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June 1998

**TAX  
ADMINISTRATION**

**Increasing EFT Usage  
for Installment  
Agreements Could  
Benefit IRS**



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**General Government Division**

B-275098

June 10, 1998

The Honorable Bill Archer  
Chairman, Committee on Ways and Means  
House of Representatives

The Honorable Nancy L. Johnson  
Chairman, Subcommittee on Oversight  
Committee on Ways and Means  
House of Representatives

For years, the Internal Revenue Service (IRS) has allowed taxpayers to pay delinquent taxes in installments, primarily through a paper-based system in which IRS mails monthly statements to taxpayers, who, in turn, are to mail monthly payments back to IRS. In fiscal year 1997, taxpayers defaulted on \$6.5 billion in installment agreements—almost as much as the \$6.7 billion IRS collected through installments.<sup>1</sup>

Because of your interest in improving IRS' ability to collect delinquent taxes, you asked us to identify the best practices currently used by delinquent debt collectors and analyze them to determine if they offer IRS any prospects for improving its collection efforts. This report discusses one such practice, specifically, the use of electronic funds transfer (EFT) for making installment tax payments. EFT is a means of conducting financial transactions by using computers and electronic technology to transfer money instead of using checks and other paper documents. IRS currently accepts EFT payments from taxpayers with installment agreements, but only a small percentage of taxpayers use this method.

In this report, we (1) describe some of the uses and benefits of EFT, (2) discuss the experiences of two states that use EFT in their tax installment agreement programs and the benefits they have obtained, and (3) discuss the potential benefits IRS might realize by increasing EFT usage in its installment agreement program.

In conducting our work, we reviewed literature on EFT and interviewed officials in two states, Minnesota and California, that are recognized as having innovative collection practices. We also contacted other EFT users, including private sector organizations and the Department of the Treasury's Financial Management Service (FMS). Our analysis is based on a review of information obtained from these sources and, in particular, on a

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<sup>1</sup>These amounts include taxes, interest, penalties, and fees.

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comparison of EFT use in the states' installment agreement programs and IRS' program.

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## Results in Brief

EFT is widely used by various types of organizations, such as banks, credit unions, and mortgage companies, in receiving and transferring money. It is used for various payment transactions, such as payroll, pension, and dividends, and for collecting consumer payments. Relative to paper transactions, EFT provides better accuracy, lower mailing and processing costs, and fewer delinquencies and defaults. Because of these benefits, some financial organizations routinely offer incentives, such as interest rate reductions on loans and waivers on fees, to consumers who enter into EFT arrangements.

Both Minnesota and California changed their installment agreement programs to promote tax payments by EFT. Minnesota has required taxpayers entering into new installment agreements since July 1995 to pay by EFT, with some exceptions. In April 1997, California initiated procedures to let taxpayers make installment agreement payments by EFT. As of mid-November 1997, EFT usage was about 90 percent in Minnesota and about 60 percent in California.

According to state officials, Minnesota and California both have seen a sharp decrease in their installment agreement default rates, in part due to EFT. In Minnesota, officials said that default rates were reduced from about 50 percent to between 3 and 5 percent; and in California, officials said that they were reduced from about 40 percent to about 5 percent. Officials in both states said that the lower default rates have resulted in collecting revenues from installments faster.

In addition, officials in both Minnesota and California said they have achieved administrative cost savings from greater use of EFT, which has reduced the amount of paper processing and mailing costs related to their installment agreement programs. Additional administrative cost savings have occurred because fewer resources have been needed for follow-up collection enforcement on defaulted agreements.

IRS' installment agreement program has not taken advantage of the benefits of EFT to the extent that Minnesota and California reported, as only about 1.5 percent of IRS' delinquent taxpayers were using EFT for installment agreements as of September 30, 1997. Because its current program is similar to these states' non-EFT programs, it seems likely that IRS could

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expect to achieve a reduction in its installment agreement default rates and lower administrative costs if more taxpayers paid their installments by EFT. In fiscal year 1997, IRS' costs to process EFT installment payments were about 37 percent lower than the cost to process non-EFT installment payments.

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## Background

Section 6159 of the Internal Revenue Code authorizes IRS to allow taxpayers to pay their taxes in installments, with interest, if this would facilitate collection of the liability. IRS procedures allow taxpayers to enter into an installment agreement any time during the collection process, which involves sending notices to taxpayers, contacting them by telephone and in person, and using enforcement tools such as liens against their property and levies against their financial assets.

In 1992, IRS changed its installment agreement program by allowing (1) most IRS staff with taxpayer contact to approve agreements up to a certain dollar level, (2) taxpayers to obtain agreements up to a certain dollar level without providing financial information to demonstrate the need for an agreement, and (3) taxpayers to request agreements when they file their tax returns. As of September 30, 1997, IRS had about 2.9 million installment agreements outstanding, worth about \$13.2 billion, thus averaging about \$4,600 per agreement.

To request an installment agreement, a taxpayer completes an optional Form 9465: Installment Agreement Request. In January 1996, IRS revised the form by providing space for taxpayers to add the information needed to set up an EFT agreement, based on a recommendation we made.<sup>2</sup> Before the form was revised, taxpayers could make arrangements to pay their installment payments by EFT, but few did.

For each month that an agreement is in effect, IRS prepares and mails a statement to the taxpayer. Taxpayers with non-EFT agreements are to mail the payment coupons back with their payments. These documents must be processed monthly in order to update the taxpayers' accounts.

According to the National Automated Clearing House Association (NACHA), a national electronic banking trade association, electronic payment transaction volumes are growing faster than check volumes. The clearinghouse association reported that EFT transactions in 1996 rose 15

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<sup>2</sup>See *Tax Administration: Administrative Improvements Possible in IRS' Installment Agreement Program* (GAO/GGD-95-137, May 2, 1995).

percent, to nearly 4 billion transactions that represented over \$12 trillion, which was 9 percent higher than the amount in 1995. By comparison, check volumes rose by about 1 percent during this period. Also, in 1995, more than 500,000 companies across the nation used the Automated Clearing House (ACH) Network for EFTs, involving payment transactions such as payroll, pensions, and dividends and to collect consumer payments.<sup>3</sup> Large businesses and corporations are currently required to use EFT to make federal and state tax deposits. EFT use should increase further as provisions in the North American Free Trade Agreement (NAFTA) are implemented that will eventually require most employers to pay their federal tax deposits electronically.<sup>4</sup> Further, the Debt Collection Improvement Act of 1996 requires that most federal benefit checks be disbursed electronically beginning in 1999.<sup>5</sup>

## Objectives, Scope, and Methodology

Our objectives were to (1) describe some of the uses and benefits of EFT, (2) discuss the experiences of two states that use EFT in their tax installment agreement programs and the benefits they have obtained, and (3) discuss the potential benefits IRS might realize by increasing EFT usage in its installment agreement program.

To address the first objective, we judgmentally selected a limited number of financial institutions, including 8 banks, 1 credit union, and 14 mortgage companies, to obtain information on their use of EFT and its benefits to them and their customers. In addition, we spoke with officials from NACHA and the National Credit Union Association about the uses and benefits of EFT to financial institutions and their customers. We also contacted officials from FMS, which is ultimately responsible for collecting most of the nontax delinquent debts owed the federal government. FMS is also involved in the government's overall efforts to maximize the use of EFT as required by the Debt Collection Improvement Act of 1996. We obtained from FMS, but did not independently verify, information on IRS' cost to process installment agreement payments by paper processes and by EFT.

To address our second objective, we identified two states—Minnesota and California—that have made changes to their installment agreement

<sup>3</sup>The ACH Network is a nationwide electronic payment and collection system used to make EFT financial transactions. The Network consists of the ACH operators, including the Federal Reserve Bank System, and participating financial institutions—commercial banks, credit unions, etc.—which provide services to businesses and consumers. The Network's rules and operating guidelines are established by NACHA.

<sup>4</sup>NAFTA (P.L. 103-182) requires that the Secretary of the Treasury develop regulations to implement an EFT system for the collection of federal tax deposits.

<sup>5</sup>The act (P.L. 104-134) requires that almost all federal benefit payments, such as social security, veterans benefits, and pensions (but not tax refunds) be made using EFT by January 1, 1999.

programs that resulted in most delinquent taxpayers using EFT to pay their installments. We visited these states because we had consulted with them in our previous work on ways to improve federal tax collection efforts. On that basis, we were aware of their efforts to undertake innovative practices to improve tax administration. Also, we contacted the Federation of Tax Administrators—an organization of state and municipal tax and revenue agencies—to identify state tax departments that are recognized as having successful collection programs, and both states were mentioned by the Federation.

To assess the potential benefits IRS might realize by increasing EFT usage in its installment agreement program, we obtained data on its existing program and analyzed its installment agreement default rates. We did not independently verify the statistical data we obtained on IRS' installment agreement program. The information we obtained on IRS' current use of EFT helped us determine the feasibility of IRS' making changes to its program similar to those that Minnesota and California have made. We interviewed IRS Collection officials at the National Office to obtain current information on the processes and procedures IRS uses in collecting delinquent federal taxes to ensure that our comparisons between IRS and others were based on the most recent IRS practices. We did not perform an independent analysis to estimate the cost savings IRS might receive from additional EFT use. Lastly, we discussed the changes Minnesota and California have made to their program with IRS officials to obtain their perspectives on how similar changes might affect IRS' program.

We requested comments on a draft of this report from the Commissioner of Internal Revenue. His comments are discussed at the end of this letter and are reprinted in appendix I.

We did our work between October 1996 and December 1997, according to generally accepted government auditing standards.

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## Uses and Benefits of EFT

Private sector financial institutions and government agencies use EFT for a variety of transactions. They do so because EFT has lower default rates and is less expensive, faster, and more reliable than paper transactions. Benefits, such as the convenience of EFT, also extend to the customers of these organizations.

EFT transactions involve the paperless transfer of funds between accounts in financial institutions, which allows for transactions such as the direct

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deposit of payroll checks, mortgage payments, and installment payments. According to a NACHA official, most financial institutions can both make and receive EFT transactions, although some smaller institutions sometimes restrict the type of payment transactions they make.

Information from NACHA shows that, relative to paper transactions, EFT provides lower loan defaults, better accuracy, and reduced mailing and processing costs. A credit union loan official, for example, said defaults of loans, usually defined as missed payments, are lower with automated payments. In addition, EFTs are about one-third less expensive to handle than paper transactions, according to one banking official with whom we spoke. Exact savings, though, vary by individual financial institution, depending on its internal processing systems and costs.

Representatives from financial institutions and FMS told us that the benefits of EFT for customers as well as financial institutions are many. The financial institution officials told us that the cost savings from EFT were great enough for them to offer incentives to customers who use direct deposit and other electronic transactions. A credit union, for example, provides a 1-percentage-point discount on home equity lines of credit that are repaid using EFT. Officials from two banks told us that they waive monthly checking account fees for customers whose paychecks are directly deposited into their accounts. Another bank offers a discount on consumer loans that are repaid by EFT as a way of keeping existing customers and attracting new ones.

Customers could also benefit from the reliability and accuracy of electronic payments and deposits. FMS data, for example, showed that direct deposit recipients are 20 times less likely to have a problem, such as lost checks, with EFT than with deposits by check. Some of the other benefits for customers were the convenience and savings by not having to go to a bank to deposit checks or to write a check and use postage to mail it.

Congress passed the Debt Collection Improvement Act of 1996 requiring the use of EFT for most federal benefit payments (tax refunds are excluded) by January 1, 1999, because it recognized the advantages of electronic transactions. According to Treasury data, about 60 percent of all federal benefits are now paid electronically, and Treasury estimates that the government could save more than \$500 million over the next 5 years by switching the remaining payments to EFT. However, EFT generally requires individuals to have bank accounts to access the funds, and some



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recipients of government checks do not have bank accounts. Congress is considering what it might do to mitigate the adverse effects of the 1996 legislation—for example, allowing recipients who do not have bank accounts to access their payments by other electronic means, such as automated teller machine cards from an account held by a disbursing agency.

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## Two States' Use of EFT for Installment Tax Payments and Its Benefits

One use of EFT, as it relates to tax administration, is for installment tax payments. The two states we visited, Minnesota and California, made changes to their installment agreement programs that make EFT the primary means taxpayers use to pay their taxes in installments. Both states promoted the changes to make their installment agreement programs more effective and efficient, and officials in both states attributed reductions in their default rates and administrative costs to EFT use.

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## Overview of Minnesota's Program

The Minnesota Department of Revenue (MDOR) is that state's primary tax collection agency and, as such, administers the installment agreement program covering delinquent taxes owed by individuals and businesses. In 1995, MDOR tested the use of EFT in its installment agreement program. EFT was available in the installment agreement program before the test, but it was not used extensively. The results of the test were compared with MDOR's non-EFT program. MDOR officials told us the test showed that by requiring EFT payments, their installment agreement program could be made more efficient and effective. This led MDOR to revise its policy on installment agreements to require EFT for tax payments beginning in July 1995, with a few exceptions.

One exception was for cases where the EFT requirement would create an undue hardship on a taxpayer. For example, if a taxpayer did not have a bank account, which is necessary for electronic transactions, the requirement could be waived. Also, payment agreements of less than 4 months' duration may be exempt from EFT.

The policy also allowed taxpayers with existing installment agreements to continue with their non-EFT arrangements or convert to EFT. The state required that taxpayers continue to comply with their current tax obligations as a condition for gaining approval to pay delinquent taxes by installment, regardless of whether EFT is used. According to information obtained from MDOR, Minnesota taxpayers may be given about 1 year to pay off their installment agreements.

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MDOR reported to us that, as of mid-November 1997, about 90 percent of MDOR's 4,200 installment agreements were EFT agreements, representing about 90 percent of the delinquent taxes in the state's installment agreement program. Taxpayers with waivers and those continuing their non-EFT arrangements accounted for the other 10 percent.

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## Overview of California's Program

The California Franchise Tax Board (FTB) is that state's agency responsible for collecting income taxes. Taxpayers owing delinquent personal income taxes may be granted approval to pay their debts in installments. Previously, EFT was not available in the installment agreement program, but in April 1997, following MDOR's success with EFT usage, FTB implemented procedures for taxpayers to make installment agreement payments by EFT. According to the procedures, taxpayers who have been approved to pay their tax liabilities in installments must usually pay by EFT. As in Minnesota, FTB allows taxpayers waivers to using EFT in certain circumstances—for example, a taxpayer has no bank account, a low dollar amount is owed, or EFT would create a hardship. Taxpayers must also comply with their current tax obligations as a condition of paying delinquent taxes in installments, regardless of whether EFT is used.

A state official told us that FTB revised its installment agreement application form to include space for an EFT authorization. If the taxpayer provided the necessary information for the state to process the EFT authorization, the installment agreement request was usually approved. If a taxpayer did not complete the EFT authorization, state officials said that they would encourage EFT use by specifically discussing its benefits with the taxpayer. FTB officials would inform applicants about the potential benefits of using EFT—for example, they would not have to worry about writing and mailing checks or money orders or be concerned that their payments did not arrive on time. If a taxpayer still did not elect EFT, the state would require a more strenuous review of the taxpayer's application, including a review of their financial status. At the time of our study, approximately 8,000 of the 13,000 agreements made since April 1997—about 60 percent—were set up to use EFT. These 8,000 EFT agreements represented about 90 percent of the delinquent taxes owed in the new agreements.

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## EFT Has Lowered the Default Rates of Installment Agreements in Minnesota and California

According to state officials in Minnesota and California, one of the benefits they have realized by promoting EFT use in their installment agreement programs has been a substantial reduction in the programs' default rates. These officials said that the benefits of lower default rates included more timely payments and increased collection of taxes owed.

While the precise definition may vary, generally an installment agreement is in default if payments are not made. Some of the amounts owed in defaulted installment agreements are subsequently paid after further collection actions by the states. Some are never paid.

EFT was available, but not used extensively, in MDOR's installment agreement program before the July 1995 requirement was implemented. The program's default rate was then about 50 percent. Since the requirement was implemented, most of the state's taxpayers with installment agreements have used EFT, and according to MDOR officials, the default rate for EFT installment agreements dropped to between 3 and 5 percent.

The California FTB's overall installment agreement default rate also decreased sharply after EFT use was promoted. Officials told us that before EFT was available, the default rate for installment agreements was about 40 percent. As of October 1997, about 6 months after FTB implemented its EFT procedures, the default rate for new EFT agreements was about 5 percent. FTB officials told us that although their EFT procedures had only been in effect for a relatively short time, they expect their default rate to continue to remain lower than before EFT use.

Recurring EFT payments are generally set up to be made on a specific day of the month, which reduces some of the problems related to non-EFT arrangements, such as taxpayers' forgetting to send in their payments or sending in the wrong amount. Officials in both states said that, because these problems were reduced, some of the amounts owed were received sooner and without the need for follow-up collection actions, such as letters, telephone calls, liens, levies, or seizures.

Officials in both states also said that they experienced increased collections from installment agreements after changing their programs to promote EFT. Collections increased if payments made through EFT would not have otherwise been made. However, the states had not measured the dollar amounts that directly related to changing their programs. Also, they found it difficult to determine if other effects, such as economic

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conditions, were a factor; and in California, the program was less than a year old when we completed our field work. The officials from both states told us, however, that they had not made any other changes to their installment agreement programs that would account for the increased collections.

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**EFT Has Reportedly  
Reduced the  
Administrative Costs of  
Installment Agreements in  
Minnesota and California**

In discussing the benefits of EFT with officials in California and Minnesota, we were told that EFT use reduced the administrative costs of their installment agreement programs. Officials in both states said that the greater use of EFT has reduced the amount of paper processing and mailing costs related to their installment agreement programs. Additional administrative cost savings have occurred because fewer resources were needed to follow up on defaulted agreements.

Administrative cost savings from EFT stem from not having to process and handle paper relating to the financial transactions. With EFT, much of the personnel costs used to generate and process documents and the mailing costs generally associated with paper financial transactions can be reduced or eliminated. Officials in California and Minnesota said that they reduced their installment agreement programs' administrative costs by eliminating most of the paper documents they previously sent taxpayers, which also reduced taxpayers' need to send paper documents back to the states for processing.

Before changing their installment agreement programs to promote EFT, Minnesota and California had procedures that required sending taxpayers monthly statements. Taxpayers sent back their remittances, such as paper coupons and checks and money orders, which had to be manually processed. Under their current programs, the two states do not send monthly statements to taxpayers using EFT. This is because state officials said that the taxpayers' bank statements show that the EFT payment was made, and the statement provides the taxpayer with notification.

Although precise estimates were unavailable, officials in both states said that administrative cost savings have resulted from EFT use, which has streamlined the administrative operations of their installment agreement programs. According to data collected during MDOR's pilot test of EFT, for example, several thousand work hours were saved by not having to prepare and process the paperwork typically needed for manual agreements. Further savings stemmed from reduced paper and postage costs, which officials estimated to be about 50 cents per agreement per

month. Another benefit from reducing the amount of paper used in the programs was the reduced paperwork burden for taxpayers.

Officials in both states said that fewer resources are being used to follow up on defaulted agreements because there are fewer defaults with EFT. Defaulted agreements generally require follow-up actions, such as contacting the taxpayers and using enforcement actions, such as liens, levies, and seizures. In general, contacting taxpayers and using enforcement actions would increase administrative costs.

## Increasing EFT Usage Offers Potential Benefits to IRS

IRS has the potential to achieve benefits by expanding the use of EFT in its installment agreement program. At the time of our review, IRS had EFT payment arrangements with only 1.5 percent of taxpayers who had installment agreements. The reported experiences of Minnesota and California, whose former programs were similar to IRS' current program, showed that encouraging greater EFT use has resulted in fewer defaulted agreements and administrative cost savings. Many private and other public organizations have reported that they, too, have benefited from electronic financial transactions.

For fiscal 1997, IRS had about \$6.5 billion in defaulted agreements, nearly half its \$13.2 billion inventory of 2.9 million outstanding agreements. Table 1 shows IRS' installment agreement defaulted dollars and our estimated default rates for fiscal years 1994 to 1997. Even a slight reduction in IRS' default rate could lead to faster and increased collection of many tax dollars because IRS' defaulted agreements are in the billions of dollars annually.

Of the total agreements in 1997, about 41,500—or 1.5 percent—were being paid by EFT.

**Table 1: IRS' Installment Agreement Defaults by Rates and Dollars**

Fiscal year	1994	1995	1996	1997
Default rate	35%	37%	39%	43%
Default dollars (in millions)	\$3,961	\$4,714	\$5,635	\$6,479

Note: The default rates were estimated by dividing the number of defaults by the ending inventories of installment agreements for each year. Although cohort data were not available, our results should reasonably approximate such data because the average age of agreements in the inventories was just under a year and our analysis covers a short period.

Source: GAO computations of IRS data.

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Another benefit IRS might achieve is administrative cost savings if more of the payments it now receives by check (and other paper documents) were made by EFT. Administrative cost savings could result from (1) lower costs to process taxpayers' remittances, (2) lower postage and handling costs, and (3) lower collection enforcement costs. Administrative cost savings would result even if the default rate remained the same, but based on the reported experience of others who use EFT, lower default rates are also likely to occur.

According to NACHA, the published literature, and the organizations we contacted that used EFT, electronic payments are less expensive to process than payments made by check, and default rates are lower. For example, a 1993 study for NACHA reported that the average processing cost for a payment through the ACH system was about 46 percent less than the average processing cost for a check.

Routinely, IRS uses lockboxes for installment agreement payments. Under the lockbox concept, taxpayers are to mail payments to a lockbox, which is a postal rental box serviced by a commercial bank. The bank is to process the payments and transfer the funds to a federal government account, record the payment and payer information on a computer tape, and forward the tape to IRS for use in updating taxpayers' accounts. FMS, which pays the lockbox fees, reported to us that the average cost in fiscal year 1997 to process an IRS installment agreement payment through lockboxes was 76 cents per transaction versus 48 cents per transaction to process a payment by EFT. Thus, FMS data show that IRS' EFT costs are 28 cents lower or about 37 percent less than its lockbox costs. This shows that IRS has the potential to reduce the costs it pays banks to process installment agreement payments by increasing the number of EFT payments and decreasing the number of lockbox payments.

By promoting EFT use, IRS could further reduce the administrative cost of its installment agreement program. IRS could achieve additional cost savings by not sending taxpayers who make EFT installment payments a monthly statement, as it currently does for all taxpayers with installment agreements. This would save IRS postage and handling costs and would be similar to the practices for EFT installment agreements in Minnesota and California. It is also similar to practices used by many private sector organizations, especially for recurring EFT payments of the same dollar amount. In addition, administrative cost savings pertaining to collection enforcement would be lower as fewer resources would be needed to pursue fewer taxpayers in default.

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## IRS Has Concerns About Requiring EFT Use in Installment Agreements

In 1995, we reported on ways IRS could make administrative improvements to its installment agreement program.<sup>6</sup> IRS officials then agreed that EFT had advantages over the standard installment agreement. According to officials at that time, EFT agreements (1) are cheaper to service than the standard agreement, (2) eliminate the chance that a taxpayer will forget to make a payment or send less than the agreed-upon amount, (3) result in quicker deposit of funds to Treasury accounts, and (4) may reduce default rates.

During this review, we met with IRS Collection officials, including the Assistant Commissioner (Collection), to obtain their views about expanding EFT use in the installment agreement program and to determine if there were any barriers or concerns in doing so. The officials generally agreed with the comments IRS officials made in our 1995 report, but they expressed concerns about requiring EFT use, which is one option for expanding its use. The Assistant Commissioner told us that IRS had considered expanding EFT use for installment agreements in the past but did not develop definite plans to do so. With regard to making EFT a requirement, he said that this raises many issues for IRS, including policy, legal, and operational concerns.

From a policy perspective, the Assistant Commissioner said that IRS attempts to treat all taxpayers the same, and he was uncertain whether requiring or suggesting to taxpayers that they use a certain payment procedure would be fair unless all taxpayers had to abide by it. In this regard, we note that IRS now routinely requires taxpayers to use a specified method to pay taxes. For example, compliant taxpayers whose federal tax deposits are over \$50,000 are required to use EFT.<sup>7</sup> Thus, requiring delinquent taxpayers, such as those with installment agreements, to use EFT would not appear to be contrary to existing IRS procedures on specifying payment methods for certain taxpayers. In addition, there are circumstances in which IRS can impose even stricter payment procedures on delinquent taxpayers. For example, IRS can require a delinquent employer to file returns and pay the applicable tax monthly rather than quarterly.

The IRS officials were not certain what legal issues would have to be dealt with, and they did not provide specifics at our meeting with them. Also, because IRS is attempting to be more customer-service oriented, the Assistant Commissioner felt that imposing a requirement that delinquent

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<sup>6</sup>GAO/GGD-95-137.

<sup>7</sup>Section 6302(h) Internal Revenue Code.

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taxpayers use EFT to make installment payments might contradict the current customer service emphasis. In this regard, we noted that many organizations, as in California, promote EFT use by specifically informing their customers of the benefits it offers them, which includes enhanced customer service and convenience.

The IRS Collection officials articulated operational concerns about expanding EFT use. Regarding making EFT a requirement, they said that IRS would probably have difficulty handling the potentially large number of taxpayer inquiries that might occur from changing its program. In particular, the Assistant Commissioner felt that the service centers would be unable to manage the expected large number of waivers for potential hardships that could result if EFT payments were required. We realize that provisions would be necessary to handle hardship waivers if EFT is to be required, and one way would be to provide taxpayers with waivers without their having to verify the hardships. This would be similar to the way IRS currently approves taxpayers' applications for streamlined installment agreements without verification of their ability to pay in full.

Another concern expressed by the Assistant Commissioner was that many taxpayers pay installments in cash and that to require EFT would probably make this group of taxpayers, who essentially manage their finances on a cash basis, even less compliant in paying their taxes. We could not verify the extent of this potential concern because IRS had no specific data on how many taxpayers currently pay installments in cash. We note, however, that such taxpayers could be granted automatic waivers.

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## Conclusions

The reported successful practices of two states in using EFT for installment agreement payments appear to offer IRS the potential to make its installment agreement program more effective and efficient. In Minnesota and California, EFT is now the method used by most taxpayers to make their installment payments. With EFT, the two states reported they have reduced the percentage of taxpayer defaults and decreased the administrative costs of their installment agreement programs while achieving higher and faster collections. The benefits reported by these states were achieved with programs that included waivers in certain circumstances. Other users, such as banks, have also acknowledged the benefits of EFT, and the federal government has taken steps to promote greater usage for other nontax payments.



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## Agency Comments and Our Evaluation

In his letter dated April 15, 1998, the Commissioner of Internal Revenue concurred with our report findings that greater use of EFT might increase the efficiency and effectiveness of IRS' installment agreement program. Our draft report included a recommendation that IRS develop a strategy to increase EFT usage for installment payments, and the Commissioner stated that IRS is amenable to pursuing a voluntary program that promotes EFT installment payments. IRS agreed to revisit its procedures and training materials "to ensure there is sufficient emphasis on educating taxpayers on the benefits of EFT and encouraging taxpayers to sign up for EFT agreements." IRS also reiterated the concerns it has about requiring EFT usage for installment agreements, as discussed in this report (see pp. 13 and 14).

As we were finalizing our report, the IRS Commissioner announced major structural and organizational changes for the agency, and congressional leaders were considering legislation calling for one of the most far-reaching overhauls of IRS in decades. The proposed changes most likely will affect IRS' administrative operations and processes and future interactions with taxpayers. The proposals include, among other things, ways to improve the service IRS provides to taxpayers and expand taxpayers' rights in their dealings with IRS.

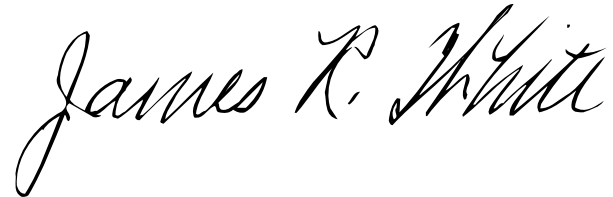
Given the complexities of the proposed IRS restructuring and the need to prioritize the necessary changes to IRS' administrative processes, we are not making a recommendation regarding EFT to IRS at this time. However, as it continues to develop strategies to improve tax administration and the services it provides to taxpayers, IRS may want to review the potential benefits that greater use of EFT for installment payments can offer it and taxpayers.

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We are sending copies of this report to the Ranking Minority Members of the House Ways and Means Committee and the Subcommittee on Oversight, the Chairman and Ranking Minority Member of the Senate Committee on Finance, various other congressional committees, the Secretary of the Treasury, the Commissioner of Internal Revenue, and other interested parties. We also will make copies available to others upon request.

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Please contact me at (202) 512-9110 if you or your staff have any questions.  
The major contributors to this report are listed in appendix II.

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

James R. White  
Associate Director, Tax Policy  
and Administration Issues

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## Abbreviations

ACH	Automated Clearing House
EFT	electronic funds transfer
FMS	Financial Management Service
FTB	Franchise Tax Board
IRS	Internal Revenue Service
MDOR	Minnesota Department of Revenue
NACHA	National Automated Clearing House Association
NAFTA	North American Free Trade Agreement

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# Comments From the Internal Revenue Service



COMMISSIONER

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

April 15, 1998

Mr. James R. White  
Associate Director, Tax Policy and Administration Issues  
United States General Accounting Office  
441 G Street, N.W.  
Washington, D.C. 20548

Dear Mr. White:

Thank you for providing us with the opportunity to review and comment on your recent draft report entitled "Tax Administration: Increasing EFT Usage for Installment Agreements Could Benefit IRS."

Overall, we concur with the report's findings and the first part of your recommendation. Your recommendation is as follows: "To make IRS' installment agreement program more efficient, we recommend that the Commissioner of Internal Revenue develop a strategy to increase EFT usage for installment tax payments. Among the ways this could be achieved are by:

- establishing a voluntary program that promotes EFT as the more beneficial method for taxpayers to use when making their installment payments, or
- considering making EFT payments a requirement for installment agreements, with waivers for causes such as hardship or other factors."

We agree that greater use of electronic funds transfer (EFT) would increase the efficiency and effectiveness of our installment agreement program, while at the same time reducing burden for many taxpayers. The framework for increasing EFT usage for installment agreements already exists in our procedural manuals, in which we explicitly direct our employees to encourage taxpayers with bank accounts to set up an EFT payment arrangement. We agree to revisit our procedures and training material to ensure there is sufficient emphasis on educating taxpayers on the benefits of EFT and encouraging taxpayers to sign up for EFT agreements.

As discussed with your staff several months ago, we have already considered mandating EFT payments for installment agreements, with waivers for hardship or other situations, and decided against changing to such a policy. We hesitate to direct taxpayers in their method of conducting their financial affairs. We feel it would be better customer service to encourage EFT for installment agreements rather than mandate its use. Anecdotally, we know that many taxpayers prefer to pay their installments with

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**Appendix I**  
**Comments From the Internal Revenue**  
**Service**

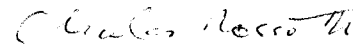
2

cash or by money order. According to a Survey of Consumer Finances, sponsored by the Federal Reserve and the Department of Treasury in 1995, 15.1 percent of families did not have a checking account. Although we could grant waivers to these taxpayers, this could lead to an appearance of disparate treatment of taxpayers. We feel the fairest and best approach for all taxpayers would be to provide them with the option of using EFT.

Our soon-to-be-published Electronic Tax Administration strategy focuses on making it easier for taxpayers to file their current tax returns and pay using EFT (if they have a balance due at the time of filing). This integrated filing experience option, coupled with acceptance of credit cards beginning in 2000, may be attractive to some taxpayers who will want to avoid paying the government in installments. Similarly, offering credit cards as another payment option for delinquent taxes (beginning in 2001) could offer a convenience that both serves as another source of financing for the taxpayer and another asset that can be considered in the collection process.

If you have any questions or need additional information regarding these issues, please let me know, or your staff may contact Deborah Reilly, Assistant Commissioner (Collection), at (202) 622-5100.

Sincerely,



Charles O. Rossotti

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