

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Who's Not Filing Income Tax Returns? IRS Needs Better Ways To Find Them And Collect Their Taxes

10,696

GAO estimates that about 5 million people owing some \$2 billion in income taxes did not file returns in 1972--the most current year for which reasonably complete data was available. This "delinquency gap" poses tax administration problems which could adversely affect the Nation's voluntary tax assessment system.

IRS secured delinquent returns from about 12 percent of those not filing in 1972. According to IRS, it has not emphasized pursuing nonfilers primarily because of limited resources.

IRS needs to give more attention to the "non-filer" problem by

- estimating and analyzing the nonfiler population periodically and using the information for more productive investigations;
- conducting more vigorously the Taxpayer Delinquency Investigation Program, its principal means for bringing nonfilers into compliance; and
- making additional efforts to catch more nonfilers through the use of special programs and available information.

The report includes numerous recommendations for improving IRS' nonfiler efforts and reducing the delinquency gap.



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COMPTROLLER GENERAL OF THE UNITED STATES
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To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the Internal Revenue Service's efforts in detecting and pursuing individuals who fail to file required Federal income tax returns. It shows that the Service needs to improve these efforts to make sure that the Nation's voluntary tax assessment system remains strong.

We are sending copies of the report to the Director, Office of Management and Budget; the Secretary of the Treasury; the Commissioner of Internal Revenue; and other interested parties.


ACTING Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

WHO'S NOT FILING INCOME TAX
RETURNS? IRS NEEDS BETTER
WAYS TO FIND THEM AND
COLLECT THEIR TAXES

D I G E S T

Some 87 million taxpayers filed individual Federal income tax returns in 1978, accounting for \$213 billion in gross tax collections. However, each year many taxpayers do not file, and as a result, the Internal Revenue Service (IRS) is not able to collect billions legally owed to the United States.

Some 68 million people were required to file Federal income tax returns in tax year 1972--the most recent year for which reasonably complete data was available for estimating the number of nonfilers. GAO estimates that about 5 million, owing about \$2 billion in taxes, did not file in tax year 1972. These "nonfilers" represent a "delinquency gap," or the difference between the number of people required to file returns and those who did.

IRS was able to reduce this gap by about 600,000, or 12 percent, of the estimated 5 million nonfilers. The remaining nonfilers were not pursued by IRS primarily because of limited resources. (See pp. 5 and 6.)

IRS needs to be more systematic and vigorous in detecting and pursuing nonfilers. Also, the Congress needs to consider whether additional resources are needed to improve IRS nonfiler efforts after IRS provides it with specific cost estimates.

IRS NEEDS TO MORE FULLY
EXAMINE THE NONFILER POPULATION

To get some perspective on the problem, GAO developed an estimate of the nonfiler population and a profile of its characteristics. While nonfilers generally are similar to those who file, certain

IRS NEEDS A MORE EFFECTIVE
PROGRAM FOR CATCHING NONFILERS

IRS' primary means for detecting and investigating nonfilers is the Taxpayer Delinquency Investigation Program. Its major weaknesses result from

- criteria for selecting potential nonfilers for investigation,
- policies and procedures restricting the investigation of those selected,
- various practices in managing non-filer cases. (See p. 22.)

IRS selects potential nonfilers for investigation on the basis of data taken from information returns, social security tax records, and its master file. Selection is based generally on whether a person's income, as shown by these sources, indicates a predetermined tax liability. It is not based on whether a person is technically required to file. In fact, IRS' data sources do not always show the requirement to file. As a result, many people who are not required to file are selected for investigation, while many who may be required to file are not selected.

For example, to determine which potential nonfilers to pursue for tax year 1975, IRS used accumulated records on about 110.3 million individuals. Not all of these people were nonfilers--persons required to file a tax return--because the records included deceased persons and those who had little or no income. Of the 110.3 million individuals, IRS selected about 1.3 million for investigation under its Taxpayer Delinquency Investigation Program but secured delinquent returns in only 31 percent of the cases investigated.

Of the 109 million people not selected for investigation as potential nonfilers, about 90 million were not selected

closures were due to IRS' decision not to investigate the taxpayers sufficiently to locate them or verify whether they were required to file.

When--at GAO's request--IRS investigated 389 of GAO's sample cases, successful closures increased to about 69 percent. Investigating such cases thoroughly increased costs, but revenues to the Government outweighed costs 3 to 1.

On the basis of the sample cases, GAO estimates that IRS did not investigate thoroughly 56,000 nonfiler cases in 7 districts for tax year 1975. This means IRS did not

- secure about 25,000 delinquent returns involving \$15.8 million in taxes owed and \$7.7 million in refunds or

- uncover about \$14.8 million in unreported income with potential tax liabilities of \$2.2 million. (See pp. 28 to 42.)

IRS can also improve its Taxpayer Delinquency Investigation Program by making a number of improvements in its caseload management practices. (See pp. 42 to 51.)

IRS officials stated that more resources are needed to increase the number of nonfilers it can thoroughly investigate. For example, IRS district offices would have needed at least \$29 million to adequately investigate about 630,000 nonfiler cases referred by the service centers nationwide for tax year 1975, yet IRS spent only about \$15 million.

Additional resources alone will not increase program effectiveness. IRS also needs to improve the way it uses the money and people it has. (See pp. 51 to 53.)

EXCESS INTEREST PAID TO
DELINQUENT TAXPAYERS DUE REFUNDS

Delays in processing tax refunds to delinquent filers are costly to the Government. IRS paid about \$6 million in interest on refunds to nonfilers who filed their returns after being identified and caught by IRS' 1975 Taxpayer Delinquency Investigation Program.

IRS had to pay out such interest because it did not process these returns within 45 days after they were filed, as required by law. To avoid having to pay such interest, IRS should make sure that delinquent tax returns involving refund claims are processed within 45 days of being filed. (See pp. 64 and 65.)

DELINQUENT TAXPAYERS DUE REFUNDS
ARE NOT PENALIZED FOR LATE FILING

Section 6651(a) of the Internal Revenue Code imposes a penalty on those delinquent taxpayers who owe additional tax. It does not assess any charge against delinquent taxpayers due refunds. This situation is contrary to the voluntary compliance concept since it does not encourage people to comply with the April 15 filing deadline, regardless of whether they are due a refund.

For tax year 1975, GAO estimated that IRS had to spend almost \$4 million to identify nonfilers due refunds and interest of about \$226 million. It is incumbent on IRS to do all it can to make sure that taxpayers due refunds receive them. GAO recognizes that, although the Government has use of the taxpayers' unclaimed refunds, the Government's primary goal is to encourage timely compliance by taxpayers, who would likewise profit from receiving refunds sooner. (See pp. 66 to 68.)

MATTER FOR CONSIDERATION
BY THE CONGRESS

The Congress should consider alternative ways to amend section 6651(a) to impose a late filing charge on nonfilers whom IRS identifies and who subsequently file returns resulting

GAO shares IRS' concerns and agrees that the choices are difficult.

Although additional resources may be needed to fully implement GAO's recommendations for improving IRS' nonfiler activities, they should not be taken from other important enforcement programs. Given the amount of resources the Administration wants to direct at nonfiling and other noncompliance problems, the size of the nonfiler population, and its potential adverse effect on the Nation's voluntary tax assessment system, the Congress should determine whether IRS' nonfiler efforts are being funded at a level sufficient to cope with the magnitude of the problem. (See pp. 56 to 58.)

RECOMMENDATION TO THE CONGRESS

The Congress should request IRS to develop and provide to the appropriate congressional committees information on the amount of additional funds needed to improve the effectiveness of IRS nonfiler efforts. This information should include cost estimates for (1) estimating and analyzing the nonfiler population, (2) developing a better nonfiler case selection method, and (3) investigating thoroughly all nonfilers selected. The Congress then can decide whether additional funds are needed. (See p. 58.)

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CHAPTER 1

INTRODUCTION

Our tax system relies on taxpayers to voluntarily assess their own tax liability, file returns, and pay taxes on time. Without voluntary compliance, the Internal Revenue Service (IRS) cannot hope to adequately administer the Nation's tax laws. Recent attention given to the size of the subterranean or underground economy suggests, however, that many people may not be complying with the tax laws.

The subterranean economy consists of persons who do not report either all income on their tax returns, or no income because of failure to file tax returns. In 1978 a Treasury official stated that many people fail to report all their income and that such noncompliance diminishes public respect for and jeopardizes our tax system. Moreover, nonfiling and underreporting is unfair to honest taxpayers who must, as a result, bear a larger share of the tax burden.

This report deals with IRS' efforts to identify and pursue the individual nonfiler portion of the subterranean economy. Individual nonfilers are those who, although required, do not file income tax return forms 1040 or 1040A. Under section 6012 of the Internal Revenue Code, individuals are required to file income tax returns if they meet certain minimum gross income criteria, regardless of whether they owe taxes.

Detecting and pursuing nonfilers is important because nonfiling is different from other forms of noncompliance. Unlike those who either underreport their income or claim deductions and credits to which they are not entitled, the nonfiler does not come under the scrutiny of the tax examiner. A filed return can be checked for errors, omissions, or fraud, but a nonfiler gives no such leads.

OVERVIEW OF IRS' NONFILER PROGRAMS

In 1978, over 87 million individual income tax returns were filed which accounted for \$213 billion of the \$400 billion in gross tax collected by IRS. However, many taxpayers did not file.

IRS' Collection Division has principal responsibility for encouraging and achieving the highest possible degree of voluntary compliance with the filing requirements of the Internal Revenue Code as well as determining the reasons

a particular type of return, but who are required to file. IRS estimates that for fiscal year 1978, the program cost about \$4.3 million and resulted in securing about 55,000 returns from individuals and businesses, with additional tax assessments of about \$21 million. As of December 1978, there were 16 national programs either in progress or under consideration. While some programs are directed to people who have not filed individual income tax returns, such as self-employed professionals, most programs are directed at identifying businesses or individuals who have not filed specific business-type tax forms. These programs include highway use tax, aircraft use tax, and manufacturers' excise tax on imported rubber.

These programs are developed by the national office team, made up primarily of former revenue officers. Ideas for the programs come from such sources as newspaper articles, television, and IRS employees. Names of potential investigative subjects are obtained from other sources, such as private business lists and government lists. The names of individuals and businesses are checked against IRS records to determine if the particular tax form had been filed. Cases are initiated on those who did not appropriately file and sent to the local service center and district office for investigation.

Other IRS nonfiler efforts

Although our review focused on the programs and efforts of the IRS Collection Division, the Criminal Investigation and Examination Divisions also detect nonfilers in carrying out their responsibilities.

The IRS Criminal Investigation Division is responsible for identifying and investigating taxpayers who willfully do not comply with the tax laws. Nonfiler cases comprise only about one-third of all cases investigated by the Criminal Investigation Division. The division generally pursues only nonfiler cases involving multiple year delinquencies because nonfiling is a misdemeanor, while tax evasion is a felony. During fiscal year 1978, the Criminal Investigation Division's nonfiler efforts resulted in 717 recommended prosecutions and 356 convictions. Figures on the amount of additional tax assessed and the cost of investigating criminal nonfilers cases were not available.

CHAPTER 2

NONFILING--A SERIOUS PROBLEM WHICH

IRS NEEDS TO ADDRESS MORE FULLY

About 5 million individuals and couples with tax liabilities of about \$2 billion did not file the required income tax returns for tax year 1972. ^{1/} These nonfilers represent a delinquency gap between the approximately 68 million people who were required to file that year and the approximately 63 million people who did file.

The nonfiler population poses a serious tax administration problem which could adversely affect our voluntary tax assessment system. IRS stated it has not emphasized pursuing nonfilers primarily because of limited resources. In addition, the characteristics of the nonfiler population are generally similar to those people who file returns, which makes it difficult to isolate and identify nonfilers. However, there are some differences in the characteristics which may give clues as to why people fail to file and which could aid IRS in detecting nonfilers.

More attention should be given to the nonfiler area. IRS has not taken the action needed to get a good understanding of how many nonfilers exist, who they are, why they fail to file, and what action will prompt their compliance with the filing requirements.

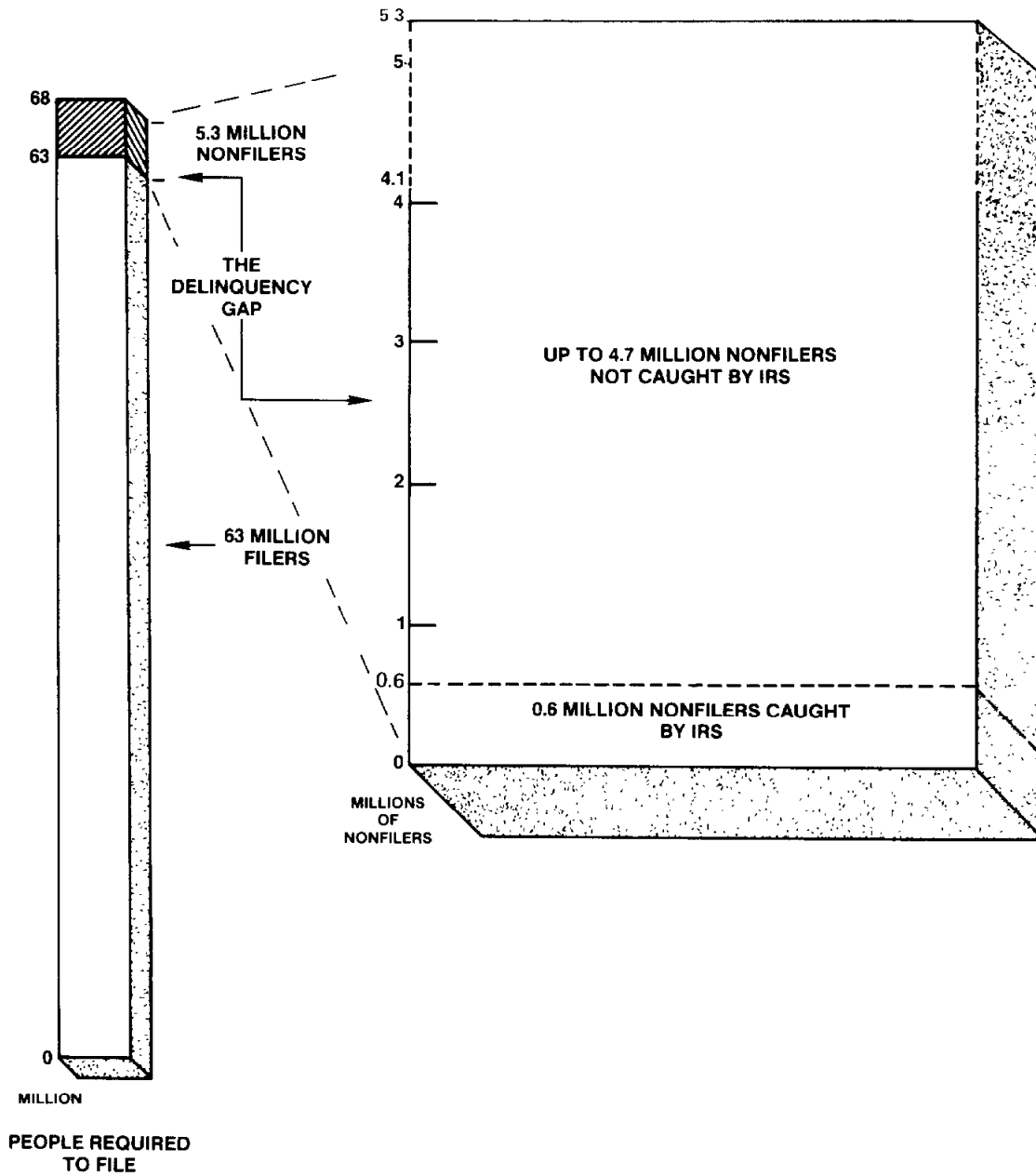
THE DELINQUENCY GAP--MILLIONS OF INDIVIDUALS FAIL TO FILE INCOME TAX RETURNS

We estimate that between 4.1 million and 5.3 million individuals and couples who should have filed tax year 1972 income tax returns did not. These nonfilers had between \$26 billion and \$35 billion in taxable income and owed between \$1.3 billion and \$2.4 billion in income taxes before considering withholdings.

Although reliable data on nonfiler withholdings were not available, we roughly estimate the amount to be about \$400 million based on a sample of nonfiler cases IRS pursued and did not pursue under its tax year 1975 Taxpayer Delinquency Investigation Program. IRS believes withholdings to be twice

^{1/}Tax year 1972 data was used because it was the most current and best available data at the time of our review.

TAX YEAR 1972 DELINQUENCY GAP



--Self-employed individuals made up a larger portion of the nonfiler population--17 percent--than the filer population--9 percent. (See chart 9.) In total about 15 percent of all self-employed people required to file were nonfilers, many of whom were managers or administrators and craftsmen. (See chart 11.) The nonfiling rate for self-employed persons may be higher than that for persons employed by someone else because information returns are not prepared by another party, namely the employer, and sent to IRS. Therefore, self-employed persons may have less incentive to file since IRS has no record of their earnings.

These and other nonfiler characteristics which are detailed in appendix III, could be useful to IRS for planning its efforts in the nonfiler area. They identify the types of persons most likely not to file, and thus indicate where IRS should direct its attention and resources. The characteristics of our estimated nonfiler population do not have as much daily operational use as planning use, however, because they are based on statistical projections and cannot be associated with specific individuals.

OCCUPATIONS—ALL WORKERS

**PERCENT OF NONFILER
AND FILER POPULATION**

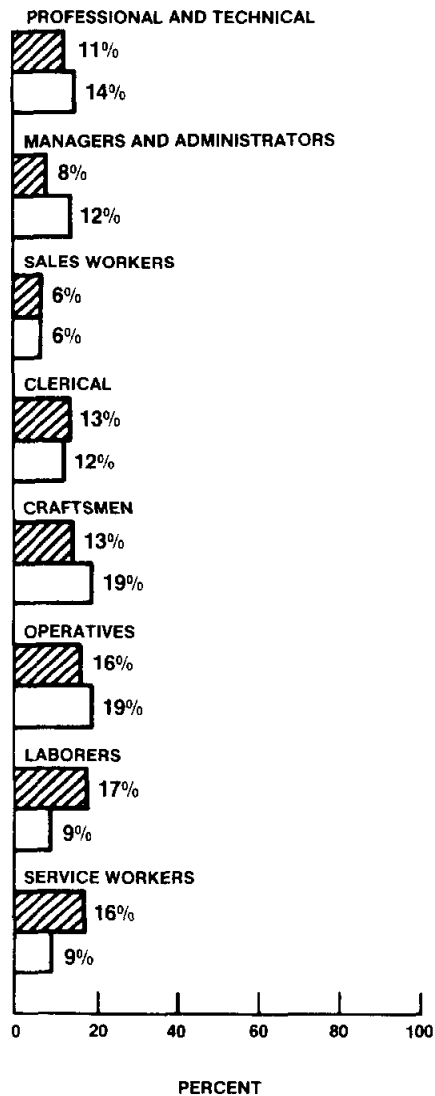


CHART 5

**PERCENT OF SOCIO-
ECONOMIC CATEGORY**

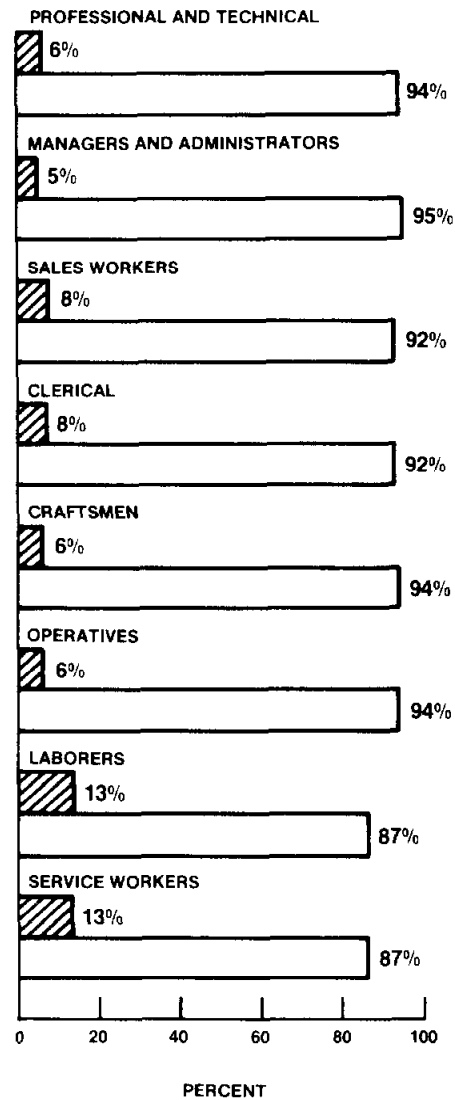


CHART 6

EMPLOYMENT STATUS

PERCENT OF NONFILER
AND FILER POPULATION

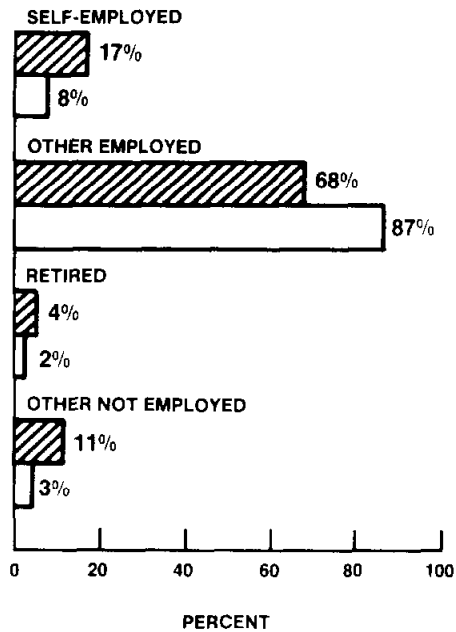


CHART 9

PERCENT OF SOCIO-
ECONOMIC CATEGORY

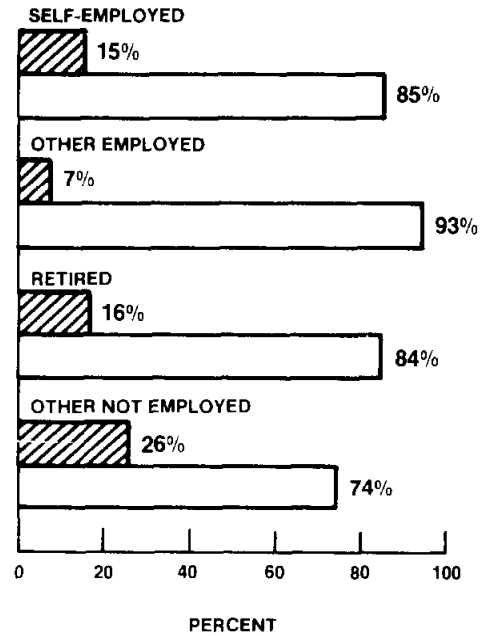


CHART 10

LIVING ARRANGEMENT

**PERCENT OF NONFILER
AND FILER POPULATION**

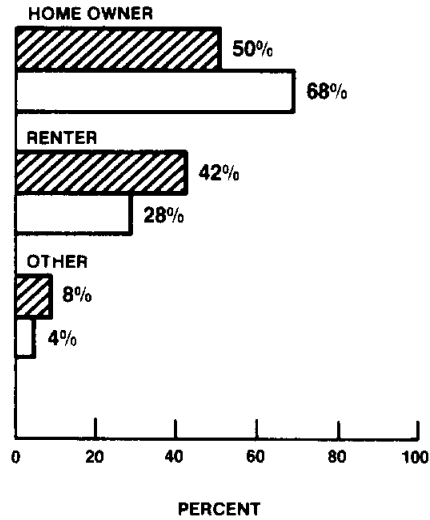


CHART 13

**PERCENT OF SOCIO-
ECONOMIC CATEGORY**

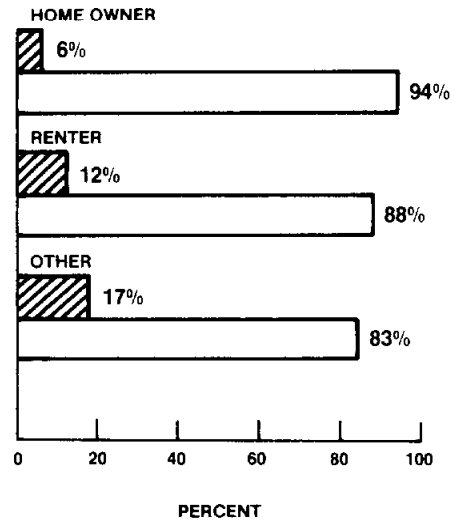


CHART 14

GEOGRAPHIC LOCATION

PERCENT OF NONFILER
AND FILER POPULATION

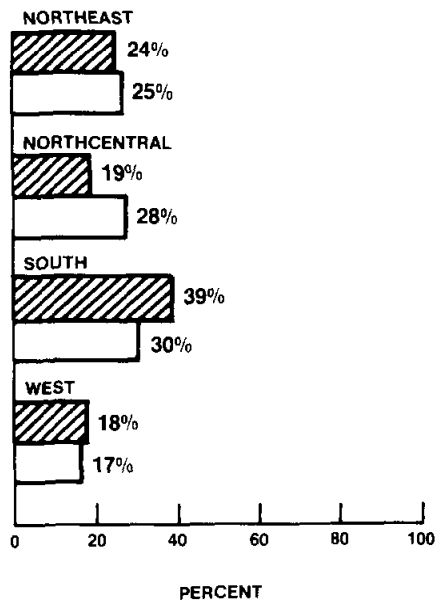


CHART 17

PERCENT OF SOCIO-
ECONOMIC CATEGORY

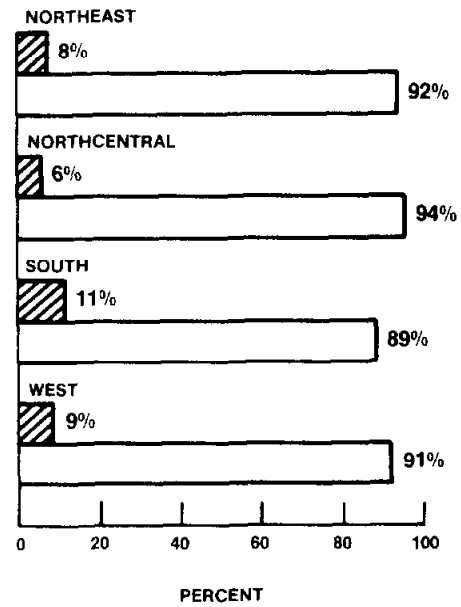


CHART 18

IRS should use its own
data sources to estimate and
analyze the nonfiler population

IRS has experienced difficulty identifying nonfilers through its traditional data sources. However, these sources can provide the (1) base for estimating the nonfiler population and (2) operational data needed to effectively attack the nonfiler problem.

IRS data sources represent a fairly comprehensive list of people who may be nonfilers. The information returns identify all individuals who had income reported to IRS from wages, interest, dividends, and some other sources. Social security records identify all reported individuals who had social security taxes withheld from their wages. IRS master file records identify individuals who filed returns in the past. The only people not included in these data sources are those who never filed a tax return and had no income reported to IRS.

IRS could estimate the nonfiler population by selecting a sample of individuals from its traditional data sources and performing surveys similar to those performed under its Taxpayer Compliance Measurement Program ^{1/} to measure the compliance level for individuals who file returns. These surveys would involve contacting the sampled individuals to determine their filing liability and develop information on their characteristics. The survey results could then be analyzed to formulate the operational data needed for systematically addressing the nonfiler problem.

Survey data could be used to (1) set priorities and allocate resources in the nonfiler area, (2) develop a systematic method for selecting nonfilers for investigation, (3) determine why people fail to file returns, and (4) identify corrective actions needed to get people to file, such as education programs, tax law changes, or tax form and instruction simplification. Conducting periodic surveys, as is done every three years in the Taxpayer Compliance Measurement Program, would allow IRS to update its estimate of the size and makeup of the nonfiler population. These surveys would

^{1/}This program is designed to measure the voluntary compliance levels through specialized audits of randomly selected tax returns. Current surveys concentrate on the measurement of potential examination workload and the voluntary compliance of filers rather than the universe of all who should file.

IRS COMMENTS AND OUR EVALUATION

By a June 6, 1979, letter, the Commissioner of Internal Revenue concurred with our recommendation to periodically estimate the size and analyze the characteristics of the nonfiler population. (See app. I.) IRS noted, however, that the amount and timing of action it can take will depend on available resources.

We recognize the scarcity of IRS resources to undertake this project; however, we believe it is vital that the project be started immediately so that IRS can begin to systematically address the nonfiler problem. We discuss the overall resource issue in our evaluation of IRS' comments in chapter 3. (See pp. 56 to 58.)

TAXPAYER DELINQUENCY INVESTIGATION
PROGRAM NEEDS A BETTER METHOD FOR
SELECTING NONFILERS FOR INVESTIGATION

The key to systematically reducing the delinquency gap is to concentrate investigative resources on people who are required to file returns. The Taxpayer Delinquency Investigation Program's method for selecting individuals to pursue, however, misallocates resources. Many people who should file but did not are not selected for investigation, while others who are not required to file are investigated. IRS needs to develop a more sophisticated system to aid it in allocating its investigative resources at those people most likely to be nonfilers. Such a system could be the cornerstone for best attacking the nonfiler problem.

IRS case selection
criteria are ineffective

The Taxpayer Delinquency Investigation Program selects people to investigate on the basis of data taken from information returns, social security tax records, and IRS master file records. The program's selection criteria are generally based on whether a person's income, as shown by these data sources, indicates a predetermined tax liability, not merely on the technical requirement to file. IRS' data sources, however, do not always show a person's total income and other factors which determine a person's requirement to file. As a result, many people are selected for investigation who are not technically required to file, and many who most likely are required to file are not selected.

For example, as shown in the chart on page 24, IRS used accumulated records on about 110.3 million individuals to determine which potential nonfilers to pursue for tax year 1975. These people may or may not have been required to file. IRS selected 1.3 million individuals out of the 110.3 million for investigation under the Taxpayer Delinquency Investigation Program. According to IRS, these cases were selected because of their potential for yielding high tax dollars at minimal cost. IRS determined that 300,000 of the 1.3 million were not required to file. It did not determine whether another 500,000 should have filed or not. It secured delinquent returns from 31 percent of the cases it selected.

The chart also shows that, of the 109 million people not selected for investigation for tax year 1975, about 90 million were not pursued because information on them was insufficient (e.g., no address, individual deceased) for investigative purposes. The remaining 19 million individuals were not pursued because they had low income with little or no potential tax liability. Our analysis of an IRS computer file of 90,593 of the 109 million individuals indicates that about 21 million had income in 1975 of which about 2 million had sufficient income to be required to file. 1/

Of the 19 million individuals whom IRS did not select to be investigated further because of their low income, our analysis shows that IRS selection criteria excluded many people who were technically required to file but did not.

- The income level needed to be selected for investigation was greater than that required for filing. We estimate that over 700,000 individuals had sufficient income to be required to file, but their income was below the amount IRS requires to investigate individuals as nonfilers.
- Individuals whose income in the prior year was primarily from wages were not selected for investigation if IRS had little income information on them for the tax year under investigation. Of the 19 million individuals, about 7 million individuals had filed tax year 1974 returns but were not pursued for their tax year 1975 return for lack of information.
- The criteria do not take into consideration that individuals with substantial nonwage income, but in amounts below the IRS cutoff level, may still be required to file. For example, self-employed individuals who did not file in the prior year and had delinquent year nonwage income below the cutoff amount would not be selected for investigation. We estimate that about 970,000 individuals

1/The confidence levels for all projections in this report are discussed in app. IV.

Of the 1,120 sampled cases, 616 were required to file, 132 were not required to file, and the filing requirement of 372 was unknown because IRS could not locate the taxpayers or the case investigation was not completed. As shown in the following table, of the 748 cases where our field work enabled us to determine the actual filing requirement, our model predicted that in 548 cases the taxpayers were required to file. Actually, 520 of the 548 cases, or 95 percent were required to file.

		<u>Predictive ability of the model</u>			
		<u>Required to file</u>		<u>Not required to file</u>	
<u>Actual requirement to file</u>	<u>Number of cases</u>	<u>Number of cases</u>	<u>Percent</u>	<u>Number of cases</u>	<u>Percent</u>
Required to file	616	520	95	96	48
Not required to file	<u>132</u>	<u>28</u>	<u>5</u>	<u>104</u>	<u>52</u>
Total	<u>748</u>	<u>548</u>	<u>100</u>	<u>200</u>	<u>100</u>

The model correctly predicted taxpayers who are not required to file 52 percent of the time. The total predictive ability of the model is 83 percent (520 required-to-file cases plus the 104 not-required-to-file cases).

By using a model such as this, IRS could concentrate its investigative efforts on those cases most likely to result in securing a tax return, instead of pursuing individuals who are not required to file.

While our model is based on cases which IRS had already selected for investigation, a model could also be built to include cases that had not been selected for investigation. Such a model could be developed from data gathered under a taxpayer compliance measurement program for nonfilers. (We recommend in Ch. 2 that IRS undertake this program in estimating the nonfiler population and analyzing its characteristics.) If such a model were developed, IRS would have a better way of selecting, for example, individuals for investigation among the 110.3 million on which it had information for tax year 1975.

insufficient investigations to locate the taxpayers or to verify whether they were required to file.

	Number of <u>cases</u>	<u>Percent</u>
<u>Successful closures</u>		
Returns secured	216	22
Returns previously filed	72	8
Individuals not required to file	<u>158</u>	<u>16</u>
	<u>446</u>	<u>46</u>
<u>Unsuccessful closures</u>		
Individuals not located	388	41
Closed without completing the investigation	68	7
Closed as not required to file without verifying filing requirement	<u>60</u>	<u>6</u>
	<u>516</u>	<u>54</u>
Total	<u>962</u>	<u>100</u>

To determine if thorough investigations would increase the number of successful closures, thereby increasing program effectiveness, we had IRS investigate 471 of the 516 cases which were closed unsuccessfully. For most of these cases, we provided IRS with such leads as where the taxpayers might be located or why they might be required to file. The following table shows the results of the 389 cases IRS had finished investigating at the time our review ended.

	Number of <u>cases</u>	<u>Percent</u>
<u>Successful closures</u>		
Returns secured	137	35
Individuals required to file but returns not secured	42	11
Individuals not required to file	<u>36</u>	<u>9</u>
	<u>215</u>	<u>55</u>
<u>Unsuccessful closures</u>		
Individuals not located	<u>174</u>	<u>45</u>
Total	<u>389</u>	<u>100</u>

	<u>Sample cases</u>	<u>Sample results projected to the seven districts</u>
Cases where		
returns secured	137	19,591
Total returns secured	325	46,475
Balance due returns	177	25,311
Total balance		
due amount	\$111,011	\$15,874,573
Refund returns	148	21,164
Total refund amount	\$54,182	\$7,748,026
Net yield: balance		
due amount minus		
refund amount	\$56,829	\$8,126,547
Total cost (based		
on 389 cases at		
\$46 per case)	\$17,894	\$2,558,842
Benefit/cost ratio:		
net yield minus		
total cost	\$38,935	\$5,567,705
	(3 to 1)	

Only limited investigation is
required to locate nonfilers

About 36 percent of our 962 sample cases were closed as unable-to-locate because IRS procedures limited the amount of investigation performed. More nonfilers can be located when available address sources are used and investigations are thorough.

For investigative purposes, there are two types of non-filer cases: those where only delinquency notices are issued and those where notices are issued but where further investigation, such as telephone calls and visits to the taxpayer's residence, is required.

Delinquency notice-only cases are low-income cases which IRS service centers close as unable-to-locate if the taxpayers do not respond to the notices. Of our 962 sample cases, 311 were delinquency notice-only cases, of which 214 were closed as unable-to-locate. IRS officials told us, however, that for tax year 1976 and subsequent years, notice-only cases will not be closed as unable-to-locate when the taxpayers do not respond to the notices. Instead, the cases will be coded so that if the individuals are delinquent in the following year they will be subject to investigation by the district offices.

1977 totaling over \$4,900 in taxes owed, interest, and penalties.

--A service center closed a notice-only case as unable-to-locate after the taxpayer failed to respond to four delinquency notices. In investigating the case for us, IRS went to the address on the delinquency notice and found the taxpayer's sister, who indicated the taxpayer lived across the street. The taxpayer was contacted and delinquent returns were secured for tax years 1974 through 1977 totaling almost \$900 in taxes owed, interest, and penalties.

--A service center closed a case which met the limited investigation criteria as unable-to-locate after the taxpayer failed to respond to four delinquency notices. We provided IRS with the taxpayer's address which we found in the local telephone directory and which differed from the address on the delinquency notice. IRS contacted the taxpayer by telephone at the new address and secured delinquent returns for tax years 1972 through 1977 totaling almost \$21,000 in taxes owed, interest, and penalties.

--A service center closed a limited investigation case as unable-to-locate. Although the taxpayer was delinquent for tax year 1975, he had filed timely returns for tax years 1976 and 1977 and received refunds of over \$1,000 each year. We had IRS contact the taxpayer at the address shown on his 1976 tax return which differed from the address on the delinquency notice. IRS was able to secure the tax year 1975 return which involved over \$1,000 in taxes owed, penalties, and interest.

The above examples show that either IRS had an accurate address for the nonfiler already in its records or the correct address was readily available elsewhere. In fact, in about 70 percent of the 135 cases, which IRS investigated for us and located the taxpayer, accurate addresses were either on IRS' master file or on case-related documents, such as the delinquency notices. Following are the address sources for the 135 cases.

For the tax year 1976 Taxpayer Delinquency Investigation Program, IRS used the most recent address from the master file in preparing the delinquency notices. However, this action only partially solved the problem. IRS has not provided for updating addresses from returns filed after the notices are sent. These new addresses will not automatically be provided to service centers or district offices working the delinquency cases. As a result, in some cases the master file will have to be searched to get a current address.

IRS also did not take advantage of the addresses available from information returns for the tax year 1975 Taxpayer Delinquency Investigation Program. It is making such addresses available to the district offices for the tax year 1976 program. However, this information will not be available to the service centers, even though they close the majority of the cases.

To make it easier to locate taxpayers, IRS should provide all new addresses from returns filed after the notices are issued to the IRS location performing the delinquency investigation. IRS should also provide the addresses from the information returns to service center employees. But, more importantly, IRS should require a visit to the taxpayer's residence when the taxpayer does not respond to the delinquency notices.

Cases are closed as not-required-to-file when returns are due

IRS procedures allow nonfiler cases to be closed as not-required-to-file even though returns are due or may be due. This can occur when the (1) IRS employees handling the cases believe the amounts owed would not warrant enough investigation to contact the taxpayers, (2) taxpayers claim that if they file, they would receive refunds, and (3) taxpayers claim their income is below the amount required for filing. We classified 62 of our 962 sample cases as unsuccessful closures because they met one of these three conditions.

We had IRS investigate the 62 not-required-to-file cases. Of the 45 cases it had finished when our review ended, it secured returns in 22.

The returns secured in the 22 cases yielded a difference of about \$1,345 between the total taxes owed and the refunds due. While this is not a significant difference, employing policies and procedures which allow

not-required-to-file because the taxpayer was supposedly due refunds. In investigating the case for us, IRS contacted the taxpayer and secured both tax year 1975 and 1976 returns for which the taxpayer owed over \$1,000 in taxes for each year.

Failing to secure delinquent returns when taxpayers claim refunds are due is a questionable policy--even if the taxpayers are due refunds--because it does not promote compliance.

Just as questionable is accepting taxpayers' claims that their income is below the amount required for filing, especially when IRS has information to the contrary. In investigating the 62 not-required-to-file sample cases for us, IRS secured returns from seven taxpayers who claimed they were not required to file. Two examples follow.

--A case was sent to a district office after the taxpayer stated in response to the delinquency notice that her accountant said she did not have to file because her income was below the amount required for filing. IRS records showed the taxpayer had almost \$5,000 in income from a realty company. The district office did not contact the taxpayer but agreed with what the taxpayer had stated on the delinquency notice and closed the case as not-required-to-file. In investigating the case for us, IRS secured both 1975 and 1976 tax returns with taxes due of about \$140 and \$50, respectively.

--A taxpayer responded to the delinquency notice stating he was not employed in 1975. The service center closed the case as not-required-to-file even though IRS records showed the taxpayer had over \$5,000 in income during 1975. IRS investigated the case for us and secured a 1975 return with taxes due of over \$100.

Although in the cases cited above both service center and district office employees had enough information on the taxpayers' income to question their claims, service center employees may not have adequate information in all cases. For investigative purposes, district office employees are provided detailed information on taxpayers' source, type, and amount of income. However, service center employees have access only to the taxpayers' total income coded on the delinquency notices. As a result, they do not always

We had IRS investigate 38 cases in our sample where only tax year 1975 returns were secured and where full compliance checks were not made. In 45 percent of these cases, IRS secured tax returns for years other than 1975. The following are examples.

--In response to a delinquency notice, a taxpayer filed a 1975 return with taxes due of over \$800. IRS records showed the taxpayer had not filed tax year 1974 and 1976 returns. In investigating the case for us, IRS secured both returns with taxes due of approximately \$200 and \$800 respectively.

--In response to a delinquency notice, a taxpayer filed a 1975 return with taxes due of over \$500. IRS records showed the taxpayer had never filed prior to 1975. In investigating the case for us, IRS secured returns for tax years 1974, 1976, and 1977, totaling over \$1,800 in taxes due.

IRS personnel do not make compliance checks because IRS policies and procedures do not require them for all cases. This applies primarily at the service centers where about 69 percent of our sample cases were closed. Collection Division managers and supervisors at the service centers reviewed said that full compliance checks for prior and subsequent years are not done unless the IRS employee closing the case has telephone contact with the taxpayer.

In contrast, district office personnel are more likely to conduct full compliance checks. IRS procedures require district office employees to annotate nonfiler case history sheets with compliance information for all delinquent years. However, only 29 percent of our sample cases closed by district offices were checked for compliance.

As a result of not making full compliance checks, taxpayers can avoid paying taxes for several years. This is especially true when taxpayers file returns in response to delinquency notices. The notices request that the taxpayer file only the return for the tax year under investigation. If the taxpayers send in the delinquent year returns, they will not be asked for prior year delinquencies. It is doubtful if IRS would ever ask about the same prior year delinquencies even if the taxpayers became delinquent in subsequent years. When IRS does make full compliance checks, it seldom checks back past the tax year when the last return was filed.

<u>Range of unreported income</u>	<u>Number of taxpayers</u>	<u>Amount of unreported income</u>	<u>Potential tax liability (note a)</u>
\$ 10 to \$ 200	60	\$ 4,440	\$ 673
\$ 201 to \$ 500	14	4,959	751
\$ 501 to \$1,000	18	14,926	2,262
\$1,001 to \$2,000	9	12,782	1,937
Over \$2,000	<u>16</u>	<u>66,937</u>	<u>10,142</u>
Total	<u>117</u>	<u>\$104,044</u>	<u>\$15,765</u>

a/The basis for the calculation of potential tax liability was that for tax year 1975, in the bottom income bracket about \$6.60 income was needed to produce \$1.00 in taxes.

On the basis of 962 sample cases, we estimate that in the 7 district offices we reviewed, IRS did not detect about \$14.8 million in unreported income with potential tax liabilities of \$2.2 million.

The following examples show the tax loss which can result from not checking for unreported income.

--In response to a delinquency notice, a taxpayer filed a 1975 tax return with a refund due of over \$500, including over \$300 for the earned income credit. By comparing the income information IRS had on the individual with the taxpayer's return, we found the taxpayer had not reported almost \$5,000 in income. We referred the case to IRS, who assessed the taxpayer over \$1,000 in taxes and penalties and disallowed the taxpayer's earned income credit.

--In response to a delinquency notice, a taxpayer filed a 1975 return with taxes owed of over \$70. By examining IRS' income records on the case, we found the taxpayer had not reported over \$2,700 in interest and dividend income. We referred the case to IRS, which assessed the taxpayer over \$600 in taxes and penalties.

IRS checks returns for unreported income at the same time nonfiler cases are created. Consequently, delinquent returns secured through the Taxpayer Delinquency Investigation Program are not subject to this underreporter check.

- send delinquency notices sooner to individuals who filed the year prior to the one under investigation;
- direct delinquency prevention resources to individual nonfilers;
- refine the income information on individuals with nontaxable pension income;
- provide nonfilers with information on filing requirements; and
- collect adequate program evaluation data.

Nonfiler cases on married couples should be consolidated

IRS creates separate nonfiler cases on both husband and wife even though they filed a joint return in the year prior to the one being investigated. No attempt is made to consolidate the two nonfiler cases so they can be investigated together. As a result, investigative resources are misdirected because some cases are subject to too much investigation while others do not receive enough. Also, the likelihood of detecting unreported income is decreased. Combining nonfiler cases on married couples should reduce program cost.

About 5 percent of the 1,120 tax year 1975 nonfiler cases we sampled involved separate investigations for each spouse when only one joint investigation would have been required. On the basis of our random sample, we estimate that this generated 8,700 additional cases at a cost of about \$200,000 in the 7 districts reviewed.

The following table shows how much investigation the 61 cases received.

<u>Investigative effort</u>	<u>Number of cases</u>	<u>Percent</u>
Both spouses received only delinquency notices	23	38
One spouse received just delinquency notices while the other was also investigated by the district office	18	29
Both spouses were investigated by the district offices	<u>20</u>	<u>33</u>
Total	<u><u>61</u></u>	<u><u>100</u></u>

could be initiated and coded or combined in such a way so they are investigated together.

Whether one case or two cases are made, the secondary taxpayers should be matched on all potential nonfiler cases and not just those that meet IRS' criteria for selection. Matching all cases will result in selecting some people who would otherwise not be selected because of their low income and will allow IRS to make a better check for unreported income. Matching should also increase the possibility that the cases will receive adequate investigation, because the income levels on the combined cases will be higher.

Delinquency notices should be
issued earlier to some nonfilers

IRS does not begin issuing delinquency notices to nonfilers until 15 months after the April 15 return due date. By the time the service centers issue the notices, many of the potential nonfilers have moved and do not receive the notices. As a result, either their cases are closed at the service centers as unable-to-locate, or they are referred to the district offices where more costly resources are used.

IRS investigated 343 of the 388 nonfiler sample cases which were closed as unable-to-locate. In about 85 percent of the 343, the individuals no longer resided at the address shown on the delinquency notice.

We could not determine how many individuals had moved from the notice address between the due date of the return and the date the delinquency notices were mailed. Some evidence exists, however, to suggest that the earlier notices are issued, the better the chances that the taxpayer will still reside at the address on the notice.

For the tax year 1975 Taxpayer Delinquency Investigation Program, notices were issued in January 1977--9 months after the April 15 return due date--to 287,678 individuals who had either (1) filed for extensions which had expired or (2) had credit balances for tax year 1975 but had not filed returns. The remaining 1 million notices were issued in July 1977--15 months after the filing deadline. Only 5 percent of those cases where notices were issued earlier were closed as unable-to-locate, whereas 28 percent of those where notices were issued later were closed as unable-to-locate.

The 15-month delay in issuing delinquency notices is due to processing information returns IRS receives on

delinquent in paying their taxes. It is not directed at individual nonfilers. As a result, little is done to ensure that individual nonfilers, once caught, will not continue to be delinquent.

One million staff hours were scheduled for the fiscal year 1979 Delinquency Prevention Program. None of these were for individual nonfilers, according to an IRS headquarters official responsible for the program and officials at two district offices we reviewed. Yet, many individual nonfilers are repeaters. About 28 percent of our 1,120 sampled cases for tax year 1975 were again selected for investigation in the tax year 1976 nonfiler program.

Individual nonfilers should be included in the Delinquency Prevention Program to ensure that nonfilers who are caught do not stop filing in the future. In addition, their inclusion will help IRS better determine the causes for nonfiling and ways to prevent people from becoming nonfilers.

Some changes should also be made to the program to ensure its effectiveness. The decision both to include taxpayers in the program and to monitor them for future compliance is left to the discretion of the employee handling the delinquent taxpayer's case. Consequently, IRS has no assurance that individual nonfilers, even if included in the program, will be monitored.

Also, the IRS employee is supposed to determine the causes for noncompliance. However, the program does not provide for the accumulation of this data to determine why nonfilers on the whole do not comply. Determining why individual taxpayers fail to file is helpful in getting particular individuals to comply. However, unless data is accumulated on why people fail to file, an overview of the actions needed to prevent nonfiling, such as educational programs which could be directed to large groups of individuals, cannot be obtained.

Pension income information on
individuals should be refined

Unnecessary nonfiler cases are developed on individuals with nontaxable pension income. Twelve of our 1,120 sample cases had nontaxable income and should not have been investigated. While these cases represent only one percent of our sample, they did result in unnecessary investigative effort and taxpayer contacts. IRS can prevent this by refining the pension income data it has on individuals.

Taxpayers would also benefit from being informed that they may be entitled to refunds regardless of whether they are required to file. For example, some low-income taxpayers who are not required to file are due refunds because they had tax deducted from their pay or because they are entitled to the earned income credit.

To help delinquent taxpayers assess their filing requirements, IRS should inform them by incorporating the requirements either on the delinquency notices or on a separate statement. This should help increase the effectiveness of the Taxpayer Delinquency Investigation Program, since taxpayers would be better informed of the filing requirements and thus better able to provide IRS with accurate assessments of their requirement to file.

Better program evaluation data needs to be collected

IRS does not have a written policy or guidelines for evaluating the Taxpayer Delinquency Investigation Program. Even if it did, little data is collected on program operation to make an adequate evaluation. Neither the statistical reports used for program evaluation purposes nor the input data to the reports are adequate for analyzing program results. As a result, IRS does not know how well its policies and procedures are meeting program objectives, nor does it have a clear picture of how nonfiler cases are closed in the field.

Statistical reports used for program evaluation are inadequate

Two IRS reports are used to show how well the Taxpayer Delinquency Investigation Program is operating--the Delinquent Return Activity Report and the Phase IV Report.

The first report, which is produced quarterly, covers both business and individual delinquent tax return data. It is used for monitoring and evaluating all delinquent return programs and for allocating resources for future programs. The report contains only general data on program results, such as the number of investigations performed by the district offices, the number of returns secured, and the amount of tax assessed and collected. Since the report does not contain important specific information, such as the results of service center investigations or reasons returns were not secured, it cannot be used effectively for evaluation purposes.

accurately describe how the case was closed. Consequently, their usefulness for program evaluation purposes is limited.

For example, the code which is used to close a case when the individual is not required to file a return can be used if (1) the taxpayer's income is below the filing requirements, (2) the taxpayer claims that a joint return was filed with a spouse, (3) the taxpayer claims to be eligible for a refund if a return were filed, (4) the taxpayer files a refund return, and (5) an IRS employee believes the taxpayer would owe little or no taxes if the return were secured. Because of the code's broad use it is not informative of program effectiveness. For instance, in evaluating the number of cases closed as not-required-to-file, management cannot determine how many of those cases were closed because the individual had filed with a spouse. Consequently, it cannot determine if a large number of people who filed joint returns are mistakenly being selected for investigation. If management knew how many joint filers were being investigated, it could initiate some corrective action and thereby make more effective use of its investigative resources.

To more accurately reflect how cases are closed and to provide management with a clearer understanding of program results, IRS should expand its transaction codes and make them more descriptive to show more precisely why the cases were closed.

IRS BELIEVES MORE RESOURCES WILL INCREASE PROGRAM EFFECTIVENESS

According to IRS Collection Division officials, more resources are needed to improve the effectiveness of the Taxpayer Delinquency Investigation Program, because resource constraints limit the number of nonfilers who can be thoroughly investigated. For fiscal year 1979, IRS budgeted about \$66 million to the nonfiler area, of which about \$14 million was for the pursuit of individual nonfilers. In contrast, it budgeted about \$930 million to audit tax returns and collect delinquent accounts. Thus, IRS is devoting 66 times more resources to monitoring people who file the returns than to investigating individuals who do not file required tax returns. While we agree that IRS should devote most of its resources to monitoring people who file returns, more resources may need to be devoted to the nonfiler problem.

IRS is faced with a dilemma--whether to allocate more resources to pursuing nonfilers, thereby increasing nonfiler compliance at the expense of other collection activities and

though its policies and procedures intentionally limit the extent nonfilers are investigated, including only sending delinquency notices to some nonfilers, many delinquent returns and taxes are still secured through the program. IRS believes that more revenue is produced in this manner than by only sending delinquency notices to fewer nonfilers where resources permit a thorough investigation.

Limiting investigation on nonfiler cases could have an adverse effect on compliance and reduce taxpayers' respect for IRS' ability to adequately administer the tax laws. If taxpayers receive only delinquency notices, they may discount the importance IRS places on nonfiling and continue to be delinquent. The taxpayers may also view future IRS attempts to secure delinquent returns as merely idle inquiries with little likelihood of being made to comply.

To overcome the possible adverse effects on taxpayer compliance which can result from cursory investigative efforts, IRS generally should not start investigations of nonfilers unless it pursues them fully. While we agree that allocating more resources to investigating nonfilers would help, additional resources alone will not solve the problem. As discussed throughout this chapter, program effectiveness can also increase by improving (1) the selection of nonfilers so that those most likely to be brought in to compliance are pursued, (2) investigative policies and procedures so that those selected are investigated thoroughly, and (3) various caseload management practices. Even if IRS were granted increased funds, these actions would be necessary to assure that any additional, as well as current resources, are well used.

CONCLUSIONS

The Taxpayer Delinquency Investigation Program has not been effective in reducing the delinquency gap and securing delinquent returns because of weaknesses in the program's selection criteria and investigation methods.

People are generally selected for investigation under the program on the basis that IRS information indicates a predetermined tax liability. However, this income information is not always complete and factors other than income can determine a person's filing requirement. As a result, IRS selects and investigates many people who are technically not required to file; while it does not select many who are most likely required to file. To better use its investigative resources, IRS needs to develop a selection method which directs the resources at nonfilers and not at people who do not have to file.

- failing to provide, along with the delinquency notices, information on the filing requirements; and
- failing to collect and analyze data on program effectiveness.

These practices need to be changed if IRS is to have a more productive Taxpayer Delinquency Investigation Program.

IRS contends that program effectiveness can be increased with more resources because resource constraints limit the number of nonfilers that it can thoroughly investigate. Although directing more resources to detecting and investigating nonfilers may be helpful, more resources alone will not remedy all program weaknesses. IRS must also improve its case selection process, strengthen its investigative policies and procedures, and improve its caseload management practices before the program can best use additional resources to attack the nonfiler problem.

RECOMMENDATIONS TO THE COMMISSIONER OF INTERNAL REVENUE

To improve the effectiveness of the Taxpayer Delinquency Investigation Program, we recommend that the Commissioner:

- Develop a method for selecting persons for investigation which will make more effective use of investigative resources by predicting with a high degree of certainty that the people selected for investigation are actually required to file returns.
- Strengthen investigative policies and procedures by requiring that all people selected for investigation be pursued to ensure that reasonable efforts, such as visiting the last known address of the taxpayer or telephoning the last known employer, are made to (1) locate the nonfilers, (2) verify their filing requirements, and (3) secure all the delinquent returns they are required to file.
- Establish a system for checking delinquent returns for unreported income.
- Consolidate, for investigative purposes, the separate nonfiler cases made on husbands and wives when IRS records show that a couple filed a joint return in the tax year prior to the one being investigated.

penalties, and interest assessed against those caught. However, IRS selects nonfiler cases based on a predetermined tax liability and not on whether the persons are likely to be required to file. IRS believes that the cases it selects in this manner will have a high tax yield. On the basis of the results of its tax year 1975 Taxpayer Delinquency Investigation Program, however, 60 percent of the returns IRS secured involved refunds or no net taxes due. Also, it secured returns from only 31 percent of the 1.3 million persons it selected. IRS determined that another 23 percent were not liable to file, and 8 percent had already filed. IRS did not determine whether the remaining 38 percent should have filed or not.

Furthermore, the results of IRS' tax year 1975 nonfiler program show that most of the taxes IRS assessed involved persons who had already shown some intent to file before IRS investigated them as nonfilers. For example, about 62 percent of the delinquent taxes, penalties, and interest IRS assessed against nonfilers involved people it investigated because they either had (1) filed for an extension which had expired or (2) not filed but had credit balances for tax year 1975. These individuals, who made up about 22 percent of the 1.3 million cases investigated, were not totally avoiding their filing responsibilities. Thus, this may have been one reason IRS was able to catch them.

Another reason why these two types of cases were productive is that they were subject to thorough investigations, even under IRS' current procedures. At least 72 percent of the delinquent taxes, penalties, and interest IRS assessed against the nonfilers it caught in the tax year 1975 program involved nonfilers who were subject to thorough investigations, as we suggest in this chapter.

IRS nonfiler efforts could be more effective in reducing the delinquency gap and fostering compliance with the filing requirements if it (1) more systematically selected nonfilers for investigation on the basis of the likelihood of their being required to file and (2) thoroughly investigated those persons it selects. We have shown in this chapter that generally, if IRS would not intentionally limit the scope of its investigations, the results would be more significant.

IRS also emphasized that its resources are limited and that devoting additional resources to detecting and investigating nonfilers would reduce other enforcement programs. It stated that the amount of its enforcement resources allocated to detecting nonfilers must be weighed against and balanced with its declining audit coverage and its increasing

CHAPTER 4

IRS ACTIONS OUTSIDE THE TAXPAYER DELINQUENCY INVESTIGATION PROGRAM CAN REDUCE THE DELINQUENCY GAP

Improving the effectiveness of the Taxpayer Delinquency Investigation Program alone will not completely reduce the delinquency gap because special measures may be required to detect and catch certain nonfilers. Once IRS has estimated the nonfiler population and analyzed its characteristics, it will be in a better position to know the extent to which other measures are needed to supplement the Taxpayer Delinquency Investigation Program and to establish a balanced effort against nonfilers. In the interim, on the basis of our analysis of the nonfiler population, IRS should consider taking other actions to reduce the delinquency gap. These involve

- initiating Returns Compliance Programs on specific nonfiler groups, such as those in certain occupations or with certain types of income;
- making better use of State data on Federal nonfilers; and
- possibly processing more information returns, such as those on interest and dividend income.

To avoid rewarding individuals for filing late, and possibly encouraging nonfiling, IRS should ensure that delinquent tax returns are processed within 45 days of filing so it does not have to pay interest on refunds due late filers and nonfilers who finally submit a tax return.

Congress could also amend the Internal Revenue Code to promote compliance with the filing requirements and help reduce the delinquency gap. It should consider amending the Code's late filing penalty provision to allow IRS to assess a charge against delinquent taxpayers due refunds instead of penalizing just those who owe taxes.

MORE RETURNS COMPLIANCE PROGRAMS MAY BE NEEDED TO CATCH CERTAIN GROUPS OF NONFILERS

IRS' Returns Compliance Programs are intended to identify nonfilers who have never filed a specific type

Because of the difficulty in detecting this unreported income, IRS may want to handle these types of cases through a Returns Compliance Program, instead of its Taxpayer Delinquency Investigation Program.

Recognizing that it will take time to develop a good estimate and analysis of the nonfiler population, IRS in the interim could base its consideration of any additional Returns Compliance Programs on our evaluation of the characteristics of the approximately 5 million nonfilers we estimated for tax year 1972. It could also randomly select from among those people it did not investigate under its Taxpayer Delinquency Investigation Program but whom IRS records showed did not file returns for a particular tax year. As discussed in chapter 2, there were about 109 million such persons for tax year 1975 whom IRS did not investigate. A sample of these persons by type and level of income could be useful. For example, we estimated that over 300,000 persons not selected for the tax year 1975 Taxpayer Delinquency Investigation Program had nonwage income of \$3,000 or more. A Returns Compliance Program directed at these individuals might reveal a significant number of nonwage-earning nonfilers.

Any consideration which IRS gives to more Returns Compliance Programs should be made in light of available resources and other priorities in the nonfiler area. The selection of such programs should complement other nonfiler efforts, like the Taxpayer Delinquency Investigation Program, and contribute to establishing a balanced attack on the nonfiler problem.

IRS SHOULD USE AVAILABLE INFORMATION TO DETECT MORE NONFILERS

To aid in identifying more nonfilers for investigation through the Taxpayer Delinquency Investigation Program or Returns Compliance Program, IRS should make more use of already available information. Specifically, it should evaluate State data (available for tax administration purposes through agreements with the States) to identify Federal nonfilers, and it should consider making more use of paper information returns, especially those relating to interest and dividend income.

IRS does not take advantage of State information on Federal nonfilers

IRS could identify more nonfilers through better use of tax data available from some States. However, it has not taken advantage of this opportunity.

returns as a result of the State letters but more returns may have been secured had IRS followed up on the State letters.

At the Fresno service center, where the taxpayer responses to the State letters were routed, IRS took action on those letters only when the taxpayer responded with a tax return or a question. IRS did not follow up with those who claimed they were not required to file, or whose delinquency letters were returned to the State as undeliverable.

Since our review, IRS and California decided to discontinue mailing the delinquency letters, partly because of the problems that arose from sending the State letters to taxpayers who had previously filed returns. However, the program has not been abandoned. IRS believes some State data is beneficial and is exploring ways to reduce duplicating and screening problems by matching the data against its computer tapes on a national level.

The State also has other data which could be useful to IRS, such as data on individuals who filed State tax returns but not Federal returns. The potential Federal nonfilers identified by California were those who had filed neither their Federal nor State tax returns. Even though no data is available to show how many taxpayers may have filed a State but not a Federal return, such a matching may be valuable. Also, the California State Disability Insurance Program provides elective insurance coverage to self-employed individuals. California uses income information on the self-employed persons who elect this coverage to identify nonfilers. This data could be useful to IRS because self-employed taxpayers are among those that IRS has difficulty identifying.

While there were problems in the way IRS was using California's data to identify nonfilers, that State, as well as other States, does have data which may be helpful to IRS in detecting more nonfilers. However, as noted in our May 1978 report, IRS still has not taken advantage of this apparent opportunity. Also, as suggested in that report, IRS has not seriously explored the feasibility of using such information to identify Federal nonfilers.

More nonfilers could be identified by processing more information returns

IRS detects many nonfilers from information returns which it receives on magnetic tape or in paper form. It matches all information it receives on magnetic tape and

a refund who has ignored the traditional April 15 filing deadline could receive up to 3 years' interest. 1/

IRS paid about \$6 million in interest on refunds to nonfilers who filed after being identified and caught by IRS under its tax year 1975 Taxpayer Delinquency Investigation Program. Although IRS did not know the number of taxpayers who received interest on late returns, we believe it was substantial. In our sample of 1,120 nonfiler cases, about 33 percent of the persons who received refunds when they finally filed received interest on those refunds. On the basis of our sample, we estimate that about 11,400 delinquent taxpayers received such interest in the 7 districts reviewed.

Having to pay interest to late filers or nonfilers because of processing delays does not encourage compliance with the filing requirements, nor is it equitable to those who file timely. For example, one delinquent 1975 joint tax return was filed on February 13, 1978--22 months after the return was due. IRS paid a \$3,000 refund on April 10, 1978--56 days after receipt of the return. It also paid interest of \$429 computed from April 15, 1976--the date the return was due--because it did not process the return within 45 days. In contrast, a taxpayer filing a 1975 return on February 15, 1976--2 months early--would not have received any interest unless IRS paid the refund after May 30, 1976--45 days after the April 15 due date and 104 days after the return was filed. Even then the interest would have been computed from April 15 only.

The law was intended to reimburse taxpayers for the use of their money from the statutory date of overpayment and to induce IRS to process refunds within a reasonable amount of time. It was not intended to reward individuals who do not comply with the filing requirements. Thus, IRS should make sure that delinquent returns are processed within the required time. It can do this by setting up a priority system to make sure delinquent returns involving refund claims are processed timely.

1/No refund or interest is paid if the return is filed more than 3 years late [26 U.S.C. 6511 (b)].

the Government paying out about \$226 million in refunds and interest. IRS was not reimbursed for the cost of the resources it had to use to investigate those nonfilers due refunds or to secure their returns.

We recognize that the Government benefits from the use of money owed taxpayers until they claim it. So theoretically, the taxpayers may have already been penalized by foregoing the use of the money. However, the basic principle underlying the voluntary assessment system is that persons required to file tax returns file them when due, whether they think they owe taxes or not. Thus, IRS should not discriminate between noncompliant taxpayers; nor should the Government have to bear the full cost of tracking down persons not in compliance with the law who ultimately receive refunds.

A change in the Internal Revenue Code's late filing penalty provision could encourage timely filing by all and help offset the Government's cost of pursuing those who do not. The charge would encourage individuals to file timely, particularly once they have been caught and penalized. Repeat nonfiling then, especially among those due refunds, should decrease.

For nonfilers who owe taxes, the Code already provides disincentives for late filing. The same disincentives could not be used for nonfilers due refunds because they are based on a percentage of taxes owed at the time returns are filed. However, a similar deterrent for nonfilers due refunds might be to assess a penalty based on a percentage of either (1) a person's total tax liability or (2) a person's refund. A third alternative might be to assess a predetermined fixed fee based on the average cost of detecting and investigating a nonfiler (presently at least \$46).

The first alternative is undesirable because the amount of the penalty could possibly exceed the amount of a person's refund. The third is reasonable because it covers the cost affiliated with catching nonfilers; however, it may not provide an effective or equitable incentive for compliance. That is, the penalty may be too low to encourage persons due higher refunds to comply; whereas from an equity standpoint, it may be too high for those due small refunds. The second alternative, involving a percentage of the refund due is more equitable than the third because all refunds would be reduced at the same rate and the penalty would be high enough to act as an incentive to file and cover IRS' costs.

IRS should change its processing of delinquent returns involving refunds to ensure that they are processed within 45 days of being filed to avoid paying interest on those refunds. As a result of not processing 1975 delinquent returns due refunds within the 45 day period, IRS had to pay out about \$6 million in interest.

In addition to being costly, this does not encourage people to comply with the filing requirements. Thus, IRS should place a priority on processing delinquent returns involving refund claims to make sure that they are processed within the 45 day statutory limitation.

Section 6651(a) does not encourage nonfilers due refunds to file timely because they are not penalized for filing late. Late filing penalties are assessed only on nonfilers who owe taxes. To encourage voluntary compliance and to provide for consistent treatment of nonfilers, the Code could be amended to allow IRS to also assess a charge against nonfiler due refunds.

A charge to delinquent taxpayers due refunds might take the form of a predetermined fixed fee based on IRS' average cost of detecting and investigating a nonfiler which would have the effect of recouping the Government cost in securing the delinquent returns. A better alternative might be to base the charge on a percentage of the refund due. This would not only recover the Government's detection and investigation cost but would penalize all nonfilers due refunds at the same rate. Exceptions could be made to any changes in the Code which may unduly penalize certain types of nonfilers, such as those with very low incomes who are also entitled to the earned income credit. IRS should develop various alternatives and provide them to the Congress for its consideration.

RECOMMENDATIONS TO THE COMMISSIONER OF INTERNAL REVENUE

To further reduce the delinquency gap created by the nonfiler population, we recommend that the Commissioner, given available resources:

- Consider establishing more Returns Compliance Programs directed at specific groups of individual nonfilers deserving concentrated attention because of their tendency toward nonfiling. Any selection of such programs should be based on periodic IRS estimates and analyses of the nonfiler population. In the interim, however, selection could be based on the characteristics

CHAPTER 5

SCOPE OF REVIEW

We concentrated our review work on the Collection Division which administers IRS' primary nonfiler programs. We reviewed pertinent IRS records, documents, procedures and policies, and interviewed responsible IRS officials. Our work was done at the IRS national office in Washington, D.C.; IRS district offices in Albany and Brooklyn, New York; Louisville, Kentucky; Indianapolis, Indiana; Phoenix, Arizona; San Francisco, California; and Honolulu, Hawaii; and IRS service centers in Andover, Massachusetts; Brookhaven, New York; Ogden, Utah; Memphis, Tennessee; and Fresno, California.

To estimate the size of the nonfiler population and its characteristics we used data on a random sample of over 100,000 individuals taken from the 1973 Exact Match Study prepared by the Social Security Administration. The methodology for developing our nonfiler estimates is explained in appendix II, while appendix III shows how the nonfiler characteristics compare with the characteristics of people who filed returns.

To evaluate the effectiveness of the Taxpayer Delinquency Investigation Program, we drew a random sample of 1,120 nonfiler cases from IRS' tax year 1975 collection case inventory. The sample was drawn from 160,214 nonfiler cases issued in the geographical areas covered by seven district offices, and the results can be projected over the seven districts. After reviewing the cases, we asked IRS to follow up on 729 of the sampled cases.

We also used the collection cases sample to determine the feasibility of building a predictive model to select nonfiler cases for investigation.

In addition, we analyzed IRS' dropped cases research file on 90,593 of the 109 million individuals IRS had accumulated records on for not filing tax year 1975 returns but who were not pursued by IRS. We used this file to determine if IRS should have investigated some of these people.

Mr. Allen R. Voss

devote sufficient resources to maintain significant coverage in all nonfiler areas. If we receive more resources, we can expand our coverage.

Another basic issue is how the efficiency of our nonfiler program should be improved. We agree there is room for improvement and we will work on the best ways to accomplish this. We do close many cases without exhausting all possible investigative procedures because of limited resources. We devote our scarce resources to a greater number of more productive cases.

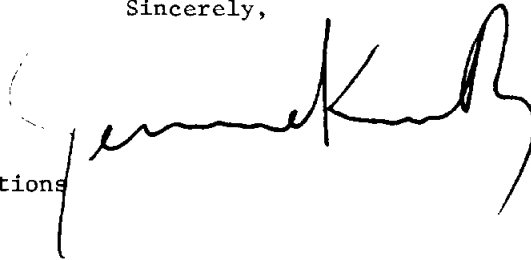
We will continue to balance the resources devoted to the serious problem of nonfiling income tax returns against the other serious needs of tax administration and to improve the efficiency of our nonfiler programs.

Our responses to your specific recommendations are enclosed.

With kind regards,

Sincerely,

Enclosure
Responses to Recommendations

A handwritten signature in black ink, appearing to be "J. Kenneth", written over a horizontal line.

Page 59-3

--Establish a mechanism for checking delinquent returns for unreported income.

Response:

We concur with this recommendation and are studying how best to implement it.

Page 59-4

--Consolidate, for investigative purposes, the separate nonfiler cases made on husbands and wives when IRS records show that a couple filed a joint return in the tax year prior to the one being investigated.

Response:

We will determine if the volume of such cases is sufficient to justify the cost of the processing modifications which would be necessary to associate cases of this type for field investigation.

Page 59-5

--Issue delinquency notices, to the extent possible, about six months after the filing deadline to certain individuals who filed returns in the tax year prior to the one under investigation.

Response:

We will explore the feasibility of alternative ways to accomplish the purpose of this recommendation.

Page 59-6

--Require that delinquency prevention measures be applied to individual nonfilers and strengthen the delinquency prevention guidelines to ensure that those nonfilers who require such measures are monitored.

Response:

We are testing this type of program on a small scale. At this time resource constraints prevent us from establishing extensive monitoring procedures.

Response:

We plan to develop and conduct a limited random sample test of taxpayers with insufficient identifying information for inclusion in the present TDI program. However, we do not presently have the resources to establish extensive investigative programs directed at targeted groups with a tendency toward nonfiling, such as household workers, farm laborers and other low income groups.

Page 72-2

--Attempt to use tax and other data available from the States to help detect more nonfilers.

Response:

We concur. A study of the availability and potential use of state tax data is underway.

Page 72-3

We also recommend that the Commissioner establish a priority system to ensure that delinquent tax returns involving refund claims are processed within the 45 day statutory limitation.

Response:

We concur and we will work to improve our procedures.

old and all unsuccessful matches as we could not determine whether or not they filed a tax return. Consecutive records were compared to determine if the individuals were from the same household unit. Individuals from the same household unit coded as married-spouse present were paired when the Detailed Household and Family Status showed them to be a head of family (subfamily) and wife of head of family (subfamily).

If either the husband or wife filed a joint tax return or if neither filed a tax return they were treated as a filing unit and their income was combined. When a joint return was filed by either spouse, the return filed by the other spouse, if any, was ignored. If either the husband or wife or both filed a nonjoint tax return they were treated as potential married-separate filers.

All individuals not paired in this process were treated as potential nonjoint (individual) filing units. The potential married-separate filers were also considered to be potential nonjoint filing units.

Income estimates

Maximum and minimum gross taxable income estimates were developed for each potential filing unit using the income accounts included in the Exact Match File.

The maximum estimate included:

- The greater of reported wages or social security wages. If the social security earnings included self employment income, only the reported wages were used.
- Property income. This includes income such as dividends, interest, or net rental income.
- Government pension income. Other government transfer income was included when the other government transfer income response status indicated the presence of a government employee pension.

Determining the filing requirements

The estimated incomes for each potential filing unit were compared to the tax year 1972 filing requirement to see if a tax return should have been filed. The age attained in 1972 from social security records was used, when available, to determine the applicable filing income. For the few individuals with no Social Security Administration age, the survey age, adjusted to December 1972 was used.

Potential tax filing units were required to file in tax year 1972 if their incomes equalled or exceeded the following amounts.

Single individual:

Under 65	\$2050
65 or over	\$2800

Married-filing jointly:

Both under 65	\$2800
One spouse 65 or over	\$3550
Both 65 or over	\$4300

Married-filing separately: \$ 750

Self-employment income \$ 400

Both the maximum and minimum gross income estimates were checked against the above filing requirements except that the single individual rather than the married-filing separately criteria was used with the minimum income estimate for potential married-separate filers.

Our estimates of the potential filing units required to file are shown in tables 9 and 13 by income, filing status, and marital status. Our maximum estimates of the nonfiler population required to file is 5.7 million individuals and couples while our minimum estimate is 4.4 million. The corresponding estimated incomes for these nonfilers are \$37 billion and \$28 billion. As explained below adjustments were made to these estimates.

These estimates are projections to the United States civilian noninstitutionalized adult population calculated

return. Both estimates agree with the adjusted gross income over 50 percent of the time and the remaining estimates generally fell within a few thousand dollars. The maximum gross income estimate tended to slightly overstate adjusted gross income estimate, while the minimum estimate more often incorrectly showed zero income.

HOW THE TAX IMPACT OF NONFILING WAS ESTIMATED

We estimate that between \$1.3 billion and \$2.4 billion in income tax was not paid by nonfilers in tax year 1972. The procedure used in arriving at this estimate was developed in conjunction with IRS. We converted our gross income estimates to correspond to IRS' definition of adjusted gross income, adjusted for the late filers, and applied the average tax for each income group.

Conversion to adjusted gross income

Because IRS statistics are maintained on the basis of adjusted gross income it was necessary to convert our gross income estimates to adjusted gross income. Each potential filing unit's estimated gross income was multiplied by the ratio of adjusted gross income to gross income. IRS computed these ratios for each income strata using 1972 tax data.

Adjusting for late filing

Potential tax filing units identified as nonfilers may have filed after the tax filing data was obtained in September 1973, either voluntarily or after being contacted by IRS. We attributed those filing from September 1973 through December 1973 to voluntary late filing because these returns were filed before IRS collection efforts began. These voluntary late filers were deducted from our estimate of nonfilers who should file. Those filing 1972 tax returns from January 1974 were attributed to IRS' collection efforts, and therefore, we reduced our estimate to show the results of IRS' efforts.

Estimating taxes not paid

In order to estimate the income taxes not paid, we multiplied the number of nonfilers who should file in each income strata by the average income tax for that strata. The average taxes were computed by IRS from 1972 tax data.

TABLE 1

U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

<u>Maximum income assumption--adjusted</u>									
<u>Total tax units</u>			<u>Tax units filing tax returns</u>			<u>Tax units not filing tax returns</u>			
<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	
----- (thousands) -----									
Total	114,648	68,076	46,572	74,364	62,782	11,582	40,284	5,294	34,990
Potential joint filers	45,724	40,441	5,283	40,612	38,774	1,838	5,112	1,667	3,445
Potential nonjoint filers:									
Males	32,168	15,206	16,962	18,325	13,337	4,988	13,843	1,869	11,974
Females	36,756	12,429	24,327	15,427	10,671	4,756	21,329	1,758	19,571

TABLE 3

U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

Maximum income assumption--adjusted									
<u>Gross income</u>	<u>Total tax units</u>			<u>Tax units filing tax returns</u>			<u>Tax units not filing tax returns</u>		
	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>
	(thousands)								
Total	114,648	68,076	46,572	74,364	62,782	11,582	40,284	5,924	34,990
\$									
0	20,777	0	20,777	720	0	720	20,057	0	20,057
1 - 999	16,581	303	16,278	5,178	145	5,033	11,403	158	11,245
1,000 - 1,999	8,022	686	7,336	4,969	443	4,526	3,053	243	2,810
2,000 - 2,999	5,786	3,971	1,815	4,303	3,215	1,088	1,483	756	727
3,000 - 3,999	5,055	4,732	323	4,091	3,907	184	964	825	139
4,000 - 4,999	4,892	4,853	39	4,167	4,136	31	725	717	8
5,000 - 5,999	4,577	4,577	0	4,101	4,101	0	476	476	0
6,000 - 6,999	4,436	4,436	0	4,031	4,031	0	405	405	0
7,000 - 7,999	4,536	4,536	0	4,188	4,188	0	348	348	0
8,000 - 8,999	4,235	4,235	0	4,002	4,002	0	233	233	0
9,000 - 9,999	4,825	4,825	0	4,588	4,588	0	237	237	0
10,000 - 10,999	4,190	4,190	0	3,999	3,999	0	191	191	0
11,000 - 11,999	3,472	3,472	0	3,363	3,363	0	109	109	0
12,000 - 12,999	3,324	3,324	0	3,221	3,221	0	103	103	0
13,000 - 13,999	2,734	2,734	0	2,668	2,668	0	66	66	0
14,000 - 14,999	2,393	2,393	0	2,337	2,337	0	56	56	0
15,000 - 16,999	4,210	4,210	0	4,129	4,129	0	81	81	0
17,000 - 19,999	3,977	3,977	0	3,892	3,892	0	85	85	0
20,000 - 23,999	2,900	2,900	0	2,814	2,814	0	86	86	0
24,000 - 29,999	1,946	1,946	0	1,896	1,896	0	50	50	0
\$30,000 +	1,816	1,816	0	1,749	1,749	0	67	67	0

TABLE 5

U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

<u>Minimum income assumption--adjusted</u>									
<u>Total tax units</u>			<u>Tax units filing tax returns</u>			<u>Tax units not filing tax returns</u>			
<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	
----- (thousands) -----									
Total	114,649	63,835	50,814	74,364	59,725	14,639	40,285	4,110	36,175
Potential joint filers	45,724	38,610	7,114	40,612	37,171	3,441	5,112	1,439	3,673
Potential nonjoint filers:									
Males	32,168	14,055	18,113	18,325	12,601	5,724	13,843	1,454	12,389
Females	36,757	11,170	25,587	15,427	9,953	5,474	21,330	1,217	20,113

TABLE 7

U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

	Minimum income assumption--adjusted								
	Total tax units			Tax units filing tax returns			Tax units not filing tax returns		
Gross income	Total units	Units required to file	Units not required to file	Total units	Units required to file	Units not required to file	Total units	Units required to file	Units not required to file
	----- (thousands) -----								
Total	114,649	63,835	50,814	74,364	59,725	14,639	40,285	4,110	36,175
\$ 0	25,060	0	25,060	2,672	0	2,672	22,388	0	22,388
1 - 999	17,030	214	16,816	5,721	81	5,640	11,309	133	11,176
1,000 - 1,999	7,583	370	7,213	5,252	224	5,028	2,311	146	2,185
2,000 - 2,999	5,287	3,816	1,471	4,302	3,206	1,096	985	610	375
3,000 - 3,999	4,726	4,501	225	4,030	3,846	184	696	655	41
4,000 - 4,999	4,628	4,608	20	4,070	4,053	17	558	555	3
5,000 - 5,999	4,446	4,446	0	4,050	4,050	0	396	396	0
6,000 - 6,999	4,264	4,264	0	3,966	3,966	0	298	298	0
7,000 - 7,999	4,323	4,323	0	4,051	4,051	0	272	272	0
8,000 - 8,999	4,079	4,079	0	3,883	3,883	0	196	196	0
9,000 - 9,999	5,520	5,520	0	5,302	5,302	0	218	218	0
10,000 - 10,999	3,869	3,869	0	3,754	3,754	0	115	115	0
11,000 - 11,999	3,235	3,235	0	3,147	3,147	0	88	88	0
12,000 - 12,999	3,114	3,114	0	3,028	3,028	0	86	86	0
13,000 - 13,999	2,533	2,533	0	2,495	2,495	0	38	38	0
14,000 - 14,999	2,212	2,212	0	2,168	2,168	0	44	44	0
15,000 - 15,999	3,807	3,807	0	3,728	3,728	0	79	79	0
17,000 - 19,999	3,547	3,547	0	3,493	3,493	0	54	54	0
20,000 - 23,999	2,430	2,430	0	2,373	2,373	0	57	57	0
24,000 - 29,999	1,585	1,585	0	1,556	1,556	0	29	29	0
\$30,000 +	1,408	1,408	0	1,366	1,366	0	42	42	0

TABLE 9

U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

Maximum income assumption									
	Total tax units			Tax units filing tax returns			Tax units not filing tax returns		
	Total units	Units required to file	Units not required to file	Total units	Units required to file	Units not required to file	Total units	Units required to file	Units not required to file
	----- (thousands) -----								
Total	116,148	68,448	47,700	74,364	62,782	11,582	41,784	5,666	36,118
Potential joint filers	45,724	40,441	5,283	40,612	38,774	1,838	5,112	1,667	3,445
Less than 65	39,516	37,812	1,704	37,104	36,357	747	2,412	1,455	957
One 65 or over	2,819	1,601	1,218	1,978	1,531	447	841	70	771
Both 65 or over	3,389	1,028	2,361	1,530	886	644	1,859	142	1,717
Potential nonjoint filers	70,424	28,007	42,417	33,752	24,008	9,744	36,672	3,999	32,673
Males less than 65	29,740	14,580	15,160	17,534	12,847	4,687	12,206	1,733	10,473
Single	23,400	9,298	14,102	12,786	8,381	4,405	10,614	917	9,697
Married--spouse present	1,476	1,418	58	1,295	1,270	25	181	148	33
Married--separated	1,253	1,007	246	821	769	52	432	238	194
Married--spouse absent	687	514	173	456	408	48	231	106	125
Widowed	651	499	152	469	446	23	182	53	129
Divorced	2,270	1,842	428	1,706	1,572	134	564	270	294
Males 65 or over	2,428	626	1,802	791	490	301	1,637	136	1,501
Single	499	146	353	205	133	72	294	13	281
Married--spouse present	83	59	24	54	44	10	29	15	14

TABLE 10

U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

Maximum income assumption									
Gross income	Total tax units			Tax units filing tax returns			Tax units not filing tax returns		
	Total units	Units required to file	Units not required to file	Total units	Units required to file	Units not required to file	Total units	Units required to file	Units not required to file
Total	116,148	68,448	47,700	74,364	62,782	11,582	41,784	5,666	38,118
\$ 0	21,422	0	21,422	720	0	720	20,702	0	20,702
1 - 999	16,903	309	16,594	5,178	145	5,033	11,725	164	11,561
1,000 - 1,999	8,182	695	7,487	4,969	443	4,526	3,213	252	2,961
2,000 - 2,999	5,866	4,035	1,831	4,303	3,215	1,088	1,563	820	743
3,000 - 3,999	5,142	4,819	323	4,091	3,907	184	1,051	912	139
4,000 - 4,999	4,941	4,902	39	4,167	4,136	31	774	766	8
5,000 - 5,999	4,611	4,611	0	4,101	4,101	0	510	510	0
6,000 - 6,999	4,470	4,470	0	4,031	4,031	0	439	439	0
7,000 - 7,999	4,578	4,578	0	4,188	4,188	0	390	390	0
8,000 - 8,999	4,248	4,248	0	4,002	4,002	0	246	246	0
9,000 - 9,999	4,833	4,833	0	4,588	4,588	0	245	245	0
10,000 - 10,999	4,196	4,196	0	3,999	3,999	0	197	197	0
11,000 - 11,999	3,473	3,473	0	3,363	3,363	0	110	110	0
12,000 - 12,999	3,332	3,332	0	3,221	3,221	0	111	111	0
13,000 - 13,999	2,734	2,734	0	2,668	2,668	0	66	66	0
14,000 - 14,999	2,394	2,394	0	2,337	2,337	0	57	57	0
15,000 - 16,999	4,210	4,210	0	4,129	4,129	0	81	81	0
17,000 - 19,999	3,979	3,979	0	3,892	3,892	0	87	87	0
20,000 - 23,999	2,903	2,903	0	2,814	2,814	0	89	89	0
24,000 - 29,999	1,950	1,950	0	1,896	1,896	0	54	54	0
\$30,000 +	1,817	1,817	0	1,749	1,749	0	68	68	0

TABLE 12

U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

Maximum income assumption									
Gross income	Total tax units			Tax units filing tax returns			Tax units not filing tax returns		
	Total units	Units required to file	Units not required to file	Total units	Units required to file	Units not required to file	Total units	Units required to file	Units not required to file
Potential nonjoint filers	70,424	28,007	42,417	33,752	24,008	9,744	36,672	3,999	32,673
\$ 0	20,016	0	20,016	534	0	534	19,482	0	19,482
1 - 999	15,369	237	15,132	4,704	100	4,604	10,665	137	10,528
1,000 - 1,999	6,862	489	6,373	4,350	307	4,043	2,512	182	2,330
2,000 - 2,999	4,652	3,760	892	3,572	3,009	563	1,080	751	329
3,000 - 3,999	3,847	3,847	0	3,154	3,154	0	693	693	0
4,000 - 4,999	3,587	3,587	0	3,026	3,026	0	561	561	0
5,000 - 5,999	2,972	2,972	0	2,621	2,621	0	351	351	0
6,000 - 6,999	2,595	2,595	0	2,283	2,283	0	312	312	0
7,000 - 7,999	2,383	2,383	0	2,082	2,082	0	301	301	0
8,000 - 8,999	1,923	1,923	0	1,780	1,780	0	143	143	0
9,000 - 9,999	1,765	1,765	0	1,605	1,605	0	160	160	0
10,000 - 10,999	1,134	1,134	0	1,021	1,021	0	113	113	0
11,000 - 11,999	765	765	0	700	700	0	65	65	0
12,000 - 12,999	564	564	0	505	505	0	59	59	0
13,000 - 13,999	363	363	0	338	338	0	25	25	0
14,000 - 14,999	309	309	0	282	282	0	27	27	0
15,000 - 16,999	431	431	0	401	401	0	30	30	0
17,000 - 19,999	332	332	0	294	294	0	38	38	0
20,000 - 23,999	203	203	0	182	182	0	21	21	0
24,000 - 29,999	163	163	0	153	153	0	10	10	0
\$30,000 +	197	197	0	176	176	0	21	21	0

TABLE 13 Continued

Married--spouse									
present	83	30	53	54	21	33	29	9	20
Married--separated	116	17	99	30	15	15		2	84
Married--spouse									
absent	70	15	55	17	10	7	53	5	48
Widowed	1,476	207	1,269	432	161	271	1,044	46	998
Divorced	185	24	161	54	21	33	131	3	128
Females less than 65	29,952	10,712	19,240	13,776	9,339	4,437	16,176	1,373	14,803
Single	18,607	5,106	13,501	8,132	4,801	3,331	10,475	305	10,170
Married--spouse									
present	1,506	833	673	1,020	753	267	486	80	406
Married--separated	2,284	886	1,398	740	607	133	1,544	279	1,265
Married--husband									
absent--Armed									
Forces	205	76	129	14	8	6	191	68	123
Married--spouse									
absent	602	215	387	149	112	37	453	103	350
Widowed	3,912	1,799	2,113	1,874	1,432	442	2,038	367	1,671
Divorced	2,843	1,802	1,041	1,852	1,631	221	991	171	820
Females 65 or over	8,304	793	7,511	1,651	614	1,037	6,653	179	6,474
Single	773	111	662	317	96	221	456	15	441
Married--spouse									
present	51	11	40	24	11	13	27	0	27
Married--separated	156	7	149	19	7	12	137	0	137
Married--husband									
absent--Armed									
Forces	0	0	0	0	0	0	0	0	0
Married--spouse									
absent	63	9	54	9	6	3	54	3	51
Widowed	6,982	616	6,366	1,207	461	746	5,775	155	5,620
Divorced	282	39	243	77	33	44	205	6	199

TABLE 15

U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

Minimum income assumption									
<u>Gross income</u>	<u>Total tax units</u>			<u>Tax units filing tax returns</u>			<u>Tax units not filing tax returns</u>		
	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>
----- (thousands) -----									
Potential joint filers	45,724	38,610	7,144	40,612	37,171	3,441	5,112	1,439	3,673
\$ 0	3,052	0	3,052	1,271	0	1,271	1,781	0	1,781
1 - 999	2,009	77	1,932	794	47	747	1,215	30	1,185
1,000 - 1,999	1,311	205	1,106	779	134	645	532	71	461
2,000 - 2,999	1,036	255	781	769	191	578	267	64	203
3,000 - 3,999	1,222	997	225	978	794	184	244	203	41
4,000 - 4,999	1,308	1,288	20	1,142	1,125	17	166	163	3
5,000 - 5,999	1,621	1,621	0	1,470	1,470	0	151	151	0
6,000 - 6,999	1,856	1,856	0	1,755	1,755	0	101	101	0
7,000 - 7,999	2,166	2,166	0	2,091	2,091	0	75	75	0
8,000 - 8,999	2,315	2,315	0	2,224	2,224	0	91	91	0
9,000 - 9,999	3,762	3,762	0	3,683	3,683	0	79	79	0
10,000 - 10,999	2,918	2,918	0	2,856	2,856	0	62	62	0
11,000 - 11,999	2,586	2,586	0	2,544	2,544	0	42	42	0
12,000 - 12,999	2,691	2,691	0	2,629	2,629	0	62	62	0
13,000 - 13,999	2,239	2,239	0	2,208	2,208	0	31	31	0
14,000 - 14,999	1,962	1,962	0	1,935	1,935	0	27	27	0
15,000 - 16,999	3,453	3,453	0	3,397	3,397	0	56	56	0
17,000 - 19,999	3,275	3,275	0	3,238	3,238	0	37	37	0
20,000 - 23,999	2,262	2,262	0	2,219	2,219	0	43	43	0
24,000 - 29,999	1,456	1,456	0	1,430	1,430	0	26	26	0
\$30,000 +	1,258	1,258	0	1,232	1,232	0	26	26	0

CHARACTERISTICS OF THENONFILER POPULATION

Based on the data from the Exact Match File, the nonfiler population does not differ substantially from those who do file. However, there are some differences in the characteristics which give clues as to who the nonfilers are and why they do not file. The characteristics include living arrangement, living quarters, years of school completed, geographic location, type of location, standard metropolitan statistical area, age, marital status, income range, employment status, part time/full time employment, worker class, industry, and occupation.

The following characteristics are for potential primary filers who should have filed based on the maximum income estimate. (See app. II) The characteristics are shown as a percent of both the nonfiler and filer populations, and also each characteristic is broken down by those who did or did not file. In addition, in a separate set of tables, we break down just the nonfiler population to show how many had low income or high income.

ANALYSIS OF
SELECTED NONFILER CHARACTERISTICS

<u>Characteristic</u>	<u>Percent of</u>		<u>Percent of each characteristic</u>	
	<u>Nonfiler population</u>	<u>Filer population</u>	<u>Nonfiler</u>	<u>Filer</u>
Living arrangement:				
Home owner	50	68	6	94
Renter	42	28	12	88
Other	8	4	17	83
	<u>100</u>	<u>100</u>		
Living quarters:				
House, apartment, and similar	93	97	8	92
Hotel	-	-	30	70
Rooming house	1	-	39	61
Trailer	4	3	10	90
Other	2	1	40	60
	<u>100</u>	<u>100</u>		

APPENDIX III

<u>Characteristics</u>	<u>Percent of</u>	
	<u>Nonfiler</u> <u>population</u>	<u>Filer</u> <u>population</u>
Standard Metropolitan Statistical Area (SMSA):		
Central city	38	31
Suburbs	31	40
Not in SMSA	31	29
	<u>100</u>	<u>100</u>

Age:

14 to 19	6	4
20 to 29	23	27
30 to 39	20	20
40 to 49	18	20
50 to 59	15	17
60 to 69	10	9
70 and older	8	3
	<u>100</u>	<u>100</u>

Marital status:

Single	24	22
Married-spouse present	36	65
Married- separated	10	2
Married-husband absent	5	1
Widowed	15	5
Divorced	10	5
	<u>100</u>	<u>100</u>

Income range:

\$5,000 and below	52	19
\$5,001 to \$10,000	32	34
\$10,001 to \$20,000	12	37
\$20,001 and over	4	10
	<u>100</u>	<u>100</u>

APPENDIX III

<u>Percent of each characteristic</u>	
<u>Nonfiler</u>	<u>Filer</u>

10	90
6	94
9	91

12	88
7	93
8	92
8	92
7	93
9	91
21	79

9	91
5	95
29	71
35	65
23	77
14	86

19	81
8	92
3	97
3	97

<u>Characteristic</u>	<u>Percent of</u>		<u>Percent of each characteristic</u>	
	<u>Nonfiler population</u>	<u>Filer population</u>	<u>Nonfiler</u>	<u>Filer</u>
Industry:				
Agricultural production	10	4	18	82
Agricultural services, forestry, and fisheries	1	1	14	86
Mining	-	1	3	97
Construction	9	8	8	92
Durable goods manufacturing	10	18	4	96
Nondurable goods manufacturing	6	11	5	95
Transportation	3	5	6	94
Communication, utilities, and sanitary services	2	3	4	96
Wholesale trade	4	5	6	94
Retail trade	15	13	8	92
Finance, insurance, and real estate	5	5	8	92
Services:				
Personal, business, and repair	15	6	16	84
Services:				
Entertainment, recreation, professional, and related	17	14	9	91
Public administration	3	6	3	97
	<u>100</u>	<u>100</u>		

APPENDIX III

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Characteristic	Percent of		Percent of each characteristic	
	Nonfiler population	Filer population	Nonfiler	Filer
Industry--				
nonagricultural				
self-employed:				
Agricultural				
services,				
forestry, and				
fisheries	2	-	48	52
Mining	-	-	0	100
Construction	19	17	18	82
Durable goods				
manufacturing	2	3	12	88
Nondurable goods				
manufacturing	1	2	10	90
Transportation	7	4	24	76
Commerce, etc.	-	-	0	100
Wholesale trade	5	5	17	83
Retail trade	26	26	16	84
Finance,				
insurance, and				
real estate	3	7	8	92
Services	24	18	21	79
Services: pro-				
fessional and				
related	11	18	11	89
	<u>100</u>	<u>100</u>		
Occupation--				
nonagricultural				
self-employed:				
Professional and				
technical	13	20	11	89
Managers and				
administrators	26	37	12	88
Sales workers	13	9	22	78
Clerical workers	1	1	12	88
Craftsmen	23	20	18	82
Operatives	10	7	23	77
Laborers	6	1	49	51
Service workers	8	5	23	77
	<u>100</u>	<u>100</u>		

APPENDIX III

APPENDIX III

<u>Characteristic</u>	<u>Percent with income of \$5,000 or less</u>	<u>Percent with income more than \$5,000</u>
Type of location:		
Urban area	49	51
Rural-farm	76	24
Rural-nonfarm	57	43
Standard Metropolitan Statistical Area (SMSA):		
Central city	50	50
Suburbs	44	56
Not in SMSA	62	38
Age:		
14 to 19	84	16
20 to 29	55	45
30 to 39	42	58
40 to 49	40	60
50 to 59	46	54
60 to 69	60	40
70 and older	68	32
Part time/full time employment:		
Full year employment:		
Full time	34	66
Part time	73	27
Part year employment:		
Full time	65	35
Part time	72	28
Worker class:		
Agricultural:		
Wage and salary	69	31
Self-employed	89	11
Nonagricultural:		
Private household	87	13
Other private	43	57
Government	35	65
Self-employed	50	50

HOW THE NONFILER SAMPLES
WERE SELECTED AND ANALYZED

As part of our review we selected two samples and analyzed the results. The first sample was of individuals investigated by IRS under the Taxpayer Delinquency Investigation Program for tax year 1975 delinquent tax returns. The second sample was of individuals who had not filed a tax year 1975 return and were not pursued by IRS.

NONFILER CASES SAMPLE

To measure the effectiveness of IRS' nonfiler programs, we randomly sampled 1,120 nonfiler cases from IRS' Selected Collection Case File containing 160,214 cases for the seven districts we reviewed.

We projected our sample results to the seven districts by multiplying by the ratio of the population to the sample size. We are 95 percent confident, with a possible sampling error of plus or minus three percent, that our sample proportions represent the characteristics of the total nonfiler cases for the seven districts.

DROPPED FILE SAMPLE

To determine the characteristics of the potential nonfilers not pursued, we examined the Nonfiler Dropped Case Research File provided by IRS. This research file included a sample, stratified by drop reason, of 90,593 of the 109 million individuals not selected for investigation under the tax year 1975 Taxpayer Delinquency Investigation Program. The breakdown by drop reason was as follows:

<u>Reason</u>	<u>Number</u>
Collection case already created	77
Invalid social security number	129
Deceased taxpayer	41,829
Overseas address	98
No address	10,760
Under money cutoff	<u>37,700</u>
Total	<u>90,593</u>

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We projected the results of the file to the total dropped cases by multiplying by the ratio of the total dropped to the sample size for each drop reason.

The research file, however, consisted of a random sample of only those cases where IRS had complete income information on both magnetic tape and paper documents. Because we cannot be certain that these sampled cases are representative of all dropped cases, we are unable to determine the confidence level of our projections of the dropped case characteristics.

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<u>Characteristic</u>	<u>Percent with income of \$5,000 or less</u>	<u>Percent with income more than \$5,000</u>
Industry:		
Agricultural production	82	18
Agricultural services, forestry, and fisheries	45	55
Mining	0	100
Construction	45	55
Durable goods manufacturing	42	58
Nondurable goods manufacturing	40	60
Transportation	30	70
Communication, utilities, and sanitary services	32	68
Wholesale trade	23	77
Retail trade	54	46
Finance, insurance, and real estate	28	72
Services: personal, business, and repair	65	35
Services: entertainment, recreation, professional and related	45	55
Public administration	25	75
Occupations:		
Professional and technical	36	64
Managers and administrators	27	73
Sales workers	49	51
Clerical workers	40	60
Craftsmen	43	57
Operatives	43	57
Laborers	68	32
Service workers	68	32

The following tables show a breakdown of certain characteristics by income levels--\$5,000 or less and more than \$5,000--for just the nonfiler population.

<u>Characteristic</u>	<u>Percent with income of \$5,000 or less</u>	<u>Percent with income more than \$5,000</u>
Living quarters:		
House, apartment, and similar	52	48
Hotel	65	35
Rooming house	45	55
Trailer	49	51
Other	69	31
Years of school completed:		
8 years and less (elementary)	61	39
9 years to 12 years (high school)	51	49
More than 12 years (college)	42	58
Geographic location:		
Northeast		
New England	52	48
Middle Atlantic	44	56
North Central		
East North Central	47	53
West North Central	58	42
South		
South Atlantic	54	46
East South Central	62	38
West South Central	58	42
West		
Mountain	49	51
Pacific	50	50

<u>Characteristic</u>	<u>Percent of</u>		<u>Percent of each characteristic</u>	
	<u>Nonfiler population</u>	<u>Filer population</u>	<u>Nonfiler</u>	<u>Filer</u>
Occupations:				
Professional and technical	11	14	6	94
Managers and administrators	8	12	5	95
Sales workers	6	6	8	92
Clerical	13	12	8	92
Craftsmen	13	19	6	94
Operatives	16	19	6	94
Laborers	17	9	13	87
Service workers	16	9	13	87
	<u>100</u>	<u>100</u>		
Selected occupations:				
Farmers (owners and tenants)	4	3	12	88
Farm laborers	5	1	34	66
Cleaning services	3	2	9	91
Food services	5	2	14	86
Health services	2	1	13	87
Personal services	2	1	14	86
Private household workers	4	-	64	36
Total	25	10	17	83
All others	75	90	6	94
	<u>100</u>	<u>100</u>		

Employed Individuals Only

<u>Characteristics</u>	<u>Percent of</u>		<u>Percent of each characteristic</u>	
	<u>Nonfiler population</u>	<u>Filer population</u>	<u>Nonfiler</u>	<u>Filer</u>
Employment status:				
Self-employed	17	8	15	85
Other employed	68	87	7	93
Retired	4	2	16	84
Other not employed	11	3	26	74
	<u>100</u>	<u>100</u>		
Part time/full time employment:				
Full-year employment:				
Full time	55	74	6	94
Part time	9	3	17	83
Part-year employment:				
Full time	26	19	10	90
Part time	10	4	21	79
	<u>100</u>	<u>100</u>		
Worker class:				
Agricultural:				
Wage and salary	4	1	26	74
Self-employed	4	3	13	87
Nonagricultural:				
Private household	4	-	53	47
Other private	50	69	6	94
Government	10	15	5	95
Self-employed	13	6	16	84
Not applicable	15	6		
	<u>100</u>	<u>100</u>		

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<u>Characteristic</u>	<u>Percent of</u>		<u>Percent of each characteristic</u>	
	<u>Nonfiler population</u>	<u>Filer population</u>	<u>Nonfiler</u>	<u>Filer</u>
Years of school completed:				
8 years and less (elementary)	26	15	14	86
9 years to 12 years (high school)	52	54	8	92
More than 12 years (college)	<u>22</u> <u>100</u>	<u>31</u> <u>100</u>	6	94
<u>Geographic location</u>				
Northeast:				
New England	6	7	7	93
Middle Atlantic	18	18	8	92
North Central:				
East North Central	12	20	5	95
West North Central	7	8	7	93
South:				
South Atlantic	19	16	10	90
East South Central	7	5	11	89
West South Central	13	9	12	88
West:				
Mountain	4	4	8	92
Pacific	<u>14</u> <u>100</u>	<u>13</u> <u>100</u>	9	91
<u>Type of location</u>				
Urban area	74	74	8	92
Rural-farm	6	5	11	89
Rural-nonfarm	<u>20</u> <u>100</u>	<u>21</u> <u>100</u>	8	92

TABLE 16

U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

Minimum income assumption									
<u>Gross income</u>	<u>Total tax units</u>			<u>Tax units filing tax returns</u>			<u>Tax units not filing tax returns</u>		
	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>
	(thousands)								
Potential nonjoint filers	70,424	25,560	44,864	33,752	22,554	11,198	36,672	3,006	33,666
0	22,747	0	22,747	1,402	0	1,402	21,345	0	21,345
1 - 999	15,333	143	15,190	4,928	34	4,894	10,405	109	10,296
1,000 - 1,999	6,398	176	6,222	4,474	90	4,384	1,924	86	1,838
2,000 - 2,999	4,322	3,621	701	3,533	3,015	518	789	606	183
3,000 - 3,999	3,582	3,582	0	3,052	3,052	0	530	530	0
4,000 - 4,999	3,369	3,369	0	2,927	2,927	0	442	442	0
5,000 - 5,999	2,854	2,854	0	2,580	2,580	0	274	274	0
6,000 - 6,999	2,436	2,436	0	2,211	2,211	0	225	225	0
7,000 - 7,999	2,199	2,199	0	1,960	1,960	0	239	239	0
8,000 - 8,999	1,775	1,775	0	1,659	1,659	0	116	116	0
9,000 - 9,999	1,767	1,767	0	1,620	1,620	0	147	147	0
10,000 - 10,999	952	952	0	898	898	0	54	54	0
11,000 - 11,999	651	651	0	603	603	0	48	48	0
12,000 - 12,999	424	424	0	399	399	0	25	25	0
13,000 - 13,999	296	296	0	288	288	0	8	8	0
14,000 - 14,999	249	249	0	233	233	0	16	16	0
15,000 - 16,999	354	354	0	331	331	0	23	23	0
17,000 - 19,999	274	274	0	255	255	0	19	19	0
20,000 - 23,999	171	171	0	154	154	0	17	17	0
24,000 - 29,999	129	129	0	126	126	0	3	3	0
\$30,000 +	151	151	0	133	133	0	18	18	0

TABLE 14

U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

Minimum income assumption									
<u>Gross income</u>	<u>Total tax units</u>			<u>Tax units filing tax returns</u>			<u>Tax units not filing tax returns</u>		
	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>
	(thousands)								
Total	116,148	64,170	51,978	74,364	59,725	14,639	41,784	4,445	37,339
\$ 0	25,796	0	25,796	2,672	0	2,672	23,124	0	23,124
1 - 999	17,339	220	17,119	5,721	81	5,640	11,618	139	11,479
1,000 - 1,999	7,708	381	7,327	5,252	224	5,028	2,456	157	2,299
2,000 - 2,999	5,358	3,876	1,482	4,302	3,206	1,096	1,056	670	386
3,000 - 3,999	4,804	4,579	225	4,030	3,846	184	774	733	41
4,000 - 4,999	4,678	4,658	20	4,070	4,053	17	608	605	3
5,000 - 5,999	4,476	4,476	0	4,050	4,050	0	426	426	0
6,000 - 6,999	4,291	4,291	0	3,966	3,966	0	325	325	0
7,000 - 7,999	4,365	4,365	0	4,051	4,051	0	314	314	0
8,000 - 8,999	4,090	4,090	0	3,883	3,883	0	207	207	0
9,000 - 9,999	5,528	5,528	0	5,302	5,302	0	226	226	0
10,000 - 10,999	3,871	3,871	0	3,754	3,754	0	117	117	0
11,000 - 11,999	3,236	3,236	0	3,147	3,147	0	89	89	0
12,000 - 12,999	3,115	3,115	0	3,028	3,028	0	87	87	0
13,000 - 13,999	2,534	2,534	0	2,495	2,495	0	39	39	0
14,000 - 14,999	2,212	2,212	0	2,168	2,168	0	44	44	0
15,000 - 16,999	3,807	3,807	0	3,728	3,728	0	79	79	0
17,000 - 19,999	3,549	3,549	0	3,493	3,493	0	56	56	0
20,000 - 23,999	2,433	2,433	0	2,373	2,373	0	60	60	0
24,000 - 29,999	1,585	1,585	0	1,556	1,556	0	29	29	0
\$30,000 +	1,410	1,410	0	1,366	1,366	0	44	44	0

100

TABLE 13

U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

Minimum income assumption									
	Total tax units			Tax units filing tax returns			Tax units not filing tax returns		
	Total units	Units required to file	Units not required to file	Total units	Units required to file (thousands)	Units not required to file	Total units	Units required to file	Units not required to file
Total	116,148	64,170	51,978	74,364	59,725	14,639	41,784	4,445	37,339
Potential joint filers	45,724	38,610	7,114	40,612	37,171	3,441	5,112	1,439	3,673
Less than 65	39,516	36,597	2,919	37,104	35,283	1,820	2,412	1,313	1,099
One 65 or over	2,819	1,342	1,477	1,978	1,292	686	841	50	791
Both 65 or over	3,389	671	2,718	1,530	595	935	1,859	76	1,783
Potential Nonjoint filers	70,424	25,560	44,864	33,752	22,554	11,198	36,672	3,006	33,666
Males less than 65	29,740	13,647	16,093	17,534	12,265	5,269	12,206	1,382	10,824
Single	23,400	8,811	14,589	12,786	8,087	4,699	10,614	724	9,890
Married--spouse present	1,476	1,182	294	1,295	1,085	210	181	97	84
Married--separated	1,253	958	295	821	742	79	432	216	216
Married--spouse absent	687	478	209	456	398	58	231	80	151
Widowed	651	458	193	469	413	56	182	45	137
Divorced	2,270	1,759	511	1,706	1,539	167	564	220	344
Males 65 or over	2,428	408	2,020	791	336	455	1,637	72	1,565
Single	499	116	383	205	109	96	294	7	287

TABLE 11

U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

Maximum income assumption									
<u>Gross income</u>	<u>Total tax units</u>			<u>Tax units filing tax returns</u>			<u>Tax units not filing tax returns</u>		
	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>
	(thousands)								
Potential joint filers	45,724	40,441	5,283	40,612	38,774	1,838	5,112	1,667	3,445
\$ 0	1,406	0	1,406	186	0	186	1,220	0	1,220
1 - 999	1,535	72	1,463	474	45	429	1,061	27	1,034
1,000 - 1,999	1,320	206	1,114	619	136	483	701	70	631
2,000 - 2,999	1,214	275	939	731	206	525	483	69	414
3,000 - 3,999	1,297	974	323	938	754	184	359	220	139
4,000 - 4,999	1,356	1,317	39	1,142	1,111	31	214	206	8
5,000 - 5,999	1,638	1,638	0	1,480	1,480	0	158	158	0
6,000 - 6,999	1,875	1,875	0	1,748	1,748	0	127	127	0
7,000 - 7,999	2,195	2,195	0	2,106	2,106	0	89	89	0
8,000 - 8,999	2,326	2,326	0	2,222	2,222	0	104	104	0
9,000 - 9,999	3,068	3,068	0	2,983	2,983	0	85	85	0
10,000 - 10,999	3,062	3,062	0	2,978	2,978	0	84	84	0
11,000 - 11,999	2,707	2,707	0	2,662	2,662	0	45	45	0
12,000 - 12,999	2,768	2,768	0	2,716	2,716	0	52	52	0
13,000 - 13,999	2,372	2,372	0	2,330	2,330	0	42	42	0
14,000 - 14,999	2,085	2,085	0	2,055	2,055	0	30	30	0
15,000 - 16,999	3,779	3,779	0	3,728	3,728	0	51	51	0
17,000 - 19,999	3,647	3,647	0	3,598	3,598	0	49	49	0
20,000 - 23,999	2,700	2,700	0	2,632	2,632	0	68	68	0
24,000 - 29,000	1,786	1,786	0	1,742	1,742	0	44	44	0
\$30,000 +	1,620	1,620	0	1,573	1,573	0	47	47	0

TABLE 9 Continued

Married--separated	116	28	88	30	18	12	86	10	76
Married--spouse absent	70	19	51	17	11	6	53	8	45
Widowed	1,476	333	1,143	432	248	134	1,044	85	959
Divorced	185	41	144	54	37	17	131	4	127
Females less than 65	29,952	1,617	18,335	13,776	9,809	3,967	16,176	1,808	14,368
Single	18,607	5,350	13,257	8,132	4,935	3,197	10,475	415	10,060
Married--spouse present	1,506	1,068	438	1,020	923	97	486	145	341
Married--separated	2,284	951	1,333	740	619	121	1,544	332	1,212
Married--husband absent--Armed Forces	205	80	125	14	8	6	191	72	119
Married--spouse absent	602	225	377	149	114	35	453	111	342
Widowed	3,912	1,992	1,920	1,874	1,535	339	2,038	457	1,581
Divorced	2,843	1,955	888	1,852	1,680	172	991	275	716
Females 65 or over	8,304	1,184	7,120	1,651	862	789	6,653	322	6,331
Single	773	229	544	317	192	125	456	37	419
Married--spouse present	51	14	37	24	13	11	27	1	26
Married--separated	156	11	145	19	9	10	137	2	135
Married--husband absent--Armed Forces	0	0	0	0	0	0	0	0	0
Married--spouse absent	63	18	45	9	7	2	54	11	43
Widowed	6,982	861	6,121	1,207	599	608	5,775	262	5,513
Divorced	282	51	231	77	42	35	205	9	196

TABLE 8
U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

Minimum income assumption--adjusted									
<u>Gross income</u>	<u>Total tax units</u>			<u>Tax units filing tax returns</u>			<u>Tax units not filing tax returns</u>		
	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>	<u>Total units</u>	<u>Units required to file</u>	<u>Units not required to file</u>
----- (thousands) -----									
Potential nonjoint filers	68,925	25,225	43,700	33,752	22,554	11,198	35,173	2,671	32,502
\$ 0 -	22,011	0	22,011	1,402	0	1,402	20,609	0	20,609
1 - 999	15,024	137	14,887	4,928	34	4,894	10,096	103	9,993
1,000 - 1,999	6,273	165	6,108	4,474	90	4,384	1,799	75	1,724
2,000 - 2,999	4,251	3,561	690	3,533	3,015	518	718	546	172
3,000 - 3,999	3,504	3,504	0	3,052	3,052	0	452	452	0
4,000 - 4,999	3,319	3,319	0	2,927	2,927	0	392	392	0
5,000 - 5,999	2,824	2,824	0	2,580	2,580	0	244	244	0
6,000 - 6,999	2,409	2,409	0	2,211	2,211	0	198	198	0
7,000 - 7,999	2,157	2,157	0	1,960	1,960	0	197	197	0
8,000 - 8,999	1,764	1,764	0	1,659	1,659	0	105	105	0
9,000 - 9,999	1,759	1,759	0	1,620	1,620	0	139	139	0
10,000 - 10,999	950	950	0	898	898	0	52	52	0
11,000 - 11,999	650	650	0	603	603	0	47	47	0
12,000 - 12,999	423	423	0	399	399	0	24	24	0
13,000 - 13,999	295	295	0	288	288	0	7	7	0
14,000 - 14,999	249	249	0	233	233	0	16	16	0
15,000 - 16,999	354	354	0	331	331	0	23	23	0
17,000 - 19,999	272	272	0	255	255	0	17	17	0
20,000 - 23,999	168	168	0	154	154	0	14	14	0
24,000 - 29,999	129	129	0	126	126	0	3	3	0
\$30,000 +	149	149	0	133	133	0	16	16	0

TABLE 6
U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL FEMALE INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

	Minimum income assumption--adjusted								
	Total tax units			Tax units filing tax returns			Tax units not filing tax returns		
	Total units	Units required to file	Units not required to file	Total units	Units required to file	Units not required to file	Total units	Units required to file	Units not required to file
	(thousands)								
Females less than 65	28,996	10,393	18,603	13,776	9,339	4,437	15,220	1,054	14,166
Single	18,607	5,106	13,501	8,132	4,801	3,331	10,475	305	10,170
Married--spouse present	1,506	833	673	1,020	753	267	486	80	406
Married--separated	1,964	762	1,202	740	607	133	1,224	155	1,069
Married--husband absent--Armed Forces	14	8	6	14	8	6	0	0	0
Married--spouse absent	340	121	219	149	112	37	191	9	182
Widowed	3,729	1,766	1,963	1,874	1,432	442	1,855	334	1,521
Divorced	2,843	1,802	1,041	1,852	1,631	221	991	171	820
Females 65 or over	776	777	6,984	1,651	614	1,037	6,110	163	5,947
Single	773	111	662	317	96	221	456	15	441
Married--spouse present	51	11	40	24	11	13	27	0	27
Married--separated	145	7	138	19	7	12	126	0	126
Married--husband absent--Armed Forces	0	0	0	0	0	0	0	0	0
Married--spouse absent	51	7	44	9	6	3	42	1	41
Widowed	6,462	602	5,860	1,207	461	746	5,255	141	5,114
Divorced	282	39	243	77	33	44	205	6	199

TABLE 4
U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

Maximum income assumption--adjusted									
Gross income	Total tax units			Tax units filing tax returns			Tax units not filing tax returns		
	Total units	Units required to file	Units not required to file	Total units	Units required to file	Units not required to file	Total units	Units required to file	Units not required to file
	(thousands)								
Potential nonjoint filers	68,924	27,635	41,289	33,752	24,008	9,744	35,172	3,627	31,545
\$ 0	19,371	0	19,371	534	0	534	18,837	0	18,837
1 - 999	15,047	231	14,816	4,704	100	4,604	10,343	131	10,212
1,000 - 1,999	6,702	480	6,222	4,350	307	4,043	2,352	173	2,179
2,000 - 2,999	4,572	3,696	876	3,572	3,009	563	1,000	687	313
3,000 - 3,999	3,760	3,760	0	3,154	3,154	0	606	606	0
4,000 - 4,999	3,538	3,538	0	3,026	3,026	0	512	512	0
5,000 - 5,999	2,938	2,938	0	2,621	2,621	0	317	317	0
6,000 - 6,999	2,561	2,561	0	2,283	2,283	0	278	278	0
7,000 - 7,999	2,341	2,341	0	2,082	2,082	0	259	259	0
8,000 - 8,999	1,910	1,910	0	1,780	1,780	0	130	130	0
9,000 - 9,999	1,757	1,757	0	1,605	1,605	0	152	152	0
10,000 - 10,999	1,128	1,128	0	1,021	1,021	0	107	107	0
11,000 - 11,999	764	764	0	700	700	0	64	64	0
12,000 - 12,999	556	556	0	505	505	0	51	51	0
13,000 - 13,999	363	363	0	338	338	0	25	25	0
14,000 - 14,999	308	308	0	282	282	0	26	26	0
15,000 - 16,999	431	431	0	401	401	0	30	30	0
17,000 - 19,999	330	330	0	294	294	0	36	36	0
20,000 - 23,999	200	200	0	182	182	0	18	18	0
24,000 - 29,999	159	159	0	153	153	0	6	6	0
\$30,000 +	196	196	0	176	176	0	20	20	0

TABLE 2
U.S. RESIDENT CIVILIAN NONINSTITUTIONAL ADULT POPULATION:
NUMBER OF POTENTIAL FEMALE INDIVIDUAL INCOME TAX
FILING UNITS FOR 1972

Maximum income assumption--adjusted									
	Total tax units			Tax units filing tax returns			Tax units not filing tax returns		
	Total units	Units required to file	Units not required to file	Total units	Units required to file (thousands)	Units not required to file	Total units	Units required to file	Units not required to file
Females less than 65	28,996	11,273	17,723	13,776	9,809	3,967	15,220	1,464	13,756
Single	18,607	5,350	13,257	8,132	4,935	3,197	10,475	415	10,060
Married--spouse present	1,506	1,068	438	1,020	923	97	486	145	341
Married--separated	1,964	818	1,146	740	619	121	1,224	199	1,025
Married--husband absent--Armed Forces	14	8	6	14	8	6	0	0	0
Married--spouse absent	340	127	213	149	114	35	191	13	178
Widowed	3,729	1,951	1,778	1,874	1,535	339	1,855	416	1,439
Divorced	2,843	1,955	888	52	1,680	172	991	275	716
Females 65 or over	7,760	1,156	6,604	1,651	862	789	6,109	294	5,815
Single	773	229	544	317	192	125	456	37	419
Married--spouse present	51	14	37	24	13	11	27	1	26
Married--separated	144	10	134	19	9	10	125	1	124
Married--husband absent--Armed Forces	0	0	0	0	0	0	0	0	0
Married--husband absent	51	15	36	9	7	2	42	8	34
Widowed	6,462	837	5,625	1,207	599	608	5,255	238	5,017
Divorced	282	51	231	77	42	35	205	9	196

Because our estimate is for income taxes only, we excluded those potential filing units required to file only because of self-employment taxes.

We estimate that \$1.9 billion to \$3.0 billion in income taxes were not paid by nonfilers. Of this amount we estimate that \$630 million was recovered through IRS' collection efforts, which results in a net loss of \$1.3 billion to \$2.4 billion in income taxes. The lost income taxes are partially offset by withholdings but we are unable to estimate the amount for tax year 1972.

LIMITATIONS

The accuracy of the estimate of the nonfiler population is limited because of inadequacies in the data. We could only determine an individual's liability to file based on the income included in the Exact Match File. We compensated for the fuzzy distinction between taxable and nontaxable income but were unable to adjust for income not included such as capital gains. We were unable to detect a nonfiler who was consistent and reported an income below the filing requirement.

We compensated for the women who filed as secondary taxpayers but we could not properly account for the men or women not living together whose incomes should have been combined and tested for joint filing. Our procedure therefore underestimated potential joint filing units and overestimated potential nonjoint filing units.

STATISTICAL TABLES

Because of the time and expense of developing these estimates and the uncertainty involved in the adjustments, we are presenting the details of both our adjusted and unadjusted estimates. These data should prove useful to agency officials and researchers who may wish to use different assumptions in adjusting the estimates. The data is presented in terms of sex, age, and marital status (the basis for our adjustments) on tables 1, 2, 5, 6, 9, 13, and by gross income (the basis of our tax impact estimate) in tables 3, 4, 7, 8, 10, 11, 12, 14, 15, 16. The totals for some tables may not agree with the sum of the column due to rounding.

using the weighting factors developed by the Social Security Administration.

Adjustments to the estimates

The data we used to determine whether or not a potential filing unit filed a tax return has an inherent weakness in that individuals filing as secondary taxpayers on a joint tax return are not identified. Because of our tax filing customs, these secondary filers are generally women. Our estimate, therefore, would count a secondary filer not paired with a primary filer as a nonfiler. This could logically occur for married-separated individuals or married individuals living apart for some other reason.

We examined the types of returns filed by the men and women we identified as potential nonjoint filers, and found men listed as married-separated and married-spouse absent-other had sometimes filed joint tax returns. We reduced the women with comparable marital status not filing tax returns by a corresponding amount prorated between those required to file and those not required to file. We also dropped all nonfiling women listed as married-spouse absent in the armed forces because their spouses were outside the population covered by the data.

An additional adjustment was required for widows who may have filed as a secondary with their deceased husbands listed as the primary, because it is a common practice to show a deceased husband as the primary taxpayer for the year of death. Based on the number of 1972 joint tax returns filed for decedents, we estimate that about nine percent of the widows we identified as not filing were included as secondaries on decedent tax returns. We therefore reduced the estimated nonfiling widows by nine percent. These adjustments decreased our maximum estimate of nonfilers who should file from 5.7 to 5.3 million and our minimum estimate from 4.4 to 4.1 million. Our maximum estimated income for these nonfilers was reduced from \$37 billion to \$35 billion and the minimum reduced from \$28 billion to \$26 billion.

Validations

We validated our income estimating procedure by comparing our maximum gross income estimates to the reported adjusted gross income for those units filing a 1972 tax

--Farm and nonfarm self-employment income.

--Other income. This includes amounts such as private pensions, annuities, alimony and child support, or net gambling winnings. Other income was excluded when the response status indicated the presence of regular contributions (contributions received periodically from persons not living in the household such as assistance provided to aged parents from their children).

All negative income amounts (losses) were excluded. Income of husband and wife were combined for potential joint filing units.

Because we could not be certain that only taxable income was included in the maximum estimate, we developed a minimum estimate excluding all the potentially non-taxable income we could identify. Nontaxable income we could not identify, such interest on nontaxable bonds, may still be included. We also excluded all allocated income. ^{2/}

The minimum estimate included:

--The greater of reported wages or social security earnings. Wages were not used if they were allocated and social security earnings were not used if they included self-employment income.

--Property income.

--Other income except when the responses status indicated the presence of regular contributions, private pension income, or alimony and child support.

--Farm and nonfarm self-employment income.

As with the maximum gross taxable income estimate, all losses were excluded, and incomes were combined for potential joint filing units.

^{2/}For the individuals who do not provide income information, the Exact Match File includes estimated (allocated) amounts. We excluded these estimates thereby assuming zero income for the income categories allocated.

METHOD USED TO ESTIMATE THE POPULATION OF
NONFILERS OF INDIVIDUAL TAX RETURNS

Data from the 1973 Exact Match Study suggests that for 1972 there were between 4.1 million and 5.3 million individuals and couples who should have filed individual tax returns (forms 1040 and 1040A) but did not. The Exact Match File 1/, a product of the Exact Match Study, was used to develop our estimate. This file contains employment, income, and tax filing data for a sample of the United States resident civilian noninstitutionalized adult population. All identifying information has been deleted from the file to preserve the confidentiality of the sampled individuals.

While the 1973 Exact Match Study's goal was to expand the knowledge of income distribution and redistribution, we believe that the resulting data can be used to estimate the extent of nonfiling of individual income tax returns.

HOW THE NONFILER POPULATION WAS ESTIMATED

The population of nonfilers who should file a tax return was estimated by converting the file to potential tax filing units, estimating each unit's income, comparing the income to the applicable filing requirements, and checking to see if a return was filed by the unit.

Potential tax filing units

Each record in the Exact Match File represents an individual. As each record was read the Social Security Administration-IRS match code was tested to check for a successful match of the data. We dropped all individuals under 14 years

1/The Exact Match File is documented in "STUDIES FROM INTERAGENCY DATA LINKAGES, Report Number 8," by Faye Aziz, Beth Kilss and Frederick Scheuren, U.S. Department of Health Education, and Welfare, Social Security Administration, Office of Research and Statistics. Included are detailed descriptions of the data elements referred to in this appendix.

Page 59-7

--Refine the pension income data used to select non-filer cases for investigation to show only taxable income so that individuals with nontaxable pension income are not selected for investigation.

Response:

The information documents we receive from payors of pensions do not always contain this information. To the extent that it is reported to us, only taxable pension income data will be used in selecting nonfiler cases.

Page 59-8

--Provide people who are sent delinquency notices information on the filing requirements so they can accurately determine their filing requirements.

Response:

We concur. We will review the current notices and stuffers and modify them to provide additional filing requirement information.

Page 59-9

--Collect meaningful statistical data which can be used to evaluate program effectiveness as well as to aid in uncovering problems in selecting and investigating nonfiler cases.

Response:

We concur and will do so to the extent a balanced allocation of our resources permits.

Page 72-1

To further reduce the delinquency gap created by the nonfiler population, we recommend that the Commissioner, given available resources:

--Consider establishing more Returns Compliance Programs directed at specific groups of individual nonfilers deserving concentrated attention because of their tendency toward nonfiling. Any selection of such programs should be based on periodic IRS estimates and analyses of the nonfiler population. In the interim, however, selection could be based on the characteristics of our estimated population, or random samples of persons not covered under the Taxpayer Delinquency Investigation Program.

Page 22-1 [See GAO note.]

We recommend that the Commissioner initiate action to periodically estimate the size and analyze the characteristics of the nonfiler population. Such estimates should (1) be made primarily from IRS' existing data sources and (2) include gathering the operational information necessary to determine the most efficient and effective methods for detecting and pursuing nonfilers and for increasing compliance with the filing requirements.

Response:

We concur but the amount and timing of action we are able to take will depend on available resources.

Page 59-1

To improve the effectiveness of the Taxpayer Delinquency Investigation Program, we recommend that the Commissioner:
--Develop and use a method for selecting persons for investigation which will make more effective use of investigative resources by predicting with a high degree of certainty that the people selected for investigation are actually required to file returns.

Response:

We concur. We will see if we can develop a predictive model which produces better results than our present selection methods. We will also work with GAO in developing a useful model.

Page 59-2

--Strengthen investigative policies and procedures by requiring that all people selected for investigation be pursued to the extent necessary to ensure that reasonable efforts, such as visiting the last known address of the taxpayer or telephoning the last known employer, are made to (1) locate the nonfilers, (2) verify their filing requirements, and (3) secure all the delinquent returns they are required to file.

Response:

We will consider what parts of your recommendation we can adopt without significantly reducing the cost beneficial nature of our present program. As long as we are faced with resource constraints for this program, we must allow for flexibility in our investigative procedures.

GAO note: Page references in this appendix refer to our draft report and may not correspond to the pages of this final report.

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

JUN 6 1979

Mr. Allen R. Voss, Director
General Government Division
General Accounting Office
Washington, D. C. 20548

Dear Mr. Voss:

This is in response to your draft report entitled "Nonfiling of Income Tax Returns: A Serious Problem that IRS Needs to Deal with More Adequately." The Service is in basic agreement with the substance of many of your recommendations. We will use the budgetary process, research initiatives and management improvements to implement those recommendations to the maximum practicable extent.

In focusing on the agreed need for improvements, we should not lose sight of the Service's present cost beneficial program to detect nonfilers. We accomplished this even though delinquent nonfiler income distribution is generally concentrated in a large number of low-income persons with relatively small amounts of tax involved in each case. As you point out, 52% of the total nonfiler income population had incomes of \$5,000 or below; 33% of farm laborers and 64% of private household workers were nonfilers; 68% of nonfiling laborers and service employees made \$5,000 or less; self-employed persons may have less incentive to file because IRS had little record of their earnings. Against the background of these problems, our achievements are significant.

We do agree that, in fairness to the approximately 92% of taxpayers who do file their income tax returns, we should do more to find the approximately 8% you estimate are delinquent. We do not minimize the seriousness of the potential \$2 billion "delinquency gap" you estimate for 1972, even in the perspective that it represents about 1% of \$213 billion gross tax collected on individual income tax returns in 1978, and about 2% of \$108 billion such tax collected in 1972 by our voluntary compliance system.

One basic issue is whether we are allocating a fair proportion of our enforcement resources to detect nonfilers. We must weigh, for example, the needs of this program against the declining audit coverage and the increasing inventory of accounts receivable. The resources devoted to finding nonfilers must be in balance with the resources devoted to ultimately collecting the accounts. Additional resources devoted to detecting and investigating nonfilers would reduce other programs. The choices are close and difficult, but we will not devote a disproportionate share of our resources to catch low income nonfilers. We will, however,

of our estimated population, or random samples of persons not covered under the Taxpayer Delinquency Investigation Program.

--Attempt to use tax and other data available from the States to help detect more nonfilers.

We also recommend that the Commissioner establish a priority system to make sure that delinquent tax returns involving refund claims are processed within the 45 day statutory limitation.

MATTER FOR CONSIDERATION
BY THE CONGRESS

To make the law regarding tax return filing more equitable and encourage voluntary compliance, the Congress should consider various alternative ways to amend section 6651(a) of the Internal Revenue Code to provide for a late filing charge on nonfilers due refunds as it imposes penalties on nonfilers who owe taxes.

To assist the Congress in its consideration, it should request the Commissioner of Internal Revenue to provide it with a series of alternative ways for imposing charges on nonfilers due refunds.

IRS COMMENTS AND OUR EVALUATION

In his June 6, 1979, letter, the Commissioner stated that IRS planned to conduct a limited, random sample test of taxpayers with insufficient identifying information for inclusion in the present Taxpayer Delinquency Investigation Program. He stated, however, that IRS did not presently have the resources to establish extensive investigative programs directed at certain groups with a tendency toward nonfiling.

IRS concurred with our recommendations to (1) use tax and other data available from the States to help detect more nonfilers and (2) establish a priority system to make sure that delinquent tax returns involving refund claims are processed within the 45-day statutory limitation.

Regardless of the alternative chosen, it may not be fair to penalize all taxpayers due refunds, especially those with low income who receive tax deductions through the earned income credit. Thus, some exceptions might be considered in changing the law.

CONCLUSIONS

Reducing the delinquency gap may require IRS to employ measures other than the Taxpayer Delinquency Investigation Program to detect and investigate some nonfilers. However, as discussed in chapter 2, before specific measures can be established for a balanced and effective approach in tackling the nonfiler problem, IRS has to systematically estimate the nonfiler population and analyze its characteristics. Until IRS makes its evaluation of the nonfiler population, it should consider taking more immediate action, contingent upon available resources, to reduce the delinquency gap.

Establishing more Returns Compliance Programs directed toward specific occupational groups, such as those we identified in our estimate of the nonfiler population, should help. Some of these groups with high levels of noncompliance include self-employed managers and administrators and self-employed craftsmen. IRS could also direct Returns Compliance Programs to persons it does not investigate under its Taxpayer Delinquency Investigation Program. These could include persons with various types and levels of income, such as those with nonwage income over \$3,000.

Making better use of available State data on those Federal nonfilers IRS cannot readily detect might also further reduce the number of nonfilers. Although we pointed out in a May 1978 report that IRS may have had an opportunity to identify Federal nonfilers by using State information, IRS still has not made a serious effort in this direction. The time has come to seriously attempt to use this data as an aid in the nonfiler area.

Matching more information returns, such as those on certain types of income like interest and dividends, might also help identify more nonfilers. Although IRS may want to consider matching all types of information returns to identify more nonfilers, it is unlikely, based on our sample analysis, that a great many more would be identified. Any decision to increase matching to identify more nonfilers would, of course, have to be made in light of other information returns matching priorities.

DELINQUENT TAXPAYERS DUE REFUNDS ARE
NOT PENALIZED FOR FILING LATE

The Internal Revenue Code 1/ requires all taxpayers to file their returns by a designated calendar quarter, usually April 15, or to secure a valid extension. However, penalties for late filing 2/ apply only to those persons owing income tax. This is contrary to the voluntary compliance concept in that it does not encourage people due refunds to comply with the April 15 filing deadline and constitutes inequitable treatment of taxpayers. Also IRS must incur costs pursuing such persons.

Unless, of course, they file beyond the 3 year statutory limit for paying refunds, delinquent taxpayers due refunds are not penalized for late filing. Moreover, they receive their full refunds with interest if IRS takes longer than 45 days to process the return. On the other hand, a taxpayer who files late and owes taxes may be assessed for filing late and not paying taxes on time, as well as be charged interest on those taxes owed. Although both persons are nonfilers for failing to file timely as required by law, only one is penalized. Furthermore, this practice does not represent even-handed treatment for taxpayers who file timely; and thus, does not encourage compliance with the filing requirements.

Even though the Internal Revenue Code does not provide sanctions against persons who are delinquent in filing returns claiming refunds, IRS cannot limit its investigatory efforts solely to people who owe the Government taxes. The law requires all people who meet the the filing requirements to file returns. Furthermore, until IRS investigates and secures a return from a nonfiler, it does not know if the person owes taxes or is due a refund.

On the basis of IRS data, we estimate that its 1975 Taxpayer Delinquency Investigation Program spent almost \$4 million pursuing nonfilers due refunds. Another \$4 million was spent pursuing nonfilers who owed taxes. IRS investigations involving nonfilers who owed taxes resulted in about \$425 million in taxes, penalties, and interest payable to the Government. In contrast, its investigations of nonfilers due refunds resulted in

1/26 U.S.C. 6072(a) and 26 U.S.C. 6081.

2/26 U.S.C. 6651(a).

about 15 percent of the paper information returns. Beginning with tax year 1978, the Social Security Administration began converting to magnetic tape for IRS all paper W-2 and W-2P forms for wage and pension income. Other types of paper information returns, such as forms 1099 and 1087 for interest and dividend income, will still have to be converted by IRS to magnetic tape for matching purposes.

We do not know how many more nonfilers will be identified when all W-2 and W-2P forms are converted to magnetic tape and matched to IRS records. However, about 3 percent of the 1,120 cases we sampled from the tax year 1975 Taxpayer Delinquency Investigation Program resulted solely from IRS' converting and matching paper W-2 and W-2P forms. The nonfilers in the other sample cases who had wages and pension income were identified through social security tax data and information returns already on magnetic tape; and thus, would not have required conversion.

While converting all paper W-2 and W-2P forms to magnetic tape and matching them will identify more nonfilers those without wage or pension income will go undetected unless other types of information returns are also converted and matched. For example, about 2 percent of our 1,120 sampled nonfiler cases resulted from converting and matching forms 1099 and 1087 for interest and dividend income. IRS may want to consider more matching for this purpose. However, in light of our sample results, it is unlikely that a great many more nonfilers would be identified. Any decision on additional matching would have to be made in the context of available funds and other information return matching priorities.

LATE FILERS RECEIVE EXCESSIVE INTEREST ON THEIR REFUNDS

Under section 6611 of the Internal Revenue Code, delinquent taxpayers receive interest on overpayments if IRS does not issue the refund within 45 days after the return was filed. The Code provides that the interest run from the date of overpayment, which in the case of a delinquent filer due a refund is the due date of the return and not the date the return is actually filed. Thus, if IRS does not process the return within 45 days, a taxpayer due

IRS makes available to each State a computer file containing information on each taxpayer in that State who filed a Federal tax return for the previous year. In our May 1978 report 1/ on the exchange of Federal and State tax information, we stated that in 1976, 41 States received information on Federal filers; 38 used the information to identify nonfilers of State tax returns. Only three States used the data to identify Federal nonfilers, while several other States either planned to provide Federal nonfiler information to IRS or had it available for IRS use. We concluded that IRS should seriously explore using State information to identify nonfilers.

Of six States reviewed only California provided information to IRS on potential Federal nonfilers. However, IRS did not adequately process or use this information.

California used IRS' computer tape to identify tax year 1975 State nonfilers who filed Federal tax returns. As a by-product of this matching process, it also identified about 46,000 individuals who had not filed either a Federal or State income tax return. As arranged with IRS, it then sent delinquency letters on IRS stationery to these potential nonfilers informing them that they appeared to be delinquent for their tax year 1975 Federal return.

Our random sample of California's 400 delinquency letters showed that:

- 43 percent of the sampled taxpayers had already received delinquency notices from the IRS Taxpayer Delinquency Investigation Program before they received California's letters,
- 37 percent of the taxpayers had filed their returns before the State letters were mailed, and
- 20 percent of the taxpayers had not filed returns nor been identified by IRS as nonfilers.

Although the Federal-State program was not too effective because about 80 percent of the State delinquency letters were not necessary, California did detect 79 nonfilers whom IRS did not know about. Only 7 of the 79 filed

1/"Better Management Needed In Exchanging Federal And State Tax Information," (GGD-78-23, May 22, 1978).

of return. These programs devote little attention to individual nonfilers, however, because IRS relies on the Taxpayer Delinquency Investigation Program to identify individuals. Therefore, certain groups of nonfilers such as those on whom IRS has incomplete income data are not investigated.

As of February 1979, the only active Returns Compliance Program directed at individual nonfilers involved self-employed professionals--doctors, dentists, lawyers, and accountants. Approved in June 1977, the program is expected to be completed in June 1979, when about 43,000 individuals will have been investigated. According to an IRS official, about 1 percent of those investigated are expected to be delinquent.

Because self-employed doctors, dentists, lawyers, and accountants comprised less than 1 percent of our estimated nonfiler population, IRS should consider emphasizing other groups of self-employed individuals in its Returns Compliance Program activities. For example, about 6 percent were self-employed laborers, 23 percent were self-employed craftsmen, and 26 percent were managers and administrators. (See app. III, p. 109.)

Although our estimate is based on a tax year 1972 data base, it is a better indicator than IRS presently has. The indicator would be more current and reliable still if IRS made its own estimate and analysis. To determine which individuals to investigate under its Returns Compliance Program on self-employed professionals, IRS selected a sample of professionals from a commercial business list and matched the names against its master file. However, the business list contained only the individuals' names and not their social security numbers, while IRS records contained both names and social security numbers. As a result, mismatches occurred; and IRS contacted many individuals under its Returns Compliance program who had filed returns.

Returns Compliance Programs might be used more effectively to reduce the delinquency gap if, as discussed in chapter 2, IRS initiated them based on information obtained through periodic estimates and analyses of the nonfiler population. Taxpayer Compliance Measurement Program-like surveys might identify certain types of nonfilers for concentrated pursuit. For example, IRS may find that many people have only certain types of income, such as interest income, reported to IRS on information returns. This income alone is not enough to require filing returns; yet the people may be nonfilers because they may have had other income, such as business income, which was not reported to IRS.

accounts receivable inventory. We agree that the choices are difficult, and we share IRS' concern with the declining audit coverage, which has decreased from about 2.3 percent of the returns filed in fiscal year 1978 to an estimated 2.1 percent of the returns expected to be filed in fiscal year 1980. Likewise, we are concerned with the accounts receivable inventory, which is expected to increase from about 0.9 million accounts in fiscal year 1978 to about 1 million in fiscal year 1980.

Although additional resources may be needed to fully implement our recommendations for improving IRS nonfiler activities, we do not believe, in light of the seriousness of the compliance problems, such resources should be taken from other enforcement programs. Given the amount of resources the Administration wants to direct at nonfiling and other noncompliance areas, additional funds may be needed to adequately improve IRS' nonfiler program and thereby reduce the delinquency gap.

Therefore, the Congress should determine whether IRS' nonfiler efforts are being funded at a sufficient level in light of the size of the nonfiler population and its potential adverse effect on the Nation's voluntary tax assessment system. However, before the Congress can make such a determination, IRS needs to determine precisely how many additional resources are needed to improve the nonfiler program, in line with our recommendations, and where and how the resources, if granted, would be used. IRS should use the resources to (1) estimate and analyze the nonfiler population, (2) develop a systematic nonfiler case selection method aimed at persons who are most likely required to file, and (3) investigate thoroughly all those nonfiler cases it selects.

RECOMMENDATION TO THE CONGRESS

The Congress should request IRS to develop and provide to the appropriate congressional committees information on the amount of additional funds needed to improve the effectiveness of IRS' nonfiler efforts. This information should include cost estimates for (1) estimating and analyzing the nonfiler population, (2) developing a better nonfiler case selection method, and (3) investigating thoroughly all nonfilers selected. The Congress then can decide whether additional funds are needed.

- Issue delinquency notices, to the extent possible, about 6 months after the filing deadline to certain individuals who filed returns in the tax year prior to the one under investigation.
- Require that delinquency prevention measures be applied to individual nonfilers and strengthen the delinquency prevention guidelines to ensure that those nonfilers who require such measures are monitored.
- Refine the pension income data used to select nonfiler cases for investigation to show only taxable income so that individuals with nontaxable pension income are not selected for investigation.
- Provide people who are sent delinquency notices information which will enable them to accurately determine their filing requirements.
- Collect statistical data specific enough to evaluate program effectiveness as well as to aid in uncovering problems in selecting and investigating nonfiler cases.

IRS COMMENTS AND OUR EVALUATION

In a June 6, 1979, letter, the Commissioner stated that IRS agrees with the substance of many of our recommendations. He said IRS will use the budgetary process, research initiatives, and management improvements to implement the recommendations to the extent practical. He did, however, raise two basic issues dealing with the (1) efficiency of IRS' current nonfiler efforts and (2) allocation of IRS' limited resources proportionately among its enforcement activities.

With regard to the first issue, IRS stated its present nonfiler program is cost beneficial and its achievements are significant considering that "delinquent nonfiler income distribution is generally concentrated in a large number of low-income persons with relatively small amounts of tax involved in each case." In addition, it stated that it closed many nonfiler cases without exhausting all possible investigative procedures because of limited resources; therefore, IRS' scarce resources are devoted to a greater number of more productive cases.

We agree that the present nonfiler program is productive and its results significant in terms of taxes,

We developed a model which predicts with a high degree of probability--about 83 percent--the likelihood of people being required or not required to file. Because our model was developed from a sample of IRS' tax year 1975 Taxpayer Delinquency Investigation Program cases and covered only seven district offices, IRS should develop a similar model for use nationwide. Such a model should include the universe of those people IRS does not presently select for investigation as well as those it does select.

People selected under the Taxpayer Delinquency Investigation Program are not always thoroughly investigated. IRS often does only cursory investigations on the people it selects because policies and procedures which limit the scope of investigation required to catch nonfilers are intentionally employed due to limited resources. We estimate that, because IRS did not thoroughly investigate the nonfiler cases it selected for pursuit in seven district offices reviewed, it failed to secure about 25,000 delinquent returns involving taxes due of \$15.8 million and refunds of \$7.7 million.

Because IRS does not follow existing policies and procedures, it often does not obtain the delinquent returns owed by a taxpayer for tax years other than the one being investigated. In addition, IRS lacks a system for checking delinquent returns for unreported income. This resulted in IRS' failing to uncover about \$14.8 million in unreported income with potential tax liabilities of \$2.2 million for the nonfiler cases it investigated for tax year 1975 in the seven district offices.

Various other caseload management practices tend to reduce program effectiveness and result in the inefficient use of investigative resources. These include

- investigating, separately, married couples who file joint returns;
- sending delinquency notices out 15 months after the return due date;
- failing to direct delinquency prevention resources to individual nonfilers;
- initiating nonfiler cases on people who have non-taxable pension income and who are not required to file;

other compliance activities, such as audit and criminal investigation, or bring fewer individuals into compliance. This dilemma has led to restrictive investigative policies and procedures which have resulted in cursory investigations of more nonfilers than perhaps should have been pursued. In turn, fewer nonfilers are made to comply than if thorough investigations had been done.

IRS estimates that the average cost to close a nonfiler case at a district office is at least \$46, while the average cost at a service center is \$1.39. Obviously, if all nonfilers responded to delinquency notices and the cases could be successfully closed at the service centers, the cost of investigating nonfilers at district offices would be relatively inexpensive. Because many nonfilers do not respond to the notices, however, either the cases are closed at the service centers without further investigation or more costly district office resources have to be used to locate the taxpayers.

About 630,000 of the 1.3 million tax year 1975 nonfiler cases were sent to the district offices for investigation. Returns were secured from 31 percent of the cases. According to our sample results, returns were not secured in many of the other cases because they were not thoroughly investigated. To have adequately investigated the 630,000 cases would have cost at least \$29 million, yet only \$15 million was spent for the investigations.

Similar resource problems will occur for tax year 1976 nonfiler cases investigated during fiscal year 1979. For that year IRS budgeted about \$14 million for the Taxpayer Delinquency Investigation Program. Only 389,000 of the 1.3 million nonfiler cases planned for investigation are expected to be referred to the district offices. The remainder are expected to be closed by the service centers. To thoroughly investigate all 389,000 cases would cost at least \$18 million.

Attempting to investigate more nonfilers cases than resources permit not only leads to cursory investigation but amounts to a "hit or miss" approach to gaining compliance. Cases where taxpayers respond to delinquency notices will probably be adequately resolved. In cases where no response to a notice is received and where IRS policy does not permit followup, the chances of securing delinquent returns are reduced. To secure returns from these individuals, IRS has to pick them up in the next year's Taxpayer Delinquency Investigation Program and hope that the taxpayers either respond to the delinquency notices or that a thorough field investigation is performed which results in securing the delinquent returns. IRS officials stated that even

Produced annually, the Phase IV Report provides by service center and district office information on delinquency rates, yields, types of closures, and nonfiler case selection criteria. The report was developed to provide a means for selecting those nonfiler cases which are considered most worthwhile within IRS' resources. According to an IRS official, however, until recently these reports contained questionable data and were difficult to use for evaluating selection criteria. Even though the report has improved, it still cannot be used to properly analyze the types of nonfiler cases which should be investigated. This requires examining not only those cases which were selected for investigation, but those that were not selected. As we pointed out earlier, IRS has not analyzed cases which were not selected.

The Phase IV Report is also inadequate for analyzing the results of selected cases. The report lists program results, such as the number of returns secured and the amount of taxes owed and refunds due. It also shows how the case was closed by the type of nonfiler case--wages only, self-employment income, or dividend income. However, the data is not broken down by income ranges--that is, by low, medium, and high income. Therefore, IRS cannot determine its success in securing returns from low-income or high-income persons or that they are really nonfilers.

For example, for the tax year 1975 Taxpayer Delinquency Investigation Program, IRS investigated about 545,000 individuals who, according to IRS records, had only wage income. According to IRS definitions (which are classified), of the 545,000 individuals investigated, we estimate that 321,000 had low income, 153,000 had medium income, and 71,000 had high income. Returns were secured from about 25 percent of the 545,000 individuals. Because the Phase IV Report does not analyze program results by income range, IRS cannot evaluate whether returns were secured from low-income people or high-income people. If few returns were secured from low-income individuals and many of them were found not required to file, it would indicate that IRS should not spend resources investigating low-income individuals whose only income source was wages.

Input data to the statistical
reports does not adequately
describe program results

When IRS closes a nonfiler case, a transaction code is entered into the master file which explains how the case was closed. Although these codes are the basis for information contained in the Phase IV Report, they do not

Payers report pension income to IRS on Form W-2P, Statement for Recipients of Annuities, Pension and Retired Pay. When IRS processes the form, it uses the gross income to develop the nonfiler case. As a result, individuals whose gross pension income meets IRS' criteria for Taxpayer Delinquency Investigation case selection will be investigated, even though all or part of their income is nontaxable. To avoid this, IRS should use only the taxable income in developing nonfiler cases.

Currently, IRS cannot pick up the taxable portion of the pension income in all cases because some payers do not enter this amount when they submit the Form W-2P. Although we could not determine why some payers omit this information, IRS should try to determine the causes and take appropriate corrective action.

Delinquency notices do not provide
information on filing requirements

IRS' delinquency notices do not inform taxpayers of the filing requirements or of the possibility that they may be due refunds if they file. As a result, taxpayers may not know whether they are required to file and thus may not respond accurately to the notices. Also, they may not realize they are due refunds even if they are not required to file.

The delinquency notices state that IRS cannot locate the taxpayers' returns and that the taxpayers should file the returns or explain why they do not have to file. The notices also tell the taxpayers that they are subject to interest and penalties on unpaid taxes. Enclosed with the delinquency notices is another notice which explains the change in interest rate and estimated tax penalty rate. Nowhere on the notice or elsewhere does it explain the minimum gross income filing requirements.

Determining the requirement to file is difficult for many taxpayers. For example, many of the questions IRS received on the tax year 1977 income tax form dealt with filing requirements. Also, we had IRS contact taxpayers in 43 of the 53 cases in our nonfiler sample who claimed that they were not required to file returns because their taxable income was below the filing requirement. Thirteen of the 43 taxpayers were actually required to file. While we do not know the reasons for these taxpayers' claims, they may not have known the filing requirements.

taxpayers. While many nonfiler cases are developed from information returns, some are selected solely on the basis of the individual's income in the year prior to the one being investigated. For example, individuals with a certain amount of self-employment income in the prior year will be selected regardless of their income shown on information returns. We could not determine how many individuals are selected on the basis of information returns rather than prior year filing. However, about 50 percent of the tax year 1975 nonfiler cases involved individuals who filed tax year 1974 returns.

IRS should issue delinquency notices earlier to some nonfilers who filed the returns in the tax year prior to the one being investigated. We recognize that to send notices earlier to all individuals would be impractical and costly because of the large numbers of individuals who file in 1 year but not the next. Over 7 million individuals filed in tax year 1974 but not in tax year 1975. Individuals such as those with self-employment income and higher than average income in the prior year, however, should be prime candidates for early delinquency notices. Notices could be sent to such persons perhaps as early as 6 months after the filing deadline.

Issuing delinquency notices as early as possible should increase program effectiveness because more individuals are likely to be located at the addresses on IRS' records. IRS would probably obtain more responses to the notices, thereby reducing program costs because the district offices would have to investigate fewer cases.

Delinquency prevention activities
should be directed to individual
nonfilers

The IRS Collection Division's Delinquency Prevention Program, established in 1978, monitors delinquent taxpayers to ensure that they remain current in filing their returns and paying their taxes.

The program's specific objectives are to (1) identify taxpayers who should be monitored, (2) find out why they are delinquent, (3) educate the taxpayers on their responsibilities under the tax law, and (4) ensure that they remain current.

The Delinquency Prevention Program is directed at business nonfilers and at businesses and individuals who are

About 33 percent of the 61 cases--the most extensive and costly--were subject to separate investigations by the district offices when only 1 joint investigation was needed. In 4 of the 61 cases, 1 spouse was unnecessarily investigated after a joint return was already secured from the other spouse. In 6 of the 23 cases where both spouses received only delinquency notices without securing returns, the investigations were insufficient. Combining the income on these cases would have met IRS' criteria for district office investigation and increased the chances for securing the returns. IRS investigated the six cases for us and secured returns in three.

In 3 of the 61 cases, the taxpayers had underreported their income. Two cases involved small amounts, but these amounts would have gone undetected if we had not consolidated the income information on both spouses. As shown in the following example, the unreported income in the third case was substantial.

--In two nonfiler cases made on a married couple, one on the joint entity (husband and wife) and one on the wife, IRS secured a 1975 joint return from the couple which involved a refund of about \$100. The nonfiler case on the wife was closed as not-required-to-file, because she filed the joint return with her husband. After comparing that return with IRS' nonfiler records on the couple, we found that it did not include over \$8,000 of the wife's wages. We referred the case to IRS, which assessed the the taxpayers an additional \$1,250 in taxes and \$475 in penalties.

Under current procedures, when developing a nonfiler case where IRS master file records show a joint filer, IRS initiates a case only on the primary taxpayer. Master file records on joint filers have one spouse listed as the primary taxpayer and the other spouse as the secondary taxpayer. Nonfiler cases on secondary taxpayers are initiated solely on information returns, and they are not matched with the master file to determine if the taxpayers are on another nonfiler's record.

Nonfiler cases on joint filers could be combined by matching all nonfiler cases with a tape of all secondary taxpayers who had filed the previous year. If both spouses are found to be nonfilers, either one case could be initiated for both taxpayers, or separate cases

Service center procedures do not specify that delinquent returns secured through the Taxpayer Delinquency Investigation Program be checked for unreported income. Instead the procedures merely state that employees should be alert for underreporting. Officials at four service centers said that delinquent returns are not checked for underreporting.

It is difficult for service center employees to check for unreported income, because they are not given complete income information to make an accurate verification. District office employees, however, are given detailed income information. When a delinquency investigation is forwarded to the district offices, a supplement is attached which lists all the income and income sources IRS has on the individual. The supplement contains information such as the employer's name, wages paid, and taxes withheld, as well as the amounts and sources of interest and dividend income.

Although a district office employee has income information to check for unreported income, the check can be made only if the taxpayer gives the return to the district employee instead of mailing it to the service center. We could not determine if any of the sample cases were checked by the district offices for unreported income.

Because of the sizable amount of income that is underreported on delinquent returns and the potential tax loss, IRS should implement a program to check for unreported income. One method would be to provide service center employees who process delinquent returns with the same income information given district office employees for their investigations. The service center employees could then manually check the returns for unreported income. Another method would be to automate the process by making a separate computer match of delinquent returns data with information returns data as is done to check for underreporting on timely filed returns.

CHANGES IN VARIOUS CASELOAD MANAGEMENT PRACTICES NEEDED

While improving the method for selecting nonfiler cases and strengthening the policies and procedures for investigating them will increase program effectiveness, changes in various caseload management practices are also needed. Specifically IRS should

- consolidate, for investigative purposes, the separate nonfiler cases made on husbands and wives;

IRS' failure to conduct full compliance checks also increases the nonfiler workload in subsequent years. This occurs because individuals identified in the current delinquent program who do not file subsequent year returns are likely to be picked up in the following year's delinquency program.

For example, about 24 percent of our 962 tax year 1975 sample cases were also identified as delinquent for the tax year 1976 program. IRS investigated 55 of these cases at our request and secured tax year 1976 returns in 44 percent of the cases.

IRS should require full compliance checks on all non-filer cases. Also, the delinquency notices should be reformulated to show the taxpayer's last return filed and to require the taxpayer to account for all delinquencies since the last return filed. These actions should increase the level of compliance and reduce the number of delinquencies in subsequent years.

Delinquent returns are not
checked for unreported income

Unlike returns filed timely in compliance with the law, delinquent returns secured through the Taxpayer Delinquency Investigation Program are seldom checked to determine if the taxpayers reported all their income. As a result, late filers are able to avoid the degree of income reporting scrutiny undergone by taxpayers who file timely.

We examined 456 tax year 1975 returns relating to our sample cases, including those IRS investigated for us. In 117 of those cases, the taxpayers underreported their income. Over \$104,000 in income was not reported for a potential tax loss to the Government of almost \$16,000.

have sufficient information to question whether taxpayers are required to file, because they do not know the source or the taxability of the income.

IRS should make available to service center employees the same income information provided to district employees. It also needs to instruct employees to properly verify all taxpayers' claims that their income is below the amount required for filing.

Nonfilers do not have to account
for all their delinquent tax returns

IRS does not always question nonfilers on whether they are delinquent for tax years other than the one under investigation. As a result, not all delinquent returns are secured. Moreover, because these individuals are likely to be delinquent in the next tax year, the nonfiler workload for that year is increased.

About 82 percent of the taxpayers in our sample nonfiler cases had not filed returns for at least 2 tax years. The table shows the number of taxpayers whose IRS records indicated they had not filed prior or subsequent tax returns at the time IRS issued delinquency notices for the 1975 tax year.

<u>Tax year(s) delinquent</u>	<u>Number of cases</u>	<u>Percent</u>
1975 only	170	18
1974 and 1975	67	7
1975 and 1976	348	36
1974, 1975, and 1976	<u>377</u>	<u>39</u>
Total	<u>962</u>	<u>100</u>

The Internal Revenue Manual states that collection personnel should make full compliance checks to ensure that taxpayers are current in their filing responsibilities, including periods prior and subsequent to the tax year under investigation. However, our sample of 962 nonfilers reveals that even though 39 percent of the taxpayers were delinquent for at least 3 tax years, IRS conducted few compliance checks.

We could not determine the total number of compliance checks conducted on our sample cases because IRS could not locate a number of pertinent documents. On the 416 of 962 sample cases where we could make a determination, IRS made only 52 compliance checks.

cases to be closed as not-required-to-file when the taxpayers are required--even though they may owe little or no taxes--is contrary to the program objective of securing delinquent returns.

Especially troublesome is IRS' policy which allows cases to be closed without contacting taxpayers to determine their filing requirements. IRS does not have any firm criteria for employing this policy. It can be applied to any nonfiler case at the discretion of the employee handling the case when the employee believes, on the basis of IRS records, that the taxpayer will owe little or no taxes. Yet, as shown in the following example, IRS cannot always determine whether the individuals are required to file or whether they owe taxes until the individuals are contacted.

--A nonfiler case was sent to a district office after the taxpayer failed to respond to four delinquency notices. The district office sent the taxpayer two letters requesting the delinquent return. After the taxpayer failed to respond to the letters, the case was closed as not-required-to-file on the basis that the taxpayer would most likely receive a refund. In investigating the case for us, IRS found the taxpayer was residing at the address on the delinquency notice and secured tax returns for 1973 through 1976, totaling over \$1,000 in taxes due.

Closing cases as not-required-to-file without contacting the taxpayer is poor tax administration policy, because the closures do not necessarily represent the true status of the individual's filing requirement. It does not foster full compliance.

Just as disturbing is IRS' policy which allows cases to be closed without securing the returns when the taxpayers claim they are due refunds. This happened in five of our sampled cases. In two of these cases, one of which is shown below, the taxpayers owed taxes.

--A nonfiler case was sent to the district office after the taxpayer failed to respond to four delinquency notices. The district office employee handling the case contacted the taxpayer at his residence which was the same address on the delinquency notices. The taxpayer, who had not filed either tax year 1975 or 1976 returns, stated he was due refunds for both years and would file the returns. The case was closed as

<u>Address source</u>	<u>Number of taxpayers located through source</u>	<u>Percent</u>
Delinquency notices	26	19
Information returns	22	16
Master computer file	32	24
Employer (identified through IRS sources)	13	10
Telephone book	10	7
Other (note a)	<u>32</u>	<u>24</u>
Total	<u>135</u>	<u>100</u>

a/Includes five cases where adequate information to determine the investigative procedures was not available.

Once an accurate address is found, the most effective way to secure a delinquent return is to visit the taxpayer's residence. Of the 135 nonfiler cases almost 50 percent were contacted through visits to the residences. How the taxpayers were contacted is shown below.

	<u>Number of cases</u>	<u>Percent</u>
Telephone call to residence	22	16
Visit to residence	64	48
Telephone call to employer	15	11
Visit to employer	12	9
Other, including visits to neighbors and relatives (note a)	<u>22</u>	<u>16</u>
Total	<u>135</u>	<u>100</u>

a/Includes five cases where adequate information to determine the investigative procedures was not available.

IRS did not use the taxpayer's most recent address from the master file in preparing the delinquency notices for the tax year 1975 Taxpayer Delinquency Investigation Program. Instead, IRS used the address from the last tax return filed prior to 1975. In some of our sample cases the addresses came from returns as old as tax year 1966. Consequently, any new addresses from returns filed for tax years after 1975 were not made available to IRS employees working the nonfiler cases.

Nonfiler cases subject to further investigation are generally forwarded to the district offices if the taxpayers do not respond to the notices. If such cases meet certain low and medium income criteria in the IRS Law Enforcement Manual, they can be closed as unable-to-locate when (1) mail is returned as undeliverable, (2) a telephone number cannot be found for the taxpayer, and (3) a new address cannot be found for the taxpayer after researching IRS' computer files. IRS procedures suggest, but do not require, further efforts to locate the taxpayer, such as a visit to the taxpayer's former address. Of our 962 sample cases, 135 met the criteria for limited investigation and were closed as unable-to-locate.

We had IRS investigate 308 of the 349 nonfiler cases (182 notice-only cases, and 126 limited investigation cases) closed as unable-to-locate. IRS was able to locate 50 percent of the nonfilers in the 273 cases it finished investigating for us when our review ended. The results of the investigated cases follow.

	<u>Number of Cases</u>	<u>Percent</u>
Returns secured	87	32
Individuals required to file but returns not secured	27	10
Individuals not required to file	21	8
Individuals not located	<u>138</u>	<u>50</u>
Total	<u>273</u>	<u>100</u>

In 87 cases, IRS secured 203 returns involving taxes owed of \$72,144 and refunds due of \$30,721. At \$46 a case, the cost to investigate the 273 cases, which included making various telephone calls and visits to the individual's residence and employer, was about \$12,558.

The following examples show that, at times, doing thorough investigations can easily result in securing delinquent returns.

--A service center closed a case as unable-to-locate after the taxpayer failed to respond to four delinquency notices. In investigating the case for us, IRS visited the address on the delinquency notice and contacted the taxpayer. IRS then secured delinquent returns for tax years 1974 through

Comparing these results with IRS' initial results shows that thorough investigations can substantially increase the number of cases successfully closed--446 to 661--and the level of program effectiveness--46 to 69 percent.

Thorough investigations also increase program costs. For example, the cost to thoroughly investigate the 389 cases was about \$18,000. This estimate is based on IRS data which shows that the average cost of closing a non-filer case at the district office is at least \$46. ^{1/} The increased cost, however, is offset by the additional taxes assessed, not to mention the additional nonfilers brought into compliance. In the 137 investigated cases where returns were secured, the taxpayers owed a total of over \$56,000 more in taxes than they were due in refunds. When compared to the cost of investigating the 389 cases the ratio (net yield to total cost) of more thoroughly investigating nonfilers is about 3 to 1.

On the basis of our sample results, we estimate that because IRS did not thoroughly investigate about 56,000 nonfiler cases in the seven district offices, it did not secure 25,000 returns involving \$15.8 million in taxes owed and \$7.7 million in refunds. The following table shows the detailed benefit/cost results of the 137 cases involving secured returns and our projections to the seven district offices.

^{1/}On the basis of data given us on the cases IRS investigated for us, the revenue officers spent an average of 2.5 hours on the cases. The average hourly wage rate for revenue officers is \$12.35; therefore, the cost to investigate the 389 cases was about \$12,000. Because we researched the cases before IRS investigated them, we will use \$46 as the average cost to thoroughly investigate nonfiler cases.

RESTRICTIVE INVESTIGATIVE POLICIES
AND PROCEDURES WEAKEN THE TAXPAYER
DELINQUENCY INVESTIGATION PROGRAM

Due to limited resources, IRS intentionally employs policies and procedures which restrict the extent nonfilers have to be investigated under the Taxpayer Delinquency Investigation Program. Thus, limited effort is made to contact nonfilers that IRS has selected for investigation and to secure their delinquent returns. Moreover, IRS lacks procedures for ensuring that detected nonfilers, once caught, file all their delinquent returns and for checking delinquent returns for unreported income. As a result, the Taxpayer Delinquency Investigation Program is not as effective as it could be.

More thorough investigation could
yield more delinquent returns

The objective of the Taxpayer Delinquency Investigation Program is to secure delinquent returns from those nonfilers it investigates. But we found that IRS secures relatively few because its policies and procedures limit the amount of investigation performed to secure the returns.

To determine how effective the Taxpayer Delinquency Investigation Program was, we reviewed 962 cases 1/ randomly selected from 160,214 nonfiler cases IRS investigated for tax year 1975 in the geographic area covered by seven district offices. (See app. IV.) These cases were part of about 1.3 million nonfiler cases IRS selected for investigation nationwide for that year. We analyzed the cases and developed a measure of program effectiveness based on successful closure of the cases. 2/

As shown below, IRS successfully closed 46 percent of the sample cases. Unsuccessful closures resulted from IRS doing

1/We actually sampled 1,120 cases, but IRS had not closed 158 cases. We did not include the open cases in our measure of program effectiveness even though IRS was not actively investigating them. Also, our sample cases did not include any cases which IRS selected for investigation because the individuals had either a credit balance or an expired extension.

2/We classified some nonfiler cases as successfully closed, even though returns were not secured, when IRS was at least able to clarify or correct its records as to the person's filing status.

with nonwage income over \$2,000 in tax year 1975 were not selected for investigation. Over 98,000 individuals had nonwage income over \$4,000.

--IRS selection criteria is biased toward selecting individuals with potential tax liabilities; so many low-income individuals due refunds are not pursued. We estimate that about 1.4 million individuals who had tax withholdings totaling \$169 million were not selected for investigation. There were probably many individuals not pursued who were also entitled to the earned income credit, but we were not able to estimate how many.

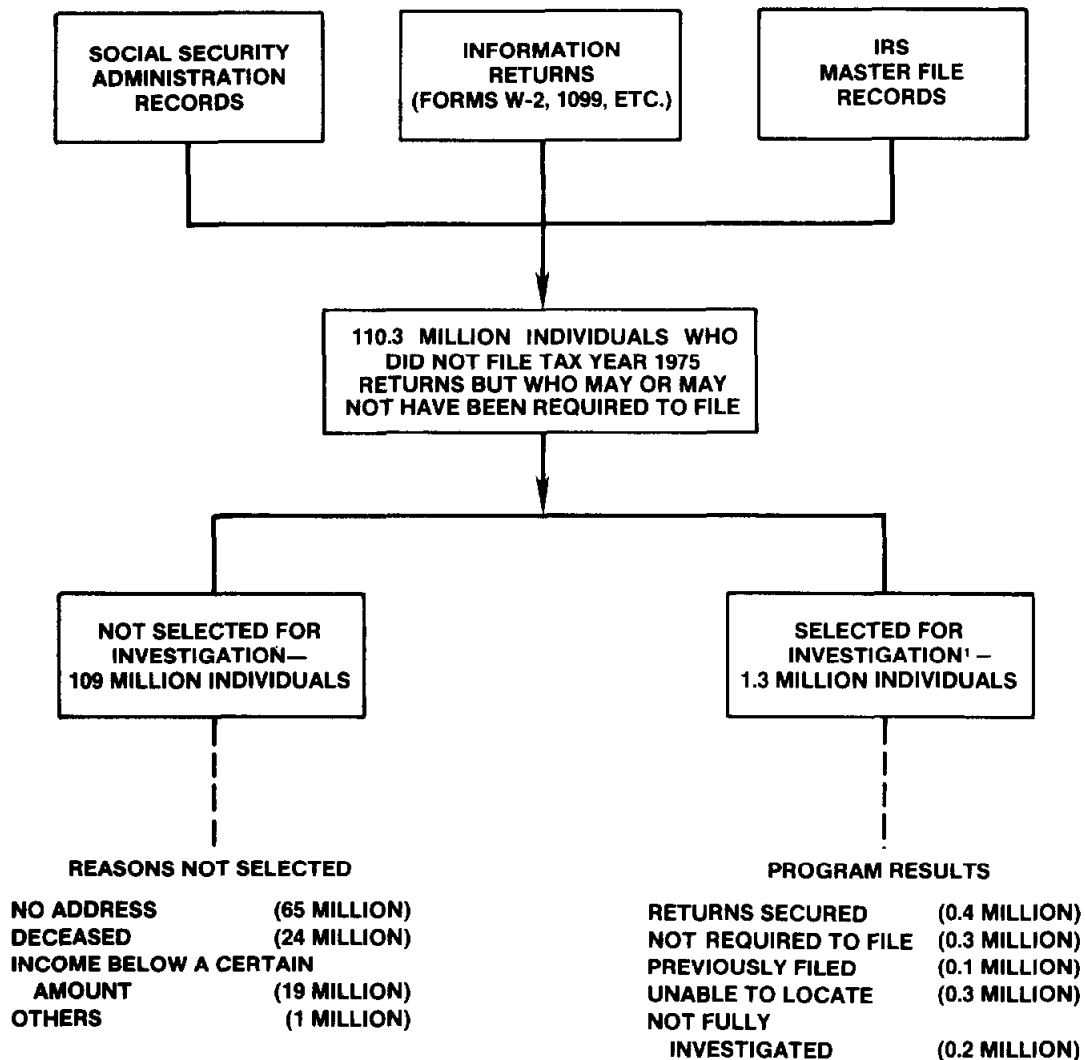
IRS needs to adopt a better method for selecting persons for investigation so that resources are used to pursue individuals who are actually required to file but have not done so. Because IRS has incomplete income data on many people and cannot always determine a person's requirement to file, the case selection method should be such that it can identify nonfilers who do not appear to have to file based solely on IRS' data sources.

Predictive modeling should be used to
select nonfiler cases for investigation

A predictive model can provide IRS a higher degree of probability that the individuals it selects to investigate are indeed required to file returns. Such a model can be developed using discriminant analysis, a statistical technique used to identify characteristics which differentiate certain cases from others. IRS already uses this technique to score individual tax returns for audit potential.

To determine the applicability of the model to the nonfiler problem, we applied this technique to a random sample of 1,120 of 160,214 nonfiler cases IRS selected for investigation in the geographic areas covered by seven district offices. These cases were part of about 1.3 million tax year 1975 nonfiler cases IRS selected under its Taxpayer Delinquency Investigation Program. From this sample, we developed a model to predict which of the sampled individuals were actually required to file. Using various nonfiler characteristics, such as type and amount of income, filing status and filing history, a score was assigned to each nonfiler case. The higher the score, the more likely the individual was to be actually required to file.

HOW IRS DETECTS NONFILERS (TAX YEAR 1975)



*Selected because (a) 1975 income was above a certain amount, (b) a combination of 1975 income and income on 1974 return was above a certain amount, (c) individual had a credit balance for tax year 1975 but had not filed, or (d) individual had received an extension to file for tax year 1975, but the extension had expired.

CHAPTER 3

IRS NEEDS TO BETTER INVESTIGATE

NONFILERS UNDER ITS TAXPAYER

DELINQUENCY INVESTIGATION PROGRAM

The Taxpayer Delinquency Investigation Program--IRS' principal means of dealing with nonfilers--could be improved. Because of limited resources, IRS' method for selecting and its policies and procedures for investigating potential nonfilers intentionally limit the extent to which they are pursued. As a result, many people who should be investigated are not. Moreover, delinquent tax returns are often not obtained from people who are investigated because they either (1) are not required to file, (2) cannot be located, or (3) are located but still fail to file a return.

Because of the large number of nonfilers and the adverse effect they could have on voluntary compliance, IRS needs to make the Taxpayer Delinquency Investigation Program more effective. It can do this by

- developing a predictive model which would direct investigative resources at those individuals who have a high likelihood of being required to file,
- strengthening investigative policies and procedures so that all individuals selected are thoroughly investigated, and
- making various other improvements in its caseload management practices.

IRS asserts that more resources are needed to improve its effectiveness in catching nonfilers because resource constraints limit the number of nonfilers which it can thoroughly investigate. We agree that more resources would allow IRS to investigate more nonfilers. However, improvements in the program are also needed to increase program effectiveness.

also provide IRS a basis for assessing its progress in reducing the delinquency gap and for determining future actions.

Although periodically estimating the nonfiler population and gathering the necessary operational data may be costly (we could not determine the cost), IRS cannot systematically attack the problem of nonfiler compliance without such information.

CONCLUSIONS

About 5 million people with tax liabilities of about \$2 billion failed to file tax year 1972 income tax returns. This delinquency gap represents a serious tax administration problem for IRS, yet IRS has not emphasized pursuing nonfilers because of limited resources. Also, the nature and characteristics of nonfilers are such that they are difficult to detect.

IRS needs to give more attention to reducing the delinquency gap. This necessarily requires estimating and analyzing the nonfiler population. This may not be an easy task and will require some additional costs. However, IRS already has data sources available from which it can develop an estimate and obtain the operational information necessary for detecting and pursuing nonfilers.

By getting a clearer picture of the size and characteristics of the nonfiler population, IRS should be able to better address some of the specific problems in its Taxpayer Delinquency Investigation Program. These problems, along with our recommendations for improvement, are discussed in chapter 3. In addition, a better understanding of the nonfiler population should help IRS to determine to what extent measures other than the Taxpayer Delinquency Investigation Program can be used to reduce the delinquency gap. Some of these measures, including tax law changes for encouraging people to file timely, are discussed in chapter 4.

RECOMMENDATION TO THE COMMISSIONER OF INTERNAL REVENUE

We recommend that the Commissioner initiate action to periodically estimate the size and analyze the characteristics of the nonfiler population. Such estimates should include gathering the operational information necessary to determine the best methods for detecting and pursuing nonfilers and for increasing compliance with the filing requirements.

IRS NEEDS TO PERIODICALLY ESTIMATE
AND ANALYZE THE NONFILER POPULATION

For operational purposes IRS needs data which more fully shows, for a particular time period, the number and identity of nonfilers. It also needs, for planning and resource management purposes, information on the reasons for failure to file and the actions required to get people to comply with the filing requirements.

Better operational data is especially important because, as discussed in chapter 3, IRS' methods for pursuing nonfilers have not been as effective as they could be. Although IRS recognizes the importance of assessing the nonfiler population, it has not done much in this regard.

In view of the size of the nonfiler population--about 5 million people--and its potential adverse impact on the voluntary compliance concept, IRS should pay more attention to reducing the delinquency gap. We recognize this is no easy task. Nonfilers are difficult to detect because of their elusive nature and because IRS does not have complete information on all of them. IRS can do a better job of closing the gap, however, by better using data it already has available to estimate and analyze the nonfiler population.

IRS has not done much to estimate
the nonfiler population

IRS has made some attempts to determine the best way to measure the nonfiler population but has not found an acceptable way. In 1976, IRS examined various ways to estimate the population. These included (1) contacting all individuals in selected geographic areas to determine if they filed, (2) selecting individuals for investigation from commercially prepared lists, such as mailing lists, and (3) matching Social Security Administration and other Government records with IRS records. IRS rejected these methods because they were either too costly or too difficult.

AGE

**PERCENT OF NONFILER
AND FILER POPULATION**

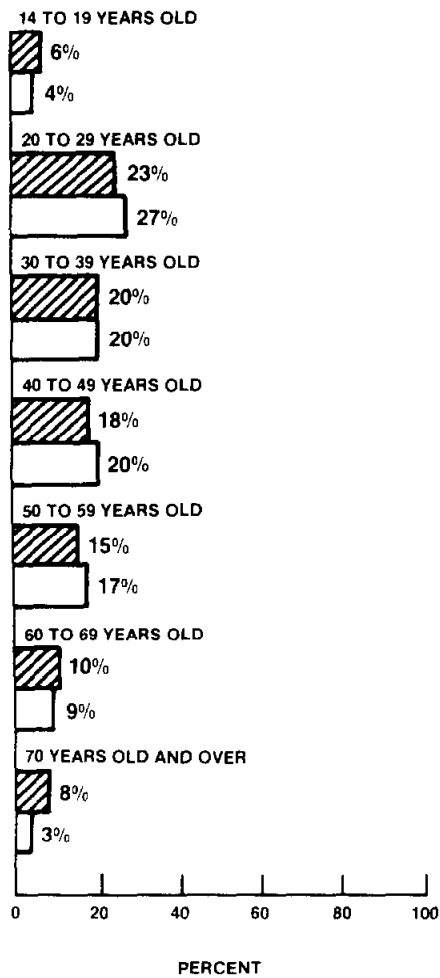


CHART 15

**PERCENT OF SOCIO-
ECONOMIC CATEGORY**

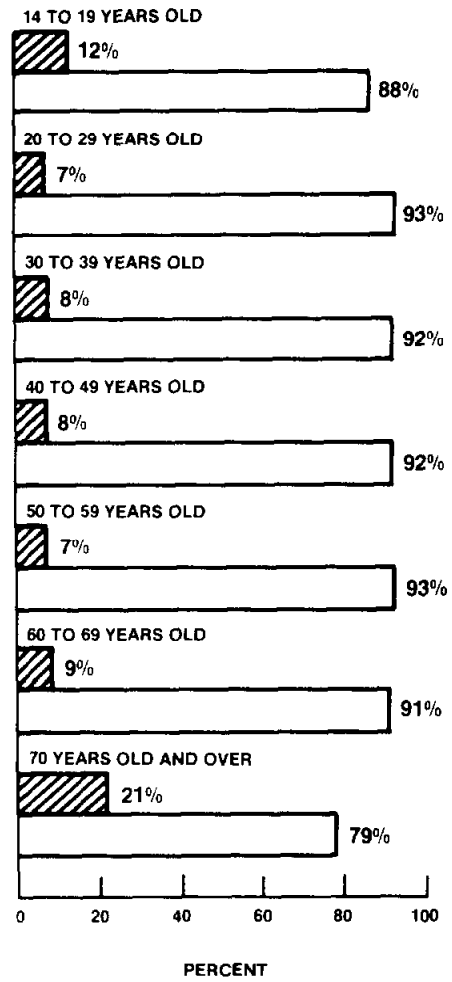


CHART 16

OCCUPATIONS—SELF-EMPLOYED (NONAGRICULTURAL)

PERCENT OF NONFILER
AND FILER POPULATION

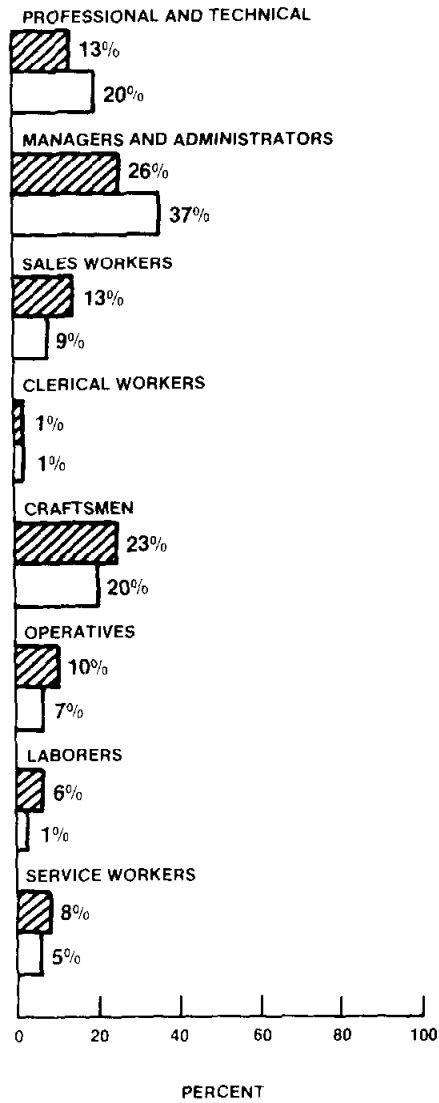


CHART 11

PERCENT OF SOCIO-
ECONOMIC CATEGORY

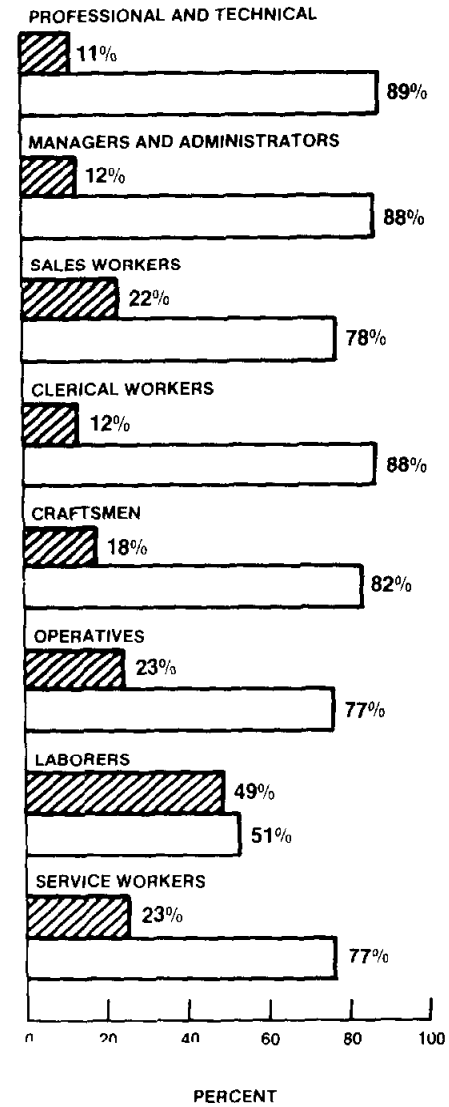


CHART 12

SELECTED OCCUPATIONS

**PERCENT OF NONFILER
AND FILER POPULATION**

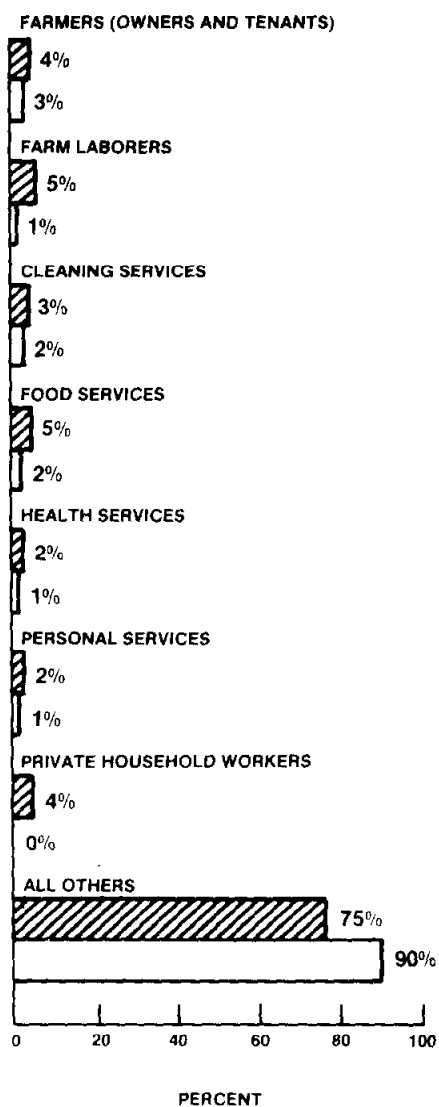


CHART 7

**PERCENT OF SOCIO-
ECONOMIC CATEGORY**

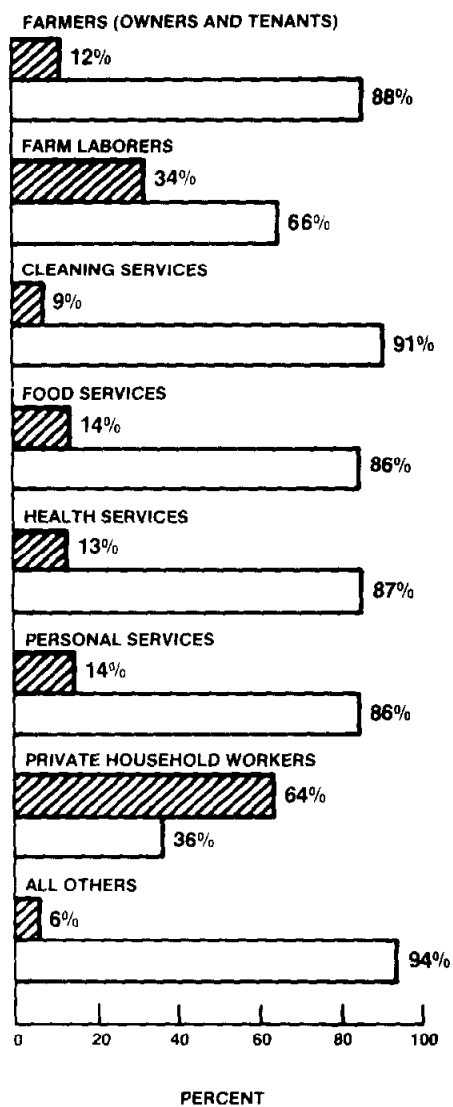


CHART 8

CHARACTERISTIC DIFFERENCES BETWEEN FILERS AND NONFILERS (TAX YEAR 1972)

NONFILERS



PERCENT OF NONFILER
AND FILER POPULATION

FILERS



PERCENT OF SOCIO-
ECONOMIC CATEGORY

YEARS OF SCHOOL COMPLETED

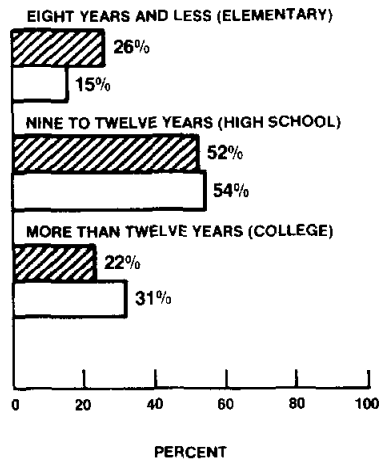


CHART 1

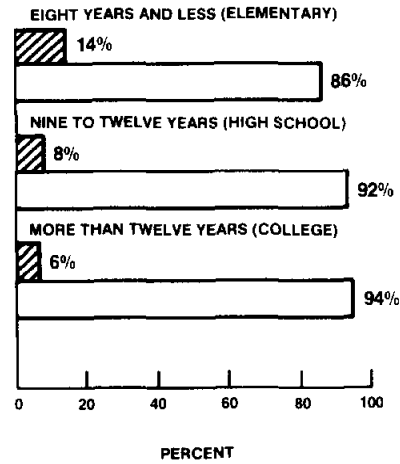


CHART 2

INCOME RANGE

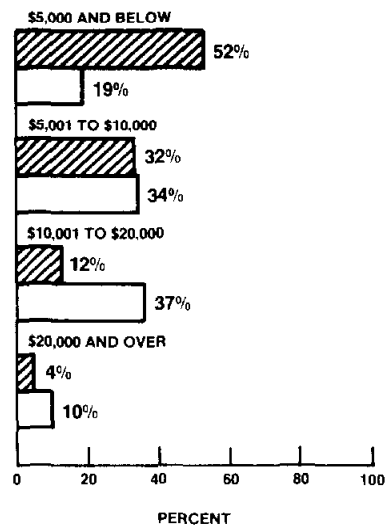


CHART 3

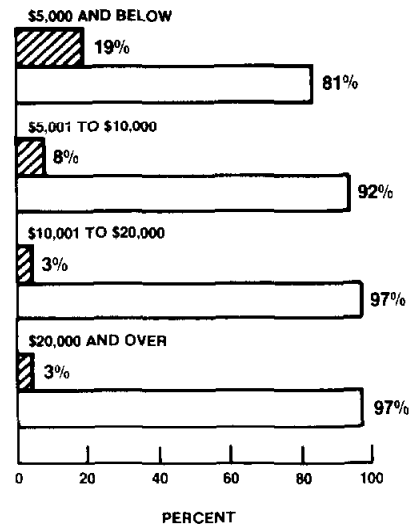


CHART 4

profile of those unlikely to file and reasons for not filing. The charts on pages 10 through 17 compare by population and socioeconomic category the characteristics of nonfilers with those of filers. For example:

- About 26 percent of the approximately 5 million nonfiler population in 1972 had 8 years or less of schooling compared with 15 percent of the approximately 63 million filer population. (See chart 1.) Moreover, as the education level increased, the nonfiler percentage decreased. For example, only about 6 percent of those required to file who had more than a high school education were nonfilers, whereas about 14 percent of those who had 8 years or less of schooling were nonfilers (See chart 2.) The reason for this could be that people with little education may find the tax laws too complicated and, thus, may not be aware of their filing responsibilities.
- About 52 percent of the nonfilers had income of \$5,000 or below whereas only about 19 percent of the filers had income in this range. (See chart 3.) Similar to education levels, as a person's income increases, the more likely the person is to file. For example, only about 3 percent of those persons earning over \$10,000 were nonfilers, while about 19 percent of those earning \$5,000 or less were nonfilers. (See chart 4.) The low-income nonfilers may not have realized that their income was sufficient for filing even though the amount required for filing tax year 1972 returns was only \$2,050 and \$2,800 for single individuals and married couples filing jointly, respectively.
- Laborers and service workers make up about 33 percent of the nonfiler population, whereas they represent about 18 percent of the filer population. (See chart 5.) Overall, 13 percent of the laborers and service workers required to file were nonfilers. (See chart 6.) Some categories of laborers and service workers had particularly high nonfiling rates. For example, about 33 percent of all farm laborers and about 64 percent of all private household workers were nonfilers. (See chart 8.) About 68 percent of all laborers and service workers who did not file for tax year 1972 made \$5,000 or less, whereas the majority of the nonfilers in all other occupations made over \$5,000.

this amount, but we were unable to test its assumptions. However, that portion of the \$2 billion in estimated taxes owed in 1972 which involved withholdings could have been offset by taxes owed on certain types of income we did not consider in our estimate, such as capital gains and income from illegal sources.

Our estimate of the nonfiler population is based on information from the Social Security Administration's Exact Match File which was developed to learn more about income distribution and redistribution in the United States. The file contains employment, income, tax filing, and demographic data for a sample of over 100,000 United States residents. We used the Exact Match File for tax year 1972 because IRS had not developed an estimate and it was the most current and best data base readily available at the time. Appendix II explains in detail how we developed our estimates.

Our estimate of about 5 million nonfilers represents a "delinquency gap," or the difference between those people who were required to file returns and those who filed. ^{1/} As shown in the chart on page 7, the delinquency gap for tax year 1972 was about 8 percent of the 68 million people who were required to file that year. IRS was able to reduce part of the gap through its collection activities; however, it only secured delinquent returns from about 600,000 or 12 percent of the estimated 5 million nonfilers.

Concurring with our methodology for deriving non-filer population estimates, IRS is using the data we compiled in its study of the subterranean economy.

WHO ARE THE NONFILERS?

Knowing the makeup of the nonfiler population is essential to effectively plan and allocate resources for reducing the delinquency gap. Although IRS does not know the identity of many nonfilers, data from the Exact Match File provides a socioeconomic picture of the nonfiler population, which permits a comparison of characteristics with those of the filer population.

The characteristics of filers and nonfilers are generally similar. Several differences, however, may reveal a

^{1/}Although many people filed tax returns who had income below the filing requirement, our estimate of the delinquency gap includes only those who were technically required to file.

IRS' Examination Division sometimes secures delinquent returns for 1 or more years while auditing other years. The Collection Division also refers certain nonfiler cases to Examination. During fiscal year 1978, the Examination Division secured 31,946 delinquent individual returns from 14,965 taxpayers for additional taxes and penalties of about \$102 million. Figures on the cost of the Examination Division's efforts in the nonfiler area were not available.

for nonfiling and ways to prevent it. The division has implemented two major programs to detect and find nonfilers--the Taxpayer Delinquency Investigation Program and the Returns Compliance Program. Although it is not their primary responsibility, other IRS divisions also identify some nonfilers in carrying out their activities.

Taxpayer Delinquency Investigation Program

The Taxpayer Delinquency Investigation Program, IRS' primary nonfiler program, covers both individual and business nonfilers. The objective of the individual nonfiler program is to secure delinquent returns and get individuals to comply with the filing requirements. According to IRS officials, in fiscal year 1978, IRS spent about \$15 million to investigate 1.3 million individuals who did not file tax year 1975 income tax returns. The investigations resulted in securing 711,000 delinquent returns from 443,740 delinquency cases. Additional tax assessments, including interest and penalties, of \$425 million were made, and refunds and interest totaling \$226 million were paid.

IRS identifies nonfilers annually by either checking (1) information returns, such as wage statements (form W-2) submitted by employers and interest statements (form 1099) submitted by financial institutions or (2) its master file for individuals who did not file in the tax year under investigation but had filed the previous year. The nonfiler cases are screened and many are not selected for investigation because of incomplete taxpayer information or indication of insufficient tax liability. Those selected are generally not investigated until approximately 15 months after the April 15 filing deadline because of the amount of time required to process information returns.

The pursuit of a nonfiler routinely begins at 1 of IRS' 10 service centers which sends up to 4 delinquency notices to the taxpayer over a 14-week period. If the case is not resolved by the service center through the notice process, it is usually forwarded to the district office having jurisdiction for investigation. The district office may then personally contact the taxpayer through telephone calls, letters, or visits to the taxpayer's residence.

Returns Compliance Program

The Returns Compliance Program is designed to identify taxpayers who are not on IRS' master files for

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ABBREVIATIONS

GAO	General Accounting Office
IRS	Internal Revenue Service

in refunds. The Congress should request IRS to provide it with a series of alternatives. (See p. 70.)

IRS COMMENTS

IRS agrees with the substance of many of GAO's recommendations and will implement the recommendations to the extent practical. It stated, however, that its present nonfiler program is cost beneficial and that due to limited resources, it can thoroughly investigate only the more productive nonfiler cases. IRS also emphasized that because of its limited resources, devoting additional resources to detecting and investigating nonfilers would reduce other enforcement programs, such as audit and collection.

IRS selects nonfiler cases on the basis of a predetermined tax liability and not on whether the persons are likely to be required to file. It believes that such cases will have a high tax yield.

GAO agrees that IRS' nonfiler program is productive in terms of taxes, penalties, and interest assessed against those caught. However, IRS still selects many persons who are not required to file and does not secure returns from many because it fails to investigate them thoroughly. Furthermore, many persons from whom IRS secured returns had shown some intent to file even before IRS investigated them as nonfilers.

IRS could be more effective in reducing the delinquency gap and fostering compliance with the filing requirements if it more systematically selected for investigation nonfilers who are most likely required to file and thoroughly investigated those persons.

IRS stated that the amount of enforcement resources it allocates to detecting nonfilers must be weighed against and balanced with its declining audit coverage and its increasing accounts receivable inventory.

IRS ACTIONS OUTSIDE THE TAXPAYER
DELINQUENCY INVESTIGATION PROGRAM
CAN HELP REDUCE THE DELINQUENCY GAP

Once IRS has estimated the nonfiler population and analyzed its characteristics, it will be in a better position to take other actions to complement its Taxpayer Delinquency Investigation Program and develop a balanced attack on the nonfiler problem.

For example, the characteristics of the approximately 5 million nonfilers estimated by GAO for tax year 1972 indicate that Returns Compliance Programs might be aimed at

- industries, such as retail trade, services, and construction; and
- occupations, such as managers, craftsmen, and sales workers.

IRS' only active program to date is directed at some self-employed professionals who make up less than 1 percent of GAO's estimated nonfiler population. (See pp. 59 to 61.)

Using State tax-related data on Federal nonfilers would also help IRS identify nonfilers that are not easily detected through its Taxpayer Delinquency Investigation Program. GAO noted this in a May 1978 report (GGD-78-23).

Yet, IRS still has not seriously explored the feasibility of using State data to identify potential Federal income tax nonfilers. Only one of six States reviewed by GAO provided such information to IRS; even then, IRS was not adequately processing or using the information. (See pp. 61 to 63.)

because of insufficient information or because they were deceased. The other 19 million were not selected because they had low income with little or no potential tax liability.

Overall GAO estimates that about 2 million of the 109 million people not selected for investigation had sufficient income to be technically required to file. GAO's analysis of the 19 million low-income people not selected for investigation shows that IRS selection criteria excluded about 700,000 persons who were required to file but did not. (See pp. 23 to 26.)

A better way for IRS to select potential nonfilers for investigation and use its resources is to develop a model assuring, with a high degree of probability, that individuals selected for investigation are indeed required to file returns.

GAO developed a model which predicts, with about 83 percent certainty, potential nonfilers most likely to be required or not required to file. Using GAO's example, IRS should create a similar model for nationwide use. (See pp. 26 and 27.)

Because resources are limited, IRS policies and procedures for investigating potential nonfilers intentionally limit the extent to which they are pursued. Moreover, IRS procedures do not ensure that nonfilers, once caught, will file all their delinquent tax returns; nor do the procedures require that delinquent returns be checked to identify unreported income.

GAO reviewed 962 randomly selected cases in 7 district offices from IRS' Taxpayer Delinquency Investigation Program for tax year 1975. About 46 percent of the cases were closed successfully either because IRS had secured delinquent returns or because the individuals were not required to file or had filed previously. Generally the unsuccessful

differences help explain their identity and the reasons they do not comply.

--About 26 percent had 8 years of schooling or less; they may have found the tax laws too complicated to understand that returns should be filed.

--About 17 percent of the nonfilers are self-employed individuals whose business income is not reported to IRS; they may have less incentive to file since IRS has no record of their earnings.

Occupations with the highest nonfiling rates were

--laborers (about 17 percent),

--service workers (about 16 percent),

--craftsmen (about 13 percent), and

--clerical workers (about 13 percent).
(See pp. 6 to 17 and app. III.)

To determine the number and identity of these nonfilers, their reasons for not filing, and the action needed to promote compliance with the laws, IRS needs to estimate the nonfiler population and analyze its characteristics. Without such information IRS is not in a position to determine the best way to reduce the delinquency gap or the best use of its nonfiler resources.

IRS has certain data, such as information returns, Social Security Administration records, and its own master file records, from which periodic estimates of the nonfiler population and its characteristics could be made. This could provide the operational data needed to attack the nonfiler problem systematically. (See pp. 18 to 20.)

