



GAO

Accountability \* Integrity \* Reliability

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

General Government Division

B-284524

February 17, 2000

The Honorable Daniel P. Moynihan  
Ranking Minority Member  
Committee on Finance  
United States Senate

Subject: Internal Revenue Service: Preparing Substitute for Returns for Individuals

Dear Senator Moynihan:

On November 22, 1999, we briefed your office about the Substitute for Return (SFR) program at the Internal Revenue Service (IRS). In accordance with statutory authority granted to the Secretary of the Treasury and his designees, IRS prepares a substitute for return for individuals who do not appear to have filed a required tax return (i.e., potential nonfilers). IRS prepares these substitute for returns using information maintained in IRS' computer files.<sup>1</sup>

This letter summarizes the points we made at the briefing and answers six questions raised by your office. To prepare the briefing, we used information about nonfilers and the SFR program that we had collected during previous work. To answer questions raised at the briefing, we interviewed responsible IRS officials in the Customer Service and Collection Divisions at the National Office. We also reviewed related IRS documents. We did our work in Washington, D.C., and New Carrollton, Maryland, from November 1999 through January 2000 in accordance with generally accepted government auditing standards.

## Results in Brief

As discussed at the briefing, IRS prepares a substitute for return for certain individuals classified as potential nonfilers for whom (1) it has what it considers to be adequate information about income and (2) the estimated tax liability is at or above a certain level. IRS receives this income information from third parties, such as banks and employers, who make payments to individuals. IRS believes that potential nonfilers who receive a substitute for return will be encouraged to respond by either filing a more accurate return or showing that they have no filing requirement. IRS is to give the potential nonfilers up to two chances to

<sup>1</sup>In its response to this letter, IRS officials indicated that they do not generally prepare actual tax returns. Instead, they said IRS prepares substitute documents that propose assessments. Although IRS and legislation refer to this as the substitute for return program, these officials said that the document does not look like an actual tax return.



B-284524

respond to information showing the proposed amount of the substitute for return. If these individuals do not respond, IRS is to assess the tax shown on the substitute for return and seek payment of the balance due through its regular collection process. Enclosure I contains more detailed information about these and other points made at the briefing.

In response to questions raised at the briefing:

- IRS can contact potential nonfilers who are not selected for the SFR program to solicit a tax return. These contacts can be made through telephone calls or visits by IRS staff.
- IRS has a few criteria to guide decisions on whether to create a substitute for return through automated or manual means. IRS is to use the automated method rather than the manual method when the sources of income are less complex, such as when they have little or no self-employment income from business activities. The automated method accounts for most substitute for returns.
- When preparing a substitute for return, IRS allows for a filing status of either "single" or, if the most recently filed return showed the taxpayer as married, "married filing separately." According to IRS officials, IRS has always allowed for only these two filing status claims on a substitute for return. IRS cannot use "married filing jointly" because the tax law only allows this filing status when taxpayers elect to use it upon filing a tax return.
- IRS rarely receives information other than income information from third parties in preparing a substitute for return.
- A balance-due account created from a substitute for return has no special priority over those created through other means. IRS is to use the same formula to set collection priorities for all types of accounts that involve the collection of unpaid assessments from individuals.
- IRS does not routinely collect data on the costs to prepare and process substitute for returns and on the impacts of the SFR program on compliance. For example, IRS does not collect data on whether the taxpayer files for future tax years. IRS does track the number of substitute for returns and whether the taxpayer responds to the notice on the related tax, penalty, and interest assessments.

Enclosure II responds to these questions in more detail.

## Agency Comments

We requested comments on a draft of this letter from the Commissioner of Internal Revenue or his designee. On February 9, 2000, we received comments from responsible IRS officials in the Examination and Customer Service Divisions. Although the Examination Division said it had no comments, Customer Service Division officials commented on the phrase "Substitute for Return." They asked us to emphasize that even though the program is commonly referred to as the SFR program, no actual tax return is prepared. Instead, these officials noted that IRS prepares a document that substitutes for the return and that proposes an assessment, which

**NO ACTUAL TAX RETURN IS PREPARED !**



B-284524

Under what statutory authority is a "proposed assessment" simply "posted to the taxpayer's account" without a subscribed signature ?

is posted to the taxpayer's account and is subject to the collection process. We added a footnote to the letter to explain this and revised references in the draft to clarify this point.

Unless you publicly announce its contents earlier, we plan no further distribution of this letter until 15 days after its date. We will then send copies to Senator William V. Roth, Jr., Chairman, Committee on Finance, and Representatives William Archer, Chairman, and Charles B. Rangel, Ranking Minority Member, House Committee on Ways and Means. We also will send copies to the Honorable Lawrence H. Summers, Secretary of the Treasury; the Honorable Charles O. Rossotti, Commissioner of Internal Revenue; and other interested parties.

A key contributor to this report was Louis Roberts. If you have any questions, please contact me or Tom Short on (202) 512-9110.

Sincerely yours,

*Cornelia M. Ashby*

Cornelia M. Ashby  
Associate Director, Tax Policy and  
Administration Issues



refusal to file under the provisions of the Internal Revenue Code.

(4) In instances where the delinquent taxpayer has turned the records over to a tax practitioner for preparation and completion of the return(s), the Collection employee will continue to look to the taxpayer for filing compliance except where power of attorney has been given to the practitioner.

**5282 (6-12-87)**

**Subsequent Activity**

(1) Generally, IMF cases where no return has been secured and Policy Statement P-5-133 does not apply, the Collection function employees have the following alternatives:

- (a) Referral to the Criminal Investigation Division, see IRM 52(10)1;
- (b) Summons, see IRM 5283;
- (c) Referral to Examination, see IRM 52(10)2; or,
- (d) Referral to Substitute for Return Unit, see IRM 52(10)5

(2) Refusal to file employment and excise tax return(s) should be processed by Collection under IRC 8020(b) procedures.

**5283 (11-15-85)**

**Summons Procedures**

**5283.1 (11-15-85)**

**Procedures**

Revenue Officers should review the summons procedures provided in IRM 52(12)0 and Chapter 600 of IRM 57(16)0, Legal Reference Guide for Revenue Officers.

**5283.2 (11-15-85)**

**Taxpayer Response to Summons**

- (1) Accept the return(s) when a taxpayer presents the return(s) completed and signed.
- (2) If the return(s) has not been prepared, the Revenue Officer will prepare the return(s) if the taxpayer's records are such that the skills of a Revenue Agent or Tax Auditor are not required.
- (3) If the records presented by the taxpayer are such that the skills of a Revenue Agent or Tax Auditor are required, the Examination person designated to be on standby should be contacted.

**5281**

IR Manual

MT 5200-14

**5283.3 (8-18-86)**

**Summons Follow-up Action**

If the taxpayer does not comply with the summons, the Revenue Officer should prepare a Form 4443, Summons Referral. See IRM 52(12)(14).21.

**5290 (11-15-85)**

**Refusal to File—IRC 6020(b)  
Assessment Procedure**

**5291 (11-15-85)**

**Scope**

(1) The procedure applies to employment, excise and partnership tax returns. Generally, the following returns will be involved.

- (a) Form 940, Employer's Annual Federal Unemployment Tax Return;
- (b) Form 941, Employer's Quarterly Federal Tax Return;
- (c) Form 942, Employer's Quarterly Tax Return for Household Employees;
- (d) Form 943, Employer's Annual Tax Return for Agricultural Employees;
- (e) Form 11-B, Special Tax Return—Gaming Devices; (The Revenue Act of 1978, P.L. 95-600 repealed the coin-operated gaming device tax effective June 30, 1980. Therefore, Form 11-B is not required for gaming devices after June 30, 1980. These procedures are provided to cover delinquent situations prior to June 30, 1980.)
- (f) Form 720, Quarterly Federal Excise Tax Return
- (g) Form 2290, Federal Use Tax Return on Highway Motor Vehicles;
- (h) Form CT-1, Employer's Annual Railroad Retirement Tax Return.
- (i) Form 1065, U.S. Partnership Return of Income.

What forms?

**5292 (6-12-87)**

**General**

- (1) Revenue officers, ACS and CSF managers, GS-9 and above, are authorized to execute returns under IRC 6020(b).
- (2) When the taxpayer is contacted, the Collection employee will set a specific date for filing and secure sufficient information so that an accurate return can be prepared if the taxpayer fails to file by the specified date.

INTERNAL REVENUE SERVICE SOUTHWEST REGION OKLAHOMA CITY DISTRICT	Order No. DD-OKC-150, Rev. 5 CR: SD-61	
DELEGATION ORDER	DATE OF ISSUE NOV 27 1987	EFFECTIVE DATE NOV 27 1987

SUBJECT

**AUTHORITY TO EXECUTE RETURNS**

Authority is redelegated to Revenue Officers, GS-9 and above to prepare and execute the following returns on behalf of the District Director under Section 6020(b) of the Internal Revenue Code:

- Form 940, Employer's Annual Federal Unemployment Tax Return;
- Form 941, Employer's Quarterly Federal Tax Return;
- Form 942, Employer's Quarterly Tax Return for Household Employees;
- Form 943, Employer's Annual Tax Return for Agricultural Employees;
- Form 11-B, Special Tax Return - Gaming Services;
- Form 720, Quarterly Federal Excise Tax Return;
- Form 2290, Federal Use Tax Return on Highway Motor Vehicles;
- Form CT-1, Employer's Annual Railroad Retirement Tax Return; and
- Form 1065, U.S. Partnership Return of Income

This Authority may not be redelegated.

This order supersedes Delegation Order DD-OKC-150 (Rev. 4) dated December 13, 1984.

Reference: Treasury Regulations 301.6020-1(b)  
 Commissioner Delegation Order No. 182, (Rev: 1)  
 IRM 5292

*K. J. Sawyer*  
 K. J. Sawyer  
 District Director

**Delegates:**

- District Director
- Chief, Collection & TPS Division
- Chief, Special Procedures Staff
- Chief, Collection Support Function
- Chief, Field Branch I
- Chief, Field Branch II
- Group Managers, Collection
- ARC-Collection, Southwest Region
- Regional Management Staff: Regional Office Library

DISTRIBUTION: