

**Consolidated Report on Opportunities for the
Internal Revenue Service to Improve
Service to Business Taxpayers**

December 1999

Reference Number: 2000-30-015

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.




DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

December 9, 1999

MEMORANDUM FOR COMMISSIONER ROSSOTTI

FROM: Pamela J. Gardiner 
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Consolidated Report on
Opportunities for the Internal Revenue Service to Improve
Service to Business Taxpayers

This report presents the combined results of our comprehensive effort to identify opportunities for the Internal Revenue Service (IRS) to better serve business taxpayers and to increase IRS efficiency and effectiveness. We initiated a series of reviews and analyses of the following five processes in which business taxpayers frequently deal with the IRS: providing upfront education, establishing a new business entity, processing Federal Tax Deposits (FTD), monitoring FTD compliance, and processing tax returns. In addition to summarizing results from previously issued audit reports, this report includes additional opportunities for improvement.

During our review, the IRS announced its plans to modernize and change the way it does business. To complement the modernization efforts, we identified three opportunities for the IRS to reduce burden and improve service to business taxpayers, and increase its efficiency and effectiveness. These involve expanding the avenues for providing education to small businesses, re-evaluating the current program for monitoring and following up on delinquent FTD payments, and moving towards centralized processing of business tax returns in two locations.

The Chief Operations Officer initiated appropriate corrective actions in response to the recommendations in the report. Management's comments have been incorporated into the report where appropriate, and the full text of their response is included as an appendix.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions, or your staff may call Gordon C. Milbourn, Associate Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

**Consolidated Report on Opportunities for the Internal Revenue Service
to Improve Service to Business Taxpayers**

Table of Contents

Executive Summary	Page	i
Objective and Scope	Page	1
Background.....	Page	3
Results	Page	4
Process I: Providing Upfront Education and Assistance	Page	5
Greater Emphasis Needs to Be Placed on Education to Help Taxpayers Understand and Comply with Their Federal Tax Obligations	Page	6
Process II: Establishing a New Business Entity	Page	11
Process III: Processing Federal Tax Deposits	Page	12
Process IV: Monitoring Federal Tax Deposit Compliance	Page	16
The Program for Monitoring Federal Tax Deposit Payments Focuses on Only a Small Percentage of Taxpayers and May Not Result in More Timely Full Payment	Page	16
Process V: Processing Tax Returns	Page	20
Business Tax Return Processing Is Costly Because the Majority of the Returns Are Manually Processed and Resolved.....	Page	20
Conclusion	Page	28
Appendix I – Detailed Objective, Scope, and Methodology.....	Page	30
Appendix II – Major Contributors to This Report	Page	32
Appendix III – Report Distribution List.....	Page	33
Appendix IV – Overview of the Reviews Dealing with Business Taxpayers.....	Page	34
Appendix V – Electronic Data Processing Data Validation.....	Page	38
Appendix VI – Management’s Response to the Draft Report.....	Page	39

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

Executive Summary

This report presents the combined results of a series of reviews and analyses dealing with business taxpayers. The overall objective of this collective effort was to identify opportunities for the Internal Revenue Service (IRS) to:

- Better serve business taxpayers by reducing taxpayer burden and improving customer service.
- Increase IRS efficiency and effectiveness.

For these reviews, we defined business taxpayers as corporations, small business corporations, partnerships, fiduciaries, employers, or individuals with their primary source of income from a sole proprietorship or farm. These taxpayers represent approximately 14 percent of total taxpayers and 85 percent of total dollars collected by the IRS. In Fiscal Year (FY) 1996, there were approximately 18 million business taxpayers who filed about 47 million tax returns and paid an estimated \$1.3 trillion in taxes.

We conducted reviews of five processes in which business taxpayers frequently deal with the IRS: providing upfront education, establishing a new business entity, processing Federal Tax Deposits (FTD), monitoring FTD compliance, and processing tax returns. We conducted audit work to varying degrees within each process and recommended opportunities for improvement. In addition to summarizing those reviews in this report, we are making additional recommendations to improve service provided to business taxpayers. (Appendix IV provides an overview of the individual reviews and recommendations and actions taken by IRS management to address the recommendations.)

Results

The current IRS systems and procedures for business taxpayers were designed to primarily facilitate IRS operations rather than address all the various individual needs of taxpayers. As a result, they are often complex, confusing, and burdensome. We determined that the processes for dealing with business taxpayers could be improved and updated.

The IRS recognized that across-the-board changes were needed and, in January 1998, announced its plans to modernize and change the way it does business. The goals of the new, modernized organization are to enable taxpayers to better understand and comply with the tax laws and ensure fairness in compliance programs. In addition, the IRS implemented changes during our review. For example, the IRS increased the threshold

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

requirement for making FTDs so that taxpayers would not have to make FTDs until their employment taxes reached \$1,000 per quarter, up from \$500 per quarter. This should eliminate monthly FTDs and reduce taxpayer burden for approximately 500,000 small business taxpayers.

To complement the modernization efforts, we made recommendations in the series of individual audits that addressed opportunities for the IRS to reduce burden and improve service to business taxpayers. The following highlights the actions taken or planned by the IRS in response to some of our recommendations made in the series of individual audits, as well as the potential benefits to both business taxpayers and the IRS.

- **The IRS submitted a request for programming changes in computer instructions to prevent notices to new businesses who have not filed an employment tax return because they have not yet hired employees.**

Benefits to Business Taxpayer

-- Eliminates notices to at least 18 percent (about 219,000) of the 1.2 million taxpayers who file at least one \$0 Employer's Quarterly Federal Tax Return (Form 941) during the year.

Benefits to the IRS

-- Fewer notices and cases on delinquent returns.

- **The IRS will conduct a risk assessment to explore the possibility of having taxpayers satisfy their Form 941 filing requirements via a telephone call if they have \$0 liability.**

Benefits to Business Taxpayer

-- Could eliminate the need to file \$0 liability Form 941 returns.

Benefits to the IRS

-- Could reduce processing costs by eliminating approximately 2 million \$0 liability Form 941 returns annually.

- **The IRS will develop new criteria for identifying taxpayers who may need an early contact to fully pay their delinquent employment tax liabilities.**

Benefits to Business Taxpayer

-- Could increase early notification of missed or substantially underpaid FTD payments.

Benefits to the IRS

-- Could increase revenue by contacting taxpayers with delinquent tax liabilities earlier.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

- **The IRS will revise customer surveys for small business workshops and classes to obtain evaluative feedback, and use the feedback to identify taxpayers' needs.**

Benefits to Business Taxpayer

-- Updated educational products that better meet taxpayers' needs.

Benefits to the IRS

-- Ability to obtain and track feedback from approximately 260,000 taxpayers attending small business workshops and classes annually.

- **The IRS will increase publicity about its educational workshops for businesses by using the Internet and business periodicals, and expand joint efforts with tax professional organizations to recruit volunteers to be instructors at tax workshops.**

Benefits to Business Taxpayer

-- Increases awareness and use of the various educational products and avenues offered by the IRS.

Benefits to the IRS

-- Could increase taxpayers' understanding of how to comply with their tax obligations.

In addition to these actions already taken or planned, the IRS can further improve its processes by considering the following areas for improvement.

Greater Emphasis Needs to Be Placed on Education to Help Taxpayers Understand and Comply with Their Federal Tax Obligations

The existing avenues for providing education to small businesses are not readily available to all taxpayers. Although the IRS is seeking to expand the types of education offered, it will not be able to reach all taxpayers. Many taxpayers: live outside the geographical location where workshops, classes or walk-in sites are offered; may be reluctant to attend an IRS-sponsored event; and/or may not have Internet or CD-ROM access.

The Program for Monitoring Federal Tax Deposit Payments Focuses on Only a Small Percentage of Taxpayers and May Not Result in More Timely Full Payment

The current program to identify taxpayers who do not make their FTD payments does not consider both organizational goals of increased revenue and increased compliance and may not result in more timely full payment. The IRS concentrates on only a small

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

number of taxpayers when making early contacts about missed FTD payments, which does not sufficiently address the goal of increased compliance among all taxpayers. We also question the effectiveness of the current program because taxpayers fully paid their tax liabilities at about the same rate (88 percent within a year for employers with more than or equal to \$50,000 annual Form 941 liability versus 82 percent for employers with less than \$50,000 annual liability), regardless of whether they were included in the delinquent FTD program.

Business Tax Return Processing Is Costly Because the Majority of the Returns Are Manually Processed and Resolved

Business returns processing would be more effective and efficient if centralized in a few locations. In FY 1997, about 92 percent of the estimated 42.5 million business returns (excluding individual returns for sole proprietors or farms) processed were paper returns. Paper return processing is much more costly and involves a higher error rate than electronic return processing (10 percent versus 0.2 percent). If business returns were processed at service centers that process only business returns (rather than a mixture of individual and business returns), the estimated 42.5 million returns could be processed at three locations. With increased electronic filing, the IRS could process the returns in one location, with another location as back-up. Centralized processing would provide increased effectiveness, efficiency, and executive accountability for the IRS. Taxpayers could benefit because the IRS could provide greater consistency and expertise in processing and resolving returns.

In addition to these three areas for improvement, we also evaluated the opportunity of annual filing of Form 941 returns for some segments of the small business employer population. Form 941, which is filed quarterly, is used by employers to report and pay their portion of employment taxes, as well as the taxes withheld from their employees. With annual Form 941 filing, small business employers could eliminate filing quarterly returns and just file an annual return. Similarly, the IRS would not have to process these quarterly returns, which would save on processing costs. We did not make any recommendations to the IRS regarding annual filing, but we did issue a memorandum to provide information for future consideration by IRS management.

Summary of Recommendations

We identified three additional opportunities for the IRS to reduce burden and improve service to business taxpayers, and increase its efficiency and effectiveness. These involve expanding the avenues for providing education to small businesses, re-evaluating the current program for monitoring and following up on delinquent FTD payments, and moving towards centralized processing of business tax returns in two locations.

**Consolidated Report on Opportunities for the Internal Revenue Service
to Improve Service to Business Taxpayers**

Management's Response:

IRS management responded that they had joined efforts with the Small Business Administration (SBA) and developed partnerships with several entities of the SBA to provide information, IRS materials, and small business workshops on tax related topics. The IRS Collection Division will re-evaluate the cost effectiveness of the FTD monitoring program and also determine how it can be tailored more toward the IRS' goals of increased revenue and increased compliance. In addition, the IRS Executive Officer for Service Center Operations is responsible for developing a transition plan to consolidate business return processing into the determined number of locations.

Management's complete response to the draft report is included as Appendix VI.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

Objective and Scope

A series of audits and reviews dealing with the business taxpayer was initiated to identify opportunities to reduce burden and improve service.

We initiated a comprehensive evaluation of the Internal Revenue Service's (IRS) processes for dealing with business taxpayers beginning in April 1997. The overall objective was to identify opportunities for the IRS to better serve business taxpayers by:

- Reducing burden on business taxpayers.
- Improving IRS responsiveness and timeliness.
- Increasing IRS efficiency and effectiveness.

To accomplish our objective, we performed the following activities:

This report includes information and audit recommendations previously reported in individual audit memoranda and reports.

- I. Initiated a series of audits and reviews addressing the major points of contact business taxpayers have with the IRS. We also considered taxpayers' perspectives of how they might view the IRS. See Appendix IV for an overview of the individual audits and reviews.
- II. Extracted and analyzed Tax Year (TY) 1995 and 1996 Employer's Quarterly Federal Tax Returns (Form 941) and Masterfile¹ entity² and module³ data. Many of the reviews conducted separate analyses of data extracted from the Masterfile. See Appendix V for the Electronic Data Processing validation steps.

¹ Masterfile is the IRS' database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

² Entity is the portion of the Masterfile record that identifies taxpayers (e.g., name, address, Social Security or Employer Identification number, filing requirements, etc.).

³ Module is the portion of the taxpayer's account that reflects tax data for one type of return and one tax period.

**Consolidated Report on Opportunities for the Internal Revenue Service
to Improve Service to Business Taxpayers**

- III. Reviewed and analyzed FY 1996 IRS Collection Division reports and the *IRS 1996 Data Book*.
- IV. Reviewed prior IRS and external stakeholder studies, IRS Inspection Service (now Treasury Inspector General for Tax Administration (TIGTA)) audit reports, and General Accounting Office reports relating to filing and paying federal taxes by business taxpayers.
- V. Met with IRS management and various task forces to identify and obtain information on current initiatives affecting business taxpayers.

We performed this comprehensive evaluation between April 1997 and December 1998 in accordance with *Government Auditing Standards*. We received IRS management's response to our recommendations in April 1999. Appendix I provides the detailed objective, scope, and methodology for this review which consolidated the results of the various reviews and analyses. Appendix II provides a listing of the major contributors to this report. Appendix IV provides an overview of the reviews dealing with business taxpayers, which includes the audit reports and memoranda issued, recommendations made, and the actions taken or planned by the IRS.

This consolidated report is based on data obtained from many sources, including IRS management information reports, service center⁴ reports, Masterfile data, the *IRS Data Book*, IRS Inspection Service (now TIGTA) audit reports, and TIGTA Office of Audit reports covering various portions of the period from TY 1995 through August 1999. In many instances, we had to compare several sources and time periods to arrive at a general estimate of the volume of taxpayers or dollars involved.

⁴ Service centers are the data processing arm of the IRS. The service centers process paper and electronic submissions, correct errors and forward data to the computing centers for analysis and posting to taxpayer accounts.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

However, most calculations were based on complete populations rather than samples. As a result, the numbers presented in this report are approximate amounts.

Background

Business taxpayers represent approximately 14 percent of total taxpayers and 85 percent of total dollars collected by the IRS. We defined business taxpayers as corporations, small business corporations, partnerships, fiduciaries, employers, or individuals with their primary source of income from a sole proprietorship or farm.

Business taxpayers comprise a variety of types of businesses, industries, and income levels. Collectively, in FY 1996, approximately 18 million business taxpayers (14 percent of total taxpayers) filed about 47 million tax returns. We defined business taxpayers as corporations, small business corporations, partnerships, fiduciaries, employers, or individuals with their primary source of income from a sole proprietorship or farm. In FY 1996, the IRS collected an estimated \$1.3 trillion (85 percent of total dollars collected) from employment, corporate and excise tax returns.

Characteristics of FY 1996 business taxpayers include:

Type of Taxpayer

- Individuals with their primary source of income from sole proprietorships or farms – 46 percent.
- Corporations or small business corporations – 27 percent.
- Fiduciaries and partnerships – 27 percent.

Number of Returns Filed

- Employment tax returns – 60.4 percent.
- Individual returns with Schedule C or F (primary source of income for the taxpayer) – 17.3 percent.
- Corporate or small business corporate tax returns – 10.3 percent.
- Fiduciary, partnership, and excise tax returns – 12 percent.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

Type of Collections

- Employment taxes (\$1 trillion) – 82 percent.
- Corporate income taxes (\$189 billion) – 15 percent.
- Excise taxes (\$42 billion) – 3 percent.

Size of Employers

- Less than \$20,000 annual employment tax liability (2.3 percent of the total liability, \$21.6 billion) – 59.5 percent.
- Between \$20,000-\$50,000 annual employment tax liability (3.3 percent of the total liability, \$31 billion) – 17 percent.
- More than or equal to \$50,000 annual employment tax liability (94.4 percent of the total liability, \$886 billion) – 23.5 percent.

Results

The IRS' current systems and procedures affecting business taxpayers are complex, confusing, and burdensome. We evaluated five processes to determine whether the IRS has taken actions to address inefficiencies or taxpayer burden and to identify any new recommendations to improve the overall process.

The IRS' current systems and procedures for business taxpayers to meet their filing and paying requirements are complex, confusing, and burdensome. They were designed primarily to facilitate IRS operations rather than address all the various individual needs of taxpayers. We determined the IRS' processes for dealing with business taxpayers could be improved and updated.

The IRS recognized that across-the-board changes were needed and, in January 1998, announced its plans to modernize and change the way it does business. The goals of the new, modernized organization are to enable taxpayers to better understand and comply with the tax laws and ensure fairness in compliance programs.

This report highlights our analysis of the following five processes which affect business taxpayers:

- I. Providing upfront education and assistance.
- II. Establishing a new business entity.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

III. Processing Federal Tax Deposits.

IV. Monitoring Federal Tax Deposit compliance.

V. Processing tax returns.

This report contains our analysis of each process, in terms of:

- Our overall assessment of how the process is currently operating (e.g., providing quality customer service, minimizing taxpayer burden, and ensuring efficient operations).
- Recommendations made in the individual audit reports and actions taken by the IRS to address those recommendations.
- Any additional opportunities for process improvements and recommendations to address them.

Process I:

Providing Upfront Education and Assistance

The IRS needs to place greater emphasis on customer education assistance to help taxpayers understand and comply with their federal tax obligations.

We looked at the IRS' process of providing business taxpayers sufficient education on their federal tax obligations and record keeping requirements and identified the following opportunity for improvement.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

Greater Emphasis Needs to Be Placed on Education to Help Taxpayers Understand and Comply with Their Federal Tax Obligations

The IRS' process for providing taxpayers upfront education includes a variety of educational products at numerous locations, such as the IRS Internet web site, Small Business Workshops, One Stop Business Assistance Centers, toll-free telephone lines and walk-in sites.

When taxpayers start up a business, they look for information on the type of business to set up (e.g., sole proprietor, partnership, or corporation), tax consequences of hiring employees, and the various federal legal and tax obligations. The IRS' process for providing taxpayers this upfront education includes a variety of educational products at numerous locations, as follows:

- IRS Internet web site – The IRS provides broad and immediate access to tax information for businesses via the Internet. The IRS web site provides access to business forms and publications and frequently asked questions, such as those on employment taxes and electronic services. To better serve business taxpayers, the IRS is considering a Small Business Corner for the web site.
- Small Business Workshops (SBWs) – IRS districts provide workshops covering an overview of business taxes. Agenda items include orientation to business taxes and employment taxes, and may include state and local tax information. Over 40,000 taxpayers participated in SBWs last year. The IRS Inspection Service (now TIGTA) audit report titled, *Opportunities to Improve IRS Business Taxpayer Education* (Reference Number 085507, dated August 31, 1998), recommended the IRS promote the district SBWs on the IRS Internet web site and in small business periodicals; recruit practitioner volunteers to serve as instructors; and gather customer feedback on a consistent basis. Customer Service management agreed to take the recommended actions. In addition to these actions, the IRS should also consider using other agencies' small business sites or workshops to provide federal tax information.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

- Small Business Tax Education Program (STEP) – The IRS works with third parties, such as community colleges and professional associations, to instruct tax courses and seminars for taxpayers. In FY 1995, the IRS estimated that STEP sponsors provided education to over 220,000 taxpayers. However, the course materials have not been updated in many years.
- One Stop Business Assistance Centers – The IRS has developed or is participating at specialized centers for small business taxpayers at three locations: Buffalo, Houston, and Indianapolis. These centers provide small businesses with one location to obtain federal, state, and local information and help in meeting tax obligations, either over the telephone or in person. Because these centers are very costly to operate, the IRS Inspection Service (now TIGTA) audit report dated August 31, 1998 (Reference Number 085507), recommended the IRS evaluate the level of service and cost effectiveness of existing sites before considering additional centers. Customer Service management is conducting a national strategy to evaluate these centers.
- Toll-free customer service tax information line – The IRS provides a 1-800 Tax Assistance Telephone Number for taxpayers to call when they have a tax question that cannot be answered by reading the tax form instructions or tax publications.
- Walk-in assistance offices – The IRS provides in-person assistance to taxpayers that come into an IRS office. This assistance includes tax forms and publications, answers to tax questions, and return preparation.

In addition, the IRS has initiated joint efforts with other agencies.

- Small Business Administration (SBA) Business Information Centers (BIC) – The SBA has established approximately 50 BICs nationwide that

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

provide current and future small business owners with a variety of no-cost services, as well as printed and electronic educational material. The IRS was planning to provide federal tax forms and publications at all of the BICs in late 1998. The IRS will provide computers and printers to the BICs so taxpayers can access and download information, tax forms, and publications off the IRS Internet web site. The IRS is also considering having an IRS person on-site one day a week.

- Fed/State initiatives – In the past, districts have developed joint efforts with their respective state tax agencies to visit new businesses and educate them on their tax responsibilities. However, these initiatives are, by nature, individual efforts with the respective state and local agencies, not nationwide initiatives.

Taxpayers outside the geographical location or without Internet or CD-ROM access do not benefit from these educational opportunities.

Although the IRS provides a variety of educational products, not all business taxpayers may be able to take advantage of them. For example, the sites providing in-person assistance or classes may not be convenient for taxpayers located outside that geographical location. Also, some businesses may not have Internet or CD-ROM access. In addition, Public Liaison & Small Business Affairs management stated that although many taxpayers may be willing to attend an educational program sponsored by the SBA, they were sometimes reluctant to attend an IRS-sponsored event.

The IRS should continue to pursue joint efforts with other agencies. This will enable the IRS to have more opportunities to provide education to business taxpayers.

The IRS needs to consider supplementing its educational products so that they are convenient and readily accessible to business taxpayers across the country, yet still provide individualized service to meet taxpayers' particular education needs. In addition, the IRS should continue to pursue joint efforts with other agencies to be able to take advantage of their facilities, training, and visibility within the business community. The IRS also needs to better publicize its efforts so more taxpayers are aware of these educational opportunities.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

The IRS has begun to address the gap in its educational products through the following efforts:

- *Plans for the new, modernized IRS.*
- *FY 1999 Taxpayer Education Program Letter and draft Taxpayer Education Concept of Operations.*
- *Increased joint efforts with the SBA.*

The IRS has begun to address the gap in its educational products. There is increasing organizational commitment in this area, both in the plans for the modernized IRS and in current efforts. The new modernization concept for the IRS places a high emphasis on customer service in both the new mission statement and throughout the organizational structure. One of the three major units within the Small Business/Self Employed Operating Division will be the Education and Communication Unit, which will provide pre-filing information to help taxpayers comply with their tax obligations.

Customer Service management has prepared a FY 1999 Taxpayer Education Program Letter that focuses on individual and small business taxpayers. There are plans to provide comprehensive educational programs at the district level, develop outreach efforts to non-compliant market segments, and identify volunteers to instruct workshops. Customer Service management has also drafted a Taxpayer Education Concept of Operations, with a separate section on Self-Employed and Small Business Taxpayers. The IRS recognized that because of the complexity facing these taxpayers, comprehensive education programs are required to reduce non-compliance resulting from lack of knowledge.

A cross-functional Taxpayer Education Steering Committee was established in April 1998 to develop a future design for the national Taxpayer Education Program consistent with the plans for the modernized IRS. The committee's work was completed in July 1998 when it issued a decision document with several recommendations for executive consideration. In July 1998, a high-level executive Small Business Transition Committee was formed to coordinate and share information on the various IRS initiatives affecting small businesses.

In addition, the Small Business Resource Guide CD-ROM (Publication 3207) was available for distribution in March 1999. The CD-ROM is organized

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

by stages of the business life cycle (e.g., starting a business, hiring employees, getting out of business) and provides comprehensive information and Internet hyperlinks directly to federal and other regulatory advisors (e.g., state and local governments). The CD-ROM will be distributed at SBA facilities and directly through the IRS.

Recommendation

1. Expand avenues for providing education to small businesses through an additional toll-free education line or increase joint efforts with other federal agencies that already have a toll-free line and numerous office locations and training facilities.

Management's Response: The IRS is improving the availability and accessibility of educational resources to small business taxpayers by joining efforts with the SBA. The IRS has already formed partnerships with several entities of the SBA, such as the BIC and the Small Business Development Centers (SBDC). The IRS is working with SBDC representatives and other external stakeholders to develop basic small business tax lessons covering topics such as "Overall Introduction to the IRS," "Starting a Business," "Business Use of the Home," "Keeping Records," and "Employment Taxes."

In January 1999, the IRS and the BICs signed a Memorandum of Understanding to provide selected IRS tax forms and publications at all 54 BICs and 17 One Stop Capital Shops. In March 1999, the IRS began providing information, IRS materials, and small business workshops at four BIC pilot sites. Also in March 1999, the IRS began a one-year pilot of providing business taxpayer education staffing at four BICs (Atlanta, Boston, Chicago, and Los Angeles), eight hours a week, to determine if providing IRS assistance at the BICs will help new business owners understand their tax rights and responsibilities.

The IRS is planning to have its telephone assistors refer taxpayers to their local BIC or SBDC if they call about

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

starting a new business or partnership, and to the Service Corporation of Retired Executives if taxpayers call about small business inquiries. In addition, taxpayers calling IRS toll-free telephone lines will be encouraged to attend local IRS-sponsored SBWs.

IRS management's response included an update of its up-front educational efforts and can be reviewed in Appendix VI. These efforts include: A Small Business Corner on Internet, SBW, STEP, Products for Small Businesses, and Monitoring and Mentoring New Employers.

Process II:

Establishing a New Business Entity

The IRS has an effective process for assigning EINs and establishing the business entity on Masterfile, although the process is still dependent on paper.

We looked at the IRS' efforts to process the Application for Employer Identification Number (Form SS-4), which is used to assign an Employer Identification Number (EIN) and establish the business entity on the Masterfile. An EIN is a unique nine-digit number used to identify a taxpayer's business account. We determined that the IRS has an effective process for assigning EINs and establishing the business entity on Masterfile, although the process is still dependent on paper.

Assigning EINs: Business taxpayers who file federal tax returns are required to have an EIN. Approximately two million EINs are issued annually.

The IRS' process for assigning EINs allows taxpayers to call, fax, or mail in their requests. In the future, some states will be allowed to assign EINs when taxpayers apply for state business licenses.

The IRS' process for assigning EINs primarily involves the Form SS-4. Taxpayers can either call, fax, or mail in their request to the IRS. If they call in, they can obtain their EIN immediately over the telephone via the Tele-TIN Program. It takes approximately three days to get an EIN via Fax-TIN, and up to four weeks if the form is mailed in. If taxpayers file a return without an EIN, the IRS assigns an EIN using information on the return and mails a notice to the taxpayer.

An additional method for obtaining an EIN was piloted in the Pacific Northwest District. This program, Federal

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

The IRS' process for establishing the business entity on Masterfile involves inputting information from the EIN request form into the IRS' computer system. The IRS' accuracy rate for this process could be as high as 96 percent.

EIN, is a FedState initiative that enables state licensing bureaus to assign EINs when taxpayers apply for state business licenses. Because the pilot was so successful, the IRS plans to expand the Federal EIN Program to two states per region.

Establishing the business entity: The IRS uses the Form SS-4 to establish the taxpayer (business entity) on the Business Masterfile. Certain information about the taxpayer's business is input, such as the name of the business, type of business (e.g., partnership, corporation, sole proprietor, etc.), and the tax return filing requirements.

Based on our limited tests at one service center and a comprehensive survey conducted by the IRS in 1992, we concluded that the IRS may have as high as a 96 percent accuracy rate in processing Forms SS-4 and establishing filing requirements as stated on the Form SS-4.

Filing requirements identify the types of tax returns taxpayers are required to file and when they are required to start filing returns. Filing requirements are also used to determine if taxpayers are delinquent in filing their required tax returns. Later in this report, we will discuss some of the burden and cost issues that arise when taxpayers do not hire employees as of the date they estimated they would on their Form SS-4.

Process III:

Processing Federal Tax Deposits

The IRS is taking actions to encourage taxpayers to voluntarily make their FTDs electronically since it is a more effective and efficient process than the costly and burdensome paper FTD process.

We looked at the IRS' process of handling Federal Tax Deposit (FTD) payments and recording deposits to taxpayers' accounts. We determined that although the electronic process is effective and efficient, the paper process is burdensome to taxpayers and costly for the IRS. The IRS is taking actions to try to increase the number of taxpayers who voluntarily switch from paper to alternative payment options.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

Employers are responsible for withholding several different employment taxes from employees each pay day, as well as calculating the employer's share of the employment taxes. The combined employer-employee taxes are required to be paid periodically during each quarter, either through paper FTDs or electronic fund transfers through their bank. The deadlines for making these periodic deposits vary from monthly, semi-weekly, or next day, according to the employment tax liability amount.

Taxpayers send their payment and paper FTD coupon to an authorized financial institution, which credits the U.S. Treasury's account and forwards the FTD coupon to the IRS. The IRS records the payment on the taxpayer's Masterfile account.

Paper FTDs: Taxpayers send their FTD payment to the Federal Reserve Bank or authorized financial institution, along with a paper FTD coupon showing their business name, EIN, type of tax, tax period and payment amount. The financial institution credits the payment to the United States (U.S.) Treasury's account and notifies the IRS of the payment by sending the FTD coupons and FTD transmittal (summary of payments received). The IRS uses this notification to record the payment to the taxpayer's Masterfile account.

In FY 1997, approximately 85 million paper FTD payments were processed with less than a one percent error rate.

In FY 1997, the IRS processed an estimated 85 million paper FTD payments with an error rate of less than one percent. The volume of paper FTDs should be reduced in the future, however, because of the following two initiatives.

Raising the minimum FTD dollar amount:

Approximately 6 million FTDs could be eliminated annually because the IRS raised the minimum FTD dollar amount from \$500 to \$1,000, effective July 1, 1998. These taxpayers will not be required to make deposits during the quarter, but rather can include a payment for their quarterly Form 941 liability when they file their employment tax return. The IRS Inspection Service (now TIGTA) audit memorandum, "Analysis of Factors Relevant to Changing the Payment Requirements for FTDs," issued April 1, 1998, presented an analysis of the potential costs and benefits of eliminating all paper FTD payments by either allowing the payment with the return, or encouraging electronic FTD payments.

**Consolidated Report on Opportunities for the Internal Revenue Service
to Improve Service to Business Taxpayers**

Marketing electronic payments:

In addition, due to the IRS' planned marketing efforts, some taxpayers will probably voluntarily switch to the electronic FTD method.

Taxpayers who have more than \$50,000 annually in employment taxes are required to make their FTD payments via electronic funds transfer through the EFTPS.

Electronic FTDs: Taxpayers who have more than \$50,000 annually in employment taxes are required to make their FTD payments via electronic funds transfer through the Electronic Federal Tax Payment System (EFTPS). This requirement was included in the North American Free Trade Agreement Implementation Act of 1993 (NAFTA), which requires the IRS to collect 94 percent of all FTDs via electronic funds transfer by 1999.

Taxpayers instruct their banks to make electronic FTDs. The banks transfer the funds to the Government account and send the information to the IRS computer system, EFTPS, which updates the taxpayers' accounts. The EFTPS had a less than one-half percent error rate in FY 1997.

The EFTPS is the IRS computer system that processes electronic tax payment information. With the EFTPS, taxpayers contact their banks to request a payment be made. The banks transfer credits from the taxpayers' accounts to the Government account, and also electronically transfer the payment information to the EFTPS. The EFTPS will send the payment information directly to the Masterfile for recording. In FY 1997, there was a less than one-half percent error rate on EFTPS payments.

The following chart shows the increase in EFTPS usage between FY 1997 and FY 1998:

EFTPS Usage	Fiscal Year		Percent Increase
	1997	1998	
Total deposits (volume)	17.6 million	47.9 million	172%
Total deposits (dollars)	\$634 billion	\$1.15 trillion	82%
Total enrolled volunteers	448,000	634,000	42%
Total volunteer users	Not Available	376,000	unknown

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

While EFTPS use has increased, there still is significant potential for more growth, especially in the number of taxpayers who are not required, but voluntarily choose, to use the EFTPS. A large percentage of the 376,000 volunteers did not individually elect to use the system, but rather are bulk filers' customers or small service providers who chose to use the EFTPS as their preferred means of transacting payroll deposits and payments for their clients.

Taking into consideration the new \$1,000 minimum FTD dollar criteria, there still could be approximately 2.9 million taxpayers making monthly FTD payments in the future. This would represent about 34.2 million paper FTD payments annually, based on TY 1996 volumes.

In 1998, the IRS recognized the need to focus on increasing the number of electronic payments and to encourage more taxpayers to voluntarily switch from paper to alternative payment options. By the end of September 1998, only 634,000 of the approximately 2.9 million potential (per 1996 volumes) volunteers have enrolled in the EFTPS.

In 1998, the IRS recognized the need to focus on increasing the number of electronic payments. The September 1998 draft Electronic Tax Administration (ETA) strategy identifies various marketing efforts to increase voluntary usage of the EFTPS.

In addition to these actions, the TIGTA audit report titled, *The IRS Needs to Increase the Capacity, Follow Up on Reported Problems, and Encourage Voluntary Use of the EFTPS* (Reference Number 092303, dated August 1999), recommended that IRS ETA management and its marketing partners analyze small business voluntary EFTPS use to identify common factors which might explain the taxpayers' willingness to use the EFTPS. Based on this analysis, IRS should develop and implement marketing and communication strategies directed towards the potential voluntary user populations.

**Consolidated Report on Opportunities for the Internal Revenue Service
to Improve Service to Business Taxpayers**

Process IV:

Monitoring Federal Tax Deposit Compliance

It is difficult to determine the effectiveness of this process because there is no measurement system. In addition, the process focuses on only a small percentage of business taxpayers.

We looked at the IRS' early intervention process for identifying and contacting business taxpayers not making their FTD payments (known as the FTD Alert Program) and identified the following opportunity for improvement.

The Program for Monitoring Federal Tax Deposit Payments Focuses on Only a Small Percentage of Taxpayers and May Not Result in More Timely Full Payment

The IRS has an early intervention process to identify missed or substantially underpaid FTDs. However, this process addresses only 23 percent of the employer population.

The IRS has developed an early intervention process to identify missed or substantially underpaid FTDs before the quarterly returns are due. At the end of each quarter, a program identifies taxpayers who had no or substantially underpaid FTDs for the quarter and had prior delinquencies. The program puts an FTD alert indicator on their tax account.

The IRS issues FTD alert notices to the district Collection groups so they can follow up with the taxpayer to resolve the delinquency before the return is due. However, the FTD alerts are only issued for those taxpayers required to make semi-weekly FTDs (i.e., taxpayers who report over \$50,000 in annual employment taxes). These taxpayers make up only 23 percent of the employer population.

Because of this reduced population, the IRS may have worked only one percent of the total number of taxpayers with potential FTD delinquencies, based on the FTD alerts issued for September 30, 1996. The taxpayers with less than \$50,000 annual employment tax liabilities are not included in the FTD alert early intervention process. Their delinquencies would not be identified or followed up on until the delinquency checks are run after the returns are processed.

**Consolidated Report on Opportunities for the Internal Revenue Service
to Improve Service to Business Taxpayers**

We analyzed all the taxpayers who had FTD alert indicators on their accounts as of the quarter ending September 30, 1996, and identified the following characteristics:

- Taxpayers with more than or equal to \$50,000 annual employment tax liabilities with a total combined quarterly liability of \$880 million – 86 percent (19,000 taxpayers).
- Taxpayers with less than \$50,000 annual employment tax liabilities with a total combined quarterly liability of \$22 million – 14 percent (3,000 taxpayers).

As shown in the following chart, the rate of full payment is approximately the same for both groups. This raises a question about the effectiveness of the current FTD Alert Program.

Taxpayers fully paid their delinquent employment taxes in approximately the same time period, regardless of whether they may have received early contact from the IRS or not (88 percent of those who may have been contacted fully paid within a year versus 82 percent of those not contacted).

Characteristics	More Than or Equal to \$50,000 Annual 941 Liability (19,000 TPs)	Less Than \$50,000 Annual 941 Liability (3,000 TPs)
Percent of taxpayers with:		
No FTDs in the quarter	52%	66%
Fully paid 12/31/96 liability by 6/97	65%	57%
Fully paid 9/30/96 liability by 6/97	76%	71%
Fully paid 6/30/96 liability by 6/97	88%	82%
Fully paid liabilities on or before 941 return filed	25%	26%
Fully paid liabilities after 1 st notice	23%	20%
Fully paid liabilities after 4 th notice	27%	26%

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

However, the IRS does not have a measurement process in place to determine whether the FTD Alert Program (including some type of follow up with taxpayers) caused the taxpayer to fully pay the tax liability or to pay the liability sooner.

For those smaller businesses that are not included in the FTD Alert Program, we determined that in Calendar Year (CY) 1996, 69 percent of them were compliant with their Form 941 FTD payments and filing for all four quarters. We did not analyze the remaining 31 percent (1.3 million taxpayers) to determine how many had untimely FTD payments and if they fully paid their liabilities. However, we did analyze approximately 3,000 smaller taxpayers that had FTD alert indicators on their September 30, 1996, modules (see prior Characteristics chart). Although the IRS did not make early contacts with the taxpayers, their accounts were fully paid in the same time period as the larger-dollar taxpayers who may have been contacted by the IRS.

The IRS Inspection Service (now TIGTA) recommended that Collection management update the criteria for assigning FTD alert indicators, determine how to measure the effect on collections, and consider alternative functions to work alerts.

The IRS Inspection Service (now TIGTA) audit report titled, *Service Procedures for Monitoring Federal Tax Deposits* (Reference Number 085105, dated August 14, 1998), recommended that Collection management periodically update and test the criteria for assigning FTD alert indicators. We also recommended that Collection management determine a method to measure the effect of FTD alert follow-up actions on collections and consider alternative functions to work alerts (e.g., Technical Support Branch, Automated Collection System or Customer Service).

Collection management is reengineering the FTD Alert Program to ensure that only the alerts needing taxpayer contact are sent to the district Collection offices. They will also test different alert criteria.

Collection management responded they were currently reengineering the FTD Alert Program to ensure only alerts needing taxpayer contact are received in the district Collection office. They will also test different alert criteria for all taxpayers (not just the larger employers) and various educational and outreach treatments to assist taxpayers who may be having difficulty complying with their tax requirements, but may not yet require contact from district Collection

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

employees. However, this reengineering effort is not scheduled to be completed until July 2000.

The revised FTD Alert Program needs to focus on both increased revenue and increased compliance, as stated in the IRS' new goals of "service to each taxpayer" (assisting those who cannot pay what they owe) and "service to all taxpayers" (increasing overall compliance). Continued emphasis and commitment during this period by both Collection Division and Research and Statistics of Income Division management is crucial to ensure the revised FTD Alert Program is successfully tested and implemented.

Although the IRS does not have the capability for on-line monitoring, the IRS does have plans for a Payment Database that could have this capability.

We researched the possibility of on-line monitoring through the electronic FTD method. However, based on our reviews, the EFTPS does not have the capability to provide on-line monitoring for missing or substantially underpaid FTDs. The IRS does have plans to develop a Payment Information Database, which could have the capability to perform "real-time" missed/late payment analysis.

Recommendation

2. Expand the current FTD alert reengineering effort to re-evaluate the cost effectiveness of the Program. If the FTD Alert Program is continued, determine how the organizational goals of increased revenue and increased compliance will be prioritized when determining the size of taxpayers and type of early intervention contact to include in the Program.

Management's Response: The Assistant Commissioner (Collection) agreed to implement our recommendation, as stated, by July 1, 2000.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

Process V:

Processing Tax Returns

We looked at the IRS' process of receiving and processing tax returns and resolving conditions which occur after the returns are recorded on the Masterfile and identified the following opportunity for improvement regarding paper return processing.

Business Tax Return Processing Is Costly Because the Majority of the Returns Are Manually Processed and Resolved

The IRS' process for receiving and processing business tax returns is extremely costly because the majority of the returns have to be manually processed and resolved.

Business taxpayers file a variety of tax returns based on their type of business. For example, many taxpayers file quarterly and yearly employment tax returns because they have employees. There are also several different types of income tax returns filed by partnerships, corporations, fiduciaries, and small business corporations. Some business taxpayers also file returns dealing with heavy vehicle use, excise tax, or taxes on wagering.

There are two separate processes for returns:

The IRS has two primary processes for handling tax returns:

- *Initial return processing (from receipt to recording on Masterfile).*
- *Resolving accounts after return is processed (adjusting accounts and issuing and resolving notices).*

- Initial Return Processing – from receipt to recording on Masterfile.
- Resolving Accounts After Return Is Processed – adjusting accounts and issuing and resolving notices.

Initial Return Processing: The IRS' process usually involves receiving paper returns and inputting the information into the computer for processing and recording to the business taxpayers' Masterfile accounts.

Based on IRS reports, we determined that, in FY 1997, the IRS processed an estimated 42.5 million business returns (excluding individual returns with a sole proprietorship or farm business). Approximately

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

We estimated the IRS processed more than 39 million business paper returns and 3.5 million electronic returns in FY 1997. It would take three service centers to process this volume of returns. However, with 80 percent electronic filing, it could be done at only one service center, with a second center used for back-up purposes.

We believe there is merit in considering a centralized approach for processing business tax returns. This would provide increased effectiveness, efficiency, and executive accountability for the IRS. Taxpayers could benefit by the IRS providing greater consistency and expertise in processing and resolving returns.

39 million returns were paper, and the IRS projected that about 3.5 million returns would be electronic. During 1997, the error rate for paper return processing was 10 percent versus a 0.2 percent error rate for electronic return processing.

If the estimated 42.5 million business returns were processed at service centers that process only business returns, it would likely take three centers to process and resolve all business returns (using average 1995 processing volumes at the centers). However, with 80 percent electronic filing, it might be possible to handle both the paper and electronic returns at one center, with a second center used for back-up purposes. There appears to be sufficient capacity on the IRS' existing computers to handle the 80 percent electronic volume, except for four weeks in late March and early April each year. However, the system should be able to catch up a few weeks later and remain current for the rest of the year.

We limited our analyses to the feasibility of having centers only for business return processing, but did not conduct an in-depth review to determine how to overcome transition and personnel issues, or the fallout on the other centers processing Individual Income Tax Returns (Forms 1040). However, we believe there is merit in considering a centralized approach for processing business returns. Centralized processing would provide increased effectiveness, efficiency, and executive accountability. Taxpayers could benefit by the IRS providing greater consistency and expertise in processing and resolving returns.

Recommendation

3. Move towards centralized processing of business returns in two locations.

Management's Response: The Small Business/Self-Employed and Large and Middle Sized Business Design Teams are studying the appropriate sites to process business tax returns (both electronic and paper filings)

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

and plan to be completed by January 1, 2000. The outcome of this study will be the basis for the decision on where and when to centralize business return processing.

Before considering any further long-term business return centralization efforts, the Executive Officer for Service Center Operations will await the results of the Design Team studies. An evaluation of the Design Team results will determine the optimal number of locations to process business returns. In addition, a transition plan will be developed to move toward centralized processing of business returns in the determined number of locations.

Office of Audit Comment: Subsequent to IRS management's response, the IRS announced that five service centers would support the small business and self-employed taxpayers and five service centers would support the wage and investment taxpayers.

Filing Initiatives: The following paragraphs provide information on several initiatives within the IRS designed to reduce the volume of paper returns and/or increase electronic filing.

The IRS' draft ETA strategy has a goal to have 80 percent of all tax and information returns filed electronically by 2007.

Draft Electronic Tax Administration (ETA) Plan.

The IRS prepared a draft ETA Strategy Plan, dated September 1998. The Plan establishes a goal to have 80 percent of all tax and information returns filed electronically by 2007. The Plan is designed to remove barriers, increase benefits and broaden the appeal of electronic transactions to all taxpayers. Some of the goals include:

- Making electronic filing, payment and communication so simple, inexpensive and trusted that taxpayers will prefer these to calling and mailing.
- Substantially increasing taxpayer access to electronic filing, payment, and communication products and services.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

- Substantially reducing “per return” processing costs for electronically-filed returns.

941 TeleFile. For TY 1996, approximately 22 million paper quarterly Form 941 returns were filed. In 1997, the IRS offered a limited number of small business taxpayers the opportunity to file their Forms 941 through the 941 TeleFile System, starting with the returns due on April 30, 1997. The 941 TeleFile Program provided employers the option of filing quarterly Forms 941 via a touch-tone telephone. Approximately 225,000 returns were filed over the telephone the first year. Once the system accepts the return, the taxpayer is provided a confirmation number. The 941 TeleFile returns are then put on tape and processed along with the paper-filed returns.

In 1998, the IRS allowed taxpayers nationwide to electronically file their quarterly Form 941 returns through the 941 TeleFile Program. The IRS projects that approximately 1.2 million returns will be filed through the system.

In 1998, the IRS expanded its 941 TeleFile Program nationwide. The IRS estimated that 1.2 million TY 1998 Form 941 returns will be filed electronically through the 941 TeleFile System.

Annual Form 941 Returns. Another way to reduce the volume of paper returns is to consider annual filing of Forms 941. There have been several attempts to evaluate this option by internal and external groups; however, these evaluations considered the entire population of employers. An IRS Inspection Service (now TIGTA) audit memorandum, “Analysis of Factors Relevant to the Annualization of Form 941,” issued April 1, 1998, presented a number of factors, including the costs, benefits and barriers of moving towards annual filing for a small segment of employers. Our analysis showed that the potential costs and barriers might not be as significant when considering the smaller employers, as shown in the following chart:

**Consolidated Report on Opportunities for the Internal Revenue Service
to Improve Service to Business Taxpayers**

Factors	Annual Form 941 liability	
	\$1 - \$2,500	\$1 - \$5,000
Number of Taxpayers	1 million	1.7 million
Total annual Form 941 liability	\$1.2 billion	\$3.6 billion
Compliance Rate (no penalty, notice, or delinquent status for all four quarters in 1996)	74%	72%
IRS processing cost savings annually	\$14 million	\$22.7 million

Allowing some small businesses to file their Form 941 returns annually instead of quarterly would reduce processing costs for the IRS; however, it would increase the risk of lost revenue if taxpayers became less compliant over the course of a year. In addition, many external stakeholders do not support annualizing this return.

Although annual filing would affect many small businesses and reduce processing costs for the IRS, it would increase the risk of lost revenue if taxpayers became less compliant over the course of a year. In addition, quarterly employment tax information is used heavily by several internal and external stakeholders who do not support annualizing the Form 941. According to focus group studies, taxpayers would prefer to file one employment tax form that could satisfy all federal and state tax requirements. The Simplified Tax and Wage Reporting System working group currently has an initiative (Single-Point Filing) in Oregon and Montana where the state quarterly employment tax forms were expanded to also include federal quarterly employment tax return information.

The IRS Penalty Task Group reviewed the IRS Inspection Service (now TIGTA) April 1, 1998, audit memorandum on annual Form 941 filing as part of its analysis of potential improvement issues in the penalty area. This memorandum presented an analysis of the compliance levels for employers, at various levels of annual employment tax liability. One of the Task Group's recommendations was based on the analysis presented in the memorandum and involved considering annual Form 941 filing for small businesses with employment tax liabilities under \$5,000 annually.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

The IRS' process for resolving issues that occur after the initial return processing usually involves sending a notice to the taxpayer. Notices are burdensome to taxpayers and costly for the IRS. We identified several instances where notices could be reduced or taxpayer contact prevented.

The IRS' FTD rollover/rollback process prevented about 600,000 notices to taxpayers who had different FTD credits on their accounts and tax returns.

Resolving Accounts After Return Is Processed: After returns are processed and the information is updated on the Masterfile, the taxpayer's account may need additional work because the taxpayer may have made an error on the return, still owe taxes, or the account may reflect an overpayment. To resolve the account, the IRS usually sends a notice to the taxpayer informing him/her of the necessary action, penalty assessment, or a request for additional information. Notices are burdensome to taxpayers and costly for the IRS to process. In 1997, IRS reports show that 16.8 million notices were issued on business accounts.

We identified several instances where notices could be reduced or taxpayer contact prevented and made recommendations in our individual audit reports to address this. The following presents an overview of our reviews and recommendations.

Notice Review. The IRS reviews a sample of notices before they are mailed to taxpayers to ensure they are correct. During FY 1997, the IRS reviewed a sample of more than 1.2 million notices and stopped or retyped approximately 500,000 notices. This Notice Review process required about 160,000 staff hours annually, but resulted in the prevention of unnecessary and incorrect notices.

Misapplied FTD Payments. If a taxpayer files a Form 941 claiming payments that do not match those on the IRS' records, the IRS has processes to identify and resolve payments that appear to be submitted to the wrong period to avoid sending erroneous or unnecessary notices to taxpayers. For TY 1995, the FTD rollover/rollback process identified and moved over 700,000 misapplied FTD payments with an accuracy rate exceeding 90 percent. This prevented approximately 600,000 notices from being sent to taxpayers asking them to respond to resolve payment problems.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

The IRS agreed to rewrite the notices to require taxpayer responses only when the payments should be transferred to a different tax period.

We identified one situation with good potential to reduce taxpayer burden. If taxpayers have an overpaid account that cannot be resolved in the rollover process, the IRS sends a notice to the taxpayer requiring a response in 30 days. If the taxpayer does not respond, the IRS automatically issues a refund 15 weeks after the notice was issued. Approximately 80 percent of the taxpayers due a refund did not respond to the notices.

In the TIGTA report titled, *The IRS Could Reduce the Burden Placed on Business Taxpayers When Resolving Account Overpayments* (Reference Number 093402, dated August 1999), we recommended the IRS consider rewording notices to require a response only when credits should be moved rather than refunded, and to inform taxpayers that the refund would be released in 15 weeks. In addition, we recommended the notice also instruct taxpayers to respond if they would like the refund sooner. Notifying the taxpayer of when they can expect their refunds based on how and if they respond to the notices gives business taxpayers the knowledge to make an informed decision.

The Chief Operations Officer responded that the notices have been rewritten and that this should expedite responses from taxpayers. The Chief Operations Officer further stated that requiring taxpayers to respond by calling rather than writing would expedite refunds and reduce costs.

The IRS needs to consider an alternative process to prevent or reduce the number of \$0 liability Form 941 returns. In CYs 1995 and 1996, approximately 10 percent of the Form 941 returns had \$0 liability. It cost the IRS approximately \$9 million a year to process these \$0 liability returns.

\$0 Liability Form 941 Returns. For CYs 1995 and 1996, the IRS processed about 44 million Forms 941, with 4 million of these returns showing \$0 liability. It cost the IRS approximately \$9 million a year to process these \$0 returns, in addition to the hours spent resolving delinquency inquiries and satisfying filing requirements for these taxpayers. Some of the characteristics we noted for these \$0 returns include:

- Final returns – 21 percent.
- Businesses in their first year of business – 16 percent.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

- Taxpayers received a delinquency notice prior to filing a \$0 liability return – 30 percent.

Once the IRS takes action in response to a former IRS Inspection Service (now TIGTA) follow-up recommendation to change a computer program, there should be a reduction in delinquency notices on new businesses who do not hire employees as originally intended.

While this computer change will benefit some taxpayers, the IRS does not have a process for addressing other taxpayers who stopped having employees and stopped filing Form 941 returns. The IRS Inspection Service (now TIGTA) audit report titled, *Employer Identification Numbers and Related Filing Requirements* (Reference Number 090602, dated November 12, 1998), recommended the IRS establish a system that allows taxpayers to telephonically satisfy their filing requirements to prevent a delinquency notice. The IRS has agreed to conduct a risk assessment on the 941 TeleFile system to determine if it would be feasible and beneficial to use for \$0 Form 941 returns.

Taxpayers are incorrectly filing a second “corrected” or “amended” Form 941 instead of making corrections on the current period Form 941 return.

Correcting or Amending Form 941. In CYs 1995 and 1996, there were at least 500,000 taxpayers who filed more than one Form 941 in at least one quarter. We evaluated these duplicate return filings and identified the following characteristics:

- Taxpayers who filed a duplicate return did so on only one of the eight quarters, indicating that taxpayers do not repeatedly file duplicate returns – 83 percent.
- In 21 percent of the duplicate filings, the taxpayers wrote “amended” or “corrected” on the returns, indicating that the taxpayers may not understand how corrections should be reported (IRS' instructions for Form 941 state that corrections to income taxes withheld from wages paid in prior tax periods of the same calendar year should be made on the current period Form 941 return).

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

- In 51 percent of the tax periods with duplicate returns, the original returns had less than \$2,500 in employment tax liability, indicating that smaller businesses may not understand the filing instructions.

To reduce the number of duplicate returns, the IRS should consider a prescreening process to identify and resolve these amended or corrected returns upfront.

The IRS Inspection Service (now TIGTA) audit report titled, *Duplicate Form 941 Return Filings* (Reference Number 091402, dated December 7, 1998), recommended the IRS consider a prescreening process on amended or corrected Form 941 returns, which should reduce the volume of duplicate return filings. Customer Service management responded that they have provided one service center's prescreening guidelines to the other service centers to consider. Also, Submission Processing and Customer Service management will conduct a risk analysis to determine the effect, costs, and benefits of a presorting and prescreening process in the service centers for duplicate Forms 941.

Conclusion

The IRS' processes for dealing with business taxpayers can be further improved by focusing on upfront taxpayer education, monitoring of untimely FTD payments, and centralizing return processing. The IRS should consider these actions in the current IRS modernization process.

Although the IRS is currently seeking to modernize its operations and business practices to improve service to taxpayers and has already implemented some interim actions, its processes for dealing with business taxpayers can be further improved. We identified several outdated or burdensome processes that need to be considered in the ongoing Phase II IRS modernization effort. These practices fall in the areas of upfront taxpayer education, identification of untimely FTD payments, and centralized return processing.

We determined that business taxpayers need an additional avenue to obtain information or ask questions that would be easily available to everyone, regardless of geographical location. The IRS can expand its educational efforts by continuing joint efforts with other agencies to enhance more of its facilities, training, and visibility within the business community. Also, the current delinquent FTD program should be reconsidered to evaluate its cost effectiveness, since it may not result

**Consolidated Report on Opportunities for the Internal Revenue Service
to Improve Service to Business Taxpayers**

in more timely full payment of FTD liabilities. In addition, although the IRS has developed plans and strategies for increasing electronic filing, it also needs to consider a reduction in the number of centers which process paper returns.

The opportunities for improvement discussed in this report and the recommendations to address them provide the IRS with valuable information to use during its current modernization process.

Detailed Objective, Scope, and Methodology

The overall objective was to identify opportunities for the Internal Revenue Service (IRS) to better serve business taxpayers by reducing taxpayer burden, improving customer service, and to increase IRS efficiency and effectiveness. To increase the value of our report to the IRS, we included an assessment of each process. To accomplish our objective, we performed the following audit steps.

- I. To analyze the business taxpayer population, we:
 - A. Extracted and analyzed Tax Year 1995 and 1996 Employer's Quarterly Federal Tax Return (Form 941), Masterfile entity and module data to identify characteristics such as:
 1. Volume of returns filed.
 2. Amount of tax liability.
 3. Type of business.
 4. Volume of payments.
 5. Compliance.
 6. Age, Geographic Location, Industry.
 - B. Reviewed and analyzed Fiscal Year (FY) 1996 IRS Collection reports and the *IRS 1996 Data Book* (contains IRS statistical data and organizational information for FY 1996).
 - C. Flowcharted the process of processing and resolving tax payments and returns from the business taxpayer through the IRS processes to Masterfile.
- II. To identify taxpayer needs, we:
 - A. Reviewed IRS Inspection Service (now Treasury Inspector General for Tax Administration) audit reports and General Accounting Office reports relating to business taxpayers.
 - B. Reviewed the following IRS and external stakeholder studies:
 1. *Contract with America Advancement Act, Public Law 104-121, Title I - Small Business Regulatory Enforcement Fairness Act.*
 2. Taxpayer Burden – *Simplified Tax and Wage Reporting System (STAWRS)*

**Consolidated Report on Opportunities for the Internal Revenue Service
to Improve Service to Business Taxpayers**

Focus Group Interviews Final Report.

3. *Feasibility and Merits of Annualized IRS Form 941 Filing Requirements* by The MITRE Corporation.
 4. *1995 IRS Small Business Customer Satisfaction Survey: Final Report.*
 5. IRS – National Office Research and Analysis/District Office Research and Analysis Final Draft FY 1997 Research Plan.
 6. IRS Business Reengineering Office.
 7. IRS – *Repeat Delinquent Strategy.*
 8. *Micro Businesses and the IRS: An Environmental Scan.*
 9. IRS Compliance Research – 941 Federal Tax Deposit Study.
 10. IRS – *Taxpayer Advocate Report to Congress – FY 1996.*
 11. Worker Classification Issue (Employee/Independent Contractor).
 12. Business Assistance Center.
 13. Small Business (Value Tracking Focus Groups).
- III. To evaluate the IRS' processes for dealing with business taxpayers and identify opportunities for taxpayer burden reduction and improved service effectiveness and efficiency, we:
- A. Conducted a series of audits and reviews that addressed the IRS' processes for dealing with business taxpayers (see Appendix IV).
 - B. Identified current and planned IRS actions to address taxpayer needs by meeting with the IRS' modernization teams, executive management, Office of Public Liaison and Small Business Affairs, and the Penalty Task Force.
 - C. Identified issues that executive level management needs to consider during the Phase II Modernization efforts.

Major Contributors to This Report

Gordon Milbourn, Associate Inspector General for Audit (Small Business and Corporate Programs)
Scott Wilson, Associate Inspector General for Audit (Information Systems Programs)
M. Susan Boehmer, Director
Scott Macfarlane, Director
Nancy Nakamura, Director
Parker Pearson, Director
Stanley Rinehart, Director
Mary Baker, Deputy Director
Michael Murray, National Director, Information Technology
Steven Weber, Assistant Director, Data Extraction
Preston Benoit, Audit Manager
William Burke, Audit Manager
Edward Neuwirth, Audit Manager
Kevin Riley, Audit Manager
Steve Root, Audit Manager
Gary Swilley, Audit Manager
Danny Verneuille, Audit Manager
James Westcott, Audit Manager
Lynn Wofchuck, Audit Manager
Gail Yorgason, Audit Manager
Thomas Dalton, Senior Auditor
Lynn Faulkner, Senior Auditor
Edward Gorman, Senior Auditor
Patricia Lee, Senior Auditor
Jeffrey Williams, Senior Auditor

**Consolidated Report on Opportunities for the Internal Revenue Service
to Improve Service to Business Taxpayers**

Appendix III

Report Distribution List

Deputy Commissioner Modernization C:DM
Deputy Commissioner Operations C:DO
Chief Information Officer IS
Chief Operations Officer OP
National Taxpayer Advocate C:TA
Assistant Commissioner (Collection) OP:CO
Assistant Commissioner (Customer Service) OP:C
Assistant Commissioner (Electronic Tax Administration) OP:ETA
Assistant Commissioner (Examination) OP:EX
Assistant Commissioner (Forms & Submission Processing) OP:FS
Assistant Commissioner (Program Evaluation and Risk Analysis) M:OP
Assistant Commissioner (Research & Statistics of Income) OP:RS
Assistant Commissioner (Systems Development) IS:S
National Director, Customer Service Compliance, Accounts & Quality OP:C:A
National Director, Education, Walk-In, and Correspondence Improvement OP:C:E
National Director, Multimedia Production OP:FS:M
National Director, Office of Public Liaison and Small Business Affairs CL:PL
National Director, Specialty Taxes OP:EX:ST
National Director, Submission Processing OP:FS:S
National Director, Tax Forms and Publications Division OP:FS:FP
Executive Officer for Service Center Operations OP:SC
Deputy Commissioner, Large and Mid-Sized Business Division
Large and Mid-Sized Business Phase IIB Modernization Team Leader
Small Business/Self Employed Phase IIB Modernization Team Leaders (2)
National Director for Legislative Affairs CL:LA
Office of the Chief Counsel CC
Office of Management Controls M:CFO:A:M
TIGTA Liaison, Customer Service OP:C
TIGTA Liaison, Submission Processing OP:FS
TIGTA Liaison, Collection OP:CO

Overview of the Reviews Dealing with Business Taxpayers

We conducted the following reviews dealing with business taxpayers. We performed our audits during the period April 1997 to December 1998 in accordance with *Government Auditing Standards*. For each review, we have included a brief description of the overall objective and a summary of the recommendations and management's corrective action. The following reviews are listed in the order as they relate to the five processes, or as they appear in the report.

I. *Opportunities to Improve Internal Revenue Service (IRS) Business Taxpayer Education Program*
(Report Reference Number 085507, dated August 31, 1998)

Overall objective: Evaluate IRS educational products and identify opportunities to improve and expand them to better serve the needs of small business taxpayers.

Recommendations: Although the IRS has a variety of products available to educate small business taxpayers, the IRS could improve the Small Business Workshops (SBWs) and Small Business Tax Education Program (STEP) by soliciting customer feedback, increasing publicity and recruiting volunteers. The IRS should also evaluate the extent of customer service provided and the cost effectiveness of the different business assistance centers before considering future sites.

Management actions: Customer Service will survey taxpayers attending Small Business Workshops and Small Business Tax Education Programs to assess customer satisfaction, identify areas for improvement, and increase publicity through the Internet and business periodicals. In addition, the IRS will emphasize increased use of instructional volunteers and review the business assistance centers currently in operation to determine the national guidelines needed if the review proves these types of centers are cost effective.

II. *Employer Identification Numbers and Related Filing Requirements*
(Report Reference Number 090602, dated November 12, 1998)

Overall objective: Determine if procedures for establishing business entities and related filing requirements on the Business Masterfile could be improved to reduce taxpayer burden, decrease costs and improve customer service.

Recommendation: Although business entities are efficiently and effectively established, the IRS could decrease both taxpayer burden and IRS processing costs by establishing a system by which taxpayers can telephonically satisfy their

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

Employer's Quarterly Federal Tax Returns (Forms 941) filing requirements when there are no employees or tax liability.

Management action: Electronic Tax Administration and Customer Service plan to conduct a risk assessment before considering the development of a simplified system to file Forms 941 when there is no tax liability.

III. *The IRS Needs to Increase the Capacity, Follow Up on Reported Problems, and Encourage Voluntary Use of the Electronic Federal Tax Payment System* **(Report Reference Number 092303, dated August 1999)**

Overall Objective: Determine whether IRS management has developed an effective strategy to increase voluntary use of the Electronic Federal Tax Payment System (EFTPS).

Recommendations: The IRS should perform an analysis of small business voluntary use data and use the results to focus marketing and communication efforts on potential user populations.

Management actions: The IRS initiated actions to develop additional marketing and communication strategies directed towards voluntary users.

IV. *Service Procedures for Monitoring Federal Tax Deposits* **(Report Reference Number 085105, dated August 14, 1998)**

Overall objective: Determine how the IRS could improve the Federal Tax Deposit (FTD) monitoring system.

Recommendations: The IRS needs to establish priority, identification and processing methods for FTD alerts. Also, to effectively assess the IRS's efforts on compliance, it should establish a means to track early intervention actions.

Management actions: Research and Statistics of Income and Collection management will issue a memorandum to address priority, develop a measurement system, and improve the identification of alerts appropriate for field intervention.

V. *Analysis of Factors Relevant to Changing the Payment Requirements for Federal Tax Deposits* **(Memorandum dated April 1, 1998)**

Overall objective: Determine whether changes to FTD payment requirements on Forms 941 should be considered to reduce taxpayer burden, IRS processing costs, and FTD processing errors, but not significantly risk increasing non-compliance, enforcement workload and revenue loss to the Treasury.

Recommendations: None

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

Management action: Effective July 1, 1998, the minimum deposit level for FTD payments was increased from \$500 to \$1,000 per quarter.

VI. Concept for Centralizing the Processing and Customer Service Activities for Business Taxpayers (No formal document issued – results included in this report)

Overall objective: Determine the feasibility of centralizing the activities of business taxpayers.

Recommendation: No recommendation made in a separate document. Centralizing issue is addressed in this report. Our research showed that with 80 percent electronic filing, the IRS could consider a centralized location for processing all business tax returns.

VII. Analysis of Factors Relevant to the Annualization of Form 941, Employer's Quarterly Federal Tax Return (Memorandum dated April 1, 1998)

Overall objective: Determine whether a segment of the business taxpayer population could be allowed to file their quarterly Forms 941 on an annual basis to reduce taxpayer burden and processing costs.

Recommendations: No recommendations were made due to the cost to overcome the barriers raised by internal and external stakeholders who rely heavily on quarterly employment tax information. However, taxpayers would realize some degree of burden relief by filing fewer Form 941 returns and receiving fewer penalties and notices, and the IRS would recognize a certain amount of decreased processing costs.

VIII. *The IRS Could Reduce the Burden Placed on Business Taxpayers When Resolving Account Overpayments* (Report Reference Number 093402, dated August 1999)

Overall objective: Evaluate the IRS' process for resolving instances where taxpayers submit FTD payments to the wrong tax period.

Recommendations: The IRS should re-evaluate its policy of holding taxpayer overpayments for extended periods and consider rewording notices to require taxpayer responses.

Management actions: The notices have been rewritten and should expedite responses from taxpayers. However, the Chief Operations Officer did not agree to reduce the time period refunds are held.

**Consolidated Report on Opportunities for the Internal Revenue Service
to Improve Service to Business Taxpayers**

IX. *Duplicate Form 941 Return Filings*
(Report Reference Number 091402, dated December 7, 1998)

Overall objective: Profile 1995 and 1996 Form 941 business taxpayers for whom more than one return was processed and determine if there were any cost-effective solutions to reduce the volume, expedite processing and improve service to business taxpayers.

Recommendations: The IRS should consider a prescreening process to identify and immediately resolve returns received as amended or corrected. The IRS should eliminate a duplicate notice and use the IRS computer to review the original returns filed.

Management actions: Submission Processing and Customer Service management plan to conduct a risk analysis to determine the affect, costs and benefits of a presorting and prescreening process in the service centers for duplicate Forms 941. The duplicate notices have been eliminated.

X. *Abatements for Business Taxpayers*
(No formal document issued – results included in this report)

Overall objective: Determine the efficiency and effectiveness of the process for abating selected Business Masterfile tax and penalties and whether the process can be improved to reduce taxpayer burden and improve customer service.

Recommendations: The review was terminated September 30, 1998, due to conflicting priorities. However, we informed management that 84 percent of all penalty abatements lacked the penalty reason codes, which identify the reasons for the abatements.

Management action: Management issued a memorandum dated August 14, 1998, mandating the use of penalty reason codes.

Electronic Data Processing Data Validation

During Fiscal Year (FY) 1997 and FY 1998, the former IRS Inspection (now Treasury Inspector General for Tax Administration) Data Analysis Section (DAS) extracted data from the Business Masterfile (BMF) and performed analyses in support of the reviews dealing with business taxpayers. As of February 1998, the group had received 21 specific Electronic Data Processing (EDP) requests in support of 7 national reviews.

In executing these EDP requests, the group took certain steps to ensure the integrity of the data and output before providing it to the requester. In summary, those steps included ensuring that the data extracted from the BMF was an exact replica of the original and that the character of the data was not changed. We made a basic assumption that the BMF is an accurate source of data and, as such, we are not certifying the accuracy of the BMF in this appendix. The group also took steps to ensure the program logic used provided results asked for in the individual EDP requests. In addition to the group's testing, the requesting auditors independently verified the output received from the group. The specific steps and procedures taken are described below.

1. Wrote programs based on the criteria specified in the EDP requests from the different audit teams to extract entity and tax modules.
2. Performed tests to establish that our extract programs operated as intended. The programs ran under the Information Services-controlled BMF monthly production extract process. This process ran against all business entity and tax modules residing on the BMF as of the subject cycle. The records meeting the criteria specified in the EDP requests were extracted unchanged. These records were placed in a separate file for additional testing. Using the subject BMF data extracts, for each request, we:
 - Coordinated and finalized the EDP requests which specified the input file, time period and selection criteria.
 - Wrote and tested programs to provide the data.
 - Verified that all input files were processed.
 - Verified that all records extracted met the agreed upon selection criteria.
 - Verified that each data element within the record accurately reflected those elements from the input file.

Consolidated Report on Opportunities for the Internal Revenue Service
to Improve Service to Business Taxpayers

Appendix VI

Management's Response to the Draft Report



COMMISSIONER

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

April 12, 1999

OFFICE OF TREASURY
INSPECTOR GENERAL
RECEIVED
199904-46WQZ Pdt
APR 13 P 2 32

MEMORANDUM FOR ACTING TREASURY INSPECTOR GENERAL FOR ADMINISTRATION
TAX ADMINISTRATION

FROM Charles O. Rossotti 
Commissioner of Internal Revenue

SUBJECT Draft Internal Audit Report - Opportunities for the Internal
Revenue Service (IRS) to Reduce Burden and Improve Service
to Business Taxpayers

This memorandum consolidates our response to the recommendations contained in the above-referenced report. We appreciate that your review recognized the efforts we have already taken or plan to take in the near term to reduce burden and improve service to business taxpayers. We would also like to take the opportunity to provide you an update on our efforts to provide front-end education and assistance to taxpayers on their federal tax obligations and recordkeeping requirements in addition to responding to the specific recommendations in the report.

The comments in this report deal with the specific recommendations you have made. However, we are addressing the needs of the small business community specifically in the redesign of our business processes and organization. One of our four operating divisions will be the Small Business and Self-Employed Division. This division will have three components, the first of which is devoted to taxpayer education and assistance. We anticipate a major increase in emphasis and resources in this area. This component will also have the objective of working with taxpayers to identify opportunities to reduce burdens on small businesses.

Currently, the IRS' process for providing taxpayers up-front education includes a variety of education products at numerous locations, such as:

- **A Small Business Corner (SBC) on Internet** - The SBC is located on the IRS Homepage. It will be organized by stages of the business life cycle. The SBC is a work in progress whose mission is to provide taxpayers with easy-to-access and understand information that they need to know in order to comply with their tax requirements. We are continuously reviewing existing topics and adding new ones. Current topics include critical forms and publications, frequently asked questions, an employment tax calendar, and information about Electronic Federal Tax Payment System (EFTPS) requirements. Hyperlinks to various business sites, such as the Small Business

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

2

Administration web site and the National Institute of Standard and Technology's (NIST) Y2K site, are also included. The NIST Y2K site enables small business owners to download NIST's "Conversion 2000 Y2K Self-Help Tool."

- Small Business Workshops (SBW) - We currently offer workshops in IRS offices, at Small Business Development Centers (SBDC) and at other state agencies on a district level. We are promoting these workshops on the IRS Internet web site and in small business periodicals. The workshops cover a range of topics including business taxes. We are working with external stakeholders to develop new training modules to meet the needs of small business taxpayers. We have submitted for OMB approval an evaluation form that will be used at all workshops to gather customer feedback.
- Small Business Tax Education Program (STEP) - Each year, the IRS updates the STEP course material to ensure the information is accurate. We are planning to revise our STEP Workbook training modules on recordkeeping, office in the home, employment taxes, and selecting a business structure. We have submitted a Statement of Work requesting the assistance of a vendor to create a totally new and updated STEP CD-ROM. The revised STEP Workbook materials will be incorporated in the next edition of the small business CD-ROM along with any newly developed materials. Part of our Statement of Work requests that an evaluation system/survey be developed for the new materials.
- Products for Small Businesses - The IRS has a number of products useful to the small business community. The Small Business Resource Guide CD-ROM (Publication 3207) was available for distribution in March 1999. A total of 17,000 copies of the CD will be distributed through two methods: 8,000 through direct bulk shipment of specified quantities to 71 Small Business Information Centers (BIC) and One Stop Capital Shops, and 9,000 directly through IRS. The Tax Tip Calendar (Publication 1518) is a 12-month calendar which shows 1999 due dates for making payroll deposits, paying estimated taxes, and for filing major business tax forms. It also includes information on business tax law, bookkeeping and recordkeeping tips, and information about IRS notices and penalties.
- Burden Reduction Initiatives - The IRS has undertaken a number of initiatives that will result in lower burden on small businesses:

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

3

- **EFTPS:** The Electronic Federal Tax Payment System (EFTPS) allows taxpayers to make federal tax payments and deposits by electronic funds transfer. All taxpayers can easily make tax deposits from their home or office by using a telephone or personal computer, or through their financial institution. Beginning 01/01/00, the threshold for mandatory participation will be raised to aggregate deposits over \$200,000. In addition, IRS will continue to waive penalties for mandated small businesses who made federal tax deposits of \$200,000 or less in calendar year 1998 for the transition period July 1, 1999 through December 31, 1999. The proposed regulations were issued on March 22, 1999. A public hearing is scheduled for May 11, 1999. The program has just received the "Hammer Award" from Vice President Gore's Reinventing Government Group for the huge savings of tax dollars this program has achieved.
- **STAWRS:** Under the Simplified Tax and Wage Reporting System (STAWRS) initiative, the IRS is working with other federal agencies and the states to reduce employer burden by improving customer service, establishing a harmonized wage code database and developing a pilot for single point filing of federal and state employment returns. Currently, there are two pilots underway - in Iowa and in Montana.
- **FEIN/EFEIN:** This initiative allows small business taxpayers the opportunity to obtain their Federal Employer Identification Number (FEIN) at the same time they apply for their business license. IRS provides a block of FEINs to state licensing agencies in Arizona, Hawaii, Kentucky, Minnesota, Montana, New Mexico, Oklahoma, Tennessee, Vermont, and Washington. In a pilot, IRS electronically provides a state agency with a block of FEINs that the state agency conditionally assigns to taxpayers applying for business licenses. The state then electronically sends the conditionally assigned FEINs and Form SS-4 line items to the IRS.
- **941-Telefile and Online Filing:** Form 941 Telefile was tested and then implemented nationwide in April 1998. Also in 1998, IRS offered to small businesses on a test basis, the opportunity to use off-the-shelf tax preparation software to prepare and file tax returns using a third party transmitter and a personal computer. This option saved time and paperwork. Taxpayer burden was reduced and processing time reduced to one week. IRS is evaluating the results of the pilot test to determine whether to continue and/or expand the program.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

4

- **Monitoring and Mentoring New Employers:** This is a new initiative which is in the developmental stage. The North Texas District will implement a prototype of this initiative which will include:
 - a pilot to inform new employers of education and assistance opportunities at the time they receive their Employer Identification Number,
 - telephone contacts with employers who need additional assistance to help them understand and comply with tax laws, and
 - monitoring their tax compliance and intervention by telephone to resolve delinquencies.

If this initiative is successful, we will begin providing similar assistance to new businesses nationwide.

RECOMMENDATION #1

Expand avenues for providing education to small businesses through an additional toll-free education line or increased partnering efforts with other federal agencies that already have a toll-free line and numerous office locations and training facilities.

ASSESSMENT OF CAUSE(S)

The current toll-free customer service tax information line that taxpayers call when they have a small business tax question does not handle in-depth educational calls from these taxpayers.

CORRECTIVE ACTIONS

1a. The IRS is improving the availability and accessibility of educational resources to small business by partnering with the SBA. The IRS has already formed partnerships with several entities of the SBA such as the BICs and the SBDCs. There are currently 970 SBDCs, and 54 BICs, and 17 One Stop Capital shops nationwide. SBA organizations like the SBDCs and the BICs offer a wide array of services to new businesses. They have an excellent reputation with the small business community and provide their services at over 1,000 locations. However, the SBA does not provide direct tax-related training, and they understand that startup businesses must have a sound understanding of their tax obligations.

The SBDCs and BICs provide many more workshops and at many more locations than does the IRS. By teaming up, the SBA and the IRS can significantly improve the level and quality of educational services to small businesses. Unfortunately, the IRS does not have the resources to directly provide small business tax training everywhere it is needed. However, we are working with SBDC representatives and other external stakeholders to develop basic small business tax lessons. These lessons may later be

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

5

used by these stakeholders and the IRS to provide tax training to small businesses. The training lessons cover such important topics as "Overall Introduction to the IRS," "Starting a Business," "Business Use of the Home," "Keeping Records," and "Employment Taxes."

1b. The IRS and BICs signed an MOU in January 1999 to provide selected IRS tax form and publications at all BICs and One Stop Capital Shops. In March 1999, we began providing information, IRS materials, and small business workshops on tax-related topics, such as recordkeeping, filing business returns, hiring employees, and making FTD payments at four BIC pilot sites. The pilot is being conducted to assist small businesses to comply with their tax obligations and to improve the accessibility and availability of IRS educational products.

1c. In March 1999, the IRS began providing business taxpayer education staffing at four BICs (Boston, Atlanta, Chicago, and Los Angeles) 8 hours a week. This is a 1-year pilot to determine if providing IRS assistance at BICs will help new business owners with their tax rights and responsibilities.

1d. The IRS is planning to have our assistors refer taxpayers calling about starting a new business or partnership to their local BIC or SBDC. Assistors may also refer customers to the Service Corporation of Retired Executives when fielding small business taxpayer inquiries. Additionally, appropriate taxpayers calling IRS toll-free will be encouraged to attend local IRS-sponsored SBWs.

Furthermore, we have initiated partnering efforts with other agencies to provide additional taxpayers with an array of no-cost services and have a very aggressive Fed/State initiative where districts have developed joint efforts with their respective state tax agencies to visit new businesses and educate them on their tax responsibilities.

IMPLEMENTATION DATE(S)

- 1a. MOU with South Texas SBDC - December 31, 1999
Provide workshop modules - July 31, 1999
- 1b. MOU with BICs - January 1999
- 1c. March 1999
- 1d. Provide phone guidelines - October 31, 1999

RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (Customer Service)
National Director, Education, Walk-In, and Correspondence Improvement

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

6

Assistant Commissioner (Examination)
National Director, Specialty Taxes

Assistant Commissioner (Forms and Submission Processing)
National Director, Multimedia

Chief Communications and Liaison
National Director, Public Liaison and Small Business Affairs

POTENTIAL MEASURABLE OUTCOMES

- Decreased taxpayer burden due to fewer contacts with the IRS. The taxpayers who go to a BIC or SBDC will also be able to get tax information on their rights and responsibilities as new small business taxpayers. They will also have access to the BIC/SBDC toll-free site. We will attempt to obtain from SBA the number of small businesses that come into their BIC/SBDC offices for assistance. This information will give us a potential population of taxpayers that were assisted as a result of these corrective actions. One outcome that cannot be determined is how many of these taxpayers actually started a business, and if they did start businesses, are they more or less compliant because they visited a BIC or SBDC.
- Customer Satisfaction. We have submitted for OMB approval an evaluation form that will be used at all BICs to gather customer feedback.
- To get a measurable outcome of taxpayers who visit BIC/SBDC offices for assistance, we would have to gather data that would include the taxpayer's name, TINs, and other pertinent information that taxpayers may be reluctant to volunteer to IRS.

RECOMMENDATION #2

Expand the current FTD alert reengineering effort to reevaluate the cost effectiveness of the program. If the FTD Alert Program is continued, determine how the organizational goals of increased revenue and increased compliance will be prioritized when determining the size of taxpayers and type of early intervention contact to include in the program.

ASSESSMENT OF CAUSE(S)

The IRS concentrates on only a small number of potential delinquent taxpayers, generally larger employers, when making early contacts about missed FTD payments. In addition, the report found that over a 1-year period, delinquent taxpayers full paid at about the same rate, regardless of whether they were included in the IRS' FTD Alert Program.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

7

CORRECTIVE ACTIONS

The Assistant Commissioner (Collection) will expand the scope of the current FTD alert reengineering effort to reevaluate the cost effectiveness of the program. In addition, if the FTD Alert Program is continued, a determination will be made regarding how the organizational goals of increased revenue and increased compliance will be prioritized when determining the size of taxpayers and type of early intervention to include in the program.

IMPLEMENTATION DATE

July 1, 2000

RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (Collection)

POTENTIAL MEASURABLE OUTCOMES

Our research project (the "FTD alert reengineering effort" which is the subject of our corrective action) will be measuring the revenue impact from the standpoint of increased dollars collected and subsequent delinquencies prevented. There will also be cost savings due to more efficient use of resources if the FTD Program is changed or discontinued. The potential cost savings would not be determined until the changes have been implemented.

RECOMMENDATION #3

Move toward centralized processing of business returns in two locations.

ASSESSMENT OF CAUSE(S)

Processing of business returns at all 10 service centers is less effective and does not promote consistency in resolving errors. Internal Audit found if the 42 million business returns were processed at dedicated service centers, it would likely take 3 service centers to process and resolve all business returns (using average 1995 processing volumes at the service centers).

CORRECTIVE ACTIONS

The Small Business/Self-Employed and Large and Middle Sized Business Design Teams are studying the appropriate sites to process business tax returns (both electronic and paper filings) and plan to be completed by January 1, 2000. The outcome of this study will be the basis for the decision on where and when to centralize business return processing.

We will await the results of the Design Team studies before considering any further long-term business return centralization efforts. We will evaluate the Design Team results and determine the optimal number of locations to process business returns.

Consolidated Report on Opportunities for the Internal Revenue Service to Improve Service to Business Taxpayers

8

We will also develop a transition plan to move toward centralized processing of business returns in the determined number of locations.

IMPLEMENTATION DATE

October 1, 2000

RESPONSIBLE OFFICIAL(S)

Executive Officer for Service Center Operations

POTENTIAL MEASURABLE OUTCOMES

Once we have centralized processing, we will attempt to determine the following potential measurable outcomes:

- Cost savings due to fewer processing sites, and
- Reduced taxpayer burden and improved service to taxpayers.

If you have any questions, please contact John Dalrymple, Chief Operations Officer, at 202-622-6860.