

April 2000

TAX ADMINISTRATION

IRS' Low-Dollar Notices Sent to Individual Taxpayers



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

General Government Division

B-284264

April 14, 2000

The Honorable Bill Archer
Chairman, Committee on Ways and Means
House of Representatives

The Honorable Amo Houghton
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

IRS begins the process of checking whether taxpayers have reported the correct tax liability on their tax returns as the returns are being processed at IRS Service Centers. An example of such checking is when returns are reviewed for computational errors. IRS' checking process also includes computer matching of information reported by taxpayers on their returns with information reported to IRS by third parties (e.g., a bank report of interest earnings). Based on the results of such checks, IRS sends computer-generated notices to communicate with taxpayers about discrepancies it has found and adjustments it has made to their tax returns.¹ In 1999, IRS sent 31 million such notices to individual taxpayers.

The notices IRS sends have long been a source of taxpayer complaint and misunderstanding, especially those that involve relatively small amounts of money. Recognizing that taxpayers spend time and resources to deal with these notices, even when small amounts of money are involved, you asked us to develop information about computer-generated notices involving (1) amounts due of less than \$5 or (2) refunds of less than \$1. As agreed with your office, we met with IRS officials and used IRS data on notices sent during tax year 1999 to determine

- the number and type of computer-generated low-dollar notices IRS sends to individual taxpayers;
- IRS' cost to prepare and send these notices, respond to taxpayer inquiries related to them, and process any resulting payments; and
- the reasons IRS sends these notices and any plans it might have regarding them.

¹IRS does not consider such checking activities to be audits, and the notices taxpayers receive as a result of them are not considered audit contacts. Further, these are not the only notices that IRS may send to taxpayers. Other notices can result from subsequent IRS processes, such as audits and collections.

Results in Brief

Of the over 31 million computer-generated notices IRS sent to individual taxpayers in 1999, about 1.5 million were low-dollar notices. Eighty-two percent of these (about 1.3 million) reflected adjustments IRS had made to correct discrepancies such as those between information reported to IRS by a third party and information reported on the taxpayer's original return. Most notices had zero balances, requiring no additional action or response by the taxpayer. However, in considering taxpayer burden issues related to low-dollar notices, it is important to note that in the vast majority of cases, while the final dollar amounts reported on the notices were small or zero, they represented "net" amounts. That is, they were the net result of changes to the taxpayer's account involving larger amounts.

According to IRS estimates, the agency cost to prepare and send a low-dollar notice is about \$0.42. The cost would rise by about an additional \$1.30 if IRS needed to process a payment received from a taxpayer because of the original notice, and by another \$14.32 if it needed to respond to a taxpayer inquiry related to the notice.

IRS sends low-dollar notices to taxpayers pursuant to statutory requirements, such as to correct a math error (Internal Revenue Code section 6213(b)) or to issue a notice of deficiency (Internal Revenue Code section 6212), or in accordance with the IRS Internal Revenue Manual. The notices, which inform taxpayers of any change to their account, are sent regardless of the dollar amounts involved. IRS is aware of the potential burden placed on taxpayers in dealing with low-dollar notices and has formed an internal task team to examine the issue and identify potential improvements.

Background

In 1998, over 123 million individual taxpayers filed income tax returns. For most, this ended their interaction with IRS for the year, aside from any refund they might receive. IRS audits about 1 percent of individual taxpayers and has nonaudit contacts with millions of other taxpayers about mistakes (e.g., computational or "math" errors) they might have made. Computer-generated notices are an important type of nonaudit contact and a major means through which IRS communicates with taxpayers about such mistakes on their returns.

Although they are sent to advise taxpayers of changes IRS has made to their accounts, notices differ in purpose and content. One type of notice explains changes IRS makes to a taxpayer's account because it has found discrepancies between a tax return and information it has received from one or more third parties. These discrepancies are detected when IRS performs computer matches of the information it receives from banks and

other third parties with that reported on the taxpayers' original returns. When discrepancies are found, IRS adjusts the taxpayers' account and sends a notice explaining what it has done and the effect on their tax liability. IRS uses a second type of notice to inform taxpayers of computational errors in their returns, the corrections it has made, and any resulting change in their tax liability. A third type of notice concerns instances in which taxpayers have requested an IRS computation of their return, and it is sent to inform the taxpayers of IRS' results. Finally, IRS uses notices to inform taxpayers when the total estimated tax payments that they have reported do not agree with IRS' information.

Scope and Methodology

To determine the number and types of computer-generated low-dollar notices IRS sent in 1999, we obtained data from IRS on the over 31 million notices the agency sent to taxpayers notifying them of changes to their accounts, including those that involved low-dollar amounts. We reviewed the data in terms of the dollar amounts of the notices, the reasons for sending them, and the dollar amounts of the underlying account adjustments causing the notices to be sent.

We obtained data from IRS personnel working in the Taxpayer Correspondence and Submission Processing areas regarding the cost involved in preparing and sending notices to taxpayers and other data reflecting the cost to respond to subsequent taxpayer inquiries or to process payments made by taxpayers.

To identify the reasons that IRS sends low-dollar notices to taxpayers, we met with Customer Service officials at IRS' National Office and Notice Review officials at the Kansas City Service Center and reviewed relevant information they provided to us.

We also obtained examples of low-dollar notices sent to taxpayers and discussed with IRS program staff the causes, reasons, and other issues related to these and other notices.

We conducted our work from November 1999 to February 2000 in accordance with generally accepted government auditing standards. We performed work at the IRS National Office in Washington, D.C., and at the IRS Kansas City Service Center. We did not assess the internal controls, completeness, or accuracy of IRS notice records.

On March 13, 2000, we requested comments on a draft of this report from the Commissioner of Internal Revenue. The comments are discussed at the end of this letter and reprinted in the appendix.

Number and Type of Low-Dollar Notices Sent

Of the over 31 million computer-generated notices IRS sent to individual taxpayers in 1999, about 1.5 million were low-dollar notices. As table 1 shows, about 1.3 million, or 82 percent, were to inform taxpayers about adjustments IRS made to their accounts because of discrepancies it detected. There were many fewer notices about taxpayer computational errors, IRS computations made at the request of taxpayers, and mistakes in estimated tax credits—7, 5, and 4 percent, respectively.

Table 1: Low-Dollar Notices Sent by IRS in Calendar Year 1999

Type of notice	Number of notices			Total
	Zero balance	Refund due	Payment due	
IRS adjustments	931,845	69,269	260,781	1,261,895
Taxpayer error	93,324	4,492	11,390	109,206
IRS computation of tax or refund due	78,721	567	145	79,433
Estimated tax credit discrepancy	43,243	1,022	21,197	65,462
Others	14,105	680	1,493	16,278
Total	1,161,238	76,030	295,006	1,532,274

Source: GAO compilation of IRS data.

Table 1 also shows that most notices did not involve refunds or payments due. About 1.2 million, or 76 percent, had zero balances, meaning no further action was required on the part of the taxpayer.

However, in considering the potential effects of low-dollar notices on taxpayers, it is important to note that while the final dollar amounts shown on the notices were small or zero, many notices reflected changes involving larger dollar amounts. To illustrate, a taxpayer may be expecting to receive a refund of \$315 based on the tax return he or she filed (see fig. 1). However, due to an adjustment that IRS made to the tax return, the taxpayer may now owe \$3.92, and IRS would send a notice reflecting the adjustment.

Figure 1: Illustration of a Low-Dollar Notice

Department of the Treasury
Internal Revenue Service
Kansas City MO 64999

Date of this notice: Jan. 10, 2000
Taxpayer Identifying Number:
Form 1040 Tax Period: Dec. 31, 1997

For assistance you may
call us at: x-xxx-xxx-xxxx

Caller ID:

We changed your account

We changed your 1997 account to correct your interest and/or dividend income and other income.

If you have any questions, please call us at the number listed above.

Statement of account

Account balance before this change	Prior payment	\$315.00cr	Dec. 10, 1999
Increase in tax because of this change		281.00	
Interest charged		37.92	
Amount you now owe		\$3.92	

Please pay the full amount by Jan 20, 2000. If you've already paid your tax in full or arranged for an installment agreement, please disregard this notice.

If you haven't paid, mail your check or money order and the tear-off stub from the last page of this notice. Make your check payable to the United States Treasury and write your Social Security Number on it. If you can't pay in full, please call us to discuss payment.

Note: This is an illustration of page 1 of a multipage notice. The additional pages include information explaining penalty and interest charges.

Table 2 shows that, for the previously mentioned 1.3 million notices with discrepancies that IRS detected, a majority (78 percent) involved underlying adjustments from \$150 to \$14,999.

Table 2: IRS Adjustment Notices and Corresponding Adjustments to Taxpayers' Accounts

Type of notice	Number of notices by corresponding adjustments					Total
	\$0 to \$14.99	\$15 to \$149	\$150 to \$1,499	\$1,500 to \$14,999	More than \$15,000	
Zero balance	27,171	143,955	566,168	185,408	9,143	931,845
Refund due	2,638	11,428	48,243	6,736	224	69,269
Payment due	17,320	65,553	157,015	20,201	692	260,781
Total	47,129	220,936	771,426	212,345	10,059	1,261,895

Source: GAO compilation of IRS data.

IRS' Cost to Prepare and Send Notices

IRS estimates that, in most cases, it costs about \$0.42 to prepare and send a notice, an amount that includes labor, supplies, and postage. This cost reflects the fact that, for the most part, IRS' process to prepare and send notices is computerized. The notices are automatically printed and sent to taxpayers. In a small percentage of cases, when IRS randomly selects a low-dollar notice for a quality review, the cost rises to \$0.70.

There are other instances when the cost is higher, however. For example, in some cases, IRS notices result in taxpayers submitting payments to IRS. These payments generally pass through up to 10 separate processing steps, such as mail sorting, computer data input, data verification, account resolution, and deposit. Further, depending on the volume of payments to be processed, the time involved can range from 1 to 15 days. According to IRS estimates, the cost to process each such taxpayer payment is about \$1.30.

Another instance where the cost is higher is when the receipt of the original notice by the taxpayer generates further correspondence between the taxpayer and IRS. In these cases, an IRS staff member would generally respond directly to the taxpayer regarding the correspondence or the information provided. IRS estimates the cost for these cases to be about \$14.32 because of the additional amount of labor required.

Why IRS Sends Low-Dollar Notices

The fact that most low-dollar notices do not require any taxpayer action raises a question as to why IRS sends them, particularly those having a zero balance. The answer is that IRS notifies taxpayers, pursuant to a statutory provision or in accordance with the IRS Internal Revenue Manual, of any changes it makes to their account, regardless of the dollar amounts involved.

IRS' Internal Task Team Evaluating Low-Dollar Notices

IRS recognizes the possible burden placed on taxpayers as a result of low-dollar notices and has formed an internal task team to examine the issue. The team, formed in early 1999 and comprised of staff from various IRS functional disciplines, is obtaining information and developing possible solutions. In that regard, the team has been analyzing different aspects of the issue, including computer programming, legal requirements, and impact on taxpayers.

One possible proposal identified by the team is for IRS to add specific language to all low-dollar notices informing taxpayers that the notice is not a bill and that payment by the taxpayer is not required. This would allow IRS to meet its requirements for advising taxpayers of changes made to their accounts but reduce the burden on the taxpayers in terms of responding to IRS. Another idea being considered is the possibility of reprogramming IRS' computers so that low-dollar payments due are changed to zero balances, and the notices sent to taxpayers would explain the adjustment.

The task team expects to complete its work over the next several months and send its final report to the IRS Commissioner by the end of calendar year 2000.

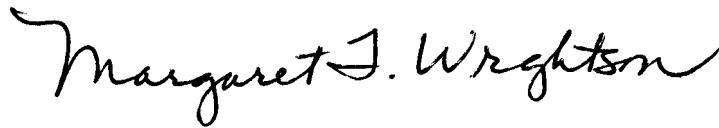
Agency Comments

The Commissioner of Internal Revenue provided written comments on a draft of this report in an April 5, 2000, letter, which is reprinted in the appendix.

IRS said that it was pleased that we cited its efforts to recognize and reduce the possible burden placed on taxpayers as a result of low-dollar notices. IRS also highlighted several examples of recommendations being considered by its internal task team studying the issue.

We are sending copies of this report to Senators William V. Roth, Jr., and Daniel P. Moynihan, the Chairman and Ranking Minority Member of the Senate Finance Committee; Representatives Charles B. Rangel and William J. Coyne, Ranking Minority Members of the House Committee on Ways and Means and Subcommittee on Oversight, respectively; the Honorable Lawrence H. Summers, Secretary of the Treasury; and the Honorable Charles O. Rossotti, Commissioner of Internal Revenue. We will also make copies available to others upon request.

If you have any questions, please call me or Joseph E. Jozefczyk at (202) 512-9110. A key contributor to this report was Julie A. Cahalan.

A handwritten signature in black ink that reads "Margaret T. Wrightson". The signature is written in a cursive style with a large, stylized "M" and "W".

Margaret T. Wrightson
Director, Tax Policy and
Administration Issues

Comments From the Internal Revenue Service



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

April 5, 2000

Ms. Margaret T. Wrightson
Associate Director, Tax Policy
and Administration Issues
U.S. General Accounting Office
Washington, DC 20548

Dear Ms. Wrightson:

Thank you for the opportunity to review and comment on the GAO's draft report entitled "Low Dollar Notices" (Job Code 268901). I am pleased you cited our efforts to recognize and reduce the possible burden placed on taxpayers as a result of low dollar notices.

In certain situations, such as where there are clerical or mathematical errors, we are required by law to tell taxpayers when we change their tax return information, even if the change results in the taxpayer owing a small dollar amount. Our internal task force is examining various ways that we may be able to better serve the taxpayer, such as:

- adding specific language to all low-dollar notices informing taxpayers that the notice is not a bill and payment is not required;
- requesting a change to the legal requirement for issuing notices where adjustments have been made because of clerical or mathematical errors; or
- reprogramming computers so that low-dollar payments due are changed to zero balances and the notices sent to taxpayers would explain the adjustment.

We will make this decision by the end of April. Of course, there would be times when sending a small dollar notice is appropriate. As stated in your report, if a taxpayer is expecting a refund, but ultimately has a small balance due, we would certainly want to notify him/her of the reason. We believe the taxpayer would also want to be notified in this instance.

We are committed to reducing taxpayer burden and providing quality service to all taxpayers. Eliminating the requirement of sending notices to taxpayers for all clerical or mathematical error adjustments resulting in a small balance due will help us reach our goal.

Comments From the Internal Revenue Service

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If you have any questions or need additional information, please let me know or your staff may contact Robert C. Wilkerson, Assistant Commissioner (Customer Service) at (202) 622-5044.

Sincerely,


Charles O. Rossotti

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