

February 2004

TAX
ADMINISTRATION

IRS Issued Advance
Child Tax Credit
Payments on Time but
Should Study Lessons
Learned



G A O

Accountability * Integrity * Reliability



Highlights of [GAO-04-372](#), a report to the Chairman and Ranking Minority Member, Committee on Finance, United States Senate

Why GAO Did This Study

The Jobs and Growth Tax Relief Reconciliation Act of 2003 provided eligible taxpayers up to \$400 in advance Child Tax Credit (ACTC) payments. GAO was asked for information on (1) the number, dollar amount, and timeliness of the ACTC payments, (2) the impact on the Internal Revenue Service's (IRS's) toll-free telephone service, (3) the cost to IRS and the Financial Management Service (FMS) for implementing the advance payment effort, including the impact of these costs on other IRS programs, and (4) the extent to which IRS identified and used evaluations from the 2001 advance refund effort to implement the ACTC payment effort and whether an evaluation of the ACTC payment effort is planned.

What GAO Recommends

GAO recommends the Commissioner of Internal Revenue conduct a modestly scaled "lessons learned" evaluation of the ACTC payment effort similar to the one conducted for the 2001 advance refund effort.

TAX ADMINISTRATION

IRS Issued Advance Child Tax Credit Payments on Time but Should Study Lessons Learned

What GAO Found

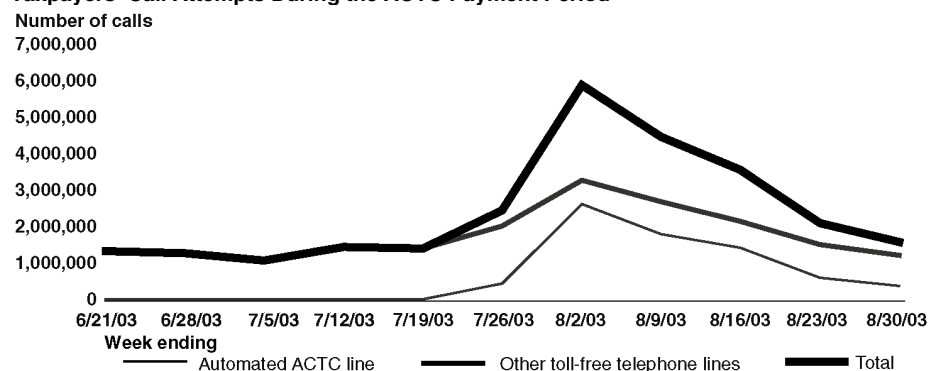
Between July and December 2003, IRS, through FMS, issued over \$14 billion in ACTC payments to more than 25 million taxpayers. IRS was able to issue the checks on schedule over a 15-day period ending August 8, 2003, to taxpayers who had filed by April 15, 2003. Other taxpayers received their checks later.

The ACTC had an impact on IRS's toll-free telephone assistance service. Between late July, when the first notices of the advance payments were sent to taxpayers, and the middle of August, by which time the majority of notices had been sent, IRS experienced both a marked increase in the number of telephone call attempts from taxpayers and a corresponding decline in taxpayers' success in reaching an IRS assistor. IRS's strategy for dealing with the expected increase in taxpayer inquiries may have mitigated the impact of the ACTC payment effort on IRS's toll-free telephone service.

According to IRS and FMS officials, implementing the ACTC payment effort cost about \$32 million, nearly all incurred by IRS. In order to accomplish this mandate, IRS used funds earmarked for other programs. As a result, some of these programs, for example improvements to IRS's computer servers, were delayed slightly.

IRS officials said they identified and used "lessons learned" from the evaluations of the 2001 advance refund effort done by GAO and the Treasury Inspector General for Tax Administration, and their own internal evaluation. With the exception of the telephone service, IRS officials believe the implementation of the ACTC has gone more smoothly because they used the lessons learned. Although IRS officials acknowledged the usefulness of the lessons learned evaluation, IRS had not committed to a similar evaluation of the ACTC effort at the time of our review.

Taxpayers' Call Attempts During the ACTC Payment Period



Source: IRS.

www.gao.gov/cgi-bin/getrpt?GAO-04-372

To view the full product, including the scope and methodology, click on the link above. For more information, contact James White at (202) 512-9110 or whitej@gao.gov.

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

February 17, 2004

The Honorable Charles E. Grassley
Chairman
The Honorable Max Baucus
Ranking Minority Member
Committee on Finance
United States Senate

In recent years, Congress has twice authorized the issuance of advance tax refund payments to provide taxpayers immediate tax relief before they actually file their returns. Congress used this approach with the Economic Growth and Tax Relief Reconciliation Act of 2001,¹ when it required the Internal Revenue Service (IRS) to issue taxpayers advance refunds. Congress repeated this approach in 2003 when it passed the Jobs and Growth Tax Relief Reconciliation Act of 2003² (the act), which, among other things, increased the upper limit of the Child Tax Credit from \$600 to \$1,000 per child in the years 2003 and 2004. The act authorized IRS to send taxpayers a check in the amount of the increase as a partial advance payment of their 2003 Child Tax Credit. For eligible taxpayers who filed their 2002 tax returns by April 15, 2003, the advance payment checks were to be sent out by August 8, 2003. Taxpayers who filed an extension on their 2002 tax returns could expect their advance payment checks 4 to 6 weeks after the IRS received their 2002 tax return.

The 2001 advance refund effort generally went smoothly, but was not problem free, so you asked us to provide information on IRS's efforts to implement the advance Child Tax Credit (ACTC) payments. Specifically, you asked us for information on (1) the number, dollar amount, and timeliness of the advance payments, (2) the impact of the ACTC payments on IRS's toll-free telephone operations, (3) the cost to IRS and the Financial Management Service³ (FMS) for implementing the ACTC payment effort, including the impact of these costs on other IRS programs, and (4) the

¹Pub. L. No. 107-16 (June 7, 2001).

²Pub .L. No. 108-27 (May 28, 2003).

³FMS is the federal agency responsible for providing central payment services to federal program agencies, operating the federal government's collections and deposit systems, providing governmentwide accounting and reporting services, and managing the collection of delinquent debt.

extent to which IRS identified and used evaluations from the 2001 advance refund effort to implement the ACTC payment effort, and whether an evaluation of the ACTC payment effort is planned.

The information we report on the ACTC payment effort is based on discussions with IRS and FMS officials; analyses of data on the volume and timing of ACTC payments, on call volume, on taxpayers' success in reaching an IRS telephone assistor, and on IRS's implementation costs; and a review of IRS's use of the "lessons learned" from the 2001 advance refund effort. Our scope and methodology is discussed in greater detail in appendix I. We conducted fieldwork between September 2003 and November 2003 in accordance with generally accepted government auditing standards.

Results In Brief

Between July and December 2003, IRS, through FMS, issued over \$14 billion in ACTC payments to more than 25 million taxpayers.⁴ Over a 15-day period ending August 8, 2003, IRS and FMS were able to issue checks on schedule to all taxpayers who filed their 2002 tax returns by April 15, 2003. For taxpayers who filed after April 15 but before mid-November, IRS issued checks through December 31.

However, the ACTC payment effort had an impact on IRS's toll-free telephone service. Between late July and early August, when notices of ACTC payments were sent to taxpayers, IRS experienced both a marked increase in the number of telephone call attempts from taxpayers and a corresponding decline in taxpayers' success in reaching an IRS assistor. IRS's strategy for dealing with the expected increase in taxpayer inquiries was to (1) direct as many telephone inquiries as possible to automated messages and (2) encourage taxpayers to use its Web site for information and payment status. This strategy may have mitigated the impact of the ACTC payment effort on IRS's toll-free telephone service.

IRS and FMS officials told us they spent about \$32 million to implement the ACTC payment effort, of which 98 percent was incurred by IRS.⁵ In order to accomplish this mandate, IRS used funds earmarked for other programs.

⁴Two taxpayers who filed a joint return are considered one taxpayer for this discussion because they would have been sent one check.

⁵The reliability of this estimate is discussed in a later section.

As a result, some of these programs, for example improvements to IRS's computer servers, were slightly delayed.

IRS identified and used "lessons learned" from program evaluations of its 2001 advance refund effort by us⁶ and the Treasury Inspector General for Tax Administration (TIGTA)⁷ as well as its own internal evaluation.⁸ With the exception of the telephone service, IRS encountered few problems in issuing the ACTC payment checks. IRS officials believe the implementation of the ACTC has gone more smoothly, in part, because they used both the positive and negative lessons learned from its 2001 advance refund effort. Although acknowledging the usefulness of the lessons learned from the 2001 advance refund effort in implementing the ACTC payment effort, IRS officials were not planning a similar evaluation of the ACTC effort at the time we completed our work.

Because the evaluations of the 2001 advance refund effort contributed to the smooth implementation of the ACTC payment effort, we recommend that the IRS Commissioner conduct a modestly scaled "lessons learned" evaluation of the ACTC payment effort similar to the one conducted for the 2001 advance refund effort.

Background

The act increased the upper limit of the Child Tax Credit from \$600 to \$1,000 per child for 2003 and 2004. The act included a schedule that detailed the amount of the Child Tax Credit from 2003 until 2010. Under current law, the credit will remain at \$1,000 in 2004, decrease to \$700 for 2005 through 2008, and will increase to \$800 in 2009 and to \$1,000 in 2010. The ACTC payment was included in the President's fiscal year 2004 budget proposal, which was submitted to Congress on February 3, 2003.

⁶U.S. General Accounting Office, *Tax Administration: Advance Tax Refund Program Was a Major Accomplishment, But Not Problem Free*, [GAO-02-827](#) (Washington, D.C.: Aug. 2, 2002).

⁷Treasury Inspector General for Tax Administration, *Advance Refunds Were Accurately Calculated and Issued to Eligible Taxpayers, But Some Undelivered Refunds Were Unnecessarily Delayed*, 2002-40-116 (Washington, D.C.: June 2002).

⁸Internal Revenue Service, *Lessons Learned from the IRS Implementation of the Advance Tax Refund and Tax Rate Reduction Credit Legislation*, Project Report 3-02-19-2-018 (Washington, D.C.: January 2003).

To be eligible for the ACTC payment in 2003, taxpayers generally had to have (1) claimed the Child Tax Credit on their 2002 tax return and (2) a child born after 1986. The maximum ACTC payment amount was \$400 per child.

IRS has 25 telephone call centers around the country staffed with assistors to answer taxpayer questions. When taxpayers call IRS, they can get automated messages for some routine questions or concerns, or can choose to speak with an IRS assistor. During periods of anticipated heavy call volume, such as during the tax filing season, IRS employs over 10,000 assistors to answer telephone inquiries. For the ACTC payment effort, IRS established a special phone line with its own telephone number to provide basic information to taxpayers about the credit through an automated menu. One of the options on the automated menu allowed taxpayers to be switched to an IRS assistor. The assistors were supplied by IRS management with information addressing the concerns IRS thought taxpayers would ask about most frequently.

In our August 2002 report, we recommended that IRS convene a study group to assess its performance with respect to its 2001 advance refund effort. We said that IRS should identify implementation issues with the 2001 advance refund effort that would be applicable to future, similar tax programs. The 2001 advance refund effort was similar to the ACTC payment effort in that IRS mailed out checks to taxpayers in an amount that approximated the reduction of their tax liabilities in the current year. As will be discussed in the body of this report, IRS assessed its implementation of the 2001 advance refund effort and issued a report in January 2003.

Billions of Dollars in Advance Payments Sent to Millions of Taxpayers in a Timely Fashion

Altogether, more than 25 million taxpayers received about \$14 billion in advance payments. IRS set up a schedule for mailing out ACTC payments to taxpayers who filed their 2002 tax returns by April 15, 2003. IRS, through FMS, mailed out ACTC payments according to this schedule between July 25 and August 8, 2003.⁹ Taxpayers who filed their 2002 tax return after April 15, 2003, received their checks approximately 6 weeks after their return was processed. No checks were issued after December 31, 2003. IRS based its determination of whether taxpayers were eligible to receive

⁹A taxpayer's social security number determined the order in which they received their advance payment.

an ACTC payment based on the information from their 2002 returns, such as the number and age of their dependents. Therefore, taxpayers who did not file their return within 6 weeks of the December 31 deadline (mid-November, 2003) did not receive an advance payment, but, if eligible, will be able to claim the full \$1,000 credit when they file their 2003 tax returns in 2004.

The \$14 billion in advance payments is the net amount taxpayers received after offsets by IRS and FMS of about \$824 million to collect various types of taxpayer debt. IRS sent notices to all eligible taxpayers a few days before it mailed the advance payment checks to taxpayers. When appropriate, the notices included statements that the amount of their advance payment would be reduced by either the amount of federal tax or federal nontax debt (such as child support payments, student loans, or state income tax) they owed. IRS offset ACTC payments, either in whole or in part, by about \$617 million to recover delinquent federal tax. FMS offset about \$207 million to collect the federal nontax debt via the Treasury Offset Program.¹⁰

The Call Volume Increased and the Level of Service Declined but IRS's Strategy To Deal with Calls May Have Mitigated the Impact

The mailing of ACTC notices and payments caused an increase in the number of telephone calls IRS received and a decline in the assistors' level of service, but the impact may have been mitigated by IRS's strategy regarding taxpayer inquiries.¹¹ IRS had a two-pronged strategy for dealing with the anticipated taxpayer inquiries following the announcement of the ACTC payments. Specifically, IRS planned to (1) direct as many telephone inquiries as possible to messages on its automated telephone system and (2) encourage taxpayers to use its Web site for information and payment status.

IRS receives millions of calls from taxpayers each year requesting assistance concerning tax law issues, the status of their refunds, and other issues regarding their accounts. As shown in figure 1, in the weeks

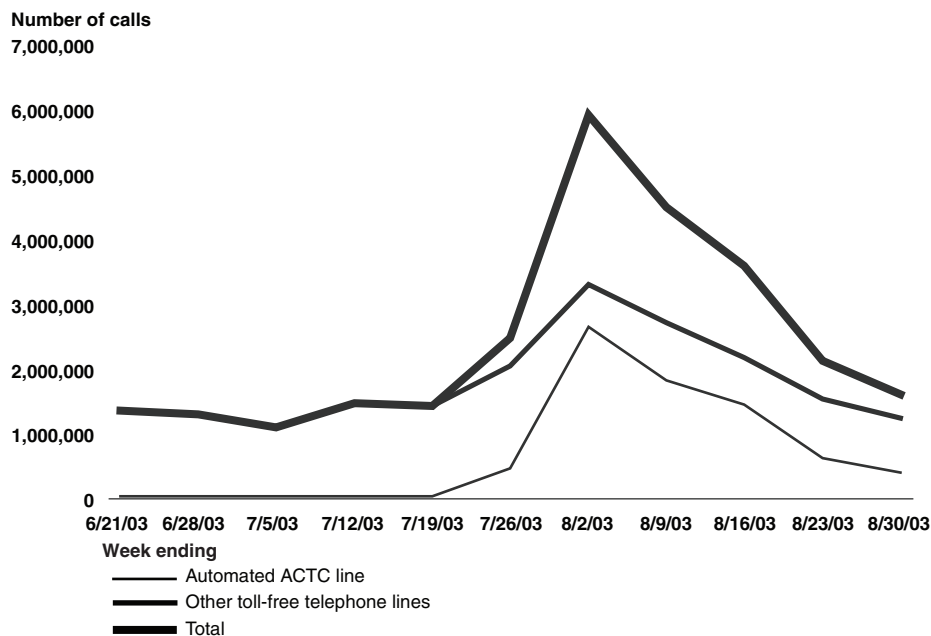
¹⁰The Treasury Offset Program involves a centralized database of delinquent nontax debts referred to FMS for offset against federal payments.

¹¹The performance measure level of service is intended to show IRS's effectiveness in providing callers with access to an assistor. Essentially, it is the total number of taxpayers who obtain pertinent information (that is, talk to an assistor or access pertinent automated messages) divided by the total number of taxpayers who seek information (that is, talk to an assistor, access pertinent automated messages, receive a busy signal, receive a message that assistors are not currently available, and who hang up before receiving service).

immediately preceding the issuance of the first ACTC payment checks, IRS was receiving approximately 1.5 million call attempts per week to all its toll-free telephone lines. After IRS began sending ACTC notices to taxpayers during the week ending July 19, 2003, call volume to its toll-free telephone lines began to increase. Immediately following the issuance of the first ACTC payment checks during the week ending July 26, 2003, calls to IRS's toll-free telephone lines increased to about 5 million. Although calls then rapidly declined, the number of calls remained elevated until the week ending August 30, 2003.

Many of the additional calls were to IRS's dedicated ACTC line. Between the weeks ending July 19 and August 30, 2003, IRS's ACTC line received about 7.3 million telephone calls. About 3.9 million of the 7.3 million calls, or 53 percent, were routed by IRS's telephone menu to automated messages, thus reducing the number of calls directed to assistors.

Figure 1: Taxpayers' Call Attempts During the ACTC Payment Period



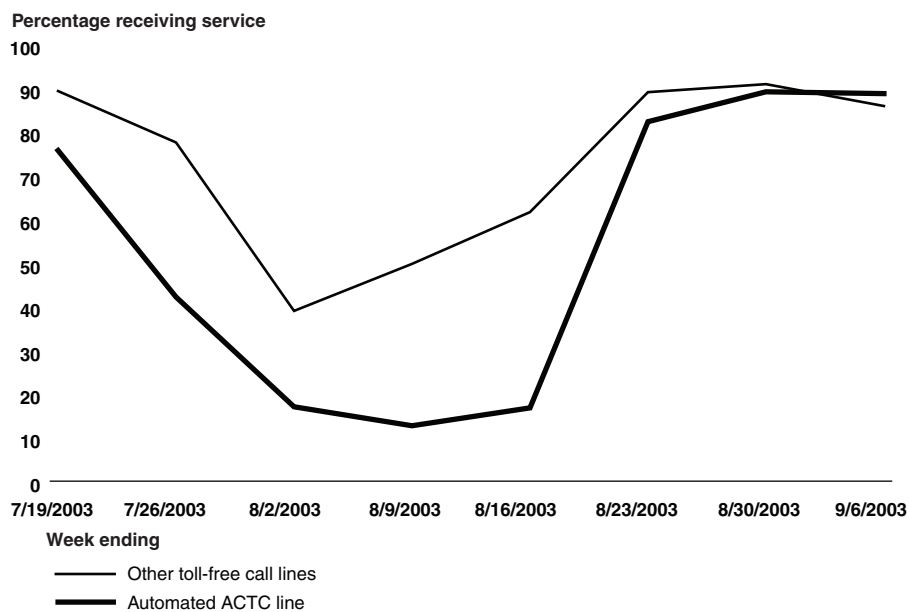
Source: IRS.

Figure 1 also shows that calls to IRS's other telephone lines for information increased. IRS does not have statistics on how many of the total calls to

other lines were related to ACTC payments. However, many of the calls routed to assistors were ACTC-related. IRS officials estimated that assistors on the other lines answered about 525,000 ACTC-related telephone calls during this period.

IRS uses several measures to gauge its performance in providing service to callers on its toll-free telephone lines. One measure, the assistor level of service, is the percentage of callers that IRS estimates wanted to speak to an assistor who actually got through and received service. The level of service provided on the special toll-free ACTC telephone line began to decline the week the first advance payments were mailed and remained low for a week after the last payments were mailed to those taxpayers who had filed by April 15 (see fig. 2). For 3 weeks, the assistor level of service was less than 20 percent.

Figure 2: Assistor Level of Service Declined for a Few Weeks



Source: IRS.

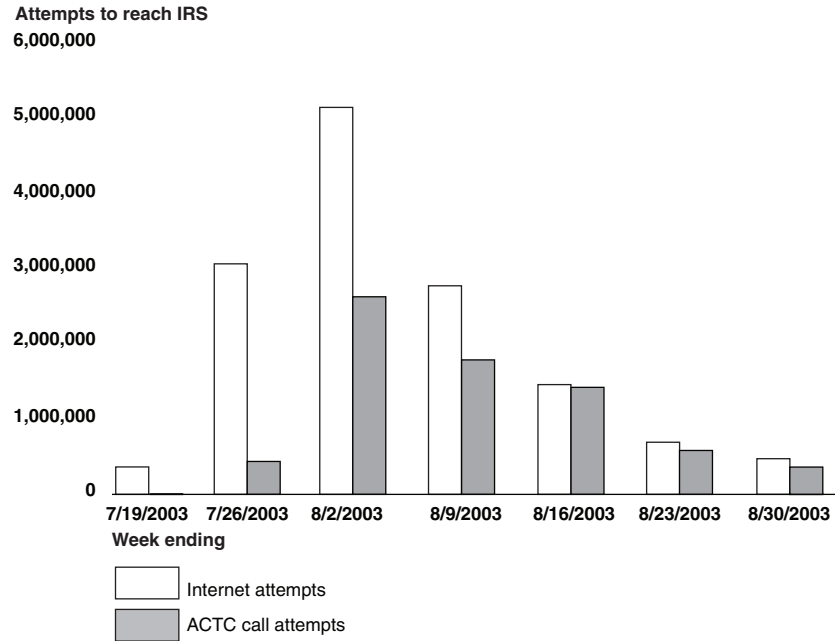
The level of service for all toll-free telephone lines also was affected, falling from about 90 percent to as low as about 40 percent. The level of service for all toll-free telephone lines returned to its normal level during the week ending August 30, 2003. To address the expected increase in telephone

calls, IRS paid telephone assistors overtime and extended seasonal employees past their normal time. IRS did not hire new assistors, but it is unclear that hiring and training new employees for a few weeks would have been cost beneficial.

However, another measure of telephone service was not affected as much. Of the more than 6 million calls to the ACTC telephone line for the 5-week period from July 19 through August 16, only 117,000 callers, or 1.9 percent, received busy signals.

In addition to the ACTC telephone line, IRS set up a special feature on its Web site to provide taxpayers information on their ACTC payments. Approximately 10.6 million attempts were made to access IRS's ACTC Web feature for information during the 5-week period ending August 30, 2003, although about 2 million of these attempts were not successful. IRS officials believe the ACTC Web feature reduced ACTC related calls to its toll-free telephone system because of the large number of contacts. IRS does not have an estimate of the manner in which taxpayers used both services, that is, the number of taxpayers who used the Web site but still called IRS, or the number of calls eliminated by the Web feature. However, IRS officials told us that, in speaking with tax practitioners, they heard that many taxpayers used the feature on IRS's Web site instead of calling IRS to get information. Figure 3 shows a breakdown of how taxpayers attempted to gain information on the ACTC.

Figure 3: Breakdown on Taxpayers' Attempts to Gain ACTC Information



Source: IRS.

IRS Estimated the ACTC Payment Effort Cost About \$32 Million, Which IRS Funded by Reallocating Resources

IRS and FMS officials told us they spent about \$32 million, 98 percent of which was incurred by IRS, to implement the ACTC payment effort.¹² IRS's cost figures are a combination of estimates and actual costs. Congress did not appropriate funds to IRS specifically for the agency to implement the ACTC payment effort. As a result, IRS funded this effort by reallocating funds from other programs or operations, as well as by shifting staff resources to deal with the ACTC payments.

¹²Some costs, such as labor costs, were estimated by IRS, while others, such as postage and telecommunications fees, were actual costs. However, as we have reported before (U.S. General Accounting Office, *Financial Audit: IRS's Fiscal Years 2003 and 2002 Financial Statements* (GAO-04-126, November 2003)), IRS does not have a cost accounting system capable of providing timely and reliable cost information related to its activities and programs, so the \$32 million estimate may not accurately reflect the true costs of implementing the ACTC payment effort.

Costs to IRS and FMS

In order to implement the ACTC payment effort, IRS, among other things, had to

- develop the computer programming necessary to determine taxpayer eligibility for an advance payment and the amount of the payment, including any related federal tax offset;
- develop an application on its Web site to help taxpayers determine their eligibility for an advance payment and the amount of the payment;
- arrange for printing and mailing notices informing eligible taxpayers that they would be receiving the payment;
- respond to telephone calls and correspondence from taxpayers concerning the advance payment; and
- resolve undelivered and returned advance payment checks.

In addition, FMS spent about half a million dollars on items related to issuing advance payment checks, including labor, check stock, and other expenses (see table 1). IRS reimbursed FMS for postage costs, and those costs are included in the costs in table 1. Overall, IRS incurred about \$31.1 million, or 98 percent of the total costs for implementing the ACTC payment effort.

Table 1: Costs Reported by IRS and FMS

Item	IRS cost (in \$ millions)	FMS cost (in \$ millions)
Labor	\$ 4.8	\$.12
Postage	15.4	-
Printing of notices	1.6	-
Telecommunications	5.3	-
Contract	4.0	-
Check stock	-	.19
Other	-	.22
Total	\$ 31.1	\$.53

Source: IRS and FMS.

Note: IRS's cost figures are a combination of estimates and actual costs.

By early June, IRS developed the necessary computer programming to implement the ACTC payment effort. By mid-June, it had tested the programming, with help from contractors.

Funding the ACTC Effort Caused Some Delays in Other Activities

Because Congress did not appropriate funds to IRS for the implementation of the ACTC payment effort, IRS officials said they funded this effort by reallocating funds from other programs or operations, as well as shifting staff resources to deal with the ACTC payment effort. More specifically, IRS officials funded the ACTC payment effort as follows:

- \$11.6 million in unobligated funds, which were monies that were not spent by IRS in fiscal year 2002 and were available to spend in fiscal year 2003.
- \$10.2 million from IRS's existing postage budget. This figure represents the money that was allocated to IRS's postage machines and that was then reallocated to the ACTC payment effort. As a result, some mailings that were not time-critical were delayed until the beginning of fiscal year 2004.
- \$9.3 million from allocating money originally intended for updating information systems. By allocating those monies to the ACTC payment effort, the updates were delayed about 1 month, until the beginning of fiscal year 2004.

Taken by itself, absorbing the cost of the ACTC payment effort had a minimal impact on IRS's other activities. However, IRS has typically had to absorb the costs of other initiatives each year. For example, in 2002 IRS faced unbudgeted cost increases related to rent, pay raises, security, and postage rate increases.¹³

¹³ U.S. General Accounting Office, *Internal Revenue Service: Assessment of Budget Request for Fiscal Year 2003 and Interim Results of 2002 Tax Filing Season*, [GAO-02-580T](#) (Washington, D.C.: Apr. 9, 2002).

IRS Used Lessons Learned Which It Believes Helped the Implementation of ACTC Go More Smoothly

IRS identified lessons learned from the evaluations of the 2001 advance refund effort and used the lessons when implementing the ACTC payment effort. With the exception of telephone service, IRS officials believe the implementation of the ACTC payment effort has gone more smoothly, in part, because they used both the positive and negative lessons learned from the 2001 effort. Although acknowledging that identifying and using lessons learned was valuable, IRS officials had not yet committed to conducting a lessons learned evaluation of the ACTC payment effort at the time of our review.

IRS Identified and Used Lessons Learned from the 2001 Advance Refund Effort

In our review of IRS's implementation of the 2001 advance refund effort, we recommended that IRS identify any changes in procedures or processes that might be warranted if it faced similar challenges in the future. IRS conducted such an evaluation and issued a report in January 2003. IRS officials said that the cost of the evaluation was modest, and the report synthesized the responses of 19 executive and front-line managers who were interviewed about their experience in implementing the 2001 advance refund effort.

In table 2, we summarize the lessons learned identified by managers from the 2001 advance refund effort and merged them with the lessons we and TIGTA identified. Some of the lessons learned, such as early planning, were positive lessons about actions that IRS managers believed contributed to the overall success of the effort. The table also identifies the actions taken to use these lessons in the ACTC payment effort.

Table 2: Lessons Learned from the 2001 Advance Refund Effort and Use in the ACTC Payment Effort

Lessons Learned from the 2001 Advance Refund Effort (Sources)	Use in the ACTC Payment Effort
1. Plan the project early before enactment of legislation. (IRS)	Planning began in January 2003, 5 months before the Jobs and Growth Tax Relief Reconciliation Act of 2003 was signed into law on May 28, 2003.
2. Involve high-level officials and establish a venue for frequent communication (e.g., periodic meetings). (IRS)	Meetings were held every 1 or 2 weeks, beginning on January 14, 2003, and included programmers and high-level officials from all impacted functions.
3. Designate high-level managers with decision authority, including an attorney, who can circumvent unintentional barriers, such as formal procedures. (IRS)	IRS executives were instructed by the Deputy Commissioner to provide whatever was needed for the ACTC implementation. An attorney was assigned to address any legal questions raised during the meetings.
4. Test programming extensively, anticipating downstream processing problems, including those that may conflict with internal procedures. (IRS, GAO, TIGTA)	Programming was tested internally and externally.
5. Test forms and instructions extensively, relying on focus groups or similar methods. (IRS, GAO)	Consulting firm was hired to review notice. Focus groups were not used. Sixteen drop-in paragraphs were developed for the notices to address taxpayers' individual circumstances.
6. Provide adequate resources (i.e., funds and people) to accomplish the project. (IRS)	See funding sources discussed in previous section.
7. Refine relevant list of eligible taxpayer names and address information. (GAO)	The program identified and eliminated taxpayers who no longer qualified for the Child Tax Credit. Allowed verbal change of address from taxpayers over the phone for current address.
8. Anticipate system overload (e.g., phone inquiries) and effects on other tax work, including the regular filing season. (IRS, GAO, TIGTA)	A media strategy was prepared. Officials indicated that they took a broad strategic approach to telephone service.
9. Involve Chief Financial Office (CFO) throughout the project. (IRS)	CFO was invited to all planning meetings.
10. Garner and focus all resources on accomplishing the task, including working overtime, when necessary. (IRS)	Overtime was worked. IRS executives were instructed to provide all necessary resources for the task.
11. Address problems quickly. (IRS)	IRS managers maintained ongoing dialogue with relevant stakeholders, including TIGTA, to identify and address problems as they arose.
12. Emphasize the advance refund effort as "priority one." (IRS)	The importance of the ACTC payment effort was communicated to all employees.

Source: GAO, IRS, TIGTA.

For example, in our report on the 2001 advance refund effort, we noted that IRS's notices and instructions for the 2001 advance refund could have been clearer. IRS's 2001 instructions for the Form 1040 did not use consistent terminology when referring to the advance refund, emphasize the existence of a new credit on the first page of the instructions, or provide all relevant information in the section discussing the advance refund. IRS considered our concerns when preparing the 2003 tax return forms and instructions.

The forms and instructions use consistent terminology when referring to the ACTC payment, highlight the ACTC payment on the cover, and include relevant information in the section discussing the ACTC payment. In addition, IRS hired a consulting firm to provide guidance on the process used for developing notices.

IRS Officials Believe ACTC Payment Effort Has Gone More Smoothly in Part Due to Lessons Learned

IRS officials said that from their perspective, the process of issuing the ACTC payments has gone more smoothly than the 2001 advance refund effort and they believe taxpayers have had fewer problems. IRS officials did not have to build a process from scratch for managing the effort—they were able to build on their prior experience by focusing on the management activities that had worked well in the 2001 effort. For example, IRS officials told us that convening frequent meetings involving high-level stakeholders was important in communicating the status of the effort, the resources needed, and any problems that needed to be resolved.

While neither IRS nor GAO has directly contacted taxpayers to discuss their experience with the ACTC payment effort, available evidence suggests that IRS has experienced few problems in sending out the ACTC payment notices and checks. For example, the Office of Taxpayer Advocate (OTA) told us that, although it did not track the number of phone calls it received regarding ACTC payments, OTA staff believe its call volume related to taxpayer inquiries regarding ACTC payments was lower than it was when the 2001 advance refund effort was introduced. Although at the time of our review OTA had not done an analysis of the calls they received, the lower call volume may have been resulted from IRS's efforts to write clearer notices. In addition, IRS data suggest that IRS was about as successful in the ACTC payment effort as it was in the 2001 advance refund effort in mailing checks to the correct address. Both efforts resulted in less than 1 percent of checks being returned as undeliverable.

One lesson that IRS learned is that taxpayers may experience more problems when they begin filing their 2003 tax returns, which are due April 15, 2004. Although IRS instructed taxpayers to keep their ACTC notices for reference when filing their returns, IRS officials expect many taxpayers will throw them away or lose them before the filing season. This could lead to problems similar to those we identified with the 2001 advance refund effort. We found that taxpayers were confused about the amount of the rate reduction credit they had received as an advance refund and how to properly report this on their tax return. For example

-
- Over 4.4 million taxpayers who were entitled to a credit failed to claim it on their return.
 - Almost 1.8 million taxpayers who had received the maximum advance refund and so were not entitled to a credit claimed the credit on their return.
 - Over 800,000 taxpayers who were entitled to and claimed a credit incorrectly computed the amount to which they were entitled.

IRS officials believe the efforts they made to draft clearer notices and instructions as described above will help mitigate these problems.

In addition to benefiting from the evaluations of the 2001 advance refund effort, IRS officials cited other factors that contributed to a smooth implementation. These factors included the experience of having successfully completed a previous advance payment effort and fewer recipients of the ACTC payment than there were of the 2001 advance refund.

IRS Has Not Yet Committed to Repeating the Lessons Learned Process

At the time of our review, IRS officials said they had not yet decided whether to undertake a lessons learned evaluation of the ACTC payment effort as they had done for the 2001 advance refund effort. In their opinion, the effort has gone very smoothly and they were unsure whether anything would be gained by a formal evaluation of the process.

However, as pointed out in IRS's lessons learned report, higher ranking officials provided most of the positive responses regarding the 2001 advance refund effort, while front-line managers were the most likely to point out problems with the process. As a result, an evaluation of the ACTC payment process involving all levels of IRS managers could identify lessons not currently evident to IRS senior managers that could be used in implementing future efforts. In addition, even if a lessons learned evaluation only identified positive lessons, such an effort would still be useful because managers would know which actions they should be sure to incorporate into any new efforts.

Conclusions

ACTC payments were sent to 25 million taxpayers. IRS officials acknowledged that using the evaluations of the 2001 advance refund effort

was partly responsible for the smooth implementation of the 2003 ACTC payment effort. It is possible that such an evaluation of the 2003 ACTC payment effort would also yield benefits if IRS is asked to carry out a similar effort in the future. This could be the case even if the lessons learned from such an evaluation are about which implementation steps worked well. The costs of an evaluation of the same magnitude as the one covering the 2001 advance refund effort would be quite modest. IRS staff who were involved in the planning and implementation of this effort are in the best position to assess both the positive and negative aspects of IRS's performance and suggest alternative approaches for handling the challenges involved in such an effort.

Recommendation

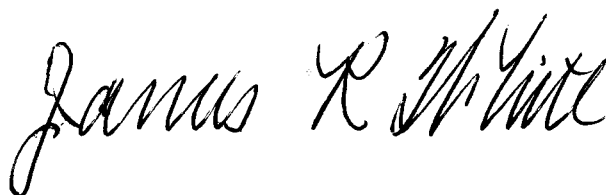
We recommend that the Commissioner of Internal Revenue conduct a modestly scaled "lessons learned" evaluation of the ACTC payment effort similar to the one conducted for the 2001 advance refund effort.

Agency Comments and Our Evaluation

We received written comments on a draft of this report from the Commissioner of Internal Revenue, which is reprinted in appendix II. The Commissioner agreed with our assessment of IRS's implementation of the ACTC payment effort, including our conclusion that the dramatic increase in taxpayer contacts over a short period of time resulted in a brief decline in telephone service. The Commissioner also said that IRS's lessons learned report on the 2001 advance refund effort was a cornerstone of the improvement for the ACTC payment effort, and agreed with our recommendation that the IRS should conduct a similar assessment of the implementation of the ACTC payment effort.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to the Chairman and Ranking Minority Member of the House Committee on Ways and Means and the Chairman and Ranking Minority Member of its Subcommittee on Oversight; the Secretary of the Treasury; the Commissioner of Internal Revenue; the Director of the Office of Management and Budget; and other interested parties. We will make copies available to others on request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

This report was prepared under the direction of Jonda Van Pelt, Assistant Director. If you have any questions regarding this report, please contact her at (415) 904-2186 or vanpeltj@gao.gov or me at (202) 512-9110 or whitej@gao.gov. Other major contributors are acknowledged in appendix III.

A handwritten signature in black ink that reads "James R. White". The signature is written in a cursive style with a large, stylized initial "J".

James R. White
Director, Tax Issues

Objectives, Scope and Methodology

Our objectives were to provide information on (1) the number, dollar amount, and timeliness of the advance payments, (2) the impact of the ACTC payments on IRS's toll-free telephone operations, (3) the cost to IRS and FMS for implementing the ACTC payment effort, including the impact of these costs on other IRS programs, and (4) the extent to which IRS identified and used evaluations from the 2001 advance refund effort to implement the ACTC payment effort, and whether an evaluation of the ACTC payment effort is planned.

From IRS and FMS, we obtained information on the number, dollar amount, and timeliness of the advance payments issued, including the number and dollar value of offsets deducted from the advance payments as a result of taxpayers' tax and other federal debts.

To identify the impact this effort had on IRS's toll-free operations, we obtained statistical information from IRS on the impact of the ACTC on its toll-free telephone operations. Specifically, we obtained (1) the costs of training telephone operators to answer questions about the ACTC payments, (2) the costs of hiring new telephone operators to handle the increased number of calls due to the implementation of the ACTC payment effort, and (3) the number of calls that IRS received about the advance payments and the number of taxpayers who were unable to speak to an IRS assistor. In addition, we obtained data on how IRS used a special feature on its Web site to mitigate the impact of its toll-free telephone service.

We obtained from IRS and FMS the costs to implement the ACTC payment effort. From IRS we also obtained information on how it used funds earmarked for other programs to implement this effort. We discussed with IRS officials the impact that reallocating funds had on other IRS activities.

To determine what lessons IRS learned from the 2001 advance refund effort, we analyzed the lessons learned from evaluations done by IRS's internal study group, TIGTA, and GAO on the advance refund effort in 2001. We discussed with IRS officials how they used the lessons learned to implement the ACTC payment effort.

We relied on statistical and cost data provided by IRS and FMS to report the \$14 billion in ACTC payments to more than 25 million taxpayers, the \$32 million to implement the ACTC payment program, the \$824 million in offsets, and the \$11.6 million, \$10.2 million, and \$9.3 million funding figures associated with the reallocation of funds from other programs and operations. To determine the reliability of the statistical and cost data we

present in this report, we reviewed the results of our most recent audit of IRS's financial statements. In our recently completed audit of IRS's fiscal year 2003 financial statements, we gave IRS an unqualified opinion on the financial statements, but we also reported the continued existence of several material internal control weaknesses that could have impacted the validity of the ACTC payments that we report. Specifically, we found material internal control weaknesses in (1) tax revenue and refunds, (2) unpaid tax assessments, and (3) computer security which had the potential to impact the validity of the disbursements for the ACTC. These weaknesses could impact the ability of IRS to have reasonable assurance that (1) the individuals who received the payments should have received them or should have received them in the amount paid and (2) all individuals entitled to receive ACTC payments did, in fact, receive payments. However, as part of the fiscal year 2003 financial audit, we performed sufficient procedures to validate that \$14 billion was paid out under the ACTC payment effort. As a result, we believe that IRS's data on the amount disbursed and the number of taxpayers who received ACTC payments are sufficiently reliable for our reporting effort. In our fiscal year 2003 financial audit, we also found that IRS continues to lack a cost accounting system capable of accurately and timely tracking and reporting the costs of its various programs and projects, meaning that IRS's cost amounts may not reflect the true cost of administering the ACTC payment. In a recent report, we assessed the methodologies IRS used for computing its current suite of performance measures, including its telephone service.¹ At that time, we reported that some of its performance measures had attributes of successful performance measures including objectivity and reliability, although in some cases, the measures could be further refined. Even recognizing the limitations of these measures, we have determined that the data we are using are sufficiently reliable and useful for reporting on IRS's implementation of the ACTC payments.

This report covers the time frame from January 2003 to December 2003, from IRS's initial planning for the ACTC payments to when all of the advance payment checks had been issued. We did our work at IRS's National Office in Washington, D.C. and at the IRS campus in Atlanta, Ga. We conducted fieldwork between September 2003 and November 2003. Our work was performed in accordance with generally accepted government auditing standards.

¹ U.S. General Accounting Office, *Tax Administration: IRS Needs to Further Refine Its Tax Filing Season Performance Measures*, [GAO-03-143](#) (Washington, D.C.: Nov. 22, 2002).

Comments from the Internal Revenue Service



COMMISSIONER

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

February 11, 2004

Mr. James R. White
Director, Tax Issues
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. White:

I agree with your assessment of our successful implementation of the Advance Child Tax Credit (ACTC) provision of the Jobs and Growth Tax Relief Reconciliation Act of 2003. Each piece of new legislation presents unique challenges to the IRS. I am pleased your report recognizes that we accurately and timely issued over \$14 billion in payments to more than 25 million taxpayers. This accomplishment is the result of diligent staff work, detailed planning, and close coordination with our partners at the Financial Management Service and Treasury's Office of Tax Policy. I am pleased these efforts successfully delivered the tax relief intended by Congress.

Our implementation strategy enabled us to proactively communicate with taxpayers eligible for this tax relief. The message we sent to the public stressed, "You don't need to contact us. You'll automatically get a check if you qualify." In addition to the wide-scale media attention and targeted IRS News Releases, we also sent each qualifying taxpayer a notice informing them of their eligibility, providing the amount of the anticipated advance payment and stressing they needed to take no action to receive their check. The notice directed questions and requests for additional information to a special section of the IRS website or to a special ACTC 1-800 toll-free telephone number. The "Where's My Advance Child Tax Credit?" feature on www.irs.gov and the ACTC 1-800 toll-free number allowed users to determine their eligibility and to find out the amount and scheduled mailing date of their check. These two special features provided service to over 15.5 million taxpayers.

Our proactive measures provided accurate and timely information to millions of taxpayers eliminating their need to receive personal service from a Customer Service Representative. Despite the success of these efforts many taxpayers still wished to contact us. The issuance of billions of dollars in tax relief captures public interest and prompts them to contact us any way they can. We anticipated and accurately projected the impact of these contacts. However, I agree with your conclusion that this dramatic increase in contacts compressed into a short period of time resulted in a brief decline in telephone service.

2

We will continue to proactively assist ACTC recipients. We anticipate many ACTC recipients will need to verify the amount of their advanced credit prior to filing their 2003 tax return. As part of our "1040 Central" web page, we have a section titled "Your 2003 Advance Child Tax Credit." This section gives the taxpayer the amount of their ACTC credit along with instructions on how to figure their Child Tax Credit on their 2003 tax return. Providing this information in the fast and easily accessible web environment helps taxpayers file accurate returns. In the first 18 days of "Your 2003 Advance Child Tax Credit" feature, it has received over 1.2 million inquiries. As tax return processing gets underway, we are targeting "Quick Alerts" to tax return preparers and the electronic filing community to stress the importance of accurately computing the Child Tax Credit. We are also covering this important point with the public through News Releases related to the filing of 2003 tax returns.

Your observation that we have improved our process of implementing new legislation is accurate. As a result of our increased experience, internal review, and the insight provided by the General Accounting Office and the Treasury Inspector General for Tax Administration, we were better prepared to develop a comprehensive implementation plan for the Jobs and Growth Tax Relief Reconciliation Act of 2003. As you noted, our internal report, "Lessons Learned from the IRS Implementation of the 2001 Advance Tax Refund and Tax Rate Reduction Credit Legislation," was a cornerstone in our improvement process.

My response to your recommendation is as follows:

Recommendation

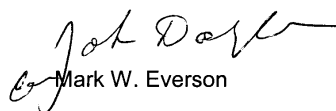
GAO recommends that the Commissioner of Internal Revenue conduct a modestly scaled "lessons learned" evaluation of the ACTC payment effort similar to the one conducted for the 2001 advanced refund effort.

Response

I agree with your recommendation. The Commissioner, Wage and Investment Division will conduct a "lessons learned" assessment of our implementation actions of the Advance Child Tax Credit provision for the Jobs and Growth Tax Relief Reconciliation Act of 2003. We anticipate completing the "lessons learned" report by December 15, 2004.

If you have any questions, please call Floyd Williams, Director, Legislative Affairs, at (202) 622-3720.

Sincerely,


Mark W. Everson

GAO Contacts and Staff Acknowledgments

GAO Contacts

James White, (202) 512-9110
Jonda Van Pelt, (415) 904-2186

Acknowledgments

In addition to those named above, Evan Gilman, Tre Forlano, Ron Heisterkamp, Susan Mak, Larry Malenich, Edward Nannenhorn, Cheryl Peterson, Amy Rosewarne, and Jeff Schmerling made key contributions to this report.

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