REPORT OF THE
JOINT COMMITTEE ON TAXATION
RELATING TO THE INTERNAL REVENUE SERVICE
AS REQUIRED BY THE
IRS REFORM AND RESTRUCTURING ACT OF 1998

Prepared for the

HOUSE COMMITTEES ON WAYS AND MEANS,
APPROPRIATIONS, AND GOVERNMENT REFORM
AND THE SENATE COMMITTEES ON
FINANCE, APPROPRIATIONS, AND GOVERNMENTAL AFFAIRS

For a Joint Review
Scheduled on May 25, 1999

By the Staff

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JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The Internal Revenue Service Restructuring and Reform Act of 1998 [1] (the "IRS Reform Act") made comprehensive changes relating to the operations of the Internal Revenue Service ("IRS"). Goals of the IRS Reform Act included increasing public confidence in the IRS and making the IRS an efficient, responsive, and respected agency that acts appropriately in carrying out its functions.[2] The IRS Reform Act included changes relating to IRS organization and management, Congressional oversight, electronic filing, and taxpayer protections and rights.[3]

As part of the provisions relating to Congressional oversight, the IRS Reform Act requires that there is to be a joint review of IRS activities.[4] The joint review is to include two members of the majority and one member from the minority of each of the House Committees on Ways and Means, Appropriations, and Government Reform and the Senate Committees on Finance, Appropriations, and Governmental Affairs. The joint review is to be held at the call of the Chair of the Joint Committee on Taxation, and is to take place before June 1 of each calendar year after 1998 and before 2004. The joint review is to address the strategic plans and budget of the IRS and such other matters as determined by the Chair of the Joint Committee on Taxation.

The IRS Reform Act also requires the Joint Committee on Taxation to report annually to the House Committees on Ways and Means, Appropriations, and Government Reform and the Senate Committees on Finance, Appropriations, and Governmental Affairs regarding certain matters relating to the IRS. The report is to be made in each calendar year after 1998 and before 2004.[5]

Pursuant to the IRS Reform Act, a joint review of the strategic plans and budget of the IRS for fiscal year 2000 has been scheduled for May 25, 1999. This document,[6] prepared by the

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[1] Pub. L. 105-206 (July 22, 1998).

[2] H. Rept. 105-364, Pt. 1, at 34-35 (1997) (hereinafter the "House Committee Report") and S. Rept. 105-174, pp. 11-12 (1998) (hereinafter the "Senate Committee Report").

[3] For a summary of the IRS Reform Act's taxpayer rights and protections, *see Summary of Revenue Provisions Contained in Legislation Enacted During the 105th Congress* (JCX-75-98), November 19, 1998, 61-77. *See also*, Internal Revenue Service, Publication 553, *Highlights of 1998 Tax Changes* (December 1998), 20-25.

[4] Internal Revenue Code ("Code") sec. 8021(f)(2).

[5] Code sec. 8022(3)(C).

[6] This document may be cited as follows: Joint Committee on Taxation, *Report of the Joint Committee on Taxation Relating to the Internal Revenue Service as Required by the IRS*

(continued...)

staff of the Joint Committee on Taxation, contains the report of the Joint Committee on Taxation relating to the IRS as required by the IRS Reform Act. Part I of the document provides a description and analysis of the strategic plans and fiscal year 2000 budget of the IRS, including a discussion of the progress of the IRS in meeting its objectives and how the fiscal year 2000 budget proposal supports those objectives. Part II discusses the 1999 filing season. Part III discusses progress relating to other matters addressed by the IRS Reform Act, specifically, the IRS Oversight Board, the office of the National Taxpayer Advocate, the Treasury Inspector General for Tax Administration and personnel flexibilities.

[6](...continued)
Reform and Restructuring Act of 1998 (JCX-24-99), May 20, 1999.

I. DESCRIPTION AND ANALYSIS OF STRATEGIC PLANS AND BUDGET OF THE IRS

A. Overview of IRS's Strategic Goals

In the IRS Reform Act, the Congress directed the IRS to review and restate its mission to increase its emphasis on serving the public and meeting taxpayer needs.[7] Prior to its revision, the IRS's mission statement focused on collecting the proper amount of tax.[8]

The new mission statement, announced by the Commissioner in September 1998, has the IRS's interaction with taxpayers as its focus. It states:

> Provide America's taxpayers with top quality service by helping them to understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

To assist in achieving its new mission, the IRS has developed three strategic goals.[9] The IRS's first goal is to provide top quality service to <u>each</u> taxpayer. Second, the IRS has determined that it must provide top quality service to <u>all</u> taxpayers. The third strategic goal ensures that productivity within the IRS will be increased by providing IRS employees with a quality work environment.

The IRS's first strategic goal, providing top quality service to each taxpayer, is designed to ensure that every taxpayer receives first-quality service when dealing with the IRS. Whether

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[7] IRS Reform Act sec. 1002.

[8] The IRS's previous mission statement read:

> The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

[9] The IRS is currently updating its strategic plan for fiscal years 1999-2004 to include, among other things, the revised IRS mission statement and the Commissioner's modernization concept. Until the strategic plan is revised, the IRS has stated that pages SD-9 through SD-24 of IRS Document 10968, *Fiscal Year 2000 Congressional Justification* (February 1, 1999) (hereinafter "IRS FY 2000 Justification") will serve as its strategic plan. The IRS plans to issue a revised strategic plan in 1999. The goals and objectives outlined in the Fiscal Year 2000 Justification are also reflected in IRS Publication 3349 (2-1999), *Modernizing America's Tax Agency* (1999) (hereinafter *"Modernizing America's Tax Agency").*

the IRS is providing forms, advising taxpayers about their accounts with the IRS, or engaged in the examination function, the IRS has determined that it must have a clear understanding of the facts and circumstances surrounding a particular taxpayer's case to ensure the proper application of the tax law to the taxpayer. The Commissioner stated in his April 14, 1999, testimony before the Senate Finance Committee, that this goal also requires that "taxpayers should always be treated professionally and courteously and with full consideration of their rights."

The second strategic goal requires the IRS to provide top quality service to all taxpayers. This goal aims for fundamental fairness to all taxpayers. The IRS hopes to ensure that the tax law is applied with fairness and integrity such that taxpayers who fail to comply do not burden those who comply. Success in this area is measured by the IRS in terms of uniformity of compliance among various segments of the population. In measuring its success in achieving this goal, the IRS will focus on increased compliance rather than revenue collected from enforcement activities.

As its third strategic goal, the IRS plans to increase productivity by providing a quality work environment for its employees. Comparing its goals to organizations within the private-sector, the IRS noted that success with this goal requires providing employees with high-quality technology tools, adequate training, effective management, and active engagement in the goals of the organization. The IRS will adhere to creating a positive work place where there exist equal opportunity, recognition of employee performance, and no artificial barriers to advancement.

To carry out the IRS strategic goals, the Commissioner has developed five guiding principles: (1) understanding and solving problems from the taxpayer's point of view; (2) expecting managers to be accountable; (3) using balanced performance measures; (4) fostering open and honest communication; and (5) insisting on total integrity. To complement the IRS strategic goals and guiding principles, the Commissioner has established five specific "levers of change" for the IRS. The IRS intends to implement the levers of change in an integrated fashion over the next three years. The IRS views each lever as having equal importance. The levers of change are: (1) revising business practices for dealing with taxpayers; (2) modifying the organizational structure around the needs of taxpayers; (3) having management roles with clear responsibility; (4) establishing measures of performance that balance business results, customer satisfaction, and employee satisfaction; and (5) implementing and managing new technology to replace outdated computer systems.

B. Revision of IRS Business Practices

In general

The way the IRS interacts with taxpayers is defined by its business practices.[10] Included in the IRS's business practices are procedures for filing, procedures for determining when notices are sent to taxpayers, how telephones are answered, how examinations of taxpayers' returns are conducted, and how taxes are collected. The Commissioner has developed strategies to guide the IRS in carrying out its business practices. These detailed strategies include: (1) preventing taxpayer problems or addressing them as early as possible; (2) improving communications with taxpayers; (3) expanding taxpayers' rights; (4) broadening the use of electronic tax administration; (5) leveraging IRS resources through effective partnerships; (6) tailoring practices and strategies based on specific taxpayer needs and problems; (7) applying risk-based compliance intervention techniques; and (8) integrating compliance strategies.

Preventing taxpayer problems or addressing them as early as possible

The IRS identifies three stages of activities when it deals with taxpayers: (1) pre-filing; (2) filing; and (3) post-filing.[11] According to the IRS, 73 percent of its budget is allocated to post-filing activities, i.e., dealing with problems after they happen. Nine times as much is spent by the IRS on fixing problems after they occur than is spent on preventing them.[12] The IRS anticipates that significant increases in both service and compliance will occur by shifting its focus to taxpayers' pre-filing activities. The IRS also anticipates that, if compliance errors and problems are addressed early, less burden will be imposed on the taxpayer.

Improving communications with taxpayers

In general

The IRS communicates with taxpayers through a variety of methods including the mail, the telephone, the Internet, and in-person meetings. According to the IRS, in 1998, it mailed over 100 million tax packages and postcards to taxpayers and distributed an additional 650 million forms and publications, including those documents that were downloaded from the IRS

[10] Many IRS practices are in the Internal Revenue Manual and various rulings and regulations. *See also Modernizing America's Tax Agency*, 15-27.

[11] *Id.* at 17.

[12] *Id.*

site on the World Wide Web.[13] During that year, the IRS also mailed taxpayers 105 million notices, received between 20 and 30 million incoming pieces of correspondence, and 143 million incoming phone calls on toll-free numbers, and served over ten million taxpayers at its walk-in sites.[14] Over 20,000 employees are dedicated solely to these tasks, and, in total, over 70,000 employees regularly communicate with taxpayers.[15] The IRS recognizes the volume of its communications with taxpayers and has focused on ways to improve its communication methods.

The Internet and the World Wide Web

The IRS has implemented programs that it maintains will provide the easiest and most efficient way for taxpayers to get information from the IRS throughout the year. For example, since January 1998, the IRS has determined that 84 million forms, publications, and products have been downloaded from the IRS's Digital Dailey Web site. The IRS Web site also provides the latest information regarding tax law changes, tax tables and rate schedules, TeleTax topics, tax regulations, and the weekly Internal Revenue Bulletin. The Web site also provides taxpayers with "Special Taxpayer Alerts," which identify problems and what the IRS is doing to fix the problems. In January 1999, the IRS launched its Small Business Corner. This Web-based resource is intended to provide these taxpayers with accessible, understandable information based on their needs as a taxpayer group.[16] Similarly, the Tax Professional's Corner of the IRS's Web site was designed to provide a quick listing of information and news items, which are needed by tax professionals.[17]

CD-ROM

The Federal Tax Products CD-ROM contains over 600 Federal tax forms and instructions and nearly 3,000 pages of topic-oriented tax information.[18] Users can electronically search, view-on-screen, or print out any of the items contained on the CD-ROM. The two-issue

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[13] *Id.*

[14] *Id.* at 18.

[15] *Id.*

[16] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Oversight House Committee on Ways and Means (April 13, 1999), 8.

[17] *Id.* at 9.

[18] *Id.*

subscription is available through the National Technical Information Service for $25.[19] As of March 22, 1999, nearly 65,000 subscriptions were sold.[20] The IRS has also produced the "Small Business Resource Guide: What You Need to Know About Taxes and Other Topics" on CD-ROM. This interactive product provides small businesses with information, which is easy to access and understand. 17,000 copies will be available for distribution with over half going to Small Business Administration Small Business Information Centers. The information is organized by stages in the business life cycle, and the product provides information on preparing and financing a business, record keeping, selecting a business structure, employment taxes, and other topics.[21]

TAXI On-Line Learning Lab

Developed based on the collaborative efforts of the IRS and the American Bar Association's Section of Taxation, the Internet Application TAXI was launched in July 1998. This is an on-line learning lab for first-time taxpayers, students 13 to 18, who learn about taxes in school. This program covers the reasons why we pay taxes and how students can meet their tax obligations. The program also addresses the availability and benefits of electronic filing.[22]

IRS Local News Net

IRS Local News Net is a list server that provides targeted, localized, and immediate information for tax professionals across the nation. The system is designed to support the localized nature of information based upon the tax professional's specific, localized needs. Any IRS District Office, Service Center, or Computing Center that needs to communicate with the public or with tax professionals on a regular basis can request a list server.[23] Local News Net Servers are being developed primarily to reduce the print and postage costs incurred with Director newsletters.

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[19] *Id.*, as updated with information supplied to the Joint Committee on Taxation staff by the IRS.

[20] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Oversight House Committee on Ways and Means (April 13, 1999), 9.

[21] *Id.*

[22] *Id.* at 10.

[23] *Id.*

Expanding taxpayer rights

Many of the IRS's modernization efforts will focus on implementing and reinforcing the expansion of taxpayer rights in accordance with the provisions included in the IRS Reform Act.

Broadening the use of electronic tax administration

The conference report to the IRS Reform Act states that "the policy of Congress is to promote paperless filing, with a long-range goal of providing for the filing of at least 80 percent of all tax returns in electronic form by the year 2007."[24] The IRS has recognized the need for improvement in its technological equipment to allow for the filing of a full range of returns, resolution of security issues to eliminate requirements for separate signature documents, tailoring of marketing and education programs to attract taxpayers and practitioners with varying needs, and broadening of the number of effective payment options with filing returns.[25] Experience with electronic tax administration during the 1999 tax filing season is discussed in Part II, below.

Leveraging IRS resources through effective partnerships

The IRS intends to place greater emphasis on working in partnership with those organizations and groups that are actively involved in tax administration. Those groups identified by the IRS include State revenue agencies, tax practitioners, industry associations, small business associations (e.g., the Small Business Administration), community and volunteer groups, low-income and disadvantaged taxpayer services, and large businesses and institutions offering tax filing assistance to their employees. Many of these groups work with the IRS by sharing information about IRS programs and taxpayer concerns. States work with the IRS by providing compliance information and, in some cases, by participating in a joint electronic filing program. Because taxpayers often provide overlapping information to both the IRS and at least one State, the IRS believes that there are significant opportunities to reduce the compliance burden on taxpayers.[26]

Tailoring practices and strategies based on specific taxpayer needs and problems

The IRS's strategic plan calls for it to improve its business practices by tailoring them to address particular taxpayer issues, similar to what is done by companies that develop and market their products according to their customers' different needs. The IRS recognizes that different kinds of taxpayers have different concerns. For example, individual taxpayers with income reported by third parties experience less reporting and payment problems than those with

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[24] H. Rept. 105-599, at 234 (1998) (hereinafter the "Conference Report").

[25] *Modernizing America's Tax Agency* at 20.

[26] *Id.* at 20-21.

business income, yet prompt payment of refunds is very important to these taxpayers. College students who file by telephone have different service needs than do senior citizens with retirement income. Large businesses with extensive international activities have different issues and concerns than do small, start-up businesses. Identifying the particular needs of taxpayers and providing them with appropriate service is critical at all stages. The IRS regards this strategy as so fundamental to meeting its strategic goals that it is viewed as a key organizing principle for the way the IRS is managed.[27] The IRS structural reorganization based on taxpayer needs is discussed in detail in Part I. C., below.

Applying risk-based compliance intervention techniques

Because of its limited resources, the IRS has determined that it must apply its resources where they will provide the most benefit in reducing specific incidences and patterns of noncompliance. The IRS finds that strategies that target resources effectively will benefit individual taxpayers by reducing the compliance burden on those taxpayers who comply. The IRS cites as an example of targeting strategies its use of statistical techniques to select returns for audit that are likely to contain understatements of tax. The IRS has also observed that progress has been made in developing more effective collection techniques and practices in both private and public agencies. The IRS identified two keys to effective collections: (1) early identification of those taxpayers who may present a risk of nonpayment; and (2) effective intervention with taxpayers in working out a payment program that addresses a particular taxpayer's payment problem.[28] Moreover, the retention of accurate, current taxpayer data is essential to the IRS in meeting this strategic plan.[29]

Integrating compliance strategies

The IRS has determined that it will experience the greatest benefits from its strategic goals when its improved business practices can be implemented through effective and integrated compliance strategies. "Integrated Strategies" are those in which the problems and needs of a set of taxpayers are understood, and all the resources and techniques from the appropriate disciplines of the IRS are applied appropriately to solve those problems over a period of time. For example, the IRS has reported that a California-based IRS team, in conjunction with an association of farm contractors and State agencies, convinced a highly noncompliant group of agricultural farm labor contractors to comply with employment tax and withholding obligations. The IRS team was able to develop agreements and educational programs that convinced most of the contractors to

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[27] *Id.* at 21-22.

[28] *Id.* at 23.

[29] *Id.*

comply, while working out acceptable arrangements for those taxpayers with past-due obligations.[30]

Management of customer service initiatives

As part of revising IRS business practices, in January 1998, the IRS established a central office, the Taxpayer Treatment and Service Improvements ("TTSI") program, to manage the overall implementation of customer service improvements.[31] At the same time, an Executive Steering Committee, chaired by the Commissioner, was established to provide authoritative and timely decisions on all matters affecting implementation of initiatives and to ensure that all initiatives are consistent with the IRS's business strategy.[32]

The General Accounting Office ("GAO") reviewed the progress of 25 specific customer service improvement initiatives as of January 1999. Examples of these initiatives include: marketing TeleFile aggressively to individual taxpayers; establishing a uniform set of leadership competencies for all levels of management; expanding telephone service hours to 24 hours, 7 days a week; using multiple strategies to reduce demand on the telephone lines, such as educating customers on when to expect refunds; assessing the skills of IRS employees and training those with the most critical needs; changing, over the long term, how the IRS selects, trains, evaluates, rewards, and supports its employees so they may better serve customers; eliminating, by the end of 1998, unnecessary notices; and standardizing the format and content of written responses, using appropriate commercial software.[33] The GAO concluded that the IRS has established a promising strategy for managing the agency's customer service initiatives. The GAO believes this strategy could be strengthened by the development of an approach and the provision of guidance to managers for determining the appropriate cost and benefit information

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[30] *Id.* at 23-24.

[31] *See* General Accounting Office, *IRS Customer Service, Management Strategy Shows Promise But Could Be Improved* (GAO/GGD-99-88, May 9, 1998) (hereinafter "GAO Report 99-88"), at 4-5. The head of TTSI was authorized to build a staff and create a strategy for coordinated review and implementation of more than 5,000 improvement initiatives by the IRS. In January 1999, this list was reduced to 157 initiatives as primary customer service improvement actions to be managed by TTSI in the short term.

[32] IRS FY 2000 Justification at SD-21 - SD-22.

[33] GAO Report 99-88 at 15-17. As of January 1999, some of the initiatives were closed, some were in process, and some had been deferred. Initiatives were classified as closed if the IRS believed the work had been completed or the work did not need to be done. For example, the initiative to expand telephone service to 24 hours, 7 days a week had been closed by January 1999 because the expansion had been completed. *Id.*

for the customer service initiatives and for measuring the results of the initiatives as they apply to the IRS's customer service objectives.[34]

C. IRS Reorganization and Management

At the time of Congressional consideration of the IRS Reform Act, the Commissioner had announced the broad outline of a plan to reorganize the structure of the IRS in order to help make the IRS more oriented toward assisting taxpayers and providing better taxpayer service. Prior to announcement of this plan, the IRS had a three-tier structure of district and regional offices and a national office. Thirty-three district offices and ten service centers administer the entire spectrum of taxpayers by defined geographical boundaries. Four regional offices preside over the districts, with one national office in Washington, D.C. at the top of the command chain.

As announced by the Commissioner, the new organizational structure would be based on units that serve particular groups of taxpayers with similar needs. Under this structure, each unit would be charged with start-to-finish responsibility (e.g. education, audit, and collection responsibility) for serving a particular group of taxpayers. The Commissioner believed that this new structure would solve many of the problems that taxpayers had been encountering with the IRS. The Congress agreed that the current IRS organizational structure was one of the factors contributing to the inability of the IRS to properly serve taxpayers and that the proposed structure would help enable the IRS to better serve taxpayers and provide the necessary level of services and accountability to taxpayers. In order to support the Commissioner in his efforts to modernize and update the IRS, the IRS Reform Act included a statutory direction for the Commissioner to eliminate or substantially modify the existing organizational structure and to establish organizational units to serve particular groups of taxpayers with similar needs.[35]

The Commissioner's reorganization plan centers on taxpayer needs rather than geographical location. The plan eliminates regional and district offices as they now exist.[36] Four

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[34] *Id.* at 4, 8.

[35] IRS Reform Act sec. 1001.

[36] IRS FY 2000 Justification at SD-1. Each of the four operating divisions will have field operations, with at least one "territory" in each state and with "areas" serving as a multistate presence. This portion of the plan has been provisionally approved. The IRS Deputy Commissioner for Modernization recently stated that the new territories will not simply replace the existing districts. In distinguishing the new structure, the Deputy Commissioner said that a territory manager will have authority over joint collection and exam issues and that the five layers of management will be eliminated. An issue will go from an agent to the group manager to the territory manager, who controls both exam and collection functions. The geographic structure is designed to meet the needs of each operating division's taxpayer base. The Deputy (continued...)

operating divisions comprise the centerpiece of the plan: Wage and Investment Income,[37] Small Business and Self-Employed,[38] Large and Mid-Size Business,[39] and Tax Exempt and Governmental Entities.[40] Each division will have its own functions for education, communication, customer account services, and compliance.[41]

The Taxpayer Advocate and Appeals will provide assistance to taxpayers independent of the operating divisions.[42] The national office will be responsible for setting broad policy, reviewing the plans and goals of the business units and developing major improvement initiatives.[43] Other divisions of the IRS include Chief Counsel, the Chief Information Officer,

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[36](...continued)
Commissioner indicated that he envisioned moving only two percent of the current field workforce. "ABA Tax Section: New Article IRS Will Have 'Territories,' 'Areas,'" *Tax Notes Today*, 1999 TNT 84-2 (May 3, 1999).

[37] The Wage and Investment Income division will cover individual taxpayers with simple returns, who are not self employed or do not have supplemental income. These include individual taxpayers filing Form 1040A, 1040EZ, and simple 1040s. IRS FY 2000 Justification at SD-15. This division will have its headquarters in Atlanta, Georgia.

[38] The Small Business and Self-Employed division includes those individual filers who file Schedules C, E, F, or Form 2106. It also includes partnerships, S corporations and corporations with assets under $5 million. *Id.* at SD-15. This division will have its headquarters in Washington, D.C.

[39] The Large and Mid-Size Business division covers mid size corporations, having assets valued between $5 million and $250 million, and large corporations, having assets in excess of $250 million. *Id.* at SD-15. This division will have its headquarters in Washington, D.C.

[40] The Tax Exempt and Governmental Entities division includes tax-exempt organizations, employee plans, and governmental entities. Employee Plans comprises over 1 million private and public retirement plans. Exempt Organizations includes over 1 million tax-exempt organizations and an estimated 350,000 religious organizations. Governmental Entities includes 220,000 outstanding tax-exempt bond issuances, 86,000 Federal, State, and local entities and 559 Federally recognized Indian tribes. Internal Revenue Service, "Petschek to Head IRS Tax Exempt Operating Division," Press Release IR-99-42 (April 20, 1999). This division will have its headquarters in Washington, D.C.

[41] IRS FY 2000 Justification at SD-15.

[42] *Id.*

[43] *Id.*

Criminal Investigation and Shared Services (i.e., facilities management, personnel services and procurement).[44]

The reorganization is being staged in phases:[45]

> Phase I: Identifying and validating the major components of the new organization's structure.
>
> Phase II A: Developing individual organizational unit blueprints and an integrated Master Plan Blueprint for the Modernization Program as well as detailed Infrastructure Implementation Plans.
>
> Phase II B: Developing detailed design team implementation plans for blueprints and implementing the Infrastructure Implementation Plans. These plans will be required for the start up of the operating divisions.
>
> Phase III: Implementing the new organization.

Phase I was completed in July 1998. In that phase, Booz-Allen & Hamilton confirmed that the Commissioner's Concept to Modernize the IRS is the appropriate organizational structure to reorganize the IRS.[46] Phase II A (blueprints) was completed on April 15, 1999. Phase II B (design team implementation plans) is ongoing.

The IRS has begun implementing parts of the new organization. In the first quarter of FY 1999, the Information Systems activities of the regions, districts and service centers began reporting to the Chief Information Officer. The nationwide Taxpayer Advocate staff began reporting directly to the National Taxpayer Advocate.

The Commissioner has named the head of the new Tax Exempt and Governmental Entities Operating Division. This division will be headquartered in Washington, D.C. with operations scheduled to begin in late 1999 or early 2000.[47] A search for the heads of the other operating divisions is underway.

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[44] *Id.*

[45] *Id.* at SD-16.

[46] *Id.*

[47] Internal Revenue Service, "Petschek to Head IRS Tax Exempt Operating Division," Press Release IR-99-42 (April 20, 1999).

D. Development of Organizational Performance Measures

As part of efforts to implement the new IRS mission and the Commissioner's modernization plans, the IRS is changing its organizational performance measures and the way it uses measures to focus attention on priorities, assess organizational performance, and identify improvement opportunities. The new framework for measuring organizational performance will balance business results (both quantity and quality), customer satisfaction, and employee satisfaction. The redesigned measures will ensure that customer satisfaction and employee satisfaction share equal importance with business results. The IRS views fiscal year 1999 as a transition period to introduce new measures, educate and train managers and employees about the performance measures, gather and analyze data (i.e., "baseline" the new measurement system), and refine the measurement system. The IRS views the new system as a first step in establishing how to manage the new IRS.[48] Establishing appropriate measures is also critical to assist in oversight of IRS operations. The lists of measures included with the fiscal year 2000 budget request are not final or complete because the IRS is still in the process of developing the measures.

The IRS has acknowledged that the new performance measurement system being put in place is still in the first steps for several reasons: it does not include a measure of voluntary compliance; it will need to be revisited to adapt to the new organizational structure of the IRS; it is constrained by systems and data availability; and it must allow for organization learning on the effectiveness of the measures and how they are used.[49] While difficult, developing a measure of taxpayer compliance will enable the IRS to quantify how its increased focus on taxpayer service increases voluntary compliance and revenues, as compared to the prior focus on enforcement. As the Commissioner has stated:

> In the future, it will also be essential for the IRS to develop regular and meaningful measures of overall compliance. This is important not only for effective management but also for fundamental fairness, to assure taxpayers who pay their taxes that others are also complying. In the absence of such measures, informed decisions on strategies to encourage voluntary compliance...will be impossible and the historic tendency to fall back on enforcement revenue as a measure of performance may reoccur.[50]

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[48] IRS FY 2000 Justification, at SD-19-SD-21. *See also, Modernizing America's Tax Agency*, at 42-46.

[49] IRS FY 2000 Justification, at SD-20.

[50] *Modernizing America's Tax Agency,* at 44-45.

The GAO concurs that measures of voluntary compliance and taxpayer burdens are critical to assessing IRS performance.[51] The IRS Organizational Performance Management Executive has told the GAO that measuring voluntary compliance without using something similar to the discontinued Taxpayer Compliance Measurement Program ("TCMP") would be difficult. TCMP used detailed audits to measure taxpayer compliance. The last TCMP audits were related to tax years 1987 and 1988; TCMP audits were discontinued due to concerns about taxpayer burdens.[52] The IRS has also told the GAO that the TCMP data has certain limitations. The GAO has suggested that a modified version of the TCMP studies could be useful in assessing voluntary compliance, such as using smaller samples that project nationwide results, sampling groups of taxpayers and projecting results to specific groups of taxpayers, or continuously sampling a small number of returns over a period of several years.[53]

The IRS has discontinued a previously-used performance measure to gauge taxpayer burdens, because it was based on outdated methodology and was considered to be a poor indicator of burden. The IRS is working with a consultant to develop new methods of measuring taxpayer burden.

E. Technology Modernization

Year 2000 compliance

Like other entities, public and private, dependent on technology, the IRS is engaged in the task of making its computer systems Year 2000 compliant. Failure to successfully complete this task could have a significant impact on taxpayers. The IRS had set a goal of January 31, 1999, for completion of most of its Year 2000 work, in order to avoid complications during the 1999 filing season and to provide time for testing.[54] As of the end of March 1999, the IRS

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[51] General Accounting Office, *Tax Administration: IRS' Fiscal Year 2000 Budget Request and 1999 Tax Filing Season* (GAO/T-GGD/AIMD-99-140, April 13, 1999) (hereinafter "GAO Report 99-140"), at 15.

[52] While the IRS administratively discontinued TCMP audits, subsequent statutory changes relating to certain audit techniques could have an impact on the IRS's ability to reinstate TCMP audits in the same manner as they were previously conducted. *See* Code sec. 7602(e).

[53] GAO Report 99-140, at 16-17.

[54] General Accounting Office, *IRS' Year 2000 Efforts: Status and Remaining Challenges*, (GAO/T-GGD-99-35, February 24, 1999) (hereinafter "GAO Report 99-35"), at 1.

reported that approximately 93 percent of its mission critical systems were Year 2000 compliant.[55]

According to the Commissioner, the Year 2000 prognosis is generally positive, but there still is risk and significant work remains to be done.[56]

To complete its Year 2000 efforts, the IRS will conduct end-to-end testing to ensure that the Year 2000 remediated systems function together. The IRS has reported that it has been conducting such testing since July 1998, and so far been successful.[57] The IRS is also working on an "end game" strategy for the weekend of December 31, 1999, through January 2, 2000. The IRS is also developing contingency plans that outline the procedures to follow in the event that any of the mission critical tax processing systems suffer a major failure. In order to assist in Year 2000 compliance, the IRS is continuing to receive independent assessment of its work from outside consultants.[58]

Finally, the IRS is working with the Treasury Department to develop recommendations to ensure that taxpayers who attempt to file in good faith or pay on a timely basis are not harmed because of a Year 2000 computer problem beyond their control. For example, while the IRS can abate penalties for reasonable cause, there is limited authority to abate interest.[59]

Systems modernization

IRS systems modernization is a necessary element to achievement of IRS strategic plans. The work required to modernize IRS systems is substantial. As recently described by Commissioner Rossotti, updating IRS business practices for dealing with taxpayers "requires almost a complete replacement of IRS information technology systems, which are built on a 30-

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[55] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Oversight House Committee on Ways and Means (April 13, 1999), at 2. In February of this year, the GAO reported that, despite significant progress, the IRS had not met the January 1999 completion goal for (1) upgrading systems software and hardware for its three types of computers and (2) fully implementing one of two major system improvement projects. GAO Report 99-35, at 2.

[56] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Oversight House Committee on Ways and Means (April 13, 1999), at 2.

[57] *Id.* at 3.

[58] *Id.* at 3-4. *See also*, GAO Report 99-35, at 1.

[59] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Oversight House Committee on Ways and Means (April 13, 1999), at 4.

year old fundamentally deficient foundation that cannot provide accurate up-to-date information about taxpayer accounts."[60]

The IRS has been working on systems modernization efforts for over a decade. The path to systems modernization has not been trouble free. In 1995, the GAO reviewed IRS's tax systems modernization ("TSM") projects, and identified significant problems.[61] The GAO found that, while the IRS had progressed in many actions initiated to improve management of information systems, pervasive management and technical weaknesses impeded modernization efforts and put at risk the funds that had been allocated to systems modernization. The GAO made a number of recommendations to correct the identified problems, and also placed TSM on its list of high-risk areas as a critical information systems project vulnerable to schedule delays, cost over-runs, and failure to meet mission goals.

The GAO again reviewed TSM efforts in 1996.[62] At that time, the GAO found that the IRS had again made progress, but that none of the GAO recommendations had been fully implemented and that the IRS progress was not adequate to correct the management and technical weaknesses. The GAO recommended that, until IRS weaknesses were corrected, the Congress should consider limiting TSM spending to only cost-effective modernization efforts that: (1) support ongoing operations and maintenance, (2) correct IRS management and technical weaknesses, (3) are small, represent low technical risk, and can be delivered in a relatively short time frame, and (4) involve deploying already developed systems only if such systems have been fully tested, are not premature given the lack of a completed architecture, and produce a proven, verifiable business value.

In its 1996 report on TSM, the Treasury Department also found that, while the IRS had made some progress on systems modernization, modernization efforts had taken longer than expected, cost more than originally estimated, and delivered less functionally than originally envisioned. The Treasury Department study concluded that significant changes in IRS management approach were needed, and that it was beyond the scope of IRS ability to develop

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[60] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Oversight, House Ways and Means Committee (April 13, 1999), 18.

[61] General Accounting Office, *Tax Systems Modernization: Management and Technical Weaknesses Must be Corrected if Modernization is to Succeed* (GAO/AIMD-95-156, July 26, 1995).

[62] General Accounting Office, *Tax Systems Modernization: Tax Systems Modernization Under Way But IRS Has Not Yet Corrected Management and Technical Weaknesses* (GAO/AIMD-96-106, June 7, 1996).

and integrate TSM without expanded use of external expertise.[63] In 1997, GAO again included IRS systems modernization on its list of "high-risk" areas.

The IRS has continued to make progress toward systems modernization. On May 15, 1997, the IRS issued its Modernization Blueprint detailing its information technology plan. The Blueprint had four principal parts: (1) a systems life cycle ("SLC"), (2) business requirements; (3) functional and technical architectures; and (4) a sequencing plan. GAO reviewed the Modernization Blueprint to determine whether it provided the foundation needed to develop or acquire modern systems and reported on the Blueprint in early 1998.[64] The GAO found that the Blueprint was a good start, but that the Blueprint was not complete and did not provide sufficient detail and precision for building or acquiring new systems. The IRS CIO acknowledged that essential elements were missing from the Blueprint, and stated that he had been taking steps to address the missing elements.[65]

The IRS fiscal year 1998 appropriation included $325 million for information technology and, in response to concerns regarding IRS system modernization efforts, restricted obligation of the funds until IRS submits to Congress for approval a plan for expenditure that: (1) implements the IRS Modernization Blueprint submitted to Congress on May 15, 1997; (2) meets the information systems investment guidelines established by the office of Management and Budget in the fiscal year 1998 budget; (3) has been reviewed and approved by the IRS's Investment Review Board, the Office of Management and Budget, and the Department of the Treasury's Modernization Management Board, and has been reviewed by the General Accounting Office; (4) meets the requirements of the May 15, 1997 Internal Revenue Service's Systems Life Cycle program; and (5) is in compliance with acquisition rules, requirements, guidelines, and systems acquisition management practices of the Federal Government.[66] The fiscal year 1999 information technology appropriation included similar restrictions.[67]

In December 1998, the IRS awarded its prime systems integration services contract ("PRIME"). The IRS is currently working with the PRIME contractor to update the strategic systems plan, complete the Modernization Blueprint, account for changes in systems

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[63] Department of the Treasury, *Report to House and Senate Appropriations Committees, Progress Report on IRS's Management and Implementation of Tax Systems Modernization* (May 6, 1996) at 1.

[64] General Accounting Office, *Tax Systems Modernization: Blueprint is a Good Start But Not Yet Sufficiently Complete to Build or Acquire Systems* (GAO/AIMD/GGD-98-54, February 24, 1998).

[65] *Id.* at 2-3.

[66] Pub. L. 105-61 (October 10, 1997), 111 Stat. 1281.

[67] Pub. L. 105-277 (October 21, 1998), 112 Stat. 2681-488.

requirements and priorities caused by the IRS reorganization and the IRS Reform Act, and to implement near-term projects (such as improved phone service and electronic filing options).[68] The IRS will be requesting $35 million of the previously appropriated funds to finalize planning activities. By September 30, 1999, the IRS plans to have its strategic business systems plan for the entire reorganization. This plan is expected to identify the systems to be modernized over the next 5 years, their estimated costs, business case justification, the sequence in which the systems will be developed and deployed, and the architecture standards governing their development.[69]

F. IRS Budget Request for Fiscal Year 2000

In general

For fiscal year 2000, the IRS budget request (not including the funding for the earned income tax credit ("EITC") program) totals $8.105 billion and 97,767 full-time equivalent ("FTE") positions.[70] The amount of the fiscal year 2000 budget request is almost the same as the funding level for fiscal year 1999.[71] The approximately $2 million difference from fiscal year

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[68] IRS FY 2000 Justification, at SD-23.

[69] GAO Report 99-140, at 36-37.

[70] IRS FY 2000 Justification, at SD-26.

[71] The GAO recently presented the results of its audit of the principal financial statements of the IRS for Fiscal Year 1998. In summary, the GAO found extensive weaknesses in the design and operation of the IRS's financial management systems, accounting procedures, documentation, recordkeeping, and internal controls (including computer security controls), which prevented the IRS from reliably reporting the results of its administrative activities. For Fiscal Year 1998, however, the GAO did conclude, after extensive, costly, and time-consuming ad hoc procedures to overcome these weaknesses, that the IRS did report reliably on the results of its custodial activities.

The GAO described the IRS's major accounting, reporting, and internal control deficiencies to include: (1) an inadequate financial reporting process; (2) improperly managing unpaid assessments; (3) deficiencies in preventive controls over tax refunds that have permitted the disbursement of millions of dollars of fraudulent refunds; (4) the failure to reconcile its fund balance to Treasury records during Fiscal Year 1998; (5) the inability to properly safeguard (or reliably report) its property and equipment; (6) vulnerabilities in computer security that may permit unauthorized access to IRS programs, data, and taxpayer information; (7) vulnerabilities in controls over tax receipts and taxpayer data; and (8) the inability to provide assurance that its budgetary resources are being properly accounted for, reported, and controlled.

(continued...)

1999 is the net result of several increases and decreases.[72] According to the GAO, the most significant of these are an increase of $249 million to maintain current service levels, an increase in $197 million for organizational modernization, implementation of provisions of the IRS Reform Act and training, and a decrease of $444 million in funding for IRS information systems.[73]

The IRS budget request also includes $144 million and 2,095 FTEs for the EITC compliance initiative. The EITC program is funded outside the discretionary spending caps. Fiscal Year 2000 is the third year of funding for this five-year program. The program provides for expanded customer service and public outreach programs, strengthened enforcement activities, and enhanced research efforts to reduce overclaims and erroneous filings associated with the EITC.[74]

Funding to maintain current service levels

The IRS believes that the funding to maintain current service levels is essential to enable the IRS to implement the IRS Reform Act and continue modernization efforts while maintaining day-to-day operations. The IRS objective is to handle increased workload due to the growing economy and tax law changes while holding the overall workforce constant.[75]

Organizational modernization; implementation of IRS Reform Act; training

The fiscal year 2000 budget request includes $140 million for implementing the structural reorganization plan for the IRS, as described in Part I.C., above. According to the IRS, this funding will be used to realign, revise, and retool certain occupations through buyouts, relocations, and retraining of IRS staff. The IRS anticipates that base funding will be spent to

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[71](...continued)

As a result of these weaknesses, the GAO was unable to render an opinion on the IRS's statement of net cost, statement of changes in net position, statement of budgetary resources, or statement of financing. The GAO did render a qualified opinion on the IRS's balance sheet and an unqualified opinion on the IRS's statement of custodial activities.

[72] IRS FY 2000 Justification, at SD-26.

[73] GAO Report 99-140, at 3-4. The IRS reports the request to maintain current service levels as $299 million IRS FY 2000 Justification, at SD-27. The difference between the two numbers is a base reduction of $50 million that the Office of Management and Budget requested the IRS to absorb. IRS FY 2000 Justification, at SD-29.

[74] IRS FY 2000 Justification, at SD-30.

[75] *Id.* at SD-27.

deliver other aspects of modernization, including contract support, facilities modifications, computer support and other expenses of implementing the new organizational structure.[76]

The IRS has requested $40 million and 500 FTEs for implementing the provisions of the IRS Reform Act, which the IRS has stated requires changing business priorities and practices. During the current fiscal year, IRS operational divisions have estimated that they will spend over $200 million on implementing the IRS Reform Act. Most of this money will be redirected from compliance activities. The IRS believes additional resources are required in fiscal year 2000 to complete the transition and fully and effectively carry out the legal mandates of the IRS Reform Act.[77]

The IRS is requesting the $40 million to fund two program areas: $13 million for electronic filing aimed at meeting the Congressional goal of 80 percent electronic filing reflected in the IRS Reform Act, and $27 million and 500 FTEs for implementation of various taxpayer protections and rights provisions of the IRS Reform Act.[78]

Included in the budget request is $17 million for enhancing customer service through improved training. According to the IRS, $13 million of this amount is needed to permanently increase training funds that had been reduced during the past few years. The IRS believes that training shortfalls and their resulting skills gaps contributed to some of the taxpayer treatment issues leading up to the IRS Reform Act.[79]

The GAO has commented that, while the IRS initiatives related to reorganization, implementation of the IRS Reform Act, and training are critical if the IRS is to provide first-class customer service, the IRS has not provided sufficient information regarding how these elements of the budget request were determined to enable the GAO to determine whether the requested funding levels are reasonable.[80] With respect to the reorganization, the GAO also said it could not comment on the reasonableness of the request because planning for the reorganization is still

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[76] *Id.* at SD-29.

[77] *Id.* at SD-27 - SD-28.

[78] These include: (1) $18.6 million to meet increased notice activity and processing for innocent spouse relief (IRS Reform Act sec. 3201) and due process in collection actions (IRS Reform Act sec. 3401) and Spanish language assistance (IRS Reform Act sec. 3705); (2) $4 million to fund additional grants for low-income taxpayer clinics (IRS Reform Act sec. 3601); and, (3) $4 million to fund toll-free circuitry and equipment costs and enhanced Internet access (IRS Reform Act sec. 2803). *Id.* at SD-28.

[79] *Id.*

[80] GAO Report 99-140, at 1-2, 4-6.

in progress and, until plans are finalized, it will be difficult to estimate items such as buyouts, relocation expenditures, and training needs.[81]

Year 2000 compliance

The IRS has requested $250 million and 239 FTEs for its Year 2000 compliance efforts.[82] These efforts include funding for two major system projects: (1) $100.6 million for the Service Center Mainframe Consolidation project which involves consolidation of the IRS's mainframe computer processing operations from 10 service centers to two computing centers; and (2) $26.4 million for the Integrated Submission and Remittance Processing System which is to replace the IRS's two primary tax return and remittance input processing systems with one system that is to be Year 2000 compliant. $123.4 million of the Year 2000 budget is for the activities of the Century Date Change ("CDC") Project office which oversees the conversion and testing of changes made to existing systems. (Of the $123.4 million, approximately $29 million has been allocated primarily for CDC Project labor and discretionary costs, $60 million the GAO notes are still subject to approval, and $34 million is for a contingency fund for needs that may be identified later.)

Information technology

The IRS's budget request also includes $1.46 billion for information systems. Of this amount, $1.14 billion is to (1) operate and maintain information systems that support tax administration, (2) consolidate mainframe computing from 10 centers to 2, and (3) restructure the information systems organization. Another $250 million is for Year 2000 conversion activities, discussed above. The balance of $66 million is for initiatives to correct IT management weaknesses or to develop systems to sustain IRS operations until it implements modernized systems.[83] The IRS has also requested an advance appropriation of $325 million for the IRS's multiyear capital account systems modernization, referred to as the Information Technology Investments Account ("ITIA").[84]

The GAO has testified that the fiscal year 2000 budget request of $1.46 billion for information systems is consistent with the spending categories GAO has previously set forth for the IRS, i.e., cost-effective modernization efforts that (1) support ongoing operations and maintenance, (2) correct IRS management and technical weaknesses, (3) are small, represent low technical risk, and can be delivered in a relatively short time frame, and (4) involve deploying

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[81] *Id.* at 5.

[82] IRS FY 2000 Justification, at SD-26.

[83] GAO Report 99-140, at 37.

[84] *Id.* at 32-33.

already developed systems only if such systems have been fully tested, are not premature given the lack of a completed architecture, and produce a proven, verifiable business value.[85] However, the GAO has testified that the IRS has not justified its request for advance funding the ITIA of $325 million.[86]

In particular, the GAO found that the IRS did not comply with Federal requirements that, before requesting multiyear funding for capital assets acquisitions, agencies develop accurate, complete cost data and perform thorough analyses to justify the business needs for the investment. GAO determined that the IRS will not be able to prepare such analyses until after it completes its strategic business plan in September 1999. Thus, the IRS did not base its budget request on a complete definition of fiscal year 2001 investments and did not justify these investments with a cost-benefit analysis. IRS officials have reported to GAO that they developed an estimate for the fiscal year 2000 budget process in order to ensure that funds would be available for modernization in fiscal year 2001. The GAO found that these estimated were flawed and, in some cases, lacked verifiable data and supporting data.[87]

The GAO recommends that the IRS fiscal year 2001 advance request of $325 million be denied, or that the Congress consider restricting the obligation of such funds until the IRS develops the requisite analysis and supporting information. The GAO believes that neither of the suggested options would impair fiscal year 1999 and 2000 modernization efforts, because the ITIA has sufficient funds to cover IRS proposed spending in both years.[88]

General discussion of IRS budget request

The GAO has made several observations in addition to those described above regarding the IRS fiscal year 2000 budget request. First, the GAO has noted that oversight of IRS fiscal year 2000 operations could be more complex while the IRS is in the process of structural reorganization because the budget format is based on the current operational structure, which may not be the same in fiscal year 2000, and because many performance measures in the year 2000 budget request are new. The GAO recognizes that it is premature to change the IRS budget format until reorganization is complete.

The GAO also recommends a separate budget activity for the office of the Taxpayer Advocate in order to make Congressional oversight easier and to enhance the independence of the Taxpayer Advocate. The GAO agrees with IRS comments that it is preferable to make all

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85 *Id.* at 32, 37-38.

86 *Id.* at 33.

87 *Id.* at 38-40.

88 *Id.* at 40.

needed changes to IRS financial and budget structures at one time (i.e., to make changes to the Taxpayer Advocate's budget when the budget is revised to reflect the new organizational structure). In the meantime, the GAO recommends a descriptive narrative of the amount of the budget for the office of Taxpayer Advocate.[89]

The GAO had several comments related to IRS efforts relating to enforcement and customer service and voluntary compliance. As noted above, there currently is no reliable measure of voluntary compliance. The GAO has pointed out that this makes it difficult to assess the effects of the diversion of enforcement resources to implement the provisions of the IRS Reform Act and enhance customer service.[90] The GAO also believes that Congressional oversight would be enhanced if the IRS budget distinguished between resources allocated to taxpayer assistance and enforcement activities. For example, the GAO notes that the $3.3 billion requested for Tax Law Enforcement is not exclusively for enforcement, but includes[91] an unspecified amount of money and FTE's for various form of assistance, including walk-in service and taxpayer education efforts.

In some cases, it may be difficult to distinguish between taxpayer assistance and enforcement activities. The latter, often referred to as "compliance", has traditionally included things such as audits and collection of taxes. It is possible that a diversion of resources from such enforcement activities will result in a decrease in tax revenues. It is also possible, however, that increased taxpayer assistance efforts will increase voluntary compliance, as well as have a positive impact on the perceived fairness of the tax system. Developing measures of the effects of such activities is likely to be difficult, but, if realistic, such measures would be useful in assessing IRS activities and IRS oversight.

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[89] *Id.* at 10-11.

[90] *Id.* at 6-7.

[91] *Id.* at 9-10.

II. THE 1999 TAX FILING SEASON

The 1999 Federal tax filing season experienced progress in several areas, many of which related to the IRS's strategic plan. The IRS also is implementing what it deems as critical mandates of the IRS Restructuring and Reform Act of 1998.[92]

Regarding this filing season, the IRS projected net collections for Fiscal Year 1999 of $1.7 trillion.[93] The IRS expects to have received 228 million returns during 1999, including over 126 million individual returns, and it expects to have issued over 93 million individual refunds.[94] The IRS reported that, as of March 1999, 93 percent of the its mission-critical systems were made Year 2000 compliant and were successfully placed back into production for the 1999 filing season.[95] As of April 2, 1999, refunds were up over four percent from last year, with the average refund at $1,575, and on-line filing was up, running 156 percent ahead of last year's pace.[96]

A. Electronic Tax Administration

The IRS experienced growth in its electronic tax administration for the 1999 tax filing season. The IRS has reported to the JCT staff that, through April 23, 1999, nearly 29 million individual taxpayers filed using one of the three e-file options -- a 19 percent increase over the same period in 1998. Almost 21 million taxpayers e-filed their tax returns through an IRS-authorized Electronic Return Originator ("ERO"), which reflects a 19.8 percent increase over the same period in 1998. Nearly 2.4 million taxpayers filed their returns via their home computer through a third-party transmitter. Volume for on-line filing was 161 percent ahead of last year's pace, and approximately 5.6 million taxpayers filed their returns over the telephone via TeleFile. Relating to the IRS's partnerships with State tax agencies, individuals were able to file both their Federal and State income tax returns in a single telephone call during the pilot of the first Federal/State TeleFile option. Over 7 million taxpayers chose to file both their Federal and State

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[92] These include: instituting new personnel flexibilities, including a broad-band pay system; improving employee training and assistance; and achieving the goal that, by the year 2007, 80 percent of all tax and information returns will be filed electronically.

[93] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Oversight, House Ways and Means Committee (April 13, 1999), at 1.

[94] *Id.*

[95] *Id.*

[96] *Id.*

income tax returns in a single electronic transmission--with 35 States and the District of Columbia participating in the program this year.[97]

This filing season, the IRS conducted two pilot programs designed to eliminate the need to file paper signature forms. Over 1 million taxpayers participated in the Signature Pilot. Approximately 650,000 taxpayers engaged in the On-Line Signature Pilot whereby e-file Customer Numbers were distributed to taxpayers who prepare their own returns using tax preparation software and file from their home computers. Another 490,000 taxpayers participated in the Practitioner Signature Pilot whereby taxpayers chose a personal identification number ("PIN") to file through more than 8,000 participating practitioners.

Finally, 74,000 taxpayers paid their balance due using an Automated Clearing House debit as part of their electronic return. Under this payment system, taxpayers were able to file early while having the debit occur as late as April 15.[98] Another 53,000 taxpayers were able to remit their balance due with credit cards as part of two credit card pilots the IRS conducted this year.[99]

Many business taxpayers also utilized the electronic filing options available to them. These taxpayers may now make their Federal tax deposits over the telephone or via personal computer, thus eliminating paper payments and coupons. During Fiscal Year 1998, 582,000 quarterly employment tax returns were filed over the telephone by small businesses in addition to the nearly 750,000 Forms 941 that were filed electronically by payroll service providers.[100] In Fiscal Year 1998, $1.153 trillion was deposited and 47 million deposits were made via the Electronic Federal Tax Payment System, which accounted for approximately 86 percent of all payroll deposit amounts during that period. In Fiscal Year 1999, the IRS expects that over 2.3 million Forms 941 will be filed either electronically or over the telephone.[101] The IRS is also working with other Federal agencies and States to reduce employer burdens by conducting single-point filing projects for Federal and State taxes in Iowa and Montana under the Simplified

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[97] *Id.* at 6.

[98] *Id.*

[99] Taxpayers are responsible for any credit card fees incurred in the transaction. Code section 6311(d)(2) provides that the Secretary may not pay any fee for the use of credit, debit, or charge cards for the payment of income taxes.

[100] *Id.* at 7.

[101] *Id.*

Tax and Wage Reporting System ("STAWRS").[102] The IRS has established a Harmonized Wage Code database and is working to improve customer service.

In 1998, the IRS established the Electronic Tax Administration Advisory Committee ("ETAAC") to provide an organized public forum for the discussion of electronic-filing-related issues and the goal that paperless filing should be the preferred and most convenient method of filing tax and information returns. Comprised of tax practitioners and preparers, transmitters of electronic returns, tax software developers, small and large businesses, employers and payroll service providers, individual taxpayers, State governments, and financial industry members, the ETAAC continues to provide input into the development and implementation of the strategic plan for electronic tax administration.[103]

B. Providing Information and Service to Taxpayers

Walk-in assistance

During the 1999 tax filing season, the IRS provided Saturday walk-in service at nearly 262 locations nationwide, serving over 122,000 taxpayers on the weekends.[104] The Saturday Service sites were selected based on their weekend accessability and high-traffic volume, as well as 32 non-traditional locations (e.g., shopping malls, community centers, and post offices). During these Saturdays, the IRS provided taxpayers with forms, publications, account information, Taxpayer Identification Number verification, alien clearances, and payment acceptance.[105]

Begun in November 1997, IRS Problem Solving Days continue to assist the IRS in problem resolution. Since their beginning, over 32,000 taxpayers have taken advantage of this program. Monthly Problem Solving Days provide taxpayers with the opportunity to make an

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[102] Section 976 of the Taxpayer Relief Act of 1997, Pub. L. 105-34 (August 5, 1997), authorizes a demonstration project in the State of Montana and permits the disclosure of the taxpayer's identity as defined in Code section 6103(d)(5) (i.e., the taxpayer's name, address, and taxpayer identification number), and signature. The IRS is also conducting a demonstration project with the State of Iowa, without the disclosures that are permitted under the Montana demonstration project.

[103] *Id.*

[104] *Id.* at 12.

[105] *Id.*

appointment with IRS personnel to assist them in resolving their tax problems.[106] Moreover, many taxpayers who called to schedule an appointment had their problems resolved over the phone.[107]

Taxpayers continue to receive assistance through the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs. Many taxpayers have also benefitted from the IRS's outreach program, which focuses on providing assistance with the Earned Income Tax Credit ("EITC").[108]

Telephone communication

The IRS implemented its 24 hours-a-day, 7 days-a week telephone customer service during the end of the 1998 filing season, becoming permanent as of January 4, 1999.[109] As of March 27, 1999, over 28 million taxpayers have been served via "24/7" phone service, compared to nearly 30 million over the same filing period last year.[110] The IRS is now measuring the percentage of calls in which the taxpayer receives actual service, compared to the percentage of time the taxpayer merely gains access to the system. Quality is also rated based on those who receive complete and accurate service, as well as technical tax law and accurate account information. Taxpayers may also receive forms, instructions, TeleTax topics, and small business newsletters via facsimile. TeleTax also has information on 148 tax topics available 24 hours via Touch-tone telephone. In addition, as of March 27, 1999, 22.5 million used the Automated Refund Information system on TeleTax to check the status of their refunds.[111]

The IRS found that the average length of a phone call with a taxpayer is eight to ten minutes, versus an average 3.5 minutes call with a typical commercial credit corporation. Moreover, in 1997, a taxpayer had a 51-percent chance of getting through to the IRS when placing a telephone call, as opposed to a 90 to 95 percent chance of getting through when calling other leading commercial companies.[112]

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[106] Taxpayer problems with the IRS are also addressed by the Office of the Taxpayer Advocate, which is discussed in Part III. B., below.

[107] *Id.*

[108] *Id.* at 13.

[109] *Id.* at 10.

[110] *Id.*

[111] *Id.* at 11.

[112] *Modernizing America's Tax Agency* at 18.

Other taxpayer services

The IRS's Corporate Partnership program continues to provide more than 13 million employees with access to IRS forms through their corporation's World Wide Web site or LAN.[113]

Forms

For the 1999 tax filing season, 11 new forms were developed and 177 forms and instructions and 39 publications were revised.[114] Moreover, its 1998 form packages were revised to improve readability, highlight tax law changes,[115] and protect taxpayer privacy. Finally, in those areas that have insufficient outlets for distributing tax forms, the IRS has engaged its Newspaper Supplement Program, which provides pre-selected, common tax forms in one of the Sunday local newspaper editions.[116]

The IRS is developing a forms simplification research plan that will provide strategies for moving taxpayers to the simpler tax forms and for targeting where changes are needed. During 1999, forms and publications personnel have been working with an outside contractor to redesign the EITC and child tax credit forms and instructions.[117]

C. 1999 Revenue Protection Strategy

The IRS reports that, in 1998, there were 3.4 million occurrences on the electronic filing system of missing, invalid, or duplicate uses of social security numbers ("SSNs"), which caused the tax returns to be rejected back to the electronic transmitter. During the 1999 filing season, validation of SSNs continued to be a very visible portion of the IRS's fraud and abuse prevention

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[113] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Oversight, House Committee on Ways and Means (April 13, 1999), at 13.

[114] *Id.* at 14.

[115] For example, to improve readability, for example, the IRS printed the instructions to the 1998 Form 1040 in larger, bolder type. Moreover, the 1998 tax package also reflected changes to the tax law, including, for example: the child credits; education credits; ROTH conversion IRAs; credit for Federal tax paid on Kerosene; and a change in the standard mileage rates. Finally, taxpayers' social security numbers were not printed on the peel-off label that was mailed with the tax package, in order to protect taxpayer privacy.

[116] *Id.* at 14-15.

[117] *Id.*

efforts. The IRS is expanding the validation of SSNs and taxpayer identification numbers to essentially all forms and schedules requiring identification numbers.[118]

The EITC Communications Strategy is also being continued by the IRS. This includes educating taxpayers and practitioners about the EITC rules and consequences of and penalties associated with non-compliance. The IRS will also publicize free return preparation assistance and electronic filing through the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs.[119]

D. GAO Review of the 1999 Filing Season

In general

The GAO was asked to review the IRS's performance during the 1999 tax filing season. In its April 13, 1999, testimony before the Subcommittee on Oversight of the House Committee on Ways and Means, the GAO made four specific observations. First, the GAO noted that taxpayers had experienced a significant decline in telephone service, although service had increased in recent weeks. Second, the number of returns filed electronically increased, although the number filed via telephone decreased. Third, taxpayers have been experiencing a significant amount of confusion regarding the new child tax credit. Finally, the GAO observed that the IRS's new computer systems for processing returns and remittances appeared to be performing well.[120]

Decline in telephone service

The GAO reported that, over the past few years, there has been a steady increase in the ability of taxpayers to reach the IRS by telephone. In 1999, however, there have been serious problems. For example, the IRS decided to discontinue a procedure that it used in 1997 and 1998 which handled questions involving complex tax topics. Under the procedure, the IRS would direct a caller to a voice messaging system. The caller could leave their name, address, telephone number, and best time to receive a call. Within two to three business days, an IRS employee with knowledge in the specific area would return the call. In 1999, however, the IRS expected to have sufficient staff available to answer these calls directly. There was also concern that, by making taxpayers wait two or three days, the IRS was not providing the best possible service to taxpayers. Therefore, the IRS decided to terminate the use of voice messaging. Other

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[118] *Id.* at 16.

[119] *Id.* at 17.

[120] GAO Report 99-140 at 40-41. The GAO observations reflect the filing statistics prior to the end of the filing season. Final numbers of the filing season may affect the GAO's findings.

problems included staffing issues associated with the expansion of telephone service to 24 hours, seven days; start-up issues with the IRS's new call routing system; and the lack of reliable data on accessibility during the first weeks of the 1999 tax filing season.

The IRS has taken steps to address these problems. For example, during the week of February 15, 1999, the IRS reestablished its messaging system for questions involving certain tax topics.

The GAO also testified that taxpayers were more likely in 1999 to receive inaccurate telephone responses to their tax questions than in 1998. According to the IRS, this decline can be attributed, for example, to the decision to stop using voice messaging. This decision required customer service representatives to answer questions concerning topics that they were not responsible for in 1998.[121]

Electronic filing

Overall, electronic filing has increased--although at a reduced rate according to the GAO. Electronic filing, however, has not been entirely paperless, and the IRS has been conducting tests targeted at making electronic filing completely paperless and eliminating the need for taxpayers to send their Forms W-2 to the IRS.[122]

There has been a decline, however, in returns filed via telephone. The decline in the number of taxpayers using TeleFile may be partially attributed to the significant increase in on-line filing. In addition, Commissioner Rossotti testified that the IRS believes the decline in telephone filing may be due to the fact that the student loan interest deduction and the Hope credit cannot be claimed using TeleFile.[123]

Errors in calculating the child tax credit

Eligible individual taxpayers could claim a child tax credit on their 1998 tax returns. Of the 1.88 million total error notices sent to taxpayers for all reasons, 202,000 (nearly 11 percent) involved errors associated with the child tax credit. The GAO reported that these errors generally involved taxpayers either miscalculating the credit or erroneously not claiming the credit.

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[121] *Id.* at 41-45.

[122] *Id.* at 45-47.

[123] Testimony of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Oversight, House Committee on Ways and Means (April 13, 1999).

As of March 1999, the IRS changed its procedure for processing returns when taxpayers fail to claim the child tax credit even though they indicate on the front of the return that they have one or more qualifying dependents. Initially, the IRS's procedure required it to adjust such taxpayers' returns to include the credit so long as information was included that indicated that the taxpayer met the adjusted gross income test and certain other eligibility criteria. The IRS later changed its procedure to require its service centers to determine whether the child meets the age criteria before adjusting the return. If research determines that the taxpayer qualifies, then the adjustment is to be made. If research determines that the taxpayer does not qualify, then no adjustment is to be made and the service center is to process the return as filed. However, if the research is inconclusive, the service center is to process the return as filed (i.e., without the credit) and notify taxpayers that they may be eligible and should file an amended return if they determine that they are eligible to claim the credit.[124]

IRS's computer systems

This year, the IRS has made major changes to its computer systems. The first major change included replacement of the returns processing system at all 10 IRS service centers and replacement of the remittance processing system at six service centers. Another major change entailed the consolidation of mainframe service center computer equipment at the IRS's two computing centers in Martinsburg, West Virginia, and Memphis, Tennessee. Notwithstanding these major changes, the GAO did not identify any significant disruption in the IRS's ability to process returns and issue refunds this tax filing season.[125]

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[124] GAO Report 99-140 at 47-50.

[125] GAO Report 99-140 at 50.

III. OTHER MATTERS ADDRESSED BY THE IRS REFORM ACT

A. Establishment of IRS Oversight Board

The National Commission on Restructuring the IRS ("the Restructuring Commission") conducted a year-long study of the IRS. Among other things, it found that while Treasury was responsible for IRS oversight, it had provided little consistent strategic oversight or guidance to the IRS. For the most part, the IRS has operated independently in recent years. One of the specific causes for this lack of oversight noted by the Restructuring Commission is that Treasury officials responsible for IRS oversight hold their positions for less than three years on average. Similarly, the Commissioner of the IRS generally holds the position for less than three years. The Restructuring Commission concluded that focus, consistency, and direction from the top was necessary for the IRS to carry out its functions.

The Congress agreed that a fundamental change in the management and oversight structure of the IRS was necessary. It believed that a new management structure would bring greater expertise in needed areas. Further, the Congress thought that more focus, continuity, and private sector expertise would help the IRS in appropriately carrying out its function.

As a result, the IRS Reform Act created within the Department of Treasury the IRS Oversight Board ("the Oversight Board"). Generally, the Oversight Board is to oversee the IRS's administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws.[126] Specific responsibilities of the Oversight Board include reviewing and approving the IRS's strategic plans and operational functions (such as modernization, outsourcing, training and education). The Oversight Board also is to recommend candidates for appointment as IRS Commissioner, as well as recommend whether the Commissioner should be removed. The Commissioner's selection, evaluation and compensation of senior executives are also to be reviewed by the Oversight Board. The Oversight Board is to review and approve any major reorganization of the IRS. The Conference Report notes that to the extent that the Commissioner has already taken measures to develop and implement such a plan, the Commissioner should not be precluded from going forward with such planning and implementation prior to the appointment of the Board.[127]

The Oversight Board is also to be involved in the IRS budget preparation process.[128] Budget requests prepared by the Commissioner are to be reviewed and approved by the Oversight Board to ensure that the budget request supports annual and long range strategic plans of the IRS. The Oversight Board is to submit the IRS budget request to the Treasury

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[126] Code sec. 7802(c) and (d).

[127] Conference Report at 203-204.

[128] Code sec. 7802(d)(4).

Department. The Treasury Department is required to submit that budget to the President, who in turn submits it to the Congress without revision. This provision does not preclude the President from including his own budget for the IRS.

The Oversight Board is to be comprised of nine members.[129] Six members are to be drawn from the private sector. The other three members are to be the IRS Commissioner, the Treasury Secretary (or Deputy Secretary), and one full-time federal employee or employee representative. The President appoints the private sector and federal employee representation members, with the advice and consent of the Senate, for staggered five-year terms.

The oversight board nominees were to be sent to Congress on January 22, 1999. The President has not yet submitted any nominations to the Senate for confirmation. Although no formal announcement has been made, it has been reported that the President has named four of the private-life nominees, and the employee representative.[130]

B. Establishment of Independent National Taxpayer Advocate

<u>**Provisions of IRS Reform Act**</u>

The IRS created the Problem Resolution Program ("PRP") in 1976. PRP's purpose was to provide an independent means of ensuring that taxpayer problems were promptly and properly handled. In 1979, the IRS created the position of the Taxpayer Ombudsman to head PRP. In 1996, the Taxpayer Bill of Rights 2 ("TBOR 2") established the position of Taxpayer Advocate and the Office of the Taxpayer Advocate in place of the Taxpayer Ombudsman and the national office headquarters PRP staff.[131] The Taxpayer Advocate was expected to represent taxpayer interests independently in disputes with the IRS. The IRS Reform Act renamed the Taxpayer

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[129] Code sec. 7802(b).

[130] *Tax Report*, Wall Street Journal, (May 12, 1999); *Administration Soon to Name Five Nominees for New IRS Oversight Board, Official Says,* BNA Daily Report for Executives, G-9 (May 13, 1999).

[131] The Commissioner of the Internal Revenue Service appointed the Taxpayer Advocate.

Advocate the National Taxpayer Advocate ("NTA").[132] The NTA supervises the Office of the Taxpayer Advocate.

The Office of the Taxpayer Advocate has four principal functions:

(1) to assist taxpayers in resolving problems with the IRS;
(2) to identify areas in which taxpayers have problems in dealing with the IRS;
(3) to propose changes in the administrative practices of the IRS to mitigate problems identified in (2); and
(4) to identify potential legislative changes which may be appropriate to mitigate such problems.

The IRS Reform Act established a system of local Taxpayer Advocates that report directly to the NTA. The local Taxpayer Advocates are independent of the IRS' examination, collection, and appeals functions. Local Taxpayer Advocates are employees of the Office of the Taxpayer Advocate. The NTA appoints Local Taxpayer Advocates. With the Commissioner, the NTA must develop career paths for local taxpayer advocates choosing to make a career in the Office of the Taxpayer Advocate.

The NTA monitors the coverage and geographic allocation of local taxpayer advocate offices and ensures that at least one local advocate is available for each state.[133] The IRS has a taxpayer advocate in each of the four regional offices. Each of the 33 district offices, 30 former district offices, and 10 service centers has local advocates. The NTA must also ensure that local telephone numbers for each office are published and available to taxpayers served by the office.[134] Additionally, the NTA must develop guidance to be distributed to all IRS officers and employees that outlines the criteria for referral of taxpayer inquiries to local offices of taxpayer advocates.[135]

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[132] The IRS Reform Act now requires that the Secretary of the Treasury, after consultation with the Commissioner and the Oversight Board, appoint the NTA. The NTA is required to have experience in customer service, tax law, and representing individual taxpayers. Compensation for the NTA is at the highest rate of basic pay established for the Senior Executive Service. For the two year period preceding appointment, the NTA must not have been an IRS officer or employee. After leaving the Office of the NTA, the NTA can not accept employment with the IRS for five years.

[133] Code sec. 7803(c)(2)(C)(i).

[134] Code sec. 7803(c)(2)(C)(iii).

[135] Code sec. 7803(c)(2)(C)(ii). Four criteria determine which cases are brought into PRP: (1) any contact on the same issue at least 30 days after an initial inquiry or complaint; (2)
(continued...)

The IRS Reform Act also expanded the NTA's ability to issue Taxpayer Assistance Orders. A taxpayer can request a Taxpayer Assistance Order ("TAO") if the taxpayer is suffering or about to suffer a "significant hardship" from tax law administration.[136] A TAO may require the IRS to release property of the taxpayer that has been levied upon, or to cease any action, take any action as permitted by law, or refrain from taking any action with respect to the taxpayer.

The NTA is required to submit two reports annually to the House Committee on Ways and Means and to the Senate Finance Committee.[137] One report, due June 30 of each year, covers the Office of the Taxpayer Advocate's objectives for the fiscal year beginning in that calendar year. Besides statistical information, the report must contain a full and substantive analysis of the objectives.

The other report, due December 31 of each year, concerns the activities of the Office of the Taxpayer Advocate. The content of this report is set by statute.[138] Generally, the report must cover initiatives taken to improve taxpayer services and problems encountered, as well as the actions taken to resolve them and the results. Specifically, the report must cover the twenty most serious problems experienced by taxpayers. The IRS Reform Act required that the report identify the ten most litigated issues for each category of taxpayer and the areas of the tax law that impose significant compliance burdens on taxpayers or the IRS. Recommendations received from individuals with the authority to issue Taxpayer Assistance Orders, and any Taxpayer Assistance Order not promptly honored by the IRS, must also be included in the report. The report must also set forth recommendations for administrative and legislative action to resolve problems encountered by taxpayers.

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[135](...continued)
no response by date promised, including commitments made by the IRS; (3) any contact that indicates that established systems have failed to resolve the taxpayer's problem; or (4) when it is in the best interest of the taxpayer or the IRS. Internal Revenue Service, Publication 2104, *National Taxpayer Advocate's Annual Report to Congress* (December 1998) (hereinafter "NTA Report"), at 3.

[136] Code sec. 7811(a)(1)(A). Significant hardship is deemed to occur if one of four factors exists: (1) there is an immediate threat of adverse action; (2) there has been a delay of more than 30 days in resolving the taxpayer's problems; (3) the taxpayer will have to pay significant costs (including fees for professional services) if relief is not granted; or (4) the taxpayer will suffer irreparable injury, or a long term adverse impact if relief is not granted. Code sec. 7811(a)(2). The NTA may also issue a TAO if the taxpayer meets requirements to be set forth in regulations. Code sec. 7811(a)(1)(B).

[137] Code sec. 7803(c)(2)(B).

[138] Code sec.7803(c)(2)(B)(ii)(I) through (XI).

The NTA, is required by statute to submit the reports directly to the Congressional committees without prior review of the Commissioner, the Secretary, or any officer or employee of the Treasury, the Oversight Board, or the Office of Management and Budget.[139]

Implementation efforts

Taxpayer Advocate activity report

The most recent NTA report identified the following areas as some of the most serious problems encountered by individual taxpayers and small business:[140]

- Complexity of the tax law;
- fairness of treatment to taxpayers;
- listening to taxpayer concerns;
- length of IRS processes;
- explanation of IRS processes;
- consideration by the IRS of the information presented by taxpayers;
- IRS explanation of taxpayer rights;
- amount of time spent on an issue;
- attitude of the IRS; and
- lack of responsiveness by the IRS.

The NTA cited penalty issues, taxability of income and dependency exemptions as the most litigated issues for individual taxpayers.[141] Complexity, the ability to access the IRS, and understanding requirements and procedures were cited as areas of the tax law that impose the most significant compliance burden on taxpayers.[142]

The NTA reported that during fiscal year 1998, PRP resolved 272,437 cases. Requests for assistance on potential hardship cases totaled 32,049.[143]

GAO testimony: challenges facing the NTA

Recent GAO testimony identified three challenges facing the NTA. They are: (1) resolving staffing and operational issues while maintaining independence from the IRS; (2)

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[139] Code sec. 7803(c)(2)(B)(iii).

[140] NTA Report at 12.

[141] *Id.* at 74.

[142] *Id.* at 85.

[143] *Id.* at 3.

strengthening advocacy efforts within the Taxpayer Advocate's Office to prevent recurring problems and (3) developing measures of effectiveness.[144]

Staffing and operational issues

Principal among the staffing and operational issues is adequate training for the PRP staff. Historically, PRP staff were IRS function employees (e.g. Examination and Collection Division employees). As a result they routinely received training in functional matters. Although PRP staff are no longer part of an IRS function, the functional training needs continue. The NTA is considering whether to implement a cross-functional training program for caseworkers. Such a program would cover multiple IRS functions and improve a caseworkers' ability to provide faster and more accurate service. GAO also suggested that a competitive selection process would help ensure that qualified staff are selected as case workers.

Another consequence of the PRP staff's separation from IRS functions affects the ability to obtain additional workers to cover workload fluctuations. Previously, the Taxpayer Advocate Office relied on IRS functions to supply additional staff to cover workload increases. Since PRP workers are now within the Taxpayer Advocate's office, this traditional means of obtaining additional staff may not be available. Workload increases may also require the NTA to prioritize cases to address with PRP resources, possibly compromising the ability to help taxpayers.

Use of advocacy

Through its advocacy efforts, the Taxpayer Advocate Office can recommend changes to the Commissioner, IRS functions, and Congress to improve IRS operations and to remedy problems causing an undue burden on taxpayers. GAO noted that advocates and their staff were spending only ten percent of their time on advocacy efforts and that PRP caseworkers were spending less than one percent.[145] Case workloads limit the amount of time available to spend on advocacy.[146]

GAO noted that there is an absence of strategy for conducting advocacy efforts and data with which to prioritize potential advocacy work.[147] No system exists for sharing information on

[144] General Accounting Office, *IRS Management: Challenges Facing the National Taxpayer Advocate*, (GAO/T-GGD-99-28, February 10, 1999), (hereinafter "GAO Testimony 99-28"), at 1.

[145] *Id.* at 6.

[146] *Id.*

[147] *Id.* at 7.

local advocacy efforts, which may result in duplication. GAO also noted that no system exists for transmitting feedback on field recommendations to the National Taxpayer Advocate Office.

Effectiveness measures

Currently the Taxpayer Advocate Office uses four program measures. These measures, however, do not produce all of the information necessary to assess program effectiveness.[148] Average processing time and currency of inventory do not provide information on how effectively PRP is operating. The third measure, which determines whether taxpayers are being properly identified and referred to PRP, is used only at service centers, so there is no data for the districts. The fourth measure, quality, involves assessing whether a taxpayer was contacted by the promised date, the clarity of communications to the taxpayer and whether the problem appeared completely resolved. GAO noted that this measure does not have a customer satisfaction element. Without this information, the NTA cannot assess whether taxpayers are satisfied with PRP services. The Taxpayer Advocate Office is currently piloting a method for collecting such data.

C. Treasury Inspector General For Tax Administration

Background and provisions of the IRS Reform Act

Prior to the IRS Reform Act, the IRS Office of the Chief Inspector was primarily responsible for carrying out internal audits and investigations regarding the IRS. Created in 1951 in response to reports of widespread corruption and abuse, the Chief Inspector was an appointee of the IRS Commissioner.[149] The Office of the Inspector General for the Department of Treasury ("Treasury IG") could also investigate allegations of IRS employee and officer misconduct. The IRS and the Treasury IG had an agreement as to their respective roles in investigating and overseeing the IRS.[150]

The IRS Reform Act eliminated the IRS Office of the Chief Inspector. In its place, Congress created the Office of Treasury Inspector General for Tax Administration ("TIGTA"). This office is in addition to the Office of Inspector General for the Department of Treasury, which, after the Act, no longer has responsibility for the IRS.

The IRS Reform Act transferred to the TIGTA almost all of the responsibilities previously assigned to the IRS Chief Inspector, in addition to the Treasury IG's duties to the

[148] *Id.* at 7-8.

[149] Conference Report at 220.

[150] *Id.*

IRS.[151] The TIGTA conducts audits, investigations, and evaluations of IRS programs and operations (including the Oversight Board).[152] On an ongoing basis, the TIGTA is to evaluate the adequacy and security of IRS technology. Part of the TIGTA's responsibility includes protecting the IRS from external threats to corrupt or threaten employees. The TIGTA also investigates criminal misconduct as well as administrative misconduct, such as violations of Taxpayer Bill of Rights and ethical violations. Taxpayers are to be provided with a toll-free number to report allegations of IRS misconduct.

In addition, the TIGTA is to conduct periodic audits of at least one percent of all determinations where the IRS has asserted the confidentiality provisions (either alone or in conjunction with the Freedom of Information Act or Privacy Act), or law enforcement considerations as the basis for denying requested information.[153] The program is to be implemented within 6 months of establishing TIGTA. The TIGTA is to report any improper assertions to the Oversight Board.

Implementation efforts

On April 29, 1999, the Senate confirmed the new Treasury Inspector General for Tax Administration. The Department of Treasury issued Treasury Order No. 115-01, which sets forth the authority and responsibilities of the TIGTA.

Treasury Directive 27-14 describes the organization and functions of the TIGTA's office. Under the supervision of the TIGTA are a Deputy Inspector General ("IG") for Tax Administration, a Counsel to the TIGTA, an Assistant IG for Audit, an Assistant IG for Investigation, four Regional Inspector Generals for Tax Administration, a Director-Office of Resources Management, a Director-Office Systems Development and Integration, a Director-Central Case Development Center, a National Director for Communication, Education, and Quality and other support staff as the TIGTA deems necessary.

Most of the staff of the former IRS Office of the Chief Inspector were transferred to the TIGTA. The IRS retains some personnel from Inspection to establish an internal audit function for management. The IRS also retains responsibility for IRS employee background investigations and physical security.

[151] The TIGTA did not assume responsibility for background checks and physical security. Treasury Order 115-01(1)(b) and (d)(6) (January 14, 1999).

[152] Treasury Order 115-01(1)(b) (January 14, 1999).

[153] Code sec. 7803(d)(3)(A).

D. Personnel Flexibility

IRS Reform Act

Congress believed that as part of restructuring the IRS, the Commissioner should have the ability to bring in experts and the flexibility to revitalize the current workforce.[154] In discussing the need for personnel flexibilities, the legislative history noted that existing personnel rules and procedures on hiring, evaluating, promoting, and firing employees are subject to extensive regulation. Further, according to the committee, the risk-averse nature of the IRS provided minimal incentive for managers or front-line employees to achieve the agency's mission, and stifled creativity, innovation, and quick problem resolution. The committee stated its intention that the personnel flexibilities lead to increased accountability by IRS managers and employees and to increased focus on IRS mission, goals, and objectives.[155]

Senator William V. Roth, Jr., Chairman of the Senate Finance Committee, spoke of giving the Commissioner "the tools necessary to bring the IRS into the next century."[156] Among the tools provided to the Commissioner, said Senator Roth, are "the wherewithal to transform the agency's workforce by providing bonuses and other incentives, and to sufficiently discipline employees whose inappropriate actions are a plague on the agency." Another change in personnel law emphasized by Senator Roth was the legislation's prohibition on "the use of enforcement statistics to evaluate any IRS employee, not merely front line collection employees and their supervisors." Senator Roth identified the use of enforcement statistics as "one of the most troubling issues raised in our September hearings."[157]

Congressman Rob Portman, co-chairman of the National Commission, noted the legislation enables the IRS to effect change throughout the agency by bringing in top experts, rewarding employees for taxpayer service and increasing the accountability of IRS employees and management:

> . . . the legislation reforms the IRS management structure to increase accountability and performance. It gives the IRS Commissioner new personnel flexibilities to drive change through the agency, such as the ability to bring in

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[154] Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 1998*, (JCS-6-98) November 24, 1998, at 45.

[155] Congressional Research Service, 98-4 GOV, *Implementation of P.L. 105-206: Personnel Management Flexibility for the Internal Revenue Service*, CRS-2 (March 11, 1999) (hereinafter "CRS Report") citing H. Rept. 105-364 Pt. I, at 45-46 (1997).

[156] CRS Report, at CRS-2.

[157] *Id.*, at CRS-3, citing 144 Cong. Rec. S4182-S4183 (daily ed. May 4, 1998).

experts from the private sector at a high level in the IRS, the ability to reward IRS employees for taxpayer service, and fire employees who provide inferior service. It also increases the accountability of IRS employees and managers in the collection area to stop the tactics of intimidation.[158]

The IRS Reform Act gave the IRS considerable authority beyond the personnel rules and procedures found in Title 5 relating to:

- Pay authority for critical positions.--Upon request of the Treasury Secretary, the Office of Management and Budget is authorized to set a basic salary rate for "critical pay positions" at levels higher than those generally authorized in the civil service laws for critical positions. These rates, including bonuses, awards and differentials, cannot exceed the rate of pay for the Vice President (currently $175,000).

- Streamlined critical pay authority.--The Treasury Secretary can designate positions, set pay and appoint up to 40 individuals to critical administrative, technical and professional positions. These appointments assist in recruiting and retaining individuals exceptionally well-qualified for a position. Compensation cannot exceed that of the Vice President.

- Recruitment, retention and relocation incentives.--The Treasury Secretary was given the authority to offer incentives for recruitment, retention, and relocation and to pay relocation expenses.

- Performance awards for senior executives.--The Treasury Secretary was also given greater authority to pay performance bonuses to members of the Senior Executive Service ("SES").

- New performance management system.--A new performance management system, stressing individual accountability is to be implemented. The Act prohibits the use of enforcement goal, quotas or statistics as the basis for awarding bonuses or merit pay.

- Workforce classification and pay.--The Secretary can combine grades and salary ranges to create broad banded systems for any or all of the IRS work force.

- Limited appointments to career reserved SES positions.--The IRS Reform Act permits the IRS to fill certain permanent positions with temporary employees. The Act broadens the definition of a career reserved position

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[158] CRS Report, at CRS-4, citing 144 Cong. Rec. H5354 (daily ed. June 25, 1998).

to include a limited emergency appointee. It also covers a limited term appointee who immediately upon entering the career reserved position, served under a career or a career-conditional appointment outside of the SES, or where OPM approved the limited emergency or limited term appointment in advance.

- Workforce staffing.--Candidates for positions can be selected from the highest quality category regardless of individual numerical rating. Further, the IRS can establish a three year probationary period when a shorter period is insufficient to evaluate an employee. The Secretary may also detail an employee without regard to the 120 day limitation.

- Streamlined demonstration project authority.--The IRS Reform Act permits the IRS to take a streamlined approach to conducting research and testing alternative management constructs. A demonstration project under this section would not be subject to the ordinarily lengthy approval process.

The Act defined specific acts of misconduct for which an IRS employee must be terminated.[159] In his sole discretion, the Commissioner may determine that there are

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[159] The acts or omissions that will subject an IRS employee to firing are:

(1) willful failure to obtain the required approval signatures on documents authorizing the seizure of a taxpayer's home, personal belongings, or business assets;

(2) providing a false statement under oath with respect to a material matter involving a taxpayer or taxpayer representative;

(3) with respect to a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service, the violation of–

(A) any right under the Constitution of the United States; or

(B) any civil right established under–

(i) title VI or VII of the Civil Rights Act of 1964;

(ii) title IX of the Education Amendments of 1972;

(iii) the Age Discrimination in Employment Act of 1967;

(iv) the Age Discrimination Act of 1975;

(v) section 501 or 504 of the Rehabilitation Act of 1973; or

(vi) title I of the Americans with Disabilities Act of 1990;

(4) falsifying or destroying documents to conceal mistakes made by any employee with respect to a matter involving a taxpayer or taxpayer representative;

(continued...)

mitigating factors which weigh against terminating an employee. This discretionary authority cannot be delegated.

Congress also gave the IRS the ability to offer incentives for voluntary separation (buyout authority).

The Act requires the IRS to implement a training program for its employees within 180 days of enactment. The IRS is to submit an employee training plan to Congress.

Implementation efforts

Commissioner Rossotti indicated that he has used the additional personnel flexibility to hire persons from outside the agency, particularly in the information systems area. The IRS is currently recruiting for the heads of three operating divisions.

With respect to employee evaluations, the Commissioner indicated that all of the prohibited measurements have been withdrawn. In their place, the IRS has created "Balanced Measures." It uses a three-part system of customer satisfaction, business results that have a quality and quantity measure, (but not enforcement revenues), and an employee satisfaction

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[159](...continued)

(5) assault or battery on a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service, but only if there is a criminal conviction, or a final judgment by a court in a civil case, with respect to the assault or battery;

(6) violations of the Internal Revenue Code of 1986, Department of Treasury regulations, or policies of the Internal Revenue Service (including the Internal Revenue Manual) for the purpose of retaliating against, or harassing, a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service;

(7) willful misuse of the provisions of section 6103 of the Internal Revenue Code of 1986 for the purpose of concealing information from a congressional inquiry;

(8) willful failure to file any return of tax required under the Internal Revenue Code of 1986 on or before the date prescribed therefor (including any extensions), unless such failure is due to reasonable cause and not to willful neglect;

(9) willful understatement of Federal tax liability, unless such understatement is due to reasonable cause and not to willful neglect; and

(10) threatening to audit a taxpayer for the purpose of extracting personal gain or benefit.

measure.[160] The IRS plans to implement the measures for at least part of the organization this year. Managers are currently being trained in the new system. For front-line employees the desired activities and behavior consistent with the strategic goals[161] are incorporated into the "critical elements of each employee's position descriptions and should be evaluated by the manager based on informed observation of that employee's job performance."[162] Thus, quantitative measurements are not used to evaluate performance, except in certain submissions processing functions.[163]

The IRS recently outlined how it plans to implement the IRS Reform Act mandatory firing provision. Notice 99-27 outlines the basic principles for IRS will follow in administering the provision. The IRS will apply existing personnel law and procedures, including the current personnel definition of employee. It will apply the law only to those employee acts or omissions that have a clear nexus to an employee's position at the IRS and that are undertaken with some degree of intent. The IRS determined that an administrative or judicial determination is final only if an employee is granted full rights to participate as a party to the action or proceeding. It also determined that the provision will apply only to those acts or omissions occurring after July 22, 1998, the date of the IRS Reform Act's enactment.

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[160] FY 2000 Justification at SD-19.

[161] These goals are: service to <u>each</u> taxpayer, service to <u>all</u> taxpayers, and "productivity through a quality work environment.

[162] *Modernizing America's Tax Agency* at 44.

[163] *Id.*