TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Elderly Taxpayers Would Benefit by the Internal Revenue Service and Tax Professionals Partnering to Reduce Unnecessary Filings

May 28, 2009

Reference Number: 2009-30-076

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

May 28, 2009

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Elderly Taxpayers Would Benefit by the Internal Revenue Service and Tax Professionals Partnering to Reduce Unnecessary Filings (Audit # 200830013)

This report presents the results of our review to determine what steps, if any, the Internal Revenue Service (IRS) had taken to inform taxpayers who file returns to reclaim withholding from non-taxable Social Security benefits for which they do not have to have income tax withheld or file returns. This review is included in our Fiscal Year 2009 Annual Audit Plan under the major management challenge of Providing Quality Taxpayer Service Operations.

Impact on the Taxpayer

Taxpayers aged 65 or older will directly benefit by not filing returns when they have no need to do so. These taxpayers will have less burden and will save time and financial costs. To realize these benefits, taxpayers will need to work with tax professionals and guidance from the IRS to reevaluate their withholding requirements if they do not anticipate tax liabilities in future years.

Synopsis

This review focused on taxpayers aged 65 or older who had minimal income yet filed returns regardless if they were due a refund from income tax withholding. Many taxpayers used tax professionals to file these unnecessary returns. Since these are taxpayers with minimal income, any unnecessary costs can pose a financial burden. Although taxpayers would likely maintain their financial records whether they filed or not, there is still a significant amount of time and money expended to file unnecessary returns. The IRS and the tax professional community share responsibility to educate taxpayers aged 65 or older to discontinue their withholding and filing of unnecessary tax returns.

Recommendations

We recommended that the Commissioner, Wage and Investment Division, ensure consistency between the IRS' public web site (IRS.gov) and written products by reviewing and, if necessary, revising the IRS' most common publications and U.S Individual Income Tax Return (Form 1040/1040A) instructions. The revisions should include language that advises taxpayers to discontinue income tax withholding if there is little likelihood that they will be required to file in subsequent years.

Also, the Commissioner, Wage and Investment Division, should conduct focus groups with the elderly, tax professionals, and/or payers of pensions and annuities to determine why taxpayers are filing unnecessary returns. In addition, the IRS should include discussions on 1) tax responsibilities of the elderly, 2) discontinuing withholding on Social Security benefits, 3) coordinating rollovers with financial institutions to avoid the mandatory 20 percent withholding, and 4) filing requirements. These actions may be conducted within the IRS' existing outreach and education efforts for tax professionals and should result in a reduced number of unnecessarily filed tax returns, thereby reducing taxpayer burden.

Response

IRS management disagreed with all of our recommendations and outcome measures. They did not agree to revise the IRS' most common publications and the instructions to the Form 1040/1040A because such a change would risk causing confusion for the vast majority of taxpayers in order to accommodate a small number of filers. However, they will reinforce the message about unnecessary filings in the *Tax Guide for Seniors* (Publication 554) and will review those publications specifically targeting the elderly to determine whether similar language as provided on IRS.gov may be appropriate. The Wage and Investment Division Research office is working in conjunction with the Media and Publications function to review prior research from the Reduce Unnecessary Filing program and from external entities, such as the American Association of Retired Persons. Once they have reviewed this research, they will determine what future action is necessary, including whether they should conduct focus groups with the elderly, tax professionals, and/or payers of pensions and annuities. Management's complete response to the draft report is included as Appendix VI.

Office of Audit Comment

We agree that reinforcing the message regarding unnecessary filings in publications specifically targeting the elderly is necessary. However, an increased awareness effort may not be successful if it is limited to only those publications. At a minimum, the IRS should refer elderly taxpayers from the instructions and most common publications to the targeted publication for more detailed information. In addition, IRS management stated that they would only consider conducting focus groups if their review of prior research warranted them. However, we believe the focus groups will provide valuable insight into the root causes of why the elderly continue to file and/or have income tax withheld. Focus groups and outreach efforts to engage the preparer community will assist the IRS with its effort to reduce taxpayer burden.

IRS management did not agree with the outcome measures because they were unable to verify that the returns in question were truly unnecessary. Therefore, they could not comment on the associated taxpayer costs and time burden. Our analyses focused on taxpayers whose reported income was equal to or less than the exemption amount which is only one of the components for determining filing requirements. Had we taken both components – the exemption amount and the standard deduction – the population would have been larger. Taking such a conservative approach makes us confident that our outcome measures are sound and reasonable.

Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.

Table of Contents

Abbreviations

DCW	Data Center Warehouse
IDRS	Integrated Data Retrieval System
IRS	Internal Revenue Service
RUF	Reduce Unnecessary Filing

Background

In its 2007 Annual Report, the Internal Revenue Service (IRS) Oversight Board stated,

> *To take taxpayer service to the next level, the IRS must do more than respond to taxpayer inquires. It must understand taxpayers' needs better through new research and implement education and outreach services tailored to the needs of specific groups of taxpayers. Great service requires that the IRS proactively provides taxpayers with information that helps them easily understand their tax obligations, provides more self-service applications, simplifies information sharing, and facilitates electronic filing.*

In August 2007, the Treasury Inspector General for Tax Administration reported that over 8 million tax returns were unnecessarily filed in each of the Tax Years 2003, 2004, and 2005.[1] Eighty-five percent of these returns were filed to obtain a refund of taxes withheld. The remaining 15 percent of these unnecessarily filed returns did not generate tax collections or a refund. We observed that taxpayers who received income solely from non-taxable Social Security benefits were filing tax returns to reclaim income tax withheld. The taxpayers in this group had no filing requirements or tax liabilities and, except for the withholding issue, were filing unnecessary returns. Eliminating unnecessary filings could reduce the IRS' processing costs as well as reduce taxpayer burden for this specific group of individuals.

Our review focused solely on taxpayers aged 65 or older, why they filed, and the IRS' outreach and education efforts to curtail their continued filing. There is the potential that more and more taxpayers will fall into this category since the number of taxpayers receiving Social Security benefits is increasing with the "graying of America" as the baby boomer generation retires and life expectancy increases. Due to the economic stimulus payments, many taxpayers filed in Tax Year 2007 after years of not filing, thereby skewing any current trend analyses to monitor this group. However, the Social Security Administration Fiscal Year 2007 Performance and Accountability Report showed a steady increase in Social Security benefit recipients as indicated in Figure 1.

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[1] *Evaluation of the Characteristics of Unnecessarily Filed Individual Income Tax Returns* (Reference Number 2007-40-130, August 17, 2007).

Figure 1: Number of Beneficiaries
As of September 30th of Each Year (In Millions)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Old Age Survivor Insurance only[2]	37.9	38.0	38.7	38.9	39.2	39.4	39.6	40.0	40.4	40.9
Disability Insurance only	6.3	6.5	6.6	6.8	7.1	7.5	7.8	8.2	8.5	8.8
Supplemental Security Income only[3]	4.2	4.2	4.2	4.3	4.4	4.4	4.6	4.6	4.7	4.8
Total[4]	48.4	48.7	49.5	50.0	50.7	51.3	52.0	52.8	53.6	54.5

Source: Social Security Administration Fiscal Year 2007 Performance and Accountability Report, dated November 11, 2007.

In Calendar Year 1991, the IRS conducted a study to determine the volume of unnecessary filings. From the results of this study, it began a program called Reduce Unnecessary Filings (RUF). The RUF program targeted 2 groups of individuals who were needlessly filing returns: young taxpayers between the ages of 15 and 19, and taxpayers aged 65 or older. In Calendar Year 1998, three publications were developed and issued to each group of taxpayers advising them not to file and to discontinue having income tax withheld during subsequent tax years. The third publication was last updated for Tax Year 2004. The publications were:

1. *People 15-19 Years Old: You May Not be Required to Have Federal Tax Withheld* (Publication 3136).
2. *People on a Pension: You May Not be Required to Have Federal Tax Withheld* (Publication 3137).
3. *You May Not Need to File a 2004 Tax Return* (Publication 3195), which was sent in lieu of a tax package to taxpayers in both groups.

With the advent of electronic filing, processing costs for the IRS began to decline. Inversely, the costs for direct mailing of RUF program publications were increasing. As a result, the RUF

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[2] Old Age Survivor Insurance benefits are for working Americans who qualify upon their retirement. Benefits are also paid to certain family members and survivors of the retiree. This entitlement program is commonly referred to as Social Security.
[3] Supplemental Security Income is a nationwide assistance program administered by the Social Security Administration designed to provide or supplement the income of aged, blind, or disabled adults and children with limited income and resources.
[4] Receiving Old Age Survivor Insurance, Disability Insurance, or Supplemental Security Income only.

program was discontinued for budgetary reasons. Notices were no longer issued starting with the 2005 Filing Season. Further, the IRS believed that the information provided by the RUF program was creating confusion for some taxpayers, particularly those who did have a filing requirement and were receiving notices not to file or have withholding discontinued.

This review was performed at the IRS Brookhaven Campus[5] in Holtsville, New York, during the period April through November 2008, and included a review of tax returns filed nationwide and discussions with personnel in the Submission Processing and Strategy and Finance functions of the Wage and Investment Division and personnel from the Office of Legislative Affairs. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

[5] The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

Results of Review

The Internal Revenue Service and Tax Professionals Can Partner to Reduce Taxpayer Burden

To aid in reducing unnecessary filings, the educational material developed during the RUF program became an integral part of the public IRS Internet web site (IRS.gov). A link on IRS.gov, *Do You Need to File a Federal Income Tax Return?*, guides taxpayers through an interactive decision-making process that determines whether they need to file a tax return. IRS.gov is one of the few taxpayer resources that specifically provides taxpayers information on when to discontinue withholding and stop filing. The language on the web site is very direct, stating "The questions below will help you determine if you need to file a Federal Income Tax return or if you need to stop your withholding so you will not have to file an unnecessary return in the future." If it is determined that the taxpayer is not required to file, the web site advises the taxpayer to discontinue withholding for the subsequent year.

The IRS also uses other venues to advise taxpayers of their income tax obligations and filing requirements. The most common are the instructions that accompany the U.S. Individual Income Tax Return (Form 1040) providing guidance on whether the taxpayer meets the minimum filing requirements. Taxpayers who do not meet the filing requirements are advised to file if they are entitled to a refund of income tax withheld.

Throughout the IRS instructions, the taxpayer is directed to various publications for more detailed information regarding tax advice for the elderly, filing requirements, Social Security benefits, withholding, and pension and annuity income. IRS publications consistently advise taxpayers that withholding is optional for Social Security benefits. Taxpayers are advised to use the Voluntary Withholding Request (Form W-4V) to commence or discontinue income tax withholding on their Social Security benefits. Although withholding is not mandatory, the taxpayer is warned that if tax is not withheld, other income sources might need to have additional withholding or the taxpayer may be subject to estimated tax payments. Publication language that warns the taxpayer of estimated tax requirements may be a deterrent for taxpayers to discontinue withholding.

A November 2008 Gallop Organization survey[6] reported more than half of all Americans have visited a government web site. However, those Americans aged 65 or older comprised the smallest group of Internet users. Therefore, it is likely that taxpayers aged 65 or older are not utilizing IRS.gov. To reduce the burden for this specific group of taxpayers, it would benefit the

[6] *In The Public We Trust: Renewing the Connection between the Federal Government and the Public.*

IRS to include the language from its web site in its most commonly used publications such as the Form 1040 series instructions and publications designed for the elderly. By revising its forms and instructions, the IRS would provide a message consistent with its web site. This revision would provide consistent guidance to the elderly regardless of the medium they use to research IRS products.

As shown in Figure 2, our analysis identified taxpayers that are unnecessarily filing tax returns. The characteristics of taxpayers filing unnecessary tax returns are aged 65 or older, receiving Social Security benefits, reporting minimal taxable income, and may or may not have had income tax withholding to generate a refund. Additional demographics for these taxpayers are contained in Appendix V.

Figure 2: Number of Elderly Taxpayers Who Filed Unnecessary Tax Returns for Tax Years 2005 and 2006

	Tax Year	
	2005	**2006**
Refund Filers	20,890 (29%)	53,535 (59%)
Taxpayers With No Obvious Reason to File	52,365 (71%)	37,046 (41%)
Total	73,255	90,581

Source: Our analysis of Tax Years 2005 and 2006 Individual Income Tax Returns.

We also evaluated a statistically valid sample of the taxpayer population[7] to determine the source of withholding on these tax returns and found that taxpayers were not having income tax withheld from their Social Security benefits. Instead, the primary source of withholding came from pension and/or annuity income. We could not ascertain any other obvious reason for these taxpayers to be filing, particularly those taxpayers who did not have income tax withholding.

For those taxpayers who had withholding from pension and/or annuity income, it is possible that the taxpayer had received periodic payments or a lump-sum distribution of an annuity. If a lump-sum payment is made directly to the taxpayer, current tax law requires the financial institution to withhold income tax on the taxable portion. If the taxpayer’s intent is to rollover the amount into another annuity, the taxpayer can avoid this withholding by having the two financial institutions coordinate the rollover. The IRS presents this information in its publications and on its web site. When the taxpayer receives a lump-sum distribution directly, even if it is rolled over within the requisite 60 days, a return must be filed to reclaim the withholding. Tax return preparers should advise their clients to rollover any lump-sum distributions through the financial institutions and avoid the 20 percent withholding requirement.

[7] We sampled 382 taxpayer returns for Tax Year 2005 and 383 taxpayer returns for Tax Year 2006.

This would assist in reducing the number of unnecessary returns filed by taxpayers aged 65 and older who may rollover annuities.

A significant number of individual taxpayers hired tax professionals to prepare and file their income tax returns. Figure 3 shows that taxpayers spent a significant amount of time and money to prepare and submit unnecessary tax returns. Since these are taxpayers with minimal income, any unnecessary costs can pose a financial hardship. Although taxpayers would likely maintain their financial records, they would save a significant amount of time and costs by not filing. Using the IRS' estimates and projecting the filing behavior of our sample to the total taxpayer population, we estimated the potential costs and time expended by our population of taxpayers.

Figure 3: Costs to Taxpayers Who Filed Unnecessary Tax Returns

Tax Year	Type of Tax Return	Number of Taxpayers	Average Cost to Prepare a Tax Return	Total Cost	Average Hours to Prepare a Tax Return	Total Hours
2005	1040	48,348	$103	$4,979,844	13.2	638,194
	1040A/1040EZ	24,907	$ 72	$1,793,304	11.1	276,468
2006	1040	29,892	$114	$3,407,657	14.1	421,473
	1040A/1040EZ	60,689	$ 72	$4,369,627	10.4	631,168
Total		**163,836**		**$14,550,432**		**1,967,303**

Source: Our analysis of Tax Years 2005 and 2006 Individual Income Tax Returns. Tax return preparation costs and hours are from the Form 1040 instruction booklet.

The IRS' costs to process the unnecessary returns are not substantial. Further, to obtain certain one-time tax benefits provided by law, such as the recent Federal telephone excise tax credit and the economic stimulus payment, taxpayers who normally do not have a filing requirement should file returns to obtain the tax benefits. However, in general, taxpayers will directly benefit by not filing unnecessary returns.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Ensure consistency between IRS.gov and written products by reviewing and, if necessary, revising the IRS' most common publications and Form 1040/1040A instructions. The revisions should ensure that language is included that advises taxpayers to discontinue income tax withholding if there is little likelihood that they will be required to file in subsequent years.

> ***Management's Response:*** IRS management disagreed with this recommendation and its outcome measures. They did not agree to revise the IRS' most common

publications and the instructions to the Form 1040/1040A because such a change would risk causing confusion for the vast majority of taxpayers in order to accommodate a small number of filers. However, they will reinforce the message about unnecessary filings in the *Tax Guide for Seniors* (Publication 554) and will review those publications specifically targeting the elderly to determine whether similar language as provided on the web site may be appropriate.

Office of Audit Comment: We agree that reinforcing the message regarding unnecessary filings in publications specifically targeting the elderly is necessary. However, an increased awareness effort may not be successful if it is limited to only those publications. Many taxpayers rely just on the instructions provided for information and guidance. At a minimum, the IRS should refer elderly taxpayers from the instructions and most common publications to the targeted publication for more detailed information.

IRS management disagreed with the outcome measures because they were unable to verify that the returns in question were truly unnecessary. Therefore, they could not comment on the associated taxpayer costs and time burden. Our analyses focused on taxpayers whose reported income was equal to or less than the exemption amount, which is only one of the components for determining filing requirements. Had we taken both components – the exemption amount and the standard deduction – the population would have been larger. Taking such a conservative approach makes us confident that our outcome measures are sound and reasonable

Recommendation 2: Conduct focus groups with the elderly, tax professionals, and/or payers of pensions and annuities to determine why taxpayers are filing unnecessary returns. In addition, the IRS should include discussions on 1) tax responsibilities of the elderly, 2) discontinuing withholding on Social Security benefits, 3) coordinating rollovers with financial institutions to avoid the mandatory 20 percent withholding, and 4) filing requirements. These actions may be conducted within the IRS' existing outreach and education efforts for tax professionals and should result in a reduced number of unnecessarily filed tax returns, thereby reducing taxpayer burden.

Management's Response: IRS management disagreed with this recommendation. The Wage and Investment Division Research office is working in conjunction with the Media and Publications function to review prior research from the RUF program and from external entities, such as the American Association of Retired Persons. Once they have reviewed this research, they will determine what future action is necessary, including whether they should conduct focus groups with the elderly, tax professionals, and/or payers of pensions and annuities.

Office of Audit Comment: IRS management stated that they would only consider future action if their review of prior research indicated that focus groups are warranted.

However, we believe the focus groups will provide valuable insight into the root causes of why the elderly continue to file and/or have income tax withheld. Focus groups and outreach efforts to engage the preparer community will assist the IRS with its effort to reduce taxpayer burden. Without this important knowledge, the IRS will be unable to take measures effectively to reduce unnecessary filings.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to determine what steps, if any, the IRS had taken to inform taxpayers who file returns to reclaim withholding from non-taxable Social Security benefits for which they do not have to have income tax withheld or file returns. To accomplish our objective, we:

I. Identified those taxpayers who had minimal income other than Social Security benefits that were not taxable and who filed returns in Tax Years 2005 and 2006.

   A. Identified the population of taxpayers who filed returns for Tax Years 2005 and 2006 through the Data Center Warehouse (DCW).[1]

   B. Assessed the reliability of DCW and Integrated Data Retrieval System (IDRS) data[2] by reviewing a random sample of taxpayers' accounts for both tax years. To verify DCW data, we selected 57 DCW files and compared them to IDRS taxpayer account information. To verify IDRS data, we selected 10 returns and compared the source documents to IDRS transcripts. Upon completion of our tests, we deemed the data sufficiently reliable to accomplish the overall objective of the audit.

   C. Extracted files from the DCW for Processing Years 2006 and 2007 consisting of all taxpayers aged 65 and older who received Social Security benefits and had income less than the exemption amounts for their filing status. Using various queries, we eliminated those taxpayers with:

      1. Income from wages; schedules associated with U.S. Individual Income Tax Return (Form 1040) including Profit or Loss from Business (Schedule C), Capital Gains and Losses (Schedule D), Supplemental Income and Loss (Schedule E), and Profit or Loss From Farming (Schedule F) to decrease the likelihood that taxpayers would have a reportable transaction or a loss to offset income; withholding from wages; or liability for self-employment taxes.

      2. Negative other income (losses) that would offset reportable income, such as net operating losses offsetting positive income.

      3. Refundable credits and/or earned income tax credit that would require the

[1] The DCW provides data and data access services; centralizes storage, security, and administration of files; and develops uniform and user-friendly interfaces for users to access data.
[2] An IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

taxpayer to file in order to receive the credit.

4. A tax liability, which could necessitate withholding.
5. Itemized deductions that would offset positive income.
6. Refunds greater than withholding which would indicate some sort of refundable credit was due to the taxpayer.

Based on the results of Step I.C., we determined that the population for Tax Year 2005 was 73,255 taxpayers and the population for Tax Year 2006 was 90,581.

D. Matched Tax Years 2005 and 2006 taxpayer accounts against the Information Return Master File to annotate the amounts of Social Security benefits and withholding reported on each taxpayer's Social Security Benefit Statement (Form SSA-1099). The annotated file was analyzed for trends and patterns.

E. Using various queries, analyzed the Tax Years 2005 and 2006 populations' demographics for the following information:

1. Number of taxpayers who had withholding.
2. Number of taxpayers who used preparers.
3. Number of taxpayers who filed electronically.
4. Sources of income reported on the return.

II. Selected a statistically valid sample of taxpayers from each tax year's population based on a 95 percent confidence level, a confidence interval of +/- 5 percent, and an estimated error rate of 50 percent. A statistical sampling method was used to make projections about the populations from which the samples were selected. We provided the numbers to the statistician contracted by the Treasury Inspector General for Tax Administration to validate our statistical sampling methodology.

III. From our samples of 382 taxpayers in Tax Year 2005 and 383 taxpayers in Tax Year 2006, determined why these taxpayers continued to file tax returns by analyzing taxpayer accounts and tax return data to identify reportable but not taxable events that required filing an income tax return. We:

A. Researched the IDRS to determine if there was underreported income, sale of residence, or stock sales that could generate potential losses; nonemployee compensation resulting in potential self-employment taxes; or Individual Retirement Arrangement rollovers.

B. Researched the IDRS to determine if subsequent adjustments or amended returns posted to the taxpayers' accounts.

C. Used IDRS transcripts to match the withholding on the return to the transcript to determine the source of the withholding claimed.

IV. Determined what steps, if any, the IRS had taken to educate these taxpayers of not having withholding on their Social Security benefits and to discourage unnecessary filing.

A. Researched the:

1. IRS web site for publications addressing when to have income tax withheld from Social Security benefits. We reviewed these publications for guidance regarding Social Security benefits and withholding.

2. Instructions for Forms 1040 and 1040A regarding the taxability of and reporting of Social Security benefits.

3. Social Security Administration and the Railroad Retirement Board web sites to determine if there was any information available to the public regarding withholding from Social Security or Railroad Retirement benefits.

B. Discussed with IRS officials their current and future plans to reduce the unnecessary filings from this population.

V. Determined the impact these unnecessary filings have on the IRS and the taxpayer by estimating:

A. How many taxpayers used paid preparers to prepare their tax returns. From our samples, we determined the percentage of types of returns filed and applied those percentages to the populations for each tax year. Using the IRS' cost estimates, we projected the annual costs for taxpayers to prepare and submit unnecessary returns.

B. The time it took taxpayers to prepare their returns. Projecting the filing patterns from the sample to the population, we used the IRS' time estimates to calculate the estimated time expended for taxpayers to prepare and submit unnecessary returns.

C. How many taxpayers electronically filed their tax returns. This information was used to estimate the IRS' costs to process these returns.

D. The IRS' costs to process these returns. We estimated the filing behavior of the populations using the projections from the samples to quantify the types of returns filed and how they were filed. For each tax year, we used the processing costs provided in the Cost Estimate Reference (Document 6746) to estimate what it cost the IRS to process these unnecessary returns. We then compared these costs to the actual costs of the RUF program.

Appendix II

Major Contributors to This Report

Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
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Appendix III

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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 163,836 taxpayer accounts affected (see page 4).

Methodology Used to Measure the Reported Benefit:

Our review focused on taxpayers aged 65 or older who had minimal income, no apparent filing requirement, yet continued to file tax returns. Using the DCW[1] to analyze taxpayer accounts, we identified 163,836 taxpayer accounts that met the criteria and filed a tax return for which 73,255 taxpayers were from Tax Year 2005 and 90,581 taxpayers were from Tax Year 2006.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; $14,550,432 taxpayer costs for filing unnecessary returns (see page 4).
- Taxpayer Burden – Potential; 1,967,303 taxpayer hours expended unnecessarily preparing and filing tax returns (see page 4).

Methodology Used to Measure the Reported Benefit:

From a population of 73,255 tax returns filed in Tax Year 2005 and 90,581 filed in Tax Year 2006, we evaluated a statistically valid sample[2] of 382 taxpayers who filed 2005 tax returns and 383 taxpayers who filed 2006 tax returns. Figure 1 shows our projection of the filing pattern from the sample to the population for each tax year.

[1] The DCW provides data and data access services; centralizes storage, security, and administration of files; and develops uniform and user-friendly interfaces for users to access data.
[2] We used a confidence level of 95 percent, reliability factor of +/- 5 percent, and error rate of 50 percent.

Figure 1: Filing Patterns of Taxpayers Who Filed Unnecessary Tax Returns

Tax Year	Type of Tax Return	Number of Taxpayers in Sample	Percentage of Filers[3]	Percentage Projected to Population
2005	1040	254	66%	48,348
	1040A/1040EZ	128	33%	24,907
2006	1040	125	33%	29,892
	1040A/1040EZ	258	66%	60,689
Total				**163,836**

Source: Our analysis of Tax Years 2005 and 2006 Individual Income Tax Returns.

We projected the costs and time estimates to the number of taxpayers in our population (see page 6, Figure 3).

[3] Percentages were rounded to nearest whole number.

Appendix V

Population Demographics

Using various queries, we analyzed the Tax Year 2005 population of 73,255 taxpayers and Tax Year 2006 population of 90,581 taxpayers for the following demographics as shown in Figure 1.

Figure 1: Demographics of Taxpayers Who Filed Unnecessary Tax Returns

Characteristic	Tax Year 2005	Percentage of Filers[1]	Tax Year 2006	Percentage of Filers
Paid Preparer	46,645	64%	37,552	41%
Electronic Filers	30,607	42%	29,550	33%
Spouse 65 or Older	23,999	33%	28,820	32%
Withholding				
Withholding	20,890	29%	53,535	59%
No Withholding	52,365	71%	37,046	41%
Income Sources[2]				
Taxable Pension	33,689	46%	41,080	45%
Taxable Individual Retirement Arrangement	14,768	20%	19,582	22%
Dividends	13,214	18%	13,276	15%
Unemployment	885	1%	1,632	2%
Other Income	3,597	5%	3,472	4%
Interest Income[3]			50,901	56%

Source: Our analysis of Tax Years 2005 and 2006 Individual Income Tax Returns.

[1] Percentages were rounded to nearest whole number.
[2] Percentages will not add to 100 percent since taxpayers could have income from multiple sources.
[3] Interest income was not available on the DCW for Tax Year 2005.

From a population of 73,255 tax returns filed in Tax Year 2005 and 90,581 filed in Tax Year 2006, we evaluated a statistically valid sample[4] of 382 taxpayers who filed 2005 tax returns and 383 taxpayers who filed 2006 tax returns. Figure 2 shows our projection of the filing pattern from the sample to the population for each tax year.

Figure 2: Filing Patterns of Taxpayers Who Filed Unnecessary Tax Returns

Tax Year	Type of Tax Return	Number of Taxpayers in Sample	Percentage of Filers[5]	Percentage Projected to Population
2005	1040	254	66%	48,348
	1040A/1040EZ	128	34%	24,907
2006	1040	125	33%	29,892
	1040A/1040EZ	258	67%	60,689
Total				**163,836**

Source: Our analysis of Tax Years 2005 and 2006 Individual Income Tax Returns.

[4] We used a confidence level of 95 percent, reliability factor of +/- 5 percent, and error rate of 50 percent.
[5] Percentages were rounded to nearest whole number.

Appendix VI

Management's Response to the Draft Report

RECEIVED
MAY 6 - 2009

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

COMMISSIONER
WAGE AND INVESTMENT DIVISION

MAY 05 2009

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr.
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Elderly Taxpayers Would Benefit by the Internal Revenue Service and Tax Professionals Partnering to Reduce Unnecessary Filings (Audit # 200830013)

I reviewed the subject draft report and appreciate your review regarding senior taxpayers unnecessarily having income tax withheld and/or filing tax returns. Your report indicates that these taxpayers may spend significant time and money to prepare and submit unnecessary returns.

In Figure 2 of your report on Page 5, you state the number of senior taxpayers who filed unnecessary tax returns was 73,255 in Tax Year 2005 and 90,581 in Tax Year 2006. This is a very small number compared to the total number of individual tax return filers, which was 134 million in 2005 and 138 million in 2006. We agree that we need to assess the potential unnecessary burden on senior taxpayers. However, because of the small number of senior taxpayers affected, we do not think it would be appropriate to change the IRS' most common publications and the instructions to the U.S. Individual Income Tax Return (Form 1040/1040A). Instead, we will consider providing some enhancements to publications targeted for older Americans.

Our first step will be to research existing data on this issue. There may be valid reasons for having income tax withheld and/or filing, including state or local requirements to file a federal return, intangible reasons such as peace of mind, or other unknown factors. We also plan to contact the American Association of Retired People (AARP) to determine if they have conducted any research on the topic. After our initial examination, if necessary, we will hold focus groups with seniors, tax professionals, and/or payers to gather additional information.

We do not agree with the outcome measures in the report. At this time, we are unable to verify that the tax returns in question are truly unnecessary and can not comment on the costs of preparing a return or the time burden associated without that information.

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Our responses to your recommendations are attached. If you have any questions regarding this response, please call me at (404) 338-7060, or members of your staff may contact Peter J. Stipek, Director, Customer Account Services, Wage and Investment Division, at (404) 338-8910.

Attachment

Attachment

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1
Ensure consistency between IRS' public website and written products by reviewing and, if necessary, revising the IRS' most common publications and Form 1040/1040A instructions. The revisions should ensure that language is included that advises taxpayers to discontinue income tax withholding if there is little likelihood that they will be required to file in subsequent years.

CORRECTIVE ACTION
We do not agree to revise the IRS' most common publications and the instructions to the U.S. Individual Income Tax Return (Form 1040/1040A) because such a change would risk causing confusion for the vast majority of taxpayers in order to accommodate a small number of filers. However, we will reinforce the message about unnecessary filings in Publication 554, Tax Guide for Seniors, and will review those publications specifically targeting the elderly to determine whether similar language as provided on the web site may be appropriate.

IMPLEMENTATION DATE
April 15, 2010

RESPONSIBLE OFFICIAL
Director, Media & Publications

CORRECTIVE ACTION MONITORING PLAN
This corrective action will be monitored as part of our Internal Managerial Control System.

RECOMMENDATION 2
Conduct focus groups with the elderly, tax professionals, and/or payers of pensions and annuities to determine why taxpayers are filing unnecessary returns. In addition, the IRS should include discussions on 1) tax responsibilities of the elderly, 2) discontinuing withholding on Social Security benefits, 3) coordinating rollovers with financial institutions to avoid the mandatory 20 percent withholding, and 4) filing requirements. These actions may be conducted within the IRS' existing outreach and education efforts for tax professionals and should result in a reduced number of unnecessarily filed tax returns, thereby reducing taxpayer burden.

CORRECTIVE ACTION
We do not agree with this recommendation. The Wage and Investment Division Research office is working in conjunction with Media and Publications to review prior research from the Reduce Unnecessary Filing program and from external entities, such as the AARP. Once we have reviewed this research, we will determine what future

action is necessary, including whether we should conduct focus groups with the elderly, tax professionals, and/or payers of pensions and annuities.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A