businesses voluntarily comply with this requirement, millions do not. At the beginning of fiscal year 1993, IRS had an inventory of about 10 million known nonfilers—about 7 million individuals and about 3 million businesses that had not filed one or more required returns.[1] IRS estimated that the amount of unpaid individual income taxes on returns due but not filed for 1992 alone was more than $10 billion.

IRS identifies potential nonfilers in several ways. One of the more significant ways to identify potential nonfilers of individual income tax returns is through the document matching program. Under that program, IRS matches taxpayers' returns with information returns (generally Forms W-2 and 1099) showing income, such as wages and interest, paid by third parties, such as employers and banks. When the match shows income but no corresponding tax return, a potential nonfiler is identified. IRS identifies business nonfilers by computer-matching filed returns with the business' filing requirements. Once it has identified potential nonfilers, and after considering what resources are available, IRS decides what action to take.

In 1993, IRS received about 114 million individual income tax returns. Almost all of those returns were for tax year 1992. For that same tax year, IRS identified 59.6 million potential individual nonfilers. Of the 59.6 million, IRS took no enforcement action on 54.1 million (91 percent), primarily because IRS subsequently determined that the individual or business had no legal requirement to file. Collection officials at IRS' National Office and regional offices evaluated the remaining 5.5 million cases to determine the potential tax due. Cases that IRS judged to have the least potential, 2.5 million, or 46 percent, received a reminder to file. Cases judged to have medium potential, 0.6 million, or 11 percent, received up to 2 notices. Cases judged to have the highest potential, 2.3 million, or 43 percent, received up to 4 notices.

Under IRS procedures, nonfiler cases that are not resolved during the notice process are assigned to either the automated Substitute-for-Return

[1]For purposes of the Nonfiler Strategy, IRS defined a nonfiler as an individual or business with an annual tax return more than 360 days past due or a business with a quarterly return more than 90 days past due.

(SFR) program,[2] an Automated Collection System (ACS) call site,[3] or a district office. Generally, cases are assigned to the automated SFR program when (1) IRS has enough income information from other sources, such as information documents filed by employers and banks, to prepare a return for the nonfiler; and (2) the potential tax due meets established criteria. Other cases are assigned, using predetermined criteria, to ACS or a district office, where they are scored to establish working priority.

Cases assigned to a district office are put in an automated inventory called the "queue" at the district office. Cases with higher estimated net tax yield are assigned to revenue officers in IRS' Collection function. Revenue officers attempt to contact nonfilers and obtain delinquent returns through telephone calls, letters, or visits. Nonfiler cases with low estimated yield may remain in the queue indefinitely.

Objectives, Scope, and Methodology

Our objectives, addressed under our basic legislative authority, were to assess the results of IRS' Nonfiler Strategy and identify any opportunities for IRS to improve future nonfiler efforts.

To accomplish our objectives, we did the following:

- We interviewed IRS National Office officials responsible for overseeing the Nonfiler Strategy about planning and managing the Strategy and about its results.
- We interviewed officials and personnel at the Central, Mid-Atlantic, and Southeastern Regional Offices; Atlanta, Baltimore, Cincinnati, and Detroit District Offices; and Atlanta and Cincinnati Service Centers about their roles in the Nonfiler Strategy, their procedures for implementing the Strategy, and the results obtained. We chose the Central Region and Cincinnati District Office because of earlier work done at those locations. We selected the other locations because they had large inventories of

[2]Section 6020 of the Internal Revenue Code authorizes the Secretary of the Treasury or his designee to make "substitute for return" (SFR) assessments for persons who fail to file their tax returns. In an SFR assessment, IRS determines the taxpayer's liability using a filing status of "single," the standard deduction, and income information available from third parties and notifies the taxpayer that it will assess this amount unless the taxpayer responds by filing a correct return for a different amount. If the taxpayer fails to respond or disagrees with IRS' calculation but does not file a return, IRS pursues the assessment using standard deficiency procedures.

[3]ACS call sites are Collection offices that attempt to resolve nonfiler cases through phone calls. Before doing so, IRS scores the cases to determine investigative priorities. For those nonfiler cases that have a high score compared to other collection cases, an ACS tax examiner attempts to identify the nonfiler's telephone number and, if successful, attempts to contact the nonfiler to secure all past due returns. Cases that ACS is unable to resolve, and that meet certain criteria, are transferred to a district office. Nonfiler cases with lower scores may remain inactive in the ACS inventory indefinitely.

nonfilers. The four district offices had 10 percent of IRS' nonfiler inventory as of August 31, 1993.

- We interviewed Austin Compliance Center officials about their analysis of IRS' process for identifying nonfilers and selecting nonfiler cases.
- We reviewed relevant IRS manuals, instructions, reports, and statistics.
- We reviewed IRS Internal Audit reports and met with Internal Audit personnel doing work in the nonfiler area.

Because IRS' Examination function redirected a significant number of staff to help with nonfiler cases during the Nonfiler Strategy, we took some specific steps directed at that aspect of the Strategy. To help identify the types of nonfiler cases worked by Examination staff, as well as how they were worked, we randomly selected 35 cases worked by Examination in each of the 4 district offices we visited. In each district, we selected 15 cases from the cases closed by Examination in fiscal year 1993, 15 cases from the cases closed by Examination in fiscal year 1994, and 5 cases that had been closed by Examination in fiscal year 1995 but were still physically located at the district offices when we visited them in November and December 1994. These 140 cases involved a total of 464 nonfiled returns. We also reviewed IRS' account records as of February and May 1995 to determine whether the taxpayers in our sample cases remained compliant by filing returns in subsequent years. Our sample results are not projectable. Appendix I contains a profile of the nonfilers in our sample and a profile developed by IRS' Statistics of Income Division from returns filed in fiscal year 1993 that were 360 days or more late.

Much of the statistical data in this report on the results of IRS' Nonfiler Strategy was taken from the Commissioner's Nonfiler Report, a statistical report prepared by National Office staff responsible for overseeing the Strategy. After we finished our review and had drafted our report, IRS told us that the Commissioner's Nonfiler Reports on which we had based our analyses were erroneous. IRS provided revised reports, which showed significant differences from the reports we had relied on. Also, the revised reports covered only 11 months of the fiscal year because data that IRS needed to reconstruct the reports for the full fiscal year were not available. We updated our report and, where appropriate, our analyses to reflect the revised data provided by IRS. We did not assess the data's accuracy or reliability.

We did our audit work from December 1993 through May 1995 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 designee. On December 4, 1995, we met with several IRS officials, including the National Director, Service Center Compliance; the National Director, Compliance Specialization; the Acting Director of the Office of Return Delinquency; and the Acting Director for Special Compliance Programs. They provided us with oral comments, which the National Director, Service Center Compliance, reiterated and expanded on in memoranda dated December 11, 1995, and February 12, 1996. Their comments are summarized and evaluated on pages 23 and 32 and are incorporated in this report where appropriate.

Results of IRS' Nonfiler Strategy

IRS became increasingly concerned about the nonfiler problem in 1991, when its delinquent return inventory—which had been growing by about 12 percent a year—increased by 30 percent. In October 1992, IRS initiated a Nonfiler Strategy with the basic objective of bringing nonfilers into the system and keeping them there. During the planned 2 years of the Strategy, fiscal years 1993 and 1994, IRS took several positive steps to achieve that objective.[4] Those actions included deployment of staff from the Examination function to work on nonfiler cases, an increased emphasis on nonfiler activities by other IRS functions, elimination of aged cases from inventory, cooperative working arrangements with states and the private sector, and implementation of a refund hold program.

IRS considers the Nonfiler Strategy a success because, as a result of the actions noted in the preceding paragraph, IRS, among other things, (1) reduced the size of the nonfiler inventory, (2) eliminated unproductive cases that allowed IRS to focus its enforcement resources more effectively, (3) eliminated backlogs in the automated SFR inventory, and (4) increased the number of returns secured from individual nonfilers.

While we acknowledge all of those accomplishments, our comparison of the results IRS achieved during the 2 years of the Strategy (1993 and 1994) with the results achieved in the year before the Strategy (1992) was inconclusive. Some of the data showed improved results compared with 1992, but other data showed the opposite. The results of the Strategy were also inconclusive when compared with IRS' three goals.

IRS achieved its goal of reducing the backlog of nonfiler investigations, but there is insufficient information with which to judge IRS' success in achieving its other two goals. In that regard, it is unclear how much, if at all, voluntary compliance improved as a result of the Strategy. For example, IRS knows the extent to which nonfilers who were brought into compliance during the Strategy became noncompliant again, but it does not know how that rate of recidivism compares to years before the Strategy. Likewise, IRS did not have the comprehensive cost data needed to assess return on investment—a key component of IRS' third goal. Also affecting an assessment of IRS' results was the absence of measurable goals for such things as the number of overdue returns IRS expected to

[4]Although the Strategy was for only 2 years, IRS decided to continue emphasis on nonfilers as part of its ongoing business. In that regard, the Chief Compliance Officer said, in an August 22, 1994, memorandum that "[a]lthough the same level of resources will not be devoted to the program in the new fiscal year, enforcement activities, outreach and assistance efforts should continue through fiscal year 1995." As part of that continuing effort, Examination provided staffing in fiscal year 1995 to complete work on over 200,000 cases that were in process at the end of fiscal year 1994.

secure or the number of nonfilers IRS expected to bring into compliance during the Strategy. In our opinion, these various factors would make it difficult for IRS management to adequately assess its efforts during the Nonfiler Strategy and make informed decisions on the nature and extent of any future efforts.

IRS Took Several Positive Steps to Address the Nonfiler Problem

The objective of IRS' Nonfiler Strategy, as described by the Commissioner of Internal Revenue in October 1993 testimony before the Subcommittee on Oversight of the House Committee on Ways and Means, was to bring nonfilers into the system and keep them there. The Commissioner cited three goals that IRS established to help achieve that objective: (1) use a combination of outreach and enforcement to improve taxpayer compliance and the identification of nonfilers, (2) eliminate the backlog in the number of nonfiler investigations by the end of fiscal year 1994 so that IRS can work individual nonfiler cases promptly, and (3) improve the way IRS directs its enforcement resources in working nonfiler cases so that it can employ the most effective techniques on different types of cases to achieve the highest return on its resource investment.

A major feature of the Nonfiler Strategy was its crossfunctional approach to a problem that had primarily been the responsibility of one function—Collection. This approach increased the involvement of other functions, such as Examination, Underreporter,[5] Taxpayer Service, and Public Affairs. In that regard, two major components of the Nonfiler Strategy involved the deployment of (1) revenue agents and tax auditors from the Examination function to work nonfiler cases and (2) staff from IRS' Underreporter function to work SFR cases. According to IRS, the Examination and Underreporter functions redirected a total of about 4,000 staff years and 550 staff years, respectively, to those efforts in fiscal years 1993 and 1994.

Another major component of the Nonfiler Strategy was to remove unproductive, low-priority cases from the nonfiler inventory. That inventory is the universe of nonfilers known to IRS and selected for some type of enforcement action. Within that universe are those cases that IRS has selected for possible detailed investigation—known as Tax Delinquency Investigations (TDI). According to IRS, at the start of fiscal year 1993, (1) the nonfiler inventory consisted of about 10.2 million individuals

[5]The Underreporter function is generally responsible for investigating cases of potential income underreporting identified by matching the income reported on tax returns with wage and other income information reported by third parties, such as employers and banks.

and businesses that had not filed at least 1 required tax return and (2) the number of TDI cases stood at 2.3 million.

By the end of fiscal year 1994, IRS had reduced the nonfiler inventory to about 6.8 million cases, mostly by purging millions of cases that IRS deemed to have low potential because of their age. IRS plans to continue purging aged nonfiler cases annually. IRS also reduced the number of TDIS to 1.8 million cases through the deployment of additional resources to help with cases and through other efforts like the refund hold program, discussed later.

Perhaps the most visible component of the Nonfiler Strategy and another example of its crossfunctional nature was IRS' effort to encourage and help nonfilers get back into compliance through outreach and assistance (as opposed to enforcement). The Taxpayer Service function conducted educational workshops and helped taxpayers meet their return filing requirements while Public Affairs had primary responsibility for the communications and outreach strategy. That strategy generated a considerable amount of positive publicity for IRS. As part of the outreach effort, many districts held "nonfiler days" during which IRS volunteers, sometimes accompanied by volunteers from professional associations, such as the American Institute of Certified Public Accountants and the American Bar Association, were available to answer questions and help taxpayers prepare returns.

Many IRS district offices also entered into cooperative working arrangements with state tax agencies. As a result of those joint efforts, IRS obtained tax returns, generated publicity and educational materials, identified market segments to be targeted for outreach efforts and enforcement actions, and gained access to state databases to aid in identifying nonfilers. For example, one state did a comparison that identified a large number of individuals and businesses that had filed state sales tax returns but not federal income tax returns.

Also as part of the Strategy, in January 1994 IRS began putting a hold on refunds claimed by some individuals who had a prior year's return in TDI status. The hold applied to returns involving refund claims above a certain amount filed by persons who were not in bankruptcy or under criminal investigation. IRS instructed the taxpayer by letter to file the delinquent return(s) or explain why there was no filing requirement. IRS' letter also said that if it did not receive either the delinquent return(s) or an acceptable explanation, IRS could prepare a substitute return based on available information. IRS released the refund in cases where there was no filing requirement or the taxpayer established that a significant hardship existed. Otherwise, the refund was applied to the balance due on any delinquent return(s), with any remaining balance sent to the taxpayer.

IRS data show that the refund hold program in 1994 resulted in the receipt of about 106,000 delinquent returns and the collection of about $16 million with those returns. IRS expanded the program in 1995 to include any situation where a refund return for more than a certain amount was filed for tax year 1994 and a prior year's return was more than 1 year overdue, even if the overdue return was not in TDI status. According to IRS data, as of May 1995 IRS had secured about 24,000 returns and collected about $1.8 million in revenue with those returns.

Was the Nonfiler Strategy a Success?

According to IRS, the Nonfiler Strategy was generally a success. In reaching that conclusion, it pointed to several aspects of the Strategy, some of which were discussed in the preceding section. Among other things, IRS cited (1) a decrease in the nonfiler inventory, (2) creation of the refund hold program, (3) elimination of unproductive cases that allowed IRS to focus its enforcement resources more effectively, (4) elimination of backlogs in the automated SFR inventory, (5) increases in the number of returns secured from and dollars assessed against individual nonfilers during the 2 years of the Strategy (fiscal years 1993 and 1994) compared with the year before the Strategy (fiscal year 1992), and (6) a closer working relationship between IRS and outside stakeholders and professional associations.

We assessed the results of the Strategy by looking at the key performance indicators tracked by IRS during the Strategy. We concentrated on indicators that were identified by the Commissioner in her October 1993 testimony—total number of nonfiler returns secured, number of returns filed by unknown nonfilers,[6] and the dollar amount assessed and collected as a result of these filings. For those indicators, we compared data for 1993 and 1994 with comparable data for the year preceding the Strategy—1992 (we could not go back before 1992 because, according to IRS, comparable data were not available). Also, because the basic objective of the Strategy was not only to bring nonfilers into the system but also keep them there, we looked at data on recidivism—the extent to which

[6]Unknown nonfilers are individuals or businesses that IRS did not realize were nonfilers until they filed an overdue tax return.

nonfilers who were brought into compliance during the Strategy became nonfilers again.

While informative, the above analyses were insufficient for us to determine whether the Nonfiler Strategy was a success. We were unable to assess success because IRS (1) did not have specific goals for any of the measures discussed in the preceding paragraph, such as the number of returns it expected to secure or an acceptable rate of recidivism; and (2) did not compile data on the overall cost of the Strategy.

Number of Returns Secured From Nonfilers

IRS' Strategy emphasized bringing individual nonfilers into compliance, and the number of returns secured from individual nonfilers increased steadily during the 2-year period over the number secured in fiscal year 1992. However, IRS also tracked the results of its Strategy on business nonfilers, and the number of returns secured from business nonfilers decreased (see table 2.1).

Table 2.1: Number of Returns Secured From Nonfilers During the Nonfiler Strategy (Fiscal Years 1993 and 1994) and in the Year Preceding the Strategy (Fiscal Year 1992)

Fiscal year[a]	Number of individual returns	Number of business returns	Total returns	Net change from fiscal year 1992
1992	2,221,751	1,446,527	3,668,278	
1993	2,305,167	1,290,225	3,595,392	- 72,886
1994	2,360,760	1,196,615	3,557,375	- 110,903

Note: According to an IRS National Office spokesperson for the nonfiler program, comparable data for years before 1992 were not available.

[a]The data in this table are for the first 11 months of each fiscal year. IRS was unable to provide complete fiscal year data.

Source: Commissioner's Nonfiler Report, National Executive Summary, October 6, 1994, and October 25, 1995.

IRS had intended that the redeployment of Examination staff to work nonfiler cases would free Collection staff in district offices to concentrate on collecting delinquent taxes and working business nonfiler cases. However, IRS' statistics show declining results in both of those areas.

The number of returns secured from business nonfilers declined, as noted earlier. IRS said that this decline could be attributable to an increase in timely filings. Another contributing factor could be the fact that according to IRS data, the percent of time that Collection staff in district offices spent on nonfiler work dropped from 6.3 percent in fiscal year 1992 to 4.9

percent in fiscal year 1993 and 4.2 percent in fiscal year 1994. Whatever the reason for the decrease in returns secured from business nonfilers, the fact remains that during the Nonfiler Strategy and despite the use of thousands of Examination staff to help work cases, the number of returns secured from nonfilers in total was less than the number secured the year before the Strategy was implemented. In addition, district office collections of delinquent taxes decreased almost 9 percent—from about $7.9 billion in fiscal year 1992 to about $7.2 billion in fiscal year 1994. In constant 1994 dollars, the decline in collections was about 13 percent—from about $8.2 billion in fiscal year 1992 to about $7.2 billion in fiscal year 1994.

Table 2.2 shows how many of the returns secured during the Nonfiler Strategy came from unknown nonfilers. Compared with 1992, the average number of returns secured from unknown business nonfilers increased 6.5 percent during the Strategy while the average number of returns secured from unknown individual nonfilers decreased slightly.

Table 2.2: Number of Returns Secured From Unknown Nonfilers in Fiscal Years 1992, 1993, and 1994

		Nonfiler Strategy		
Type of return	**Fiscal year 1992**	**Fiscal year 1993**	**Fiscal year 1994**	**Average**
Individual	132,331	140,760	121,941	131,351
Business	131,808	145,646	135,080	140,363
Total	**264,139**	**286,406**	**257,021**	**271,714**

Note: According to an IRS National Office spokesperson for the nonfiler program, comparable data for years before 1992 were not available.

Source: IRS' Nonfiler Strategy Analysis—Fiscal Years 1993 and 1994.

Net Tax Assessments and Dollars Collected With Returns

IRS officials responsible for the Nonfiler Strategy said that IRS' objective was to bring nonfilers into compliance rather than to generate revenue. Accordingly, collection of additional revenues was not a specific goal of the Strategy. Nevertheless, IRS' key performance indicators for the Nonfiler Strategy included (1) dollars assessed and (2) dollars collected at the time the return was secured.

As shown in table 2.3, if constant 1994 dollars are used, (1) net assessments[7] decreased from fiscal year 1992 to fiscal year 1993 and then increased in fiscal year 1994; and (2) fewer dollars were collected with the return, in absolute numbers and as a percent of net assessments, in 1993 and 1994 than in 1992. The "dollars collected with return" indicator does not reflect the total amount eventually collected from the nonfilers; only the amount collected at the time the return was secured. Additional amounts may have been collected later through installment agreements, but IRS did not track that information.

[7]IRS defines net dollars assessed as gross dollars assessed less any prepaid credits (e.g., withheld taxes) plus any dollars refunded or offset. For example, in one of our sample nonfiler cases, the net assessment was $0, based on a $133 gross assessment, less a $385 withholding credit, plus a $252 refund.

Table 2.3: Net Dollars Assessed on and Dollars Collected With Nonfiler Returns Secured in Fiscal Years 1992, 1993, and 1994[a]

Constant 1994 dollars in billions

Nonfiler returns	Fiscal year 1992	Fiscal year 1993	Fiscal year 1994
Net dollars assessed on individual returns	$7.1	$7.0	$7.1
Net dollars assessed on business returns	3.8	3.7	4.2
Total net dollars assessed	10.9	10.7	11.3
Dollars collected with individual returns[b]	$0.45	$0.39	$0.35
Dollars collected with business returns[b]	0.41	0.41	0.36
Total dollars collected[b]	0.86	0.80	0.71
Percent of net assessment collected with return (individual)[c]	6.3%	5.6%	5.0%
Percent of net assessment collected with return (business)[c]	10.9%	10.8%	8.5%
Percent of net assessment collected with return (combined)[c]	7.9%	7.4%	6.3%

Note: According to an IRS National Office spokesperson for the nonfiler program, comparable data for years before 1992 were not available.

[a]The data in this table are for the first 11 months of each fiscal year. IRS was unable to provide complete fiscal year data.

[b]IRS may collect additional dollars through subsequent payments, such as through installment agreements, but it does not track that information.

[c]Calculations were done using unrounded figures.

Source: Commissioner's Nonfiler Report, National Executive Summary, October 6, 1994, and October 25, 1995, and our calculations of constant dollars.

Repeat Nonfilers

In an internal briefing document prepared for the Commissioner in advance of her October 1993 testimony before the Oversight Subcommittee of the House Committee on Ways and Means, IRS stated that the Nonfiler Strategy would be a success "if the taxpayers who return to the system remain in compliance and we are able to fully pursue compliance from those who don't."

IRS has since found, and our sample cases corroborated, that many of the people brought into compliance during the Strategy had apparently become nonfilers again. IRS matched computer files to determine whether nonfilers brought into the system in fiscal year 1993 filed tax year 1993 returns in 1994. According to IRS, its match showed that 38 percent had not filed by August 1995—16 months after tax year 1993 returns were due. IRS had no data to show how this rate of recidivism compared with other years and no specific rate-of-recidivism goal for the Nonfiler Strategy. Thus, we had no basis for determining whether a rate of 38 percent was acceptable.

Our review of a sample of cases closed by Examination also showed a large rate of recidivism. Of the 60 individuals involved in the sample cases closed in 1993, 29 (48 percent) did not file in 1994. Of those 29, 19 also had not filed in 1995 (as of May 1995), and 10 had extensions to file that had not yet expired.[8] Similarly, of the 60 individuals involved in the sample cases closed in 1994, 31 (52 percent) had not filed in 1995 (as of May 1995); another 12 had extensions to file that had not expired.

Nonmeasurable Goals and Lack of Cost Data Hampered Assessment of the Nonfiler Strategy

IRS did not have measurable goals for most aspects of the Nonfiler Strategy nor comprehensive cost data against which to compare its results. Measurable program goals and reliable data on costs are important if management is to effectively assess its efforts and make informed decisions about future efforts.

Although IRS' basic objective in implementing the Strategy was to bring nonfilers into the system and keep them there, it had no goals for such things as the number of nonfilers it expected to bring into compliance or the percentage of nonfilers it expected to remain compliant in future years. The only measurable goal associated with the Nonfiler Strategy was one that called for reducing the number of TDI cases to 1.5 million cases by the end of fiscal year 1994.

The absence of specific goals makes it difficult for IRS officials responsible for carrying out the Strategy to know exactly what was expected of them and to measure the Strategy's success. Some Examination personnel in the four district offices we visited said that their objective was to redirect a certain amount of staff years to the effort and that they believed the Strategy was successful because they did so. However, an input measure, such as staff years, is less likely to produce a desired outcome than an output or outcome measure, such as the number of nonfilers brought into compliance.

[8]The typical extension to file gives the person an additional 4 months—until August 15—to file.

IRS did not track the overall cost of the Nonfiler Strategy. Some cost-related data, such as the number of Examination and Collection staff years spent on the Nonfiler Strategy, were available, but (1) data on other costs, such as those incurred by other IRS functions like Taxpayer Service and Public Affairs, were not available; and (2) those data that were available were not compiled in a way that would provide management with information on the Strategy's overall cost.

IRS officials explained that return on investment was not really an important consideration with respect to the Nonfiler Strategy and that IRS never intended to measure the success of the Strategy by cost. As noted earlier, however, one of the goals of the Strategy as described by the Commissioner in her October 1993 testimony was to "improve the way we direct our enforcement resources in working nonfiler cases . . . to achieve the highest return on our resource investment [underscoring added]." Comprehensive cost data are also important if management is to make informed decisions on the nature and extent of future nonfiler efforts.

Conclusions

IRS initiated its Nonfiler Strategy to counteract a growing nonfiler problem, and it took many positive steps to deal with that problem. Its outreach effort was commendable as was its recognition that this was an agency problem that required crossfunctional attention. Although IRS considers the Strategy a success, we were not able to reach that same conclusion on the basis of a review of available IRS data. Also, IRS' assessment of the Strategy was limited by the absence of measurable goals and comprehensive cost data against which to compare results.

Recommendations to the Commissioner of Internal Revenue

To better assess the results of future nonfiler efforts, if any, and provide a better foundation for deciding about subsequent efforts, we recommend that the Commissioner of Internal Revenue (1) establish measurable goals and (2) develop comprehensive data on program costs.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from the Commissioner of Internal Revenue or her designee. On December 4, 1995, we met with several IRS officials, including the National Director, Service Center Compliance; the National Director, Compliance Specialization; the Acting Director of the Office of Return Delinquency; and the Acting Director for Special Compliance Programs. They provided us with oral comments, which the National Director, Service Center Compliance, reiterated and expanded on in memoranda dated December 11, 1995, and February 12, 1996.

IRS officials took strong exception to the "extremely negative tone" of our draft report. They said that the draft focused almost exclusively on criticisms of the Strategy without fully acknowledging its accomplishments and that, as a result, an uninformed reader would likely judge the Strategy to have been a failure when, in IRS' view, it was generally a success. In response to those comments, we revised chapter 2 of the report to give more prominence to the positive aspects of the Strategy and to recognize IRS' position on the Strategy's success. We reiterate, however, that although IRS is confident that the Strategy was a success, we could not reach the same conclusion given the statistical data available and the absence of other data.

IRS acknowledged that it had only one goal for which a specific target was set, the TDI goal, but pointed out that it did have several key performance indicators (such as the number of returns secured and the net dollars assessed) that were designed to show positive or negative trends in results. We agree that it is useful to track trends, but such an exercise is more meaningful if there are goals against which to compare those trends. For example, speaking hypothetically, a 5-percent increase in the number of returns secured might look good on its face but would not look as good if the goal were a 25-percent increase. IRS said that experience and statistical information obtained during the 2 years of the Strategy will permit better planning and goal-setting for any future endeavor.

As for cost data—IRS said that it never intended to measure the success of the Strategy by cost and that it is debatable whether all of the goals of the Strategy are amenable to accurate cost/benefit analysis. We are not suggesting that cost should be the sole measure of success, but we think it should be part of any overall assessment.

Our draft report also included a recommendation that IRS reconcile conflicting data on the results of the Strategy. However, as discussed in chapter l, IRS subsequently told us that it had revised some data in the Commissioner's Nonfiler Report. Because those revisions resolved the data inconsistencies referenced in our draft, we dropped that proposed recommendation.

Opportunities to Improve Future IRS Nonfiler Efforts

Our review of the Nonfiler Strategy identified several areas where we think opportunities exist for IRS to enhance future efforts directed at nonfilers. Those areas include (1) the length of time that expires from the time a return becomes delinquent until IRS first attempts to make telephone contact with the nonfiler, (2) the use of higher graded staff to work cases or do tasks that might be effectively done by lower graded staff, and (3) the absence of special procedures for dealing with recidivists—nonfilers who are brought into compliance and then become nonfilers again.

IRS has taken some action in two of these areas. It shortened the time that elapses before a first notice is sent to persons who have been identified as potential nonfilers. However, IRS' procedures still call for sending several notices to a potential nonfiler before IRS attempts to make telephone contact. IRS also developed special procedures for dealing with recidivists. Those procedures call for, among other things, eliminating some notices but say nothing about revising the language of the remaining notices.

IRS Takes a Long Time to Make Telephone Contact With Nonfilers

IRS officials have stated that the faster they can act to obtain nonfiled returns and related taxes, the more likely that the action will be successful. However, as described in chapter 1, IRS' process for identifying and investigating nonfilers is a lengthy one.

To identify nonfilers, IRS computer-matches data on information returns with data on income tax returns. In the past, this match was usually not done until December—after IRS had finished processing information returns and those income tax returns that were filed late because of extensions. IRS staff must then review the results of the match to determine what action to take. Only after that review is the nonfiler sent a notice.

For example, individuals who did not file tax returns in 1993 would not have received a notice until a year later—April 1994. Subsequent notices would have been issued about 6 to 8 weeks later, with the last notice going out in late August 1994. If the case was still unresolved and met the criteria for referral to ACS, it would not have gone to an ACS site for telephone contact until October 1994—1-1/2 years after the return was due. Those cases unresolved by ACS and meeting certain criteria would then be assigned to a revenue officer who might attempt to visit the taxpayer. The whole process may take years, and, as noted earlier, IRS ends up dropping millions of nonfilers from its inventory—more than 5 million in 1994—whose returns have been in inventory for several years.

IRS has a project directed at reducing the time it takes to match data on information returns with data on income tax returns and thus shortening the time before the first notice is issued by several months. As a result of that project, according to an IRS National Office official responsible for managing the Nonfiler Strategy, IRS plans to move up first contact with certain nonfilers to the November after the tax return is due. More significant changes, according to IRS, depend on successful implementation of IRS' multibillion-dollar systems modernization effort, known as Tax Systems Modernization.

Besides shortening the time before issuance of the first notice, as it is now doing, IRS could further enhance the resolution of nonfiler cases by making more timely telephone contact with the nonfiler after issuance of the first notice. We took a similar position in a May 1993 report on IRS' methods for collecting delinquent taxes.[9] In that report, we said the following:

> "According to private and state collectors, early telephone contact is cost-effective and allows the collector to determine why payment has not been made, establish future payment schedules, and update information on the debtor's status. Collectors can also discuss with the debtor possible adverse actions that could be taken if payment is not received."

In the same report, we recommended, among other things, that IRS restructure its collection organization to support earlier telephone contact with delinquent taxpayers. Although that quote and recommendation relate to the collection of delinquent taxes, they would seem equally appropriate to the collection of delinquent returns (and any delinquent taxes associated with those returns).

In January 1995, IRS implemented an Early Intervention Project nationwide. Although the project focuses on the collection of delinquent taxes from persons and businesses that have filed returns, its goal (shortening the notice process and contacting the taxpayer by telephone sooner) is also relevant to delinquent returns. We were told that the project was not extended to nonfilers because sufficient staff would not have been available to handle the resulting workload.

[9] Tax Administration: New Delinquent Tax Collection Methods for IRS (GAO/GGD-93-67, May 11, 1993).

In a similar vein, an IRS business process reengineering team reviewed the collection process and made several recommendations, some of which were directed at reducing the time taken to resolve nonfiler cases by eliminating some notices and moving certain cases more quickly to a call site for attempted telephone contact with the taxpayer. As of July 1995, those recommendations were under consideration by IRS management.

Some Nonfiler Case Work Could Be Done by Lower Graded Staff

Nonfiler cases that cannot be resolved by ACS and that meet certain criteria are referred for investigation by field personnel—revenue officers in IRS' Collection function and, during the Nonfiler Strategy, revenue agents and tax auditors in IRS' Examination function. In 1993 and 1994, IRS' Examination function had about 18,000 revenue agents and tax auditors. Over that 2-year period, Examination redirected about 4,000 staff years to work nonfiler cases.

Of the 140 cases we reviewed that had been closed by Examination in 4 IRS district offices, 92 (66 percent) were worked by GS-11 revenue agents. Of the remaining cases, 40 (29 percent) were worked by staff (generally tax auditors) below grade GS-11, 4 (3 percent) were worked by revenue agents above GS-11, and 4 (3 percent) were worked by staff whose grades could not be determined.[10] Those data are not projectable. However, national data from Examination's management information system showing the hours charged to nonfiler cases closed in fiscal years 1993 and 1994 also showed that GS-11 revenue agents accounted for most of the time spent by Examination on nonfiler work. Specifically, of the approximately 3.6 million hours charged by revenue agents and tax auditors on those cases, about 2.4 million hours (66 percent) were charged by GS-11 revenue agents. Another 491,000 hours (14 percent) were charged by revenue agents above GS-11, and 155,000 hours (4 percent) were charged by agents in grades 5 through 9. The remaining hours were charged by tax auditors. Generally, higher graded revenue agents audit more complex tax returns. For example, when not working nonfiler cases, GS-11 and above revenue agents generally audit complex returns filed by individuals and returns filed by corporations.

Although it helped IRS to reduce its nonfiler inventory and secure delinquent returns, the use of GS-11 and above Examination staff on nonfiler cases might have also contributed to an increase in IRS' audit rate for individual returns and a decline in the audit rate for nonindividual returns. For example, the audit rate for individual returns went from

[10]The percents add to 101 due to rounding.

0.92 percent in fiscal year 1993 to 1.08 percent in fiscal year 1994, an increase that IRS has attributed to the Nonfiler Strategy.[11] At the same time, however, the audit rate for corporate returns decreased from 3.05 percent to 2.31 percent. Although other factors may have contributed to that decrease, several of the revenue agents and Examination officials we interviewed in four district offices told us that if the GS-11 and above agents had not been doing nonfiler work, they would have been doing corporate audits. Examination officials in one district, for example, told us that because of the nonfiler work, the number of corporate audits done in that district decreased by about 10 percent.

Although Examination officials, revenue agents, and tax auditors we interviewed in the four district offices we visited had several positive things to say about the Nonfiler Strategy and Examination's role therein, a common theme expressed by many of them was that much of the nonfiler case work done by revenue agents and tax auditors could have been done by lower graded staff. In one district office, for example, that view was expressed by the Chief and Assistant Chief of Examination as well as the two Branch Chiefs, one Group Manager, three revenue agents, and three tax auditors we interviewed. Our review of case files in the four districts led to a similar conclusion—that the nonfiler case work in those districts involved tasks that could be done by lower graded staff.

Our case file reviews indicated that with some exceptions, the work done on those cases was not so complex that it required the expertise of higher graded staff. That perception was confirmed by several of the agents and auditors we spoke with in the four district offices who said that nonfiler cases were easier to work than audit cases and were not technically challenging. One reason why revenue agents and tax auditors might not have found nonfiler work technically challenging is that audits of returns secured from nonfilers during the Nonfiler Strategy were different from normal audits. As explained in an August 1992 document on the Nonfiler Strategy signed by the then Acting Commissioner, the nonfiler audit process was streamlined so that cases could be worked in a minimal amount of time. As noted in the document, audits of nonfiler returns were to be limited in scope, with the rule of thumb being "if the return makes sense, accept it."

One presumed advantage of using revenue agents on nonfiler cases is that they are accustomed to making field visits to contact taxpayers. However,

[11]Although the returns secured from nonfilers by Examination were often given only a cursory review by a revenue agent or tax auditor, IRS considered them audits for statistical purposes.

in only 15 percent of the cases we reviewed was there any evidence of a field visit, and an IRS analysis of 1,000 cases completed by Examination in one district office showed that a field visit was made in only 23 cases (2.3 percent).

It is not our intent to second-guess IRS' staffing decisions for the Nonfiler Strategy. We do not know what options were available to IRS when it implemented the Strategy and, even if we did, second-guessing would serve no useful purpose. Our intent, rather, is to suggest, on the basis of our case reviews and our interviews of persons involved in doing those cases, that different staffing patterns might be appropriate for future nonfiler efforts, if any. Those patterns might involve (1) using lower graded revenue agents instead of GS-11s, (2) using more tax auditors or service center tax examiners instead of revenue agents, and/or (3) making greater use of paraprofessionals or administrative staff.

The kinds of tasks that could be done by paraprofessionals or administrative staff, in our opinion, include such things as locating nonfilers, contacting them by telephone or letter, scheduling and rescheduling appointments, and preparing SFRS. In many of the cases we reviewed, for example, it was our perception that Examination's success in securing delinquent returns was due, in large part, to the agents' and auditors' persistence in contacting nonfilers by telephone and in following up with nonfilers when they missed an appointment or when returns or information they had promised to mail were not received. Because it did not appear that the person making the phone calls needed any special auditing skills, it seemed that IRS could achieve the same result by using paraprofessionals or other lower graded staff, leaving higher graded staff more time to audit.

One of the district offices we visited had some experience using paraprofessionals. The Detroit District Office, in June 1994, trained 15 Accounting Aides, primarily grade 5, to help prepare reports and case files for nonfiler cases. The Detroit office reported such advantages as enhanced productivity, reduced nonfiler workload, and more time for revenue agents and tax auditors to do other duties. The average annual base salary of a GS-5 in 1995 (figured at step 6, the middle of the pay scale) was $21,827, compared with $33,070 for a GS-9 and $40,010 for a GS-11.

Although our work focused on the use of Examination staff during the Nonfiler Strategy, it seems logical that our observations may also be pertinent to the use of Collection staff. Revenue officers range in grade between GS-5 and GS-12, any of whom, according to Collection officials, might be asked to perform nonfiler investigations.

IRS Recently Developed Special Procedures to Deal With Nonfiler Recidivism

IRS has three broad business objectives, the first of which is to increase voluntary compliance.[12] With that in mind, a key indicator of the success of IRS' nonfiler efforts, in our opinion, is the extent to which nonfilers brought into compliance remain compliant. As noted in chapter 2, our analysis and a broader analysis done by IRS showed that many of the nonfilers brought into compliance in 1993 did not file returns in 1994. IRS spent resources getting these nonfilers to comply only to have many stop filing 1 year later. When they are identified as nonfilers again, IRS must spend additional resources and begin the enforcement cycle again.

IRS developed a strategy for dealing with these repeat nonfilers, whom we refer to as recidivists, that was approved by the Deputy Commissioner in July 1995. The strategy calls for such things as expediting cases against certain nonfilers by eliminating some notices, developing a separate scoring system for recidivists, and referring some cases for possible criminal investigation. IRS officials told us in November 1995 that those procedures were being reconsidered since the extent of recidivism (38 percent) was less than what they thought at the time the procedures were prepared. At that time, IRS' initial analysis of recidivism had indicated a rate of more than 50 percent.

While the proposed strategy for dealing with recidivists calls for eliminating some notices, there is no mention of any intent to revise the language of the notices that will be sent. If the intent is to reduce the number of notices from four to two, for example, by simply eliminating the second and third notices and keeping the first and fourth, then the language in the remaining two notices might have to be revised to reflect the truncated process.

Because a notice's content and format may affect the recipient's ability and willingness to comply, it is important that notices be clear, informative, and comprehensive. The first notice IRS now sends nonfilers, for example, is very low key. It notes that IRS has yet to receive a return and asks the person or business to either (1) file a return, (2) notify IRS if a return has already been filed, or (3) explain why the person or business has no filing requirement. Subsequent notices are increasingly more urgent

[12]The other two objectives are to (1) maximize customer satisfaction and reduce burden and (2) achieve quality-driven productivity through systems improvement and employee development.

in tone. If IRS intends to reduce the number of notices it sends to recidivists, the first notice may have to convey a greater sense of urgency than is now the case while still giving the apparent recidivists the opportunity to explain why they have no filing requirement.

An IRS official responsible for the nonfiler program acknowledged that if IRS decides to send fewer notices to recidivists, it may need to revise the wording of those notices. It is important that IRS make that determination in a timely manner because of the lengthy process involved in approving and making the computer programming changes needed to revise a notice.[13]

Conclusions

We believe that opportunities exist for IRS to further enhance its efforts to deal with nonfilers.

We believe that the quicker IRS can make telephone contact with a nonfiler, the better its chances of making that nonfiler compliant. IRS is moving in that direction by speeding up issuance of the first notice to potential nonfilers. We believe that IRS could move even further in that direction if, as recommended by an internal study group, it reduced the number of notices sent to nonfilers and moved nonfiler cases more quickly to a telephone call site—similar to its Early Intervention Project for delinquent taxes. IRS should consider extending that project to nonfilers, at least to the extent deemed feasible given the amount of staff available to work on the project. In that regard, IRS might want to consider testing early intervention for nonfilers to see what impact, if any, it has on compliance.

Related to our views on telephone contact is our belief that IRS could use its enforcement resources more efficiently in dealing with nonfilers. We believe that it is to IRS' benefit to limit as much as possible the extent to which higher graded enforcement staff are doing work that could be done effectively by lower graded enforcement staff or even, in some instances, by paraprofessionals or administrative staff. As we discussed earlier, for example, successful closure of many of the cases we reviewed seemed to be due, in no small part, to the revenue agent's persistence in calling nonfilers. We see no reason why lower graded staff could not be just as persistent.

[13]We discussed this issue in a recent report entitled Tax Administration: IRS Notices Can Be Improved (GAO/GGD-95-6, Dec. 7, 1994).

Keeping nonfilers compliant once they have been brought into compliance is critical if IRS is to increase voluntary compliance and maintain control over its nonfiler workload. IRS' recently approved strategy for dealing with recidivism, if implemented, would be a big step in the right direction. Part of that strategy calls for reducing the number of notices sent to recidivists. There is no mention, however, of any intent to review the language of the remaining notices to ensure that it is still appropriate.

Recommendations to the Commissioner of Internal Revenue

To enhance any future IRS efforts directed at nonfiling, we recommend that the Commissioner of Internal Revenue do the following:

- Revise procedures to provide for more timely telephone contact with nonfilers in line with the reengineering team's recommendations. In that regard, IRS should consider whether the Early Intervention Project, which includes, among other things, earlier telephone contact with taxpayers whose taxes are delinquent, should be extended to nonfilers.
- Consider the feasibility and appropriateness of assigning more nonfiler work to lower graded professional staff, paraprofessionals, and administrative staff. In considering its options, IRS might want to solicit input from district managers and staff who worked on the Nonfiler Strategy.
- If IRS decides to send fewer notices to recidivists, it should determine whether the language of the remaining notices should be revised.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from the Commissioner of Internal Revenue or her designee. On December 4, 1995, we met with several IRS officials, including the National Director, Service Center Compliance; the National Director, Compliance Specialization; the Acting Director of the Office of Return Delinquency; and the Acting Director for Special Compliance Programs. They provided us with oral comments, which the National Director, Service Center Compliance, reiterated and expanded on in memoranda dated December 11, 1995, and February 12, 1996.

In commenting on our draft, IRS said that it agreed with only one of our three recommendations—the one dealing with the language of notices sent to recidivists.

IRS said that our proposed recommendation on timely contact with nonfilers was unnecessary because IRS has been working to accelerate the processing of information returns for several years with the intent of making earlier contacts with nonfilers and filers who have underreported their income. We have revised the body of our report to more clearly acknowledge those efforts. However, our recommendation was intended to go beyond the initial identification of and contact with nonfilers. Our intent was to encourage IRS to make more timely telephone contact with nonfilers. Although the accelerated processing of information returns should speed up the entire process and lead to quicker telephone contact, we believe that there are other steps IRS could take, similar to its Early Intervention project for delinquent taxes, to help achieve that end. In that regard, we think our recommendation is necessary, and we have reworded it to clarify the focus on earlier telephone contact.

In response to our revised recommendation, IRS said that it (1) has established the framework for expanding the Early Intervention Project to business nonfilers, if sufficient resources become available; and (2) does not anticipate having sufficient staffing to expand the Project to individual nonfilers. IRS said that if circumstances change in the future, it may find it feasible to consider including individual nonfilers in the Project. Although we acknowledge the resource limitations, we wonder whether it might be feasible for IRS to revise the Early Intervention Project to include a mix of delinquent tax and nonfiler cases, even if that means having to exclude some delinquent tax cases, rather than limiting the Project to only delinquent tax cases. That might enable IRS to assess the relative benefits of early intervention on both types of cases.

IRS took most exception to our proposed recommendation on assigning nonfiler case work. IRS said that the recommendation was unnecessary and reflected a basic misunderstanding of the purpose of the Nonfiler Strategy. IRS said that the decision to assign nonfiler cases to Examination employees, even those capable of working higher graded, more productive cases, was (1) a management decision based on the view that maintaining the viability of the nonfiler program outweighed possible short-term productivity losses in other areas and (2) a short-term response to stem the growth of the nonfiler inventory that was never intended as an ongoing work assignment practice. IRS also said that a review of the special nonfiler auditing standards makes it clear that techniques needed under the nonfiler initiative required more technical expertise than could be provided by paraprofessionals.

As noted earlier, it was not our intent to second-guess IRS' staffing decisions for the Nonfiler Strategy but rather to suggest that IRS consider other options in staffing any future nonfiler initiatives. Our work at four district offices indicated that other options might be more efficient, depending on the availability of staff. In that regard, our review of case files in four district offices indicated that the audit work on nonfiler cases in those districts was often less involved than suggested by the auditing standards referred to by IRS and thus often did not require the expertise of GS-11 revenue agents. That perception was supported by many of the district office Examination staff and managers we interviewed who said that nonfiler work could be done by lower graded staff. Those lower graded staff could be revenue agents below GS-11 or tax auditors or, for some tasks, paraprofessionals or administrative staff. We revised the report and reworded the recommendation to avoid the impression that we are advocating that all nonfiler work be done by paraprofessionals.

IRS also questioned how we could draw conclusions about staffing when our review was limited to four districts and our results are not projectable. We believe the scope of our work was sufficient to raise questions about the level of staffing needed to do the kind of nonfiler case work that was done during the Nonfiler Strategy. We agree, however, that it was not sufficient to support a specific recommendation that IRS adopt different staffing patterns for any future nonfiler effort (which is how we had worded the recommendation in our draft report). Thus, we revised our recommendation to (1) give IRS more flexibility in deciding how, if at all, the staffing of future nonfiler efforts should differ; and (2) suggest that IRS, in considering its options, solicit input from managers and staff in district offices that we did not visit.

After we revised our recommendation, IRS advised us that it will, in the future, “consider using appropriately graded employees, if available.”

Profiles of Individual Nonfilers

IRS' Statistics of Income Division developed a profile of individual nonfilers from returns filed in fiscal year 1993 that were 360 days or more late. That profile showed that 1.7 million taxpayers filed 2.6 million returns that were 360 days or more late in fiscal year 1993. Of the 1.7 million taxpayers, 71 percent filed 1 return, 18 percent filed 2 returns, and 11 percent filed 3 or more returns.

Of the 2.6 million returns:

- Forty-three percent were at least 1 year but less than 2 years past due, 41 percent were either 2 or 3 years late, and 16 percent were more than 3 years overdue.
- Forty percent were from wage earners with no self-employment income; 23 percent were filed by those claiming self-employment income or some combination of wages and self-employment income; and 5 percent were filed by persons claiming income only from other sources, such as interest and dividends, alimony, and capital gains. No data were available for the other 32 percent.
- Fifty-five percent involved a balance due, 38 percent involved a refund, and 7 percent had a zero balance.
- Eighty-three percent were filed by taxpayers older than 31.
- Forty-five percent were from persons who filed as "single,"[14] 31 percent were from persons who claimed the "married filing jointly" status, 14 percent were from persons who filed as the "head of household," and 10 percent were from persons who claimed the "married filing separately" status.

Table I.1 shows some profile data from the returns in our sample of individual nonfiler cases closed by the Examination Division in four IRS district offices in fiscal years 1993, 1994, and 1995. Our sample included 140 cases—60 cases closed in fiscal year 1993, 60 cases closed in fiscal year 1994, and 20 cases closed in fiscal year 1995. Those cases involved 182, 207, and 75 returns, respectively—an average of about 3 returns per case.

[14]The number of returns on which the "single" filing status was claimed would include all returns prepared by IRS under the SFR program. In computing the tax liability to be assessed on an SFR return, IRS assumes that the taxpayer is single.

Table I.1: Profile Data From Returns in Our Sample of Individual Nonfiler Cases

Individual nonfiler cases	Closed in FY 1993	Closed in FY 1994	Closed in FY 1995
Filing status (returns)			
Single	60	110	27
Married filing jointly	64	47	21
Married filing separately	42	43	23
Head of household	15	7	1
Other/unknown	1	0	3
Total	**182**	**207**	**75**
Preparer of return			
Taxpayer	63	67	15
Preparer	79	70	16
Exam staff	32	62	41
Other	4	3	0
Unknown	4	55	3
Total	**182**	**207**	**75**
Taxpayer self-employed?			
Yes	133	170	57
No	44	32	15
Unknown	5	5	3
Total	**182**	**207**	**75**

We also stratified our 140 sample cases by average annual adjusted gross income. We computed the average for each case by adding the adjusted gross income shown on each return secured from the nonfiler and dividing the total by the number of returns secured from that nonfiler. The results are shown in table I.2.

Table I.2: Stratification of Our Nonfiler Case Sample by Average Adjusted Gross Income

Average adjusted gross income	Number of cases in our sample
Under $10,000	37
$10,000 to $19,999	48
$20,000 to $29,999	26
$30,000 to $39,999	9
$40,000 to $49,999	8
$50,000 to $59,999	1
$60,000 and over	11
Total	**140**

Source: Nonfiler cases in GAO's sample.

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