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 3, 2000

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 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 Chairman of the Joint Committee on Taxation ("Joint Committee"), and is to take place before June 1 of each calendar year 1999 through 2003.[5] The joint review is to address the strategic plans and budget of the IRS and such other matters as determined by the Chairman of the Joint Committee.

The IRS Reform Act also requires the Joint Committee 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 1999 through 2003.[6]

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[1] Pub. L. No. 105-206 (July 22, 1998).

[2] H.R. Rep. No. 105-364, Pt. 1, at 34-35 (1997) and S. Rep. No. 105-174, at 11-12 (1998).

[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, *Highlights of 1998 Tax Changes*, Publication 553 (December 1998), 20-25.

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

[5] The first joint review was held on May 25, 1999. A transcript of the joint review is published in Joint Committee on Taxation, *Strategic Plans and Budget of the Internal Revenue Service, 1999, May 25, 1999* (JCS-4-99).

[6] Sec. 8022(3)(C). The report relating to fiscal year 2000 is found at *Report of the Joint*
(continued...)

Pursuant to the IRS Reform Act, a joint review of the strategic plans and budget of the IRS for fiscal year 2001 has been scheduled for May 3, 2000. This document,[7] prepared by the staff of the Joint Committee, contains the report of the Joint Committee relating to the IRS as required by the IRS Reform Act.

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[6](...continued)
Committee on Taxation Relating to the Internal Revenue Service as Required by the IRS Reform and Restructuring Act of 1998 (JCX-24-99), May 20, 1999.

[7] 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 Reform and Restructuring Act of 1998* (JCX-46-00), April 28, 2000.

I. IRS MISSION STATEMENT AND OVERVIEW OF IRS STRATEGIC PLANS

A. Mission Statement and Statement of 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.[8] Prior to its revision, the IRS mission statement focused on collecting the proper amount of tax.[9]

The new mission statement, announced by the Commissioner in September 1998, has 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.[10] The first goal is to provide top quality service to <u>each</u> taxpayer. The second goal is to provide top quality service to <u>all</u> taxpayers. The third strategic goal is to increase productivity within the IRS by providing IRS employees with a quality work environment. The IRS describes the process of change necessary to meet its strategic goals and fulfill its new mission statement as "modernization."

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[8] IRS Reform Act sec. 1002.

[9] The IRS 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.

[10] The strategic direction and plans of the IRS are described in brief in IRS Document 10968 (Rev. 01-2000), *Fiscal Year 2001 Congressional Justification* (February 7, 2000) (hereinafter "FY 2001 Justification") at SD-11 through SD-17, and in detail in IRS Publication 3349 (Rev. 1-2000), *Modernizing America's Tax Agency* (2000) (hereinafter "Modernizing America's Tax Agency"). During the current fiscal year, the IRS intends to update its strategic plan, as originally sent to Congress in 1997 (and revised through an interim update included in the FY 2000 Annual Performance Plan) to reflect the reorganized IRS. FY 2001 Justification at SD-11. The FY 2001 Justification contains the FY 1999 Program Report, the FY 2000 Final Performance Plan Explanation, and the FY 2001 Proposed Performance Plan Explanation as required by the Government Performance and Results Act of 1993.

B. Providing Top Quality Service to Each Taxpayer

The 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. Regardless of the type of interaction with taxpayers (e.g., providing forms, advising taxpayers about their accounts with the IRS, or engaging in the examination function), the IRS recognizes that it must have a clear understanding of both the law as well as the facts and circumstances surrounding a particular taxpayer's case to ensure the proper application of the tax law to the taxpayer. The Commissioner has stated that this goal also requires that "taxpayers should always be treated professionally and courteously and with full consideration of their rights."[11]

Success in achieving the first strategic goal will be measured by the IRS by the response of taxpayers to the service they receive from the IRS, including taxpayer responses to surveys, comparison of ratings given the IRS by taxpayers with other private and public sector institutions, and taxpayer complaints. The IRS does not yet have performance measures in place with respect to this strategic goal, but expects to begin work on such measures in 2000.

In the interim, the IRS reports that in recent survey results from the University of Michigan, known as the American Customer Satisfaction Index, the IRS generally ranks below the private sector, as well as below certain public administrative or government functions. The electronic filing program received a higher ranking than the IRS generally.[12] Another survey, performed by the Roper opinion research organization, shows that the IRS was once comparable to that of other government agencies. During the 1980s, the ratings of the IRS and other agencies declined substantially. In the 1990s, the ratings of other agencies improved, while that of the IRS continued to decline, reaching an all-time low in 1998, before a slight improvement in 1999.[13]

The IRS has produced better customer satisfaction in particular areas. For example, according to the IRS, taxpayers attending Problem Solving Days rated the IRS 6.5 on a scale of 7.0, regardless of whether the taxpayer achieved the desired result.[14]

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[11] Statement of Charles O. Rossotti, Commissioner of Internal Revenue Service, before the Senate Finance Committee (April 14, 1999).

[12] The survey results are reported in *Modernizing America's Tax Agency* at 5-6.

[13] *Id.* at 6.

[14] *Id. See also* General Accounting Office, *Tax Administration: IRS' Problem Solving Days* (GAO/GGD-99-1, October 16, 1998) and Internal Revenue Service, *National Taxpayer Advocate Annual Report to Congress for Fiscal Year 1999*, Publication 2710 at V-12-13 (December 1999).

C. Providing Top Quality Service to All Taxpayers

Objective

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 goal is to ensure that the tax law is applied with fairness and integrity so that taxpayers who fail to comply with the tax laws do not burden those who comply.

Measuring success; compliance and enforcement

The IRS will measure success in this goal by the total collection percentage, that is, the fraction of taxes that are actually paid as compared to those that would be paid if everyone paid what was due under the law. Success in this area is also measured by the IRS in terms of uniformity of compliance among various segments of the population.[15]

One issue that arises with respect to this goal is how to measure compliance. There is currently no reliable measure of compliance. As discussed more fully below, a key issue in measuring the success of the IRS is developing such a measure. In the meantime, the IRS has extrapolated from previous studies of noncompliance. The IRS estimates that noncompliance of all kinds equated to about $195 billion in fiscal year 1997, which is approximately $1,600 per individual tax return.[16]

The IRS also reports that previous studies indicate that compliance is uneven among sectors. For example, taxpayers who have most of their income reported to the IRS by third parties are generally more compliant than those who report most of their income to the IRS themselves. The IRS also reports that collections of corporate income taxes decreased by two percent in fiscal year 1999 over the previous fiscal year,[17] even though corporate profits rose by approximately 3.6 percent at the same time. One of the reasons attributed by the IRS to this decline is the proliferation of corporate tax shelters.[18]

Another issue that arises with respect to measuring IRS success with respect to this goal is the difference between compliance and enforcement and the emphasis that should be placed on

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[15] *Modernizing America's Tax Agency* at 7.

[16] *Id.*

[17] *Id.*

[18] *Id.* For a discussion of measuring corporate tax shelter activity, *see Testimony of the Staff of the Joint Committee on Taxation Concerning Interest and Penalties and Corporate Tax Shelters Before the Senate Committee on Finance* (JCX-23-00) March 8, 2000, at 15-18.

each. Enforcement generally refers to actions taken by the IRS to bring taxpayers into compliance with the law, such as audits or levies. Since the passage of the IRS Reform Act, the number of enforcement actions has declined substantially. The IRS reports that the fraction of individual returns audited in face-to-face audits has declined about 40 percent and the number of collection cases closed has declined a similar amount.[19] The IRS attributes this decline to continued decline in staff due to budget constraints and a substantial increase in the amount of time required per case due to provisions in the IRS Reform Act.[20]

The IRS acknowledges that enforcement is essential, but believes that the goal should be increasing overall compliance rather than simply increasing enforcement revenue. The IRS reports that 98 percent of the tax revenues received are paid through voluntary compliance rather than through enforcement actions. Historically, the IRS placed great emphasis on enforcement activities, partly because enforcement revenue is easy to measure. Such emphasis, and problems taxpayers reported with IRS enforcement activities, was one of the issues sought to be addressed by the IRS Reform Act. The IRS hopes to increase voluntary compliance through such actions as better and more targeted taxpayer education, better reporting, voluntary agreements, improved regulations, and earlier interventions through notices and phone calls. [21]

D. Productivity Through a Quality Work Environment

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 notes 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 is working to create a positive work place where there exist equal opportunity, recognition of employee performance, and no artificial barriers to advancement. The IRS measures success in this goal by employee satisfaction, as reflected in employee surveys.[22]

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[19] *Modernizing America's Tax Agency* at 7.

[20] Some have attributed the decline to reallocation of staff to customer service. The IRS reports that such reallocations amount to less than 3 percent of compliance resources.

[21] *Id.* at 8.

[22] *Id.* at 9.

II. IMPLEMENTATION OF IRS STRATEGIC GOALS

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. 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.

The IRS recognizes that achieving its modernization plan will take a number of years and requires an integrated approach because of the interdependency of the various components of the process. For example, full implementation of the planned changes in business practices is dependent on changes in organizational structure and technology modernization.

A. Revision of IRS Business Practices

<u>In general</u>

The way the IRS interacts with taxpayers is defined by its business practices.[23] Included in the IRS 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.

<u>Preventing taxpayer problems or addressing them as early as possible</u>

The IRS identifies three stages of activities when it deals with taxpayers: (1) prefiling; (2)

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[23] Many IRS practices are in the Internal Revenue Manual and various rulings and regulations. *See also Modernizing America's Tax Agency* at 17-32.

filing; and (3) postfiling.[24] 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.[25]

The IRS estimates that the majority of IRS resources are being used to address issues that arose three to seven years ago. For example, there can be a significant delay between the time a taxpayer is determined to owe taxes and the commencement of IRS collection actions. In general, the private sector attempts to avoid such delays. The IRS reports that data from the commercial sector indicates that the chances of successful collection decline rapidly with time, dropping to 56 percent after six months of delinquency.[26]

The IRS anticipates that significant increases in both service and compliance will occur by shifting its focus to taxpayers' prefiling activities and addressing issues more rapidly. The IRS also anticipates that, if compliance errors and problems are addressed early, less burden will be imposed on the taxpayer.

<u>Improving communications with taxpayers</u>

The IRS communicates with taxpayers through a variety of methods including the mail, the telephone, the Internet, and in-person meetings. The IRS currently provides 484 different tax forms and 105 publications. According to the IRS, in 1999, it mailed over 100 million tax packages and postcards to taxpayers and distributed an additional 650 million forms and publications, including over 57 million downloaded from the IRS site on the World Wide Web. During that year, the IRS also mailed taxpayers 105 million notices, received between 20 and 30 million incoming pieces of correspondence, received 143 million incoming phone calls on toll-free numbers, and served over ten million taxpayers at its walk-in sites. Over 20,000 employees are dedicated solely to these tasks, and, in total, over 70,000 employees regularly communicate with taxpayers.[27] The IRS recognizes the volume of its communications with taxpayers and has focused on ways to improve its communication methods.

The IRS has recently instituted or expanded programs aimed at improving taxpayer communications, such as expanding telephone service to 24 hours a day, 7 days a week, expanding walk-in hours, increasing use of technology, and revising notices, forms, and publications. Among other technology-based innovations, the IRS has a variety of Internet-

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[24] *Id.* at 17.

[25] *Id.*

[26] *Id.* at 19.

[27] *Id.* at 20.

based programs.[28]

Although the IRS has made progress in the area, it acknowledges that problems still exist and significant improvements can still be made.[29]

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 enacted in the IRS Reform Act. These issues are discussed in detail in Part IV. D below.

Broadening the use of electronic tax administration

Electronic filing is generally thought to have advantages over paper returns for both the IRS and taxpayers. According to the IRS, taxpayers who file electronically are able to obtain their tax refunds faster than taxpayers who file paper returns.[30] In addition, electronic filing is more accurate than paper filing. The error rate associated with processing paper returns is approximately 20 percent, half of which is attributable to the IRS and half to errors in taxpayer data.[31] Because electronically filed returns usually are prepared using computer software programs with built-in accuracy check, undergo pre-screening by the IRS, and experience no key punch errors, electronic returns have an error rate of less than one percent.[32] The GAO has commented that maximizing electronic filing is important to the IRS because the agency is "drowning in paper."[33] Because of the advantages of electronic tax administration, the IRS

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[28] For a detailed discussion of IRS information services, see Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the House Ways and Means Subcommittee on Oversight (March 28, 2000)(hereinafter "Rossotti House Oversight Testimony") at 7-19. Communication issues arising in relation to the 2000 filing season are discussed in Part , below.

[29] *Modernizing America Tax Agency,* at 20.

[30] *See, e.g.,* Internal Revenue Service, *Electronic Tax Administration-A Strategy for Growth,* Publication 3187 (Rev. 11-99) at 3.

[31] *See* Internal Revenue Service, *IRS e-file Using a Personal Computer,* <http://www.irs.gov/elec-sus/il-txpyr.html>.

[32] *Id.* at 11.

[33] General Accounting Office, *IRS Modernization: Business Practice, Performance Management, and Information Technology Challenges* (GAO/T-GGD/AIMD-00-144, April 10,
(continued...)

Reform Act provides 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."[34]

Despite the benefits of electronic filing, 77 percent of individual returns are still filed on paper.[35] The IRS has taken steps to try to increase the attractiveness of electronic filing. For example, one of the problems identified with electronic filing is that it is not truly paperless because of the need to file paper W-2s and a signature document. To address these concerns, since 1996 the IRS has been conducting various pilot programs to determine how best to eliminate the paper associated with electronic returns.[36] The IRS is also taking steps to try to dispel taxpayer perceptions that electronically filed returns are more likely to be audited.[37]

The IRS has developed a strategic plan to implement the goal set forth in the IRS Reform Act. The IRS strategic plan recognizes that reaching the congressionally-mandated goal will require 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.[38]

The IRS also hopes to improve electronic business practices in addition to filing through the use of electronic communications. Eventually, the IRS anticipates that Internet communications will be used for a variety of purposes, such as resolving taxpayer account issues and facilitating the resolutions of examinations.[39] To this end, in 1999, the IRS begun a pilot project to communicate taxpayer account data over the Internet.

Leveraging IRS resources through effective partnerships

The IRS intends to place greater emphasis on working in partnership with those

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[33](...continued)
2000) (hereinafter "GAO Report 00-144") at 5.

[34] IRS Reform Act sec. 2001.

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

[36] GAO Report 00-144 at 5-6.

[37] Internal Revenue Service, *Electronic Tax Administration - A Strategy for Growth*, Publication 3187 (Rev. 11-99) at 17.

[38] *Modernizing America's Tax Agency* at 21.

[39] *Id.* at 22.

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, 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.[40] In the future, the IRS expects to place greater emphasis on working in partnership with all the groups to solve taxpayer issues and improve taxpayer education and assistance.

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 business income; 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.[41] The IRS structural reorganization based on taxpayer needs is discussed in detail in Part II. B., 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 has 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

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[40] *Id.* at 22-23; *See also* Rossotti House Oversight Testimony at 11, 16.

[41] *Modernizing America's Tax Agency* at 23-24.

working out a payment program that addresses a particular taxpayer's payment problem.[42] The IRS is developing a risk-based examination model to implement this strategy.

Both the IRS and the GAO have noted that effective risk-based compliance techniques are dependent upon quality, centralized data systems that the IRS does not currently have, and that lack of such systems will hinder IRS efforts in this area.[43]

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.

The IRS cites as an example of this approach its Earned Income Tax Credit Program, which combines outreach to practitioners and compliance checks.[44] In addition, based on the success with Problem Solving Days, the IRS is establishing a new Tax Resolution Representative ("TAR") position. At Problem Solving Days, the IRS brought employees from various functional groups to resolve taxpayers' problems. Similarly, TARs are to provide prefiling assistance and education and postfiling compliance support.

The GAO believes that the TAR position fits clearly with the strategic goal of improving service to each taxpayer. The GAO finds that successfully implementing the TAR program will require significant training and enhanced information systems.[45]

Near-term improvement priorities

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.[46] At the same time, an Executive

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[42] *Id.* at 23.

[43] *Id.* at 25; GAO Report 00-144 at 7.

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

[45] GAO Report at 00-144 at 4.

[46] *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
(continued...)

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.[47] At that time, the IRS had received nearly 5,000 recommendations all aimed at improving customer service. By January 1999, this list was reduced to 157 primary customer service initiatives to be managed by TTSI in the short term.

The GAO reviewed the progress of 25 specific customer service improvement initiatives identified as of January 1999. 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 for the customer service initiatives and for measuring the results of the initiatives as they apply to the IRS's customer service objectives.[48]

The IRS reports that many of the higher profile initiatives were implemented or partially implemented in 1999, and that 12 initiatives were added and six expanded for 2000.[49]

B. IRS Reorganization

<u>Background</u>

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 administered the entire spectrum of taxpayers by defined geographical boundaries. Four regional offices presided 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

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[46](...continued)
99-88") at 4-5.

[47] IRS Document 10968 *Fiscal Year 2000 Congressional Justification*, (February 1, 1999) at SD-21 - SD-22.

[48] GAO Report 99-88 at 4, 8.

[49] *Modernizing America's Tax Agency* at 27. A list of the initiatives and a progress report may be found in *Modernizing America's Tax Agency* at 28-31.

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.[50]

<u>Description of reorganization plan and status report</u>

The Commissioner's reorganization plan centers on taxpayer needs rather than geographical location. The plan eliminates regional and district offices. Four operating divisions comprise the centerpiece of the plan: Wage and Investment Income,[51] Small Business and Self-

[50] IRS Reform Act sec. 1001.

[51] 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. This division will serve approximately 116 million taxpayers, including those who file jointly, accounting for 90 million returns with wage and investment income only. This division will have its headquarters in Atlanta, Georgia. Internal Revenue Service, *IRS Organization Blueprint,* Document 11052 (5-1999)(hereinafter "Organization Blueprint") at 20, 24.

Employed,[52] Large and Mid-Size Business,[53] and Tax Exempt and Governmental Entities.[54] Each division will have its own functions for education, communication, customer account services, and compliance.

In addition to the four operating divisions, the new organization structure includes four functional organizations responsible for specific issues and cases. The Taxpayer Advocate and Appeals provide assistance to taxpayers independent of the operating divisions.[55] The national office will be smaller than previously and is responsible for setting broad policy, reviewing the plans and goals of the business units and developing major improvement initiatives.[56] Counsel will provide legal interpretation of the revenue laws.[57] The Criminal Investigation Division investigates criminal tax matters.[58] Following the recommendations of a year-long study, the Criminal Investigation Division will be organized as a separate line unit reporting directly to the

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[52] The Small Business and Self-Employed division will service approximately 33 million individual taxpayers who file Schedules C (Profit or Loss From Business), E (Supplemental Income and Loss), or F (Profit or Loss from Farming), or Form 2106 (Employee Business Expenses). It also includes approximately 7 million partnerships, S corporations and C corporations with assets of $5 million or less. It will also have responsibility for estate and gift taxpayers, fiduciary returns, and all individual taxpayers with international returns. *Id.* at 42-43. This division will have its headquarters in Washington, D.C.

[53] 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. This division is organized by industry rather than geography. Each industry will have a separate headquarters. *See Organization Blueprint* at 68-71. This division will have its headquarters in Washington, D.C.

[54] The Tax Exempt and Governmental Entities division includes tax-exempt organizations, employee plans, and governmental entities. Employee Plans comprises private and public retirement plans that control approximately 4.1 trillion in assets. The majority of those plans have less than 250 participants. Exempt Organizations includes over 1.5 million tax-exempt organizations and an estimated 350,000 religious organizations. Governmental Entities includes 270,000 outstanding tax-exempt bond issuances, 86,000 Federal, State, and local entities and 559 Federally recognized Indian tribes. *Id.* at 74. This division has its headquarters in Washington, D.C.

[55] *Id.* at 10, 11.

[56] *Id. at 8*

[57] *Id.* at 10.

[58] *Id.* at 11.

Commissioner and Deputy Commissioner.[59] Two internal organizations, Information Systems and Agency-Wide Shared Services, provide common services internally (e.g., facilities management, personnel services and procurement).[60]

The reorganization is being staged in phases:[61]

> Phase I: Identifying and validating the major components of the new organization's structure.
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> 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.[62] Phase II A (blueprints) was completed in Spring 1999 and culminated in the publication of the Organization Blueprint. Phase III is currently underway.

The IRS has begun implementing parts of the new organization. In the first quarter of fiscal year 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 Commissioners and Deputy Commissioners for all four Operating Divisions are now

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[59] *Modernizing America's Tax Agency at 37-38. See also* Internal Revenue Service, *Review of the Internal Revenue Service: Criminal Investigation Division*, Publication 3388 (April 1999).

[60] *Id.*

[61] *Organization Blueprint* at 7-8.

[62] *Id.* at 7.

in place.[63] The Tax Exempt and Government Entities division has been in operation since December 1999.[64] The Large and Mid-Size Business Division is scheduled to begin operations in June 2000. The Wage and Investment and Small Business/Self-Employed Divisions are expected to be operational in the fall of 2000.[65]

C. Development of Organizational Performance Measures

Historically, enforcement revenue has been a key measure of success at the IRS. The IRS Reform Act sought to change this focus through provisions such as the mandate for a new IRS mission statement. Accordingly, as part of efforts to implement the new IRS mission and the Commissioner's modernization plans, the IRS is changing its organizational performance measures to 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.[66] As one way of avoiding prior misuses of enforcement statistics as a performance measure, quantitative measures will generally not be used at the individual employee level.[67] Appropriate performance measures are needed to determine how to manage the new IRS, gauge progress toward the IRS goals, as well as to assist in IRS oversight. Performance measures can also help the IRS develop compliance initiatives and develop customer assistance products.

In September 1999, a balanced measures regulation was issued to formally establish the new performance management system.[68] The IRS completed development of balanced measures for the Examination, Collection and three Customer Service product lines in 1998. In 1999, additional balanced measures were approved for Tax Exempt and Government Entities, Large and Mid-Size Businesses, Appeals, the Office of the Taxpayer Advocate, Research, Statistics of Income and additional Customer Service product lines. Other measures are expected to be approved in 2000 for Information Systems, Criminal Investigation, Counsel, Submission

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[63] Statement of Charles O. Rossotti, Commissioner of Internal Revenue, before the Senate Finance Committee (February 2, 2000) (hereinafter "Rossotti Senate Finance Testimony") at 14.

[64] *Id.*

[65] *Id.*

[66] *See Modernizing America's Tax Agency* at 47-52.

[67] *Id*. at 49. Employee performance measures are discussed further in Part IV. E., below.

[68] The regulation is reproduced in Appendix 2 of *Modernizing America's Tax Agency.*

Processing and Agency Wide Shared Services.[69]

The Commissioner has emphasized that, while enforcement measures are necessary, enforcement revenues are not an appropriate performance measure. However, overall revenue collections, compared with revenues due under the law, is a valid measurement.[70] The Commissioner has also acknowledged that developing a measure of overall compliance is essential. 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.[71]

The GAO agrees that a balanced set of performance measures are key to achieving the IRS mission and also concurs that measuring voluntary compliance is critical to assessing IRS performance.[72] 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.[73] 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

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[69] *Id.* at 51.

[70] *Id.* at 7-8, 49-50.

[71] Modernizing America's Tax Agency at 44-45.

[72] GAO Report 00-144 at 5, 9, 10-11. *See also*, 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.

[73] 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* sec. 7602(e).

returns over a period of several years.[74]

The GAO has also commented that it is not clear that IRS employees fully understand the IRS mission statement, particularly the idea that customer service and compliance can be mutually supportive. The GAO believes that balanced performance measures, including a measure of compliance, can help employees better understand the relationship between customer service and compliance.[75]

The IRS Office of Program Evaluation and Risk Analyses is working with a contractor to determine how to measure compliance and develop a compliance strategy. This effort is reported to be still in its early stages.[76]

D. Technology Modernization

<u>Year 2000 compliance</u>

The Commissioner has reported that the IRS experienced a smooth transition into the year 2000. Over the weekend between December 29, 1999, and January 3, 2000, the IRS experienced fewer problems than in a normal year. There were also no problems associated with the leap year on February 29, 2000. The IRS does not expect any future problems due to the year 2000 conversion. The Commissioner attributes this success to the IRS's comprehensive planning and preparations over the past three years.[77]

<u>Systems modernization</u>

IRS systems modernization is a necessary element to achievement of IRS strategic plans. The work required to modernize IRS systems is substantial. As 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-year old fundamentally deficient foundation that cannot provide accurate up-to-date information about taxpayer accounts."[78]

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

[75] GAO Report 00-144, at 9, 11.

[76] *Id.* at 11.

[77] Rossotti House Oversight Testimony at 2. Pages 2-3 of this testimony contain a summary of the IRS Year 2000 readiness efforts.

[78] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the (continued...)

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.[79] 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.[80] 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 and integrate TSM without expanded use of external expertise.[81] In 1997, GAO again included IRS systems modernization on its list of "high-risk" areas.

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[78](...continued)
Subcommittee on Oversight, House Ways and Means Committee (April 13, 1999) at 18.

[79] 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).

[80] 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).

[81] 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.

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; (2) business requirements; (3) functional and technical architectures; and (4) a sequencing plan. The 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.[82] 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 Chief Information Officer acknowledged that essential elements were missing from the Blueprint, and stated that he had been taking steps to address the missing elements.[83]

The IRS fiscal year 1998 appropriation included $325 million for information technology[84] 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.[85] The fiscal year 1999 information technology appropriation included similar restrictions.[86] The fiscal year 2000 appropriation did not include an amount for information technology.

In December 1998, the IRS awarded its prime systems integration services contract ("PRIME"). In mid-1999, the IRS submitted is first expenditure plan requesting approximately $35 million for modernization initiatives through October 1999. The GAO reported that the initial expenditure plan was an appropriate first step toward successful systems modernization

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[82] 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).

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

[84] The account from which systems modernization is to be funded is call the Information Technology Investments Account ("ITIA").

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

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

and satisfied the conditions set forth by the Congress for use of the funds.[87]

A second expenditure plan was not finalized before the original $35 million was obligated. In December 1999, the IRS requested approval to obligate $33 million as a stopgap funding measure until submission of the next expenditure plan.[88] The GAO reviewed this request and raised concerns regarding the lack of progress in completing and implementing certain management controls and the risks associated with the plans to develop certain systems without such controls in place.[89] The IRS request was approved, and the IRS was directed to take actions to address the concerns raised by the GAO.

The GAO reports that the IRS has scaled back its new system development efforts, recognizing that it must first put in place the requisite modernization management capability.[90] On March 9, 2000, the IRS submitted a new expenditure plan requesting obligation of approximately $176 million in funds. The plan includes provisions to address management weaknesses previously identified and emphasizes completing the enterprise architecture, implementing the enterprise life cycle, and rescheduling projects to avoid problems.

The GAO has noted that the March 9, 2000, plan addresses some longstanding weaknesses. However, the GAO will continue to designate IRS systems modernization as a high-risk program until management and technical weaknesses have been corrected.[91]

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[87] General Accounting Office, *Tax Systems Modernization: Results of Review of IRS' Initial Expenditure Plan* (GAO/AIMD/GGD-99-206)(June 1999) at 2-3.

[88] GAO Report 00-144 at 12.

[89] *Id.*

[90] *Id.* at 13.

[91] *Id.*

III. DESCRIPTION AND ANALYSIS OF THE IRS BUDGET REQUEST FOR FISCAL YEAR 2001

A. In General

For fiscal year 2001, the IRS budget request, not including the funding and staffing for the earned income tax credit ("EITC") program, totals $8.841 billion and 98,051 full-time equivalent ("FTE") positions. The fiscal year 2001 budget request reflects a $769 million increase and an increase of 2,284 in FTEs over the budget enacted for fiscal year 2000; this difference includes a supplemental appropriation for fiscal year 2000 of $40 million as part of efforts to stabilize the IRS workforce.[92] The increase in the budget request is due to a number of increases and decreases, including increases for (1) an initiative called Staffing Tax Administration for Balance and Equity ("STABLE"), (2) information systems and technology investments, and (3) organizational modernization.[93] The IRS has indicated that it requires this increase to deliver on the 98 mandates contained in the Reform Act of 1998, to manage organizational modernization, and to invest in critically needed information technology.[94]

The IRS budget request includes $145 million and 2,082 FTEs for the EITC compliance initiative, which reflects a $1 million increase from fiscal year 2000 due to adjustments necessary to maintain current levels.[95] The EITC program is funded outside the discretionary spending caps. Fiscal year 2001 is the fourth 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.

The IRS's overall budget request for fiscal year 2001, including funding and staffing for the EITC, totals $8.986 billion and 100,133 FTEs.

A table showing the IRS fiscal year 2001 budget request, broken down by category, compared to the proposed fiscal year 2000 operating level is contain in the Appendix.

The GAO has reviewed the IRS fiscal year 2001 budget request. While generally supportive of the IRS request, the GAO recommends that the Congress not approve the requested

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[92] FY 2001 Justification at SD-18.

[93] General Accounting Office, *Tax Administration: IRS' 2000 Tax Filing Season and Fiscal Year 2001 Budget Request*, (GAO/T-GGD)/AIMD-00-133, March 28, 2000) (hereinafter "GAO Report 00-133") at 10.

[94] FY 2001 Justification at SD-18.

[95] *Id.* at EITC-7.

increase for telephone service and the funding for the multiyear technology capital account. The GAO also notes that some of the items requested in the budget may lead to increases in funding in future years.[96] These matters are discussed in more detail below.

The GAO has also made a general comment that several portions of the IRS's budget request do not contain a clear link between the requested funding and the expected results. The GAO noted that an agency's performance goals are of little value to the Congress without a connection to the resources sought. The GAO believes that the IRS could make its budget requests more useful to the Congress by doing a better job of making that connection.[97]

B. Funding to Maintain Current Operations and Service Levels

In general

The IRS believes that, in order to implement the mandates from the IRS Reform Act, it must modernize its organizational structure and technological base and maintain its current level of operations.[98]

Funding to maintain current service level

The IRS has requested an increase of $336 million to maintain current service levels, which includes funding for pay raises, benefits, and non labor inflation increases.[99] The IRS notes that it is a labor-intensive organization, which must have a stable workforce to enable it to carry out its operations. The IRS finds that in order to maintain its current service level and operations, carry out a successful tax filing season, oversee tax administration programs, and implement organizational modernization, it must have the resources to pay for the inflationary cost of statutory pay and other mandatory increases.[100] The IRS reports that funding of the current services level request, together with funding for the STABLE project will also enable the IRS to meet the need for critical skilled positions for which no hiring has been done since 1995 due to funding constraints.[101]

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[96] GAO Report 00-133 at 1-2.

[97] *Id.* at 2, 10.

[98] FY 2001 Justification at SD-19.

[99] *Id.*

[100] *Id.* at 20.

[101] Rossotti House Oversight Testimony at 24.

STABLE

The STABLE initiative is designed to stabilize and strengthen tax compliance and customer service. For this program, the IRS has requested $144 million and 1,633 FTEs for fiscal year 2001 and $39.8 million and 301 FTEs for a fiscal year 2000 supplemental appropriation which would allow the hiring of 301 FTEs in fiscal year 2000. The IRS notes that this would ensure that most training of new hires would be undertaken in fiscal year 2000, allowing the impact of these new hires to be fully maximized in fiscal year 2001.[102] The STABLE initiative includes staffing increases across the IRS in the following areas: submission processing, telephone and correspondence, document matching, examination, collection, and tax-exempt and government entities.[103]

The GAO has noted that the IRS budget request for STABLE does not reflect FTEs for an entire fiscal year, because the budget request assumes that many new hires will not be brought on board until April 1, 2001. Thus, if the initiative is funded and the IRS implements it as intended, the IRS can be expected to seek a further increase in fiscal year 2002 to fund additional staffing costs.[104]

The GAO found that many aspects of the STABLE initiative are appropriate, but raised concerns about the part of the initiative that would increase staffing for the toll-free telephone assistance program. Under this part of the program, the IRS has requested 300 FTEs[105] to increase telephone service.

According to the GAO, the IRS has not provided justification for the proposed toll-free telephone service staffing increase, nor sufficient detail as to how it determined the size of its proposed staff increase or how such increase would affect service. Moreover, the GAO observed that the IRS is unable to project the level of service it can expect from its current staff level; thus, it is unclear how the IRS could project the level of service it would receive from an increase in

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[102] FY Justification at SD-21.

[103] *Id.*

[104] GAO Report 00-133 at 12. The GAO has questioned whether the IRS will in fact be able to implement STABLE as intended. The IRS has reported to the GAO that they expect to fill all of the requested positions. *Id*.

[105] The STABLE initiative includes 500 additional FTEs for the IRS's toll-free telephone service; 200 of these FTEs will be used to hire Customer Service staff to replace those 200 FTE Examination staff that have been detailed to take telephone calls. Thus, the GAO views the STABLE initiative as including 300 FTEs to increase the number of individuals devoted to telephone service and the remaining 200 FTEs as an increase in Examination staff. *Id.* at 21-22.

staff.[106] The GAO has noted that the IRS has shown that it may be able to provide better service with fewer staff than previously. For example, the level of service during the current filing season improved significantly over the last year (63 percent as of March 4, 2000, as compared to 43 percent as the same time in 1999), even though fewer staff were allocated this year.[107]

The GAO recommends that Congress consider withholding approval of the request relating to the toll-free phone service until the IRS provides additional supporting information regarding the request.

Electronic tax administration

As discussed above, the IRS Reform Act mandates that 80 percent of all tax and information returns be filed electronically by 2007. The IRS is requesting an increase of $3 million for fiscal year 2001 for electronic tax administration so it may continue progress toward achieving this goal.[108] The IRS has indicated that funding will be used to expand marketing efforts on the benefits of filing electronically (e.g., television, radio, and print media advertising), as well as conducting research to ensure that electronic tax administration products and services meet customers' needs.[109]

Contract management

The IRS believes that its capability to use contractual support is vital to basic activities that support the IRS organizations that are implementing the mandates of the IRS Reform Act and overall modernization. Thus, the IRS has requested an increase of $44 million to fund necessary contracts and general support operations, mandatory contractual arrangements, and necessary outside expertise.[110]

C. Funding to Support Organizational Modernization and Implementation of the IRS Reform Act

In general; organizational modernization

The IRS has requested $182 million to cover expenses related to the reorganization of the

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[106] *Id.*

[107] *Id.*

[108] Rossotti House Oversight Testimony at 25; FY 2001 Justification at SD-22.

[109] FY 2001 Justification at SD-22.

[110] *Id.*

IRS. Of the $182 million, $140 million is base funding from fiscal year 2000, which will continue to cover the general expenses of the reorganization, such as buyouts, recruitment, relocations, employee training, equipment, services and supplies, telecommunications moves and installations, and modifications of information systems to the new organizational structure.[111] The remaining $42 million is requested for fiscal year 2001.[112]

The IRS has indicated that costs for this purpose will peak in fiscal year 2001, decline in fiscal year 2002, and end in fiscal year 2003.[113] The types of expenditures related to this funding request include design work, space alterations, and contract movers (to physically align employees with their operating divisions for the Area and Industry Offices, Chief Counsel Headquarters, Information Systems, and the National Office). These funds also are intended to cover costs associated with assisting employees in transition. The IRS has noted that this funding will cover all aspects of organizational change that will complement the IRS's systems modernization efforts and implementation of the IRS Reform Act mandates.[114]

D. Information Technology

<u>Information systems</u>

The IRS fiscal year 2001 budget request includes $1.58 billion and 7,531 FTEs for information systems. Of the $1.58 billion, $1.54 billion is for funding the operations and maintenance of existing systems. The remaining $40 million is for what the IRS refers to as "Business Line Investments," which are intended to add new capabilities to five operational systems and develop three new systems to address certain business needs unique to some of IRS's newly formed divisions.[115]

The GAO reports that this request appears consistent with the spending categories established in previous budget legislation.[116]

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[111] *Id.* at SD-24.

[112] *Id.*

[113] *Id.*

[114] *Id.*

[115] FY 2001 Justification at SD-24; GAO Report 00-133 at 32.

[116] GAO Report 00-133 at 19. *See* Part II. D., above, for a discussion of the limits on IRS technology spending.

ITIA core business systems

In addition to the $1.58 billion information systems funding request, the IRS is requesting a total of $494 million for its multiyear capital account, referred to as the Information Technology Investments Account ("ITIA"), which is intended to fund contractor costs associated with IRS's core business systems modernization program.[117] Of this request, $119 million is for fiscal year 2001.[118] The additional $375 million is a request for an advanced appropriation for fiscal year 2002.[119] The IRS believes that this funding is essential to properly support modernization and to fully comply with the IRS Reform Act. The IRS believes that full funding will allow the realization of the following benefits:

- Short-term–Improved access to IRS customer service representatives; improved service to internal and other Federal customers; enhanced electronic communication with taxpayers; and timely, accurate information for personnel systems;

- Mid-Term–Improved financial management, expanded electronic filing and payment options, and expanded electronic interaction with taxpayers; and

- Long-Term–More accurate and timely information for increased customer service, more customer friendly collection capabilities, faster refund processing, and secure and auditable access to all taxpayer account information through a single terminal.

The GAO has questioned the IRS ITIA funding request.[120] The GAO reports that the IRS has not performed required analyses to justify the business need for these investments, including analyses demonstrating that the investments: (1) support a critical agency mission; (2) are justified by life cycle cost-benefit analysis (i.e., business case); and (3) have cost, schedule, and performance goals.[121] According to the GAO, the IRS based its funding request on questionable

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[117] The ITIA currently contains $438 million in appropriated, but unobligated, funds. *Id.* The establishment of the ITIA is discussed in Part II. D., above.

[118] In fiscal year 2000, the IRS requested no funds for ITIA. However, the IRS notes that remaining balances from prior year appropriations plus the $119 million requested for fiscal year 2001 will support its estimated fiscal year 2001 need of $325 million.

[119] FY 2001 Justification at SD-25.

[120] GAO Report 00-133 at 2, 20-21.

[121] *Id.* at 20.

spending estimates.[122] Consequently, the GAO has recommended that the Congress deny the funds requested for the ITIA and direct the IRS to develop a credible and verifiable fiscal year 2001 budget request based on defined modernization requirements and formal estimating methods, as well as seek a supplemental appropriation for this amount in time to meet fiscal year 2001 needs, if necessary.[123]

E. Financial Audit of IRS Fiscal Year 1999 Financial Statements

The GAO recently presented the results of its audit of the IRS principal financial statements for fiscal year 1999. The GAO expressed an unqualified opinion on the IRS Statement of Custodial Activity, finding that it presents fairly, in all material respects, the IRS custodial activity for fiscal year 1999.[124] The GAO expressed a qualified opinion on the IRS balance sheet, noting limitations on the scope of its work due to insufficient evidence regarding the reliability of the components of the net position of the IRS. Except for these limitations, the GAO found that the IRS balance sheet presents fairly, and in all material respects, the IRS assets, liabilities, and net position as of September 30, 1999.[125] Finally, the GAO was unable to express an opinion on the IRS statements of net cost, changes in net position, budgetary resources, and financing because of limitations on the scope of its work, which resulted from insufficient evidence regarding (1) the opening balances of the IRS's fund balance with the Treasury Department, property and equipment, accounts payable, and net position, (2) the reliability of program costs and budgetary balances, and (3) the components of net position.[126]

The GAO identified seven material weaknesses in the IRS's internal controls as of September 30, 1999. These weaknesses relate to the IRS's control over: (1) the financial reporting process; (2) management of unpaid assessments; (3) refunds; (4) fund balance with Treasury; (5) property and equipment; (6) budgetary activities; and (7) computer security.

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[122] *Id.*

[123] *Id.* at 2, 20-21.

[124] General Accounting Office, *Financial Audit: IRS' Fiscal Year 1999 Financial Statements* (GGD/AIMD-00-76, February 2000)(hereinafter "GAO Report 00-76") at 8.

[125] *Id.*

[126] IRS Commissioner Rossotti recently testified that the fund balance was reconciled with the Treasury Department at the end of fiscal year 1999, and monthly reconciliations have occurred for October and November of fiscal year 2000. Commissioner Rossotti also indicated that a new permanent team is now charged on a recurring basis with this duty. Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Government Management, Information and Technology of the House Committee on Government Reform (April 10, 2000).

The GAO believes that these weaknesses may have adversely affected, in whole or in part, any decision made by IRS management that is based on these weaknesses. Thus, the GAO was unable to obtain reasonable assurance that the IRS's program costs, budgetary balances, and components of net position were reliable. Further, the GAO found that some of these material weaknesses may have permitted inappropriate refunds to have been paid, reduced IRS's effectiveness in its enforcement of the tax laws, and resulted in errors in taxpayer accounts and increased taxpayer burden.[127]

[127] *Id.* at 10.

IV. OTHER MATTERS ADDRESSED BY THE IRS REFORM ACT

A. Establishment of the IRS Oversight Board

The IRS Reform Act created 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.[128] 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 also are to be reviewed by the Oversight Board. In addition, any major reorganization of the IRS is to be reviewed and approved by the Oversight Board.[129]

Budget requests prepared by the Commissioner will be reviewed and approved by the Oversight Board.[130] This review is to ensure that the request supports the annual and long range strategic plans of the IRS. The Oversight Board is to submit the IRS budget request through the Treasury Department and the President, who in turn is to submit it to the Congress without revision. This provision does not preclude the President from submitting his own budget for the IRS.

The Oversight Board is to consist of nine members.[131] 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 representative members, with the advice and consent of the Senate, for staggered five-year terms.

The IRS Reform Act required the Oversight Board nominees to be sent to the Senate by January 22, 1999. The last nominee was submitted on January 27, 2000. The President nominated the following seven persons:

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[128] Sec. 7802(c) and (d).

[129] The Conference Report for the IRS Reform Act 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. H.R. Conf. Rep. No. 105-599, at 203-204 (1998) (hereinafter "Conference Report").

[130] Sec. 7802(d)(4).

[131] Sec. 7802(b).

- George L. Farr, former Vice-Chairman of American Express (nominated for a four-year term),

- Nancy Killefer, Director, McKinsey & Company, former Treasury Department Assistant Secretary for Management and Chief Financial Officer (nominated for a five-year term),

- Charles Kolbe, Chairman of the Board, Red Oak Hereford Farms (nominated for a three-year term),

- Larry R. Levitan, former partner Arthur Anderson & Co./Andersen Consulting (nominated for a five-year term),

- Steve H. Nickles, professor, Wake Forest University School of Law and the Babcock Graduate School of Management (nominated for a four-year term),

- Robert M. Tobias, former president of the National Treasury Employees Union (nominated for a five-year term), and

- Karen Hastie Williams, partner, Crowell & Moring (nominated for a three-year term).

The nominees have a wide range of expertise, including government budget and procurement matters, the needs of small business and large corporations, customer service, debtor and creditor law, technology management, and the representation of IRS employees. On February 3, 2000, the Senate Committee on Finance held a confirmation hearing for the nominees. All seven nominations were reported favorably out of the Committee on March 2, 2000. The nominations are waiting for consideration by the full Senate.

B. Establishment of Independent National Taxpayer Advocate

Background and related provisions of the IRS Reform Act

The IRS created the Problem Resolution Program ("PRP") in 1976. PRP's purpose was to provide an independent means by which 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") replaced the Taxpayer Ombudsman with the Taxpayer Advocate.[132] The Taxpayer Advocate was expected to represent taxpayer interests independently in disputes with the IRS. The IRS Reform Act renamed the Taxpayer Advocate

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

the National Taxpayer Advocate ("NTA").[133] The NTA supervises the Office of the Taxpayer Advocate.

The Office of the Taxpayer Advocate has four principal functions:

- to assist taxpayers in resolving problems with the IRS;
- to identify areas in which taxpayers have problems in dealing with the IRS;
- to propose changes in the administrative practices of the IRS to mitigate such problems; and
- 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 to the NTA or his delegate. Local Taxpayer Advocates are to be independent of the IRS' examination, collection, and appeals functions. Local Taxpayer Advocates are also to be 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.[134] Prior to the reorganization of the Office of the Taxpayer Advocate, the IRS had 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.[135] Additionally, the NTA must develop guidance to be distributed to all IRS officers and employees that outlines the criteria for referring taxpayer inquiries to local taxpayer advocate offices.[136]

The IRS Reform Act also expanded the NTA's ability to issue Taxpayer Assistance

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[133] 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.

[134] Sec. 7803(c)(2)(C)(i).

[135] Sec. 7803(c)(2)(C)(iii).

[136] Sec. 7803(c)(2)(C)(ii).

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.[137] A TAO may require the IRS to release property of the taxpayer that has been levied upon, to cease any action or take any action as permitted by law, or refrain from taking any action with respect to the taxpayer.

As required by law, the NTA submits two reports annually to the House Committee on Ways and Means and to the Senate Finance Committee.[138] The NTA submits 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]

The first report, due June 30th 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 second report, due December 31st of each year, concerns the activities of the Office of the Taxpayer Advocate.[140] 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 20 most serious problems experienced by taxpayers. The IRS Reform Act also requires the report to 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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[137] 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. Sec. 7811(a)(2). The NTA may also issue a TAO if the taxpayer meets requirements to be set forth in regulations. Sec. 7811(a)(1)(B).

[138] Sec. 7803(c)(2)(B).

[139] Sec. 7803(c)(2)(B)(iii).

[140] Sec.7803(c)(2)(B)(ii)(I) through (XI).

Implementation efforts

Establishing independence

According to the NTA's most recent report, the NTA has taken several steps to strengthen the independence and accountability for Taxpayer Advocate goals. The reorganized Office of the Taxpayer Advocate ("Taxpayer Advocate Service") became official on March 12, 2000. The field organization consists of nine Area Taxpayer Advocate directors, seven of whom oversee casework by Local Taxpayer Advocates in assigned territories and two of whom oversee casework from Service Center Advocates. Seventy-four Local Taxpayer Advocates report to the Area Taxpayer Advocate Directors and are responsible for handling taxpayer cases at the local level. The Area Taxpayer Advocate Directors report to the NTA.[141] Previously, local Taxpayer Advocates reported to and received evaluations from IRS district and service center directors.[142] Caseworkers were also moved into the local Taxpayer Advocate organization.[143] A career path was established for these workers to allow for professional development and advancement.[144]

The NTA determined that a workforce of approximately 2,300 employees would be necessary based on historical data adjusted for the NTA's independence and additional responsibilities.[145] Over 8,000 applications were received.[146] Hiring began in fiscal year 1999 and is projected to be completed during the first half of fiscal year 2000.[147]

In addition to caseworker positions, the NTA created Operating Division Taxpayer Advocate positions to work within the new IRS organizational structure.[148] As part of the filed organization, two Operating Division Taxpayer Advocates report to the NTA. The primary responsibility of the Operating Division Taxpayer Advocate will be systemic analysis and

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[141] *See* Internal Revenue Service, *National Taxpayer Advocate Annual Report to Congress for Fiscal Year 1999*, Publication 2104 at VI-1 (December 1999) (hereinafter NTA Report FY 1999).

[142] *Id.*

[143] *Id.*

[144] *Id.*

[145] *Id.* at VI-3.

[146] Statement of W. Val Oveson, National Taxpayer Advocate, Hearing before the Senate Committee on Finance at 2 (February 2, 2000).

[147] NTA Report FY 1999 at VI-3.

[148] *Id.* at VI-1.

advocacy, as opposed to casework.[149]

To provide legal assistance, the NTA has an executive-level Chief Counsel attorney assigned as the Counsel to the National Taxpayer Advocate.[150] The Counsel to the National Taxpayer Advocate has authority to hire four highly graded attorneys to provide the NTA and the immediate office with legal support.[151] Since its inception in November 1998, the Counsel's office has assisted the NTA with over 120 cases or projects.[152]

Taxpayer Advocate activity report

The most recent NTA report identified the following areas as some of the most serious problems identified by individual and business taxpayers, tax practitioners, and IRS employees:

- complexity of the tax law;
- clarity and tone of IRS communications;
- administration of the earned income tax credit;
- lack of one-stop service;
- penalty administration;
- inability to access the toll-free number;
- lack of acknowledgment of correspondence and payments;
- divorced and separated taxpayers;
- offer-in-compromise issues; and
- misapplied payments.[153]

The general category of penalties (accuracy-related and failure to file or pay) ranks first in litigation both in the "individual" and "self-employed" categories.[154] In addition to penalties, the top five most litigated issues for individuals include the definition of gross income, trade or business expenses, earned income tax credit and head of household.[155] For the self-employed, the list includes trade or business expenses, entertainment expenses, self-employment tax, and

[149] *Id.*

[150] *Id.* at VI-3.

[151] *Id.*

[152] *Id.*

[153] *Id.* at I-2.

[154] *Id.* at III-2.

[155] *Id.*

activity not engaged in for profit.[156] The NTA noted that the earned income tax credit and business expenses, both on the most litigated lists, impose significant compliance burdens on taxpayers due to complexity.[157] According to the NTA, the earned income tax credit is one of the primary causes of Taxpayer Advocate casework.[158] Other categories that the NTA identified as imposing a significant compliance burden include interest, penalties, refunds, alternative minimum tax, and the phase-out of itemized deductions and personal exemptions.[159]

The NTA reported that during fiscal year 1999, the Office of the Taxpayer Advocate handled approximately 200,000 cases.[160] More than 56 percent of these cases involved refunds, amended returns, audit reconsideration, or revenue protection.[161] In addition, there were 93,000 applications for taxpayer assistance orders, a 290 percent increase over the previous year.[162] The NTA attributes this increase to (1) the new "30-day delay" hardship criterion for resolving a taxpayer account problem, (2) more publicity about the availability of NTA services, (3) a new toll-free number, and (4) greater emphasis on the Taxpayer Assistance Order program.[163] Five cases required an enforced Taxpayer Assistance Order.[164] An enforced Taxpayer Assistance Order is required when the local Taxpayer Advocate and the responsible IRS functional area cannot reach an agreement on case resolution. In 73.5 percent of the cases, the NTA was able to provide relief or appropriate assistance to the taxpayer.[165]

According to the NTA's report, representatives of the NTA are involved in several task

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[156] *Id.*

[157] *Id.* at II-1.

[158] *Id.*

[159] *Id.*

[160] *Id.* at VII-1.

[161] *Id.* at VII-3.

[162] *Id.* at VII-1.

[163] The Office of the Taxpayer Advocate received more than 442,000 calls through its toll-free number during fiscal year 1999. NTA Report FY 1999 at VII-1 and VII-12.

[164] Two on refund offsets, one for interest abatement, one to issue a refund to avoid foreclosure and one to stop an audit in which the taxpayer felt harassed. Statement of W. Val Oveson, National Taxpayer Advocate, Hearing before the Senate Committee on Finance at 4 (February 2, 2000).

[165] NTA Report FY 1999 at VII-1.

forces and working groups to address various taxpayer concerns, implementation of the IRS Reform Act, and innocent spouse issues.[166] In addition, the NTA initiated projects to study the procedures regarding rejected offers in compromises, ways to improve the availability of correct power of attorney information on the Central Authorization File, and the negative impact on low income taxpayers caused by the addition of the kerosene tax for kerosene used for heating purposes.[167]

The NTA previously coordinated Problem Solving Days with the IRS district offices, as well as the National Problem Solving Day.[168] In general, problem solving days permit taxpayers to have face-to-face contact with an IRS employee who can assist them in resolving their problems with the IRS.[169] The IRS held Problem Solving Days monthly in every district office through December, 1999.[170] Since the Problem Solving Day Program began two years ago, the IRS has resolved 57,450 cases.[171]

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.[172] 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.[173]

The IRS Reform Act eliminated the IRS Office of the Chief Inspector. In its place,

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[166] NTA Report FY 1999 at VII-5-7.

[167] *Id.* at VII-7 - VII-9.

[168] *Id.* at VII-12. Responsibility for Problem Solving Days was transferred to IRS Operations in January 2000.

[169] *Id.*

[170] *Id.* at VII-13.

[171] *Id.*

[172] Conference Report at 220.

[173] *Id.*

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 enactment of the IRS Reform 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 with respect to the IRS.[174] The TIGTA conducts audits, investigations, and evaluations of IRS programs and operations (including the Oversight Board).[175] 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 provided with a toll-free number to report allegations of IRS misconduct. In addition, the TIGTA also conducts periodic audits of at least one percent of all determinations in which 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.[176]

Semiannual report

In his semiannual report to the Congress, the TIGTA reported that his office had successfully completed the transition period from IRS Office of Chief Inspector to TIGTA. It has abolished its regional structure to eliminate a layer of management.[177] In addition, its Office of Audit was reorganized into specialized issue areas, which parallel the new IRS unit structure.[178] Finally, TIGTA created the Office of Investigation's Strategic Enforcement Division to investigate any attempts to interfere with the operations and security of IRS computer systems.[179]

During the six month period covered by the report, the TIGTA issued 47 final audit reports of the IRS and investigated over 1,600 allegations of criminal wrongdoing and

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

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

[176] Sec. 7803(d)(3)(A).

[177] Statement of David C. Williams, Inspector General, Treasury Inspector General for Tax Administration, before the Senate Committee on Finance at 7 (February 2, 2000) (hereinafter Williams Finance Testimony).

[178] *Id.*

[179] *Id.*

administrative misconduct.[180] The following discussion highlights some of the material contained in the semiannual report covering the period April 1, 1999, through September 30, 1999.

IRS implementation the IRS Reform Act

According to TIGTA, the IRS is not in full compliance with all IRS Reform Act provisions. The TIGTA reports that the IRS was not in compliance with the taxpayer rights provisions as they relate to seizures, liens, levies, use of enforcement statistics, and Freedom of Information Act requests.[181] For example, TIGTA identified 96 violations in which IRS management used tax enforcement results to evaluate employees or imposed or suggested employee production quotas or goals, e.g., evaluations contained references to fraud referrals, dollars assessed or collected or case closures.[182] The TIGTA also concluded that because of weaknesses in controls and inappropriate actions on cases, the IRS did not always provide fair and equitable treatment to taxpayers.[183]

Information technology and computer security

The TIGTA noted that IRS computer security continues to need attention. TIGTA's reviews indicate that the IRS is still vulnerable in the area of system security.[184] Despite increased publicity about unauthorized access and more stringent sanctions, unauthorized access comprised the largest segment of investigations of IRS employees initiated by TIGTA.[185] In addition to computer security, TIGTA found that computer applications need to be enhanced to ensure functional needs are met effectively and efficiently.[186]

Protecting revenue and minimizing tax filing fraud

The TIGTA noted that fraudulent refund schemes, especially related to the earned income

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[180] Treasury Inspector General for Tax Administration, *Semiannual Report to the Congress: April 1, 1999 - September 30, 1999*, Publication 3372 at 3 (November 1999) (hereinafter "TIGTA Semiannual Report").

[181] TIGTA Semiannual Report at 3.

[182] Williams Finance Testimony at 6.

[183] TIGTA Semiannual Report at 3.

[184] *Id.* at 4.

[185] *Id.*

[186] *Id.*

tax credit, continue to be a concern.[187] According to TIGTA, it recently investigated a former IRS employee who prepared fraudulent tax returns claiming the earned income tax credit.[188] TIGTA also reviewed selected components of the electronic filing program as they relate to preparers.[189] It was concluded that IRS management needs to ensure that procedures are consistently followed, controls are improved over the removal of preparers, computer enhancements are made, and additional emphasis is placed on return preparer fraud activities.[190]

Criminal and misconduct investigations

TIGTA has developed a new complaint tracking system that provides a centralized accounting of all complaints received by TIGTA and the dispositions of those complaints.[191] The system became operational on July 19, 1999.[192] To receive complaints of wrongdoing by IRS employees, TIGTA operates a toll-free telephone number, an e-mail account, and a central post office box.[193]

TIGTA received 5,092 complaints for the period April 1, 1999 through September 30, 1999.[194] According to TIGTA, to the extent possible, complainants are interviewed by TIGTA personnel.[195] Of the complaints received, TIGTA found 2,071 warranted further investigation.[196]

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[187] *Id.* at 6.

[188] *Id.*

[189] *Id.*

[190] *Id.*

[191] *Id.* at 24.

[192] *Id.*

[193] *Id.*

[194] *Id.*

[195] *Id.*

[196] *Id.*

Of these, 833 complaints were against IRS employees.[197]

Audit reports with unimplemented corrective actions

According to TIGTA's semiannual report, there are 29 audit reports for which corrective action for significant recommendations remain outstanding.[198] Many of the recommendations involve automation of some processes, changes to the IRS computer systems, the creation of databases, and other uses of computers. Other recommendations could be categorized generally as requiring IRS management to undertake a further review of the particular issues and develop procedures to improve operations.

D. Taxpayer Rights

The IRS Reform Act created or modified numerous taxpayer rights and procedural protections. Most of its provisions were effective either on the date of enactment or within six months of enactment. Thus, the IRS was required to provide guidance to the public and training to its almost 100,000 employees in a very short time frame. In fiscal year 1999, the IRS had briefings and training on 55 IRS Reform Act provisions and provided a total of two million hours

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[197] *Id.* at 43. The employee cases were disposed of as follows:

Removed, terminated or other	108
Suspended/reduction in grade	67
Oral or written reprimand or admonishment	84
Closed - no action taken	196
Clearance letter issued	45
TOTAL DISPOSITIONS	500*
Employees resigned prior to adjudication	85

Source: Treasury Inspector General for Tax Administration. *451 cases were pending administrative adjudication during the reporting period.

[198] TIGTA Semiannual Report at 45-51.

of training.[199] The IRS estimates that nearly 4,560 full time equivalent personnel were required for the specific administrative provisions of the IRS Reform Act.[200] The Commissioner has stated that it will be several years before the changes made by the IRS Reform Act operate at the desired level of efficiency and quality.[201] The IRS views its immediate challenges as training and management.[202] Discussed below are several areas that illustrate the difficulties encountered by the IRS in implementing the IRS Reform Act: innocent spouse, due process in collection, and third party notices.

Innocent spouse

Persons filing a joint return are jointly and severally liable for the joint return. Thus, one spouse may be subject to joint liability for the omissions from income or erroneous deductions of the other spouse.

The Code offers conditional relief to an innocent spouse.[203] The IRS Reform Act generally made innocent spouse relief easier to obtain. It eliminated all of the understatement thresholds and requires that the understatement be attributable to an erroneous (rather than grossly erroneous) item of the other spouse. It also allows for apportionment of relief for the taxpayer who simply did not know the extent of the understatement. A taxpayer who is no longer married to, is legally separated from, or has been living apart for at least 12 months from the person with whom the taxpayer originally filed the joint return can elect to limit liability to the portion of the deficiency properly allocable to that individual if he or she did not know, or had no reason to know, of an understatement on a joint return which he or she filed. The election for relief from liability for all joint filers and the separate liability election must be made no later than two years after the date the IRS has begun collection activities for the individual making the election. In addition, the IRS Reform Act gave the IRS the ability to grant equitable relief if (1) relief is otherwise unavailable and (2) taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or any deficiency.

In the four months preceding the passage of the IRS Reform Act, the IRS received 3,000

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[199] Rossotti Senate Finance Testimony at 5 (February 2, 2000).

[200] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service before the House Committee on Government Reform Subcommittee on Government Management, Information and Technology at 16 (April 10, 2000).

[201] Rossotti Senate Finance Testimony at 5.

[202] *Id.*

[203] Sec. 6015.

innocent spouse requests.[204] After passage, as of February 2, 2000, the IRS had received a total of 63,906 requests and is averaging over 2,800 requests per month.[205]

Immediately after passage, the IRS faced several difficulties in implementing the innocent spouse provisions. It had no employees trained in applying the new provisions and no training materials available for the new provisions, in particular the IRS had no familiarity with applying the equitable relief provision.[206] Thus, the IRS had to train its staff in how to handle these cases. In addition, the IRS did not anticipate the volume of requests that would be submitted. The IRS also did not have a reliable management information system to reliably track innocent spouse cases.[207] The combination of these factors has resulted in a significant backlog of cases. As of December 31, 1999, 46,665 cases were in inventory.[208]

To effectively manage the requests, the IRS has taken several steps. It has: (1) centralized management of the program under a senior manager; (2) developed specific flow charts and other training and job aids for the employees doing the screening; (3) revised the procedures and training based on initial experience; and (4) instituted a 100-percent review of completed claims to ensure quality and consistency. The IRS is also developing computer support.[209]

The IRS anticipates that it will be able to reduce its inventory of pending cases to under 30,000 by the end of the current year.[210] It estimates that this effort will require 362 full time equivalent personnel, including 153 revenue agents in fiscal year 2000.[211]

<u>Due process in collection</u>

Collection enforcement by the IRS generally takes three forms: (1) placing a lien on a taxpayer's property; (2) placing a levy on the taxpayer's wages or bank account; and (3) seizing the taxpayer's business or personal assets. The IRS must provide the taxpayer with written

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[204] Rossotti Senate Finance Testimony at 6.

[205] *Id.*

[206] *Id.* at 7.

[207] Williams Finance Testimony at 3.

[208] Rossotti Senate Finance Testimony at 7.

[209] *Id.*

[210] *Id.*

[211] *Id.* at 8.

notification of the right to an impartial hearing before an appeals officer after a notice of lien has been filed or before a notice of levy is sent.[212] The taxpayer has 30 days to request an appeal, and during this period, the levy or seizure may not take place. In addition, if the taxpayer requests an appeal, the levy or seizure may not take place until the appeals officer makes a finding. Finally, the taxpayer has 30 days to challenge an appeals finding in the U.S. Tax Court or U.S. District Court during which time the IRS may not levy or seize. The IRS Reform Act also required other procedural safeguards. For example, with respect to seizures of assets owned by an individual and used in the course of a business, approval by the district director is required and an analysis must be conducted to show that the taxpayer's other assets are insufficient to satisfy the liability. Seizure of a principal residence requires court approval.

The IRS has noted that the initial effect of the IRS Reform Act provisions has been to significantly cut the number of collection enforcement actions instituted.[213] A comparison of fiscal year 1998 with fiscal year 1999, when the changes became effective, illustrates this drop:

	FY 1998	FY 1999
Liens	382,755	167,867
Levies	2,503,409	504,403
Seizures	2,307	161

Source: Internal Revenue Service.

While collection activity has dropped, the Treasury Inspector General for Tax Administration found that of roughly a third of all liens, levies and seizures that it reviewed involved potential violations of the IRS Reform Act and/or internal IRS guidelines.[214] For example, the IRS was not always informing taxpayers and their representatives of the taxpayers' rights to a hearing once a Federal tax lien is filed. The IRS also seized business property without obtaining the required approvals, and taxpayers were not personally warned before the seizure action occurred.[215]

The IRS notes that it has devoted substantial amounts of training for both managers and collection employees and new guidance has been issued on how to handle specific collection

[212] Secs. 6320 and 6330.

[213] Rossotti Senate Finance Testimony at 9.

[214] TIGTA Semiannual Report at 9-10.

[215] Williams Finance Testimony at 6.

situations.[216] It also expects to provide new check sheets and job aids to assist collection employees in following the steps needed to take correct enforcement action.[217]

Third party notice

The IRS Reform Act required the IRS to give the taxpayer reasonable notice before contacting any other person with respect to the determination or collection of the taxpayer's taxes and then to periodically tell the taxpayer who has been contacted.[218] When the IRS first implemented the provision, it sent a broadly worded notice to almost every taxpayer in the IRS administrative process.[219] The letter was not tailored to any specific circumstances. The tone of the letters was also criticized.[220]

As a result, the IRS had to refine the notices to encompass those instances in which third party contact was likely, develop a notice appropriate for that situation, and train its employees on how to identify and handle these situations.[221] There are fifteen variations of the new notices, which are tailored to the specific situation of the taxpayer.[222] The IRS was to begin issuing these new notices in February 2000.[223]

Under the statute, the IRS is not required to give notice to the taxpayer when it would jeopardize collection, with respect to a criminal investigation, or if the third party expresses a fear of reprisal.[224] The IRS has found troubling the situation in which a third party does not claim fear of reprisal but asks the IRS not to provide his or her name to the taxpayer.[225] Based on

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[216] Rossotti Senate Finance Testimony at 10.

[217] *Id.*

[218] Sec. 7602(c).

[219] Rossotti Senate Finance Testimony at 10.

[220] *Id.* at 11.

[221] *Id.*

[222] *Id.*

[223] *Id.*

[224] Sec. 7602(c)(3).

[225] Rossotti Senate Finance Testimony at 12.

reports from its field employees, this happens frequently.[226] The statute, however, obligates the IRS to disclose the name of the third party to the taxpayer. The IRS is concerned that the ultimate effect will be an unwillingness of third parties to provide information to the IRS under any circumstances.[227] Nonetheless, the IRS continues to work toward the implementation of this provision. It estimates that 500-600 full time equivalent personnel are necessary to administer this provision.[228]

E. Personnel Flexibility and IRS Management

IRS Reform Act

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 IRS

[226] *Id.*

[227] *Id.*

[228] *Id.*

Reform Act prohibits the use of enforcement goals, 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 IRS Reform Act broadens the definition of a career reserved position 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 to a different assignment without regard to the 120 day limitation otherwise applicable.

- 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.

Implementation efforts

Personnel

The Commissioner has assembled his senior leadership team, including the heads of all of the new operating divisions. These persons have been drawn from the private sector, State and Federal Government, and from within the IRS:

- Bob Wenzel, Deputy Commissioner of Operations (37 years of experience with the IRS);

- John LaFaver, Deputy Commissioner of Modernization (former Kansas State Tax Commissioner);

- Dan Black, National Chief, Appeals (former IRS National Director of Appeals, 30 years of experience with the IRS);

- William Boswell, Chief of Agency Wide Shared Services (former Senior Vice President of Shared Services for BP America);

- Stuart Brown, Chief Counsel (has held this position since 1994 and was previously a partner at the law firm of Caplin and Drysdale and Deputy Chief of Staff for the Joint Committee on Taxation);

- Paul Cosgrave, Chief Information Officer (former Chairman and CEO of the Claremont Technology Group and partner in Andersen Consulting);

- John Dalrymple, Commissioner of the Wage and Income Division (former IRS Chief Operations Officer with 25 years of IRS experience);

- Joseph Kehoe, Commissioner of the Small Business/Self Employed Division (former Global Leader, Service Sector Consulting for PricewaterhouseCoopers);

- Larry Langdon, Commissioner of the Large and Mid-Size Business Division (former Vice President, Tax, Licensing and Customs for Hewlett-Packard);

- Mark Matthews, Chief of Criminal Investigation (former Deputy Assistant Attorney General for Criminal Tax at the Justice Department and was previously in private law practice at Crowell and Moring);

- W. Val Oveson, National Taxpayer Advocate (former Chairman of the Utah State Tax Commission);

- Evelyn Petschek, Commissioner of the Tax Exempt and Government Entities Division (former IRS Assistant Commissioner for Employee Plans and Exempt Organizations and partner in the law firm of Patterson, Belknap, Webb and Tyler); and

- David R. Williams, Chief Communications and Liaison (previously worked in the Treasury Department and the United States Senate).[229]

In addition, the IRS is set to implement a new paybanding system for senior managers, and a new pilot bonus system for key senior leadership positions, that will link executive and managerial compensation more directly to performance. According to the IRS, it is also in the process of aligning its bargaining unit employee performance standards with the balanced measures system. Further, the IRS notes that it must undertake more comprehensive pay and

[229] Rossotti Senate Finance Testimony at 12.

performance management reforms in partnership with the National Treasury Employees Union.

Performance management and enforcement statistics

The employee evaluation process is a significant method for influencing employee behavior. With respect to enforcement employees in particular, the IRS recognizes that the evaluation process is an important part of any performance management system and may be key to improving customer service.[230] Historically, the IRS performance management system has emphasized revenue at the expense of customer service.[231] As discussed above, GAO also has noted that at a fundamental level, it is not clear that IRS employees fully understand that customer service and compliance can be mutually supportive.[232]

As part of its effort to improve customer service, the IRS has incorporated into the employee evaluation process a new performance standard relating to the fair and equitable treatment of taxpayers that employees must meet at a passing level to retain their jobs.[233] The retention standard provides the employees must "[a]dminister the tax laws fairly and equitably, protect all taxpayers' rights, and treat each taxpayer ethically with honesty, integrity and respect."[234] When evaluating employees, supervisors are to first determine whether the employee met the retention standard and, if the employee did, then proceed to evaluate the employee on the critical job elements.[235] The new retention standard was put in place in July 1999.[236]

In addition, the Collection Division has taken steps to restructure its evaluation system to reflect the emphasis on customer service. The division has revised its standard position description for revenue officers and revised the critical job elements.[237] The critical job elements were reduced from three to five. The three revised elements are customer relations and

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[230] General Accounting Office, *IRS Employee Evaluations: Opportunities to Better Balance Customer Service and Compliance Objectives* (GAO/GGD-00-1, October 1999) at 14.

[231] GAO Report 00-144 at 7.

[232] *Id.* at 8.

[233] General Accounting Office, *IRS Employee Evaluations: Opportunities to Better Balance Customer Service and Compliance Objectives* (GAO-GGD-00-1, October 1999) at 14.

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

[235] *Id.* at 15.

[236] *Id.*

[237] *Id.*

assistance, case resolution, and case management.[238] Previously, revenue officers were evaluated based on time and workload management, case decisions, investigation and analysis, accounts maintenance and customer relations.[239] The revised elements became effective in July 1999.[240]

The IRS Reform Act prohibited any IRS employee from being evaluated based upon enforcement statistics. In its semiannual report, TIGTA noted that the IRS is not in full compliance with this provision and that some employees still believe IRS managers use records of tax enforcement results inappropriately.[241] In the 28 IRS offices reviewed, 96 violations were identified by TIGTA.[242] Separately, the IRS identified 525 additional violations.[243] The IRS intends to resolve this problem through the implementation of a balanced system of business measures.[244]

Section 1203 violations

The IRS Reform Act defined 10 specific acts of misconduct for which an IRS employee must be terminated.[245] In his sole discretion, the Commissioner may determine that there are

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[238] *Id.*

[239] *Id.*

[240] *Id.*

[241] TIGTA Semiannual Report at 8.

[242] *Id.*

[243] Williams Finance Testimony at 6.

[244] TIGTA Semiannual Report at 8.

[245] 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;

(continued...)

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

TIGTA received over 900 complaints; however, it determined that only 218 of these complaints warranted investigation as possible section 1203 allegations.[246] Of these 218, TIGTA referred 87 to the IRS for adjudication.[247] IRS management is emphasizing to its employees that

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[245](...continued)

(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;

(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.

[246] Williams Testimony at 6.

[247] *Id.*

disciplinary action will not be imposed on those employees who make honest mistakes.[248] Nonetheless, according to the National Treasury Employees Union ("NTEU"), the perceived broad scope and vague nature of the provisions have created anxiety and confusion among IRS employees.[249] NTEU asserts that the requirement for mandatory dismissal is having a chilling effect on collections and morale at the IRS.[250]

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[248] *Id.*

[249] Statement of Colleen M. Kelley, National President, National Treasury Employees Union, Before the Subcommittee on Government Management, Information and Technology, House Committee on Government Reform at 9 (April 10, 2000).

[250] *Id.* at 10.

V. THE 2000 TAX FILING SEASON

Overview

The IRS has projected net collections for fiscal year 2000 of $1.767 trillion. During fiscal year 2000, the IRS expects to receive 213.1 million returns, including over 127.3 million individual returns, and expects to issue over 93 million individual refunds. As of March 10, 2000, the IRS reports that refunds are up over 10 percent from last year, with an average refund of $1,731.[251] The IRS recently announced that 35 million tax returns were filed electronically this tax filing season.[252]

The GAO was asked to review the IRS's performance during the 2000 tax filing season. In its March 28, 2000, testimony before the Subcommittee on Oversight of the House Committee on Ways and Means, the GAO made three specific observations. First, the GAO noted that the computer systems for processing returns and remittances are operating without significant problems, and are in fact performing better than in 1999. Second, the number of individual returns filed electronically has continued to increase. The GAO attributed at lease part of this increase to IRS effort. Finally, GAO reports that it has been easier for taxpayers to reach the IRS by telephone compared to last year, although service has not yet reached the level IRS attained in 1998.[253]

Certain issues relating to the filing season are discussed in greater detail below.

Electronic filing

The GAO noted a continuing increase in electronic filing. The IRS has taken a number of steps to encourage electronic filing this tax filing season, including (1) expanding tests aimed at making electronic filing paperless, (2) allocating $7 million to promote electronic filing through marketing, and (3) increasing the types of forms that can be filed electronically.[254] The IRS has reported that the 35 million returns filed electronically this year was 1.4 million more than the

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[251] The IRS also completed what it describes as an "enormous, yet almost flawless" Year 2000 conversion. Rossotti House Oversight Testimony at 1.

[252] Curt Anderson, *Taxpayers' Electronic Filing Rises*, Associated Press, April 27, 2000, available at <http://www.washingtonpost.com/wp-srv/aponline/20000427/aponline062256_ 000.htm> (hereinafter "A.P. Article").

[253] GAO Report 00-133 at 1.

[254] *Id.* at 7.

IRS has anticipated, and an overall 20 percent increase from last year.[255] Electronic returns, the IRS notes, represents 27 percent of the total returns filed.[256]

The expansion of paperless filing tests is aimed at correcting a major criticism of electronic filing, i.e., it is not truly paperless because a signature document and copies of Forms W-2 must be filed. Also, if money is owed, a check and payment voucher must be submitted.[257]

In 1999, the IRS implemented two tests to provide alternatives to the paper signature documents and two tests that provide electronic payment alternatives for taxpayers that owe money. For the 2000 filing season, the IRS expanded each of those tests. The two alternative signature tests waive the need for taxpayers to submit paper signature documents and copies of their Forms W-2. The first test allows certain tax practitioners' clients who file electronically to use a self-selected identification number rather than a signature document. The IRS expanded the number of practitioners eligible to participate in this test. The GAO reports that IRS data shows that about 3.95 million taxpayers had already used this option as of March 9, 2000, which is a significant increase over last year.[258] Moreover, the IRS reported that, as of April 27, 2000, approximately 7 million taxpayers used this signature option, including 1.4 million who self-prepared their returns.[259] The GAO also reports that in 1999 approximately 660,000 taxpayers utilized the second alternative signature test, in which the IRS sends them a postcard with a unique customer number that they can use in lieu of mailing in a signature document. As of March 9, 2000, approximately 778,000 taxpayers had used this option.[260]

The IRS also expanded the two tests involving alternative payment options for taxpayers. One test, involving the use of credit cards was expanded to taxpayers who file estimated tax payments (Form 1040ES) or extensions of time to file (Form 4868). Approximately 186,000 taxpayers charged $536 million in Federal taxes on their credit cards as of April 27, 2000, which is an increase from $184 million charged during the first year of the program.[261] The second test, which involves payments via direct debit was expanded to include TeleFile users. The GAO reports that, according to the IRS, as of March 10, 2000, 28,200 taxpayers had used one of these two payment alternatives, compared to 7,286 at the same time last year. Of the 28,200, 20,697

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[255] A.P. Article at 1.

[256] *Id.*

[257] *Id.* at 5.

[258] *Id.* at 9.

[259] A.P. Article at 1.

[260] *Id.*

[261] A.P. Article at 2.

were electronic filers who paid by direct debit (including 6,367 TeleFilers) and 7,503 were an unknown combination of electronic and paper filers who used a credit card.[262]

Telephone service

The IRS continued its 24 hours-a-day/7 days-a-week, toll-free telephone service. Offered throughout the filing season, the "24/7" service became permanent on January 4, 1999. As of March 11, 2000, over 26 million taxpayers have been served in fiscal year 2000, compared with almost 29.9 million over the same period last year. The IRS explains this decline by noting the expansion of the 24/7 service last year, plus the increased training demands to implement new tax law requirements, particularly during the start of the filing season. Nonetheless, the IRS has experienced, in total, a 65 percent level of service (compared with its target of 58 percent). For the four weeks prior to March 28, 2000, the IRS experienced a 70 percent average level of service.

Some of the IRS's initiatives in the telephone service area included the Customer Service Field Realignment, which was implemented October 1, 1999. This service helps route calls to where trained people are most available, increasing the number of calls that will be answered. The IRS also increased the staff's ability to answer tax law questions by assigning additional compliance staff during regular and overtime hours and supplementing them with Appeals officers. In addition, the IRS improved accessability to and service from the National Taxpayer Advocate and expanded the Spanish Language Assistance.[263]

The GAO reported that, over the past years, there has been a steady improvement on the ability of taxpayers to obtain telephone assistance. However, in 1999, this trend ended, when the IRS experienced problems that significantly reduced taxpayers' ability to reach the IRS by telephone. Some of the problems were addressed in 1999, and others were improved this year. However, the service level as of March 7, 2000, remained below the level achieved in 1998, in part because the productivity of telephone staff has declined, and fewer staff have been dedicated to the service.

The GAO noted that there has been one major problem this year that had a significant effect on the IRS's telephone system. This occurred in late January 2000, when contract delays resulted in over 1 million bulk notices being mailed out over a two-week period, rather than having been staggered over seven weeks. Thus, as taxpayer received these notices, the IRS received an abundance of telephone activity. The GAO reports that the service level was 67 percent for the week ended January 22, 2000, 44 to 48 percent the following two weeks, then 66 percent the week ended February 12, 2000.

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

[263] *Id.* at 12-13.

Forms

For the 2000 tax filing season, the IRS released a new version of Form 8857, "Request for Innocent Spouse Relief," which makes it easier for taxpayers to use the form by providing guidance on completing the form as well as simple-to-answer checkboxes.[264] The IRS also has targeted improving certain other forms, including the EITC and Child Tax Credit forms, worksheets, and instructions. Moreover, for the 2000 tax filing season, most taxpayers whose only capital gains are from mutual fund distributions need not file Schedule D of Form 1040 to report these gains. In addition, for the 2001 tax filing season, the IRS anticipates that a line will be added to Form 1040A on which to report such capital gain distributions, thus allowing approximately 2.5 million more taxpayers to file on Form 1040A rather than Form 1040.

Fiscal year 1999 revenue protection strategy

During the 2000 filing season, the IRS reports that validation of identifying numbers continues to be a very visible portion of its efforts to prevent overclaims of the EITC.[265] Starting this filing season, the IRS plans to test the Dependent Database that includes records from the Social Security Administration and the Office of Child Support Enforcement at Health and Human Services. These records link the names and SSNs of dependent children with the names of their parents and their parents' SSNs, along with custody and child support obligation information.[266] The IRS is testing this data to identify the appropriate tax return for examination and ruling out any unnecessary contacts with taxpayers who appear eligible for the EITC, the Child Tax Credit, and dependency exemptions.[267]

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[264] *Id.* at 17.

[265] Rossotti House Oversight Testimony at 21.

[266] *Id.*

[267] *Id.*

Appendix I

IRS' Fiscal Year 2001 Budget Request Compared With Proposed Fiscal Year 2000 Operating Level [268]

Dollars in thousands

	FY 2000		FY 2001		Percent change	
Budget activity	**Dollars**	**FTEs**	**Dollars**	**FTEs**	**In dollars**	**In FTEs**
Submission Processing	$930,325	15,682	$1,036,818	16,040	11.45	2.28
Telephone and Correspondence	932,190	20,480	1,026,742	21,291	10.14	3.96
Taxpayer Advocate Service	133,145	2,294	141,095	2,294	5.97	0.00
Document Matching	59,036	1,437	73,023	1,690	23.69	17.61
Management Services	609,771	6,694	686,155	6,694	12.53	0.00
Rent and Utilities	695,579	67	735,666	67	5.76	0.00
Subtotal: Processing, Assistance, and Management Appropriation	**$3,360,046**	**46,654**	**3,699,499**	**48,076**	**10.10**	**3.05**
Criminal Investigation	384,549	3,750	399,065	3,750	3.77	0.00
Examination	1,772,371	22,089	1,885,882	22,900	6.40	3.67
Collection	676,676	10,548	721,547	10,785	6.63	2.25
Tax Exempt/Government Entities	156,600	2,102	168,654	2,166	7.70	3.04
Statistics of Income	28,390	471	29,696	471	4.60	0.00
Chief Counsel	225,059	2,378	234,176	2,372	4.05	-0.25
Subtotal: Tax Law Enforcement Appropriation	**$3,243,645**	**41,338**	**3,439,020**	**42,444**	**6.02**	**2.68**
Operations and Maintenance	1,258,155	7,292	1,543,565	7,531	22.68	3.28
Year 2000	250,426	239	0	0	NA	NA
Investments	0	0	40,000	0	NA	NA
Subtotal: Information Systems Appropriation	**$1,508,581**	**7,531**	**1,583,565**	**7,531**	**4.97**	**0.00**
Information Technology Investments	**0**	**0**	**119,000**	**0**	**NA**	**NA**
Earned Income Credits (outside caps)	**$144,000**	**2,082**	**$145,000**	**2,082**	**0.69**	**0.00**
Total	**$8,256,272**	**97,605**	**$8,986,084**	**100,133**	**8.84**	**2.59**

Source: IRS' Fiscal Year 2001 Congressional Justification

[268] This table is reproduced from GAO Report 00-133, Appendix I. Data for this table may be found at FY 2001 Justification at SD 1, PAM-1, TLE-1.

Appendix II

Comparison of IRS' Fiscal Year 2000 Proposed Operating Level and Fiscal Year 2001 Total Budget Request [269]

Dollars in thousands		
	Subtotal	**Total**
Fiscal year 2000 proposed operating level (includes Earned Income Tax Credit appropriation)		**$8,256,272**
Decreases for fiscal year 2001		
Information Systems (non-recur)	($50,897)	
Transfer of resources to Treasury Inspector General for Tax Administration	(732)	
Subtotal-decreases	**($51,629)**	
Increases for fiscal year 2000		
Adjustments necessary to maintain current levels	347,596	
Program annualization	40,736	
Staffing Tax Administration for Balance and Equity	144,071	
Electronic Tax Administration	3,000	
Operational support contracts	43,631	
Organizational modernization	42,407	
Business line investments	40,000	
Information Technology	119,000	
Earned Income Tax Credit compliance initiative	1,000	
Subtotal-increases	**781,441**	
Fiscal year 2001 budget request		**$8,986,084**
Difference between fiscal year 2000 operating level and fiscal year 2001 budget request		**$729,812**

Source: IRS' Fiscal Year 2001 Congressional Justification.

[269] This table is reproduced from GAO Report 00-133, Appendix II. Data for this table may be found at FY 2001 Justification at SD 1, PAM-1, TLE-1.