

August 2000

**TAX
ADMINISTRATION**

**IRS Faces Several
Challenges as It
Attempts to Better
Serve Small
Businesses**



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

General Government Division

B-282856

August 10, 2000

The Honorable Christopher S. Bond
Chairman, Committee on Small Business
United States Senate

Dear Mr. Chairman:

Small businesses—a category that includes farmers, other self-employed individuals, and small corporations and partnerships—are a diverse and important group of about 40 million taxpayers that are responsible for remitting nearly half of the taxes collected by the Internal Revenue Service (IRS) annually.

Enactment of the IRS Restructuring and Reform Act of 1998 sent a strong signal that Congress expected IRS to address the problems that taxpayers, including small businesses, have with IRS. The Commissioner of Internal Revenue has embraced the need for change so that taxpayers receive top-quality service from IRS to help them understand and meet their tax responsibilities. IRS has revised its mission statement and is on a path to transform its culture to one that more fully embraces customer service as a core organizational value. As part of this effort, IRS is well on the way to restructuring its operations around specific groups of taxpayers. One new organizational unit, known as the Small Business and Self-Employed Operating Division (SB/SE) to become operational in October 2000, is to focus on the needs of small businesses.

You asked us to determine how IRS' reorganization plans address the difficult issues that affect the interactions between small businesses and IRS. As agreed with your office, our objectives for this report were to (1) identify what factors, if any, complicate the interactions between small businesses and IRS; and (2) determine how, if at all, IRS' reorganization plans address those factors.

Results in Brief

From responses to a survey we conducted of 1,000 businesses and the results of interviews with IRS officials and representatives of the small business community, we identified the following factors that complicate the interactions between small businesses and IRS:

- According to IRS, small businesses are more likely than other taxpayers to have compliance problems. IRS data show, for example, that small

businesses tend to have more collection cases involving withheld employment taxes than do larger businesses. Tax law complexity was the most commonly mentioned reason why small businesses might have trouble complying. Small businesses, like larger businesses, can encounter such complex tax issues as employment taxes and depreciation and are subject to multiple layers of filing, reporting, and deposit requirements. However, small businesses may not always have the kind of resources needed to deal with those complexities.

- IRS has not operated in a way that best enables it to serve small businesses. IRS has been structured along functional and geographic lines, with each function (e.g., customer service and collection) and each geographic unit (e.g., district office) responsible for all types of taxpayers, from individuals whose only income is from wages to multinational corporations. IRS has also historically allocated most of its resources to correcting problems after they occur rather than preventing problems from occurring. A focus on back-end correction versus up-front prevention can be especially problematic for small businesses that need assistance up front and that, absent that help, are at a high risk of going out of business if problems arise.
- Many small businesses in our survey population were unaware of various services that IRS has developed specifically for small businesses, and many others who knew of the services did not use them. Small business representatives told us that small businesses are often reluctant to go to IRS for help.
- When small businesses in our survey population used certain IRS services, such as tax publications and toll-free telephone assistance, they were often not happy with the experience. For example, they said that publications, though easy to obtain, were not easy to understand, and telephone assistance was not easy to access.

The various changes discussed in IRS' plans for the new organization indicate that it will be taking steps to address those factors that we have identified as complicating the interactions between IRS and small businesses. Although the new organization may not be able to do much to reduce the tax law complexity facing small businesses, it should be better able to help businesses deal with those complexities. For example, IRS' plans clearly recognize that many small businesses are reluctant to go to IRS for help, preferring instead to rely on tax practitioners. Thus, IRS plans to partner with practitioners and other outside organizations to deliver

assistance while focusing some of its direct service efforts on those small businesses most in need of help (such as start-up businesses).

All of this assumes that the various changes discussed in IRS' plans come to fruition. However, implementing the new SB/SE operating division will not be easy. For example, the diversity of the taxpayer population for which the new operating division will be responsible could stretch the capabilities of management and staff and dilute the division's customer focus. The new division also will be (1) hindered in its ability to deliver new programs and services by antiquated information systems and a shortage of employees with needed skills; and (2) challenged, as is all of IRS, to develop an integrated performance management system that creates incentives for employee behavior that supports organizational goals.

In commenting on a draft of this report, the Commissioner of Internal Revenue said that IRS was committed to implementing a customer-focused organization that will benefit all taxpayers and that our report would help IRS improve its products and services for small businesses.

Background

IRS is in the process of implementing a major reorganization, which will, among other things, structure the agency around four major operating divisions, each responsible for a particular customer segment. One division is to be responsible for small businesses. As part of its reorganization effort, IRS has developed a definition of small businesses, which we used in our work. Based on that definition, small businesses include partnerships and corporations (including S corporations)¹ with assets of \$5 million or less and all self-employed individuals (also known as sole proprietors).²

A large majority of all businesses are small businesses. To illustrate, IRS data showed that of the about 6.1 million partnerships, S corporations, and corporations that filed returns for tax year 1995, about 5.9 million (or 97 percent) reported total assets of \$5 million or less. In total, according to

¹ Corporations with no more than 75 shareholders can elect to be treated as S corporations for federal tax purposes if certain requirements are met.

² Self-employed individuals file a Form 1040 (U.S. Individual Income Tax Return) with either a Schedule C (Profit or Loss From Business) or Schedule F (Profit or Loss From Farming) attached.

IRS, small businesses account for about 44 percent (\$915 billion) of all money collected by IRS annually.³

Scope and Methodology

To identify factors that complicate the interactions between small businesses and IRS, we conducted a survey designed to gather information on (1) IRS services that small businesses have used, (2) their past experiences with IRS, and (3) their views on various aspects of IRS service. We sent the survey to a stratified random sample of 1,000 businesses representing a study population of 398,105 businesses nationwide. We identified the study population from the membership list of the National Federation of Independent Businesses (NFIB), whose membership includes all business types (i.e., sole proprietorships, partnerships, S corporations, and corporations) and a wide variety of business operations.⁴ NFIB officials told us that although NFIB is not exclusively an organization of small businesses, nearly all of its members are small businesses. We stratified our sample by type of business to ensure that we obtained the views of self-employed individuals.⁵ We received 548 usable responses to our questionnaire—a response rate of 55 percent.

The results for our sample of 1,000 can be generalized only to the population of NFIB members. Also, because our results pertain to a sample of the study population, all results are subject to sampling errors. Unless otherwise noted, all estimates of percentages in this report have a 95-percent confidence interval of less than plus or minus 10 percentage points. (See app. I for a detailed description of our sampling methodology and app. II for a copy of our survey document and the results.)

In addition to the survey, we took the following steps to identify factors that complicate the interactions between small businesses and IRS:

³ The \$915 billion includes individual and corporate income taxes, employment taxes, excise taxes, and taxes withheld for employees.

⁴ After considering a number of national organizations that represent small businesses, we chose NFIB because its membership was the largest and included members from a wide range of business sectors. We reached a general consensus regarding this choice with cognizant officials from IRS, the Small Business Administration, and a number of other membership organizations that represent small businesses.

⁵ Our sample consisted of two strata, defined by NFIB's classification—sole proprietorships and other types of business structures. During our analysis, we did not find a statistical difference between those describing their business as a sole proprietorship and other types of business structures. Therefore, we are only reporting on only the accumulated results for the small businesses in our study population.

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- We interviewed IRS headquarters officials and visited 2 of IRS' 4 regional offices (Midstates and Western) and 3 of its 33 district offices (North Texas; Northern California; and Kansas-Missouri).⁶ At the field locations, we interviewed officials responsible for various IRS functions that have dealings with small businesses (i.e., taxpayer education, customer service, compliance, and taxpayer advocacy).
 - We attended 4 of 14 focus group meetings that IRS held with small business owners and self-employed individuals to identify the needs of small business taxpayers. We also obtained the final report summarizing the comments made by small businesses at all 14 meetings.
 - We interviewed representatives from the Small Business Administration, tax practitioner associations, small business associations, and conferees to the White House Conference on Small Business.
 - We used a structured interview to gather information from 10 small business and tax practitioner associations.

To determine how IRS' reorganization plans address the complicating factors we identified, we analyzed IRS' plans as they related to small businesses and interviewed officials responsible for leading the teams that developed those plans. We also discussed the reorganization plans with officials from small business and tax practitioner associations.

We requested comments on a draft of our report from the Commissioner of Internal Revenue, and those comments are reprinted in appendix III. We did our work in accordance with generally accepted government auditing standards between October 1999 and July 2000.

⁶ Because we had no reason to believe that the kind of information we were gathering would be affected by which regional office we visited, we judgmentally selected the Midstates and Western Regional Offices. We visited the North Texas and Northern California District Offices because they were located in the same areas as the two regional offices. We visited the Kansas-Missouri District Office because of its convenience to our audit staff.

Various Factors Complicate the Interactions Between Small Businesses and IRS

Responses to our survey and the results of various interviews identified the following factors that complicate the interactions between small businesses and IRS:

- Small businesses have a greater potential for noncompliance than other taxpayers,⁷ primarily because they face the same complex requirements as larger businesses without the kind of resources available to larger businesses to deal with those requirements.
- IRS has not been operating in a way that best enables it to serve small businesses.
- Many small businesses were unaware of key IRS services, and many who know of the services did not use them.
- Many small businesses had negative reactions to their past interactions with IRS, ranging from difficulties in understanding IRS publications and accessing IRS' telephone assistance to difficulties in resolving problems.

Small Businesses Have a Greater Potential for Noncompliance

According to IRS, small businesses are more likely than other segments of the taxpayer population to have problems complying with the tax law. For example, IRS data show that (1) small businesses tend to have more collection cases involving employment tax withholdings than large and mid-sized businesses, and (2) self-employed persons and supplemental income earners⁸ make up about 40 percent of the examination and collection cases involving individual taxpayers. Our interviews of IRS officials and representatives of the small business community identified several reasons why small businesses might have trouble complying.

The most commonly mentioned reason was complexity. According to IRS, for example, although self-employed persons and supplemental income earners are individual filers and, therefore, have characteristics similar to individual filers whose only income comes from wages and investments, self-employed persons and supplemental income earners face more complex issues and file twice the number of forms and schedules. Similarly, small corporations and partnerships, like larger businesses, can

⁷ Noncompliance can mean any number of things, including an honest mistake that leads to an incorrect tax return, a failure to pay income taxes on time, a failure to remit taxes withheld from employees, and fraud.

⁸ Supplemental income earners are wage earners who file a Form 1040 with a Schedule E for rental, royalty, or other supplemental income. They are included in the population to be served by IRS' new organizational unit for small businesses.

encounter such complex tax issues as those related to employment taxes,⁹ depreciation,¹⁰ and the alternative minimum tax¹¹ and are subject to multiple filing, reporting, and deposit requirements.¹² Unlike larger businesses, however, many small businesses may not have the kind of resources on a continual basis that they need to understand and deal with those complex issues and requirements.

Complexity is a key reason why an estimated 94 percent of our study population used a paid preparer or accountant to prepare their tax year 1998 federal tax returns. Of those who used a paid preparer or accountant, an estimated 36 percent said that they used a tax professional because the tax laws and requirements are too complex; and another 56 percent said that they would rather rely on a tax professional to ensure compliance. Also, as shown in figure 1, a large percentage of the small businesses in our study population relied on tax practitioners to understand various complex issues that applied to their businesses.

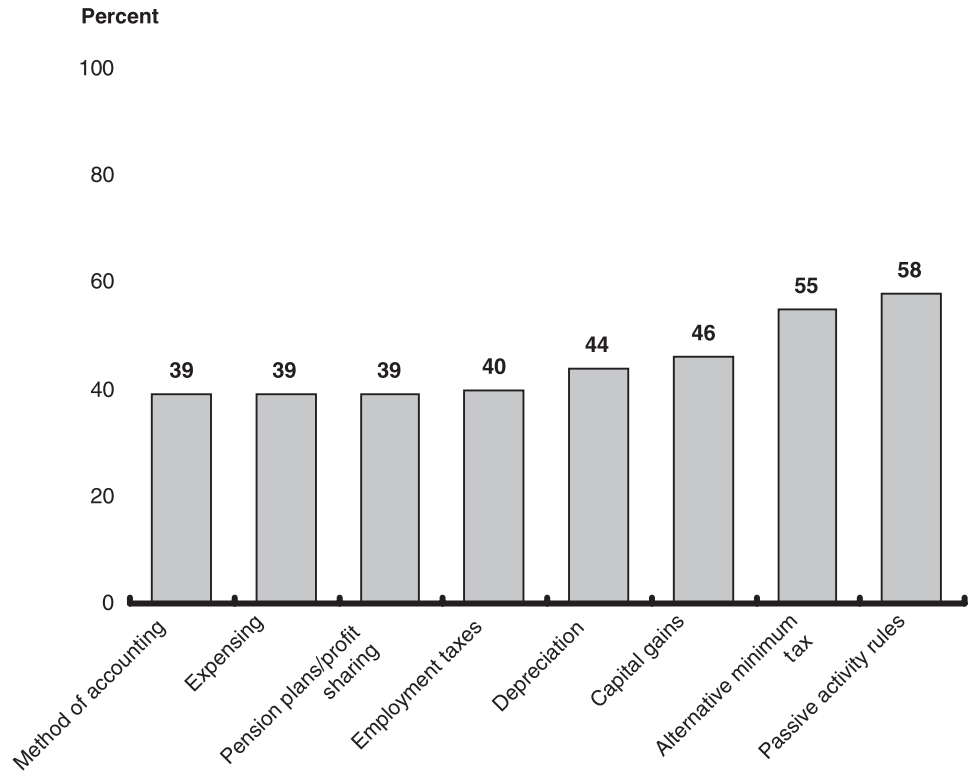
⁹ Employment taxes include Social Security and Medicare taxes, federal income tax withholding, and federal unemployment tax.

¹⁰ Depreciation is the annual deduction allowed to recover the cost of business or investment property having a useful life substantially beyond the tax year.

¹¹ The tax law gives special treatment to some kinds of income and allows special deductions and credits for some kinds of expenses. Taxpayers who benefit from the law in these ways may have to pay at least a minimum amount of tax through an additional tax, called the alternative minimum tax.

¹² The extent to which those issues and requirements apply to a specific business would depend on how the business is organized, whether it has employees, and the nature of its business operations.

Figure 1: Extent to Which Small Businesses Relied on Practitioners to Understand Tax Issues



Note: N = 398,105.

Source: Responses to GAO questionnaire.

Some of the respondents to our survey added narrative comments to explain why they used a tax practitioner. For example:

“I rely on my CPA [certified public accountant] for all my taxes. There are too many forms, rules, penalties, etc. for me to understand and keep up with. I have to try to make a living through my small business and I am afraid I would do my taxes wrong if I tried to do them myself. My CPA is very expensive, but I feel like I have to have one.”

“We depend almost completely upon our accountant in all of the previously mentioned matters. The tax codes are far too complicated for the average small businessman to tackle.”

Other factors mentioned by persons we interviewed as contributing to a small business’ potential for noncompliance were that (1) business income, unlike wages and investment income, is generally not subject to withholding or some form of information reporting; and (2) small businesses often have cash flow limitations. It is generally recognized that

compliance is highest when taxes have been withheld (as is the case with wages) or when a third party (such as a bank or mutual fund) reports payments (such as interest and dividends) to IRS. Cash flow limitations can cause a small business to become delinquent in making required tax payments or in remitting taxes that have been withheld from employees.

IRS Has Not Operated in a Way That Best Enables It to Serve Small Businesses

IRS' ability to meet the needs of small businesses has been hampered in the past by its (1) organizational structure and (2) focus on problem correction versus prevention.

Under IRS' current organizational structure, authority for serving taxpayers and administering the tax code is decentralized to 33 districts and 10 service centers, each of which is organized along functional lines, such as collection, examination, and customer service. Because IRS allocates its resources, such as staff and information systems, along geographic and functional lines, it is designed to handle a wide range of issues pertaining to all taxpayers—from individuals whose sole income is from wages to multinational corporations—with little or no focus on specific taxpayer segments, such as small businesses. For example, IRS has dozens of discrete databases that are function-specific and are designed to reflect transactions at different points in the life of a return or information report—from receipt to disposition. As a consequence, IRS does not have any easy means to access comprehensive information about small business taxpayer accounts.

IRS has described the problems caused by its organizational structure as follows:

"Service centers and districts each performed these functions [e.g., collection, examination, and customer service] for the same taxpayer, the responsibility shifting depending on whether the work was done by phone, mail, or in person. For example, in the collection area, there are three separate kinds of organizations spread over all 43 operational units that use four separate computer systems to collect taxes. Each of these three units and four systems collects from every kind of taxpayer, from individuals to businesses."¹³

IRS' ability to address small businesses' needs has also been hampered by IRS' focus on correcting problems after they have occurred rather than preventing their occurrence. According to IRS, it allocates about 11 percent of its budget for customer education and assistance (i.e., problem prevention) compared to 72 percent for compliance (i.e., problem correction). The other 17 percent is allocated to customer account services, such as processing tax returns and adjusting taxpayer accounts.

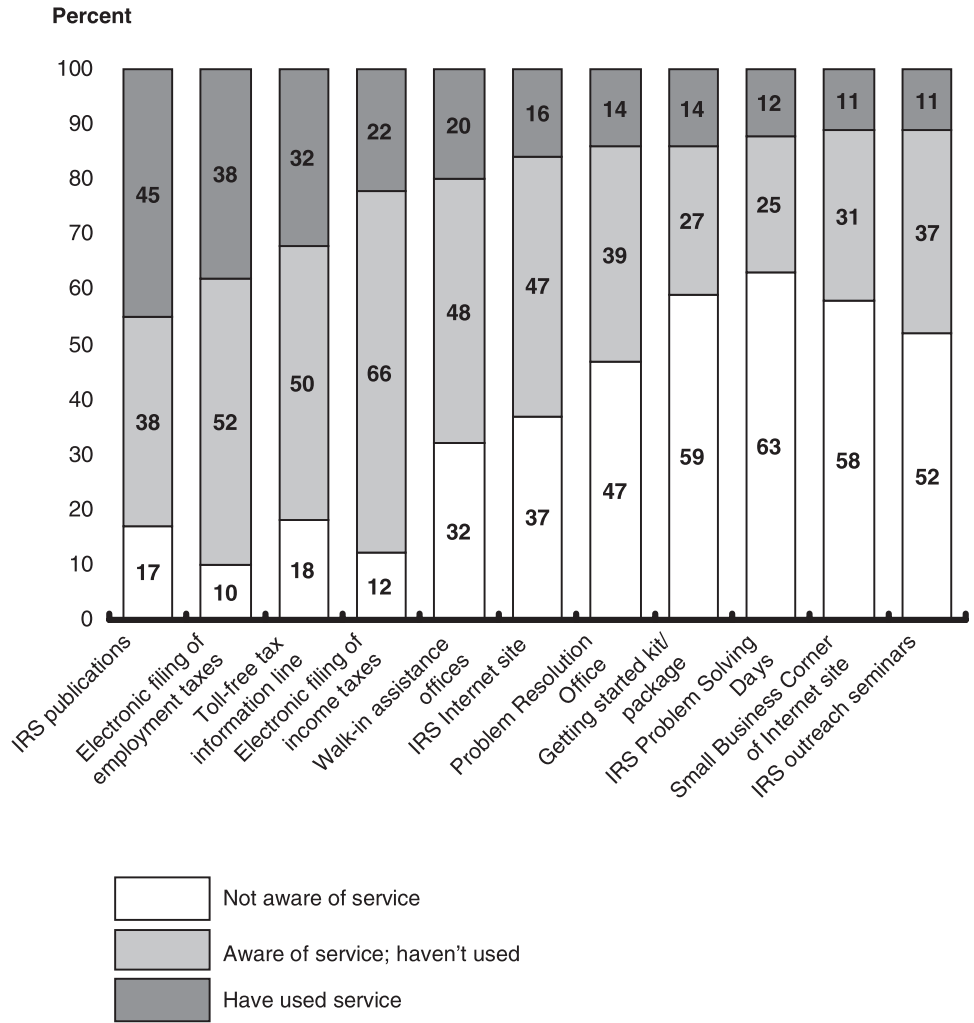
¹³ *Modernizing America's Tax Agency*, IRS Publication 3349, revised January 2000.

This emphasis on correction versus prevention can be especially problematic for small businesses that need assistance up front and that, absent that help, are at a high risk of going out of business if problems arise. In other words, by the time IRS determines that a small business has a compliance problem and sets out to correct the problem, it may be too late.

**Many Small Businesses
Were Unaware of Key IRS
Services and Many Who
Knew of the Services Did
Not Use Them**

As shown in figure 2, many small businesses in our study population were unaware of various IRS services that are available to small businesses, such as outreach seminars and a small business corner on IRS' World Wide Web site on the Internet; and many other businesses who were aware of the services did not use them.

Figure 2: Awareness and Use of Selected IRS Services Among Small Businesses



Note: N = 398,105.

Source: Responses to GAO questionnaire.

Our survey results were consistent with many of the views expressed by participants in IRS' 14 small business focus groups. For example, according to IRS' report on the focus group results, most participants did not know that IRS maintained an Internet presence and few participants had heard about IRS-sponsored seminars.

Many of the focus group participants indicated that they had limited familiarity with or use for IRS' products and services because they relied on tax practitioners. Small business representatives told us that small

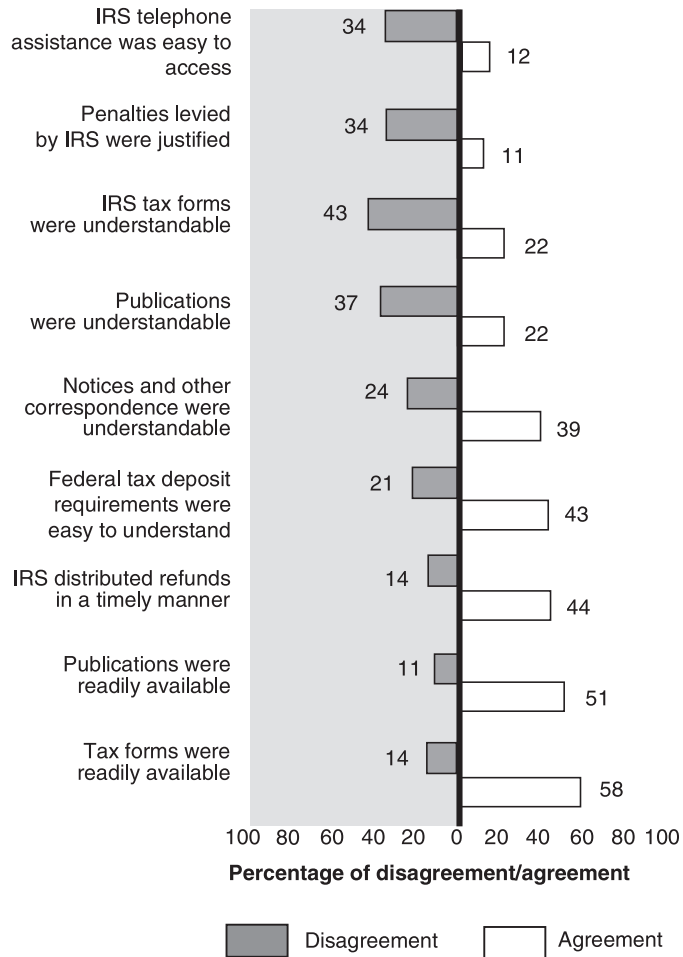
businesses would rather rely on tax practitioners because they are too busy, they do not trust IRS, or IRS' services are not conveniently offered. For example, one small business owner responding to our survey commented that certain IRS services, such as walk-in sites and outreach seminars, are not available in small towns and that it would be helpful if there was more information available on IRS' Internet site. Another small business owner commented that he would personally find it difficult to contact any source other than a local tax preparer for information because of fear of an audit. He further suggested that IRS needs to change the image that it treats small businesses as tax cheats.

Small Businesses Had Mixed Feelings About Their Past Interactions With IRS

Small businesses can have a variety of interactions with IRS ranging from general written advice, such as that provided through tax publications; to more personalized service, such as that provided over the telephone or at walk-in sites; to enforcement actions, such as audits. Negative reactions of small businesses to any such interactions in the past can complicate their future interactions with IRS.

Our survey included several questions about small businesses' interactions with IRS over the past 5 years, including their level of satisfaction or dissatisfaction with several aspects of IRS' service. More small businesses in our study population were satisfied with the overall quality of IRS' service than were dissatisfied. However, as shown in figure 3, when asked about specific aspects of IRS' service, small businesses had mixed feelings. For example, when asked about the availability of forms and publications or IRS' timeliness in issuing refunds, many more businesses commented positively than negatively. The opposite was true, however, when they were asked about such things as the understandability of forms, the accessibility of IRS' telephone assistance, and the levying of penalties.

Figure 3: Reaction of Small Businesses to Selected Interactions With IRS



Note 1: N = 398,105.

Note 2: Percentages do not add to 100 because this figure does not include responses from businesses who said that they neither agreed nor disagreed or who said that they had no basis to judge.

Source: Responses to GAO questionnaire.

Several respondents who expressed dissatisfaction with certain aspects of IRS' service provided narrative comments to explain their feelings. For example, one respondent commented that IRS' instructions have too much fine print and not enough plain English. Other examples include the following:

“When I do finally get a phone call through, I [dislike] all of the menus that you go through and the passing from one person to another when you finally do get to talk with a human. I also despise the noncaring, uninterested attitude that I usually get from IRS employees.”

“The frustrating thing about [IRS] is they send you a notice about tax discrepancies, you answer and about a month later you get another notice. You answer again and then you get a notice telling you this is your final notice. They need to have a person assigned to your tax problem so you could call them and work it out. It seems most of the time the person sending you the notice never sees your replies.”

“IRS employees on the whole do not seem helpful or knowledgeable. Plus, each time you call on a situation you have to start over each time with another employee. Problems should be assigned to one person to follow through to the end.”

“During any type of audit or inquiry, IRS personnel generally treat taxpayers as ignorant boobs who obviously are lying on their tax returns and it is only a matter of time until it can be proven.”

Among the few positive comments provided by respondents were the following:

“I must say that the auditor was flexible in that he was willing to review the records at our accountant’s office and also was willing to accept receipts over a certain dollar amount in order to facilitate the record-producing process. Also, we were treated very well by the auditor, which we appreciated.”

“The IRS telephone assistance people have been very professional with me and have an attitude of cooperation.”

We asked respondents whether they had seen any change in the overall quality of IRS’ service during the year preceding our survey. Of the 398,105 small businesses in our study population, an estimated 45 percent had seen no change, an estimated 14 percent had seen a positive change, and an estimated 2 percent had seen a negative change.¹⁴ Some small business owners responding to our survey mentioned changes they would like to see. For example, one owner commented that IRS employees should have a more positive attitude toward small businesses—a view shared by small business owners who participated in IRS’ focus groups. Another survey respondent said that:

“As much publicity as there has been about good intentions, I have seen no improvement in how the IRS operates. To some extent, the IRS is no better or worse than other federal agencies, none of them very good by the standards a for-profit business must operate under.”

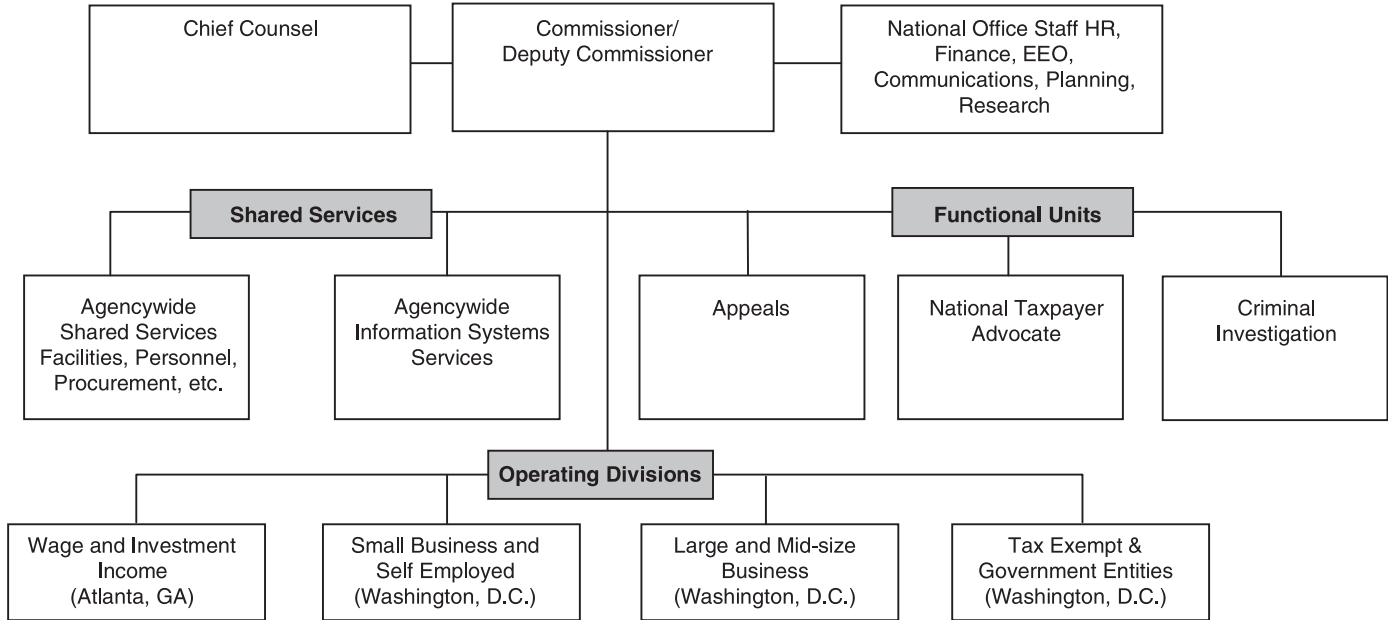
¹⁴ The other 38 percent had no basis to judge. These percents do not add to 100 because of rounding.

Some small business owners and representatives said that although IRS can improve its services, dissatisfaction with IRS is often misplaced. For example, one small business representative said that many small businesses that are dissatisfied with IRS have likely had little experience with IRS and are really expressing their dissatisfaction with the complex tax code. Misplaced or not, the level of dissatisfaction with various aspects of IRS' service expressed by our survey population is significant and can complicate the relationship between small businesses and IRS.

Reorganization May Enable IRS to Address Many of the Factors That Have Complicated Its Interactions With Small Businesses

IRS is implementing a major reorganization that it has characterized as its most significant reform effort in more than 50 years. As shown in figure 4, the reorganization is to, among other things, structure the agency around four primary customer segments and operating divisions. One of those operating divisions—SB/SE—is to focus on taxpayer education and assistance, specialized account services, and revamped compliance efforts tailored to small businesses and other taxpayers that IRS has decided have needs and interests that are similar to those of small businesses.

Figure 4: Structure of IRS' New Organization



Source: IRS.

The various changes discussed in IRS' plans for the new organization indicate that SB/SE will be taking steps to address those factors that have been identified as complicating the interaction between IRS and small businesses. Although the new organization may not be able to do much to reduce the tax law complexity facing small businesses, it should be better able to help businesses deal with those complexities and increase customer satisfaction. By dedicating an operating division to small businesses, increasing its knowledge base on the characteristics and needs of the population, and customizing its products and services to meet those needs, IRS intends to shed the limitations of its historic structure and improve its customer focus.

SB/SE might be able to implement some of its plans relatively quickly, such as those that involve partnering with outside organizations to enhance the delivery of assistance to small businesses. Other plans, such as those involving a revamped compliance strategy, could take much longer. Such things as the diversity of the small business population, antiquated computer systems, and staffing limitations pose challenges for the division, and IRS in general, as they attempt to implement the new organization.

Operating Division Dedicated to Small Businesses Is Intended to Improve Service and Accountability

With respect to small businesses, IRS' goal is to improve customer satisfaction and increase voluntary compliance through earlier and quicker resolution of problems. To achieve that end, SB/SE is to have the following three major units:

- Taxpayer Education and Communication is to manage both national and local education and assistance programs for small businesses.
- Customer Account Services is to process returns and provide specialized account services for small businesses.
- Compliance is to conduct compliance operations based on an approach that combines education, community outreach, and traditional enforcement actions (i.e., examinations and collections) based on the facts, circumstances, and risks of each small business case.

Taxpayer Education and Communication

As we discussed earlier, IRS' ability to meet the needs of small businesses has been hampered in the past by its focus on correcting problems after they occur (i.e., compliance) rather than preventing them from occurring (i.e., assistance). IRS has recognized the need for a greater focus on assistance and (1) is placing the Taxpayer Education and Communication unit on the same organizational level as the Compliance unit and (2) intends to increase the number of staff dedicated to small business education and communication from fewer than 100 in its current organization to about 1,300 in the new organization. As currently envisioned, the Taxpayer Education and Communication unit is to be a customer-focused organization that educates and informs SB/SE taxpayers about their tax obligations by conducting research on customer education needs, developing and delivering products and services focused on those needs, and analyzing customer feedback to improve products and services.

Although IRS intends to increase its taxpayer assistance and education efforts, it recognizes that many small businesses are reluctant to go to IRS for help. Thus, to increase the effectiveness of its education and assistance efforts, IRS intends to partner with tax practitioners and professional trade organizations to develop and deliver education and assistance to this population.

In considering its options for partnering, IRS might find it useful to know that many potential non-IRS sources of tax information were rarely used by our survey population. As shown in table 1, when asked from which non-IRS sources they had obtained tax-related information during the past

5 years, the only sources mentioned extensively were attorneys, accountants, and other tax practitioners.

Table 1: Non-IRS Sources of Tax Information

Non-IRS source	Percent not aware of source	Percent aware of source but have not used	Percent aware of source and have used
Tax practitioner or accountant	5	7	88
Attorney	11	54	35
Local bank	34	48	18
Local library	24	65	11
Local college or community college class	33	59	8
Small Business Administration information or development center	38	54	8
Small Business Administration Web site	41	53	6

Source: Responses to GAO questionnaire.

IRS also intends to focus its assistance on those small businesses most in need of help. One group of small businesses that IRS has identified as needing special attention is new businesses. The Commissioner of Internal Revenue discussed this need in May 23, 2000, testimony before this Committee, as follows:¹⁵

“... there are as many as one million start-up businesses each year in the United States. However, we now reach only 65,000 of them through our extremely limited education outreach program, missing an enormous window of opportunity to help these taxpayers understand what is expected of them and stay in compliance from the start.”

A cognizant IRS official told us that SB/SE is reviewing the assistance currently provided to new businesses and that the division, through consultations with the tax practitioner community, might establish a system that will help SB/SE decide, on a case-by-case basis, what form of interaction would be best for a particular start-up business.

Customer Account Services

As discussed earlier, under IRS' functional structure, IRS employees have been responsible for understanding tax law and filing requirements and providing account management for all taxpayers—from wage earners to large businesses—with little or no focus on small businesses. SB/SE, on the other hand, is to have five account management centers dedicated to

¹⁵ IRS Restructuring: A New Era for Small Business (May 23, 2000).

serving small businesses¹⁶ as well as dedicated phone sites to handle such activities as tax law assistance and automated collection for small businesses. According to IRS, this will allow SB/SE staff to become experts in only those tax code sections and filing requirements that apply to small businesses and, thus, provide specialized account assistance.

IRS expects to customize account management activities for small businesses¹⁷ and provide more timely and accurate account resolution through a short and long-term strategy for real-time account services. IRS expects to transition the Customer Account Services workload between October 2000 and 2002, but many of the unit's capabilities depend on other modernization efforts, such as those involving information systems, and will not be operational for a few years.

Compliance

As noted earlier, small businesses are more likely than other segments of the taxpayer population to have problems complying with the tax law due to a combination of complex filing requirements and limited resources available to meet those requirements. Through a new compliance strategy and streamlined management structure, SB/SE hopes to increase compliance and improve customer satisfaction.

Similar to IRS' current organization, most of SB/SE's resources are to be allocated to the Compliance unit. Unlike the current organization, however, SB/SE intends to implement a more balanced approach to improving compliance by blending traditional enforcement activities with education and outreach. For example, IRS' current collection process is a "one-size fits all" approach that treats all taxpayers alike. Under its new strategy, IRS intends to segment small businesses with collection issues by risk of nonpayment. A low-risk small business might receive a blend of education and enforcement activities, but a high-risk small business might receive aggressive enforcement action. Specific details about this new risk-based strategy, such as the criteria to be used in assessing risk, have yet to be developed.

To enhance this blend of enforcement and outreach, the operating division is to implement an information-sharing process between the Compliance and Taxpayer Education and Communication units. According to IRS,

¹⁶ The five account management centers are to be co-located with five compliance centers that also are to be dedicated to SB/SE. Those co-located centers are to be in Brookhaven, NY; Philadelphia, PA; Cincinnati, OH; Memphis, TN; and Ogden, UT.

¹⁷ Account management activities include responding to customer inquires; solving customer problems; providing options to settle accounts; and handling issues received through phone calls, correspondence, and electronic mail.

information gained during compliance activities should help direct education and outreach initiatives, which could help reduce the number of problems small businesses experience before returns are filed.

According to IRS, the Compliance unit will have fewer layers of management, which will better facilitate communication and free up personnel to increase support for other activities, including taxpayer education. For example, the unit is to have one management position—territory manager—that is to be responsible for the scope of work covered by three positions in IRS' current compliance function—district director, division chief, and branch chief. Also, the Compliance unit's management structure is to be cross-functional, requiring knowledge of examination and collection procedures.

Formidable Challenges Confront SB/SE and IRS

IRS' efforts to create a more taxpayer-focused organization with a streamlined management structure and greater end-to-end accountability are a step in the right direction. However, formidable challenges remain. SB/SE's ability to effectively focus on the needs and problems of small businesses may not be easy given the diversity of that segment of the taxpayer population and the need to find an effective way to serve taxpayers who migrate between operating divisions from year to year. The operating division also faces formidable challenges in its ability to deliver new services and programs because effective delivery depends on drastically improved information systems and a substantial shift in employee skills. Lastly, the operating division, and IRS as a whole, will be challenged to develop an integrated performance management system that will lead to changes in organizational and employee behavior.

Challenges to Operating Division's Customer Focus

Through reorganization, IRS intends to improve its customer focus. Although creation of SB/SE should facilitate a sharper focus on the needs and problems of small businesses than is possible under the current organization, the division will be challenged by the need to (1) serve a diverse population and (2) devise effective procedures for dealing with taxpayers who migrate between operating divisions.

SB/SE's ability to provide focused service will be complicated by the diversity of the population it is to serve. According to IRS, the approximately 40 million taxpayers to be served by SB/SE include about 6.2 million small partnerships and corporations; 19.3 million partially or fully self-employed individuals;¹⁸ 13 million individual filers with

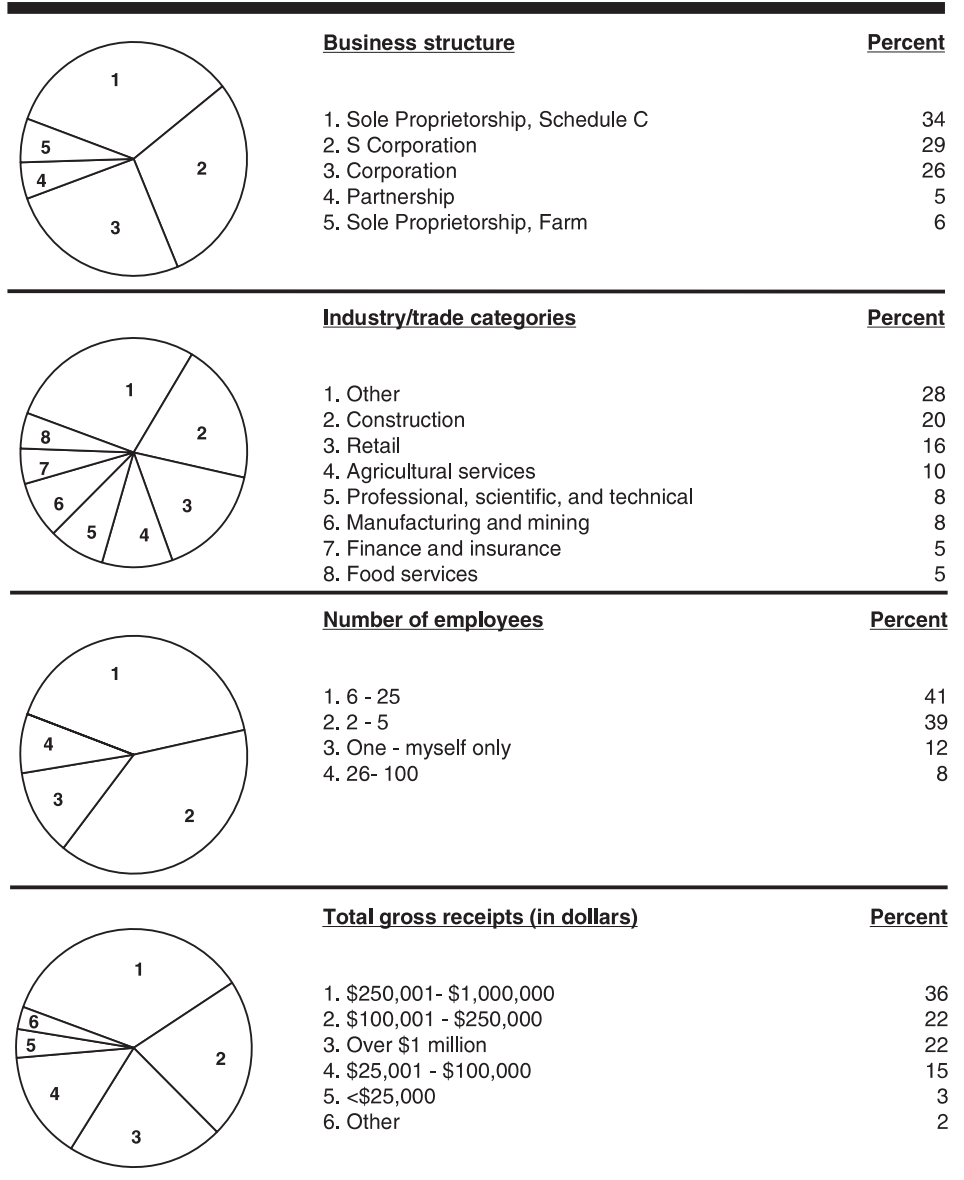
¹⁸ According to IRS, as many as one-half of self-employed filers receive the vast majority of their income from wages, not business-related enterprises, and are considered "incidental" business filers.

supplemental income or business expenses; and 1.2 million non-small business taxpayers who are considered specialty tax filers.¹⁹ This size and diversity compares with (1) the Wage and Investment Income Operating Division, which is to serve a larger but less diverse customer segment (about 116 million taxpayers who have only wage and investment income); and (2) the Large and Mid-size Business Operating Division, which is to serve a smaller and less diverse population (about 210,000 corporations and partnerships with assets of more than \$5 million).

Further evidence of the diversity of the small business population can be seen in figure 5, which is a profile of the small businesses in our study population. As the figure shows, that population involved a mixture of business structures and industries and varied widely in terms of number of employees and gross receipts.

¹⁹ Specialty tax filers include individual taxpayers with international tax returns and filers of fiduciary, estate, and gift tax returns.

Figure 5: Profile of Small Business Study Population



Note: N = 398,105.

Source: Responses to GAO questionnaire.

The diversity of the small business population will require that SB/SE staff specialize in a wide range of tax issues and deal with a wide range of taxpayer needs. For example, the needs of wage earners who also operate small, one-person businesses from their homes can vary significantly from

corporations that employ 100 persons and have gross receipts in excess of \$1 million.

Besides handling the workload for its own diverse population, SB/SE is also expected to do work for other operating divisions. For example, SB/SE is to do certain types of audit and collection work (cases involving complex examination issues or requiring enforcement action) for the Wage and Investment Income Operating Division. These additional responsibilities could stretch the capabilities of management and staff in SB/SE and dilute its customer focus.

Taxpayer migration also poses a challenge to the customer focus intended by the reorganization. Migration refers to scenarios under which a taxpayer might qualify as a small business one year but not the next, or vice versa. These scenarios could cause taxpayers to change operating divisions from year to year under the new organization. For example, according to IRS data, about 2.2 million individuals who had filed for tax year 1995 as pure wage earners (i.e., the kind of taxpayer for which the Wage and Investment Income Division is to be responsible) filed for tax year 1996 as sole proprietors (i.e., SB/SE-type taxpayers); and 1.7 million individuals who had filed as sole proprietors for tax year 1995 filed as pure wage earners for tax year 1996. Similarly, a corporation or partnership could have more than \$5 million in assets one year (and thus be part of the population to be served by the Large and Mid-size Business Operating Division) and less than \$5 million in assets the following year (which would make it part of SB/SE).

IRS acknowledges that taxpayer migration could present account management problems for SB/SE and other operating divisions. Specifically, this issue could lead to disparate treatment of taxpayers and hamper IRS' ability to provide end-to-end accountability because the responsibility for managing a migrating taxpayer's account could shift from one operating division to another. IRS is working on plans to put processes in place to allow for greater interaction between the account management units within the operating divisions to properly manage and serve migrating taxpayers.

Challenges to Operating Division's Ability to Deliver New Programs and Services

SB/SE will also be challenged to deliver the various new programs and services discussed earlier. In general, the division's challenges are a result of (1) antiquated computer systems and (2) a shortage of staff with needed skills.

IRS' antiquated computer systems have long hindered agency efforts to manage operations and serve taxpayers. IRS clearly documented the significance of this challenge in a publication entitled Modernizing America's Tax Agency.²⁰ Among the many statements in that document relating to information systems are the following:

"[IRS] has a very special problem that is a serious, on-going risk and a fundamental barrier to achieving its strategic goals. This problem is that the core data systems that keep records on taxpayers' tax accounts are fundamentally deficient."

"Because of the delays in updating files and the lack of synchronization of data among different systems, IRS employees frequently have inconsistent and out-of-date data about a given taxpayer."

These data problems contribute to the kind of issues raised in previously cited quotes from respondents to our survey who complained about getting multiple notices from IRS and about IRS employees who do not seem helpful or knowledgeable.

IRS has struggled with systems modernization for years, and we have made numerous recommendations to correct management and technical weaknesses that jeopardized the modernization process.²¹ Although IRS has made progress in addressing our recommendations, it has yet to fully implement them. More specifically, IRS needs to fully implement key controls that are needed to effectively guide and constrain modernization initiatives. These controls include (1) completing and implementing a blueprint for modernization; (2) implementing a "systems life cycle" process, including development of business cases, to manage system investments; and (3) establishing a fully operational management structure to oversee systems modernization.

Improvements to IRS' information systems are critical to SB/SE's overall success. IRS acknowledges, for example, that small business taxpayer education and communication initiatives depend on substantial investments in computer hardware and software and that major systems changes will be required to support a risk-based compliance strategy.

²⁰ IRS Publication 3349, revised January 2000.

²¹ Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected If Modernization Is To Succeed (GAO/AIMD-95-156, July 26, 1995) and Tax Systems Modernization: Blueprint Is a Good Start But Not Yet Sufficiently Complete to Build or Acquire Systems (GAO/AIMD/GGD-98-54, Feb. 24, 1998).

A shortage of staff with needed skills can also adversely affect SB/SE's ability to deliver new taxpayer education programs and services. According to IRS, the Taxpayer Education and Communication unit will require substantial resources, including staff with a blend of existing and new skills. However, the demand for employees possessing the necessary skills to staff the unit exceeds the current supply. For example, SB/SE intends to improve taxpayer education and assistance through research and analysis of taxpayer characteristics and behavior. However, according to IRS, it does not have enough employees who possess the requisite skills, such as market research, forecasting, and trend analysis. Such limitations could delay SB/SE's ability to develop and deliver specialized education and assistance to small businesses.

Operating Division and IRS Will Be Challenged to Develop and Implement a Performance Management System

A coherent organization and management structure dedicated to small businesses will not significantly improve service to taxpayers without a performance management system that aligns employee, program, and strategic performance measures and creates incentives for behavior that supports agency goals. IRS has made some headway in this area as it develops a new set of performance measures balancing customer satisfaction, employee satisfaction, and business results and updates its employee evaluation system.

Although IRS has clearly made progress in implementing new performance measures, it is missing a key indicator for voluntary compliance with the tax laws. Such a measure is essential for a number of reasons. Regularly measuring voluntary compliance is important to gauge whether IRS is accomplishing a key aspect of its mission. Also, the information about taxpayers that would be generated in measuring voluntary compliance may help IRS identify the characteristics of taxpayers who have difficulty understanding and meeting their tax responsibilities. Finally, the data IRS would develop as part of any voluntary compliance measurement effort may allow IRS to better direct its enforcement resources to those taxpayers who willfully violate the tax laws, thus reducing the burden on compliant taxpayers. The absence of a measure of voluntary compliance could hinder SB/SE more than other operating divisions because, according to IRS, the SB/SE population generally has a greater potential for noncompliance. IRS recognizes that it needs a reliable and meaningful measure of voluntary compliance and is working with a contractor to determine how to measure compliance with the least burden on taxpayers. However, that effort is still in its early stages.

A second critical aspect of performance management is an employee evaluation system that reflects the agency's mission. As mentioned earlier,

for example, SB/SE intends to refocus its compliance capabilities to provide a mix of education and outreach along with an integration of its traditional enforcement activities, examination and collection. IRS recognizes that a successful blend of customer service and integrated enforcement activities requires not only a substantial shift in employees' skills but also a significant change in employee attitude and behavior. IRS also recognizes that to achieve this shift, employees must have a clearer line of sight between their day-to-day activities, their resulting performance evaluations, and the agency's broader goals. IRS is exploring several different approaches for revising its employee evaluation system to make the relationship between employee performance and agency performance more transparent.

Conclusions

IRS' new organizational structure is a positive step toward improving IRS' ability to effectively and efficiently administer the tax system for small businesses. The new organization may not be able to do much to reduce the tax law complexity facing small businesses, but it should be able to help businesses better deal with those complexities. With the establishment of SB/SE, IRS will have an organization that can focus on addressing the factors that make small businesses more likely to be noncompliant and on correcting those factors that have aroused the kind of negative feelings about IRS that some respondents expressed in our survey.

Any improvement in these areas will depend on the processes and procedures the new organization adopts and how effectively they are implemented. Some of the planned changes, such as those related to partnering, may be fairly easy to implement. However, for the more substantive changes, such as risk-based compliance, to happen, SB/SE, and indeed all of IRS, will have to overcome several challenges. Because some of those challenges, especially the need to modernize IRS' computer systems, will require a significant amount of sustained effort, it may be several years before those more substantive changes are fully implemented.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from IRS. We obtained IRS' written comments in a July 18, 2000, letter from the Commissioner of Internal Revenue (see app. III).

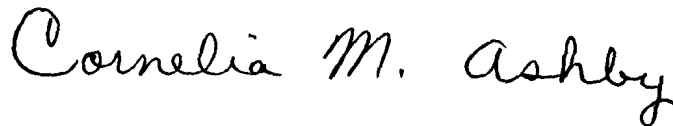
The Commissioner said that IRS was committed to implementing a customer-focused organization that will benefit all taxpayers and that our report would help IRS improve its products and services for small businesses.

The Commissioner cited several actions, in addition to those mentioned in our report, that IRS is taking to improve its products and services. The cited actions generally involved changes to simplify certain small business-related publications and steps to improve telephone service for small businesses and practitioners. The Commissioner noted, for example, that IRS (1) streamlined its Tax Guide for Small Business by removing information pertaining to larger businesses and (2) would begin accumulating telephone service customer satisfaction data from SB/SE customers, which is expected to result in improved telephone service.

As agreed with your office, unless you publicly release its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to Senator John Kerry, Ranking Minority Member of your Committee; Senator William V. Roth, Jr., Chairman, and Senator Daniel P. Moynihan, Ranking Minority Member, Senate Committee on Finance; and Representative Bill Archer, Chairman, and Representative Charles B. Rangel, Ranking Minority Member, House Committee on Ways and Means. Copies will also be sent to the Honorable Lawrence H. Summers, Secretary of the Treasury; the Honorable Charles O. Rossotti, Commissioner of Internal Revenue; and the Honorable Jacob Lew, Director, Office of Management and Budget. Copies will be made available to others upon request.

If you or your staff have any questions concerning this report, please contact me or David Attianese on (202) 512-9110. Key contributors to this report are acknowledged in appendix IV.

Sincerely yours,



Cornelia M. Ashby
Associate Director, Tax Policy
and Administration

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Contents

Abbreviations

CPA	certified public accountant
IRS	Internal Revenue Service
NFIB	National Federation of Independent Businesses
SB/SE	Small Business/Self-Employed Operating Division

Sampling and Data Analysis Methodology

Sample Selection Methodology

To identify the problems small businesses have encountered in the past in dealing with IRS, we identified a population of small businesses from the membership list of the National Federation of Independent Businesses (NFIB), a major national organization representing this population.¹

An ideal survey population would have been all small businesses in the country. In the absence of such a database or list, we identified a number of national organizations that represent small businesses. We chose NFIB's membership list because it was the largest and included members from a wide range of business sectors. NFIB is an organization of businesses that are not publicly held. Although not exclusively an organization of small businesses, NFIB officials told us that nearly all members of NFIB are small businesses. NFIB's membership list is actively used by the organization and is updated frequently.

We reached a general consensus regarding this choice with IRS' Executive Director for Small Business Modernization, the Small Business Administration's Office of Advocacy, and a number of other membership organizations representing small businesses. We included a screener question on the questionnaire asking respondents about their businesses' total assets, and we did not include responses from businesses that had \$5 million or more in total assets.

The mailing list of NFIB members that we used contained 398,105 businesses nationwide. In constructing this list, we excluded some members because they were either (1) a call center company that was excluded from NFIB mailings, (2) a company that did not want personal names and/or company names to appear on mailing pieces, (3) a company with a negative zip code number in the database, (4) a company that requested to not receive any mail as a result of NFIB membership, or (5) a so-called "decoy" company whose presence on NFIB's mailing list was only to detect unauthorized use of the mailing list. The mailing list we used to select the sample was current as of September 11, 1999.

We selected a stratified random sample of 1,000 businesses from our list of 398,105. The strata were defined by whether the business was structured as a sole proprietorship or other type of structure. These strata were selected because we wanted to ensure that sole proprietorships were adequately represented in our study population. The strata population and number of businesses selected are shown in table I.1.

¹ As defined previously, the term "small business" includes self-employed individuals (also known as sole proprietorships).

Table I.1: Strata for Small Business Study Population

Stratum	Population	Number of businesses selected
Sole proprietorships	151,908	500
All other businesses	246,197	500
Totals	398,105	1,000

Source: GAO analysis of NFIB membership list.

Questionnaire Design

Our questionnaire asked for background information about the business, such as the number of employees, the type of industry the business was involved in, and whether the respondent typically prepared the federal tax returns for the business or hired a tax preparer or accountant to do it. It asked about what IRS and non-IRS services and resources the respondent had used; and it asked the respondent to rate his or her satisfaction with various products, services, and functions provided by IRS.

We sought reactions from officials at IRS, the Small Business Administration, and NFIB to a draft of the questionnaire. We then pretested it with two small business owners who completed the questionnaire and shared their opinions and suggestions. The questionnaire took each pretest respondent about 15 minutes to complete. A copy of the final questionnaire and the survey responses are shown in appendix II.

To encourage candid responses, the questionnaire was completely anonymous, with no way for us to identify the answers of any business individually. A postcard was included with each questionnaire, for respondents to return separately to let us know that they had mailed back their questionnaires. That enabled us to exclude those who had already responded from follow-up mailings.

In addition, a letter from NFIB, encouraging members to respond, accompanied the questionnaire and our cover letter. We conducted the initial mailout on September 30, 1999. We sent a follow-up mailing to nonrespondents on October 28, 1999, and sent a final mailing on December 2, 1999.

Response Rates

We received 548 usable responses to our questionnaire, or a response rate of 55 percent. Five other questionnaires were returned to us as not deliverable, and another five questionnaires were received but not used because the respondents said that they had \$5 million or more in total assets, which exceeded our criteria for a small business.

Sampling and Nonsampling Errors for Key Estimates Used in the Report

Because our survey results come from samples, all results are estimates that are subject to sampling errors. We calculated sampling errors for all of the survey results presented in this report. These sampling errors measure the extent to which samples of these sizes and structure can be expected to differ from their total populations. Each of the sample estimates is surrounded by a 95-percent confidence interval. This interval indicates that we are 95-percent confident that the results for the total population fall within this interval. Unless otherwise noted, the 95-percent confidence intervals for proportions do not exceed 10 percentage points. All numeric estimates other than proportions have sampling errors smaller than 10 percent of the value of those estimates, unless otherwise noted.

In addition to the reported sampling errors, the practical difficulties of conducting any survey may introduce other types of errors, commonly referred to as nonsampling errors. For example, differences in how a particular question is interpreted, in the sources of information that are available, or in the types of files not available introduce unwanted variability into the survey results. We included steps in our audit to minimize such nonsampling errors. For example, we carefully pretested the survey instrument and discussed our survey results with cognizant IRS officials at the National Office and at field locations we visited and in discussions with various small business representatives.

Final Results From Survey of Small Businesses

GAO

U. S. General Accounting Office

Small Business Survey

Introduction

At the request of the U.S. Senate Committee on Small Business, the U.S. General Accounting Office, an agency of Congress, is conducting a study of small businesses and self-employed individuals on their experiences with the IRS.

We realize that your time is valuable, but your answers will assist us in a report we are drafting for Congress. Please be as accurate and thorough as you can. However, we do not intend for you to have to consult with your tax preparer or accountant in order to respond. If you do not know the answer to a particular question, you may leave it blank.

Most questions should be answered based on your experiences over the past 5 years. However, other questions may ask you to answer based on a more recent time period. If you have not been in your current business for 5 years, please answer based on as much of the given time period as is possible.

To ensure your anonymity, we ask that you return the enclosed postcard separately, indicating that you have completed and returned your questionnaire. We need these cards returned so that we can send a follow-up questionnaire to those who have not returned their postcards and questionnaires.

This questionnaire should take about 30 minutes of your time to complete. If you have any questions concerning any part of this survey, please call Ms. Yong Meador of our Kansas City Office at (913) 384-7556, or email meadorh.kcro@gao.gov.

Please return the completed questionnaire in the enclosed pre-addressed envelope within 10 working days. In the event the envelope is misplaced, the return address is:

U.S. General Accounting Office
Attn: Yong Meador
5799 Broadmoor – Suite 600
Mission, Kansas 66202

Thank you for your assistance.

Note: The results shown in this appendix are percentages, based on 548 useable responses to our survey.

Appendix II
Final Results From Survey of Small Businesses

Part I. Information About Your Business

1. How long has your current business been in existence (include only the time you have owned or operated this business)? (Enter number.) <5=18, 6-10=17, 11-25=46, >25=18

_____ years (please round to the nearest year)

2. In 1998, what were your business' total assets? (Check one.)

98 1. Less than \$5 million

2 2. \$5 million or greater

3. Don't know

3. In 1998, what were your business' total gross receipts? (Check one.)

3 1. Less than \$25,000

15 2. Between \$25,001 to \$100,000

22 3. Between \$100,001 to \$250,000

36 4. Between \$250,001 to \$1,000,000

22 5. Over \$1 million

2 6. Don't know

4. Which one of the following industry or trade categories best describes your business? (Check one.)

10 1. Agricultural services

5 2. Food services

20 3. Construction

5 4. Finance & insurance

8 5. Manufacturing & mining

2 6. Transportation and public warehousing

1 7. Real estate & rental

16 8. Retail

4 9. Wholesale

8 10. Professional, scientific & technical services

0 11. Administrative & support services

2 12. Healthcare & social assistance

20 13. Other - Please specify: _____

Appendix II
Final Results From Survey of Small Businesses

5. Including yourself, how many employees do you have in your business (include full and part-time employees)? (Check one.)

12 1. One – myself only

39 2. 2-5

41 3. 6-25

8 4. 26-100

5. Over 100

6. Which one of the following categories best describes the primary structure of your business? (Check one.)

34 1. Sole proprietorship – Commercial (Schedule C attached to Form 1040)

5 2. Sole proprietorship – Farm (Schedule F attached to Form 1040)

6 3. Partnership – (Form 1065 including LLCs and LLPs)

29 4. S corporation – (Form 1120S)

26 5. Corporation – (Form 1120)

6. Other - Please specify: _____

7. Don't know

7. Did you use a paid preparer or accountant to prepare your 1998 federal tax returns? (Check one.)

6 1. No

94 2. Yes → If yes, which of the following best describes why you used the paid preparer or accountant? (Check one.)

4 1. It is more cost effective to hire a preparer than do it myself.

4 2. I do not understand how to complete the forms.

36 3. The tax laws and requirements are too complex.

56 4. I would rather rely on a tax professional to assure compliance.

5. Other _____

**Appendix II
Final Results From Survey of Small Businesses**

Part II. IRS Services You Have Used

8. Over the past 5 years, to what extent, if at all, have the following IRS services been useful to you to obtain tax related information?

(Check one box in each row. If you are not aware of a service, check column 1 for that service. If you are aware of the service, but have not used it, check column 2 for that service.)

IRS Services	Not aware Of this Service	Aware of service but have not used	Very Useful	Moderately useful	Of some use	Of little use	Not useful at all
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
a. Getting started kit/package	59	27	3	2	3	1	5
b. IRS publications	17	38	10	16	13	4	3
c. Walk-in assistance offices	32	48	2	2	4	3	9
d. IRS outreach seminars (e.g., small business workshops)	52	38	1	1	2	1	5
e. Toll-free tax information line	18	50	7	8	7	4	7
f. IRS' internet site	37	47	3	3	1	1	8
g. Small business corner on IRS' internet site	58	31	2	1	1	1	7
h. Electronic filing of employment taxes (941 TeleFile or Electronic Federal Tax Payment System - EFTPS)	10	52	18	7	3	2	8
i. IRS problem solving days	63	25	1	1	2	2	7
j. Electronic filing of income taxes	12	66	7	3	2	1	9
k. Problem resolution office	47	39	2	2	3	2	6
l. Other – Please Specify: _____							

**Appendix II
Final Results From Survey of Small Businesses**

9. Over the past 5 years, have you obtained tax related information from any of the following non-IRS resources?

(Check one box in each row. If you are not aware of a resource, check column 1 for that resource. If you are aware of the resource, and have used it, check column 2 for that resource. If you are aware of the resource, and have not used it, check column 3 for that resource.)

Non-IRS Resources	I am not aware of this resource to obtain tax information (1)	I am aware of this resource and have used it to obtain tax information (2)	I am aware of this resource but have not used it to obtain tax information (3)
a. A tax practitioner or accountant	5	88	7
b. An attorney	11	35	54
c. A local college or community college class	33	8	59
d. Small Business Administration (SBA) website regarding tax information	41	6	53
e. A local bank	34	18	48
f. A local library	24	11	65
g. Any Small Business Administration (SBA) information or development center	38	8	54
h. Other Small Business Administration (SBA) service(s) – Please specify: _____	[REDACTED]	9	91
i. Other – Please specify: _____	[REDACTED]		

**Appendix II
Final Results From Survey of Small Businesses**

PART III. YOUR EXPERIENCES WITH THE IRS.

Please answer the following questions based on your experiences *as a small business owner or a self-employed individual* in dealing with the IRS. Please base your answers on your experiences with the IRS over the past 5 years.

10. Do you agree or disagree with the following statements regarding your past dealings with the IRS before you filed your tax returns? (Check one box in each row. Feel free to add any other areas that are not listed.)

	Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly Disagree	No basis to judge/ Not applicable
	(1)	(2)	(3)	(4)	(5)	(6)
a. IRS publications were readily available	7	44	25	9	2	14
b. IRS publications were understandable	1	21	27	29	8	14
c. IRS tax forms were readily available	6	52	18	11	3	12
d. IRS tax forms were understandable	1	21	24	33	10	13
e. IRS tax form instructions were understandable	1	21	24	31	10	13
f. Federal tax deposit requirements were easy to understand	3	40	24	16	5	13
g. IRS tax return preparation assistance was readily available (e.g. telephone or walk-in)	1	12	30	11	6	40
h. IRS tax return preparation assistance was helpful	1	8	30	8	2	51
i. IRS employees exhibited professionalism during your interactions	2	20	27	6	3	43
j. IRS employees had the proper level of knowledge to answer specific small business tax questions	1	13	25	10	5	46
k. IRS small business workshops were helpful	-	3	28	1	-	69
l. IRS problem solving days were helpful.	-	1	25	2	1	71
m. Other - Please Specify: _____						

**Appendix II
Final Results From Survey of Small Businesses**

11. Do you agree or disagree with the following statements regarding your past dealings with the IRS after you filed your tax returns? (Check one box in each row. Feel free to add any other areas that are not listed.)

	Strongly agree (1)	Agree (2)	Neither Agree nor disagree (3)	Disagree (4)	Strongly Disagree (5)	No basis to judge/ Not applicable (6)
a. IRS notices and other correspondence were understandable	1	38	22	19	5	16
b. IRS distributed refunds in a timely manner	2	42	20	10	4	23
c. Penalties levied by IRS were justified	–	11	23	20	14	32
d. IRS telephone assistance was easy to access	–	12	17	20	14	36
e. IRS telephone assistance provided useful help	–	17	25	12	7	39
f. IRS employees provided prompt attention to your account discrepancies	1	15	22	12	7	43
g. IRS employees treated you professionally during an audit	1	13	16	1	2	66
h. The amount of additional taxes you had to pay were commensurate with the documentation you provided	–	16	19	5	3	57
i. Information requested by the IRS audit staff was concise	–	10	15	4	3	68
j. The audit was completed within a reasonable amount of time	–	10	15	2	3	70
k. IRS appeals officers were knowledgeable of applicable tax law.	–	3	14	2	2	79
l. IRS audit officers were knowledgeable of applicable tax laws.	–	7	15	3	1	73
m. A settlement on disputed issues was reached in a reasonable amount of time.	–	5	14	3	4	74
n. IRS collection officers discussed all available alternatives with you in paying your tax obligation.	–	5	14	4	3	73
o. The problem resolution staff was able to resolve your problems in a timely manner.	–	4	15	3	3	75
p. Other – Please specify: _____						

**Appendix II
Final Results From Survey of Small Businesses**

Part IV. General

12. Taking everything into consideration, how satisfied or dissatisfied have you been over the past 5 years with the following aspects of the IRS' service? (Check one box in each row. Feel free to add any other areas that are not listed.)

Aspects of IRS' Service	Level of satisfaction with IRS' Service					
	Very Satisfied (1)	Generally satisfied (2)	Neither satisfied nor dissatisfied (3)	Generally dissatisfied (4)	Very dissatisfied (5)	No basis to judge/ Not Applicable (6)
a. Overall quality of IRS' service	1	29	38	12	4	17
b. Quality of IRS' publications	1	30	34	11	3	20
c. Quality of IRS' forms and instructions	1	30	30	19	5	15
d. Quality of IRS' notices and correspondence	–	30	31	17	4	18
e. Quality of IRS' telephone assistance	1	17	22	10	7	43
f. Quality of IRS' walk-in assistance	1	3	18	3	2	74
g. Professionalism of IRS employees during an audit	1	10	14	3	1	72
h. Quality of service by IRS' audit employees	1	9	15	3	2	71
i. Professionalism of IRS' collection employees	1	6	17	4	3	70
j. Quality of service by IRS' collection employees	1	7	16	4	3	70
k. Professionalism of IRS' appeals employees	–	3	14	1	2	80
l. Quality of service by IRS' appeals employees	–	3	14	2	2	80
m. Professionalism of IRS' problem resolution employees	1	5	14	2	3	76
n. Quality of IRS' final resolution of any disputed issue	–	6	15	3	2	74
o. Timeliness of IRS' final resolution of any disputed issue	–	5	15	4	4	72
p. Other - Please specify: _____						

**Appendix II
Final Results From Survey of Small Businesses**

13. Over the past 12 months, have you noticed a positive change, no change, or a negative change in the following areas of IRS' service? (Check one box in each row. Feel free to add any other areas that are not listed.)

Aspects of IRS' Service	Changes in Quality of IRS' Service					
	A very Positive Change (1)	A Somewhat positive change (2)	No Change (3)	A somewhat negative change (4)	A very negative change (5)	No basis to judge/ Not Applicable (6)
a. Overall quality of IRS' service	1	13	45	2	-	38
b. Quality of IRS' publications	-	10	50	1	1	39
c. Quality of IRS' forms and instructions	-	11	51	2	1	36
d. Quality of IRS' notices and correspondence	-	10	51	2	1	37
e. Quality of IRS' telephone assistance	1	7	29	3	1	59
f. Quality of IRS' walk-in assistance	-	1	18	1	-	80
g. Professionalism of IRS employees during an audit	-	2	15	1	1	81
h. Quality of service by IRS' audit employees	-	2	14	1	1	82
i. Professionalism of IRS' collection employees	-	2	17	-	1	80
j. Quality of service by IRS' collection employees	-	2	17	-	1	80
k. Professionalism of IRS' appeals employees	-	1	13	1	1	85
l. Quality of service by IRS' appeals employees	-	2	13	-	1	85
m. Professionalism of IRS' problem resolution employees	-	3	15	-	1	81
n. Quality of IRS' final resolution of any disputed issue	-	3	15	1	1	80
o. Timeliness of IRS' final resolution of any disputed issue	-	2	16	1	1	79
p. Other - Please specify: _____						

**Appendix II
Final Results From Survey of Small Businesses**

PART V. YOUR EXPERIENCES WITH THE INTERNAL REVENUE CODE.

Please answer the following questions based on your experiences *as a small business owner or a self-employed individual* in dealing with the tax code. Please base your answers on your experiences with the code *over the past 5 years*.

14. To what extent, if at all, do you feel you have a good understanding of the following tax issues as they apply to your business?

(Check one box in each row. If an issue does not apply to your business, check column 1. Also, feel free to add other areas that are not listed below.)

Tax Issues	Does not apply to my business (1)	Very Great extent (2)	Great extent (3)	Moderate extent (4)	Some extent (5)	Little or no extent (6)	Rely on tax preparer to understand (7)
a. Method of accounting (e.g., cash or accrual)	2	8	11	29	9	3	39
b. Depreciation	1	5	12	21	13	5	44
c. Expensing	1	7	16	24	11	3	39
d. Alternative minimum tax	5	2	2	7	9	20	55
e. Pension plans/profit sharing	13	3	5	15	12	14	39
f. Capital gains	6	4	5	18	13	8	46
g. Passive activity rules	8	2	3	6	6	18	58
h. Employment taxes	2	9	14	22	9	3	40
i. Other - Please specify: _____							

Appendix II
Final Results From Survey of Small Businesses

15. Please use the space below to provide any additional comments about the IRS that affected you either positively or negatively. You may attach additional sheets if necessary.

Thank you for your assistance.
Please return your survey in the enclosed preaddressed envelope and your postcard separately.

Comments from the Internal Revenue Service



COMMISSIONER

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

July 18, 2000

Ms. Cornelia M. Ashby
Associate Director, Tax Policy and Administration Issues
General Accounting Office
Washington, D.C. 20548

Dear Ms. Ashby:

Thank you for the opportunity to review and comment on your report to the Chairman of the Senate Committee on Small Business, entitled Tax Administration: IRS Faces Several Challenges as it Attempts to Better Serve Small Businesses. We would like you to consider some additional actions we are taking to improve our small business services and products.

Enhancing Systems

Specialized Telephone Service for Small Businesses. Currently, an IRS team is determining which small business tax law and account-related topics should be answered by our 12 designated small business call sites. We believe specialization will increase the expertise of our Customer Service Representatives (CSRs). The team's recommendation should be implemented during FY 2001, with full benefits realized in FY 2002. During the fall of 2000, we will begin routing more small business-related calls to the 12 designated Call Sites, which will help our CSRs to gain additional experience and improve performance.

Practitioner Hotline Service Realignment. The IRS' Practitioner Hotline program is located at multiple sites across the country. The level of service and expertise of our personnel varies from location to location. We plan to improve service by realigning the Practitioner Hotline to one or two specialized sites. We expect to implement this change during FY 2001.

Improving Small Business Taxpayer Customer Service

At present, the IRS does not have Customer Satisfaction Survey results for small businesses who access our toll-free numbers. However, overall satisfaction survey results for all toll-free customers ranged from 89 to 93 percent (averaging 91 percent) from April 1, 1998 to March 31, 2000.

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We use customer feedback and survey results to make systemic and procedural changes and train our CSRs in an ongoing effort to improve service. Although the survey results are generally positive, we always try to improve the quality of our tax answers and the level of service we provide to the public.

When the reorganization becomes effective, Toll-free customer satisfaction data will be accumulated for the new Small Business/Self-Employed Operating Division. The focus on service to the Small Business taxpayer that will result from the reorganization combined with utilization of data specifically elicited from this customer segment is expected to result in improved service and greater customer satisfaction.

Simplifying Tax Forms and Publications

The GAO draft report said that small business owners often find IRS forms, instructions, and publications difficult to understand. The IRS has been working to address this concern. We have asked small business taxpayers for their feedback and help in simplifying tax forms and publications. As an example of our progress, we streamlined Publication 334, *Tax Guide for Small Business*, by removing information pertaining to larger businesses. Sole proprietors now find the publication much more suited to their needs.

We also redesigned Publication 583 and renamed it *Starting a Business and Keeping Records*. Feedback from our customers and tax practitioners indicate the publication is a very useful guide for people interested in starting a business. We removed complex employment tax issues that are often not applicable to small businesses from Publication 15, *Employer's Tax Guide*, and placed them in new Publication 15-A, *Employer's Supplemental Tax Guide*. The redesigned Publication 15 now includes information that is most useful to small business operators.

We began analyzing questions sent to the IRS Digital Daily Web site. We will use artificial intelligence software to determine the most frequently asked questions and our technical experts will then develop clear, plain English answers. We will also use this information to clarify and simplify our tax products.

We also expanded the Simplifying Filing Research Strategy to include small businesses. This program compiles data from filed returns and identifies error trends. We then use the data to simplify appropriate forms, instructions, and publications. We plan to simplify Form 1120, *Corporation Income Tax Return*, Form 1120S, *U.S. Income Tax Return for an S Corporation*, Form 941, *Employer's Quarterly Federal Tax Return*, and Form 1065, *U.S. Partnership Return of Income*. All four forms are heavily used by small businesses.

We appreciate the General Accounting Office's time and effort in compiling this report. It will help us improve our tax products and services for small businesses. We are

Appendix III
Comments from the Internal Revenue Service

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committed to implementing a more customer-focused organization that will benefit all taxpayers.

If you have any questions, please contact me or a member of your staff may contact Barry Fulcher at (202) 622-6051.

Sincerely,



Charles O. Rossotti

GAO Contacts and Staff Acknowledgments

GAO Contacts

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