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FISCAL OUTLOOK

Addressing Improper Payments and the Tax Gap Would Improve the Government's Fiscal Position

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Accessible Version

GAO Highlights

Highlights of [GAO-16-92T](#), a testimony before the Committee on Finance, U.S. Senate

Why GAO Did This Study

The federal government continues to face an unsustainable long-term fiscal path. Changing this path will require difficult fiscal policy decisions to alter both long-term federal spending and revenue. In the near term, executive branch agencies and Congress can take action to improve the government's fiscal position by addressing two long-standing issues—improper payments and the tax gap. Over time, these issues involve amounts near or exceeding \$1 trillion.

Over the past decade, GAO has highlighted the issue of improper payments—defined by statute as payments that should not have been made or that were made in an incorrect amount (including overpayments and underpayments). GAO has reported for several years that the federal government is unable to determine the full extent to which improper payments occur and reasonably assure that actions are taken to reduce them.

The tax gap is the difference between taxes owed and those paid on time, as a result of taxpayers underreporting their tax liability, underpaying taxes, or not filing tax returns. Reducing the tax gap could provide additional revenue.

This statement discusses (1) actions needed to address improper payments government-wide and (2) strategies to reduce the tax gap. It is based on GAO's recent work on improper payments, agency financial reports and inspectors general reports, and prior reports on the tax gap, including those with open recommendations or matters for congressional consideration that could potentially help reduce the tax gap.

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Addressing Improper Payments and the Tax Gap Would Improve the Government's Fiscal Position

What GAO Found

A number of strategies, including implementing preventive controls and addressing GAO's prior recommendations, can help agencies reduce improper payments, which have been a persistent, government-wide issue. The improper payment estimate, attributable to 124 programs across 22 agencies in fiscal year 2014, was \$124.7 billion, up from \$105.8 billion in fiscal year 2013. The almost \$19 billion increase was primarily due to the Medicare, Medicaid, and Earned Income Tax Credit programs, which account for over 75 percent of the government-wide improper payment estimate. Federal spending in Medicare and Medicaid is expected to significantly increase, so it is critical that actions are taken to reduce improper payments in these programs. Moreover, for fiscal year 2014, federal entities reported estimated error rates for 10 risk-susceptible programs that exceeded 10 percent. Recent laws and guidance have focused attention on improper payments, but incomplete or understated estimates and noncompliance with criteria listed in federal law hinder the government's ability to assess the full extent of improper payments and implement strategies to reduce them. For example, for fiscal year 2014, 2 federal agencies did not report improper payment estimates for 4 risk-susceptible programs, and 5 programs with improper payment estimates greater than \$1 billion were noncompliant with federal requirements for 3 consecutive years. Identifying root causes of improper payments can help agencies target corrective actions, and GAO has made numerous recommendations that could help reduce improper payments. For example, strengthening verification of Medicare providers and suppliers could help reduce improper payments. GAO has stated that continued agency attention is needed to (1) identify susceptible programs, (2) develop reliable estimation methodologies, (3) report as required, and (4) implement effective corrective actions based on root cause analysis. Absent such continued efforts, the federal government cannot be assured that taxpayer funds are adequately safeguarded.

Addressing the estimated \$385 billion net tax gap will require strategies on multiple fronts. Key factors that contribute to the tax gap include limited third-party reporting, resource trade-offs, and tax code complexity. For example, the extent to which individual taxpayers accurately report their income is correlated to the extent to which the income is reported to them and the Internal Revenue Service (IRS) by third parties. Where there is little or no information reporting, such as with business income, taxpayers tend to significantly misreport their income. GAO has many open recommendations to reduce the tax gap. For example, GAO recommended in 2012 that IRS use return on investment data to reallocate its enforcement resources and potentially increase revenues. Since 2011, GAO also recommended improvements to telephone and online services to help IRS deliver high-quality services to taxpayers who wish to comply with tax laws but do not understand their obligations. Other strategies GAO has suggested would require legislative actions, such as accelerating W-2 filing deadlines. Additionally, requiring partnerships and corporations to electronically file tax returns could help IRS reduce return processing costs and focus its examinations more on noncompliant taxpayers. Further, a broader opportunity to address the tax gap involves simplifying the Internal Revenue Code, as complexity can cause taxpayer confusion and provide opportunities to hide willful noncompliance.

Chairman Hatch, Ranking Member Wyden, and Members of the Committee:

Many difficult, major fiscal policy decisions are required to both determine the government's short-term financing and address fundamental structural issues that are currently putting our nation on a long-term, unsustainable fiscal path. In the near term, however, there are significant ongoing management challenges that if successfully addressed, can contribute to improving the government's fiscal position. They involve reducing billions of dollars in improper payments and tackling a multibillion-dollar tax gap—the difference between taxes owed and taxes paid on time, as a result of taxpayers underreporting their tax liability, underpaying taxes, or not filing tax returns.

Over time, each of these areas involves amounts near or exceeding \$1 trillion. Last year alone, improper payments government-wide were estimated to be more than \$124 billion, and the latest estimate for the annual net tax gap is \$385 billion. My statement today delineates the nature and scope of these management challenges, as well as the related recommendations we have made over the past several years to improve the government's performance in these areas—both recommendations to the relevant agencies and matters for congressional consideration.

An improper payment is defined by statute as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. Among other things, it includes payment to an ineligible recipient, payment for an ineligible good or service, and any duplicate payment.¹ Reducing improper payments is critical to safeguarding federal funds and could help achieve cost savings and improve the government's fiscal position. However, as we have reported for several years in our annual audit of the *Financial Report of the United States Government*, the federal government is unable to determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken

¹An improper payment also includes any payment for a good or service not received (except for such payments where authorized by law) and any payment that does not account for credit for applicable discounts. In addition, the Office of Management and Budget's guidance instructs agencies to report as improper payments any payments for which insufficient or no documentation was found.

to reduce them. Likewise, reducing the tax gap would raise revenue that could be put toward a host of purposes, but there are no easy fixes to this problem. Rather, the tax gap must be attacked on multiple fronts and with multiple strategies over a sustained period. In the face of large and growing structural deficits, it will be especially important to understand the causes of tax noncompliance today and continue to develop new approaches to minimize it.

My testimony today describes (1) actions needed to address government-wide improper payments and (2) strategies to reduce the tax gap. My comments are primarily based on our recent work on improper payments and analysis of agency financial reports and inspectors general (OIG) reports, as well as our prior reports on the tax gap and several other reports with open recommendations or matters for congressional consideration that could help reduce the tax gap.² The products cited throughout this statement include detailed explanations of the methods used to conduct our work. We conducted the work on which this statement is based in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions.

Actions Needed to Address Improper Payments

Improper payments have consistently been a government-wide issue despite efforts to reduce them and identify root causes, including fraud.³ Incomplete, unreliable, or understated estimates; risk assessments that may not accurately assess the risk of improper payment; and noncompliance with criteria listed in federal law hinder the government's ability to understand the scope of the issue. We have reported on a number of strategies, including implementing preventive and detective controls and addressing open recommendations, that can help agencies reduce improper payments.

²See Related GAO Products at the end of this statement.

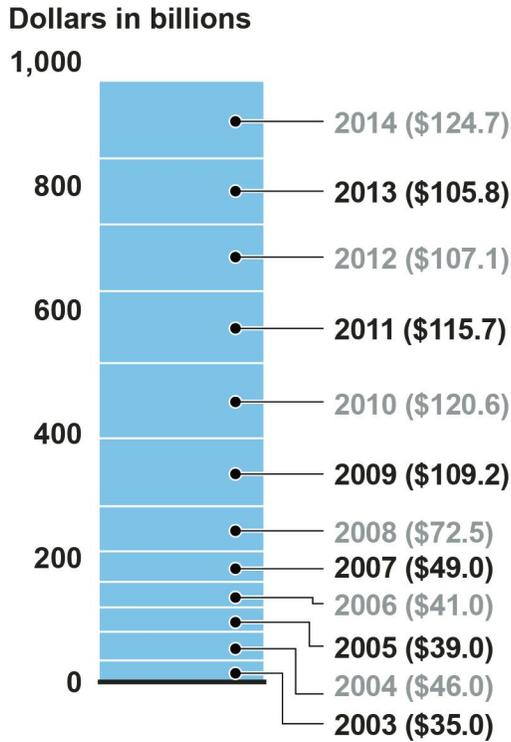
³It is important to note that while all fraud involving a federal payment is considered an improper payment, not all improper payments are fraud. Improper payment estimates are not intended to measure fraud in a particular program.

Improper Payments
Remain a Significant,
Pervasive Government-
Wide Issue

Improper payments remain a significant and pervasive government-wide issue. Since fiscal year 2003—when certain agencies began reporting improper payments as required by the Improper Payments Information Act of 2002 (IPIA)—cumulative improper payment estimates have totaled almost \$1 trillion, as shown in figure 1.⁴

⁴IPIA—as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA) and the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA)—requires executive branch agencies to (1) review all programs and activities, (2) identify those that may be susceptible to significant improper payments, (3) estimate the annual amount of improper payments for those programs and activities, (4) implement actions to reduce improper payments and set reduction targets, and (5) report on the results of addressing the foregoing requirements. IPIA, Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002), *as amended by* IPERA, Pub. L. No. 111-204, 124 Stat. 2224 (July 22, 2010), *and* IPERIA, Pub. L. No. 112-248, 126 Stat. 2390 (Jan. 10, 2013), *and codified as amended at* 31 U.S.C. § 3321 note. For fiscal year 2014 and beyond, IPIA, as amended, defines “significant improper payments” as gross annual improper payments in a program exceeding (1) both 1.5 percent of program outlays and \$10 million of all program or activity payments during the fiscal year reported or (2) \$100 million (regardless of the improper payment error rate).

Figure 1: Cumulative Improper Payment Estimates for Fiscal Years 2003 through 2014



Source: GAO. | GAO-16-92T

Note: Generally, the specific programs and total number of programs that constitute the government-wide improper payment estimate vary from year to year. In earlier years, the number of programs included in the government-wide estimate generally increased as programs reported improper payment estimates for the first time.

In fiscal year 2014, agencies reported improper payment estimates totaling \$124.7 billion, a significant increase—almost \$19 billion—from the prior year’s estimate of \$105.8 billion. For fiscal year 2014, overpayments accounted for approximately 90 percent of the improper payment estimate, according to www.paymentaccuracy.gov, with underpayments

accounting for the remaining 10 percent.⁵ The estimated improper payments for fiscal year 2014 were attributable to 124 programs spread among 22 agencies. Agencies reported improper payment estimates exceeding \$1 billion for each of 12 different programs, which cumulatively accounted for \$115.6 billion, or approximately 93 percent of the fiscal year 2014 government-wide estimate (see app. I).

The estimated government-wide error rate increased from fiscal year 2013 to fiscal year 2014 (from 4.0 percent of program outlays to 4.5 percent).⁶ Programs with the highest reported error rates for fiscal year 2014 included the Earned Income Tax Credit (27.2 percent), School Breakfast (25.6 percent), and Farm Security and Rural Investment Act Programs (23.1 percent).⁷

Additional Efforts Are Needed to Reduce Medicare, Medicaid, and Earned Income Tax Credit Improper Payments

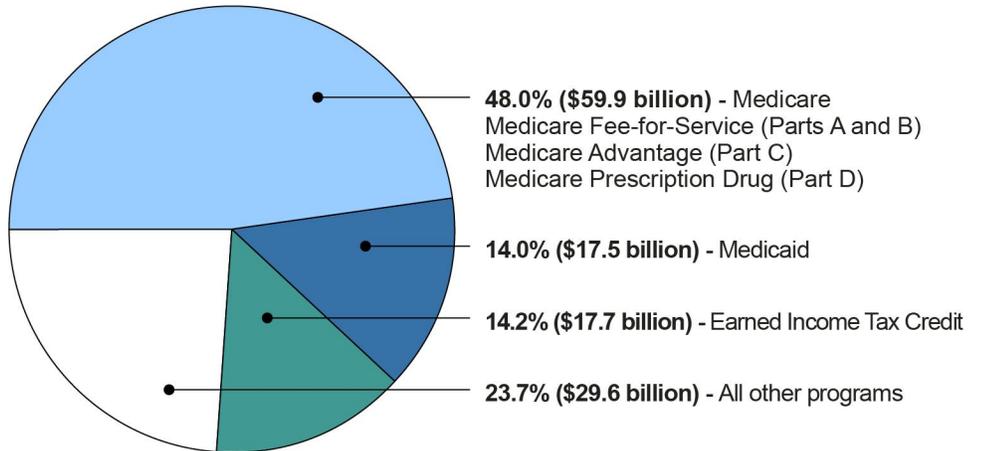
Improper payment estimates for the Medicare, Medicaid, and Earned Income Tax Credit (EITC) programs accounted for more than 75 percent of the fiscal year 2014 improper payment estimate, as shown in figure 2.

⁵The Office of Management and Budget (OMB) established paymentaccuracy.gov to enhance transparency and accountability of improper payments. The website includes information regarding government-wide improper payments as well as more detailed information—such as reduction targets and accountable officials—for high-error programs. OMB guidance directs agencies to classify payments with insufficient supporting documentation as overpayments.

⁶This estimate excludes the Department of Defense's Defense Finance and Accounting Service (DFAS) Commercial Pay program. When including the DFAS Commercial Pay program, the estimated government-wide improper payment error rate was 4.0 percent of program outlays in fiscal year 2014, an increase from 3.5 percent in fiscal year 2013. Because of long-standing financial management weaknesses, discussed later in this statement, the fiscal year 2014 improper payment estimate for the DFAS Commercial Pay program may not be reliable.

⁷For fiscal year 2014, federal entities reported improper payment error rates for 10 risk-susceptible programs that exceeded 10 percent, collectively accounting for more than 50 percent of the government-wide improper payment estimate. These 10 programs are listed in app. II. In addition, some agencies report high error rates for components of programs. For example, the Department of Health and Human Services reported error rates for certain components of its Medicare Fee-for-Service program—such as durable medical equipment and home health claims—that exceeded 50 percent for fiscal year 2014.

Figure 2: Government-Wide Improper Payment Estimates by Program for Fiscal Year 2014



Source: GAO analysis of agencies' data. | GAO-16-92T

The increase in the 2014 government-wide improper payment estimate is attributed primarily to increases in estimated error rates in three major programs: Medicare Fee-for-Service, Medicaid, and EITC. Based on HHS's fiscal year 2014 agency financial report, federal spending in Medicare and Medicaid is expected to significantly increase—on average, by 8.6 percent per year over the next 3 years. Consequently, it is critical that actions are taken to reduce improper payments in these programs. Over the past several years, we made numerous recommendations that if effectively implemented, could improve program management, help reduce improper payments in these programs, and help improve the government's fiscal position.

Medicare

In fiscal year 2014, Medicare financed health services for approximately 54 million elderly and disabled beneficiaries at a cost of \$603 billion and reported an estimated \$60 billion in improper payments.⁸ Medicare spending generally has grown faster than the economy, and in the coming years, continued growth in the number of Medicare beneficiaries and in program spending will create increased challenges for the federal government. The Centers for Medicare & Medicaid Services (CMS), which administers Medicare, has demonstrated a strong commitment to

⁸Medicare payments are made primarily to providers and suppliers.

reducing improper payments, particularly through its dedicated Center for Program Integrity. For example, CMS centralized the development and implementation of automated edits for national coverage policies—prepayment controls used to deny Medicare claims that should not be paid—to help ensure greater consistency in paying only those claims that align with national policies. In response to our recommendations, CMS has also taken steps to reduce differences among postpayment review contractor requirements when possible and has improved automated edits that assess all services provided to the same beneficiary by the same provider on the same day, so providers cannot avoid claim denials by billing for services on multiple claim lines or multiple claims. Additionally, in March 2014, CMS awarded a contract to a Federal Bureau of Investigation-approved contractor that will enable the agency to conduct fingerprint-based criminal history checks of high-risk providers and suppliers.

Nevertheless, in our February 2015 update to our high-risk series, we reported that while CMS has demonstrated efforts to reduce improper payments in the Medicare program, estimated improper payment rates have remained unacceptably high.⁹ For fiscal year 2014, the Department of Health and Human Services (HHS) reported an estimated error rate of 12.7 percent for Medicare Fee-for-Service. Some components of this estimate—such as durable medical equipment and home health claims—have estimated error rates in excess of 50 percent, meaning that most payments for these items and services were estimated to be improper. Fully exercising its authority related to strengthening its provider and supplier enrollment provisions and addressing our other open recommendations related to prepayment and postpayment claims review activities would help CMS achieve reductions in Medicare improper payments. The following are examples of actions that could help reduce Medicare improper payments.

- **Improving use of automated edits.** To help ensure that payments are made properly, CMS uses controls called edits that are programmed into claims processing systems to compare claims data with Medicare requirements in order to approve or deny claims or flag them for further review. In November 2012, we reported that use of prepayment edits saved Medicare at least \$1.76 billion in fiscal year

⁹GAO, *High-Risk Series: An Update*, [GAO-15-290](#) (Washington, D.C.: Feb. 11, 2015).

2010, but savings could have been greater if prepayment edits had been more widely used.¹⁰ To promote greater use of effective prepayment edits and better ensure that payments are made properly, we recommended that CMS (1) improve the data collected about local prepayment edits to enable CMS to identify the most effective edits and the local coverage policies on which they are based and (2) require Medicare administrative contractors to share information about the underlying policies and savings related to their most effective edits. CMS concurred with both recommendations and has begun to take steps to implement them.

- **Monitoring postpayment claims reviews.** CMS uses four types of contractors to conduct postpayment claims reviews to identify improper payments. In July 2013, we found that although postpayment claims reviews involved the same general process regardless of which type of contractor conducted them, CMS had different requirements for many aspects of the process across the four contractor types.¹¹ Some of these differences might impede efficiency and effectiveness of claims reviews by increasing administrative burden for providers. Furthermore, in July 2014, we reported that CMS did not have reliable data or provide sufficient oversight and guidance to measure and fully prevent inappropriate duplication of reviews.¹² We recommended that CMS monitor the database used to track recovery audit activities to ensure that all data were submitted, accurate, and complete. CMS concurred with the recommendation and said it would seek contract modifications to add quality assurance performance metrics related to the completeness and timeliness of data.
- **Removing Social Security numbers from Medicare cards.** The identification number on Medicare beneficiaries' cards includes as one

¹⁰GAO, *Medicare Program Integrity: Greater Prepayment Control Efforts Could Increase Savings and Better Ensure Proper Payment*, [GAO-13-102](#) (Washington, D.C.: Nov. 13, 2012).

¹¹GAO, *Medicare Program Integrity: Increasing Consistency of Contractor Requirements May Improve Administrative Efficiency*, [GAO-13-522](#) (Washington, D.C.: July 23, 2013). For example, contractors developing the improper payment estimate for Medicare Fee-for-Service must give a provider 75 days to respond to a request for documentation, whereas a contractor investigating potential fraud is only required to give the provider 30 days.

¹²GAO, *Medicare Program Integrity: Increased Oversight and Guidance Could Improve Effectiveness and Efficiency of Postpayment Claims Reviews*, [GAO-14-474](#) (Washington, D.C.: July 18, 2014).

component the Social Security number of the beneficiary (or other eligible person's, such as a spouse). This introduces risks that beneficiaries' personal information could be obtained and used to commit identity theft.¹³ In September 2013, we reported that CMS had not taken steps to select and implement a technical solution for removing Social Security numbers from Medicare cards.¹⁴ To better position the agency to efficiently and cost-effectively identify, design, develop, and implement a solution to address this issue, we recommended that CMS direct the initiation of an information technology project for identifying, developing, and implementing changes that would have to be made to CMS's affected systems.

Consistent with our recommendation, when the Medicare Access and CHIP Reauthorization Act of 2015 was enacted into law in April 2015, it included a provision requiring and providing funding for the Secretary of Health and Human Services, in consultation with the Commissioner of Social Security, to establish cost-effective procedures to ensure that a Social Security account number (or derivative thereof) is not displayed, coded, or embedded on Medicare beneficiary cards and that any identifier displayed on such cards is not identifiable as a Social Security account number (or derivative thereof).¹⁵ As of July 2015, CMS had started the Social Security Number Removal Initiative in response to the law and was in the process of establishing a program management organization to continue the planning and execution of the initiative.

- **Implementing actions authorized by the Patient Protection and Affordable Care Act (PPACA).**¹⁶ In addition to provisions to expand health insurance coverage, PPACA provides CMS with certain authorities to combat fraud, waste, and abuse in Medicare. We

¹³GAO, *Medicare: CMS Needs an Approach and a Reliable Cost Estimate for Removing Social Security Numbers from Medicare Cards*, [GAO-12-831](#) (Washington, D.C.: Aug. 1, 2012).

¹⁴GAO, *Medicare Information Technology: Centers for Medicare and Medicaid Services Needs to Pursue a Solution for Removing Social Security Numbers from Cards*, [GAO-13-761](#) (Washington, D.C.: Sept. 10, 2013).

¹⁵Pub. L. No. 114-10, § 501, 129 Stat. 87, 163 (Apr. 16, 2015).

¹⁶Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010). In this statement, references to PPACA include amendments made by the Health Care and Education Reconciliation Act of 2010.

reported in our February 2015 update to our high-risk series that CMS should fully exercise its PPACA authority related to strengthening its provider and supplier enrollment provisions.¹⁷ For example, CMS should require surety bonds—a three-party agreement in which a company, known as a surety, agrees to compensate the bondholder if the bond purchaser fails to keep a specified promise—for certain at-risk providers and suppliers.

- **Strengthening verification of providers and suppliers.** As we reported in June 2015, we estimated that about 22 percent of Medicare providers' and suppliers' practice location addresses were potentially ineligible.¹⁸ For example, we identified 46 instances out of a generalizable sample of 496 addresses in which practice location addresses were inside a mailing store similar to a UPS Store. We also identified other locations that were potentially ineligible, including vacant addresses and unrelated establishments. In addition, we found 147 out of about 1.3 million physicians listed as eligible to bill Medicare who, as of March 2013, had received a final adverse action from a state medical board for crimes against persons, financial crimes, and other types of felonies but were either not revoked from the Medicare program until months after the adverse action or never removed. We recommended that CMS modify the software integrated into the provider enrollment database to include specific flags to help identify potentially questionable practice location addresses, revise guidance for verifying practice locations, and collect additional license information. CMS agreed with our recommendations to modify its software and collect license information but did not agree to revise its guidance for verifying practice location addresses.

Medicaid

In fiscal year 2014, the federal share of estimated Medicaid outlays was \$304 billion, and HHS reported approximately \$17.5 billion in estimated Medicaid improper payments. The size and diversity of the Medicaid program make it particularly vulnerable to improper payments, including payments made for people not eligible for Medicaid or for services not actually provided. CMS has an important role in overseeing and supporting state efforts to reduce and recover improper payments and

¹⁷[GAO-15-290](#).

¹⁸GAO, *Medicare Program: Additional Actions Needed to Improve Eligibility Verification of Providers and Suppliers*, [GAO-15-448](#) (Washington, D.C.: June 25, 2015).

has demonstrated some leadership commitment in this area.¹⁹ For example, CMS issued guidance to improve corrective actions taken by states. CMS also established the Medicaid Integrity Institute, which provides training and technical assistance to states on approaches to prevent improper payments and guidance on program integrity issues.

In our February 2015 high-risk update, we reported that while CMS had taken these positive steps in recent years, in several areas, CMS had still to address issues and recommendations that had not been fully implemented.²⁰ These issues include implementing effective program integrity processes for managed care, ensuring clear reporting of overpayment recoveries, and refocusing program integrity efforts on approaches that are cost-effective. The following are actions that we recommended CMS take to help reduce Medicaid improper payments and improve program integrity.

- **Improving third-party liability efforts.** Congress generally established Medicaid as the health care payer of last resort, meaning that if enrollees have another source of health care coverage—such as private insurance—that source should pay, to the extent of its liability, before Medicaid does. This is referred to as third-party liability. However, there are known challenges to ensuring that Medicaid is the payer of last resort. For example, states have reported challenges obtaining out-of-state coverage data from private insurers. Without such data, it is difficult for states to reliably identify or recover payments from liable private insurers not licensed in the state. While CMS has issued guidance to states, in January 2015 we recommended additional actions that could help to improve cost-saving efforts in this area, such as (1) monitoring and sharing information on third-party liability efforts and challenges across all states and (2) providing guidance to states on oversight of third-party liability efforts related to Medicaid managed care plans.²¹ HHS agreed with our recommendations and in May 2015 reported that CMS has begun developing a work plan to implement the recommendations.

¹⁹Medicaid is designed as a federal-state partnership. The program is financed jointly by the federal government and states, administered at the state level, and overseen at the federal level by CMS.

²⁰[GAO-15-290](#).

²¹GAO, *Medicaid: Additional Federal Action Needed to Further Improve Third-Party Liability Efforts*, [GAO-15-208](#) (Washington, D.C.: Jan. 28, 2015).

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- **Increasing oversight of managed care.** Most Medicaid beneficiaries receive services through a managed care system, and Medicaid managed care expenditures have been growing at a faster rate than fee-for-service expenditures.²² In May 2014, we reported that most state and federal program integrity officials we interviewed told us that they did not closely examine managed care payments, focusing on fee-for-service claims instead.²³ HHS agreed with our recommendation to update Medicaid managed care guidance on program integrity practices and effective handling of managed care organization recoveries. On June 1, 2015, the agency issued a proposed rule to revise program integrity policies, including policy measures that we have recommended.²⁴ Among other measures, the rule, if finalized, would require states to conduct audits of managed care organizations' service utilization and financial data every 3 years and standardize the treatment of recovered overpayments by plans.
 - **Strengthening program integrity.** In November 2012, we reported that CMS could do more to eliminate duplication and improve efficiency of its Medicaid integrity efforts.²⁵ Since then, CMS has taken positive steps to oversee program integrity efforts in Medicaid, including reconfiguring its approach in 2013 to reduce duplicate reviewing and auditing of states' claims and improve efficiencies in its audits, redesigning its comprehensive reviews of states' program integrity activities toward a more targeted risk assessment approach, and increasing its efforts to hold states accountable for reliably reporting program integrity recoveries. However, CMS has not strengthened its efforts to calculate return on investment (ROI) for its program integrity efforts, as we recommended in November 2012. In January 2015, CMS officials confirmed that the agency is developing a methodology for measuring and calculating a single ROI that reflects the Center for Program Integrity's initiatives for both Medicare

²²Under a Medicaid managed care system, states contract with managed care organizations to provide or arrange for medical services and prospectively pay the organizations a per person, or capitated, payment. Under a fee-for-service system, health care providers claim reimbursement from state Medicaid programs for services rendered to Medicaid beneficiaries.

²³GAO, *Medicaid Program Integrity: Increased Oversight Needed to Ensure Integrity of Growing Managed Care Expenditures*, [GAO-14-341](#) (Washington, D.C.: May 19, 2014).

²⁴80 Fed. Reg. 31098 (June 1, 2015).

²⁵GAO, *Medicaid Integrity Program: CMS Should Take Steps to Eliminate Duplication and Improve Efficiency*, [GAO-13-50](#) (Washington, D.C.: Nov. 13, 2012).

and Medicaid, and they expect to have their methodology finalized later this year. We will assess the finalized ROI methodology when it is available.

Earned Income Tax Credit

In fiscal year 2014, the Internal Revenue Service (IRS) reported program payments of \$65.2 billion for EITC.²⁶ IRS estimated that 27.2 percent, or \$17.7 billion, of these program payments were improper.²⁷ The estimated improper payment rate for EITC has remained relatively unchanged since fiscal year 2003 (the first year IRS had to report estimates of these payments to Congress), but the amount of improper EITC payments increased from an estimated \$10.5 billion in fiscal year 2003 to nearly \$18 billion in fiscal year 2014 because of growth in the EITC program overall.

The persistent problems with improper EITC payments—which we have highlighted for years—are one reason we continue to designate IRS enforcement of tax laws as a high-risk area.²⁸ As we have reported, a root cause of EITC noncompliance is that eligibility is determined by taxpayers themselves or their tax return preparers and that IRS’s ability to verify eligibility before issuing refunds is limited.

²⁶Congress established EITC in 1975. It is used to (1) offset the impact of Social Security taxes on low-income families and (2) encourage low-income families to seek employment rather than public assistance. Taxpayers who are eligible individuals may take a refundable credit for a portion of their earned income. Generally, credit amounts depend on the number of qualifying children who meet age, relationship, and residency tests. The credit gradually increases with income (the phase-in range), plateaus at a maximum amount (the plateau range), and then gradually decreases until it reaches zero (the phaseout range). For EITC, program payments include tax expenditures (a tax credit that offsets income taxes) and outlays (a refund if the credit exceeds the amount of taxes owed).

²⁷EITC overpayments are the difference between the EITC amount claimed by the taxpayer on his or her return and the amount the taxpayer should have claimed (both tax expenditures and outlays, if applicable). EITC underpayments are defined as the amount of EITC disallowed by IRS in processing that should have been allowed.

²⁸[GAO-15-290](#). See also GAO, *Government Efficiency and Effectiveness: Opportunities to Reduce Fragmentation, Overlap, Duplication, and Improper Payments and Achieve Other Financial Benefits*, [GAO-15-440T](#) (Washington, D.C.: Mar. 4, 2015); *High-Risk Series: An Update*, [GAO-05-207](#) (Washington, D.C.: January 2005); and *Financial Management: Billions in Improper Payments Continue to Require Attention*, [GAO-01-44](#) (Washington, D.C.: Oct. 27, 2000).

The Department of the Treasury (Treasury) divides EITC improper payments into two categories: authentication and verification.²⁹ Authentication errors include errors associated with IRS's inability to validate qualifying child requirements, taxpayers' filing status, and EITC claims associated with complex or nontraditional living situations. Verification errors relate to IRS's inability to identify individuals improperly reporting income to claim EITC amounts to which they are not entitled. Verification errors include underreporting and overreporting of income by wage earners as well as taxpayers who report that they are self-employed. Although the EITC program has been modified a number of times since its enactment in 1975 to reduce complexity and help improve the program's administration, complexity has remained a key factor contributing to improper payments in the program.

IRS has undertaken a number of compliance and enforcement activities to reduce EITC improper payments, and Treasury reported in its fiscal year 2014 agency financial report that it protected an estimated \$3.5 billion in federal revenue in fiscal year 2014.³⁰ Among other things, IRS uses audits to help identify EITC improper payments, and in June 2014, we reported that about 45 percent of correspondence audits (audits done by mail) that closed in fiscal year 2013 focused on EITC issues.³¹ IRS has reported that tax returns with EITC claims were twice as likely to be audited as other tax returns. However, we found that the effectiveness of these audits may be limited because since 2011 there have been regular backlogs in the audits, which have resulted in delays in responding to taxpayer responses and inquiries. We also found that unclear correspondence generated additional work for IRS, such as telephone calls to IRS examiners. These issues have imposed burdens on taxpayers and costs for IRS. IRS acknowledged these concerns and has initiated several programs to address EITC improper payments, such as increasing outreach and education to taxpayers and tax return preparers.

²⁹Treasury Inspector General for Tax Administration, *Existing Compliance Processes Will Not Reduce the Billions of Dollars in Improper Earned Income Tax Credit and Additional Child Tax Credit Payments*, Reference Number 2014-40-093 (Washington, D.C.: Sept. 29, 2014).

³⁰Protected revenue refers to the total value of erroneous payments prevented or recovered through compliance activities.

³¹GAO, *IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden*, [GAO-14-479](#) (Washington, D.C.: June 5, 2014).

Legislative action and significant changes in IRS compliance processes likely would be necessary to make any meaningful reduction in improper payments. We have previously recommended matters for congressional consideration or executive actions that if effectively implemented, could help reduce EITC improper payments as well as the tax gap, as discussed later in this statement.

Recent Legislation and Guidance Have Focused Attention on Estimating and Reducing Improper Payments and Identifying Root Causes, Including Fraud

Recent Legislation and Guidance Related to Improper Payments

The Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA) is the latest in a series of laws Congress has passed to address improper payments.³² IPERIA directs the Office of Management and Budget (OMB) to annually identify a list of high-priority programs for greater levels of oversight and review, including establishing annual targets and semiannual or quarterly actions for reducing improper payments. Previously, the Improper Payments Elimination and Recovery Act of 2010 (IPERA) established a requirement for agency OIGs to report annually on agencies' compliance with specific criteria contained in IPERA, including publishing estimates and corrective action plans for

³²Pub. L. No. 112-248, 126 Stat. 2390 (Jan. 10, 2013).

programs deemed to be susceptible to significant improper payments and reporting gross improper payment rates of less than 10 percent.³³

IPERIA also enacted into law a Do Not Pay initiative, which is a web-based, centralized data-matching service that allows agencies to review multiple databases to help determine a recipient's award or payment eligibility prior to making payments. Similarly, the Digital Accountability and Transparency Act of 2014 (DATA Act) calls on Treasury to establish a data analysis center, or to expand an existing service, to provide data, analytic tools, and data management techniques for preventing or reducing improper payments.³⁴ As we have previously stated, effective implementation of the DATA Act and the use of data analytic tools could help agencies to prevent, detect, and reduce improper payments.³⁵

In addition to these legislative initiatives, OMB has continued to play a key role in the oversight of government-wide improper payments. OMB has established guidance for federal agencies on reporting, reducing, and recovering improper payments as required by IPIA, as amended, and on

³³IPERA contains six criteria for compliance. The six criteria are that the entity has (1) published an annual financial statement and accompanying materials in the form and content required by OMB for the most recent fiscal year and posted that report on the entity website; (2) conducted a risk assessment for each specific program or activity that conforms with IPIA, as amended; (3) published estimates of improper payments for all programs and activities identified as susceptible to significant improper payments under the entity's risk assessment; (4) published corrective action plans for programs and activities assessed to be at risk for significant improper payments; (5) published and met annual improper payment reduction targets for all programs and activities assessed to be at risk for significant improper payments; and (6) reported a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published. Fiscal year 2014 was the fourth year for which OIGs were required to issue annual reports on agencies' compliance with the six criteria listed in IPERA. Under OMB implementing guidance, the reports should be completed within 180 days of the publication of the federal agencies' annual performance and accountability reports or agency financial reports.

³⁴Pub. L. No. 113-101, 128 Stat. 1146 (May 9, 2014), *codified at* 31 U.S.C. § 6101 note. The DATA Act amended the Federal Funding Accountability and Transparency Act of 2006.

³⁵For more information on the DATA Act, see GAO, *Federal Spending Accountability: Preserving Capabilities of Recovery Operations Center Could Help Sustain Oversight of Federal Expenditures*, [GAO-15-814](#) (Washington, D.C.: Sept. 14, 2015), and *DATA Act: Progress Made in Initial Implementation but Challenges Must be Addressed as Efforts Proceed*, [GAO-15-752T](#) (Washington, D.C.: July 29, 2015).

Root Causes of Improper Payments

protecting privacy while reducing improper payments with the Do Not Pay initiative.³⁶

According to OMB's guidance in effect for fiscal year 2014, agencies were required to classify the root causes of estimated improper payments into three general categories for reporting purposes. As we previously reported, detailed analysis of the root causes of improper payments can help agencies to identify and implement targeted corrective actions.³⁷ The categories are (1) administrative and documentation errors, including errors caused by absence of supporting documentation necessary to verify the accuracy of a payment or by incorrect processing of payments by an agency; (2) authentication and medical necessity errors, including those caused by inability to authenticate eligibility criteria or providing a service that was not medically necessary; and (3) verification errors, including those caused by failure or inability to verify recipient information, such as income or work status, or beneficiaries failing to report correct information to an agency. Examples of root causes of improper payments that agencies identified for fiscal year 2014 include the following:

- **Administrative and documentation errors.** The Small Business Administration identified loan processing and disbursement staff that did not consistently follow guidance in standard operating procedures and policy memos for determining loan eligibility as a root cause of improper payments in its Disaster Loan program.
- **Authentication and medical necessity errors.** HHS reported a root cause of Medicare Fee-for-Service improper payments as inpatient hospital claims for short stays that were determined not to be medically necessary in an inpatient setting and should have been billed as outpatient.
- **Verification errors.** For EITC, Treasury identified misreporting of income by wage earners as one of the root causes of improper

³⁶Office of Management and Budget, *Appendix C to Circular No. A-123, Requirements for Effective Estimation and Remediation of Improper Payments*, OMB Memorandum M-15-02 (Washington, D.C.: Oct. 20, 2014); Revised, *Financial Reporting Requirements*, OMB Circular No. A-136 (Washington, D.C.: Sept. 18, 2014); and *Protecting Privacy while Reducing Improper Payments with the Do Not Pay Initiative*, OMB Memorandum M-13-20 (Washington, D.C.: Aug. 16, 2013).

³⁷GAO, *Improper Payments: Government-Wide Estimates and Reduction Strategies*, [GAO-14-737T](#) (Washington, D.C.: July 9, 2014).

payments. Likewise, the Social Security Administration reported that unreported financial accounts and wages were a source of Supplemental Security Income improper payments.

The three categories for reporting root causes of errors were very general, and in July 2014 we reported that a more detailed analysis could help agencies to identify and implement more effective preventive and detective controls and corrective actions in the various programs.³⁸

OMB's guidance in effect for fiscal year 2015 directs agencies to report on the causes of improper payments using more detailed categories than those previously required, such as program design issues or administrative errors at the federal, state, or local agency level. OMB requested that the four agencies with the largest high-priority programs implement the revised guidance early—by April 30, 2015—using fiscal year 2014 information.³⁹ This included developing comprehensive corrective action plans for each program that describe root causes and establish critical path milestones to meet improper payment reductions; identifying improper payments using the new, more detailed categories outlined in the guidance; and developing plans to provide reasonable assurance that internal controls over improper payments are in place and are working effectively. Each of the four agencies submitted a letter to OMB describing its efforts to implement the guidance early. While the revised guidance—and efforts to implement it early—may help agencies to reduce improper payments, it is too soon to determine its impact.

Fraud

Fraud is one specific type of improper payment and is particularly difficult to identify and estimate. Fraud involves obtaining something of value through willful misrepresentation.⁴⁰ Whether an act is fraudulent is determined through the judicial or other adjudicative system. According to OMB guidance, agencies should refer matters involving possible fraudulent activities to the appropriate parties, such as the relevant Office of the Inspector General (OIG) or the Department of Justice (DOJ).

³⁸[GAO-14-737T](#).

³⁹The four agencies were the Departments of Health and Human Services, Labor, and the Treasury and the Social Security Administration.

⁴⁰GAO, *Government Auditing Standards: 2011 Revision*, [GAO-12-331G](#) (Washington, D.C.: December 2011).

There are known cases in which improper payments are directly attributable to fraud. Further, a lack of sufficient supporting documentation may mask the true causes of improper payments—including fraud. When payments lack the appropriate supporting documentation, their validity cannot be determined. It is possible that these payments were for valid purposes, but it is also possible that the lack of documentation could conceal fraudulent activities. For fiscal year 2014, HHS cited documentation errors as a major contributor to improper payments in certain components of its Medicare Fee-for-Service program, such as durable medical equipment and home health claims.⁴¹

We have found these areas to be vulnerable to fraud in our past work, and recent cases continue to raise concern in these areas.⁴² For example, in June 2015, DOJ announced charges against 243 individuals for approximately \$712 million in false Medicare billing related to various health care fraud-related crimes nationwide. According to DOJ, the individuals charged included 46 doctors, nurses, and other licensed medical professionals, and in many cases, the alleged fraud included various medical treatments and services—such as home health care, psychotherapy, physical and occupational therapy, durable medical equipment, and prescription drug treatments—that were medically unnecessary or never performed. Likewise, in 2012, 7 individuals were arrested and indicted on charges related to their alleged participation in a scheme that involved fraudulent claims of nearly \$375 million for home health services that were either not provided or not medically necessary.

For fiscal year 2014, HHS and DOJ reported that the federal government won or negotiated over \$2.3 billion in health care fraud judgments and settlements through the Health Care Fraud and Abuse Control (HCFAC)

⁴¹When estimating Medicare Fee-for-Service improper payments, HHS contractors request documentation from providers multiple times before determining that payments lack sufficient supporting documentation.

⁴²GAO, *Health Care Fraud: Types of Providers Involved in Medicare, Medicaid, and the Children's Health Insurance Program Cases*, [GAO-12-820](#) (Washington, D.C.: Sept. 7, 2012).

program.⁴³ In fiscal year 2014, DOJ opened 924 new criminal health care fraud investigations, and HHS OIG investigations resulted in 867 criminal actions and 529 civil actions.⁴⁴ Table 1 lists other examples of fraud in various programs.

Table 1: Recent Examples of Reported Fraud in Government Programs

| Program | Description of reported fraud |
|--------------------------|---|
| Medicare | Two people were recently sentenced to prison for providing unnecessary psychiatric services, falsifying records for psychotherapy treatment that had not been provided, and intercepting patient billing statements to prevent them from identifying treatments that were not provided. |
| Medicaid | A recent Medicaid fraud scheme involved a business that provided personal aide care to the elderly and disabled. The business owners falsified documentation to support face-to-face visits with patients that never occurred. |
| Unemployment Insurance | A woman was convicted of submitting falsified claims that listed individuals and businesses for which she was not employed—including one claim for when she was incarcerated. She also submitted a claim for benefits using the identity of another individual. A man was sentenced to 6 years in prison for creating several fictitious companies and using names and Social Security numbers of unsuspecting individuals registered as employees of these fictitious companies to obtain fraudulent unemployment benefits. |
| Earned Income Tax Credit | A man was sentenced to prison for selling to clients the names and Social Security numbers of individuals used to improperly claim dependents and related tax credits, such as the Earned Income Tax Credit. |

Source: GAO summary of Department of Justice press releases. | GAO-16-92T

Additionally, we have recently reported on cases of potential fraud in various programs.⁴⁵

⁴³The Health Insurance Portability and Accountability Act of 1996 (HIPAA) established the HCFAC program to help combat fraud and abuse in health care programs, such as Medicare and Medicaid. HCFAC program goals include coordinating federal, state, and local law enforcement efforts to control fraud and abuse associated with health plans; conducting investigations and audits related to health care; and facilitating the enforcement of civil, criminal, and administrative statutes applicable to health care. HHS and DOJ jointly administer the program, and HIPAA requires them to issue a joint report annually to Congress.

⁴⁴Department of Health and Human Services and Department of Justice, *Annual Report of the Departments of Health and Human Services and Justice: Health Care Fraud and Abuse Control Program FY 2014* (Washington, D.C.: Mar. 16, 2015).

⁴⁵Where appropriate, we referred cases of potential fraud to the appropriate officials for further review.

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- As we reported in August 2014, we identified 28 cases of potential fraud related to Supplemental Nutrition Assistance Program benefits (food stamps).⁴⁶ Over 30 days, we detected 28 postings from one popular e-commerce website that advertised the potential sale of food stamp benefits in exchange for cash, services, and goods—including places to live, vehicles, cooking and cleaning services, phones, and beer. We recommended that the Department of Agriculture take steps to improve antifraud efforts, such as reassessing federal financial incentives for cost-effective state activities and issuing guidance to enhance the consistency of state reporting on these efforts.
 - In December 2014, we reported approximately \$39 million of Hurricane Sandy assistance as at risk for potential fraud or improper payments.⁴⁷ Among other issues, these cases included instances in which Social Security numbers were not valid or were used by multiple recipients, rental assistance was received while the recipient was incarcerated, and duplicate payments were not flagged by the Federal Emergency Management Agency (FEMA). We recommended that FEMA assess the cost and feasibility of obtaining additional data—such as the Social Security Administration’s full death file or data necessary to verify self-reported information on private homeowner’s insurance—to help identify potentially fraudulent or improper applications for assistance.
 - As we reported in May 2015, we found thousands of Medicaid beneficiaries and hundreds of providers involved in potential improper or fraudulent payments in four selected states (Arizona, Florida, Michigan, and New Jersey) during fiscal year 2011, which at the time of our study was the most recent year for which reliable data were available.⁴⁸ For example, people using the identities of about 200 deceased beneficiaries received about \$9.6 million in Medicaid benefits subsequent to the beneficiaries’ deaths, and about 90 providers had suspended or revoked licenses in the state where they performed Medicaid services yet received a combined total of at least

⁴⁶GAO, *Supplemental Nutrition Assistance Program: Enhanced Detection Tools and Reporting Could Improve Efforts to Combat Recipient Fraud*, [GAO-14-641](#) (Washington, D.C.: Aug. 21, 2014).

⁴⁷GAO, *Hurricane Sandy: FEMA Has Improved Disaster Aid Verification but Could Act to Further Limit Improper Assistance*, [GAO-15-15](#) (Washington, D.C.: Dec. 12, 2014).

⁴⁸GAO, *Medicaid: Additional Actions Needed to Help Improve Provider and Beneficiary Fraud Controls*, [GAO-15-313](#) (Washington, D.C.: May 14, 2015).

\$2.8 million from those states. We recommended that CMS issue guidance for screening beneficiaries who are deceased and supply more-complete data for screening Medicaid providers. HHS concurred with both of the recommendations and stated it would provide state-specific guidance to address them.

While fraud can be more difficult to address than other types of improper payments, implementing strategies to reduce improper payments in general may also help to reduce opportunities for fraud. In July 2015, we issued *A Framework for Managing Fraud Risks in Federal Programs* (Framework).⁴⁹ The Framework identifies a comprehensive set of leading practices that serve as a guide for program managers to use when developing or enhancing efforts to combat fraud in a strategic, risk-based manner. Minimizing fraud risks in federal agency programs can help reduce improper payments and enhance program integrity. The leading practices described in the Framework include control activities to prevent, detect, and respond to fraud, with an emphasis on prevention, as well as structures and environmental factors that influence or help managers achieve their objective to mitigate fraud risks. In addition, the Framework calls for management to conduct monitoring and incorporate feedback on an ongoing basis. As the steward of taxpayer dollars, federal managers have the ultimate responsibility in overseeing how hundreds of billions of dollars are spent annually. Thus, they are well positioned to use these practices, while considering the related fraud risks as well as the associated costs and benefits of implementing the practices, to help ensure that taxpayer resources are spent efficiently and effectively.

Unreliable Estimates and Agency Noncompliance Hinder Efforts to Understand Causes and Extent of the Issue

While there are positive steps being taken toward estimating and reducing improper payments, agencies continue to face challenges in these areas. In our report on the *Fiscal Year 2014 Financial Report of the United States Government*, we continued to report a material weakness in internal control related to improper payments because the federal government is unable to determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken

⁴⁹GAO, *A Framework for Managing Fraud Risks in Federal Programs*, [GAO-15-593SP](#) (Washington, D.C.: July 2015).

Potentially Inaccurate Risk Assessments

to reduce them.⁵⁰ Challenges include risk assessments that may not accurately assess the risk of improper payment, risk-susceptible programs that did not report improper payment estimates, estimation methodologies that may not produce reliable estimates, and noncompliance with legislative requirements.

Agencies are required to conduct their own risk assessments to determine which of their programs are susceptible to significant improper payments and then estimate improper payments for these susceptible programs. However, issues related to certain agencies' risk assessments have been identified, which calls into question whether these agencies are actually identifying all programs that are susceptible to significant improper payments.

- We reported in December 2014 that the Department of Energy's (DOE) improper payment risk assessments did not always include a clear basis for risk determinations and did not fully evaluate other relevant risk factors, such as deficiencies in key controls for preventing and detecting improper payments.⁵¹ For example, some assessments we reviewed did not contain enough information for us to determine how the entities responsible for making payments on behalf of the department arrived at their risk determinations, raising questions about who at the agency was responsible for reviewing and approving risk assessments for consistency. In another example, agency officials told us that contract audits were not always performed in a timely manner, which introduces a risk that improper payments will also not be identified in a timely manner.⁵² DOE's risk assessment guidance did not require that programs consider risk factors related to internal control deficiencies, such as untimely contract audits. DOE concurred with our recommendations to improve its risk assessments, including revising guidance on how programs are to address risk

⁵⁰GAO, *Financial Audit: U.S. Government's Fiscal Years 2014 and 2013 Consolidated Financial Statements*, [GAO-15-341R](#) (Washington, D.C.: Feb. 26, 2015).

⁵¹GAO, *Improper Payments: DOE's Risk Assessments Should Be Strengthened*, [GAO-15-36](#) (Washington, D.C.: Dec. 23, 2014).

⁵²Contract auditing assists in achieving prudent contracting by providing those responsible for government procurement with financial information and advice relating to contractual matters and the effectiveness, efficiency, and economy of contractors' operations. Depending on the contract type, various contract audit activities can occur in the preaward, award, and administration and management phases of a contract.

Programs That Do Not Report Improper Payment Estimates

factors and directing programs to consider other risk factors likely to contribute to improper payments.

- In April 2015, the Treasury Inspector General for Tax Administration (TIGTA) continued to report that IRS's risk assessment process did not provide a valid assessment of improper payments in certain IRS programs and did not adequately address specific risks commonly associated with verifying refundable credit claims.⁵³ For example, while IRS designated the Additional Child Tax Credit program as low risk, TIGTA estimated that fiscal year 2013 improper payments in this program were from 25.2 percent to 30.5 percent, or \$5.9 billion to \$7.1 billion.

We found that not all agencies had developed improper payment estimates for all of the programs and activities they identified as susceptible to significant improper payments. Specifically, two federal agencies did not report estimated improper payment amounts for four risk-susceptible programs. For example, HHS did not report an improper payment estimate in fiscal year 2014 for its Temporary Assistance for Needy Families (TANF) program, which had program outlays of about \$16.3 billion and, according to HHS's fiscal year 2014 agency financial report, is considered susceptible to significant improper payments by OMB.⁵⁴ HHS cited statutory limitations for its state-administered TANF program as prohibiting it from requiring states to participate in developing an improper payment estimate for the program.⁵⁵ In its March 2012 report

⁵³TIGTA, *Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014*, Reference Number 2015-40-044 (Washington, D.C.: Apr. 27, 2015).

⁵⁴The three remaining risk-susceptible programs that did not report an improper payment estimate for fiscal year 2014 were in the Department of Homeland Security (DHS)—the Customs and Border Protection Administratively Uncontrollable Overtime, Port Security Grant, and Federal Emergency Management Agency Vendor Pay (non-Disaster Relief Fund) programs. According to its fiscal year 2014 agency financial report, DHS plans to report improper payment estimates for these programs in fiscal year 2015.

⁵⁵The term state-administered refers to federal programs that are managed on a day-to-day basis at the state level to carry out program objectives. In our June 2004 report, we recommended that HHS gather information on a recurring basis from all states on their internal control systems and noted that HHS may determine that it needs legislative action to direct states to provide the information. GAO, *TANF and Child Care Programs: HHS Lacks Adequate Information to Assess Risk and Assist States in Managing Improper Payments*, [GAO-04-723](#) (Washington, D.C.: June 18, 2004). While HHS took some steps to collect more information on states' internal controls, this does not constitute an improper payment estimate for TANF.

Potentially Unreliable or Understated Estimates

on the department's compliance with improper payment reporting, HHS's OIG recommended that the department develop an improper payment estimate for the TANF program and, if necessary, seek statutory authority to require state participation in such a measurement.⁵⁶

While some programs did not report estimates, improper payment estimates for certain programs may be unreliable. For example, because of long-standing financial management weaknesses, the Department of Defense (DOD) reported in its fiscal year 2014 agency financial report that it could not demonstrate that all payments subject to improper payment estimation requirements were included in the populations of payments for review. Therefore, its improper payment estimates, including the estimate for its Defense Finance and Accounting Service (DFAS) Commercial Pay program, may not be reliable. We previously reported that the foundation of reliable statistical sampling estimates is a complete, accurate, and valid population from which to sample.⁵⁷ While DFAS Commercial Pay's improper payment estimate is low, its program outlays are significant—approximately \$305 billion for fiscal year 2014. Consequently, a small change in the program's estimated error rate could result in a significant change in the dollar value of its improper payment estimate.

Further, flexibility in how agencies are permitted to implement improper payment estimation requirements can contribute to inconsistent or understated estimates. For example, in February 2015, we reported that DOD uses a methodology for estimating TRICARE improper payments that is less comprehensive than the methodology CMS used for Medicare.⁵⁸ Though the programs are similar in that they pay providers on a fee-for-service basis and depend on contractors to process and pay claims, TRICARE's methodology does not examine the underlying medical record documentation to discern whether each sampled payment

⁵⁶HHS's OIG stated in subsequent reports that it has continued to emphasize this recommendation, but the recommendation remains unimplemented.

⁵⁷[GAO-15-341R](#) and GAO, *DOD Financial Management: Significant Improvements Needed in Efforts to Address Improper Payment Requirements*, [GAO-13-227](#) (Washington, D.C. May 13, 2013).

⁵⁸GAO, *Improper Payments: TRICARE Measurement and Reduction Efforts Could Benefit from Adopting Medical Record Reviews*, [GAO-15-269](#) (Washington, D.C.: Feb. 18, 2015). TRICARE is a health care program for military servicemembers, retirees, and their families.

was supported or whether the services provided were medically necessary. On the other hand, Medicare's methodology more completely identifies improper payments beyond those resulting from claim processing errors, such as those related to provider noncompliance with coding, billing, and payment rules. As a result, the estimated improper payment error rates for TRICARE and Medicare are not comparable, and TRICARE's error rate is likely understated.⁵⁹ In addition, corrective actions for TRICARE improper payments do not address issues related to medical necessity errors—a significant contributor to Medicare improper payments. We recommended that DOD implement a more comprehensive TRICARE improper payment methodology and develop more robust corrective action plans that address the underlying causes of improper payments. DOD concurred with our recommendations and identified steps needed to implement them.

Noncompliance with Criteria in IPERA

In August 2015, we analyzed agency financial reports and OIG reports for fiscal years 2012 through 2014 and identified five programs with improper payment estimates greater than \$1 billion that have been noncompliant with at least one of the six criteria listed in IPERA for 3 consecutive years, as shown in table 2.⁶⁰ These five programs account for \$75.9 billion, or 61 percent of the fiscal year 2014 government-wide reported improper payment estimate.

⁵⁹For fiscal year 2014, estimated error rates were 0.9 percent for TRICARE and 12.7 percent for Medicare Fee-for-Service.

⁶⁰In December 2014, we reported on agency compliance with the criteria contained in IPERA for fiscal year 2013, as reported by OIGs. See GAO, *Improper Payments: Inspector General Reporting of Agency Compliance under the Improper Payments Elimination and Recovery Act*, [GAO-15-87R](#) (Washington, D.C.: Dec. 9, 2014).

Table 2: Major Programs Noncompliant with Improper Payment Requirements for 3 Consecutive Years

| Program | Agency | Reported noncompliance issues |
|------------------------------|---|---|
| Medicare Fee-for-Service | Department of Health and Human Services | <ul style="list-style-type: none">• Improper payment error rate equal to or greater than 10 percent• Reduction target not met |
| Earned Income Tax Credit | Department of the Treasury | <ul style="list-style-type: none">• Improper payment error rate equal to or greater than 10 percent• Reduction target not published [Note A] |
| Unemployment Insurance | Department of Labor | <ul style="list-style-type: none">• Improper payment error rate equal to or greater than 10 percent• Reduction target not published [Note B] |
| Supplemental Security Income | Social Security Administration | <ul style="list-style-type: none">• Reduction target not met |
| School Lunch | Department of Agriculture | <ul style="list-style-type: none">• Improper payment error rate equal to or greater than 10 percent• Reduction target not met |

Source: GAO summary of agency financial reports and inspector general reports. | GAO-16-92T

Note A: The Department of the Treasury did not publish improper payment reduction targets for the Earned Income Tax Credit for fiscal years 2012 and 2013.

Note B: The Department of Labor did not publish a reduction target for fiscal year 2014 for the Unemployment Insurance program in its fiscal year 2013 agency financial report. However, according to paymentaccuracy.gov—the federal government’s website for improper payment information—the fiscal year 2014 reduction target for the Unemployment Insurance program was 10 percent, which the department did not meet.

According to IPERA, if a program is found to be noncompliant

- in a fiscal year, the agency must submit a plan to Congress describing the actions that the agency will take to bring the program into compliance;
- for 2 consecutive fiscal years, and if OMB determines that additional funding would help the agency improve, the agency and OMB may take steps to transfer or request additional funding for intensified compliance efforts; and
- for 3 consecutive years, the agency must submit to Congress a reauthorization proposal for each noncompliant program or activity or any proposed statutory changes the agency deems necessary to bring the program or activity into compliance.

Congressional oversight is important to help ensure that agencies and OMB effectively implement these requirements.

Strategies for Reducing Improper Payments Include Preventive and Detective Controls and Commitment to Implementing Required Actions

We have previously reported a number of strategies that can help agencies in reducing improper payments. After identifying and analyzing the root causes of improper payments, implementing effective preventive and detective controls that address those root causes could help advance the federal government's efforts to reduce improper payments. In addition, the level of importance federal agencies and the administration place on the efforts to implement the requirements established by IPERA and other laws and related guidance will be a key factor in determining their overall effectiveness in reducing improper payments and ensuring that federal funds are used efficiently and for their intended purposes.

Implementing strong preventive controls can serve as the frontline defense against improper payments. Proactively preventing improper payments increases public confidence in the administration of benefit programs and avoids the difficulties associated with the "pay and chase" aspects of recovering overpayments.⁶¹ The following are examples of preventive strategies, some of which are currently under way.

- **Up-front eligibility validation through data sharing.** Data sharing allows entities that make payments—to contractors, vendors, participants in benefit programs, and others—to compare information from different sources to help ensure that payments are appropriate. One example of data sharing is agencies' use of Social Security death data to guard against improper payments to deceased individuals or those who use deceased individuals' identities.⁶²
- **Predictive analytic technologies.** The Small Business Jobs Act of 2010 requires CMS to use predictive modeling and other analytic techniques—known as predictive analytic technologies—both to identify and to prevent improper payments under the Medicare Fee-for-Service program.⁶³ Through analysis of provider networks, billing patterns, and beneficiary utilization patterns, unusual or suspicious

⁶¹"Pay and chase" refers to the labor-intensive and time-consuming practice of trying to recover overpayments once they have already been made rather than preventing improper payments in the first place. See GAO, *Highlights of a Forum: Data Analytics For Oversight and Law Enforcement*, [GAO-13-680SP](#) (Washington, D.C.: July 2013).

⁶²GAO, *Improper Payments: Government-Wide Estimates and Use of Death Data to Prevent Payments to Deceased Individuals*, [GAO-15-482T](#) (Washington, D.C.: Mar. 16, 2015).

⁶³Pub. L. No. 111-240, § 4241 (Sept. 27, 2010).

patterns or abnormalities can be identified and used to prioritize investigation of suspicious transactions.

- **Program design review and refinement.** Improper payments may be caused by specific aspects of a given program, providing agencies with opportunities to address improper payments through improved program design. For example, to the extent that provider enrollment and eligibility verification problems are identified as a significant root cause in a specific program, agencies may look to establish enhanced controls in this area. Further, exploring whether certain complex or inconsistent program requirements—such as eligibility criteria and requirements for provider enrollment—contribute to improper payments may lend insight to developing effective strategies for enhancing compliance and may identify opportunities for streamlining or changing eligibility or other program requirements.

Although strong preventive controls remain the frontline defense against improper payments, effective detection techniques can help to quickly identify and recover those overpayments that do occur. Detection activities play a significant role not only in identifying improper payments but also in providing data on why these payments were made and, in turn, highlighting areas that need strengthened preventive controls. Further, strong detective controls can act as a deterrent to those intentionally trying to obtain overpayments. The following are examples of key detection techniques.

- **Data mining.** Data mining is a computer-based control activity that analyzes diverse data for relationships that have not previously been discovered. Data mining allows an organization to efficiently query a financial system to identify potential improper payments, such as multiple payments for the same invoice to the same recipient on the same date, or to the same address. In another example, in May 2015, we reported that the Department of Transportation’s federal transit benefit program established procedures for conducting debit card transaction data mining, including reviews of debit card transactions to identify potential misuse or irregular activity, such as the purchase of nontransit items.⁶⁴ Similarly, we have found that if GAO had direct

⁶⁴GAO, *Federal Transit Benefit Program: DOT’s Debit-Card Internal Controls Are Designed to Be Consistent with Federal Standards*, [GAO-15-497](#) (Washington, D.C.: May 29, 2015).

access to the National Directory of New Hires, which includes wage and employment information, from HHS, this would facilitate the identification of possible improper payments in a variety of federal programs across the federal government.

- **Recovery auditing.** Recovery auditing is used to identify and recover overpayments. IPERA requires agencies to conduct recovery audits, if cost-effective, for each program or activity that expends \$1 million or more annually.⁶⁵ In its fiscal year 2014 agency financial report, HHS reported that the Medicare Fee-for-Service recovery audit program identified approximately \$1.9 billion and recovered \$2.4 billion in overpayments by the end of the fiscal year. The amount collected is higher than the amount identified because it includes overpayments collected in fiscal year 2014 that were identified in previous years.

To determine the full extent of improper payments government-wide and to more effectively recover and reduce them, as we reported in March 2015, continued agency attention is needed to (1) identify programs susceptible to improper payments, (2) develop reliable improper payment estimation methodologies, (3) report on improper payments as required, and (4) implement effective corrective actions based on root cause analysis.⁶⁶ For example, as previously stated, agencies with programs that have been noncompliant with criteria in IPERA must take certain actions to bring the programs into compliance. These actions could improve transparency and accountability for agency management of improper payments and provide an opportunity for congressional oversight. We have also reported that agency top management needs to provide greater attention to ensure compliance with the provisions of federal improper payment laws and related guidance, especially the issues identified in the OIG reports, to help reduce improper payments and ensure that federal funds are used efficiently and for their intended purposes. Absent such continued efforts, the federal government cannot be assured that taxpayer funds are adequately safeguarded. Likewise, implementing recommendations we have previously made to address

⁶⁵Some agencies have reported statutory or regulatory barriers that affect their ability to pursue recovery auditing. For example, the Department of Agriculture has stated that a section of the Department of Agriculture Reorganization Act of 1994 affects the Farm Service Agency's ability to recover improper payments.

⁶⁶GAO, *General Government: Governmentwide Improper Payments*, accessed July 20, 2015, http://gao.gov/duplication/action_tracker/Governmentwide_Improper_Payments.

sources of improper payments in the three programs with the largest estimates—Medicare, Medicaid, and EITC—could significantly contribute to reducing improper payments overall.

Need to Address a Significant Tax Gap

The tax gap has been a persistent problem for decades. In January 2012, IRS estimated that the gross tax gap was \$450 billion in tax year 2006 (the most current estimate available).⁶⁷ From 2001 to 2006, IRS estimated that the gross tax gap increased by \$105 billion. However, according to IRS during this period the percentage of taxes owed and paid on time remained relatively constant—just over 83 percent. IRS estimated that it would eventually recover about \$65 billion of the gross tax gap through late payments and enforcement actions, leaving an annual estimated net tax gap of about \$385 billion.⁶⁸

In the face of large and growing structural deficits, it is especially important to understand the causes of tax noncompliance and continue to develop new approaches to minimize noncompliance. The sheer size of the net tax gap—equivalent to roughly one-third of total federal discretionary spending—is reason enough to renew efforts to address its root causes. In addition to its effects on the deficit, tax noncompliance—intentional or not—could discourage compliant taxpayers and undermines the integrity of the tax system and the public’s confidence in it. This confidence is critical because the U.S. tax system relies heavily on voluntary compliance. If confidence declines, voluntary compliance is likely to decline as well. As we have previously testified, there are no easy fixes to reducing the tax gap.⁶⁹ Rather, the tax gap must be attacked on multiple fronts and with multiple strategies over a sustained period.

⁶⁷According to IRS officials, IRS plans to release an updated tax gap estimate in December 2015, at the earliest, which will be based on data from tax years 2008, 2009, and 2010.

⁶⁸The tax gap does not include taxes due from illegally derived income or various forms of fraud. For example, in general, refund fraud related to identity theft would not be included in the tax gap estimate because it does not involve evading a tax liability. For filing season 2013, IRS estimated that attempted identity theft refund fraud totaled about \$30 billion, of which \$5.8 billion was paid out.

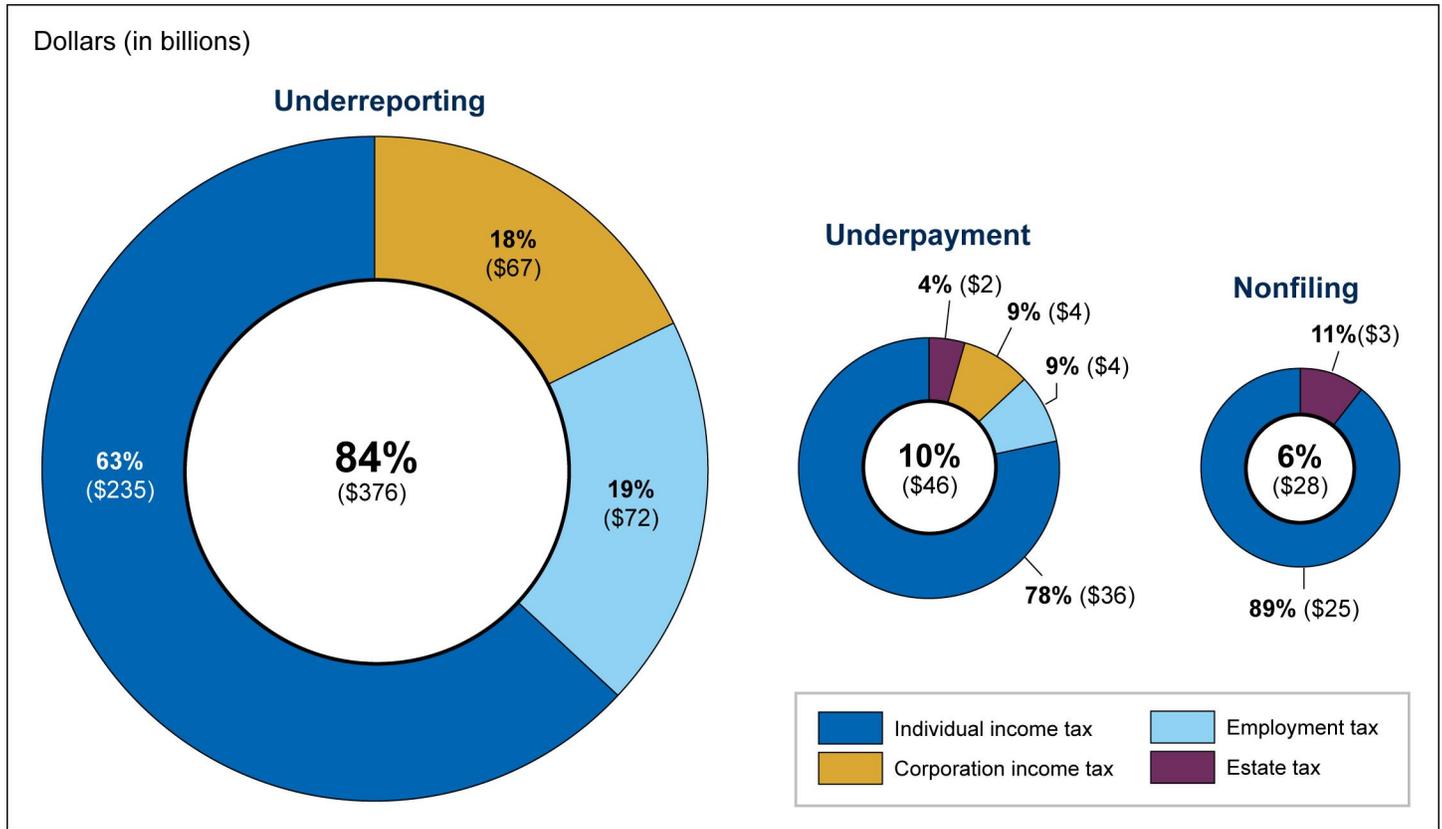
⁶⁹GAO, *Tax Gap: Sources of Noncompliance and Strategies to Reduce It*, [GAO-12-651T](#) (Washington, D.C.: Apr. 19, 2012), and *Tax Gap: Complexity and Taxpayer Compliance*, [GAO-11-747T](#) (Washington, D.C.: June 28, 2011).

Underreporting Is the Biggest Source of the Tax Gap

The tax gap is spread across different types of taxpayer noncompliance and five types of taxes that IRS administers: individual income, corporate income, employment, estate, and excise taxes. The tax gap arises when taxpayers do not report their full tax liability on filed tax returns (underreporting), do not pay the full amount of taxes reported on filed returns (underpayment), or do not file a required tax return (nonfiling). As shown in figure 3, underreporting accounts for the largest portion of the tax gap—\$376 billion of the \$450 billion tax gap for tax year 2006. Underreporting of tax liabilities can occur when taxpayers report earning less income than they actually earned or report greater tax deductions, credits, or other tax benefits than they were entitled to claim.⁷⁰ Individual income tax underreporting accounted for most—about \$235 billion—of the underreporting tax gap estimate for tax year 2006. Of that amount, IRS reported that over half—\$122 billion—comes from individuals' business income, including income from (1) sole proprietorships (persons who own unincorporated businesses by themselves), (2) partnerships (a group of two or more individuals or entities, such as corporations or other partnerships, that carry on a business), and (3) S-corporations (corporations meeting certain requirements that elect to be taxed under subchapter S of the Internal Revenue Code).

⁷⁰Other tax benefits available to taxpayers are exemptions and exclusions from income and preferential tax rates, such as those for capital gains.

Figure 3: Estimated Gross (\$450 Billion) Tax Gap Noncompliance by Source and Type of Tax for Tax Year 2006



Source: GAO analysis of IRS information. | GAO-16-92T

Note: Individual income tax includes individual business income tax. Excise tax is not shown in this graphic as IRS does not have an excise tax estimate for underreporting noncompliance or nonfiling noncompliance and estimates it is less than 1 percent of total underpayment noncompliance. In addition, IRS does not have an employment tax estimate for nonfiling noncompliance.

Reducing the Tax Gap Would Help Improve the Government's Fiscal Position and Promote Taxpayer Confidence

As we have previously reported, completely closing the tax gap is not feasible as it would entail more intrusive enforcement and more burdensome recordkeeping or reporting than the public is willing to accept, and more resources than IRS is able to commit.⁷¹ However, given the size of the gross tax gap, which is larger than the interest the United States paid on its debt in fiscal year 2014 (\$430 billion), even modest

⁷¹GAO-12-651T.

reductions would yield significant financial benefits and help improve the government's fiscal position. For example, just a 1 percent reduction in the 2006 net tax gap would recover about \$3.8 billion more in revenue legally owed for just that one year. For illustrative purposes,⁷² this amount of revenue could fund

- nearly 90 percent of the legislative branch, or
- over half the judicial branch, or
- the entire National Park Service, or
- the combined operations of the U.S. Census Bureau (\$1.1 billion), the Small Business Administration (\$0.9 billion), the Smithsonian (\$0.8 billion), the Library of Congress (\$0.6 billion) and the National Archives (\$0.4 billion).

Even when unintentional, tax noncompliance could discourage compliant taxpayers and undermines the integrity of the tax system and the public's confidence in it. For example, consider two taxpayers with similar tax situations—one who pays the full amount of tax due and the other who does not. The one who does not pay taxes is not meeting his or her obligation to fund government services and, in effect, shifts the fiscal burden to those who do pay. Also, IRS devotes resources to attempt to collect taxes due from the noncompliant taxpayer, resources that could be used for other purposes.

Likewise, noncompliance can create an unfair competitive advantage between businesses, as those that do not pay tax debts are avoiding costs that tax-compliant businesses are incurring. For instance, our past investigations identified instances in which federal contractors with tax debts won awards based on price differentials over tax compliant contractors. We made several recommendations to address the issue of

⁷²Examples are based on fiscal year 2015 appropriations.

federal contractors that do not pay their tax debts, most of which were implemented.⁷³

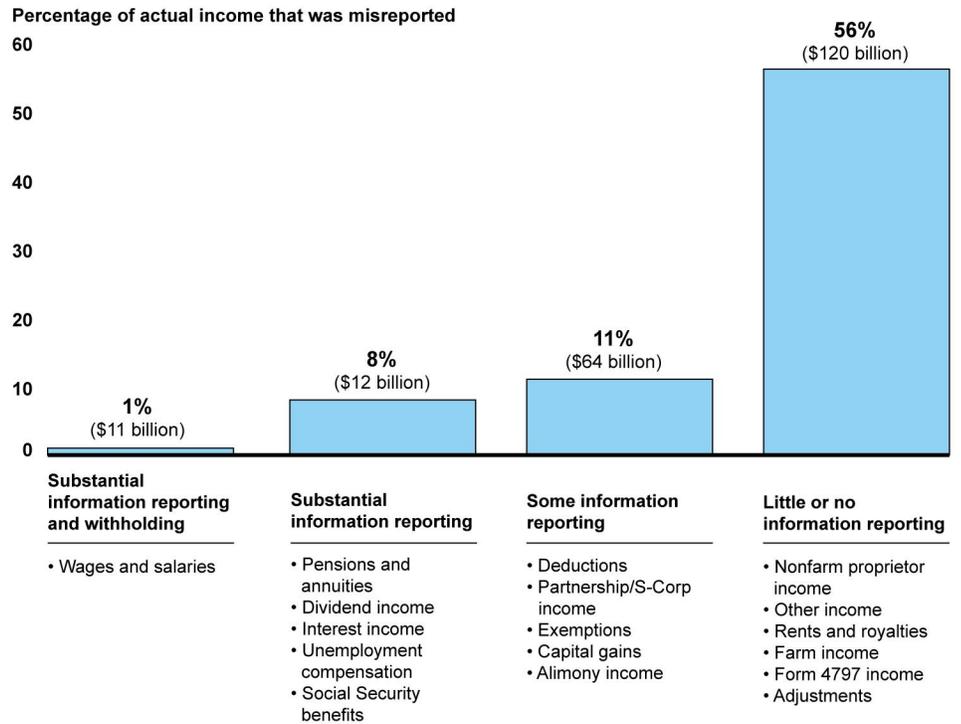
Key Factors Contributing to the Tax Gap Include Limited Third-party Information Reporting, Resource Trade-offs, and Complexities in the Tax Code

Our past work has found that three important factors contributing to the tax gap are the extent to which income is reported to IRS by third parties, IRS's resource trade-offs, and tax code complexity.

- **Limited third-party information reporting.** The extent to which individual taxpayers accurately report their income is correlated to the extent to which their income is reported to them and IRS (or taxes on that income are withheld) by third parties. For example, according to 2006 IRS data, for types of income for which there is little or no third-party information reporting, such as business income, over half of these types of income were misreported (see fig. 4). In contrast, employers report most wages and salaries to employees and IRS through Forms W-2 (Wage and Tax Statement). As shown below, nearly 99 percent of these types of income were accurately reported on individual tax returns. Similarly, banks and other financial institutions provide information returns (Forms 1099) to account holders and IRS showing taxpayers' annual income from some types of investments, and over 90 percent of these types of income were accurately reported.

⁷³We made recommendations to DOD, IRS, the Financial Management Service, and OMB to address issues with delinquent federal contractors. See GAO, *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, [GAO-05-637](#) (Washington, D.C.: June 16, 2005), and *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, [GAO-04-95](#) (Washington, D.C.: Feb. 12, 2004).

Figure 4: Effect of Third-Party Information Reporting on Taxpayer Compliance, Tax Year 2006



Source: IRS. | GAO-16-92T

Note: Percentages are not intended to sum to 100 percent. Each percentage shown refers to a different category of information reporting. For example, for income subject to substantial information reporting and withholding (such as wages and salaries), 1 percent of these income amounts are misreported; 99 percent of these income amounts are properly reported.

- **Resource trade-offs.** Since fiscal year 2010, IRS’s annual appropriations have declined by \$1.2 billion, and since fiscal year 2009, staffing has fallen by about 11,000 full-time equivalent employees.⁷⁴ At the same time, the agency’s workload has increased because of a surge in identity-related refund fraud and the implementation of key provisions of PPACA, among other reasons. As a result of this imbalance, for example, IRS decreased its individual examination (or audit) coverage rate by 20 percent from fiscal years

⁷⁴GAO, *Internal Revenue Service: Observations on IRS’s Operations, Planning, and Resources*, GAO-15-420R (Washington, D.C.: Feb. 27, 2015).

2013 to 2015. Reducing examinations can reduce revenues collected through such enforcement action and may indirectly reduce voluntary compliance.

- **Tax code complexity.** The federal tax system contains complex rules that may be necessary to appropriately target tax policy goals, such as providing benefits to specific groups of taxpayers. However, this complexity imposes a wide range of recordkeeping, planning, computing, and filing requirements upon taxpayers. For example, taxpayers who receive income from rents, self-employment, and other sources may be required to make complicated calculations and keep detailed records. This complexity can engender errors and underpaid taxes. Complexity, and the lack of transparency that it can create, can also exacerbate doubts about the tax system's integrity.

Tax expenditures—tax credits, deductions, exclusions, exemptions, deferrals, and preferential tax rates estimated by Treasury to reduce tax revenue by about \$1.2 trillion in fiscal year 2014—can add to tax code complexity in part because they require taxpayers to learn about, determine their eligibility for, and choose between tax expenditures that may have similar purposes. For example, as we reported in 2012, about 14 percent of filers in 2009 (1.5 million of almost 11 million eligible returns) failed to claim an education credit or deduction for which they appear eligible.⁷⁵ This complexity may be acceptable if tax expenditures achieve their intended purposes.⁷⁶ However, in many cases, their effectiveness is questionable or unknown. We have recommended greater scrutiny of tax expenditures since 1994, as periodic reviews could help determine how well specific tax expenditures achieve their goals and how their benefits and costs (including complexity) compare to those of other programs with similar goals.⁷⁷

⁷⁵GAO, *Higher Education: Improved Tax Information Could Help Families Pay for College*, [GAO-12-560](#) (Washington, D.C.: May 18, 2012).

⁷⁶GAO, *Tax Expenditures: IRS Data Available for Evaluations Are Limited*, [GAO-13-479](#) (Washington, D.C.: Apr 30, 2013).

⁷⁷GAO, *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined*, [GAO-05-690](#) (Washington, D.C.: Sept. 23, 2005) and *Tax Policy: Tax Expenditures Deserve More Scrutiny*, [GAO/GGD/AIMD-94-122](#) (Washington, D.C.: June 3, 1994). See also GAO, *Tax Expenditures: Background and Evaluation Criteria and Questions*, [GAO-13-167SP](#) (Washington, D.C.: Nov. 29, 2012).

By tracking changes in tax laws, paid tax return preparers and tax software developers may help taxpayers navigate the complexities of the tax code. However, some paid preparers may introduce their own mistakes. For example, in a limited study in 2014, we found that 7 of 19 preparers who completed returns for our undercover investigators made errors with substantial tax consequences.⁷⁸ Likewise, using IRS data, we estimated that 60 percent of returns prepared by preparers contained errors.

Multiple Strategies Are Needed to Reduce the Tax Gap

IRS's overall approach to reducing the tax gap consists of improving services to taxpayers and enhancing enforcement of the tax laws. In spite of these efforts, the percentage at which taxpayers pay their taxes voluntarily and on time has remained constant over the past three decades. Our past work has demonstrated that no single approach will fully and cost-effectively address noncompliance since the problem has multiple causes and spans different types of taxes and taxpayers. In light of these challenges, the following strategies could help reduce the tax gap and are generally reflected in recommendations we have made to IRS that have not yet been implemented (see table 3) and matters for congressional consideration. A summary of these recommendations and matters for congressional consideration follows.

⁷⁸GAO, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors*, [GAO-14-467T](#) (Washington, D.C.: Apr. 8, 2014).

Table 3: Strategies to Reduce the Tax Gap by Key Factors Contributing to the Tax Gap

| Limited third-party information reporting | Resource trade-offs | Complexities in the tax code |
|--|--|--|
| <p>Enhancing information reporting by third parties</p> <ul style="list-style-type: none"> • Education payment information • Automated matching • Accelerating W-2 filing deadlines | <p>Developing a long-term strategy to enhance budget planning</p> <ul style="list-style-type: none"> • Return on investment data • Strategic planning • Reassessing the level of resources devoted to enforcement • Modernizing Information technology | <p>Ensuring high-quality services to taxpayers</p> <ul style="list-style-type: none"> • Telephone service • Online services |
| | <p>Collecting more data on noncompliance</p> <ul style="list-style-type: none"> • Correspondence examinations • Partnerships and S-corporations • Compliance assurance process • Tax gap estimates | <p>Leveraging stakeholders</p> <ul style="list-style-type: none"> • Paid tax preparers • Foreign governments • Whistleblowers |

Source: GAO. | GAO-16-92T

Enhancing Information Reporting by Third Parties

Information reporting is a powerful tool that reduces tax evasion, helps taxpayers comply voluntarily, and increases IRS’s enforcement capabilities. Generally, new requirements on third parties to submit information returns would require statutory changes. We have also identified the following improvements that IRS could make to existing forms and better ways to use them.

- **Education payment information.** We previously recommended that IRS revise Form 1098-T (Tuition Statement) on which educational institutions are required to report to IRS information on qualified tuition and related expenses for higher education. Taxpayers can also use this information to determine the amount of educational tax benefits they can claim on their tax return.⁷⁹ IRS allows institutions to report either the amount paid or the amount billed for qualified expenses. IRS officials stated that most institutions report the amount billed and do not report the actual amount paid. The amount billed may be different than from the amount that can be claimed as a credit. For example, the amount billed may not account for all scholarships or grants the student received. In such cases, the Form 1098-T may overstate the amount that can be claimed as a credit, confusing taxpayers. Conversely, if institutions are not providing information on

⁷⁹GAO, *2009 Tax Filing Season: IRS Met Many 2009 Goals, but Telephone Access Remained Low, and Taxpayer Service and Enforcement Could Be Improved*, [GAO-10-225](#) (Washington, D.C.: Dec. 10, 2009).

other eligible items, such as books or equipment, taxpayers might be understating their claims. In order to reduce taxpayer confusion and enhance compliance with the requirements, we recommended that IRS revise the form. The administration has sought legislative authority to require reporting of amounts paid. Legislation enacted in June 2015 only allows a taxpayer to claim a credit or deduction for education expenses if he or she received a Form 1098-T from an educational institution.⁸⁰ The Joint Committee on Taxation estimates that this requirement will raise approximately \$576 million through 2025 by reducing erroneous claims by taxpayers without valid Forms 1098-T. However, without a requirement for institutions to report amounts paid, taxpayers may remain confused by the information reported to them, and IRS may miss an opportunity to make use of a low-cost, less intrusive tool that could help ensure compliance.

- **Automated matching.** Taking greater advantage of automated processes could enhance some IRS enforcement programs. For example, IRS does not routinely match the K-1 information return—on which partnerships and S corporations report income distributed to partners or shareholders—to income information on tax returns for partners and shareholders that are themselves partnerships and S corporations. Matching such information could provide another tool for detecting noncompliance by these types of entities. In 2014, we recommended that IRS test the feasibility of such matching.⁸¹ IRS reported that it understands the objective of this recommendation and, at such time that resources are available to enhance capabilities, it would consider the proposed methodology of advanced testing. These resource limitations are precisely why we believe that IRS needs to take action to develop better information for making decisions on how to allocate existing resources.
- **Accelerating W-2 filing deadlines.** Accelerating W-2 filing deadlines could help IRS reduce improper EITC payments and help close the tax gap. Specifically, IRS has reported that a common EITC error is misreporting income; however, the timing of deadlines for filing Forms W-2 poses a challenge for enforcement. Rather than holding refunds until all compliance checks can be completed, IRS issues most

⁸⁰Trade Preferences Extension Act of 2015, Pub. L. No. 114-27, §804, 129 Stat 362, 415 (June 29, 2015).

⁸¹GAO, *Partnerships and S Corporations: IRS Needs to Improve Information to Address Tax Noncompliance*, [GAO-14-453](#) (Washington, D.C.: May 14, 2014).

refunds months before receiving and matching information returns, such as the W-2 to tax returns. As a result, IRS's "pay and chase" compliance model tries to recover bad refunds and unpaid taxes after matching information and pursuing discrepancies. If IRS had access to W-2 data earlier, it could match such information to taxpayer returns to identify discrepancies with EITC claims and potentially collect additional taxes. Moreover, earlier matching could help IRS prevent issuing billions of dollars of potentially fraudulent refunds because of identity theft.

Treasury recently proposed to Congress that the due date for filing information returns with IRS, including the Form W-2, be moved to January 31 to facilitate the use of earnings information in the detection of noncompliance.⁸² Because any change to filing deadlines could impose burdens on employers and taxpayers as well as create additional costs to IRS for systems and process changes, Congress and other stakeholders would need information on this impact to fully assess any potential changes. For example, the deadline change could involve upgrades to IRS's information technology systems; logistical challenges coordinating with other agencies, such as the Social Security Administration; and regulatory and policy changes, such as delaying refunds and the start of the filing season.

In August 2014, we recommended that IRS estimate the costs and benefits of accelerating W-2 deadlines and options to implement pre-refund matching using W-2 data as a method to combat the billions of dollars lost to identity refund fraud, allowing the agency more opportunity to match employers' and taxpayers' information.⁸³ In November 2014, IRS reported that it had convened a working group of internal stakeholders and subject matter experts to identify the costs and benefits of accelerating Form W-2 deadlines. As of July 2015, the working group had drafted a document that is currently under review by other agencies, including Treasury and the Social Security Administration. In September 2015, the Senate Committee on Finance scheduled a committee markup of a bill to prevent identity

⁸²By law, employers have until February 28 to file Forms W-2 with the Social Security Administration on paper and until March 31 to file W-2 information electronically, except when those deadlines fall on a weekend or federal holiday. In that case, the deadline is the next federal business day.

⁸³GAO, *Identity Theft: Additional Actions Could Help IRS Combat the Large, Evolving Threat of Refund Fraud*, [GAO-14-633](#) (Washington, D.C.: Aug. 20, 2014).

Developing a Long-Term
Strategy to Enhance Budget
Planning

theft and tax refund fraud, including a provision to modify due dates for filing Forms W-2. The Joint Committee on Taxation estimated that the provision would raise \$151 million in revenue through fiscal year 2025.⁸⁴

A long-term strategy that includes a fundamental reexamination of IRS's operations, programs, and organizational structure could help it operate more effectively and efficiently in an environment of budget uncertainty. IRS has taken some interim steps, but they are not sufficient to stem performance declines.

- **Return on investment data.** IRS could use return on investment data to allocate its enforcement resources and potentially increase revenues. In 2012, we found that IRS was spending most of its enforcement resources on examinations of taxpayers with less than \$200,000 in positive income, even though direct revenue return on investment was highest for examinations of taxpayers with \$200,000 or more in positive income.⁸⁵ Therefore, we recommended that IRS conduct a cost-benefit analysis across different enforcement programs and cases within programs to determine whether to reallocate its enforcement resources each year. We demonstrated how a relatively small hypothetical shift in resources could potentially increase direct revenue by \$1 billion annually (as long as the average ratio of direct revenue to cost for each category of returns did not change), without significant negative effects on voluntary compliance. Resource reallocation can also affect tax collections indirectly by influencing the voluntary compliance of nonexamined taxpayers.

Similarly, in a 2009 report, we found that IRS was able to examine only about 1 percent of estimated noncompliant sole proprietors in 2008 even though it had invested nearly a quarter of all revenue agent

⁸⁴In 2015, the administration also submitted a legislative proposal for FY 2016 to accelerate the filing dates of certain information returns, including the W-2, with an estimated revenue effect of \$1.6 billion for fiscal years 2016 through 2025. However, compared to the provision on which JCT based its estimate, the administration's proposal included additional types of returns and an earlier filing date.

⁸⁵GAO, *Tax Gap: IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources*, [GAO-13-151](#) (Washington, D.C.: Dec. 5, 2012).

time toward this purpose.⁸⁶ We found that not only are these examinations burdensome for businesses, they are also costly for IRS and yield less revenue than examinations of other categories of taxpayers, in part because most sole proprietorships have low receipt amounts.

IRS officials reported they have developed a methodology for estimating marginal direct revenue and costs for selected workload categories within their correspondence examination program. They are working to apply this methodology to other categories within that program and to other forms of examinations; however, they expect that effort will be much more complex and time-consuming. As of July 2015, officials do not yet have a timeline for full implementation.

- **Strategic planning.** In June 2014, we reported that IRS's strategic plan did not address budget uncertainty, although there are reasons to believe that funding will be constrained for the foreseeable future.⁸⁷ We recommended that IRS reexamine programs, related processes, and organizational structures to determine whether they are effectively and efficiently achieving the IRS mission, and streamline or consolidate management or operational processes and functions to make them more cost-effective. IRS agreed with our recommendation and is taking steps to implement it; for example, according to IRS officials, a new process was developed for building the fiscal year 2017 budget request, which included determining IRS-wide priorities.
- **Reassessing the level of resources devoted to enforcement.** Additional resources for enforcement would enable IRS to contact millions of potentially noncompliant taxpayers it identifies but cannot contact because of budget constraints. Since fiscal year 2010, IRS's enforcement resources have declined by more than 10 percent, from \$5.5 billion to \$4.9 billion in fiscal year 2015. To determine the appropriate level of enforcement resources, we have previously reported that policymakers would need to consider how to balance

⁸⁶GAO, *Tax Gap: Limiting Sole Proprietor Loss Deductions Could Improve Compliance but Would Also Limit Some Legitimate Losses*, [GAO-09-815](#) (Washington, D.C.: Sept. 10, 2009). IRS revenue agents examine taxpayers' tax returns to determine federal tax liability and compliance with tax law.

⁸⁷GAO, *IRS 2015 Budget: Long-Term Strategy and Return on Investment Data Needed to Better Manage Budget Uncertainty and Set Priorities*, [GAO-14-605](#) (Washington, D.C.: June 12, 2014).

taxpayer service and enforcement activities and how effectively and efficiently IRS currently uses its resources.⁸⁸

- **Modernizing information technology.** IRS relies on information systems in many aspects of its operations from taxpayer service to compliance and enforcement. Therefore, investing resources to modernize IRS's information systems is an important step toward improving taxpayer compliance. For example, in fiscal year 2009, IRS began funding the Information Reporting and Document Matching (IRDM) program in part to implement two new information reporting requirements focused on merchant card payments and securities basis reporting. IRDM also established a new matching program to identify underreported business income and expanded IRS's ability to use information returns to improve voluntary compliance and accurate reporting of income. Under IRDM, IRS built or enhanced several information systems to sort, match, identify, and manage returns that are likely sources of revenue that IRS could not have easily identified using its existing matching system.⁸⁹ IRS has other modernization efforts underway, such as its Customer Account Data Engine 2 investment, which enables daily tax processing and is intended to provide faster refunds to taxpayers, more timely account updates, and faster issuance of taxpayer notices. We have ongoing work to determine the progress of such modernization efforts, and plan to issue a report associated with this work in the spring of 2016.

Collecting More Data on Noncompliance

A critical step toward reducing the tax gap is to understand the sources and nature of taxpayer noncompliance. We have long encouraged regularly measuring tax noncompliance as well as estimating the tax gap, in part because analyzing the data used to determine the estimate can help identify ways to improve IRS's efforts and increase compliance. IRS continues to measure the extent of taxpayer noncompliance. However, our work has found that IRS does not adequately measure the effect of some specific components of its compliance programs, such as the following:

⁸⁸GAO-12-651T.

⁸⁹GAO, *Information Technology: IRS Needs to Improve the Reliability and Transparency of Reported Investment Information*, GAO-14-298 (Washington, D.C.: Apr. 2, 2014); *IRS Management: Cost Estimate for New Information Reporting System Needs to be Made More Reliable*, GAO-12-59 (Washington, D.C.: Jan. 31, 2012); and *Information Reporting: IRS Could Improve Cost Basis and Transaction Settlement Reporting Implementation*, GAO-11-557 (Washington, D.C.: May 19, 2011).

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- **Correspondence examinations.** IRS does not have information to determine how its program of examining individual tax returns via correspondence affects the agency's broader strategic goals for compliance, taxpayer burden, and cost. Thus, it is not possible to tell whether the program is performing better or worse from one year to the next. In 2014, we made several recommendations related to monitoring program performance.⁹⁰ IRS officials said they will review current documentation and ensure that they establish correspondence audit program objectives and measures and clearly link them to the overall IRS goals and objectives. Officials also said they will update official guidance as warranted and plan to implement this recommendation by March 2016.
 - **Partnerships and S-corporations.** In 2014, we found that the full extent of partnership and S-corporation income misreporting is unknown, and that IRS examinations and automated document matching have not been effective at finding most of the estimated misreported income.⁹¹ Further, IRS does not know how income misreporting by partnerships affects taxes paid by partners. We recommended, among other things, that IRS (1) develop a strategy to improve its information on the extent and nature of partnership misreporting and (2) use the information to potentially improve how it selects partnership returns to examine. IRS has developed a strategy, which would involve a multi-year examination effort to collect audit data from a representative, statistical sample of partnerships. In September 2015, IRS officials stated that they were beginning a discussion about implementing the proposed strategy, and therefore do not yet have a timeline for implementation. Without this information, IRS is unable to make fully informed, data-based decisions on examination selection.
 - **Compliance Assurance Process (CAP).** IRS does not fully assess the savings it achieves from its CAP—through which large corporate taxpayers and IRS agree on how to report tax issues before tax returns are filed. In 2013, we recommended that IRS track savings from CAP and develop a plan for reinvesting any savings to help

⁹⁰GAO, *IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden*, [GAO-14-479](#) (Washington, D.C.: June 5, 2014).

⁹¹[GAO-14-453](#).

ensure the program is meeting its goals.⁹² In response to our recommendation, IRS has taken steps to track savings by analyzing and comparing the workload inventory of account coordinators who handle CAP cases against team coordinators who handle non-CAP cases. However, as of September 2015, IRS has not shown how such a workload comparison demonstrated savings from CAP or developed a plan for reinvesting any savings. Without a plan for tracking savings and using the savings to increase examination coverage, IRS cannot be assured that the savings are effectively invested in either CAP or non-CAP taxpayers with high compliance risk.

- **Tax gap estimates.** IRS issued its last detailed study of the tax gap in January 2012, which used tax year 2006 data. According to IRS officials, the next tax gap update is scheduled to be released in December 2015, at the earliest. Without more compliance information, IRS does not have reliable data about its compliance results to fully inform decisions about allocating examination resources across different types of businesses.

Ensuring High-Quality Services to Taxpayers

IRS provides taxpayers an array of services by telephone, by correspondence, and online. Ensuring high-quality services is a necessary foundation for voluntary compliance, as it can help taxpayers who wish to comply with tax laws but do not understand their obligations. However, in recent years IRS has struggled to maintain or improve services in the following areas.

- **Telephone services.** In fiscal year 2014, taxpayers had to wait an average of about 20 minutes to speak with someone at IRS, more than twice as long as they did in fiscal year 2009, when the average wait time was about 9 minutes. Wait times have increased in part because IRS devoted fewer full-time equivalent employees to answering telephones and because the average time assisting taxpayers with their questions has increased. In December 2014, we recommended that IRS benchmark its telephone service measures to the best in the business.⁹³ IRS disagreed with this recommendation,

⁹²GAO, *Corporate Tax Compliance: IRS Should Determine Whether Its Streamlined Corporate Audit Process Is Meeting Its Goals*, [GAO-13-662](#) (Washington, D.C.: Aug. 22, 2013).

⁹³GAO, *Tax Filing Season: 2014 Performance Highlights the Need to Better Manage Taxpayer Service and Future Risks*, [GAO-15-163](#) (Washington, D.C.: Dec. 16, 2014).

noting in February 2015 that it is difficult to identify comparable organizations with a size or scope similar to that of IRS. We disagree that IRS's telephone operations cannot be compared to others. IRS previously benchmarked its telephone level of service measure to both private and public sector organizations, which allowed it to identify options for modifying that measure. IRS uses more than one measure (i.e., level of service) to fully evaluate its telephone performance, and benchmarking all of these measures alongside each other to the best in the business could help inform Congress about resources needed to improve the level of service provided to taxpayers in a budget constrained environment. Accordingly, we believe this recommendation remains valid and should be implemented.

- **Online services.** Taxpayers benefit from online services because they can research large amounts of tax guidance, the services are available 24 hours a day, and there is no waiting to speak to a telephone representative. While IRS's website provides some basic tools to request personalized information, such as the status of refunds, the website does not give taxpayers interactive personal account access. The National Taxpayer Advocate, the Electronic Tax Administration Advisory Committee, and others have all recommended that IRS provide taxpayers with online access to their accounts, including ways to resolve compliance problems. In December 2011 and April 2013, we recommended that IRS develop a long-term strategy to improve web services.⁹⁴

As of July 2015, IRS reported that it is integrating online services as a key component of its new Service on Demand (SOD) strategy, which aims to deliver service improvements across different taxpayer interactions, such as individual account assistance, refunds, identity theft, and billings and payments. However, the SOD strategy does not include specific goals, performance metrics, or implementation time frames. A comprehensive long-term strategy for online services that includes these characteristics—whether or not it is incorporated into a broader strategy such as SOD—would help ensure that IRS is maximizing the benefit to taxpayers from this investment and reduce

⁹⁴GAO, *IRS Website: Long-Term Strategy Needed to Improve Interactive Services*, [GAO-13-435](#) (Washington, D.C.: Apr. 16, 2013), and *2011 Tax Filing: Processing Gains, but Taxpayer Assistance Could Be Enhanced by More Self-Service Tools*, [GAO-12-176](#) (Washington, D.C.: Dec. 15, 2011).

Leveraging Stakeholders

costs in other areas, such as IRS's telephone operations. Further, it could address procedures to better protect online accessible data, which are especially important after the data breach discovered in May 2015 in which individuals used IRS's online services to gain access to information from over 330,000 taxpayers. Thus, we believe this recommendation remains valid and should be implemented.

Another way IRS may be able to reduce the tax gap is by leveraging stakeholders. Given the complexities in the tax code, taxpayers and IRS can benefit from the expertise of tax return preparers and information shared by foreign governments and whistleblowers.

- **Paid tax return preparers.** Over half of all taxpayers rely on the expertise of a paid preparer to provide advice and help them meet their tax obligations. IRS regards paid preparers as a critical link between taxpayers and the government. Consequently, paid preparers are in a position to have a significant impact on the federal government's ability to collect revenue and minimize the tax gap. We have previously reported that for IRS to improve its enforcement of tax laws, it must continue to seek ways to leverage paid preparers to improve tax compliance.⁹⁵
- **Foreign governments.** Information from foreign governments is also important to help improve tax compliance. Increasingly, tax authorities around the world are exchanging information with other countries to administer and enforce the tax laws of their respective countries. Under the Foreign Account Tax Compliance Act,⁹⁶ for example, U.S. financial institutions and other entities are required to withhold a portion of certain payments made to foreign financial institutions, if those institutions have not entered into an agreement with IRS to report U.S. account holders' details to IRS. We have previously reported that it is particularly important that the United States continues to develop and maintain cooperative relationships with

⁹⁵GAO, *High-Risk Series: An Update*, [GAO-13-283](#) (Washington, D.C.: February 2013). As discussed later in this statement, however, additional regulation of paid preparers could improve the accuracy of returns they prepare.

⁹⁶ Pub. L. No. 111-147, Title V, 124 Stat. 71, 97-117 (Mar. 18, 2010).

other countries to help ensure that U.S. taxpayers comply with U.S. tax laws.⁹⁷

- **Whistleblowers.** Whistleblowers provide IRS information on suspected noncompliance. They have the potential to help IRS collect billions in tax revenue that may otherwise go uncollected. Since IRS expanded its whistleblower program in 2007, it has collected over \$1 billion because of whistleblower claims.⁹⁸ We have ongoing work for this committee that focuses on improving IRS's communication with whistleblowers and the timeliness of claims processing, among other things, which could help IRS recover more unpaid tax revenues.⁹⁹

Considering Legislative Action

Given that the tax gap has been a persistent issue, we have previously reported that reducing it will require targeted legislative actions, including the following:

- **Additional third-party information reporting.** As noted earlier, taxpayers are much more likely to report their income accurately when the income is also reported to IRS by a third party. In 2008 and 2009, we suggested Congress consider expanding third-party information reporting to include payments for services to rental real estate owners and payments for services provided by corporations, respectively.¹⁰⁰ In 2010, the Joint Committee on Taxation estimated potential revenue increases for a 10-year period to be \$2.5 billion for third-party information reporting of rental real estate service payments and \$3.4 billion for third-party information reporting of service payments to corporations. Congress enacted a more expansive regime in 2010, covering reporting of payments for goods as well as services, and subsequently repealed these provisions. A more narrow extension of reporting requirements of payments for services provided by

⁹⁷GAO, *Tax Administration: IRS's Information Exchanges with Other Countries Could Be Improved through Better Performance Information*, [GAO-11-730](#) (Washington, D.C.: Sept. 9, 2011).

⁹⁸The Tax Relief and Health Care Act of 2006 expanded the IRS whistleblower program, making award payments to whistleblowers mandatory in certain circumstances and directing IRS to create its Whistleblower Office.

⁹⁹We expect to report on our results later this year.

¹⁰⁰GAO, *Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements*, [GAO-09-238](#) (Washington, D.C.: Jan. 28, 2009), and *Tax Gap: Actions That Could Improve Rental Real Estate Reporting Compliance*, [GAO-08-956](#) (Washington, D.C.: Aug. 28, 2008).

corporations and for services provided to rental real estate owners remains an important option for improving compliance.

- **Enhanced electronic filing.** Requiring additional taxpayers to electronically file tax and information returns could help IRS improve compliance in a resource-efficient way. For example, partnerships with more than 100 partners and corporations with assets of \$10 million or more that file at least 250 returns during the calendar year must electronically file their returns. In 2014, we suggested that Congress consider expanding the mandate for partnerships and corporations to electronically file their tax returns, as this could help IRS reduce return processing costs, select the most productive tax returns to examine, and examine fewer compliant taxpayers.¹⁰¹
- **Math error authority.** IRS has the authority to correct calculation errors and check for other obvious noncompliance such as claims above income and credit limits. Treasury has proposed expanding IRS’s “math error” authority to “correctible error” authority to permit it to correct errors in cases where information provided by the taxpayer does not match information in government databases, among other things. Expanding such authority—which we have suggested Congress consider with appropriate safeguards—could help IRS correct additional errors and avoid burdensome audits and taxpayer penalties.¹⁰² In March 2015, the Joint Committee on Taxation estimated that more flexible correctible error authority could raise \$133 million through 2025.
- **Paid preparer regulation.** Establishing requirements for paid tax return preparers could improve the accuracy of the tax returns they prepare. Oregon began regulating preparers in the 1970s and

¹⁰¹[GAO-14-453](#). IRS is generally prohibited from requiring those filing fewer than 250 returns annually to electronically file their returns. However, partnerships with more than 100 partners must electronically file regardless of the number of returns they file annually. 26 U.S.C. § 6011(e)(2).

¹⁰²GAO, *Recovery Act: IRS Quickly Implemented Tax Provisions, but Reporting and Enforcement Improvements Are Needed*, [GAO-10-349](#) (Washington, D.C.: Feb. 10, 2010). GAO recently recommended that IRS assess whether data received from the health insurance marketplaces are sufficiently complete and accurate to be used to correct claims for the premium tax credit on returns, and if the assessment determines that such corrections would be effective, seek legislative “correctible error” authority for this specific purpose. GAO, *Patient Protection and Affordable Care Act: IRS Needs to Strengthen Oversight of Tax Provisions for Individuals*, [GAO-15-540](#) (Washington, D.C.: July 29, 2015).

requires testing among other requirements. In August 2008, we found that the odds that a return filed by an Oregon paid preparer was accurate were 72 percent higher than the odds for a comparable return filed by a paid preparer in the rest of the country.¹⁰³ In August 2014, IRS reported that 68 percent of all tax returns claiming the EITC in tax years 2006 and 2007 were prepared by paid tax preparers—most of whom were not subject to any IRS regulation—and that from 43 to 50 percent of the returns overclaimed the credit.¹⁰⁴ Similarly, in our undercover visits in 2014 to randomly selected tax preparers, a sample that cannot be generalized, we found errors in EITC claims and non-Form W-2 income reporting (for example, cash tips) resulting in significant overstatement of refunds.¹⁰⁵ Establishing requirements for paid tax return preparers could improve the accuracy of the tax returns they prepare, not just returns claiming EITC. In 2014, we suggested Congress consider granting IRS the authority to regulate paid tax preparers, if it agrees that significant paid preparer errors exist.¹⁰⁶ In September 2015, the Senate Committee on Finance scheduled a committee markup of a bill to introduce legislation that would regulate all paid tax return preparers, which the Joint Committee on Taxation estimated would raise \$135 million in revenue through fiscal year 2025.

- **Tax reform and simplification.** A broader opportunity to address the tax gap involves simplifying the Internal Revenue Code, as complexity can cause taxpayer confusion and provide opportunities to hide willful noncompliance. Fundamental tax reform could result in a smaller tax

¹⁰³GAO, *Tax Preparers: Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation*, [GAO-08-781](#) (Washington, D.C.: Aug. 15, 2008).

¹⁰⁴Internal Revenue Service, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006- 2008 Returns*, Publication 5162 (8-2014) (Washington, D.C.: August 2014).

¹⁰⁵GAO, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors*, [GAO-14-467T](#) (Washington, D.C.: Apr. 8, 2014). A previous study found similar results: see *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, [GAO-06-563T](#) (Washington, D.C.: Apr. 4, 2006).

¹⁰⁶[GAO-14-467T](#). Treasury and IRS issued regulations in 2010 and 2011 to require registration, competency testing, and continuing education for paid tax return preparers and to subject these new registrants to standards of conduct in their practice. However, the district court ruled, and the court of appeals affirmed, that IRS did not have the statutory authority to regulate these preparers. *Loving v. IRS*, 917 F. Supp. 2d67 (D.D.C. 2013), *aff'd* 742 F.3d 1013 (D.C. Cir. 2014).

gap if the new system has fewer tax preferences or complex tax code provisions; such reform could reduce IRS's enforcement challenges and increase public confidence in the tax system. Short of fundamental reform, targeted simplification opportunities also exist. Amending the tax code to make definitions more consistent across tax provisions could help taxpayers more easily understand and comply with their obligations and get the maximum tax benefit for their situations. For example, there are several provisions in the tax code benefiting taxpayers' educational expenses, but the definition of what qualifies as a higher-education expense varies between these tax expenditures.¹⁰⁷

There are no easy solutions to addressing the tax gap. Reducing the tax gap will require multiple strategies and long-term changes in IRS's operations and systems. Such changes are as important as ever given the nation's fiscal challenges and require the combined efforts of Congress and IRS. Implementing our recommendations and legislative options could increase revenues and promote savings, leading to greater fiscal stability.

With outlays for major programs, such as Medicare and Medicaid, expected to increase over the next few years, it is critical that actions are taken to reduce improper payments and minimize the tax gap. There is considerable opportunity to improve the government's fiscal position without detrimentally affecting the valuable programs that serve our citizens. For this reason, we will continue to assist Congress by focusing attention on issues related to improper payments and the tax gap.

Chairman Hatch, Ranking Member Wyden, and Members of the Committee, this completes my prepared statement. I would be pleased to answer questions that you may have at this time.

GAO Contacts

For further information on improper payment issues, please contact Beryl H. Davis, Director, Financial Management and Assurance, who may be reached at (202) 512-2623 or davisbh@gao.gov. For information on tax

¹⁰⁷GAO, *Student Aid and Postsecondary Tax Preferences: Limited Research Exists on Effectiveness of Tools to Assist Students and Families through Title IV Student Aid and Tax Preferences*, [GAO-05-684](#) (Washington, D.C.: July 29, 2005).

gap issues, please contact James R. McTigue, Jr., Director, Strategic Issues, who may be reached at (202) 512-9110 or mctiguej@gao.gov, or Jessica Lucas-Judy, Acting Director, Strategic Issues, who may be reached at (202) 512-9110 or lucasjudyj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs offices may be found on the last page of this statement.

Appendix I: Programs with Improper Payment Estimates Exceeding \$1 Billion in Fiscal Year 2014

| Program | Agency | Fiscal year 2014 reported improper payment estimates | |
|---|---|--|--|
| | | Estimated dollars (in millions) | Estimated error rate (percentage of outlays) |
| Medicare | Department of Health and Human Services (HHS) | \$59,914 | — |
| <i>Medicare Fee-for-Service (Parts A and B)</i> | <i>HHS</i> | <i>45,754</i> | <i>12.7%</i> |
| <i>Medicare Advantage (Part C)</i> | <i>HHS</i> | <i>12,229</i> | <i>9.0%</i> |
| <i>Medicare Prescription Drug (Part D)</i> | <i>HHS</i> | <i>1,931</i> | <i>3.3%</i> |
| Earned Income Tax Credit | Department of the Treasury | 17,700 | 27.2% |
| Medicaid | HHS | 17,492 | 6.7% |
| Unemployment Insurance | Department of Labor | 5,604 | 11.6% |
| Supplemental Security Income | Social Security Administration (SSA) | 5,107 | 9.2% |
| Old Age, Survivors, and Disability Insurance | SSA | 3,000 | 0.4% |
| Supplemental Nutrition Assistance Program | Department of Agriculture (USDA) | 2,437 | 3.2% |
| School Lunch | USDA | 1,748 | 15.3% |
| Direct Loan | Department of Education | 1,532 | 1.5% |
| Public Housing/Rental Assistance | Department of Housing and Urban Development | 1,029 | 3.2% |

Source: GAO summary of agencies' data. | GAO-16-92T

Appendix II: Programs with Estimated Improper Payment Error Rates Exceeding 10 Percent in Fiscal Year 2014

| | Program | Agency | Fiscal year 2014 reported improper payment estimates | |
|--|--|---|--|--|
| | | | Estimated dollars (in millions) | Estimated error rate (percentage of outlays) |
| Estimated error rates above 20 percent | Earned Income Tax Credit | Department of the Treasury | \$17,700 | 27.2% |
| | School Breakfast | Department of Agriculture (USDA) | \$923 | 25.6% |
| | Farm Security and Rural Investment Act Programs | USDA | \$508 | 23.1% |
| Estimated error rates from 15 to 20 percent | Loan Deficiency Payments | USDA | 0 [Note A] | 18.8% |
| | School Lunch | USDA | \$1,748 | 15.3% |
| Estimated error rates from 10 to 15 percent | Disaster Relief – Administration for Children and Families Social Services Block Grant | Department of Health and Human Services (HHS) | \$9 | 13.5% |
| | Medicare Fee-for-Service (Parts A and B) | HHS | \$45,754 | 12.7% |
| | Disaster Relief (Substance Abuse and Mental Health Services Administration) | HHS | 0 [Note A] | 12.7% |
| | Disaster Assistance Loans | Small Business Administration | \$70 | 12.0% |
| | Unemployment Insurance | Department of Labor | \$5,604 | 11.6% |

Source: GAO summary of agencies' data. | GAO-16-92T

Note A: Improper payment estimates for these programs are displayed as zero because of rounding.

Appendix III: Accessible Data

Data Tables

Data Table for Figure 1: Cumulative Improper Payment Estimates for Fiscal Years 2003 through 2014

Dollars in billions

| Fiscal year | Improper payment estimate |
|-------------|---------------------------|
| 2003 | \$35.0 |
| 2004 | \$46.0 |
| 2005 | \$39.0 |
| 2006 | \$41.0 |
| 2007 | \$49.0 |
| 2008 | \$72.5 |
| 2009 | \$109.2 |
| 2010 | \$120.6 |
| 2011 | \$115.7 |
| 2012 | \$107.1 |
| 2013 | \$105.8 |
| 2014 | \$124.7 |

Source: GAO. | GAO-16-92T

Note: Generally, the specific programs and total number of programs that constitute the government-wide improper payment estimate vary from year to year. In earlier years, the number of programs included in the government-wide estimate generally increased as programs reported improper payment estimates for the first time.

Data Table for Figure 2: Government-Wide Improper Payment Estimates by Program for Fiscal Year 2014

| Program | Improper payment estimates (Dollars in billions) | Percentage |
|--|--|------------|
| Medicare: Medicare Fee-for-Service (Parts A and B), Medicare Advantage (Part C), Medicare Prescription Drug (Part D) | \$59.9 | 48.0% |
| Medicaid | \$17.5 | 14.0% |
| Earned Income Tax Credit | \$17.7 | 14.2% |
| All other programs | \$29.6 | 23.7% |

Source: GAO analysis of agencies' data. | GAO-16-92T

Data Table for Figure 3: Estimated Gross (\$450 Billion) Tax Gap Noncompliance by Source and Type of Tax for Tax Year 2006

Dollars in billions

| | Individual Income Tax | Corporation Income Tax | Employment Tax | Estate Tax | Excise Tax | Total |
|-----------------------|-----------------------|------------------------|----------------|------------|-------------|-----------|
| Underreporting | \$235 (63%) | \$67 (18%) | \$72 (19%) | \$2 (0%) | N/A | 376 (84%) |
| Underpayment | \$36 (78%) | \$4 (9%) | \$4 (9%) | \$2 (4%) | \$0.10 (0%) | 46(10%) |
| Nonfiling | \$25 (89%) | N/A | N/A | \$3 (11%) | N/A | 28 (6%) |

Source: GAO analysis of IRS information. | GAO-16-92T

Note: Individual income tax includes individual business income tax. Excise tax is not shown in this graphic as IRS does not have an excise tax estimate for underreporting noncompliance or nonfiling noncompliance and estimates it is less than 1 percent of total underpayment noncompliance. In addition, IRS does not have an employment tax estimate for nonfiling noncompliance.

Data Table for Figure 4: Effect of Third-Party Information Reporting on Taxpayer Compliance, Tax Year 2006

| | Substantial information reporting and withholding | Substantial information reporting | Some information reporting | Little or no information reporting |
|---|--|---|--|--|
| Examples | <ul style="list-style-type: none"> Wages and salaries | <ul style="list-style-type: none"> Pensions and annuities Dividend income Interest income Unemployment compensation Social Security benefits | <ul style="list-style-type: none"> Deductions Partnership/S-Corp income Exemptions Capital gains Alimony income | <ul style="list-style-type: none"> Nonfarm proprietor income Other income Rents and royalties Farm income Form 4797 income Adjustments |
| Percentage of actual income that was misreported | 1% (\$11 billion) | 8% (\$12 billion) | 11% (\$64 billion) | 56% (\$120 billion) |

Source: IRS. | GAO-16-92T

Note: Percentages are not intended to sum to 100 percent. Each percentage shown refers to a different category of information reporting. For example, for income subject to substantial information reporting and withholding (such as wages and salaries), 1 percent of these income amounts are misreported; 99 percent of these income amounts are properly reported.

Related GAO Products

A Framework for Managing Fraud Risks in Federal Programs. [GAO-15-593SP](#). Washington, D.C.: July 2015.

Improper Payments: Government-Wide Estimates and Use of Death Data to Help Prevent Payments to Deceased Individuals. [GAO-15-482T](#). Washington, D.C.: March 16, 2015.

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