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

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

For a Joint Review
Scheduled on May 14, 2002

By the Staff

of the

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 organization and management of the IRS, Congressional oversight, electronic filing, and taxpayer protections and rights.[3]

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.[4] Prior to its revision, the IRS mission statement focused on collecting the proper amount of tax.

The new mission statement 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.[5] 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 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 mission statement as "modernization."

Under provisions relating to Congressional oversight, the IRS Reform Act requires a joint review of IRS activities.[6] The joint review is to include two members from the majority and one

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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 at 61-77. See also, Internal Revenue Service, Highlights of 1998 Tax Changes, Publication 553 (December 1998) at 20-25.

[4] IRS Reform Act sec. 1002.

[5] The most recent strategic plans and major strategies of the IRS are contained in Internal Revenue Service, *IRS Strategic Plan (Fiscal Years 2000-2005)*, Publication 3744 (February 2001) (hereinafter referred to as "IRS Strategic Plan").

[6] Internal Revenue Code ("Code") sec. 8021(f)(2). Unless otherwise indicated, all section references are to the Code.

member from the minority of each of the Senate Committees on Finance, Appropriations, and Governmental Affairs, and the House Committees on Ways and Means, Appropriations, and Government Reform. 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.[7] 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 Senate Committees on Finance, Appropriations, and Governmental Affairs, and the House Committees on Ways and Means, Appropriations, and Government Reform regarding certain matters relating to the IRS. The report is to be made in each calendar year 1999 through 2003.[8]

Pursuant to the IRS Reform Act, a joint review of the strategic plans and budget of the IRS for fiscal year 2003 has been scheduled for May 14, 2002. This document,[9] 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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[7] The first, second, and third joint reviews were held on May 25, 1999, May 3, 2000, and May 5, 2001, respectively. Transcripts are published in Joint Committee on Taxation, *Strategic Plans and Budget of the Internal Revenue Service, 1999,* May 25, 1999 (JCS-4-99); Joint Committee on Taxation, *Strategic Plans and Budget of the Internal Revenue Service, 2000,* May 3, 2000 (JCS-4-00); Joint Committee on Taxation, *Joint Review of the Strategic Plans and Budget of the Internal Revenue Service, 2001,* May 8, 2001 (JCS-2-02).

[8] Sec. 8022(3)(c). The previous three reports can be found at *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-24-99), May 20, 1999; *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; and *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-33-01), May 4, 2001.

[9] 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-38-02), May 10, 2002.

EXECUTIVE SUMMARY

A. Providing Top Quality Service to Each Taxpayer

In general

The IRS's first strategic goal, providing top quality service to each taxpayer, is designed to ensure that every taxpayer receives first-quality service when dealing with the IRS. Roper opinion research organization surveys show a 44 percent improvement in the public approval rating in the last two years. Electronic filers have shown higher satisfaction than paper filers. The data show that the IRS has made a modest improvement in customer satisfaction with in-person and telephone/correspondence collections procedures, while customer satisfaction has decreased with respect to toll-free and local walk-in service. The IRS notes that the number of IRS employees has decreased while the number of returns filed has increased, and this has resulted in taxpayers receiving a lower-than-expected level of service.

The 2002 filing season

The IRS and the GAO report that, with the exception of errors arising from the rate reduction credit, the filing season has been smooth and returns are being processed on time. Electronic filing has increased substantially and there has been an improvement in telephone service; however, the General Accounting Office reports that some of the errors resulting from the rate reduction credit may have been avoided with clearer IRS instructions, that some of the IRS's performance measures for telephone service are misconceived, and that important performance measures for walk-in assistance have been delayed.

The IRS projects that net collections for fiscal year 2002 will be approximately $2 trillion. For fiscal year 2002, the IRS also projects that it will receive 231 million returns, including over 132 million individual returns, and the IRS expects to issue over 99 million individual refunds -- 3 million more than for 2001. As of March 23, 2002, the IRS reported that the average dollar amount per refund was up over 12 percent from last year, and the average refund as of that date was $1,980.

The IRS has reported that, through April 4, 2002, a little more than 40 million tax returns were filed electronically, which is a 13.7 percent increase from the same period last year. The number of taxpayers filing electronically from their home computer increased 39 percent over last year. In addition, 3.6 million taxpayers filed their returns over the telephone and the IRS reported that over 16 million taxpayers chose to file both their Federal and state tax returns simultaneously in a single electronic transaction, an increase of 23.8 percent over last year at this time. Since 1997, electronic filing has increased by 110 percent and on-line filing has grown by 1,700 percent. The General Accounting Office found that, although the increase in the percentage of returns filed electronically is not insignificant, the IRS will need larger future increases to achieve the IRS Reform Act's goal of 80 percent of all returns filed electronically by 2007. The IRS is undertaking a number of initiatives to expand electronic filing for individual and business taxpayers. In addition, the IRS introduced a new web site (www.irs.gov) and has developed CD-ROMs for small business taxpayers.

On telephone service, the IRS notes that through March 30, 2002, the total volume of incoming calls on toll-free lines was up 13 percent, primarily due to questions concerning the rate reduction credit and refunds. Even with the increased volume, through March 30, 2002, approximately 66 percent of taxpayers who wanted to speak with a customer service representative got through, compared to 68 percent at the same time in 2001. Over a four-week period beginning in March, the IRS reports that 74 percent of callers got through, which makes the IRS's goal of 71 percent for the year, within reach. Wait time for questions on tax law was 2.58 minutes (down from 4.27 minutes), and on account questions, 4.76 minutes, (down from 6.11 minutes). The correct response rate for tax law and tax account questions was 83 percent and 89 percent respectively (compared to 75 percent and 88 percent a year ago). In addition, 45.3 million taxpayers (or 8 percent more than last year) have used automated services to get refund and other information. The IRS notes further that a special telephone line for victims of the September 11, 2001 attacks was established by September 24 and over a 90 percent level of service has been provided on the line. The General Accounting Office found that this filing season, taxpayers are spending less time waiting to talk to an assistor and receive accurate answers at a higher rate than a year ago. The General Accounting Office confirms, however, that the rate at which callers connect with an assistor is down, due in part to callers hanging up after inquiring about the rate reduction credit and being transferred to automated services. The National Taxpayer Advocate ranks access to IRS toll-free service as the number one problem faced by taxpayers. The IRS Oversight Board notes that, while service is hampered by the lack of modern tools and technology for providing better service, there is a direct correlation between the number of calls that can be answered and staffing levels.

Walk-in service is available at more than 400 locations throughout the United States. As of March 16, 2002, the IRS estimates that it had served over 3.3 million taxpayers at all Taxpayer Assistance Centers, slightly more than for the same period in 2001. The General Accounting Office reports that the accuracy rate reported through mid-March 2002 at walk-in sites is encouragingly high, at 84 percent. Although this is clearly a better figure than the low accuracy rates reported by the IRS in 2000 (24 percent) and by the Treasury Inspector General for Tax Administration in 2001 (51 percent) the measurement methodology for 2002 is not comparable to prior years so it is difficult to assess the degree of improvement. After delays, the IRS plans to begin measuring the accuracy of account and return preparation services at walk-in sites by June 2002.

Other service issues

In the summer of 2001, the IRS mailed out over 90 million advance payment checks for the rate reduction credit and issued notices to all taxpayers and coordinated an unprecedented outreach to America's taxpayers through an intricate computer programming project, numerous news releases, an updated Web site, and additional assistors to handle record call volumes.

Immediately following the September 11 terrorist attacks, the IRS provided administrative relief to the victims in the form of extensions to file returns and pay taxes and suspended many enforcement actions for the affected taxpayers. In addition, special toll-free numbers were established to answer any questions, and a special disaster relief page was created on the IRS's Web site.

During the 2002 filing season, the IRS is averaging 12 days to issue a refund (compared to 14.6 last year) for an electronic return and 26 days (compared to 28 days last year) for a paper return, though the average rate is expected to increase at the end of the filing season.

The IRS acknowledges customer service shortcomings in the Employer Identification Number assignment process. Telephone coverage for Employer Identification Number service at IRS facilities has been inconsistent. Faxed requests for Employer Identification Numbers also have not been handled expeditiously. On January 2, 2002, the IRS consolidated Employer Identification Number services into three sites and now offers telephone service at consistent times.

The IRS redesigned six notices, and continues to redesign 24 additional notices. In addition, the IRS has hired a consultant to develop a taxpayer burden model and has hired a contractor to redesign Form 941 (Employer's Quarterly Federal Tax Return) and its instructions. Schedule D, which is used to calculate capital gains and losses, was redesigned for the 2002 tax-filing season. Nevertheless, the General Accounting Office reports that the IRS paperwork burden increased in fiscal year 2001 by 250 million hours, due in significant part to changes initiated by the IRS, as well as a reaction to new tax laws.

B. Providing Top Quality Service to All Taxpayers

In general

The second strategic goal requires the IRS to provide top quality service to all taxpayers. A tax system designed to promote and ensure compliance, and effective enforcement of the law, are essential components to achieving fair and uniform application of the tax law. In general, the IRS ensures compliance by matching information received from employers, financial institutions, and other businesses with information received by taxpayers. The IRS estimates that the total personal income that cannot be verified by document matching was about $1.2 trillion in fiscal year 1998, or 19.7 percent of total reported personal income. In fiscal year 2001, the IRS began capturing the data from 16.8 million K-1 forms which are used to report income, credits, and deductions of partners, shareholders and beneficiaries of passthrough entities. In 2002, the IRS will begin processing and matching K-1 forms with individual tax returns. Trusts and offshore bank accounts (including credit cards from offshore banks) used by upper-income taxpayers to hide income have become a significant loss of revenue to the Treasury -- the IRS estimates losses in the tens of billions of dollars. Among other things, the IRS has started a special initiative to identify offshore credit card accounts.

Enforcement activity

Levies, liens, and seizures all increased significantly from fiscal year 2000: levies more than tripled, liens increased by approximately 50 percent, and seizures jumped from 74 to 234. However, total enforcement actions were a fraction of levels in fiscal years 1995 through 1998 (e.g., levies were approximately 18 percent of 1997 levels, liens approximately 79 percent, and seizures approximately 2 percent). Enforcement revenue remained at fiscal year 2000 levels at $33.8 billion, a drop from $37.2 billion in fiscal year 1997. The IRS attributes its inability fully to pursue enforcement cases to the modernization effort, a decrease in staff, reassignment of collection employees to support customer service activities, and additional staff time needed to implement certain taxpayer protections that were included in the IRS Reform Act. Additionally, the IRS reports that inadequate financial and operational information has hindered development of cost-based performance information for tax collection and enforcement programs.

The IRS Oversight Board is concerned that the broad decline in enforcement activity increases the tax system's reliance on voluntary compliance, and fears that the public's attitude towards voluntary compliance is eroding.

The IRS has identified four areas of systemic non-compliance on which it plans to focus its (limited) enforcement resources: (1) misuse of trusts and passthrough entities to hide or improperly reduce income; (2) use of complex and abusive corporate tax shelters to reduce taxes improperly; (3) failure to file and pay large accumulations of employment taxes; and (4) erroneous refund claims and Earned Income Tax Credit fraud.

Audit activity

In fiscal year 2001, the audit rate increased slightly to .58 percent and the number of returns audited increased to approximately 732,000. By contrast, the number of returns audited in fiscal years 1997, 1998, and 1999 were approximately 1,519,000, 1,193,000, and 1,100,000 -- demonstrating a steady decline in number of returns audited. The IRS continues to audit the 1,100 largest corporations every year but the audit rate for all other corporations declined from 3 percent in 1992 to 1.1 percent in fiscal year 2001. The audit rate for all large corporations has declined significantly since fiscal year 1997 (12,972 closures) to fiscal year 2001 (8,718 closures), and the decrease for small corporations is more dramatic, from fiscal year 1997 (56,323 closures) to fiscal year 2001 (14,332 closures). The IRS audited only one of every 256 returns of passthrough entities -- the equivalent of 0.39 percent. The IRS's new K-1 matching program will not provide any verification of the income reported by the passthrough entity itself; this still requires an audit.

Technical staffing levels for audit activity have declined, from 14,399 revenue agents in fiscal year 1997, 12,550 in 2000, and 11,598 in 2001, and from 2,318 tax compliance officers in fiscal year 1997 to 1,702, in 2000, and 1420 in 2001. The IRS says it will rely on the Business Systems Modernization program to increase the effectiveness and efficiency of compliance activities over the long term. The IRS also hopes to reduce the need for some enforcement efforts by focusing on prefiling initiatives, thereby increasing voluntary compliance.

Measuring compliance -- National Research Program

The IRS acknowledges that the lack of a reliable way to measure taxpayer compliance limits the IRS's ability to assess progress in serving all taxpayers through effective and fair application of the tax laws. The IRS is developing a new program, the National Research Program, which will measure filing compliance, payment compliance, and reporting compliance by taxpayers. The data gathered through the National Research Program will be used to update the formulas used for selecting returns for audit. The IRS Oversight Board supports the National Research Program and requests Congressional support for the Program.

C. Productivity Through a Quality Work Environment

In general

As its third strategic goal, the IRS plans to increase productivity by providing a quality work environment for its employees. The IRS is working to create a positive work place characterized by equal opportunity, recognition of employee performance, and no artificial barriers to advancement. According to the IRS, overall job satisfaction for IRS employees was 59 percent in the year 2000. This number decreased to 51 percent in 2001, a 14 percent decrease from fiscal year 2000. According to the IRS Oversight Board, IRS employee morale and job satisfaction are not adequate and that the IRS is not providing a quality work environment.

Violations for which IRS employees may be terminated

The IRS Reform Act defined 10 specific acts of misconduct for which an IRS employee may be terminated ("section 1203 violations"). The Commissioner may determine that there are mitigating factors that weigh against terminating an employee. As of February 28, 2002, there were 327 substantiated violations of section 1203. Of the 327 substantiated violations, 282 were for failure to file a Federal tax return. Of the 3,045 completed section 1203 inquiries, 2,098 inquires found that the allegation was not substantiated; 620 inquires were found to constitute non-section 1203 misconduct. Fifty-four employees have been removed for section 1203 violations, 46 of whom were removed for willful failure to timely file a Federal tax return. The IRS reports that since enactment of section 1203, IRS employees frequently report that fear of a section 1203 allegation causes reluctance to take appropriate enforcement actions and that section 1203 is negatively affecting employee morale and effectiveness.

As part of this year's budget request, the IRS requested that two section 1203 violations be eliminated from the list. These are the late filing of tax returns for which a refund is due and actions by IRS employees that violate another IRS employee's rights, rather than a taxpayer's rights. The IRS also requested that the unauthorized inspection of returns or return information be added to the list of violations. In addition, the IRS wants the Commissioner to be able to establish guidelines that outline specific penalties, including termination, for the types of wrongful conduct listed under section 1203. The IRS Oversight Board found that section 1203 needs reform.

Personnel flexibility and IRS management

The IRS Reform Act gave the IRS considerable authority relating to recruitment and pay authority. To attract and retain highly qualified and exceptional individuals, the IRS uses professional search firms and often has IRS and Treasury executives interview Streamlined Critical Pay candidates. The IRS credits the recruitment techniques and the streamlined aspect of the program with finding executives that are better qualified than by using traditional recruitment means. According to the IRS, the Streamlined Critical Pay executives have brought exceptional talent and a wide range of skills to the IRS. In recruiting critical pay personnel, the IRS spent $1,822,759 for moving expenses (the program is the same as for career personnel except the IRS Reform Act covers an executive's first move prior to government service) and

$3,639,985 on executive searches. The IRS states that more could be accomplished if IRS employees were eligible for Streamlined Critical Pay positions.

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. Accordingly, the IRS is changing its organizational performance measures to balance business results (both quantity and quality), customer satisfaction, and employee satisfaction. The IRS Oversight Board reports that the IRS will complete the implementation of the balanced measures program in 2002.

D. Organizational and Technological Modernization

Organizational modernization

The IRS has made significant progress in implementing the new organizational structure. The IRS created four operating divisions to serve taxpayers of similar needs: Wage and Investment; Small Business and Self-Employed, Large and Mid-Size Business, and Tax Exempt and Government Entities. There are also several functional units, including Appeals, the Taxpayer Advocate Service, Criminal Investigation, and Communication and Liaison. This new organization formally replaced the prior geographically based organizational structure on October 1, 2000. Top management is in place for each of the operating divisions and business units. The final stages of implementation, including the redistribution of workload, will require another year (through fiscal year 2002).

However, the transition to the restructured IRS continues to be awkward. Problems stemming from the new structure include: providing managers and executives with appropriate authority to make decisions, change-induced decrease to employee morale, uncertain relationships among the new operating divisions, uncertain understanding by IRS personnel about how the new structure is meant to work, and the lack of appropriate information systems.

Technology modernization

Presently, the IRS relies on computer systems developed in the 1960's and 1970's to maintain taxpayer records. Modernization of such systems is a massive long-term project that aims to improve: access to information and tax data for all taxpayers, accuracy of information provided by the IRS to all taxpayers, speed of response to taxpayers, timeliness of IRS initiated actions, and productivity of IRS staff.

There are two major modernization efforts: Business Systems Modernization and Tier B modernization. Business Systems Modernization is the more significant, involving the long-term reconstruction of the IRS's business technology and processes. Tier B modernization typically involves shorter-term projects directed toward updating software and coordinating old computer systems with new technology as improvements are made by Business Systems Modernization.

For the past seven years, the General Accounting Office has discussed with the IRS the importance of establishing sound management controls to guide its systems acquisition projects.

In June 2001, the General Accounting Office found that although the IRS continued to make important progress in implementing modernization management controls, the IRS's modernization management capacity was still not where it needed to be. In February 2002, the General Accounting Office reported progress, specifically, that the IRS had: (1) reviewed the PRIME contractor's quality-assurance function and recommended improvements; (2) defined risk management policies and procedures for its enterprise lifecycle approach; (3) issued the second version of the IRS's enterprise architecture and implemented steps to ensure that the architecture would be integrated with other modernization projects; and (4) planned an independent assessment of selected projects. In addition, IRS recently hired technical and managerial executives with substantial private-sector experience for its reorganized Business Systems Modernization Office.

In March 2002, the Treasury Inspector General for Tax Administration released an audit report of the IRS's modernization efforts and called the IRS "overly optimistic" about the timetable for delivering modernized systems, "given the immaturity of [the IRS's] management processes." The Treasury Inspector General for Tax Administration noted areas requiring improvements needed to avoid future delays and cost increases.

This April, the General Accounting Office reported continued progress and noted a number of IRS accomplishments. Despite progress made, however, the General Accounting Office reports that the IRS is not where it committed to be in acquiring both infrastructure and application systems and not where it needs to be in implementing modernization management controls. In particular, the General Accounting Office found that the IRS is proceeding with building systems -- including detailed design and software development work -- before the IRS has (1) fully implemented mature software acquisition management processes, (2) developed and deployed a human capital management strategy, and (3) established effective cost and schedule estimating practices.

The IRS has reported that Business Systems Modernization projects have already encountered cost, schedule, and/or performance shortfalls. The General Accounting Office's analysis has showed that weak management controls contributed directly to these problems. According to the IRS, until the weaknesses are fully addressed, the IRS will be (1) relying on existing immature processes; (2) leveraging the knowledge, skills, and abilities of experienced senior executives to ensure that issues are properly managed; and (3) hiring additional experienced executives. The General Accounting Office believes the answer lies in a more modest scope and pace of systems projects until management capacity is brought up to the level needed.

There are a number of key modernization programs. The Customer Account Data Engine (often referred to as CADE) will provide a modern system for storing, managing, and accessing taxpayer records and accounts. The Customer Account Data Engine incrementally will move individual filers from the 1960s tape system to a modern database, and will create applications for daily posting, settlement, maintenance, refunds processing and issue detection for taxpayer tax accounts and return data. The Customer Account Data Engine will be deployed over a six-year period in five "Releases." First steps were scheduled to begin in October 2001 but have been delayed.

The Customer Account Management program will allow the IRS to update data in the Customer Account Data Engine and will help the IRS give taxpayers timely and accurate responses to requests and inquiries; however it cannot be deployed beyond its initial limited releases without Customer Account Management.

The e-Services project will support the IRS's ability to conduct most transactions with taxpayers and their representatives in an electronic format, as required by the IRS Reform Act.

Another program will deliver a self-service Internet application to allow taxpayers to check on the status of their income tax return posting and their refund.

The Custodial Accounting Project will provide the IRS with the control and reporting capabilities mandated by Federal financial management laws.

The Enterprise Data Warehouse will provide the foundation for data mining and decision analytic tools, and will enable risk-based analysis for case selection and provide the tools to report on IRS balanced performance measures.

Filing and Payment Compliance will use technology to improve IRS communications with taxpayers on compliance issues and also protect taxpayer rights.

E. IRS Budget Request for Fiscal Year 2003

In general

For fiscal year 2003, the IRS budget request totals $10.418 billion and 101,080 full-time equivalent positions. The fiscal year 2003 budget request reflects a $482 million increase from the fiscal year 2002 appropriated level of $9.936 billion and an increase of 1,179 full-time equivalent employees from the fiscal year 2002 proposed operating level of 99,901 full-time equivalent employees. The IRS fiscal year 2003 budget request has four building blocks: (1) provide a world class level of service; (2) modernization; (3) maintain current operations; and (4) legislative proposals.

Funding for customer service

To provide a world class level of service, the IRS requests $260 million to fund initiatives to enhance customer service and compliance and workload increases, $158 million of which will be funded through reapplication of resources within the base budget. This amount reflects $125 million and 1,857 full-time employees for compliance, $91 million and 1,595 full-time employees for customer service and workload increases, and $44 million for non-labor increases.

Funding to support IRS modernization

The IRS has requested an increase of $68 million for Business Systems and Tier B Modernization above the $432 million operating level for fiscal year 2002. The IRS has requested a total of $450 million for Business Systems Modernization (a $58 million increase). The IRS states that the increase will fund the contract, equipment, and software costs needed to improve the speed, timeliness and accuracy of the IRS's interactions with taxpayers. The IRS plans to deliver a number of benefits for businesses, employees, taxpayers, and a number of project-related benefits.

The IRS has requested a total of $50 million for Tier B modernization (a $10 million increase). The IRS states that the Tier B projects will support objectives in criminal investigations, national headquarters business units, and wage and investment business activities. In addition, Tier B investments will provide all Remittance Transaction payment information on-line in real time, allow for team-based reporting compliance, give employees electronic training tools, support the National Forensic Lab's technology, and create computer enhancements that permit multiple system interfaces on one computer terminal.

Funding to maintain current operations

The IRS requests $342 million to maintain current operations. Of this amount, $295 million funds pay, benefits, and non labor inflationary costs, $37 million covers the costs of within-grade pay increases for on-board employees, and $10 million is for enhanced security arrangements pursuant to the Homeland Security Supplemental. The IRS expects to save $39 million from better business practices and notes that $31 million from the fiscal year 2002 budget for homeland security does not recur in fiscal year 2003.

Legislative proposals and other adjustments

Proposals in the President's fiscal year 2003 Budget require an increase and adjustments of $40 million for the costs of retirement and health benefit retiree costs, the costs of services provided by the General Services Administration, the National Archives and Records Service and the Department of Agriculture, and a surcharge to the Department of Labor for Federal Employees' Compensation Act benefits.

Financial audit of IRS fiscal year 2001 financial statements

Like fiscal year 2000, the General Accounting Office expressed an unqualified opinion on all IRS financial statements. The General Accounting Office rendered unqualified opinions in both years due to the "extraordinary efforts of IRS senior management and staff to compensate for serious internal control and system deficiencies." By contrast, the General Accounting Office's audit of IRS financial statements for fiscal year 1999 resulted in an unqualified opinion on its custodial activity statement, a qualified opinion on its balance sheet, and a disclaimer that no opinion could be issued on the remaining IRS financial statements. In prior years, the General Accounting Office's audit reports were less favorable. However, despite its unqualified opinions, the General Accounting Office continues to identify many material weaknesses in the IRS's internal controls.

F. Other Matters Addressed by the IRS Reform Act

IRS Oversight Board

In its January 2002 annual report, the IRS Oversight Board found that customer service (especially toll-free telephone and walk-in service) has not risen to desired levels but notes that taxpayer satisfaction with the IRS has increased. Enforcement results are slightly upward by many measures in 2002, with the exception of a general decrease in the number of audits. The IRS Oversight Board finds that IRS productivity has decreased by many measures over the past three years, which may be attributable to a variety of factors, such as declining resource allocation, low employee satisfactions, and tax-law complexity. The IRS Oversight Board approved the IRS's proposed budget for fiscal year 2003.

The IRS Oversight Board identified as significant challenges to the IRS the outdated state of IRS technology, the increasing complexity of the tax code, reduced staffing levels, service levels to taxpayers, declining results in enforcement, lack of compliance data to make informed resource allocation decisions, declining productivity, workforce engagement, successful implementation of the balanced measures program (which will evaluate employee performance with measures other than tax results), and other human capital issues.

To improve the Business Systems Modernization program, the IRS Oversight Board recommends that the IRS improve its program management ability, work more effectively with the PRIME Contractor, and manage change more effectively. The IRS Oversight Board also recommends that the PRIME Contractor, the Administration, Congress, and oversight organizations work to support the completion of the Business Systems Modernization program.

The IRS Oversight Board held a public meeting on January 29, 2002, during which it heard testimony about IRS operations from representatives of 16 organizations. Other activities of the IRS Oversight Board include helping to select a new IRS Commissioner, reviewing the performance evaluations and proposed bonuses of 13 IRS executives, and interviewing the current National Taxpayer Advocate prior to her selection as such.

National Taxpayer Advocate

The National Taxpayer Advocate's annual report focused on tax code complexity as the most serious problem facing business and individual taxpayers. The National Taxpayer Advocate's Report identified six main areas for legislative action: family status issues, joint and several liability, alternative minimum tax for individuals, penalties and interest, home-based service workers, and IRS collection procedures. The National Taxpayer Advocate made several detailed legislative proposals for each area. The National Taxpayer Advocate's Report also identified and discussed 23 of the most serious problems identified by individual taxpayers and identifies the top ten most litigated issues by taxpayers.

The National Taxpayer Advocate's Report states that during fiscal year 2001, the Taxpayer Advocate Service independently reviewed and took action to resolve over 272,000 cases. The National Taxpayer Advocate's Report listed the top sources of Taxpayer Advocate Service casework as Earned Income Tax Credit examinations due to the Revenue Protection Strategy, processing of claims or amended returns, initial processing of original paper or electronic individual returns, and processing of refunds.

Treasury Inspector General for Tax Administration

The Treasury Inspector General for Tax Administration's semiannual report to the Congress for the period April 1, 2001, through September 30, 2001, reports that the Treasury Inspector General for Tax Administration issued 126 audit reports during the six-month period. Financial results due to audit reports totaled $13 billion and an additional $13.3 billion in increased revenue and protected revenue. The Treasury Inspector General for Tax Administration estimates that its audit recommendations will improve tax administration for approximately 14.5 million taxpayers. In addition, the Treasury Inspector General for Tax Administration closed nearly 2,322 investigations of criminal wrongdoing and administrative misconduct during the reporting period. Investigations recovered approximately $8.1 million.

The Treasury Inspector General for Tax Administration reports that the IRS has improved security over information systems and has made notable progress in modernizing its technology systems. However, significant weaknesses continue to exist in both areas. The Treasury Inspector General for Tax Administration also reported that: the IRS needs to increase its focus on international compliance programs and improve the quality and use of information received on the income of foreign persons; the IRS's Criminal Investigation function was not making a shift to investigate tax crimes as recommended by the June 2001 Report; the IRS did not have a centralized process to ensure that all of the requirements of the Government Performance and Results Act were achieved and maintained; the IRS has made significant improvements to its remediation plan to bring its financial systems into compliance; and that while the IRS had made progress in implementing the taxpayer rights provisions of the IRS Reform Act, significant improvements are needed in compliance with IRS Reform Act provisions, including innocent spouse relief, notice of lien, prohibition on Illegal Tax Protester designations, and restrictions on the use of enforcement statistics. In addition, the Treasury Inspector General for Tax Administration reports that improvements are also needed in meeting IRS Reform Act's legal and procedural requirements for collection statute extensions and installment agreements.

The Office of Investigation completed 1,045 investigations related to threats, assaults, or harassment of IRS employees as they carry out their duties. During the reporting period, the Office received 3,902 complaints of fraud, waste, abuse, and other forms of wrongdoing by IRS agents, of which 1,600 warranted further investigation. The Strategic Enforcement Division of the Office of Investigation analyzed 293 leads of potential unauthorized access to tax information by IRS employees, resulting in 139 referrals to field special agents.

Taxpayer rights

The IRS has stated that the principal difficulty in carrying out the taxpayer due process provisions of the IRS Reform Act has been engineering an efficient system that does not disproportionately expend resources on cases in which taxpayers are abusing the process to delay collection. According to the IRS, a significant percentage of due process cases (four percent, or 800 out of a total of 20,000 cases in inventory) advance arguments that are frivolous or otherwise without merit. The IRS has requested a legislative change to permit the IRS to dismiss requests for collection due process hearings if the request is based on frivolous arguments or is intended to delay or impede tax administration. The IRS also has requested that the United States Tax Court be the exclusive venue for suits to obtain judicial review of an Appeals determination resulting from a collection due process hearing. The IRS reports that it will establish a list of known claims that the IRS will treat as frivolous and will publish the list on the IRS website.

The Treasury Inspector General for Tax Administration concluded in September 2001 that the IRS is fully compliant with the seizure of property and the notice of levy provisions of the IRS Reform Act. However, in a more recent report, the Treasury Inspector General for Tax Administration found that the IRS does not always release levies as required by the Code in cases where a determination had been made that the tax was not collectible due to economic hardship and that IRS was closing some cases that should not be closed.

The Treasury Inspector General for Tax Administration found that the IRS was not fully compliant with the notices of lien procedures. In some cases, the IRS failed to notify the taxpayer that a lien had been filed, and the IRS still was not compliant with legal and internal guidelines in 17 percent of the cases reviewed. The Treasury Inspector General for Tax Administration found that Appeals officers hearing appeals of determinations to file a lien or intent to levy generally complied with legal requirements in 85 of 87 cases reviewed.

The IRS has faced several difficulties in implementing the innocent spouse provisions. A number of factors resulted in a significant backlog of cases. However, the IRS has taken several steps to improve the program and the data show that the IRS is reducing the backlog substantially. In addition, the average processing time for claims has improved significantly. The IRS reports that efficiencies achieved through the centralization of innocent spouse claims in Cincinnati and deployment of the Integrated Case Processing software warrant a reduction in staff. The National Taxpayer Advocate concludes that the IRS's efforts are commendable and that fewer innocent spouse cases were being reported to the Taxpayer Advocate Service. The Treasury Inspector General for Tax Administration concluded that the IRS is effectively educating taxpayers about the requirements that must be met to qualify for innocent spouse relief.

In a recent report on the offer in compromise program, the General Accounting Office found that between fiscal years 1997 and 2001, the inventory of unresolved offers nearly tripled to approximately 95,000. Changes to the program have increased the demand for offers, the number of steps involved, and the number of staff hours taken. The IRS is processing far fewer offers within six months today than the IRS did in fiscal year 1999 and is processing offers within six to 12 months at about the same rate. Offers that take more than a year to process have increased substantially. The IRS attributes the delay in processing offers in compromise to several factors. To improve the process, the IRS has requested modification of the rules to permit the IRS to enter into installment agreements for amounts less than the full liability owed by taxpayers. The IRS also requests the authority to dismiss requests for offers in compromise that are based on frivolous arguments or that are intended to delay or impede tax administration. In addition, the IRS requests that an opinion of IRS Chief Counsel no longer be mandatory for compromises of $50,000 or more (including penalties and interest).

The IRS also explains this year's increase in average processing time in part to the fact that experienced employees were moved from the field to help train at the centralized offer in compromise sites and that training took longer than expected. In addition, the IRS reports that the newly established centralized sites have been understaffed and attrition at the sites has been higher than expected. The IRS says that in April 2002 an additional 82 Offer Examiners, and, by June 2002, an additional 35 Process Examiners will have completed training and the sites then will be fully staffed.

The IRS stated that it continues to address the backlog of offer in compromise cases in a number of ways. In general, the General Accounting Office characterized the likely effectiveness of the IRS's current initiatives as uncertain. In light of such uncertainty, the General Accounting Office recommended that the Commissioner: (1) develop a final implementation plan that evaluate and prioritizes the various IRS offer initiatives before moving forward with implementation; (2) determine what offer in compromise performance and cost data should be collected; (3) establish goals for offer processing time that are based on taxpayer needs, costs, and other benefits; and (4) prepare documentation describing the IRS's proposed partial payment installment agreement program.

I. PROVIDING TOP QUALITY SERVICE TO EACH TAXPAYER

A. In General

The IRS's first strategic goal, providing top quality service to each taxpayer, is designed to ensure that every taxpayer receives first-quality service when dealing with the IRS. To achieve this goal, the IRS has determined that it needs to: (1) provide clear tax law guidance, forms, and instructions; (2) provide taxpayers with accurate, quick, and convenient information about their tax accounts and assistance in determining how much to pay, how to pay, and how to make adjustments to their accounts; and (3) treat taxpayers professionally, with full consideration of their rights, and promptly inform the taxpayer when the IRS believes additional taxes are owed.[10]

Opinion surveys show that taxpayer service is improving. Roper opinion research organization surveys show that, after reaching an all time low point in 1998, the agency's public approval rating improved in 2001.[11] The survey shows a 44 percent improvement in the last two years. The American Customer Satisfaction Index survey for 2001 (conducted by the University of Michigan) reported an increase in taxpayer satisfaction of 11 percent since calendar year 2000 and 22 percent since calendar year 1999, the largest favorable gain of the 30 federal agencies surveyed.[12] The satisfaction rate for electronic filers was 77 out of 100 points, in contrast with 52 points for paper tax filers.[13]

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[10] IRS Strategic Plan at 4, 25. To carry out the IRS strategic goals, the IRS has developed six guiding principles: (1) understand and solve problems from the taxpayer's point of view; (2) enable managers to be accountable with the requisite knowledge, responsibility, and authority to take action; (3) align measures of performance at all organizational levels; (4) foster open and honest communication; (5) insist on total integrity; and (6) demonstrate effective stewardship of assets and information entrusted to the IRS. *Id.* at 37. All IRS executives, managers, and employees are expected to manage and operate using these guiding principles in their interactions with both taxpayers and other employees. In addition to guiding principles, the IRS has developed 10 "major strategies" to achieve its strategic goals. These strategies are to: meet the needs of taxpayers; reduce taxpayer burden; broaden the use of electronic interactions; address key areas of noncompliance; stabilize traditional compliance activities; build a capability to deal effectively with the global economy; meet the special needs of the tax-exempt community; recruit, develop, and retain a qualified workforce; provide high-quality efficient, and responsive information services and shared support services; and promote effective asset and information stewardship by improving internal processes for information management, financial management, and asset management.

[11] Internal Revenue Service Oversight Board Annual Report (January 2002) (hereinafter "IRS Oversight Board Report") at 10-11.

[12] Special Report: Government Satisfaction Scores (December 21, 2001), available at http://www.theacsi.org/government/govt-01.html.

[13] *Id.*

In 2001, for the first time, the IRS set performance goals for its primary programs.[14] The resulting agency-wide operational performance measures provide a benchmark for analysis of the IRS's performance with respect to service to taxpayers.[15] The data show that the IRS has made a modest improvement in customer satisfaction with in-person and telephone/ correspondence collections procedures, while customer satisfaction has decreased with respect to toll-free and local walk-in service.[16] The IRS notes that the number of IRS employees has decreased while the number of returns filed has increased, and this has resulted in taxpayers receiving a lower-than-expected level of service.[17]

B. The 2002 Filing Season

Overview

Commissioner Rossotti testified that the 2002 tax filing has been "smooth, with returns being processed on time, electronic filing increasing substantially and improved accessibility and accuracy of telephone service."[18] Although confusion and a significant number of errors have resulted from the rate reduction credit, the IRS reports that it has responded quickly to errors and taxpayers are timely receiving refunds. The General Accounting Office, in its preliminary review of the IRS's performance during the 2002 filing season, agreed that, with the exception of the rate reduction credit, the filing season so far has been smooth, there has been continued growth in electronic filing, and telephone service has improved.[19] However, the General Accounting Office reports that some of the errors resulting from the rate reduction credit may have been avoided with clearer IRS instructions, that some of the IRS's performance measures for telephone service are misconceived, and that important performance measures for walk-in assistance have been delayed.[20]

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[14] Internal Revenue Service Progress Report, From the Commissioner of the Internal Revenue Service (December 2001) (hereinafter "IRS Progress Report") at 36.

[15] However, as discussed below, the General Accounting Office reports that the performance measures do not provide useful information about certain aspects of the IRS's telephone service.

[16] IRS Progress Report at 38.

[17] *Id.* at 30.

[18] Statement of Charles O. Rossotti, Commissioner of Internal Revenue, before the Subcommittee on Oversight of the House Committee on Ways and Means (April 9, 2002) (hereinafter "Rossotti April 9, 2002, Testimony") at 2.

[19] Statement of James R. White, Director, Tax Issues, before the Subcommittee on Oversight of the House Committee on Ways and Means (April 9, 2002) (hereinafter "GAO April 9, 2002, Statement") at 3.

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

The IRS projects that net collections for fiscal year 2002 will be approximately $2 trillion.[21] For fiscal year 2002, the IRS also projects that it will receive 231 million returns, including over 132 million individual returns, and the IRS expects to issue over 99 million individual refunds -- 3 million more than for 2001. As of March 23, 2002, the IRS reported that the average dollar amount per refund was up over 12 percent from last year, and the average refund as of that date was $1,980.[22] Commissioner Rossotti testified that just over 40 million tax returns have been filed electronically, a 13.7 percent increase from last year.[23]

Rate reduction credit

In an otherwise smooth filing season, the rate reduction credit has, as of March 15, caused errors on 3.1 million returns out of 4.7 million returns with errors.[24] The credit is for taxpayers who did not receive the maximum benefit of the advance payments that were mailed in the summer of 2001, as required by the Economic Growth and Tax Relief Reconciliation Act of 2001, and whose 2001 income or tax amounts qualify them for an additional amount. To administer the one-time credit, the IRS added a line to the individual income tax forms and provided a worksheet for taxpayers to determine eligibility. Common errors have been: failure to claim the credit, mistakenly reporting as a credit the amount already paid to the taxpayer as the advance payment, and miscalculation of the amount of the credit.

The General Accounting Office reports that the IRS may have been able to prevent some of these errors with clearer instructions, for example by highlighting the rate reduction credit and the new line on the tax forms on the cover page of the instructions, where IRS alerts taxpayers to annual changes, instead of mentioning the credit under the highlighted caption "Tax Rates Reduced."[25] The General Accounting Office notes that information on the IRS's website was more informative than information on the instructions. However, the General Accounting Office and the IRS report that the IRS acted quickly once it became apparent that errors on the rate reduction credit were numerous.[26] The IRS posted information on its website, sought to increase public awareness about the credit through new releases and other measures, and for electronic filers, rejected many returns so that the error could be corrected and the return resubmitted. The General Accounting Office notes that there does not appear to have been an adverse impact on

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[21] Rossotti April 9, 2002, Testimony at 2.

[22] *Id.*

[23] *Id.*

[24] GAO April 9, 2002, Statement at 21.

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

[26] *Id.* at 22; Rossotti April 9, 2002, Testimony at 2.

the IRS's ability to process returns and refunds in a timely fashion because of the increased error-correction workload, though this could change as the filing season progresses.[27]

Electronic tax administration

In general

Electronic filing generally is 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 and, in general, electronic filing is more accurate than paper filing.

The IRS has reported that, through April 4, 2002, a little more than 40 million tax returns were filed electronically, which is a 13.7 percent increase from the same period last year. The number of taxpayers filing electronically from their home computer increased 39 percent over last year.[28] In addition, 3.6 million taxpayers filed their returns over the telephone,[29] using the *TeleFile* system, which was down from 3.8 million from the same period last year. Maryland, Oregon, and West Virginia joined and Georgia, Indiana, Kentucky and Oklahoma in the Federal/State *TeleFile* option.[30] In addition, the IRS reported that over 16 million taxpayers chose to file both their Federal and state tax returns simultaneously in a single electronic transaction,[31] an increase of 23.8 percent over last year at this time. This year, 37 states and the District of Columbia are participating in the program. Since 1997, electronic filing has increased by 110 percent and on-line filing has grown by 1,700 percent. The American Customer Satisfaction survey showed that electronic filers had a high satisfaction rate, increasing in each of the last three years. Overall, the IRS is on pace to meet its goal of receiving 46 million returns electronically this year, an increase of 15 percent from last year.

The General Accounting Office found that, although the increase in the percentage of returns filed electronically is not insignificant, the IRS will need larger future increases to achieve the IRS Reform Act's goal of 80 percent of all returns filed electronically by 2007.[32] The General Accounting Office reported that to encourage more electronic filing in 2002, the IRS mailed letters to approximately 250,000 tax professionals encouraging their continued use or

[27] GAO April 9, 2002, Statement at 23.

[28] Rossotti April 9, 2002, Testimony at 3.

[29] *Id*.

[30] Federal/State *TeleFile* allows taxpayers to file both Federal and State returns in a single telephone call.

[31] Rossotti April 9, 2002, Testimony at 3.

[32] GAO April 9, 2002, Statement at 25. See also section 2001 of the IRS Reform Act. The IRS has acknowledged that "achieving the congressionally-mandated goal of 80 percent of returns filed electronically by 2007 will be very difficult." IRS Progress Report at 13.

adoption of electronic filing. The IRS also mailed about 23 million postcards explaining the benefits of electronic filing to selected taxpayers, for example, those who had received TeleFile packages in prior years but did not utilize the program.[33]

The National Taxpayer Advocate's fiscal year 2001 Annual Report to Congress lists the cost of electronic filing for low-income taxpayers as one of the most serious problems encountered by taxpayers.[34] According to the National Taxpayer Advocate, low-income taxpayers file returns to obtain excess withholding or the Earned Income Tax Credit and many have a pressing need for funds. Although paper returns are an option, paper returns take four to six weeks to process compared to about ten days to receive a refund by direct deposit from an electronically filed return. However, many taxpayers incur a significant cost to claim the Earned Income Tax Credit electronically. They may be charged a fee for return preparation, for electronic return submission, and for a refund anticipation loan if they need money immediately.

Electronic filing for individual taxpayers

Expansion of the *e-file* program.--The IRS continues to expand availability of the *e-file* program, by increasing the number of different forms that taxpayers may file electronically. For example, for the 2002 filing season, the IRS added 29 additional forms and schedules to the individual e-filing program.[35] The IRS reports that over 99 percent of all taxpayers are eligible for electronic filing, and that this year's increase could add 38 million electronic filers.[36]

Personal identification numbers in lieu of paper signatures.--The IRS is in the process of making the e-filing process entirely paperless. In prior years, the taxpayer's signature (on paper) was required to be filed with an electronically-filed return. In 2000, the IRS successfully tested the use of a personal identification number code in lieu of a paper signature. In 2001, the program was extended to taxpayers nationwide and nine million taxpayers utilized the self-selected personal identification number option.[37] The IRS is continuing the program this year. According to the General Accounting Office, as of March 14, 2002, approximately 17.1 million returns had been filed electronically using a self-selected personal identification number, about 180 percent more than during the same period in 2001.[38]

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[33] GAO April 9, 2002, Statement at 26.

[34] Internal Revenue Service, *National Taxpayer Advocate Annual Report to Congress for Fiscal Year 2001*, Publication 2104 (December 31, 2001) (hereinafter "National Taxpayer Advocate FY 2001 Report") at 61-63.

[35] Rossotti April 9, 2002, Testimony at 3.

[36] *Id.* at 3-4.

[37] *Id.*

[38] GAO April 9, 2002, Statement at 26.

Expanded payment options.--In the 2002 filing season, the IRS expanded the electronic payment options available by accepting credit cards for payment of installment agreements and delinquent taxes. The IRS reported that as of April 4, 2002, about 46,449 payments averaging $2,459 were made by credit card and 84,671 payments averaging $979 were made by Automated Clearing House Direct Debit (which allows taxpayers to authorize the debit of a checking or savings account).[39]

Marketing the *e-file* program to taxpayers.--According to a December 2001 report by the General Accounting Office, approximately 40 million returns were prepared on computers but then filed on paper.[40] The IRS reports that this year it focused its marketing campaign on promoting electronic filing by such taxpayers and by taxpayers who use tax preparers but file on paper.

Electronic filing for business taxpayers

The IRS reports that it has expanded electronic filing options for business taxpayers. Employers already could file Form 941, "Employer's Quarterly Federal Tax Return" electronically. Now, businesses also can file electronically Form 940, "Employer's Annual Federal Unemployment (FUTA) Tax Record" and some businesses can file by telephone. In addition, Form 1065 (which reports partnership income) and the accompanying K-1s can now be filed electronically. The IRS reports progress in making Form 1099 (to report other income) available electronically, and in designing a corporate tax return electronic filing program that is scheduled to be implemented in one year.[41] To promote electronic filing by businesses, the IRS has placed advertisements in publications, including *Fortune Magazine*.

The IRS further noted that, in 2002, the electronic federal tax payment system, which permits taxpayers to pay federal taxes using electronic means, continues to be successful. In addition, on September 6, 2001, the IRS launched an online electronic federal tax payment system, which lets taxpayers pay federal taxes through a secure web site. The IRS stressed that the confidentiality and privacy of taxpayer information is of the highest priority.[42]

IRS Web site

In January, the IRS introduced a new web site (www.irs.gov). The site was designed to make it easier for taxpayers to find information and to be more focused on the taxpayers as a customer. The web site is divided into categories of taxpayers, for example, the Small

[39] Rossotti April 9, 2002, Testimony at 4.

[40] General Accounting Office, Report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, *Assessment of IRS' Tax Filing Season* (December2001), GAO-02-144 at 3.

[41] Rossotti April 9, 2002, Testimony at 5.

[42] *Id.*

Business/Self-Employed Community, which compiles relevant information for the kind of taxpayer and thus makes the site easier to use. The new web site retains features of the old, such as tax forms, instructions, and publications; the latest tax information and tax law changes; tax tables and rate schedules; hypertext versions of all taxpayer information publications; all TeleTax topics; answers to the most frequently asked tax questions; a library of tax regulations; and the weekly Internal Revenue Bulletin, which contains the latest revenue rulings, revenue procedures, notices, announcements, and proposed and final regulations. As of March 14, the IRS web site was listed as third in the Lycos search engine's Top 50 searches. In 2001, the web site recorded 2.7 billion hits and more the 336 million forms and publications were downloaded. For fiscal year 2001 through March 31, web site hits totaled 1.95 billion, a more than 36 percent increase on the same period last year. The IRS reports using the web site as a method to communicate tax scams and fraudulent schemes to taxpayers, including the slavery reparations scam.[43]

CD-ROMs

The IRS has developed CD-ROMs for small business taxpayers. *The Small Business Resource Guide 2002* contains all the business tax forms, instructions and publications needed to manage a business, as well as information about disaster relief and the Welfare-to-Work credit. Up to five copies can be ordered free online. *Introduction to Federal Taxes for Small Business/Self-Employed* is intended as an introductory guide for business students, new small business owners, and self-employed entrepreneurs. *A Virtual Small Business Workshop* replicates IRS workshops on the primary tax implications of establishing and running a small business and provides captions in English, Spanish, and Mandarin Chinese. These latter two CD-ROMs are free.[44]

Telephone and walk-in service

Telephone service

Throughout the 2001 filing season, the IRS offered 24-hour, seven-days-a-week telephone assistance. After April 16, 2001, the IRS provided around-the-clock service for refund and account callers, and service for tax law assistance was provided Monday through Saturday from 7:00 a.m. until 11:00 p.m.[45] For the 2002 filing season, the IRS determined that customer service would be improved if telephone assistance were better allocated to meet customer demand, which the IRS determined based on a usage study by AT&T.[46] Starting in October 2001, IRS assistors were available 7 a.m. to 10 p.m. Monday through Friday local time. During

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

[44] *Id.* at 10.

[45] *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-33-01), May 4, 2001 at 83.

[46] Rossotti April 9, 2002, Testimony at 7.

the filing season (January 2, through April 15, 2002), assistors also were available on Saturdays from 9 a.m. to 5 p.m., on President's Day and on Sunday April 7 and Sunday April 14. Automated assistance is available 24 hours a day, seven days a week.[47]

The IRS notes that through March 30, 2002, the total volume of incoming calls on toll-free lines was up 13 percent, primarily due to questions concerning the rate reduction credit and refunds. Even with the increased volume, through March 30, 2002, approximately 66 percent[48] of taxpayers who wanted to speak with a customer service representative got through, compared to 68 percent at the same time in 2001. Over a four-week period beginning in March, the IRS reports that 74 percent of callers got through, which makes the IRS's goal of 71 percent for the year, within reach.[49] Wait time for questions on tax law was 2.58 minutes (down from 4.27 minutes), and on account questions, 4.76 minutes, (down from 6.11 minutes). The correct response rate for tax law and tax account questions was 83 percent and 89 percent respectively (compared to 75 percent and 88 percent a year ago). In addition, 45.3 million taxpayers (or 8 percent more than last year) have used automated services to get refund and other information.[50] The IRS notes further that a special telephone line for victims of the September 11, 2001 attacks was established by September 24 and over a 90 percent level of service has been provided on the line.

The General Accounting Office found that this filing season, taxpayers are spending less time waiting to talk to an assistor and receive accurate answers at a higher rate than a year ago. The General Accounting Office confirms, however, that the rate at which callers connect with an assistor is down, due in part to callers hanging up after inquiring about the rate reduction credit and being transferred to automated services.[51]

The General Accounting Office reports that the IRS attributes improvements in telephone service to hiring and training assistors earlier than in past years, certifying that assistors completed the necessary training, using a computer-based call routing system to refer calls to an assistor trained in the pertinent topic, and to IRS's establishment of new performance measures and goals for the call sites.[52] The General Accounting Office notes, however, that although the

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[47] *Id.*

[48] *Id.*

[49] A recent memorandum from the Commissioner of the IRS to Treasury Secretary O'Neill indicated that reaching a service level of 90 percent would require additional funding of $35 million. Rossotti April 9, 2002, Testimony at 9.

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

[51] GAO April 9, 2002, Statement at 27-29. The National Taxpayer Advocate's Fiscal Year 2001 Report listed access to customer service toll-free telephone service as the most serious problem encountered by taxpayers. National Taxpayer Advocate FY 2001 Report at 8-10.

[52] GAO April 9, 2002, Statement at 29-30.

IRS's performance measures are useful in some respects, none of the measures reflect the number of callers that hang up while listening to the initial menu, even though the IRS has this data. The General Accounting Office notes that the number of such callers decreased after the IRS streamlined the menu in mid-February. In addition, the General Accounting Office notes that the IRS does not measure automated telephone service, and that the IRS counts some calls as receiving assistor service even though the only service received was by automation. Nevertheless, the General Accounting Office does not recommend that the IRS take further action on such performance measures, pending a further review.[53]

The National Taxpayer Advocate ranks access to IRS toll-free service as the number one problem faced by taxpayers.[54] The IRS Oversight Board notes that, while service is hampered by the lack of modern tools and technology for providing better service, there is a direct correlation between the number of calls that can be answered and staffing levels.[55]

Walk-in service

Walk-in service is available at more than 400 locations throughout the United States. At many walk-in sites, service was offered on 12 Saturdays between January 27, 2002, and April 14, 2002. As of March 16, 2002, the IRS estimates that it had served over 3.3 million taxpayers at all Taxpayer Assistance Centers, slightly more than for the same period in 2001.[56]

Taxpayers utilizing walk-in service can make payments, receive help with tax law and tax account questions, obtain tax forms and publications, and receive limited courtesy return preparation. Return preparation is available for taxpayers with incomes of $33,000 or less, thus ensuring assistance for taxpayers that qualify for the Earned Income Tax Credit. Taxpayer Assistance Centers also host Problem Solving Days to resolve longstanding taxpayer issues.[57] The IRS reports that this fiscal year it is developing baselines for tax law, accounts, and return preparation accuracy.[58]

According to the General Accounting Office, fiscal year 2002 is the first year the IRS is measuring the quality of Taxpayer Assistance Centers using contract reviewers instead of IRS

[53] *Id.* at 31-32.

[54] National Taxpayer Advocate FY 2001 Report at 8.

[55] IRS Oversight Board Report at 11.

[56] Rossotti April 9, 2002, Testimony at 10. See also, Appendix at 5 (showing a slight increase in taxpayers served per hour from 4.37 in fiscal year 1999 to 4.20 in fiscal year 2001, and a decrease of approximately 43,000 hours spent with taxpayers). The Appendix contains a letter and attachments from Charles O. Rossotti, Commissioner of Internal Revenue, to Lindy L. Paull, Chief of Staff, Joint Committee on Taxation (May 2, 2002).

[57] Rossotti April 9, 2002, Testimony at 11; GAO April 9, 2002, Statement at 32.

[58] Appendix at 5.

employees. Contract reviewers pose as taxpayers and make random visits to Taxpayer Assistance Centers. Reviewers ask two of four questions that the IRS has developed for this purpose based on the most common inquiries received by the IRS by telephone. The General Accounting Office reports that the accuracy rate reported through mid-March 2002 is encouragingly high, at 84 percent. Although this is clearly a better figure than the low accuracy rates reported by the IRS in 2000 (24 percent) and by the Treasury Inspector General for Tax Administration in 2001 (51 percent) the measurement methodology for 2002 is not comparable to prior years[59] so it is difficult to assess the degree of improvement. After delays, the IRS plans to begin measuring the accuracy of account and return preparation services at walk-in sites by June 2002.[60]

This filing season, auditors of the Treasury Inspector General for Tax Administration visited 40 taxpayer assistance centers and asked 168 tax law questions. IRS employees provided 36 correct responses, 42 correct responses despite procedural errors, 40 referrals to publication in lieu of a response, and 50 incorrect responses.[61]

C. Other Service Issues

<u>Administering advance payments for the rate reduction credit</u>

Just six weeks after the signing of the Economic Growth and Tax Relief Reconciliation Act of 2001, the IRS began mailing out over 90 million advance payment checks. The IRS had begun work weeks earlier so that it would be prepared to handle the $36 billion advance payment provision. The IRS coordinated an unprecedented outreach to America's taxpayers, an intricate computer programming project, numerous news releases, an updated Web site, and additional assistors to handle record call volumes.[62]

The IRS issued notices to all taxpayers, both those who qualified for an advance payment and those who did not. The notices, issued prior to the checks, helped to answer taxpayers' questions and reduce the number of telephone calls. Although a computer glitch caused almost a half-million taxpayers to receive notices with inaccurate amounts, the error was identified and those taxpayers were sent a second notice with the corrected amount. Initially, the IRS's telephone systems were overwhelmed and many taxpayers could not get through to the IRS. The

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[59] Results in 2000, 2001, and 2002 all were based on visits to walk-in sites by persons posing as taxpayers, but the questions, the number of weeks covered, and the number and selection of sites were different. GAO April 9, 2002, Statement at 33.

[60] *Id.* at 34.

[61] Testimony of Pamela J. Gardiner, Deputy Inspector General for Audit, Treasury Inspector General for Tax Administration, before the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations of the House Committee on Government Reform (April 15, 2002).

[62] IRS Progress Report at 18.

IRS responded by retaining its seasonal workers and applying additional resources to address the crisis. All told, 21.8 million taxpayer calls on the advance refund were answered.[63]

September 11th

Following the September 11 terrorist attacks, IRS and Treasury Department employees did their best to minimize the distraction of tax issues for the victims. By September 14, the IRS provided administrative relief to the victims in the form of extensions to file returns and pay taxes. Many enforcement actions for the affected taxpayers also were suspended for six months. In addition, special toll-free numbers were established to answer any questions, and a special disaster relief page was created on the IRS's Web site.[64]

In addition, on September 18, the IRS's Tax Exempt/Government Entities Division placed a new publication on the IRS's Web site that provided information to assist the public to make use of charitable organizations in providing disaster relief. On December 10, the IRS issued interim guidance that recognized the unique circumstances caused by the tragedy and made it easier for charities to distribute aid to the victims and their families.[65]

Refunds

For fiscal year 2001, the IRS averaged 14.6 days to issue a refund from an electronic return and 28 days to issue a refund from a paper filed return. During the 2002 filing season, the IRS is averaging 12 days for an electronic return and 26 days for a paper return, though the average rate is expected to increase at the end of the filing season. By contrast, in 1997 the average return rate was 16 days (electronic) and 37.7 days (paper); in 1998, 15 days (electronic) and 34.8 (paper); and in 1999, 14 days (electronic) and 35.09 (paper).[66]

Employer identification numbers

The IRS acknowledges customer service shortcomings in the Employer Identification Number assignment process.[67] The National Taxpayer Advocate's Annual Report ranks "Obtaining Employer Identification Numbers" as one of the top 15 problems faced by taxpayers.[68] According to the Taxpayer Advocate, taxpayers are unable to obtain Employer Identification Numbers within the specified timeframes. This hinders their ability to file Federal

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[63] *Id.* at 19.

[64] *Id.*

[65] IRS Notice 2001-78, 2001-50 IRB 576 (December 10, 2001).

[66] Appendix at 7.

[67] IRS Progress Report at 21.

[68] National Taxpayer Advocate FY 2001 Report at 7.

and state returns and conduct their business.[69] Telephone coverage for Employer Identification Number service at IRS facilities has been inconsistent. Prior to January 2, 2002, some sites answered their phones only three days a week; other sites answered their phones only four hours per day.[70] Faxed requests for Employer Identification Numbers also were not handled expeditiously.

On January 2, 2002, the IRS consolidated Employer Identification Number services into three sites and now offers telephone service at consistent times.[71] However, because the system shut down from December 21 until January 2, when the system reopened the telephone lines were overwhelmed and it took several weeks to stabilize the service.[72]

Burden reduction

One of the ten major strategies included in the IRS Strategic Plan is "reduce taxpayer burden." Through an approach of short- and long-term improvements, the IRS is working to provide taxpayers with both immediate and far-reaching burden relief and has created the Office of Taxpayer Burden Reduction. The IRS's short term efforts include reducing the number of taxpayers who must file specific forms, simplifying or eliminating forms and notices altogether, and making it easier through electronic means to file and pay. In order to improve the IRS's correspondence with taxpayers, and following the IRS Reform Act's directions, the IRS redesigned six notices, including those dealing with math errors, balance due, overpayments and offsets. The IRS continues to redesign 24 additional notices, and plans to release 11 by July 2002, and the remaining 13 in January 2003.[73]

The IRS is making other efforts to reduce taxpayer burden. The IRS has hired a consultant to develop a taxpayer burden model and has hired a contractor to redesign Form 941 (Employer's Quarterly Federal Tax Return) and its instructions. Schedule D, which is used to calculate capital gains and losses, was redesigned for the 2002 tax-filing season. A box was added to the Form 1040 to allow taxpayers to select a third party who may talk directly with the IRS during the processing of the return, and to discuss the status of a refund, payment or other notice with the IRS.[74] The IRS also announced on April 10 that it has reduced the paperwork for most small businesses that file corporate tax returns by eliminating completion of Schedules L, M-1, and M-2 of Form 1120, Parts III and IV of Form 1120A, and Schedules L and M-1 of Form

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[69] *Id.* at 43.

[70] *Id.*

[71] *Id*. at 43-44.

[72] Testimony of Roger Harris, Enrolled Agent, before the Committee on Ways and Means, Subcommittee on Oversight, April 9, 2002.

[73] IRS Progress Report at 18.

[74] Rossotti April 9, 2002, Testimony at 9-10.

1120S. The Commissioner estimated that the changes could save 2.6 million small businesses approximately 61 million staff hours.[75] Nevertheless, the General Accounting Office reports that the IRS paperwork burden increased in fiscal year 2001 by 290 million hours, due in significant part to changes initiated by the IRS, as well as a reaction to new tax laws.[76]

[75] IRS News Release IR-2002-48.

[76] General Accounting Office, Testimony before the Subcommittee on Energy Policy, Natural Resources, and Regulatory Affairs, Committee on Government Reform, *Burden Increases and Violations Persist* (April 11, 2002) GAO-02-598T at 2. At the hearing, the Commissioner defended some IRS initiatives as necessary to collect information on tax schemes. See BNA, Daily Tax Report, *Taxpayer Paperwork Burden Increasing, GAO Says; Rossotti Defends Agency Efforts* (April 12, 2002).

II. PROVIDING TOP QUALITY SERVICE TO ALL TAXPAYERS

A. In General

The second strategic goal requires the IRS to provide top quality service to all taxpayers. This goal aims for fundamental fairness and uniform application of the law to all taxpayers. The IRS's 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. A tax system designed to promote and ensure compliance, and effective enforcement of the law, are essential components to achieving fair and uniform application of the tax law.

In general, the IRS ensures compliance by matching information received from employers, financial institutions, and other businesses with information received by taxpayers. Third parties report approximately 80 percent of the personal income received by taxpayers. The remaining 20 percent of income, mostly business income, is not reported and often requires in-person auditing to verify. Also, business income, including that by passthrough corporations, partnerships, and trusts can be verified only by auditing.[77] The IRS estimates that the total personal income that cannot be verified by document matching was about $1.2 trillion in fiscal year 1998, or 19.7 percent of total reported personal income.[78]

In fiscal year 2001, the IRS began capturing the data from 16.8 million K-1 forms which are used to report income, credits, and deductions of partners, shareholders and beneficiaries of passthrough entities.[79] In 2002, the IRS will begin processing and matching K-1 forms with individual tax returns.[80] In the beginning stages, the IRS will match only for income and dividends, not losses, although the IRS will cross-match for potential nonfiling of returns.[81]

Trusts and offshore bank accounts (including credit cards from offshore banks) used by upper-income taxpayers to hide income have become a significant loss of revenue to the Treasury--the IRS estimates losses in the tens of billions of dollars.[82] In 2002, the IRS's Fraud, Anti-Money Laundering, and Abusive Schemes groups and the Lead Development Center were placed under the supervision of one IRS executive in order to allow better flow of information

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[77] Internal Revenue Service Accountability Report Fiscal Year 2001, Publication 3385 (Revised March 2002) (hereinafter "IRS Accountability Report") at 8.

[78] IRS Progress Report at 25.

[79] IRS Accountability Report at 8.

[80] *Id.*

[81] See Amy Hamilton, *IRS Considers Simplifying K-1s*, 2001 *Tax Notes Today* 185-8 (September 24, 2001).

[82] Rossotti April 9, 2002, Testimony at 16.

between these programs.[83] In addition, the IRS started a special initiative to identify offshore credit card accounts.[84] This initiative, which is still in its early stages, has had initial success in identifying cardholders for investigation.[85]

B. Enforcement Activity

The IRS's goal in fiscal year 2001 was to stop the long-term decline in compliance activities, and enforcement actions did increase in fiscal year 2001. For example, levies, liens, and seizures all increased significantly from fiscal year 2000: levies more than tripled, liens increased by approximately 50 percent, and seizures jumped from 74 to 234.[86] However, total enforcement actions were a fraction of levels in fiscal years 1995 through 1998 (e.g., levies were approximately 18 percent of 1997 levels, liens approximately 79 percent, and seizures approximately 2 percent).[87] Enforcement revenue remained at fiscal year 2000 levels at $33.8 billion, a drop from $37.2 billion in fiscal year 1997.[88] The IRS attributes its inability fully to pursue enforcement cases to the modernization effort, a decrease in staff, reassignment of collection employees to support customer service activities, and additional staff time needed to implement certain taxpayer protections that were included in the IRS Reform Act.[89] Additionally, the IRS reports that inadequate financial and operational information has hindered development of cost-based performance information for tax collection and enforcement programs.[90]

The IRS Oversight Board continues to find the decline in enforcement activities troubling, especially in light of the fact that the number of returns filed is increasing while the number of returns examined, and the number of IRS employees, is decreasing. The IRS Oversight Board is concerned that the broad decline in enforcement activity increases the tax system's reliance on voluntary compliance, and fears that the public's attitude towards voluntary compliance is eroding.[91]

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[83] Statement of Charles O. Rossotti, Commissioner of Internal Revenue, before the Senate Finance Committee (April 11, 2002) at 18-19.

[84] *Id.* at 19.

[85] *Id.*

[86] Appendix at 38.

[87] *Id.*

[88] *Id.* at 29.

[89] IRS Accountability Report at 24.

[90] *Id.*

[91] IRS Oversight Board Report at 11-14.

To combat tax fraud schemes in general, the IRS issued two nationwide alerts warning taxpayers not to fall victim to fraud and false refund schemes, and established on the IRS website a program to alert taxpayers and practitioners of fraud and tax schemes.[92] On November 15, 2001, the Justice Department filed lawsuits in federal courts in three states to crack down on a scam that claimed that Section 861 of the tax code exempts from taxation all domestic income earned by U.S. citizens.[93]

The IRS has identified four areas of systemic non-compliance on which it plans to focus its (limited) enforcement resources: (1) misuse of trusts and passthrough entities to hide or improperly reduce income; (2) use of complex and abusive corporate tax shelters to reduce taxes improperly; (3) failure to file and pay large accumulations of employment taxes; and (4) erroneous refund claims and Earned Income Tax Credit fraud.[94] The IRS has been active in pursuing enforcement actions in these four areas, and has begun using the civil enforcement provisions of the Internal Revenue Code to enjoin promoters of abusive schemes.[95]

IRS Criminal Investigation had 301 open investigations of abusive trusts in 2001, including 125 of promoters of such trusts.[96] The IRS also has developed specialized training programs and trained 160 agents and attorneys on abusive trust-related issues. At the end of 2001, IRS agents were auditing 57 promoters and evaluating several hundred abusive schemes.[97]

Curbing corporate tax shelters is a top priority for the Large and Mid-Size Business Division.[98] In 2000, the Division established the Office of Tax Shelter Analysis as the focal point for tax shelter compliance initiatives.[99] The Office of Tax Shelter Analysis is responsible for coordinating and planning tax shelter initiatives and supporting IRS examiners working on abusive tax shelter issues. It also serves as a clearinghouse for information provided to the IRS on potentially improper tax shelter activity by corporate and non-corporate taxpayers.[100] In

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[92] IRS Progress Report at 24.

[93] *Id.*; IRS Accountability Report at 24.

[94] IRS Progress Report at 22.

[95] Rossotti April 9, 2002, Testimony at 23. For a general overview of the IRS's compliance efforts, see Michael Brostek, Testimony before the Senate Committee on Finance, *Enhanced Efforts to Combat Abusive Tax Schemes--Challenges Remain* (April 11, 2002) GAO-02-618T.

[96] IRS Progress Report at 22.

[97] *Id.* at 23.

[98] Testimony of Larry R. Langdon, Commissioner Large & Mid-size Business Division, Internal Revenue Service, before the Senate Committee on Finance (March 21, 2002) at 1.

[99] IRS Progress Report at 23.

[100] *Id.*

2000, regulations were issued requiring corporate taxpayers to disclose reportable transactions and requiring promoters to register confidential corporate tax shelters and maintain lists of tax shelter investors. However, the Treasury Department and the IRS are disappointed in the small number of disclosures and the lack of compliance by promoters with the list maintenance rules, and have concluded that significant changes to the rules are necessary.[101]

Case openings related to employment taxes increased by 75 percent in 2001.[102] The IRS also issued a special consumer alert on the employment tax fraud problem.

The IRS fought tax-filing fraud in the Earned Income Tax Credit area in many ways. The IRS implemented a program of education and outreach visits by IRS agents to offices with a high volume of Earned Income Tax Credit return preparers, organized visits by agents to such offices to review compliance with due diligence requirements, and "partnered" with Criminal Investigation to ensure investigation of known fraudulent Earned Income Tax Credit claims and schemes. The IRS also began a check of secondary social security and identification numbers associated with a qualifying child to reduce the number and amount of ineligible claims made under the Earned Income Tax Credit to address erroneous refunds and compliance among taxpayers who claim the Earned Income Tax Credit.[103]

C. Audit Activity

An important role of audits is to verify major categories of income and deductions. In fiscal year 2000, the audit rate for individuals was less than one-half of one percent and the number of individual returns audited (including service center or correspondence audits) was approximately 618,000. In fiscal year 2001, the audit rate increased slightly to .58 percent and the number of returns audited increased to approximately 732,000.[104] By contrast, the number of returns audited in fiscal years 1997, 1998, and 1999 were approximately 1,519,000, 1,193,000, and 1,100,000 -- demonstrating a steady decline in number of returns audited.

The income reported by businesses is as important as that of individuals with respect to both tax revenues and fairness. The IRS continues to audit the 1,100 largest corporations every year but the audit rate for all other corporations declined from 3 percent in 1992 to 1.1 percent in fiscal year 2001.[105] The audit rate for all large corporations has declined significantly since

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[101] Testimony of Mark Weinberger, Assistant Secretary of the Treasury for Tax Policy, before the Senate Committee on Finance (March 21, 2002) at 6.

[102] IRS Progress Report at 24.

[103] IRS Accountability Report at 24.

[104] IRS Progress Report at 43. Most of this increase is attributable to an increase in correspondence audits of taxpayers with income in excess of $100,000. IRS Oversight Board Report at 11.

[105] IRS Progress Report at 25.

fiscal year 1997 (12,972 closures) to fiscal year 2001 (8,718 closures), and the decrease for small corporations is more dramatic, from fiscal year 1997 (56,323 closures) to fiscal year 2001 (14,332 closures).[106]

Of particular concern to the IRS is the growing number of entities, such as partnerships, trusts, and S corporations, that pay no income tax at the business level, but pass their net income through to their shareholders or partners. In 2000, these entities filed 7.4 million returns, reported $5 trillion of gross revenues, and $680 billion of income. However, the IRS audited only one of every 256 returns -- the equivalent of 0.39 percent.[107] The IRS's new K-1 matching program will not provide any verification of the income reported by the business entity itself; this still requires an audit.

A significant impediment to achieving the IRS's compliance goals was the in-person examination rate (for corporations and individuals), which declined about 20 percent in fiscal year 2001. The IRS believes that improving this number will be a long-term process, and anticipates seeing increases in this area in three years. The IRS plans to show improvement by stabilizing the number of compliance personnel, reengineering processes, and setting clear goals.[108] However, technical staffing levels for audit activity have declined, from 14,399 revenue agents in fiscal year 1997, 12,550 in 2000, and 11,598 in 2001, and from 2,318 tax compliance officers in fiscal year 1997 to 1,702, in 2000, and 1420 in 2001.[109] The IRS says it will rely on the Business Systems Modernization program to increase the effectiveness and efficiency of compliance activities over the long term.[110] The IRS also hopes to reduce the need for some enforcement efforts by focusing on prefiling initiatives, thereby increasing voluntary compliance.

In fiscal year 2001, the IRS implemented the first phase of a multi-year Collection Re-engineering Program to ensure that business tax cases are promptly assigned to revenue officers.

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[106] Appendix at 8. The IRS reports that audits conducted by automation (e.g., the Automated Underreporter Program and the Automated Substitute for Return Program) have been more constant than audits conducted in the field and by correspondence, but the decrease still is significant. For example, in fiscal year 1997 the Automated Underreporter Program closed 1,598,471 cases and sent 3,500,804 letters compared to 1,161,901 cases and 2,576,375 letters in fiscal year 2001. For the Automated Substitute for Return Program, in fiscal year 1997 392,598 cases were closed and 525,432 letters were sent compare to 333,770 cases and 393,751 letters in fiscal year 2001. *Id.* at 9.

[107] IRS Progress Report at 25.

[108] *Id.* at 26.

[109] Appendix at 33.

[110] *Id.*

The IRS also is "reinvigorating" the fraud referral program, so that taxpayers will be referred for criminal investigation whenever serious noncompliance is discovered.[111]

D. Measuring Compliance -- National Research Program

The IRS acknowledges that the lack of a reliable way to measure taxpayer compliance limits the IRS's ability to assess progress in serving all taxpayers through effective and fair application of the tax laws.[112] Because reliable and timely financial, operational, and compliance data is not available to help target efforts to collect billions of dollars in unpaid taxes, the Federal government is exposed to significant losses of tax revenue and compliant taxpayers bear an undue burden of financing the government's activities. The IRS projects that the total tax gap from nonfiling, underreporting, and underpayment was $272.4 billion in 1998 ($166.4 billion from individual income tax, $40.5 billion from corporate income tax, and $65.5 billion from employment taxes).[113] The decline in key collection actions such as levies and seizures may increase the incentives for taxpayers either not to report or to underreport their tax obligations.

To address these concerns, the IRS is developing a new program, the National Research Program, which will measure filing compliance, payment compliance, and reporting compliance by taxpayers. The IRS has designed the National Research Program to lessen taxpayer burden while still obtaining a sample sufficient to catch tax cheating and to help reduce audits of compliant taxpayers by at least 15,000 returns a year.[114] Under the Program, payment compliance data will be generated annually and reporting compliance surveys will be conducted every three years. The data gathered through the National Research Program will be used to update the formulas used for selecting returns for audit. The IRS plans to begin the National Research Program's work in September 2002 by gathering data for individual taxpayers, and plans to survey small corporations, partnerships, and trusts in the future.[115] The IRS Oversight Board supports the National Research Program and requests Congressional support for the Program.[116]

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[111] IRS Progress Report at 25.

[112] IRS Accountability Report at 9.

[113] See table at Appendix at 34. The IRS notes that the projection is based on compliance data gathered for tax years 1985 and 1988 and assumes constant compliance rates. *Id.* at 33.

[114] Rossotti April 9, 2002, Testimony at 13.

[115] Internal Revenue Service, IRS Fact Sheet, *National Research Program* (January 16, 2002).

[116] IRS Oversight Board Report at 14.

III. PRODUCTIVITY THROUGH A QUALITY WORK ENVIRONMENT

A. In General

As its third strategic goal, the IRS plans to increase productivity by providing a quality work environment for its employees. Using the private sector as a model, the IRS notes that success 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 characterized by equal opportunity, recognition of employee performance, and no artificial barriers to advancement. The IRS measures success in building productivity by increasing its workforce only slightly while concurrently handling an increased workload, and improving service to each taxpayer and to all taxpayers. Employee satisfaction also is measured as part of this goal.

According to the IRS, overall job satisfaction for IRS employees was 59 percent in the year 2000.[117] This number decreased to 51 percent in 2001, a 14 percent decrease from fiscal year 2000.[118] The IRS strategic plan notes that employee satisfaction differs significantly among race, national origin, and gender groups.[119]

According to the IRS Oversight Board, IRS employee morale and job satisfaction are not adequate.[120] Many IRS productivity measure have decreased during the past three years. Although no single factor is responsible, the IRS Oversight Board finds that the decline in productivity may be attributable to declining resource allocations, low employee satisfaction, additional case complexity, less direct time spent on cases, and additional legislated requirements.[121]

In addition, the IRS Oversight Board finds that the IRS is not providing a quality work environment. The ability of IRS personnel to respond to taxpayer questions and efficiently perform critical duties is limited by the fact that the IRS computer systems are outdated.[122] The

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[117] IRS Progress Report at 39.

[118] *Id.* at 39. The IRS notes that the definition of employee satisfaction changed in 2001, so the numbers are not fully comparable. However, the IRS further notes that the decline in employee satisfaction can be attributed to the effects of IRS reorganization. *Id.* at 29.

[119] IRS Strategic Plan at 98.

[120] IRS Oversight Board Report at 9.

[121] *Id.* at 14.

[122] *Id.* at 23.

system prevents taxpayers from receiving up-to-date account information and inhibits meaningful progress on IRS modernization,[123] which is frustrating to IRS employees.

B. Violations for Which IRS Employees May Be Terminated

Offenses and procedures

The IRS Reform Act defined 10 specific acts of misconduct for which an IRS employee may be terminated ("section 1203 violations"). These acts are:

(1) willful failure to obtain the required approval signatures on documents authorizing a 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) violation of the rights protected under the Constitution or the civil rights established under six specifically identified laws with respect to a taxpayer, taxpayer representative, or other employee of the IRS;[124]

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

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

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

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[123] *Id.* A discussion of the IRS's efforts to improve its technological infrastructure is discussed at Part IV.B. of this Report.

[124] These laws are: (1) title VI or VII of the Civil Rights Act of 1964; (2) title IX of the Education Amendments of 1972; (3) the Age Discrimination in Employment Act of 1967; (4) the Age Discrimination Act of 1975; (5) section 501 or 504 of the Rehabilitation Act of 1973; or (6) title I of the Americans with Disabilities Act of 1990. IRS Reform Act, sec. 1203(b)(3)(B).

(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.[125]

In his or her sole discretion, the Commissioner may determine that there are mitigating factors that weigh against terminating an employee. This discretionary authority cannot be delegated.

Each allegation of a section 1203 violation goes through a review and investigation process.[126] First, the allegation initially is evaluated to determine whether it should be investigated as a section 1203 violation. The Treasury Inspector General for Tax Administration has primary responsibility for investigating allegations under section 1203. The facts found as a result of the investigation are then reported to the IRS for evaluation. IRS managers then must determine whether a violation of Section 1203 has occurred. This determination is made by a Division-level or above manager, with assistance of local labor relations specialists and the staff of the Centralized Adjudication Unit. The Centralized Adjudication Unit is involved in all determinations under section 1203 for the purpose of ensuring consistency throughout the IRS. If a determination is made that sufficient facts exists to support a section 1203 violation, the employee is given a letter advising that the IRS proposes to remove him or her from Federal service. The employee has a right to respond to the letter. The management official then must determine if the charge has been sustained by a preponderance of the evidence. If it is determined that the charge has been sustained, the case file is forwarded to the IRS national office for consideration by the Section 1203 Review Board.

The Section 1203 Review Board then reviews the case to determine whether a penalty less than termination of employment is appropriate. The Section 1203 Review Board submits recommendations for mitigation to the Commissioner. If the Section 1203 Review Board does not find mitigation appropriate, the case is not submitted to the Commissioner and the statutory penalty of removal is imposed.

As of February 28, 2002, there were 327 substantiated violations of section 1203.[127] Of the 327 substantiated violations, 282 were for failure to file a Federal tax return.[128] Of the 3,045 completed section 1203 inquiries, 2,098 inquires found that the allegation was not substantiated; 620 inquires were found to constitute non-section 1203 misconduct.[129] Fifty-four employees

[125] IRS Reform Act, sec. 1203(b).

[126] See generally, *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-33-01), May 4, 2001, Appendix, Letter from the IRS at 51-53.

[127] See the final document of the Appendix (final four Appendix pages) at 2.

[128] *Id*.

have been removed for section 1203 violations, 46 of whom were removed for willful failure to timely file a Federal tax return.[130]

Effectiveness of section 1203

As part of this year's budget request, the IRS requested that two section 1203 violations be eliminated from the list. These are the late filing of tax returns for which a refund is due and actions by IRS employees that violate another IRS employee's rights, rather than a taxpayer's rights. The IRS also requested that the unauthorized inspection of returns or return information be added to the list of violations. In addition, the IRS wants the Commissioner to be able to establish guidelines that outline specific penalties, including termination, for the types of wrongful conduct listed under section 1203.[131]

According to the IRS, such changes are necessary because section 1203 is negatively affecting employee morale and effectiveness. The IRS reports that since enactment of section 1203, IRS employees frequently report that fear of a section 1203 allegation causes reluctance to take appropriate enforcement actions. Employees often report routine workplace disputes and unprofessional conduct with taxpayers as potential section 1203 violations in order to avoid a later claim that the failure to report such disputes or conduct was to hide potentially serious misconduct. In addition, taxpayers and practitioners cite section 1203 in correspondence as an apparent tactic to delay action by the IRS.[132]

Notwithstanding section 1203, the incidence of serious employee misconduct remains at the low levels reported prior to its enactment. More than 90 percent of section 1203 violations involve employee tax compliance, and according to the IRS, termination of employment obviously is too harsh a remedy in many cases.[133] Thus, 68 percent of tax compliance cases result in mitigation, half of all cases involve refund returns, and 73 percent of employees involved are at grade seven or below. The IRS concludes that removing refund return cases and those involving employee against employee actions, combined with permitting the Commissioner to establish a range of penalties, would better target section 1203 while improving employee morale. In addition, adding the unauthorized inspection of taxpayer information to the list of violations would permit the IRS to enforce such cases with greater consistency than under present procedures.[134]

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[129] *Id.*

[130] *Id.* at 3. See also *id.* at 1-4 for a more detailed breakdown of section 1203 violations.

[131] See Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2003 Revenue Proposals* (February 2002) at 58-59.

[132] Appendix at 19.

[133] *Id.*

[134] *Id.* at 19-20.

The IRS notes that front line employees and managers frequently cite "the fear and anxiety associated with section 1203 as a major factor in their approach to enforcement activity."[135] In addition, focus groups and surveys consistently report that there is a link between section 1203 and a decline in enforcement activity. The IRS reports that it will continue to monitor employee attitudes about section 1203 in order to identify ways to address concerns raised by the law.

The IRS Oversight Board found that section 1203 needs reform and identified four guidelines as a basis for reform: (1) eliminate mandatory termination and give IRS management discretion in imposing a penalty, (2) include "willfulness" as an element to any section 1203 offense, (3) eliminate from the list of offenses the failure to file a refund return, and (4) eliminate from the list of violations employee versus employee allegations.[136]

C. Personnel Flexibility and IRS Management

IRS Reform Act

The IRS Reform Act gave the IRS considerable authority 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.

- 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. 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 also was given greater authority to pay performance bonuses to members of the Senior Executive Service.

- New performance management system.--The IRS Reform Act required implementation of a new performance management system, stressing individual accountability. The IRS Reform Act prohibits the use of enforcement goals, quotas or statistics as the basis for awarding bonuses or merit pay.

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[135] *Id.* at 22.

[136] IRS Oversight Board Report at 11-12.

- 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 Senior Executive Service 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 Senior Executive Service, or where the Office of Personnel Management 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 also may 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

Performance management system

The IRS reports that the Performance Management System for Executives, Managers and Management Officials that was implemented in fiscal year 2000 continues to be improved. According to the IRS, the intent of the system is "to more closely align individual performance with organizational success through the Business Planning process and balanced Measurement System."[137] For fiscal year 2001, the IRS reports that leadership skills were included as part of the performance expectations for executives and managers, which the IRS hopes will improve the selection and development of organizational leaders.[138]

Recruitment efforts

To attract and retain highly qualified and exceptional individuals, the IRS uses professional search firms and often has executives, including the Commissioner, Deputy Commissioner, and Treasury officials interview Streamlined Critical Pay candidates. The Commissioner is the final selecting official for all Streamlined Critical Pay executives, with final approval by the Treasury Department. The IRS reports that five Streamlined Critical Pay

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[137] See Appendix at 22.

[138] *Id.*

executives could have been accommodated using the Senior Executive Service pay scale. In fact, for such executives their critical pay was less than the maximum pay available using the Senior Executive Service. Nevertheless, the IRS credits the recruitment techniques (using a search firm) and the streamlined aspect of the program with finding executives that are better qualified than by using traditional recruitment means.[139]

According to the IRS, the Streamlined Critical Pay executives have brought exceptional talent and a wide range of skills to the IRS. The IRS cites a number of significant contributions made by Streamlined Critical Pay executives in the areas of modernization, customer relations, and compliance. For example, the IRS cites reforming the office of the National Taxpayer Advocate, establishment of Business Systems Modernization, a nearly flawless Y2K conversion, new customer communications systems, a new initiative to combat abusive corporate tax shelters, and implementation of an electronic crimes unit within Criminal Investigations.[140]

In recruiting critical pay personnel, the IRS spent $1,822,759 for moving expenses (the program is the same as for career personnel except the IRS Reform Act covers an executive's first move prior to government service) and $3,639,985 on executive searches.[141]

The IRS states that more could be accomplished if IRS employees were eligible for Streamlined Critical Pay positions, noting that one of the critical challenges for the IRS is retaining IRS employees with special skills at the executive level.[142]

<u>Loss of Streamlined Critical Pay executives</u>

From the passage of the IRS Reform Act in July 1998 through April 2002, the IRS has hired 46 Streamlined Critical Pay executives, 36 of which currently are working for the IRS.[143] Through April 2002, 10 Streamlined Critical Pay executives have left the IRS. The average tenure of the executives who have left is 17 months, with some staying as few as five months and others as long as 29 months. Three departed executives stayed more than two years.[144]

D. 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

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[139] Appendix at 23.

[140] See Appendix at 26-27.

[141] *Id.* at 23.

[142] *Id.* at 27.

[143] *Id.* at 24-25.

[144] For a table showing current and departed executives, as well as salaries prior to and during IRS service, see *id*.

IRS mission statement and prohibiting the IRS from using tax enforcement results to evaluate any IRS employee or to impose or suggest production quotas or goals.[145] Accordingly, the IRS is changing its organizational performance measures to balance business results (both quantity and quality), customer satisfaction, and employee satisfaction. The IRS notes that enforcement revenues are not a measure of performance at either the strategic or operational level.[146] According to the IRS, the sole use of enforcement revenue at the strategic level is to measure the effectiveness of case selection for compliance activities.[147]

In September 1999, a balanced measures regulation was issued to formally establish the new performance management system.[148] The IRS implemented the balanced measures system for the Examination, Collection, and Customer Service in 1999.[149] In addition, balanced measures have been approved for Tax Exempt and Government Entities, Large and Mid-Size Businesses, Appeals, Taxpayer Advocate Service, Information Systems, Criminal Investigation, Appeals, and for additional Submission Processing and Customer Service product lines within the Wage and Investment and Small Business and Self-Employed operating divisions.[150] The IRS Oversight Board reports that the IRS will complete the implementation of the balanced measures program in 2002.[151] The Treasury Inspector General for Tax Administration reports that the IRS has changed its performance management process to better define and report on measures, is planning on qualifying some data, and has issued procedures requiring that reports on critical performance measures be verified and approved before being reported to the Treasury Department.[152]

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[145] In addition, the Government Performance and Results Act of 1993 requires Federal agencies to establish a hierarchy of goals, objectives, and performance measures applicable to various organizational units within their agencies. Pub. L. No. 103-62 (1993).

[146] IRS Strategic Plan at 91. According to the IRS, among other actions, it is providing guidance and training to its managers and employees on the use of statistics and establishing business units to conduct quarterly certifications of compliance with the prohibition on the use of statistics. *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-33-01), May 4, 2001, Appendix, Letter from the IRS at 15.

[147] IRS Strategic Plan at 91.

[148] *Id* at 88.

[149] *Id*. at 93.

[150] *Id*.

[151] IRS Oversight Board Report at 25.

[152] Memorandum from David C. Williams to Paul O'Neill, Management and Performance Challenges Facing the IRS (January 29, 2002) at 4.

IV. ORGANIZATIONAL AND TECHNOLOGICAL MODERNIZATION

A. Organizational Modernization

Background

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.

The Congress found that the organizational structure of the IRS was one of the factors contributing to the inability of the IRS properly to serve taxpayers. The Congress believed that a new structure focused on taxpayers with similar needs would help enable the IRS to serve taxpayers better 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.[153]

The IRS has made significant progress in implementing the new organizational structure. The IRS created four operating divisions to serve taxpayers of similar needs: Wage and Investment; Small Business and Self-Employed, Large and Mid-Size Business, and Tax Exempt and Government Entities. There are also several functional units, including Appeals, the Taxpayer Advocate Service, Criminal Investigation, and Communication and Liaison.

This new organization formally replaced the prior geographically based organizational structure on October 1, 2000. Top management is in place for each of the operating divisions and business units. The final stages of implementation, including the redistribution of workload, will require another year (through fiscal year 2002). Below is discussion of each of the operating divisions and certain functional units.

IRS operating divisions

The Wage and Investment Division serves approximately 122 million taxpayers, including married taxpayers who file jointly, accounting for 94 million returns with wage and investment income only. Most of these taxpayers have contact with the IRS only once a year, when filing their returns. Eight Service Centers provide processing, account management, and compliance services.

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[153] IRS Reform Act sec. 1001.

The Small Business and Self-Employed Division serves approximately 45 million taxpayers, including small businesses, individuals with no wage income and individuals with both self-employment income and wage income. According to the IRS, this group of taxpayers has more frequent and more complex dealings with the IRS than wage and investment taxpayers, ranging from four to 60 transactions with the IRS each year. The Small Business and Self-Employed Division carries out its functions with a compliance field organization, including examination and collection groups, reporting to a manager handling multiple functions.[154]

The Large and Mid-Size Business Division serves C corporations, S corporations, and partnerships with assets greater than $5 million. At least two percent of these taxpayers interact with IRS compliance functions each year and the largest taxpayers deal with the IRS continuously. The Large and Mid-Size Business Division is predominantly a field organization that is structured into five industry groups.

The Tax-Exempt and Government Entities division serves three million entities including local community organizations, municipalities, universities, pension funds, state and local governments, and Indian tribal governments. This division also handles tax-exempt bond issues.

IRS functional units

Appeals serves as a channel for taxpayers to contest an IRS compliance action. The mission of Appeals is "to resolve tax controversies, without litigation, on a basis that is fair and impartial to both the Government and the taxpayer, and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the [IRS]."[155] The new Appeals unit is organized into three operating units similar to the IRS operating divisions: Wage & Investment, Small Business/Self-Employed - Tax Exempt/Government Entities, and Large & Mid-Size Business.

The activities of the Small Business/Self-Employed-Tax Exempt/Government Entities unit of Appeals involve cases covering corporations with less than $5 million in assets, collection issues, estate and gift tax cases, self-employed individuals, tax-exempt entities, and government entities. This unit also has responsibility for the current Records and Processing sections. Other program responsibilities include innocent spouse cases, Freedom of Information Act appeals, excise and employment taxes, and alternative dispute resolution of bankruptcy, dyed diesel fuel, and tax-exempt bond cases. According to the IRS website, all Wage and Investment Appeals unit cases will be processed by the Small Business/Self-Employed - Tax Exempt/Government Entities Appeals unit until the Wage and Investment unit of Appeals is operational. The Large and Mid-Size Business unit of Appeals covers corporate and partnership cases with assets greater than $5 million with the most complex issues, particularly international issues.

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[154] IRS Strategic Plan at 83.

[155] *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-33-01), May 4, 2001, Appendix, Letter from the IRS at 15.

Criminal Investigation investigates potential criminal violations of the Code and related financial crimes. A report by William Webster found that the then Criminal Investigation Division had "drifted from its primary mission of investigations of criminal violations of the Tax Code into the broader role of providing federal financial investigative expertise."[156] Following the Webster report, Criminal Investigation developed an interim compliance strategy to assist in identifying, developing, and investigating cases. The Criminal Investigation Program Strategy has three components, legal source tax crimes (generally cases governed by the Code), illegal source financial crimes (includes Code and Title 18 violations, as well as money laundering), and narcotics related financial crimes (which includes both tax and money laundering violations). Criminal Investigation has been actively involved with other government agencies in the post-September 11 criminal investigations.

The Taxpayer Advocate Service assists taxpayers in resolving problems that have not been resolved through prior contacts with the IRS or cannot be resolved through normal systemic processes. On March 12, 2000, the Taxpayer Advocate Service was established as a new organization. The new organization has two components, one segment dedicated to casework and the other dedicated to advocacy. It is structured to ensure that at least one Local Taxpayer Advocate is in each state. See Part VI.B. of this Report for a discussion of the National Taxpayer Advocate's annual report to Congress.

<u>Challenges facing the new IRS organizational structure</u>

The transition to the restructured IRS continues to be awkward. In the words of the director of the National Council for Taxpayer Advocacy: "Modernizing and centralizing the IRS is causing chaos and confusion in the hinterlands for taxpayers, taxpayer representatives, and even rank-and-file IRS employees."[157] Problems stemming from the new structure include: providing managers and executives with appropriate authority to make decisions, change-induced decrease to employee morale, uncertain relationships among the new operating divisions, uncertain understanding by IRS personnel about how the new structure is meant to work, and the lack of appropriate information systems.[158] The IRS reports that the final stages of implementing the new structure, including the redistribution of workload, will continue through fiscal year 2002.[159]

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[156] William H. Webster, *Review of the Internal Revenue Service's Criminal Investigation Division*, IRS Publication 3388 (April 1999).

[157] Testimony of Bryan E. Gates, National Council of Taxpayer Advocacy, before the IRS Oversight Board (January 29, 2002).

[158] See generally, Amy Hamilton, *Practitioners Tired of IRS Asking For Understanding, Patience*, 2002 *Tax Notes* 20-2 (January 30, 2002). The IRS Oversight Board reports that the reorganization is complete except for the Modernization and Information Technology Services division, which is still being implemented. IRS Oversight Board Report at 29.

[159] IRS Progress Report at 29.

The IRS has experienced some difficulties in transitioning to the new organization. Each operating division is responsible for all of the interactions a taxpayer under its jurisdiction might have, regardless of geographic location. However, one division may be responsible for a program carried out by several divisions. For example, most collection procedures are the responsibility of the Small Business and Self-Employed division, but the Wage and Investment division shares responsibility for carrying out collection actions. Prior to the reorganization, the Collection Division would have been responsible for establishing procedures and the actual collection of tax. In general, this has resulted in confusion over which unit has ultimate decisionmaking authority, and has resulted in managers and executives spending time on coordination instead of operational issues.[160]

Outside groups also have voiced concerns about the new structure. The American Institute of Certified Public Accountants noted that implementation of new programs is hindered because of inadequate communication.[161] The National Association of Enrolled Agents suggested that the IRS needs to involve the practitioner community more directly when making important changes.[162] The Nation Treasury Employees Union stressed that training of IRS employees be better integrated into modernization plans.[163]

In addition, under the reorganized IRS, support functions such as human resources management, information systems and facilities are centralized, rather than under the control of local operational managers. The concomitant reduction in support staff has resulted in administrative burden because routine functions once carried out by administrative staff are now performed by first-line managers.[164] The new structure has been viewed by some employees as more cumbersome and less effective than when these functions were under the control of the local personnel. To address the problem, the IRS is establishing an employee resource center in Memphis that will act as a help desk.[165]

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[160] George Guttman, *IRS Organizational Modernization Not Standing Tall*, *Tax Notes* (February 25, 2002) at 959.

[161] Testimony of the American Institute of Certified Public Accountants before the IRS Oversight Board (January 29, 2002).

[162] Testimony of the National Association of Enrolled Agents before the IRS Oversight Board (January 29, 2002).

[163] Testimony of the Nation Treasury Employees Union before the IRS Oversight Board (January 29, 2002).

[164] George Guttman, *IRS Organizational Modernization Not Standing Tall*, *Tax Notes* (February 25, 2002) at 958.

[165] *Id.*

B. Technology Modernization

In general

The IRS is in the process of modernizing its information technology systems. Presently, the IRS relies on computer systems developed in the 1960's and 1970's to maintain taxpayer records, which, as Commissioner Rossotti observed: "constitutes an insurmountable barrier to efficient service and compliance operations and is a very serious risk to the whole tax system."[166] More generally, with old technology, the IRS cannot take advantage of modern technological progress in the way the IRS processes information, interacts with taxpayers, or for gains in worker productivity. In short, modernization is a massive long-term project that aims to improve: access to information and tax data for all taxpayers, accuracy of information provided by the IRS to all taxpayers, speed of response to taxpayers, timeliness of IRS initiated actions, and productivity of IRS staff.

There are two major modernization efforts: Business Systems Modernization and Tier B modernization.[167] Business Systems Modernization is the more significant, involving the long-term reconstruction of the IRS's business technology and processes. Business Systems Modernization aims to bring the IRS up to date through acquisition and implementation of new computer technology. At this time, Business Systems Modernization consists of 20 ongoing system acquisition projects at different life-cycle stages, as well as various program-level initiatives that are to provide the IRS the means to manage these projects. As one example, a project called the Customer Account Data Engine (discussed below, with other projects) will transfer individual filers from the 1960s magnetic tape-based system for recording taxpayer information to a modern database, and will create applications for daily posting of taxpayer tax account and return data.

Tier B modernization typically involves shorter-term projects directed toward updating software and coordinating old computer systems with new technology as improvements are made by Business Systems Modernization. Recent Tier B projects have included: making more forms available for e-filing, redesign and consolidation of taxpayer notices, expanded electronic tax law assistance, redesign of the determination letter system to improve the quality of responses to taxpayers, and the centralization of the Offer in Compromise program. Planned Tier B projects for 2003 include: creation of an integrated system to track taxpayer complaints, modernization of

[166] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, House Committee on Government Reform (April 15, 2002) at 3.

[167] The IRS's fiscal year 2003 budget calls for an appropriation of $450 million for the Business Systems Modernization program, and $50 million for Tier B projects. IRS Budget in Brief: Fiscal Year 2002, IRS Document 9940 (Rev. 1-2002) (hereinafter "IRS FY 2003 Budget in Brief") at 7, 9. For a discussion of the IRS budget request for modernization, see Part V.C. of this Report.

forensic evidence equipment, establishing a records management system that will ensure admissibility of electronically stored evidence, and strengthening investigative capabilities.[168]

The IRS's Business Systems Modernization Office manages the modernization effort and oversees the "PRIME Alliance," a group of contractors headed by the Computer Sciences Corporation. The Computer Sciences Corporation, also known as the PRIME contractor, was hired to help design and integrate the various modernization projects. To obtain Congressional funding for Business Systems Modernization, the Business Systems Modernization Office prepares a Business Systems Modernization Expenditure Plan[169] that lists each project and the estimated costs and delivery dates. When funding is received, the Business Systems Modernization Office issues task orders to the Computer Sciences Corporation that identify specific work and costs. The Business Systems Modernization Office is responsible for oversight of the Computer Sciences Corporation, but, as the Treasury Inspector General for Tax Administration reports, such oversight needs serious improvement.[170]

Background

The IRS has been working on systems modernization efforts for over a decade and the process continues to present the IRS with challenges. For the past seven years, the General Accounting Office has discussed with the IRS the importance of establishing sound management controls to guide its systems acquisition projects. In 1995, when IRS was involved in an earlier attempt to modernize its tax processing systems, the General Accounting Office recommended that the IRS implement fundamental modernization management capabilities before acquiring new systems. The General Accounting Office concluded that without such capabilities the IRS was not ready to invest billions of dollars in building modernized systems.[171] The General Accounting Office reported that IRS needed to improve in five interrelated and interdependent information technology management categories: investment management, system life-cycle management, enterprise architecture management, software acquisition management, and human capital management.

In December 1998, the IRS hired a systems integration support contractor to help the IRS develop and implement these management controls. In 1999, the Commissioner adopted a modernization strategy that required, for example, (1) the use of incremental investment

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[168] IRS FY 2003 Budget in Brief at 8-9.

[169] This plan was formerly called the Information Technology Investment Account Expenditure Plan.

[170] Treasury Inspector General for Tax Administration, *The Business Systems Modernization Office Needs to Strengthen its Processes for Overseeing the Work of the PRIME Contractor* (March 1, 2002) Ref. No: 2002-20-059.

[171] General Accounting Office, *Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected If Modernization Is to Succeed* (July 1995) GAO/AIMD-95-156.

decisionmaking, (2) adherence to a rigorous systems and software life-cycle management method, and (3) development and implementation of an enterprise architecture or modernization blueprint to guide and constrain the content, sequencing, and integration of systems investments. The General Accounting Office favored this approach.[172] However, the IRS decided simultaneously to proceed with project acquisition in anticipation that program controls would be in place and functioning when the projects reached their later, less formative stages.

However, for the first 18 months after adopting the modernization strategy, progress in implementing the management controls was slow while project acquisitions moved rapidly. In response, the General Accounting Office reported to Congress that modernization projects were getting ahead of the management capacity necessary to manage them effectively.[173] As a result, the IRS scaled back on modernization projects, and gave priority to implementing management capacity.

In March 2001, the IRS requested $128 million from the Information Technology Investment Account.[174] The General Accounting Office found that, although the IRS's request satisfied the conditions specified in the appropriation acts, and the IRS continued to make important progress in implementing modernization management controls, the IRS's modernization management capacity was still not where it should have been given (1) the number of system acquisition projects that the request identified as underway and planned, and (2) the fact that several of the ongoing projects were entering critical stages in their life cycles.[175] The General Accounting Office found that the IRS did not have a sufficient definition of the enterprise architecture to enable it to guide and constrain modernization projects or to use rigorous management practices. As a result, the General Accounting Office recommended that that the IRS slow ongoing projects and delay and stagger new projects, and not approve certain projects[176] until the IRS demonstrated a better definition of the enterprise architecture and across-the-board improvement in management practices. The IRS agreed with these recommendations and stated that the IRS would continue working to implement key management controls.[177]

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[172] General Accounting Office, *IRS Continues to Face Management Challenges in its Business Practices and Modernization Efforts* (April 15, 2002) GAO-02-619T at 29.

[173] See, e.g., General Accounting Office, *Tax Systems Modernization: Results of Review of IRS' August 2000 Interim Spending Plan* (November 8, 2000) GAO-01-91.

[174] General Accounting Office, *Business Systems Modernization: Results of Review of IRS's March 2001 Expenditure Plan* (June 2001) GAO-01-716 at 3.

[175] *Id.* at 4.

[176] Projects not to be approved were those exiting "Milestone 3," which is the point in the IRS's System life-cycle methodology where projects move from preliminary design into detailed design and development. *Id.*

[177] *Id.* at 5.

Recent developments

IRS has made important progress in improving its management capacity to cope with modernization, however, the General Accounting Office and the Treasury Inspector General for Tax Administration both conclude that significant hurdles remain.

In February 2002, in its review of the IRS's November 2001 expenditure plan, the General Accounting Office reported progress,[178] specifically, that the IRS had: (1) reviewed the PRIME contractor's quality-assurance function and recommended improvements; (2) defined risk management policies and procedures for its enterprise lifecycle approach; (3) issued the second version of the IRS's enterprise architecture and implemented steps to ensure that the architecture would be integrated with other modernization projects; and (4) planned an independent assessment of selected projects against the Software Engineering Institute's SA-CMM[179] requirements by December 31, 2002. In addition, IRS recently hired technical and managerial executives with substantial private-sector experience for its reorganized Business Systems Modernization Office.[180]

In March 2002, the Treasury Inspector General for Tax Administration released an audit report of the IRS's modernization efforts.[181] The objective of the audit was to determine whether the IRS's Business Systems Modernization Office had established effective processes to ensure that the PRIME contractor (the Computer Sciences Corporation) was delivering goods and services in a timely and cost-effective manner. The Treasury Inspector General for Tax Administration analyzed results from previous audits[182] of individual systems modernization

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[178] General Accounting Office, *Business Systems Modernization: IRS needs to better Balance Management Capacity with Systems Acquisition Workload* (February 2002) GAO-02-356.

[179] Carnegie Mellon University's Software Engineering Institute has developed criteria, known as the Software Acquisition Capability Maturity Model (SA-CMM), for determining an organization's software acquisition management effectiveness or maturity.

[180] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, House Committee on Government Reform (April 15, 2002) at 18.

[181] Treasury Inspector General for Tax Administration, *The Business Systems Modernization Office Needs to Strengthen its Processes for Overseeing the Work of the PRIME Contractor* (March 1, 2002) Ref. No. 2002-20-059.

[182] The audits reviewed were: *Progress in Developing the Customer Communications Project Has Been Made, But Risks to Timely Deployment in 2001 Still Exist* (March 2001) Ref. No. 2001-20-055; *The Customer Relationship Management Examination Project Experienced Delays and Increased Costs, But Lessons Learned Should Improve Future Modernization Projects* (August 2001) Ref. No. 2001-20- 140; *The Telecommunications Modernization Project Provided Some Benefits, But Process Improvements Are Needed for Future Projects* (August 2001) Ref. No. 2001-20-143; and *Improvements Are Needed in the Management of the e-*

projects to detect issues and trends affecting the Business Systems Modernization program as a whole. The report called the IRS "overly optimistic" about the timetable for delivering modernized systems, "given the immaturity of [the IRS's] management processes." The Treasury Inspector General for Tax Administration noted areas requiring improvements needed to avoid future delays and cost increases. These areas included: the Business Systems Modernization Office's failure to define and negotiate requirements and costs prior to the contractor personnel beginning work; the failure of project managers to establish accountability for tasks; and a failure to implement performance-based contracting processes. The Treasury Inspector General for Tax Administration recommended that: task orders be performance-based, key individuals should be included on assignment schedules for upcoming tasks, and project teams should "implement 'lessons learned' from previous projects" in developing project schedules and cost estimates.

This April, the General Accounting Office reported continued progress.[183] "Customer Communications 2001" was implemented last summer and now is routing routine taxpayer inquiries to automated menu driven information services, thereby freeing IRS customer service representatives to answer complex or less common inquiries. The "Customer Relationship Management Exam" software was distributed to Large and Mid-size Business Revenue Agents, and by August 2002, all tax revenue agents that deal with large and mid-sized businesses, and all international examiners, will be trained to use it for accurate and consistent computation of complex corporate taxes. The IRS recently issued an updated version of its enterprise architecture, thus giving a high-level roadmap to guide and constrain business and technological change.

Despite progress made, however, the General Accounting Office reports that the IRS is not where it committed to be in acquiring both infrastructure and application systems and not where it needs to be in implementing modernization management controls. The General Accounting Office says, once again, that this is because the IRS's first priority has been to get the new systems established before securing the necessary management controls.[184] In particular, the General Accounting Office found that the IRS is proceeding with building systems -- including detailed design and software development work -- before the IRS has (1) fully implemented mature software acquisition management processes, (2) developed and deployed a human capital management strategy, and (3) established effective cost and schedule estimating

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Services Project to Enable Timely Progress Towards Future Goals (September 2001) Ref. No. 2001-20-144.

[183] General Accounting Office, *IRS Continues to Face Management Challenges in its Business Practices and Modernization Efforts* (April 15, 2002) GAO-02-619T at 29.

[184] *Id.* The General Accounting Office notes that the same general concern was present last year. At that time, the General Accounting Office feared that systems workload and pace were getting too far ahead of the agency's ability to deal with them effectively. See generally General Accounting Office, *Internal Revenue Service: Progress Continues, but Serious Management Challenges Remain* (April 2, 2001) GAO-01-562T.

practices.[185] The General Accounting Office says that proceeding without appropriate management controls increases the risk of not delivering promised systems capabilities on time and within budget. Moreover, such risks are amplified in the future because the complexity of managing ongoing projects with more and newer projects will only increase over time.[186]

The IRS has reported that Business Systems Modernization projects have already encountered cost, schedule, and/or performance shortfalls.[187] The General Accounting Office's analysis has showed that weak management controls contributed directly to these problems.[188] Given that the IRS's fiscal year 2002 Business Systems Modernization spending plan supports progress towards the later phases of key projects and continued development of other projects, the General Accounting Office believes that it is likely that Business Systems Modernization projects will encounter additional cost, schedule, and performance shortfalls.[189] The IRS acknowledges these risks. According to its Chief Information Officer, until the weaknesses are fully addressed, the IRS will be (1) relying on existing immature processes; (2) leveraging the knowledge, skills, and abilities of experienced senior executives to ensure that issues are properly managed; and (3) hiring additional experienced executives.[190] In the view of the General Accounting Office, based on past experience, relying on such measures is not enough given the size and complexity of the Business Systems Modernization program. Past government and industry experience shows that the probability of repeated successes on projects proceeding in this manner is low, and the incidence and cost of rework is high. The General

[185] General Accounting Office, *IRS Continues to Face Management Challenges in its Business Practices and Modernization Efforts* (April 15, 2002) GAO-02-619T at 31.

[186] In February, the General Accounting Office recommended that the Commissioner reconsider the scope and pace of the modernization program to strike a better balance with the agency's capacity to handle the workload. General Accounting Office, *Business Systems Modernization: IRS Needs to Better Balance Management Capacity with Systems Acquisition Workload* (February 2002) GAO-02-356. The Commissioner agreed, promising to align the pace of the program with the maturity of IRS's management capacity, to reassess the projects planned for implementation during the rest of fiscal year 2002, and to make a priority of correcting management control weaknesses. *Id.* at 83.

[187] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, House Committee on Government Reform (April 15, 2002) at 20.

[188] General Accounting Office, *Business Systems Modernization: IRS Needs to Better Balance Management Capacity with Systems Acquisition Workload* (February 2002) GAO-02-356 at 3. IRS acknowledgement of weak management controls also has led to prudent IRS decisions not to start or continue projects. *Id.* at 83.

[189] General Accounting Office, *IRS Continues to Face Management Challenges in its Business Practices and Modernization Efforts* (April 15, 2002) GAO-02-619T at 33.

[190] *Id.*

Accounting Office believes the answer lies in a more modest scope and pace of systems projects until management capacity is brought up to the level needed.[191]

Key modernization programs in progress

IRS Master File/Customer Account Data Engine

The Customer Account Data Engine (often referred to as CADE) will provide a modern system for storing, managing, and accessing taxpayer records and accounts. Once implemented, this system will replace the existing tape-based master files and information processing system, and it will develop a central database for the management of taxpayer information and software systems that support different transactions using taxpayer account information. The Customer Account Data Engine incrementally will move individual filers from the 1960s tape system to a modern database, and will create applications for daily posting, settlement, maintenance, refunds processing and issue detection for taxpayer tax accounts and return data. The database and applications developed by the Customer Account Data Engine also will enable the development of subsequent modernized systems that improve customer service and compliance. Once implemented, modernized applications, such as Customer Account Management, will allow on-line posting of data in addition to daily batch processing. The Customer Account Data Engine will be deployed over a six-year period in five "Releases," each related to a specific segment of taxpayers.

Last year, the IRS anticipated that the Customer Account Data Engine would replace the current Master File for individual taxpayers by 2006, and that the Master File for business taxpayers and information returns would be transferred beginning in October 2001.[192] However, Customer Account Data Engine production has been delayed by six months.[193] The IRS discovered in December 2001 a problem with the procurement of critical software by the PRIME and the IRS proceeded with the development of the first Release using standard software. The IRS is now working to mitigate this problem.

In addition to the technical difficulties, the IRS encountered in late March 2002 an additional one-month delay of Release 1 to July 2002.[194] The IRS notified its Executive Steering Committee and the IRS Oversight Board of the problem and the IRS's corrective actions. Although the delay is regrettable, the IRS says that it will provide time for the development,

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[191] *Id.*

[192] 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-33-01), May 4, 2001 at 25.

[193] Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, House Committee on Government Reform (April 15, 2002) at 20.

[194] *Id*.

testing, and implementation of the pilot for the first Release in Summer 2002. The IRS says that most of the software has been developed, testing has begun, and the IRS plans to implement the software during the 2003 filing season. The first Release will move about 10 million Form 1040EZ electronic and paper single refund filers onto Customer Account Data Engine.[195]

Customer Account Management

The Customer Account Data Engine cannot be deployed beyond its initial limited releases without Customer Account Management. In general, Customer Account Management will allow the IRS to update data in the Customer Account Data Engine and will help the IRS give taxpayers timely and accurate responses to requests and inquiries.

Customer Account Management has two Operating Models: Individual Assistance and Self Assistance. The Operating Models will enable the IRS to: (1) better manage customer service functions; (2) maintain and utilize data to improve taxpayer interactions with the IRS; (3) provide comprehensive account and tax law assistance to taxpayers and practitioners; and (4) manage the case work flow of customer inquiries.

The Individual Assistance Operating Model's main function is to improve customer assistance by providing Customer Service Representatives with a desktop information system that will enable Representatives quickly to access taxpayer information and respond accurately to complex customer inquiries. The main objective of the Self-Assistance Operating Model is to provide taxpayers with the flexibility and convenience of accessing IRS-related information by telephone or the Internet to resolve relatively simple inquiries.

e-Services

The e-Services project will support the IRS's ability to conduct most transactions with taxpayers and their representatives in an electronic format, as required by the IRS Reform Act. e-Services will provide to third parties over the Internet the four most requested applications: electronic taxpayer identification number matching, electronic transcript delivery, disclosure authorization, and Electronic Account Resolution. e-Services also directly supports the President's Management Agenda's government-wide initiative to expand electronic Government.

Customer Communications Internet Refund, Fact of Filing

This program will deliver a self-service Internet application to allow taxpayers to check on the status of their income tax return posting and their refund.

Integrated Financial System

The Integrated Financial System will provide core financial capabilities and financial reporting and an integrated framework for retirement of current financial systems.

[195] See Appendix at 6.

Custodial Accounting Project

The General Accounting Office identified the lack of an acceptable accounting system for the $2 trillion collected in tax revenue as one of the most significant material weaknesses in the IRS's financial management.[196] The Custodial Accounting Project will provide the IRS with the control and reporting capabilities mandated by Federal financial management laws. It also will support the appropriate custodial subledgers containing data from tax operations and help the IRS comply with both the Federal Financial Management Improvement Act (FFMIA) and federal mandates related to custodial revenue management.

Enterprise Data Warehouse

The ability of the IRS to make effective use of information about its operations is limited by the numerous fragmented databases that evolved over time. The Enterprise Data Warehouse will provide the foundation for data mining and decision analytic tools, and will enable risk-based analysis for case selection and provide the tools to report on IRS balanced performance measures.

Filing and Payment Compliance

Filing and Payment Compliance will use technology to improve IRS communications with taxpayers on compliance issues and also protect taxpayer rights. The goals of the program are to resolve all balance due cases above a minimum threshold, shorten the filing compliance lifecycle to ensure resolution before the next filing due date, and shorten the payment compliance lifecycle to six-months for non-enforcement cases.

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[196] General Accounting Office, *IRS Continues to Face Management Challenges in its Business Practices and Modernization Efforts* (April 15, 2002) GAO-02-619T at 4, 11.

V. IRS BUDGET REQUEST FOR FISCAL YEAR 2003

A. In General

IRS fiscal year 2003 IRS budget request

For fiscal year 2003, the IRS budget request totals $10.418 billion and 101,080 full-time equivalent positions. The fiscal year 2003 budget request reflects a $482 million increase from the fiscal year 2002 appropriated level of $9.936 billion and an increase of 1,179 full-time equivalent employees from the fiscal year 2002 proposed operating level of 99,901 full-time equivalent employees.[197]

The IRS budget request includes $154,346,000 and 2,353 full-time equivalent employees for the earned income credit compliance initiative, which reflects a $406,000 increase from fiscal year 2002.[198] This appropriation covers customer service, public outreach, enforcement, and research to reduce overclaims and erroneous filings. The fiscal year 2003 budgeted staffing levels would remain unchanged from fiscal year 2002.[199]

The IRS Oversight Board supports this year's IRS budget request.[200]

IRS objectives and summary of the fiscal year 2003 budget request

The IRS fiscal year 2003 budget request has four building blocks: (1) provide a world class level of service; (2) modernization; (3) maintain current operations; and (4) legislative proposals.[201]

To provide a world class level of service, the IRS requests $260 million to fund initiatives to enhance customer service and compliance and workload increases, $158 million of which will be funded through reapplication of resources within the base budget.[202]

The IRS requests $58 million to maintain the momentum of Business Systems Modernization, which are agency-wide long-term projects. The IRS requests $10 million for

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[197] IRS Fiscal Year 2003 Congressional Justification (February 4, 2002) (hereinafter "IRS FY 2003 Justification") at SD-7, 8, 12.

[198] *Id.* at EITC-3.

[199] *Id.*

[200] IRS Oversight Board Report at 35.

[201] IRS FY 2003 Budget in Brief at 1.

[202] *Id*. at 1-2.

"Tier B" modernization projects, which provide software enhancements to improve business processes in the short term.[203]

The IRS requests $342 million to maintain current operations. Of this amount, $295 million funds pay, benefits, and non labor inflationary costs, $37 million covers the costs of within-grade pay increases for on-board employees, and $10 million is for enhanced security arrangements pursuant to the Homeland Security Supplemental. The IRS expects to save $39 million from better business practices and notes that $31 million from the fiscal year 2002 budget for homeland security does not recur in fiscal year 2003.[204]

Proposals in the President's fiscal year 2003 Budget require an increase and adjustments of $40 million for the costs of retirement and health benefit retiree costs, the costs of services provided by the General Services Administration, the National Archives and Records Service and the Department of Agriculture, and a surcharge to the Department of Labor for Federal Employees' Compensation Act benefits.[205]

The IRS notes that it provides three primary services: Pre-Filing, Filing, and Post-Filing Services. The budget request aims to improve such services by setting performance goals in ten areas: improvement of pre-filing taxpayer assistance and education, filing and account services, compliance services, research and Statistics Of Income, information services, information systems improvement programs, Business Systems Modernization, Earned Income Tax Credit initiative, shared services support, and general management and administration. The IRS also has identified 12 key strategic themes that drive its budget request, including increase in pre-filing agreements, improvement to electronic tax administration, removal of tax-law complexity, and better compliance activity.[206]

B. Funding for Customer Service

The IRS budget request takes into account projected cost savings of $158 million from a number of improvement projects, workload decreases, and modernization efforts. For example, the IRS reports that improvement projects dedicated to redesigning internal processes, electronic tax administration, and improvements to corporate tax analysis software will save $104 million (1,722 full-time employees). In addition, the IRS projects that workload decreases from expected declines in innocent spouse cases, reduction of the number of employees planned for customer service details, redirecting resources from the narcotics program to the Fraud Referral Program and the Money Laundering Program, employee attrition, and a decline in Tax Court cases will save $51 million (508 full-time employees). Finally, the IRS expects savings of $3

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[203] *Id.* at 2.

[204] IRS FY 2003 Justification at SD-10.

[205] IRS FY 2003 Budget in Brief at 2-3.

[206] IRS FY 2003 Justification at SD-2 through 6.

million (57 full-time employees) because of two Tier B modernization projects -- the Employee Plan Determination System Redesign and the Remittance Transaction Register.[207]

The IRS budget request applies the efficiencies noted above and requests an additional $102 million for certain compliance strategies ($125 million; 1,857 full-time employees), customer service and workload increases ($91 million; 1,595 full-time employees), and non-labor increases ($44 million).[208]

The IRS's major compliance goals are to stabilize audit rates, increase the audit rate for trusts and certain small businesses, address non-filers, address the employment and income tax gaps, focus on K-1 matching, act on fraud referrals, improve voluntary reporting by use of a national rotational inventory approach for selecting underreporting cases, and combat employment tax non-compliance, money laundering, and criminal cases (including electronic criminal cases).[209]

Customer service and workload increases include funding for improvement of IRS correspondence with taxpayers by written notice and telephone assistance, an increase in advanced case resolutions, increasing and more complicated legal advice, centralization of offer-in-compromise processing, providing multi-lingual services, increasing electronic filing, handling the growing number of returns filed, completing the "Design Footprint" by supporting new hires that provide pre-filing and filing support (including return preparation) to taxpayers, and merging the Tax Assistance Program and Tax Administration Advisory Service.[210]

Non-labor increases including funding for enhanced guard services, employee transportation subsidy, outsourcing studies, small business/self-employed contracts, physical security upgrades, Wage and Investment joint operations center contract, Large and Mid-Size Business CRM Exam and Net Quantile 1 returns, Tax Exempt/Government Entities EFAST, Employee Resource Center Support, and the Taxpayer Advocate publicity campaign.[211]

C. Funding to Support IRS Modernization

<u>In general</u>

The IRS reports that modernization is the central part of the effort to improve customer service and voluntary compliance. The two primary components of modernization are Business Systems Modernization and Tier B projects. Business Systems Modernization is directed at the redevelopment of IRS business practices and the acquisition of modern technology. The IRS has

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[207] IRS FY 2003 Budget in Brief at 3-4.

[208] *Id.* at 4-5.

[209] *Id.*

[210] *Id.*

[211] *Id.*

indicated that business systems modernization will provide improved access to information and tax data, more accurate information provided by the IRS to taxpayers, faster IRS responses to taxpayers, more timely IRS-initiated actions, and a more productive workforce.[212] Tier B projects are more limited and typically improve existing systems or coordinate current systems with modernization projects.

The IRS collects $2 trillion in revenues but relies on outdated computer systems developed over 35 years. The IRS notes that modernization is still at a critical point and that failure to continue the current efforts will result in increased costs in the long term to maintain existing outdated systems that are not efficient or effective.[213]

The IRS has requested an increase of $68 million for Business Systems and Tier B Modernization above the $432 million operating level for fiscal year 2002.[214]

Business systems modernization

The IRS has requested a total of $450 million for Business Systems Modernization, which reflects a $58 million increase from the fiscal year 2002 operating level of $392 million.[215] The IRS uses a formal method to prioritize, approve, fund, and evaluate its portfolio of Business Systems Modernization investments. The IRS finds that this methodology enforces a documented, repeatable, and measurable process for managing investments throughout their life cycle. Investment decisions are approved by the IRS Core Business System Executive Steering Committee, which is chaired by the Commissioner of Internal Revenue.[216]

The IRS states that the $58 million increase will fund the contract, equipment, and software costs needed to improve the speed, timeliness and accuracy of the IRS's interactions with taxpayers. The IRS plans to deliver the following benefits.[217]

Benefits for businesses

- Encourage more electronic filing by more efficient implementation of daily cycles and processing of refunds
- Improved efficiency by facilitating the transfer of taxpayer accounts from the Master File to the Customer Account Data Engine

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[212] IRS FY 2003 Justification at BSM-6.

[213] *Id.* at BSM-4.

[214] IRS FY 2003 Budget in Brief at 7, 9.

[215] IRS FY 2003 Justification at BSM-3; IRS FY 2003 Budget in Brief at 7.

[216] IRS FY 2003 Justification at BSM-4; IRS FY 2003 Budget in Brief at 7.

[217] IRS FY 2003 Justification at BSM-7-13; IRS FY 2003 Budget in Brief at 7-8.

- Provision of timely and accurate financial information to management and stakeholders

<u>Benefits for Employees</u>

- Faster resolution of third party problems
- Improving tools available to better manage partner relationships
- Improve resolution of taxpayer questions during the first call

<u>Benefits for taxpayers</u>

- Education of taxpayers using assistors and self-directed online applications
- Using the Internet and phone system to provide information to taxpayers quickly and conveniently
- Accelerated refund processing for Customer Account Data Engine accounts

<u>Project related benefits</u>

- Build the *Customer Account Data Engine*, which will replace the existing return processing systems and lead to other applications that will improve customer service and compliance
- Establish the *Integrated Financial System*, which will provide core financial capabilities and financial reporting and will permit retirement of current financial systems
- Implement the *Custodial Accounting Project*, which will help the IRS comply with legislative and policy directives related to revenue reporting and accounts receivable as well as enable the accurate distribution of trust funds
- Fund the *Enterprise Data Warehouse*, which will improve the IRS's ability to use data for research and decisions
- Continue *e-services*, which will provide additional Internet self-service applications for external IRS business partners
- Improve the customer focus of the IRS with *Customer Account Management*, which will provide IRS Customer Service Representatives with better information about customer accounts and enable the IRS to inform relevant parties of important developments
- Fund *Filing and Payment Compliance*, which will use modernized systems to select cases to meet the goal of the program, which is to resolve all balance due cases above a minimum threshold, shorten the filing compliance lifecycle to ensure resolution prior to the next filing due date, and shorten the payment compliance lifecycle to six-months for nonenforcement cases.

Tier B modernization

The IRS has requested a total of $50 million for Tier B modernization, which reflects a $10 million increase from the fiscal year 2002 operating level of $40 million.[218] The IRS states that the Tier B projects will support the following objectives.

Criminal Investigations business activities

- Provide one-touch query capability on subject information to facilitate tax-related financial crime investigations
- Establish a system that will ensure that electronically stored evidence is admissible in criminal court cases
- Modernize the equipment used to analyze forensic evidence

National Headquarters Business Units

- Establish an integrated system to receive, manage, and efficiently respond to taxpayer complaints

Wage and Investment business activities

- Use a risk-based approach to selecting workload in order to increase voluntary compliance and protect revenue

In addition, Tier B investments will provide all Remittance Transaction payment information on-line in real time, allow for team-based reporting compliance, give employees electronic training tools, support the National Forensic Lab's technology, and create computer enhancements that permit multiple system interfaces on one computer terminal.[219]

D. Funding to Maintain Current Operations

The IRS requests $342 million to maintain current operations. Of this amount, $295 million funds the cost of statutory pay increases and inflation at a level that will maintain the current level of services. An additional $37 million covers the costs of within-grade pay increases for on-board employees, which are not otherwise funded. The IRS requests $10 million for enhanced security arrangements pursuant to the Homeland Security Supplemental. This amount includes funding that is required for annualizing the Security Guard costs, space rental from the General Services Administration, and costs associated with continued participation in the Joint Terrorism Task Force. The IRS notes that $31 million from the fiscal year 2002 budget for homeland security does not recur in fiscal year 2003. The IRS expects to save $39 million by implementing the Treasury Department's better business practices, which

[218] IRS FY 2003 Budget in Brief at 9.

[219] *Id.*

encourages bureaus to review current efforts and to eliminate or curtail practices that do not have significant value.[220]

E. Legislative Proposals and Other Adjustments

The IRS budget request includes $40 million to account for proposals in the President's fiscal year 2003 Budget.

- The President's budget proposes to permit the Department of Labor to add an surcharge to the amount it charges each agency for Federal Employees' Compensation Act benefits. The IRS requests $3 million to cover this surcharge.
- The President's budget proposes legislation that would require agencies to pay the full share of the accruing cost of retirement of employees, the accruing cost of post-retirement health benefits for current employees, and the post-retirement health costs of retirees (and their dependents/spouses). The IRS requests 32 million to cover this cost.

The IRS also requests $5 million to allow the permanent transfers of funds for services provided by the General Services Administration, the National Archives and Records Administration, and the Department of Agriculture to the IRS.[221]

F. Financial Audit of IRS Fiscal Year 2001 Financial Statements

The General Accounting Office recently presented the results of its audit of the IRS's principal financial statements for fiscal year 2001. Like fiscal year 2000, the General Accounting Office expressed an unqualified opinion on all IRS financial statements.[222] The General Accounting Office rendered unqualified opinions in both years due to the "extraordinary efforts of IRS senior management and staff to compensate for serious internal control and system deficiencies."[223] By contrast, the General Accounting Office's audit of IRS financial statements for fiscal year 1999 resulted in an unqualified opinion on its custodial activity statement, a qualified opinion on its balance sheet, and a disclaimer that no opinion could be issued on the remaining IRS financial statements. In prior years, the General Accounting Office's audit reports were less favorable.

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

[221] *Id.* at 2-3, 11.

[222] The IRS financial statements report the assets, liabilities, net position, net costs, changes in net position, budgetary resources, reconciliation of net costs to budgetary obligations, and custodial activity related to the IRS's administration of its responsibilities for implementing federal tax legislation. General Accounting Office, *Financial Audit: IRS's Fiscal Years 2001 and 2000 Financial Statements* (February 2002) GAO-02-414 at 3.

[223] *Id.* at 1.

Despite its unqualified opinions, the General Accounting Office continues to identify many material weaknesses in the IRS's internal controls. These weaknesses include: (1) an inadequate financial reporting process, (2) inability to manage unpaid tax assessments, (3) identifying and collecting outstanding tax revenues and issuing refunds, (4) inability to timely report IRS property and equipment balances, (5) inadequate budgetary controls, and (6) weaknesses in computer security. Such weaknesses may adversely affect many decisions by IRS management.[224]

Commissioner Rossotti has indicated that the IRS has made significant improvements in several areas, which contributed to the IRS's success in obtaining unqualified opinions as to each financial statement.[225] These improvements include:

- Implementation of a disposal process for property and equipment;
- Implementation of a process to ensure accruals were adequately reflected as of year-end;
- Issuance of guidance and improved review of and accounting for open obligations;
- Implementation of continuity of operations efforts;
- Establishment of the Computer Security Incident Response Center; and
- Requiring all personnel offices to report monthly all individuals who entered on duty prior to a fingerprint result.

In the short-term, the IRS plans to:

- Improve field guidance regarding classification of property and equipment;
- Improve the accrual process to address timely recording of receipt of goods and services;
- Institutionalize periodic reviews of general ledger balances during the year;
- Record imputed costs regularly; and
- Provide field guidance regarding more accurate reporting of revenue activity.

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[224] *Id.* at 7.

[225] Statement of Charles O. Rossotti, Commissioner of Internal Revenue, before the Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations of the House Committee on Government Reform (April 15, 2002) at 15.

VI. OTHER MATTERS ADDRESSED BY THE IRS REFORM ACT

A. IRS Oversight Board

The IRS Reform Act created the IRS Oversight Board. The IRS Oversight Board began operations in September 2000. The IRS Oversight Board consists of nine members: seven private citizens who serve on a part-time basis, the Commissioner, and the Secretary of the Treasury. The IRS Oversight Board meets for two days approximately every two months, usually in Washington, D.C.[226] Generally, the IRS Oversight Board oversees the IRS's administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws.[227] Specific responsibilities of the IRS Oversight Board include reviewing and approving the IRS's strategic plans and operational functions (such as modernization, outsourcing, training, and education). The IRS Oversight Board also is to recommend candidates for appointment as IRS Commissioner, and may recommend whether the Commissioner should be removed. The Commissioner's selection, evaluation, and compensation of senior executives also are to be reviewed by the IRS Oversight Board. In addition, any major reorganization of the IRS is to be reviewed and approved by the IRS Oversight Board.

The IRS Oversight Board reviews and approves budget requests prepared by the Commissioner to ensure that the budget request supports IRS annual and long-range strategic plans.[228] The IRS Oversight Board submits such budget requests to the Secretary of the Treasury, who submits the request to the President, who in turn submits it, without revision, to Congress together with the President's annual budget request for the IRS for the fiscal year. The President is not precluded from submitting his own budget for the IRS.

In its January 2002 annual report, the IRS Oversight Board found that "the IRS is still not effectively and efficiently serving the needs of the American taxpayers, although it has made significant progress since 1997."[229] The IRS Oversight Board summarized the current state of the IRS and measured the IRS's progress in meeting its three objectives: service to each taxpayer, service to all taxpayers, and productivity in a quality workplace. The IRS Oversight Board found that customer service (especially toll-free telephone and walk-in service) has not risen to desired levels but notes that taxpayer satisfaction with the IRS has increased.[230] Enforcement results are slightly upward by many measures in 2002, with the exception of a general decrease in the number of audits. The IRS Oversight Board concludes that major

[226] IRS Oversight Board Report at 35.

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

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

[229] IRS Oversight Board Report at 1.

[230] *Id.* at 11.

improvement is needed on enforcement matters.[231] The IRS Oversight Board finds that IRS productivity has decreased by many measures over the past three years, which may be attributable to a variety of factors, such as declining resource allocation, low employee satisfactions, and tax-law complexity.[232] Moreover, outdated computer systems hamper productivity of IRS workers and prevent effective service from being delivered.[233]

The IRS Oversight Board identified as significant challenges to the IRS the outdated state of IRS technology, the increasing complexity of the tax code, reduced staffing levels, service levels to taxpayers, declining results in enforcement, lack of compliance data to make informed resource allocation decisions, declining productivity, workforce engagement, successful implementation of the balanced measures program (which will evaluate employee performance with measures other than tax results), and other human capital issues.[234]

The IRS Oversight Board found that progress has been made in some areas: the reorganization of the IRS into four functional units, the nearly complete implementation of the balanced measures program and the progress, albeit slow, of the Business Systems Modernization program.[235]

The IRS Oversight Board recommended that the IRS complete Business Systems Modernization as soon as possible, and recommended that the IRS receive $400 million in funding for the program in fiscal year 2002, $450 million in fiscal year 2003, and $500+ million in fiscal year 2004 and beyond. However, the IRS Oversight Board reports that at its current level of management capability, the IRS cannot spend over $500 million in a fiscal year effectively. To improve the Business Systems Modernization program, the IRS Oversight Board recommends that the IRS improve its program management ability, work more effectively with the PRIME Contractor, and manage change more effectively. The IRS Oversight Board also recommends that the PRIME Contractor, the Administration, Congress, and oversight organizations work to support the completion of the Business Systems Modernization program.[236]

The IRS Oversight Board also made recommendations for short-term improvements, including completion of the restructuring of the Modernization and Information Technology Services division, continued use of pre-filing educational activities, and effective implementation

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[231] *Id.*

[232] *Id.* at 14.

[233] *Id.* at 1.

[234] *Id.* at 3, 23.

[235] *Id.* at 25-26.

[236] *Id.* at 27-28

of the National Research Project to understand the extent and causes of noncompliance with the tax law.[237]

The IRS Oversight Board approved the IRS's proposed budget for fiscal year 2003. Because the fiscal year 2003 budget was still being formulated at the time of the report, the IRS Oversight Board did not comment on its budget recommendation with respect to the final Administration request.[238]

The IRS Oversight Board held a public meeting on January 29, 2002, during which it heard testimony about IRS operations from representatives of 16 organizations, including the National Council for Taxpayer Advocacy, the American Institute of Certified Public Accountants, the National Treasury Employees Union, and the National Association of Enrolled Agents.[239] Other activities of the IRS Oversight Board include helping to select a new IRS Commissioner, reviewing the performance evaluations and proposed bonuses of 13 IRS executives, and interviewing the current National Taxpayer Advocate prior to her selection as such.[240]

B. National Taxpayer Advocate

Background and provisions of the IRS Reform Act

The IRS created the Problem Resolution Program in 1976. The purpose of the program 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 the program. In 1996, the Taxpayer Bill of Rights 2 replaced the Taxpayer Ombudsman with the Taxpayer Advocate. The Taxpayer Advocate was expected to represent taxpayer interests independently in disputes with the IRS. The IRS Reform Act renamed the Taxpayer Advocate the National Taxpayer Advocate. The National Taxpayer Advocate supervises the Office of the Taxpayer Advocate.

The Office of the Taxpayer Advocate has four principal functions:

(1) to assist taxpayers in resolving problems with the IRS;

(2) to identify areas in which taxpayers have problems in dealing with the IRS;

(3) to propose changes in the administrative practices of the IRS to mitigate such problems; and

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[237] *Id.* at 29-30.

[238] *Id.* at 35.

[239] See Amy Hamilton, *Practitioners Tired of IRS Asking for Understanding, Patience*, 2002 *Tax Notes* 20-2 (January 30, 2002).

[240] IRS Oversight Board Report at 36.

(4) to identify potential legislative changes that may be appropriate to mitigate such problems.

The IRS Reform Act established a system of local Taxpayer Advocates that report to the National Taxpayer Advocate or her delegate. Local Taxpayer Advocates are to be independent of the IRS's examination, collection, and appeals functions. Local Taxpayer Advocates also are to be employees of the Office of the Taxpayer Advocate. The National Taxpayer Advocate appoints Local Taxpayer Advocates. With the Commissioner, the National Taxpayer Advocate must develop career paths for local Taxpayer Advocates choosing to pursue a career within the Office of the Taxpayer Advocate.

The National Taxpayer Advocate monitors the coverage and geographic allocation of local taxpayer advocate offices and ensures that at least one local advocate is available for each State.[241] 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 National Taxpayer Advocate also must ensure that local telephone numbers for each office are published and available to taxpayers served by the office.[242] Additionally, the National Taxpayer Advocate 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.[243]

The IRS Reform Act also expanded the National Taxpayer Advocate's ability to issue Taxpayer Assistance Orders. A taxpayer can request a Taxpayer Assistance Order if the taxpayer is suffering or about to suffer a "significant hardship" from tax law administration.[244] A Taxpayer Assistance Order 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. The IRS has recently clarified the guidelines for issuing Taxpayer Assistance Orders.[245]

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

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

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

[244] 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 National Taxpayer Advocate may also issue a Taxpayer Assistance Order if the taxpayer meets requirements to be set forth in regulations. Sec. 7811(a)(1)(B).

[245] Internal Revenue Service, *IRS Expands Authority for Taxpayer Advocate Service*, IR-2001-12 (January 24, 2001).

The Code requires the National Taxpayer Advocate to submit two reports annually to the Committee on Ways and Means of the House of Representatives and to the Senate Committee on Finance.[246] The National Taxpayer Advocate submits the reports directly to the Congressional committees without prior review by the Commissioner, the Secretary, or any officer or employee of the Treasury, the IRS Oversight Board, or the Office of Management and Budget.[247]

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.[248] 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. The report also must cover the 20 most serious problems experienced by taxpayers. In addition, the IRS Reform Act 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. The report must include any recommendations received from individuals with the authority to issue Taxpayer Assistance Orders, as well as any Taxpayer Assistance Orders that have not been promptly honored by the IRS. The report also must set forth recommendations for administrative and legislative action to resolve problems encountered by taxpayers.

Organization of the Office of the Taxpayer Advocate

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 National Taxpayer Advocate. Caseworkers also have been moved into the local Taxpayer Advocate organization. A career path has been established for these workers to allow for professional development and advancement.

In addition to caseworker positions, the National Taxpayer Advocate has created Operating Division Taxpayer Advocate positions to work within the new IRS organizational structure. The primary responsibility of the Operating Division Taxpayer Advocate is to provide systemic analysis and advocacy, as opposed to performing casework.

The National Taxpayer Advocate receives legal assistance from an executive-level Chief Counsel attorney assigned as the Counsel to the National Taxpayer Advocate. The Counsel to

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

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

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

the National Taxpayer Advocate has authority to hire four senior attorneys to provide the National Taxpayer Advocate and the immediate office with legal support.

National Taxpayer Advocate annual report

The National Taxpayer Advocate's annual report focused on tax code complexity as the most serious problem facing business and individual taxpayers. In the preface to her report, the National Taxpayer Advocate wrote,

> I maintain that this nation can ill afford to ignore the increasing burden (for taxpayers and tax administrators alike) and irrationality of our tax system. Our tax system is a voluntary system, relying on taxpayers to inform the government of their taxable income and resulting tax. To the extent that we, as tax legislators or tax administrators, make this compliance too burdensome, or too confusing for taxpayers, or out of tune with taxpayers' sensible way of life, we create an environment in which even the most compliant taxpayers wonder why they bother. In fact, some taxpayers will stop bothering to comply. It matters not that this complexity or irrationality is an unintended or inadvertent consequence.[249]

Legislative proposals

In general

The National Taxpayer Advocate's Report identified six main areas for legislative action: family status issues, joint and several liability, alternative minimum tax for individuals, penalties and interest, home-based service workers, and IRS collection procedures. The following paragraphs summarize the Taxpayer Advocate's primary legislative proposals.

Family status issues

The National Taxpayer Advocate's Report recommended five legislative changes relating to family status. The National Taxpayer Advocate indicated that the adoption of these proposals, described below, is fundamental to achieving a fairly administered system and also would result in significant tax code simplification.[250]

(1) Adopt a uniform definition of a "qualifying child" applicable to biological, step, and adoptive children or descendants for purposes of the dependency exemption (sec. 151 (a) and (c); sec. 152), head of household filing status (sec. 2(b)), the definition of "not married" (sec. 7703(b)), the earned income tax credit (sec. 32), the child tax credit (sec. 24), and the child and dependent care credit (sec. 21).

(2) Provide that means-tested public benefits are excluded from the computation of support in determining whether a taxpayer is entitled to claim the dependency

[249] National Taxpayer Advocate FY 2001 Report at iv-v.

[250] *Id.* at 76.

exemption and from the cost of maintenance test for the purpose of head-of-household filing status or "not married" status (secs. 152, 2(b), and 7703).[251]

(3) Clarify that a custodial parent who is eligible to claim the dependency exemption must voluntarily sign a written release of the dependency exemption to the noncustodial parent (sec. 152(e)(2)). Further, explicitly state that the dependency exemption cannot be allocated by state domestic relations courts, nor can taxpayers be ordered by such courts to relinquish the dependency exemption absent a voluntary agreement by the custodial parent.[252]

(4) Eliminate the age restrictions for those taxpayers who do not have a qualifying child and who otherwise qualify for the Earned Income Tax Credit (sec. 32(c)).[253]

(5) Allow single or separated noncustodial parents who are paying substantially all required child support to claim the Head of Household filing status as directed by a formal court ordered child support agreement (sec 2(b)).[254]

Joint and several liability issues

When a married couple files a joint income tax return, both spouses are liable for the income taxes with respect to that return regardless of who earned the income or claimed the deductions that caused the tax liability.[255] Although spouses can avoid joint and several liability by filing separately, married individuals filing a separate return are entitled to fewer tax-related benefits.[256] In general, to obtain relief from joint and several liability, an individual who filed a joint return must prove that he or she is an "Innocent Spouse" in accordance with the provisions contained in section 6015.

The National Taxpayer Advocate's Report recommends legislative changes to:

(1) Allow married individuals to elect to sever their liability by declaring their separate items of income on their original married filing joint income tax return (sec. 6013(d)).[257]

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[251] *Id.* at 101.

[252] *Id.* at 105.

[253] *Id.* at 118.

[254] *Id.* at 122.

[255] Sec. 6013(d)(3).

[256] Sec. 6013(a).

[257] National Taxpayer Advocate FY 2001 Report at 129.

(2) Provide additional guidance to the Secretary about the factors to be considered in determining whether it would be inequitable to hold the taxpayer jointly and severally liable for a jointly filed return (sec. 6015(f)).[258]

(3) Provide that when relief is granted in full or in part from joint and several liability, payments made after the date of filing an innocent spouse claim can be refunded (sec. 6015(g)(3)).[259]

(4) Provide guidance to the Secretary for developing a broader interpretation of equitable relief for the issuance of refunds (secs. 6015(f) and (g)).[260]

(5) Allow the IRS to rescind a determination letter issued under section 6015 with the agreement of the taxpayer.[261]

(6) Require the IRS to provide in the notice of final determination the last date to petition the Tax Court, and provide for the taxpayer to be able to petition the Tax Court by the later of the date the Secretary specifies in the notice of final determination or 90 days from the date of the notice (sec. 6015(e)(1)(A)).[262]

(7) Allow the taxpayer the right to petition the United States Tax Court in equitable relief determinations (secs. 6015(e) and (f)).[263]

Alternative minimum tax

Citing devilish complexity and an increasing burden on low-income and middle-income taxpayers, the National Taxpayer Advocate's Report recommends repeal of the individual Alternative Minimum Tax.[264] Alternatively, the report recommends indexing the individual Alternative Minimum Tax Exemptions to current dollars; establishing a gross income threshold (indexed for inflation) for individual Alternative Minimum Tax that can be taken directly from the tax return; or, eliminating personal exemptions, the standard deduction, deductible state and

[258] *Id.* at 146.

[259] *Id.* at 156.

[260] *Id.*

[261] *Id.* at 160.

[262] *Id.*

[263] *Id.*

[264] *Id.* at 167.

local taxes, and miscellaneous itemized deductions as adjustment items for individual Alternative Minimum Tax purposes.[265]

Penalties and interest issues

To encourage compliance by taxpayers, the Code provides for the accrual of interest and certain penalties if federal tax liabilities are not timely paid. However, the National Taxpayer Advocate reports that taxpayers who believe in good faith that they have complied with the tax laws do not understand why they are charged interest and penalties that in some cases exceed the tax liability.

The National Taxpayer Advocate's Report recommends: (1) Repealing the penalty provisions for failure to pay tax while increasing the interest rate for underpayments;[266] (2) requiring, with some exceptions, the Secretary to abate the assessment of all interest on any erroneous refund (sec. 6602) until the date the demand for repayment is made, unless the taxpayer (or a related party) has in any way caused such an erroneous refund;[267] and (3) authorizing the Secretary to grant a one-time abatement of the failure to file penalty (sec. 6651(a)(1)), and failure to pay penalty (sec. 6651(a)(2)) for first time filers and taxpayers with a consistent history of compliance where no countervailing factors are present.[268]

Home-based service workers

Home-based service workers help disabled or elderly persons with personal care or household chores. The National Taxpayer Advocate reports that in most cases the home based service worker is considered to be an employee and the service recipient is considered to be the employer. However, sometimes the workers are treated as and/or may be independent contractors. Such uncertainty may result in different tax treatment of similarly situated taxpayers.[269]

The National Taxpayer Advocate's Report recommends making clear that home-based service workers are employees rather than independent contractors.[270] The Report also recommends enacting a new section that removes liability for employment taxes from the common law employer (here, the service recipient) and deems the administrator of home-based worker funding (defined as states, their agencies, or intermediate service organizations,

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[265] *Id.* at 172.

[266] *Id.* at 179.

[267] *Id.* at 183.

[268] *Id.* at 188.

[269] *Id.* at 195.

[270] *Id.* at 194.

regardless of the original source of funding) as the responsible party to withhold, report, and pay employment taxes on behalf of home-based workers.[271]

IRS collection procedures

The National Taxpayer Advocate's Report states that the IRS occasionally commits flagrant errors that violate either statutes or the IRS's own established administrative procedures, and cause severe harm to taxpayers. The Report finds that such errors most often occur in the context of levies or seizure of assets, which are then sold. The Report says that once the errors are discovered, the IRS often is prevented from providing relief to taxpayers because of expired statutory limitation periods, or because there is no overpayment and thus no grounds for a refund. In addition, when the IRS levies upon an individual retirement account or other qualified plan, the taxpayer cannot restore any returned levy proceeds to the account and still is liable for the income tax on any distribution.[272]

The National Taxpayer Advocate's Report recommends the following changes to the IRS's collection procedures: (1) extend the period of time within which taxpayers or third parties can request a return of levied funds or the proceeds from the sale of levied property from nine months to two years from the date of levy, or longer for taxpayers if the IRS acted in reckless or flagrant disregard of established IRS rules and the taxpayer incurred significant harm (sec. 6343);[273] (2) extend the period of time within which certain third-party suits or proceedings (sec. 7426) shall begin from nine months to two years from the date of levy or agreement giving rise to such action;[274] and (3) authorize reinstatement of funds to certain retirement accounts and pension plans where the IRS levied upon the plans in error or in flagrant disregard of established IRS rules, procedures, or regulations and the funds were returned under section 6343(d).[275]

Most serious problems faced by taxpayers

The National Taxpayer Advocate's Report identified and discussed 23 of the most serious problems identified by individual taxpayers. The top ten are:

- Access to customer service toll-free telephone service
- Multiple definitions of "qualifying child"
- Determining Earned Income Tax Credit eligibility
- Answers to questions on customer service toll-free lines
- Documenting Earned Income Tax Credit eligibility

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[271] *Id.*

[272] *Id.* at 202.

[273] *Id.* at 203.

[274] *Id.*

[275] *Id.*

- Refund inquiries
- Earned Income Tax Credit examinations
- Understanding estimated tax payments
- Explanations on math error notices
- Processing claims for refund[276]

Most litigated tax issues

The National Taxpayer Advocate's Report identifies the top ten most litigated issues by taxpayers as:

- Unreported or Underreported Income
- Trade or Business Expenses
- Exemptions (Personal and Dependency)
- Accuracy Related Penalties
- Delinquency Penalty
- Collection Due Process
- Earned Income Tax Credit
- Innocent Spouse
- Entertainment Expenses
- Trust Cases[277]

Among the most litigated tax issues, the National Taxpayer Advocate noted that the personal and dependency exemptions, innocent spouse, and the Earned Income Tax Credit present significant compliance problems for taxpayers due to complexity.[278]

Taxpayer Advocate Service activities

The National Taxpayer Advocate's Report states that during fiscal year 2001, the Taxpayer Advocate Service independently reviewed and took action to resolve over 272,000 cases.[279] The National Taxpayer Advocate's Report listed the top sources of Taxpayer Advocate Service casework as Earned Income Tax Credit examinations due to the Revenue Protection Strategy, processing of claims or amended returns, initial processing of original paper or electronic individual returns, and processing of refunds.[280]

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276 *Id.* at 7.

277 *Id.* at 259.

278 *Id.* at 133, 261, 263.

279 *Id.* at 228.

280 *Id.* at 229.

Approximately 248,000 of the cases originated as Applications for Taxpayer Assistance Orders. Relief was granted in approximately 168,900 cases, including the issuance of 18 enforced Taxpayer Assistance Orders.[281] In 68.1 percent of these cases, the National Taxpayer Advocate was able to provide relief, partial relief, or appropriate assistance to the taxpayer.[282]

C. Treasury Inspector General For Tax Administration

In general

The IRS Reform Act created the Office of Treasury Inspector General for Tax Administration. The Treasury Inspector General for Tax Administration conducts audits, investigations, and evaluations of IRS programs and operations (including the IRS Oversight Board).[283] In addition, on an ongoing basis, the Treasury Inspector General for Tax Administration evaluates the adequacy and security of IRS technology. The Treasury Inspector General for Tax Administration also investigates criminal and administrative misconduct, such as violations of the Taxpayer Bill of Rights and ethical violations. Taxpayers may report allegations of IRS misconduct by a toll-free number maintained by the Treasury Inspector General for Tax Administration. Part of the Treasury Inspector General for Tax Administration's responsibility includes protecting the IRS from external threats to corrupt or harm employees. The Treasury Inspector General for Tax Administration 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.[284]

Semiannual report

In general

The Treasury Inspector General for Tax Administration's semiannual report to the Congress for the period April 1, 2001, through September 30, 2001, reports that the Treasury Inspector General for Tax Administration issued 126 audit reports during the six-month period. Financial results due to audit reports totaled $13 billion and an additional $13.3 billion in increased revenue and protected revenue. The Treasury Inspector General for Tax Administration estimates that its audit recommendations will improve tax administration for

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[281] *Id.* at 231-32. 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. Of the 18 Orders issued, 12 were Direct Taxpayer Assistance Orders and 6 were Review Taxpayer Assistance Orders.

[282] *Id.*

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

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

approximately 14.5 million taxpayers. In addition, the Treasury Inspector General for Tax Administration closed nearly 2,322 investigations of criminal wrongdoing and administrative misconduct during the reporting period. Investigations recovered approximately $8.1 million.[285]

The following discussion highlights some of the material contained in the Treasury Inspector General for Tax Administration's semiannual report.

Providing security over information systems

The Treasury Inspector General for Tax Administration reports that the IRS has improved security over information systems, including a better security environment of large processing centers, controls of the mainframe computer operating system, and significant progress in preparing disaster recovery plans. Nevertheless, despite such progress, the overall level of security is not yet adequate. Weaknesses include security of Internet gateways, network operating system controls, physical security and access privileges, and security certification of sensitive systems.[286] For example, the Treasury Inspector General for Tax Administration reports that as of May 2001, only 15 percent of the IRS's sensitive systems had been certified.[287] The Office of Audit identifies a lack of clear accountability for security throughout the IRS, insufficient knowledge and skills, and insufficient security awareness among managers and employees as factors responsible for security weaknesses.[288]

Business systems modernization

The Treasury Inspector General for Tax Administration reports that the IRS has made notable progress in modernizing its technology systems. The IRS has installed an upgraded telephone system that improves its ability to respond to taxpayer calls, and is in the process of installing a software application that assists revenue agents in accurately computing corporate tax transactions.[289]

However, the Treasury Inspector General for Tax Administration reports that certain issues pose potential barriers to the success of Business Systems Modernization. These issues include delays and cost overruns in delivering tangible benefits to taxpayers, potential funding problems, inconsistencies in implementing key systems development processes, business needs

[285] TIGTA Semiannual Report to Congress, April 1, 2001, through September 30, 2001, at 3-4.

[286] *Id.* at 7.

[287] *Id.* at 7.

[288] *Id.* at 8.

[289] *Id.* at 8.

not always being well defined, and a lack of clarity as to which systems development projects should be classified as modernization projects.[290]

Addressing the impact of the global economy on tax administration

The Treasury Inspector General for Tax Administration reported that, because of the increase in taxpayers' international transactions and operations, the IRS needs to increase its focus on international compliance programs and improve the quality and use of information received on the income of foreign persons. The Treasury Inspector General for Tax Administration recommends that the IRS more effectively monitor certain foreign partnerships, foreign controlled corporations, and the income of foreign persons.[291]

Criminal investigation

The Treasury Inspector General for Tax Administration reported that the IRS's Criminal Investigation function was not making a shift to investigate tax crimes as recommended by the June 2001 Webster Report (an independent review of the Criminal Investigation function). The Treasury Inspector General for Tax Administration recommends that the Criminal Investigation function work to comply with the Webster Report.[292] The IRS has agreed with this recommendation and is taking corrective action.

Government Performance and Results Act of 1993

The Treasury Inspector General for Tax Administration reported that the IRS did not have a centralized process to ensure that all of the requirements of the Government Performance and Results Act were achieved and maintained. The Treasury Inspector General for Tax Administration recommends that IRS management consider centralizing Government Performance and Results Act oversight; better administer the Customer Satisfaction Surveys; and improve the Annual Program Performance Report process.[293]

Managing finances

The Treasury Inspector General for Tax Administration reported that the IRS has made significant improvements to its remediation plan to bring its financial systems into compliance. However, while the plan did include all weaknesses reported by the General Accounting Office during its financial statement audits through fiscal year 2002, the plan did not always clearly identify resource commitments for all remedial actions. Also, the IRS was not performing independent verifications of implemented remedial actions, and was not providing sufficient explanations of why there were revised remedial action intermediate target dates. The Treasury

[290] *Id.*

[291] *Id.* at 9.

[292] *Id.* at 10.

[293] *Id.*

Inspector General for Tax Administration recommends that the IRS independently verify completed remedial actions, and verify the reasonableness of remedial action intermediate target dates. The IRS agreed with the recommendations and is taking further action.[294]

Taxpayer rights

The Treasury Inspector General for Tax Administration reports that, while the IRS had made progress in implementing the taxpayer rights provisions of the IRS Reform Act, significant improvements are needed in compliance with IRS Reform Act provisions, including innocent spouse relief, notice of lien, prohibition on Illegal Tax Protester designations, and restrictions on the use of enforcement statistics. The Treasury Inspector General for Tax Administration recommends that the IRS develop procedures to track programming changes through to completion, issue procedural guidance at one centralized site, and complete the necessary programming to ensure that certain statement and notices are timely sent to taxpayers.[295]

The Treasury Inspector General for Tax Administration reports that improvements are also needed in meeting IRS Reform Act's legal and procedural requirements for collection statute extensions and installment agreements. The Treasury Inspector General for Tax Administration reported that the IRS was not fully complying with the requirements. The Treasury Inspector General for Tax Administration recommended that the IRS clarify procedures to ensure that collection statute extensions are approved concurrently with a related installment agreement or levy release; update procedures to reflect the new locations for storing signed collection statute forms per the IRS's reorganization; have IRS management review the taxpayer accounts identified as inaccurate or that may not have complied with the law, and take appropriate action to correct the collection statute expiration dates; and develop a comprehensive plan for implementing the provisions of IRS Reform Act and for taking actions to collect the remaining tax liabilities before the statutes expire.

The IRS has agreed with these recommendations and is taking further action.

Other significant audit results

In addition to the results summarized, the Treasury Inspector General for Tax Administration released the following significant audit reports:

- The Exempt Organizations Function's Examination Workplan Can Be Improved to Increase Its Effectiveness
- Significant Tax Revenue May Be Lost Due to Inaccurate Reporting of Taxpayer Identification Numbers for Independent Contractors
- Tax Law Changes Are Needed to Improve Fairness in Paying Interest on Tax Refunds

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[294] *Id.* at 11-12.

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

- The Internal Revenue Service Has an Opportunity to Relieve Considerable Taxpayer Burden Involving the Estimated Tax Penalty
- Letter Report: Additional Controls Are Necessary to Ensure that All Businesses Are Classified by Their Principal Business Activity
- Management Advisory Report: The Internal Revenue Service Could Reduce the Number of Business Tax Returns Destroyed Because of Missing Information
- Some Individual Taxpayers are Inappropriately Receiving Tax Credits Intended for Businesses that Provide Access for Disabled Americans
- Millions of Dollars in Erroneous Education Credits Continue to Be Allowed
- The Internal Revenue Service Successfully Processed Individual Tax Returns During the 2001 Filing Season
- Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers
- Spanish-Speaking Taxpayers Receive Expanded Access to Telephone Assistance
- The Internal Revenue Service Is Making Progress, But Is Not Yet in Full Compliance With the Requirements of the Clinger-Cohen Act

Audit reports with significant unimplemented corrective actions

The Treasury Inspector General for Tax Administration reports that there are about 120 significant recommendations for corrective action, contained in 47 audit reports, that remain outstanding. Many of the recommendations pertain to the Treasury Inspector General for Tax Administration's review of the electronic fraud detection system, improvement to IRS computer systems, better compliance with processing requests under the Freedom of Information Act, the decline in the level of toll-free telephone service and improvements to the treatment of taxpayers during office audits.[296]

Office of Investigation

The Office of Investigation administers investigative programs that protect the integrity of the IRS and detect and prevent fraud and other misconduct within IRS programs. This includes investigating allegations of criminal violations and administrative misconduct by IRS employees, as well as protecting the IRS against external attempts to corrupt or threaten its employees. The Office of Investigation completed 1,045 investigations related to threats, assaults, or harassment of IRS employees as they carry out their duties.[297]

The Complaint Management Division of the Office of Investigation operates a centralized clearinghouse for processing and tracking allegations of fraud, waste, abuse, and other forms of wrongdoing by IRS agents. During the reporting period, the Treasury Inspector

[296] *Id.* at 43-57.

[297] *Id.* at 23.

General for Tax Administration received 3,902 complaints, of which 1,600 warranted further investigation.[298]

The Strategic Enforcement Division of the Office of Investigation is responsible for executing a proactive program to detect fraud in IRS operations, unauthorized accesses to IRS computer systems by internal users, and attempts to interfere with the security of IRS computers by external sources. The Strategic Enforcement Division identifies and initiates criminal investigations involving fraud and abuse of IRS computer systems and violations of the Taxpayer Browsing Protection Act of 1997. During the reporting period, the Strategic Enforcement Division analyzed 293 leads of potential unauthorized access to tax information by IRS employees, resulting in 139 referrals to field special agents.[299]

D. Taxpayer Rights

In general

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 after 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. The provisions of the IRS Reform Act continue to have a significant impact on the operation of the IRS. Discussed below is the progress of the IRS in implementing the collection due process, innocent spouse relief, and offer in compromise provisions of the IRS Reform Act.

Collection due process

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 Reform Act added several due process provisions that increased taxpayer rights during the collection process, such as pre-lien and pre-levy hearings and judicial review of such hearings. In particular, the IRS is required to provide the taxpayer with written 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.[300] 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. On January 17, 2002, the Treasury Department released final regulations on the right to a collection due process hearing for liens and levies.

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[298] *Id.* at 4, 24.

[299] *Id.* at 25.

[300] Secs. 6320 and 6330.

The IRS Reform Act also instituted 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.[301]

The IRS has stated that the principal difficulty in carrying out the taxpayer due process provisions of the IRS Reform Act has been engineering an efficient system that does not disproportionately expend resources on cases in which taxpayers are abusing the process to delay collection.[302] According to the IRS, a significant percentage of due process cases (four percent, or 800 out of a total of 20,000 cases in inventory) advance arguments that are frivolous or otherwise without merit.[303] The IRS estimates that frivolous cases constitute 13 percent of all cases in the Appeals office that has the most collection due process cases. Frivolous cases consume a disproportionate amount of time as the claims often are voluminous; the taxpayers often request to record the hearings, which is time consuming; and a large percentage of frivolous cases are pursued to court, and sometimes are combined with actions under section 1203 that are not sustained.[304] Taxpayers with nonfrivolous claims also abuse the process through delay by being nonresponsive in Appeals, demanding copies of documents as prerequisites to meetings, and asking for more time to produce documents. Some taxpayers intentionally file in the wrong court, which creates a further delay.[305]

The IRS has requested a legislative change to permit the IRS to dismiss requests for collection due process hearings if the request is based on frivolous arguments or is intended to delay or impede tax administration. Frivolous requests would be subject to a penalty of $5,000 for repeat behavior or failure to withdraw the request after being given an opportunity to

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[301] The IRS has stated that the collective due process provisions have created additional staffing needs at Automated Collection System sites. *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-33-01), May 4, 2001, Appendix, Letter from the IRS at 88. Prior to the IRS Reform Act, the Automated Collection System sites automatically processed levy actions with minimal staff intervention. As a result of the new due process provisions, the IRS can only initiate a lien or levy action after individually reviewing the facts and circumstances of each case. In addition, Automated Collection System staff is required to prepare cases for referral to Appeals upon receipt of due process hearing requests. Automated Collection System staff that previously had been assigned to processing collection cases has been reassigned to handle the processing of collection due process requests. *Id.*

[302] *Id.* at 90.

[303] Appendix at 22.

[304] *Id.*

[305] *Id.* at 22-23.

withdraw.[306] The IRS also has requested that the United States Tax Court be the exclusive venue for suits to obtain judicial review of an Appeals determination resulting from a collection due process hearing.[307] The IRS reports that it will establish a list of known claims that the IRS will treat as frivolous and will publish the list on the IRS website.[308]

According to a September 2001 audit report by the Treasury Inspector General for Tax Administration, the IRS is fully compliant with the seizure of property provisions of the IRS Reform Act.[309] The Treasury Inspector General for Tax Administration found no legal or procedural errors in cases reviewed for fiscal years 2000 and 2001. The Treasury Inspector General for Tax Administration also found the IRS to be fully compliant with the notice of levy provisions of the IRS Reform Act, an improvement from fiscal year 2000, reporting that upgrades to IRS computer systems enabled full compliance in fiscal year 2001.[310] However, the Treasury Inspector General for Tax Administration notes that continued monitoring is necessary because enforcement actions, in decline since 1997, might soon increase in volume. Further, in a separate and more recent report, the Treasury Inspector General for Tax Administration found that the IRS does not always release levies as required by the Code in cases where a determination had been made that the tax was not collectible due to economic hardship[311] and that IRS was closing some cases that should not be closed.[312]

The Treasury Inspector General for Tax Administration found that the IRS was not fully compliant with the notices of lien procedures. In some cases, the IRS failed to notify the taxpayer that a lien had been filed, and the IRS still was not compliant with legal and internal guidelines in 17 percent of the cases reviewed.[313]

The Treasury Inspector General for Tax Administration found that Appeals officers hearing appeals of determinations to file a lien or intent to levy generally complied with legal

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[306] Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2003 Revenue Proposals* (February 2002) at 60.

[307] *Id.* at 63.

[308] Appendix at 23.

[309] Treasury Inspector General for Tax Administration, *Compliance With Certain Taxpayer Rights Provisions Contained in the Internal Revenue Service Restructuring and Reform Act of 1998 Could Be Improved* (September 2001), Ref. No. 2001-10-147 at 3-4.

[310] *Id.* at 4.

[311] Treasury Inspector General for Tax Administration, *The Internal Revenue Service's Levy Process Can Be Improved to Ensure Compliance With the Internal Revenue Code* (March 2002), Ref. No. 2002-10-078 at 3-4.

[312] *Id.* at 8-9.

[313] *Id.* at 6.

requirements in 85 of 87 cases reviewed.[314] In the two noncompliant cases, the officers either did not adequately balance the efficiency of the proposed action against taxpayer concerns that the action be no more intrusive than necessary or did not properly verify that all regulations had been met. Nevertheless, the Treasury Inspector General for Tax Administration concluded that taxpayer rights were not violated. In 82 of the 87 cases, Appeals adequately communicated the decision to taxpayers.[315] Overall, the Treasury Inspector General for Tax Administration noted improvement from a year ago and made recommendations, including: ensuring that all determination letters address all provisions of the law considered in the decisions, ensuring all established guidelines are followed, providing additional training and guidance to officers on balancing taxpayer concerns about intrusive actions when the taxpayer claims a hardship, and finalizing the case processing guide and internal manual.[316]

Innocent spouse relief

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 provides conditional relief to an innocent spouse.[317] 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 spouse 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.[318]

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[314] Treasury Inspector General for Tax Administration, *Appeals Is Generally Complying With the Requirements of the Law for Lien and Levy Appeals Cases* (March 2002), Ref. No. 2002-10-068 at 2-3.

[315] *Id.* at 4.

[316] *Id.* at 4-6.

[317] Sec. 6015.

[318] Sec. 6015(f).

Since passage of the IRS Reform Act, the IRS has faced several difficulties in implementing the innocent spouse provisions. Initially, the IRS 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.[319] Thus, the IRS had to train its staff in how to handle these cases. In addition, the IRS did not have a reliable management information system to track innocent spouse cases.[320] The combination of these factors has resulted in a significant backlog of cases.

To effectively manage the rapidly increasing volume of pending claims for innocent spouse relief, the IRS has taken several steps, including: (1) centralizing management of the program under a senior manager; (2) developing specific flow charts and other training and job aids for the employees doing the screening; (3) revising procedures and training based on initial experience; and (4) instituting a 100-percent review of completed claims to ensure quality and consistency. The IRS also has developed additional computer support.[321]

In the four months preceding the passage of the IRS Reform Act, the IRS received 3,000 claims for innocent spouse relief.[322] In fiscal year 2000, the number of claims received by the IRS increased 22 percent, and the IRS processed a total of 42,546 innocent spouse claims.[323]

On March 6, 2001, the IRS had 40,278 pending claims (affecting 21,198 taxpayers) with regard to which the IRS had not yet notified the taxpayer of a determination.[324] On October 28, 2001, the IRS had 26,279 pending claims (affecting 14,835 taxpayers).[325]

By February 24, 2002, this number had decreased to 21,354 pending claims (affecting 11,239 taxpayers).[326] The IRS reports that the target for September 30, 2003 is 14,271 claims (affecting 7,511 taxpayers).[327]

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[319] Statement of Charles O. Rossotti, Commissioner of Internal Revenue, before the Senate Committee on Finance (February 2, 2000) at 7.

[320] Statement of David C. Williams, Inspector General, Treasury Inspector General for Tax Administration, before the Senate Committee on Finance (February 2, 2000) at 3.

[321] Statement of Charles O. Rossotti, Commissioner of Internal Revenue, before the Senate Committee on Finance (February 2, 2000) at 7.

[322] *Id.* at 6.

[323] *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-33-01), May 4, 2001, Appendix, Letter from the IRS at 102.

[324] *Id.*

[325] Appendix at 17.

[326] *Id*.

The average processing time for claims (from initial receipt of a claim to delivery of a determination letter to the taxpayer) improved significantly between fiscal year 2000 and fiscal year 2001. For example, the average number of days to issue a determination in response to a meritorious claim was 219 days in fiscal year 2001 compared to 324 days in fiscal year 2000. The IRS determined an innocent spouse claim did not qualify in an average of 68 days in fiscal year 2001 compared to 137 days in fiscal year 2000; and the IRS determined that the basic requirements of a claim were not met in an average of 84 days in fiscal year 2001 and 132 days in fiscal year 2000. The fiscal year 2001 numbers also compare favorably with the IRS's average for the full history of innocent spouse claims.[328]

The IRS proposes to reduce staffing for field examiners for innocent spouse claims for fiscal year 2003. The IRS reports that efficiencies achieved through the centralization of innocent spouse claims in Cincinnati and deployment of the Integrated Case Processing software warrant the reduction in staff.[329]

The National Taxpayer Advocate reports that a taxpayer's learning the status of an innocent spouse claim is the 22nd of 23 of the most serious problems encountered by taxpayers.[330] According to the National Taxpayer Advocate, the increase in cases since the IRS Reform Act and the changes brought by the Act meant that the IRS did not always meet case processing deadlines. In addition, taxpayers expect their claims to be handled promptly and do not understand that legal requirements may add 165 days to the process in the best of situations. The National Taxpayer Advocate reports that the IRS has taken a number of positive steps to address the issue including: encouraging pre-filing of claims, revising the applicable forms and publications, continued customer outreach, the centralization of claims processing, increased staff, additional training, and use of computer-based processing. The National Taxpayer Advocate concludes that the IRS's efforts are commendable and that fewer innocent spouse cases were being reported to the Taxpayer Advocate Service.[331]

In a recent audit report, the Treasury Inspector General for Tax Administration concluded that the IRS is effectively educating taxpayers about the requirements that must be met to qualify for innocent spouse relief.[332] The Treasury Inspector General cited the following outreach efforts: (1) detailing eligibility information in numerous IRS publications, forms, and notices; (2)

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[327] *Id.*

[328] *Id.* at 18. See also *id.* for a table that showing this and other results.

[329] *Id.*

[330] National Taxpayer Advocate FY 2001 Report at 67-69.

[331] *Id.* at 69.

[332] Treasury Inspector General for Tax Administration, *Management Advisory Report: Numerous Efforts Are Taken to Educate Taxpayers on Innocent Spouse Eligibility Requirements* (March 2002) Ref. No: 2002-40-067 at 3.

providing a number of outlets from which taxpayers can easily obtain eligibility information; and (3) targeting specific segments of the taxpaying public that are more likely to be involved in an innocent spouse claim, including presentations at low income tax clinics.[333]

Offers in compromise

Prior to the IRS Reform Act, the IRS could settle a tax liability for less than the amount assessed through an offer in compromise, but the IRS would accept an offer in compromise only if there was sufficient doubt as to the existence or amount of the tax liability or if there was doubt as to the ability of the taxpayer to pay the tax due. The IRS Reform Act codified the offer in compromise program with the intent that the program should be expanded to cover cases in which considerations of equity, economic hardship, and public policy favor accepting an offer in furtherance of effective tax administration.[334]

In a recent report, the General Accounting Office found that between fiscal years 1997 and 2001, the inventory of unresolved offers nearly tripled to approximately 95,000.[335] Changes to the program, both as a result of the IRS Reform Act and due to IRS initiatives, increased the demand for offers, the number of steps involved, and the number of staff hours taken. Staff hours more than doubled, taking 18 percent of total staff time spent on all IRS debt collection programs.

With regard to the length of time to process an offer in compromise, the IRS is processing far fewer offers within six months today than the IRS did in fiscal year 1999 and is processing offers within six to 12 months at about the same rate. Offers that take more than a year to process have increased substantially. For example, the IRS reports that in fiscal years 1999, 2000, and 2001, the total offers processed within six months of submission were 52 percent, 39 percent, and 32 percent respectively. Through five months of fiscal year 2002, the IRS reports that 33 percent of offers are processed within six months. The percentage of offers processed between six and 12 months in fiscal years 1999, 2000, and 2001 are 40 percent, 45 percent, and 43 percent, respectively, with a 40 percent rate through the first five months of fiscal year 2002. Offers taking more than a year to process were 8 percent of offers in fiscal year 1999, 17 percent in fiscal year 2000, 25 percent in fiscal year 2001, and 26 percent through the first five months of fiscal year 2002.[336] Average processing time has increased from 311 days in fiscal year 2001 to 324 days for the first five months of fiscal year 2002. The General Accounting Office attributes the increase in offer in compromise inventory and processing time

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[333] *Id.*

[334] Sec. 7122(c) and (d).

[335] General Accounting Office, *IRS Should Evaluate the Change to Its Offer in Compromise Program* (March 2002) GAO-02-311 at 2.

[336] Appendix at 14.

to the IRS's inability to keep pace with the effects of changes to the offer in compromise program, despite increases in staff.[337]

Last year, the IRS attributed the delay in processing offers in compromise to several factors, including: mandated administrative review of IRS decisions to reject offers or return offers for failure to provide financial information; expansion of the offer in compromise program to cases that would promote effective tax administration; not automatically rejecting incomplete offers; and no longer accepting installment agreements that would not satisfy the entire tax liability (thus increasing the number of offers involving cases that might otherwise be resolved through installment agreements).[338] The IRS stated that it could more efficiently evaluate and process offers in compromise through future automation and centralized processing of offers.[339]

This year, the IRS has requested modification of the rules to permit the IRS to enter into installment agreements for amounts less than the full liability owed by taxpayers.[340] The IRS believes such a change would increase the number of installment agreements and reduce the number of offers in compromise.[341] The IRS also requests the authority to dismiss requests for offers in compromise that are based on frivolous arguments or that are intended to delay or impede tax administration.[342] In addition, the IRS requests that an opinion of IRS Chief Counsel no longer be mandatory for compromises of $50,000 or more (including penalties and

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[337] General Accounting Office, *IRS Should Evaluate the Change to Its Offer in Compromise Program* (March 2002) GAO-02-311 at 2.

[338] *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-33-01), May 4, 2001, Appendix, Letter from the IRS at 100. The determination that the IRS may not enter into an installment agreement with a taxpayer unless the full amount of tax due will be paid is based upon an IRS legal interpretation of the interplay between sec. 6159 (installment agreements) and sec. 7122 (offers in compromise). According to IRS Chief Counsel, a taxpayer may resolve a tax liability for less than the full amount of the tax due only through the sec. 7122 offer in compromise procedure. *Id.* at 95.

[339] *Id.* at 99-101.

[340] Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2003 Revenue Proposals* (February 2002) at 61.

[341] The General Accounting Office reports that the IRS should submit additional detail on the proposal, describing eligibility, procedures, staffing needs, information system needs, projected costs, or evaluation plans. Such additional information would better provide Congress and other stakeholders with information about the impact of the proposal and the IRS's ability to manage the program. General Accounting Office, *IRS Should Evaluate the Change to Its Offer in Compromise Program* (March 2002) GAO-02-311 at 3.

[342] *Id.* at 60.

interest).[343] The IRS believes that such a change would permit better allocation of resources without undermining the quality of the review process.

The IRS also explains this year's increase in average processing time in part to the fact that experienced employees were moved from the field to help train at the centralized offer in compromise sites and that training took longer than expected, thus keeping such employees from the field for longer than anticipated periods and delaying the ability of newly trained employees to handle cases.[344] The impact of the anthrax attacks on the mail system also adversely affected management of inventory. In addition, the IRS reports that the newly established centralized sites have been understaffed and attrition at the sites has been higher than expected. The IRS states that full staffing has been delayed because trainees moved to higher graded positions in other areas. The IRS says that in April 2002 an additional 82 Offer Examiners, and, by June 2002, an additional 35 Process Examiners will have completed training and the sites then will be fully staffed.[345]

The IRS stated that it continues to address the backlog of offer in compromise cases in a number of ways, including:[346]

- Centralization of the process at service centers in Memphis, TN and Brookhaven, NY, where less complicated cases will quickly be resolved;
- Resolving simple cases by streamlining the level of investigation;
- Transferring work between service centers to better balance workload;
- Lowering the delegation authority for some types of offers;
- Expanding the reasons why an offer may be returned without a full investigation to include that (1) estimated tax payments are not current and (2) the offer is not significantly different from a previously rejected or defaulted offer;
- Redefining the reasons why an offer may be returned because it was submitted solely to delay collection;
- Issuing guidance from Chief Counsel to reduce the level of scrutiny required in the review for legal sufficiency;
- Approving the use of overtime for work on offers in compromise;
- Legislative changes (discussed above); and
- Developing additional changes in the process to speed case resolution in both the centralized sites and in the field, for example by: (1) reducing levels of verification and associated taxpayer burden, where appropriate, and (2) maximizing the use of screening techniques to eliminate cases that can be resolved as full pays or through installment agreements.

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[343] *Id.* at 64.

[344] Appendix at 14-15.

[345] Appendix at 16.

[346] *Id.* at 92.

According to the General Accounting Office, IRS projections of 40 percent more cases closed in fiscal year 2004 depend on a number of assumptions, such as the staff hours needed per case. The General Accounting Office notes that notwithstanding the lack of an empirical basis for such assumptions, the IRS has little choice but to rely on intangibles such as professional judgment. In general, the General Accounting Office characterized the likely effectiveness of the IRS's current initiatives as uncertain. In light of such uncertainty, the General Accounting Office recommended that the Commissioner: (1) develop a final implementation plan that evaluate and prioritizes the various IRS offer initiatives before moving forward with implementation; (2) determine what offer in compromise performance and cost data should be collected; (3) establish goals for offer processing time that are based on taxpayer needs, costs, and other benefits; and (4) prepare documentation describing the IRS's proposed partial payment installment agreement program.[347]

[347] General Accounting Office, *IRS Should Evaluate the Change to Its Offer in Compromise Program* (March 2002) GAO-02-311 at 3-4.

APPENDIX

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

COMMISSIONER

May 2, 2002

Ms. Lindy L. Paull
Chief of Staff
Joint Committee on Taxation
Congress of the United States
Washington, D.C. 20515

MAY 3 2002

Dear Ms. Paull:

I am responding to your March 8, 2002, request for information to use in preparing for the annual joint Congressional review of the strategic plans and budget of the Internal Revenue Service.

I hope this information is helpful. If you have any questions about the information, or would like to arrange for a briefing on any particular subject, please contact Floyd Williams at (202) 622-4725.

Sincerely,

Charles O. Rossotti

Charles O. Rossotti

Enclosure

Questions for the Internal Revenue Service

Many of the requests below are requests for data. For purposes of answering these data request, a history of data for each year from Fiscal Year 1997 through Fiscal Year 2001 should be provided. If there is insufficient data or the data provided is incomparable, please explain.

I. Questions Relating to Customer Satisfaction

Pursuant to the IRS Restructuring and Reform Act of 1998 (the "Act"), of the IRS changed its mission to emphasize serving the public and meeting the needs of taxpayers. Please describe how customer service has improved, providing data on customer service before the Act with levels of service today in the following areas:

1. **Telephone Service of Taxpayer Questions. Please provide data showing the number of answers to taxpayer calls today and the number answered prior to the Act. Please also show the number of taxpayer questions answered correctly. If available, please show the average waiting time for taxpayers to speak to the IRS employee who answers the taxpayer's question. If available, please approximate the number of calls completed (i.e., the number of calls answered, correctly or incorrectly) with the number of calls attempted. Also, please include the average length of a call.**

TOLL FREE QUALITY AND PRODUCTIVITY PROGRAM GOAL IMPROVEMENTS

MEASURE	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY2002 Plan
Quantity						
Unique Numbers (1)	Unavailable	45.3M	54.3M	54.5M	65.2M	55.0M
Total Number of Calls (2)	198.2M	140.6M	155.3M	120.3M	186.5M	127.6
Automated Calls Answered (3)				49.9M	76.0M	75.0M
Assistor Calls Answered (4)				32.3M	32.0M	33.75M
Total Calls Answered (5)				82.2M	108.0M	108.75M
Busies Signals (6)				3.5M	1.9M	.8M
CSR Level of Service (7)				61%	59%	71.5%

Quality						
Tax Law Quality (8)				73%	75%	78%
Accounts Quality (8)				60%	69%	72%

Chronology of Key Operational and Technological Changes

FY 1997

- Call sites were stand alone, decentralized and managed by local site executives who had multi-functional program responsibilities; customer service delivery was inconsistent across sites.
- Planning and reporting completed independently at each site.
- Performance measures tabulated manually each week by the individual sites and forwarded to the respective regional staffs for consolidation prior to national submission.
- Calls routed geographically to each site by area code.
- Hours of service varied by site.
- Automated services were unsophisticated and limited to pre-recorded tax information and refund status.
- Singular focus on delivering scheduled calls answered on a weekly basis.
- Introduced new desktop research tools for CSRs.
- Tax law quality measure based on standardized test calls by national quality reviewers with account quality determined by review of paper referrals at each site.

FY 1998

- First attempt to centralize planning and align workload to customer demand nationwide.
- Progressed from focusing performance on a weekly basis to a daily basis.
- Routed calls by percentage allocation to each site to provide uniform service nationwide; calls considered corporate workload.
- Prototyped intelligent call routing at nine sites and began nationwide standardization of sites’ telephone systems to improve service.
- Established uniform hours of service for customers across the country and expanded service to 16x6.
- Rolled out customer interactive automated applications such as change of address and establishment of installment agreements.

FY 1999

- Piloted a restructured customer service field organization in the Southeast Region with one executive in charge and singular focus on program delivery.
- Established in January the Customer Service Operations Center – later known as the Joint Operations Center – with enterprise responsibility for planning, scheduling, monitoring, reporting, and analyzing telephone performance; no longer reliance on site reporting – data could be verified as reliable and accurate.

- Introduced intelligent call routing to improve service by sending each call to the first available assistor nationwide with the necessary skills to answer the customer's question.
- Negotiated IRS/NTEU policy change and discontinued the automatic routing of another call to assistors immediately upon their completion of a call
- Established 24x7 service
- Shift in focus from traditional measure of scheduled call delivery to a balanced measurement system to include customer satisfaction, employee satisfaction, and business results.
- Introduced toll-free service for customers seeking assistance from the National Taxpayer Advocate
- Restructured CSR Training to a modularized, just-in-time format; training targeted to CSRs' specific responsibilities rather than generalized.
- Tax law and Account quality measurement system was changed to monitor live calls by a centralized unit and counted customer impact errors along with internal procedural mistakes.

FY 2000

- First complete year of reliable, comparable telephone statistical data.
- Established the Customer Service Field Operations organization with one executive in charge and singular focus on program delivery; eliminated the regional approach to customer service management.
- Introduced network prompting for callers with refund inquiries; calls were sent to automated services allowing the highly skilled CSRs to answer more complex questions.
- Introduced Spanish-language service on the toll-free lines.

FY 2001

- Stood up the modernized IRS structure; established Customer Account Services organizations with focus on specific customer markets.
- Began specialization of topics within call sites and skills among CSRs.
- Introduced voice recognition in the call menus and expanded network screening for all customers to improve delivery of calls to the appropriate automated service or CSR.
- Immediate Tax Relief enacted causing large volumes of calls between July and September; supplemented toll-free staff with assistors who answered form request inquiries during the filing season.
- Established in September special toll-free service for victims of disasters.

FY 2002

- Continued progress toward call site and assistor specialization.
- Changed hours of service to 15x5 with Saturday service during filing season; moved highly skilled CSRs from low demand, off-hours to high demand, core hours to improve service.
- Established site level balanced measures to shift accountability from enterprise responsibility to individual sites.

- Immediate Tax Relief/Rate Reduction Credit continued to cause large volumes of calls during filing season.
- Introduced specialty toll-free services for the practitioner community and requestors of Employer Identification Numbers; established technical backup service via telephone for walk-in office customers.

Footnotes

(1) Total number of specific phone numbers, regardless of the number of times the customer called over the course of a week; it includes 800-829-1040, 800-829-8815, and 800-808-4262.

(2) Total number of calls represents the number of call attempts made by customers to the Internal Revenue Service toll-free telephone numbers of 800-829-1040, 800-829-8815, 800-808-4262
And 800-829-4477.

(3) Automated calls answered includes any call attempts that were serviced by automation rather than speaking with an assistor.

(4) Assistor calls answered represents the number of calls that terminated with a Customer Service Representative. These customers were not serviced by any of the available automated options, but rather were handled by live assistors.

(5) Total calls answered represents the sum of the automated calls answered and assistor calls answered representing all service provided to the customer.

(6) Customers receiving a busy signal due to maximum utilization of resources or circuitry.

(7) CSR Level of Service reflects the percentage of callers obtaining toll-free service from a live assistor.

(8) Quality figures represent, by year, the percentage of calls answered accurately based on a valid sample. Call applications are broken down into two categories - Tax Law and Accounts.

2. Walk-In Service for Taxpayers. Please show the number of taxpayers receiving walk-in-service. If available, please provide the waiting time, accuracy of service, and duration of service.

Answer:

TOTAL WALK-IN CONTACTS

	Total Taxpayers Served	Total Hours Spent *	Taxpayers Served per Hour
FY 1999	10,263,158	2,347,616	4.37
FY 2000	9,926,252	2,659,836	3.73
FY 2001	9,683,544	2,304,702	4.20
FY 2002	4,809,353+	1,122,131#	4.29

* These hours reflect time spent face-to-face with the taxpayer and other associated time. For example, some taxpayer contact requires further research without the presence of the taxpayer and this research time is captured here as well.

+ Current as of 3/16/02

Current as of 3/16/02

Prior to the standup of the new IRS organization and the standardization of services, each Region and/or District office tracked wait time. Prior to FY 2001 the goal was to service 95% of customers within 15 minutes for non-return preparation and 30 minutes for return preparation. Beginning with FY 2001, we continued to track wait time but removed it as a measure to eliminate the time pressure to rush taxpayers in and out of the office and thus compromise the quality of services delivered. Wait time data for January through September in FY 2001 (the only period tracked) and for October through December for FY 2002 are attached.

During FY 2002, we are establishing baselines for tax law, accounts, and return preparation accuracy. We have no specific tracking mechanism on the service duration/transaction time, but we do have volume of taxpayers, hours expended, and the rates overall, for each of the major workload categories. The rate is the average number of taxpayers served per hour, which can be converted to the average transaction time or "duration of service" (e.g. FY rate is 4.29 or about 14 minutes per customer).

3. Customer account Data engine ("CADE"). The CADE program is designed to enable IRS employees instantly to access a taxpayer's return information on a computer to help address taxpayer questions about a return. Please discuss the IRS's progress in implementing the CADE program. When will CADE permit employees to directly make adjustments to taxpayer's returns?

Answer:

CADE is the foundation for all of IRS' tax administration systems. It will replace the tape-based Master Files that currently contains the only authoritative information on all individual and business tax accounts. The IRS dependence on this 1960s Master File system today constitutes an insurmountable barrier to efficient service and compliance operations and is a very serious risk to the whole tax system.

CADE will incrementally move individual filers from the 1960s tape system to a modernized database. CADE Individual Master File (IMF) will build the database that will replace the existing IMF processing systems. CADE will create applications for daily posting, settlement, maintenance, refunds processing and issue detection for taxpayer tax accounts and return data. The database and applications developed by CADE will also enable the development of subsequent modernized systems that improve customer service and compliance. Once implemented, modernized applications, such as Customer Account Management (CAM), will allow on-line posting of data in addition to daily batch processing.
CADE will be deployed over time in five releases, each related to a specific taxpayer segment, phased in over a period of six years. At the conclusion of Release 5, CADE will have replaced IMF.

Due to a number of technical difficulties and schedule delays, Release 1pilot of CADE Production has been delayed until July 2002. We discovered in December 2001 a significant issue with Procurement of a Business Rules Engine (BRE). A key part of the overall CADE development strategy was predicated on the use of BRE software that would be used to generate some programming code. Unfortunately, the PRIME was unable to procure the BRE in time to be used in the development of Release 1 and we were forced to proceed using standard development language. We notified our Executive Steering Committee and Oversight Board of the problem and our corrective actions. The delay will provide time for the development, testing and implementation of the Release 1 pilot this summer. Currently, most of the software has been developed and testing has begun. Planning for production implementation in conjunction with the startup of the 2003 filing season has also started. The release will include both 1040EZ electronic and paper single refund filers – about 10 million taxpayers. Therefore, based on this plan our most important business objective, which is to move the first block of taxpayers onto a new data base will be achieved.

4. Refunds. Please show the average length of time for a taxpayer to receive a refund from the date of filing a return for both electronic returns and paper returns.

Answer:

In Fiscal Year 2001, the IRS averaged 14.6 days to issue a refund generated from an electronic return and 28 days from the date we received the paper return. Up to this point in the 2002 Filing Season, the IRS is exceeding this timeframe with a 12-day average for electronic returns and 26-days for a paper return. These timeframes will grow longer by the end of the filing season, in particular for paper returns as balance due filers and late filers mail their returns on April 15th.

The chart below shows the average length of time for a taxpayer to receive a refund. However, due to programming problems, no information is available for 2000. In addition, data from 1997 – 1999 was calculated on a calendar year basis using sample data.

Calendar Year	Average Number of Days Originating from a Paper Return	Average Number of Days Originating for an Electronic Return
1997	37.7	16
1998	34.8	15
1999	35.09	14

5. Audits. Please show both the number of audits conducted each year (regardless of the taxable year to which they relate) and the average length of time of an audit for individuals, for large businesses, and for small businesses. Audit data should include separate results for both face-to-face audits and computer document matching audits under the Information Reporting Program ("IRP"). If the IRS conducts correspondence audits that are not part of IRP, please also identify such audits separately. For IRP (and other correspondence) audits, please show the number of contacts and the number of letters sent to taxpayers as a result. Please also project the number of IRP audits through 2007.

Answer:

Examination Closures
FY 1997 though FY 2001

All Individuals	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
Field	715,615	567,759	384,484	251,108	202,515
Service Center	803,628	625,021	715,789	366,657	529,241
Total Return Closures	1,519,243	1,192,780	1,100,273	617,765	731,756
Corporations < $10 Million	**FY 1997**	**FY 1998**	**FY 1999**	**FY 2000**	**FY 2001**
Field	55,021	40,735	27,484	17,580	13,169
Service Center	1,302	1,083	784	1,043	1,163
Total Return Closures	56,323	41,818	28,268	18,623	14,332
Corporations $10 Million & Over	**FY 1997**	**FY 1998**	**FY 1999**	**FY 2000**	**FY 2001**
Field	12,706	11,464	10,287	8,978	8,465
Service Center	266	366	250	234	253
Total Return Closures	12,972	11,830	10,537	9,212	8,718
Grand Total	**FY 1997**	**FY 1998**	**FY 1999**	**FY 2000**	**FY 2001**
Field	915,420	728,545	505,847	342,660	280,111
Service Center	812,702	634,098	722,559	373,255	534,946
Total Return Closures	1,728,122	1,362,643	1,228,406	715,915	815,057

Hours per Return

Individuals	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
Revenue Agent	22	22	25	28	29
Tax Auditor	4.3	4.5	5.7	7.1	8.3
Service Center (Non-IRP)	0.8	0.9	1.1	1.8	1.7
Corps. < $10 M	43	45	51	58	64
Corps. $10 M & Over	140	138	154	174	194

Automated Underreporter (AUR) and Automated Substitute for Return (ASFR) Programs
("Information Reporting Program")

AUR	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Cases Closed	1,598,471	1,726,098	1,770,695	1,353,545	1,161,901	1,523,361
Letters Sent	3,500,804	3,208,770	3,350,891	2,735,345	2,576,375	3,076,898
Avg. Hours per Case	1.0	0.9	0.8	1.1	1.4	1.0
ASFR	**FY 1997**	**FY 1998**	**FY 1999**	**FY 2000**	**FY 2001**	**FY 2002**
Cases Closed	392,598	426,495	584,142	332,427	333,770	200,000
Letters Sent	525,432	628,541	467,254	228,203	393,751	118,648
Avg. Hours per Case	2.0	2.0	2.0	2.0	2.0	2.0

Table Notes:
1) For AUR, letters sent include: notice of withholding adjustment, query, 30-day additional tax proposal, notification of no change, and 90-day statutory notice of deficiency.
2) For ASFR, letters sent include: 30-day and 90-day statutory notice of deficiency.
3) Figures for FY 2002 are projections.

6. Taxpayer complaints. Please show the number of telephonic and written taxpayer complaints against the IRS.

Answer:

The IRS receives a wide variety of communications from taxpayers in which they request assistance or complain about tax matters. Most of these communications are resolved by front-line employees and managers, and do not appear in a reporting system on "complaints." The IRS has several sources of information on complaints that are not resolved at the front-line. One is the Executive Correspondence Management System (ECMS), which is used to track correspondence sent to the President, the Secretary of the Treasury, the Commissioner of Internal Revenue and the Deputy Commissioner. The table below reflects total taxpayer complaints received by fiscal year, as well as some specific categories of complaints. Note that the Fiscal Year 1997 data includes several months of Fiscal Year 1996 data. The ECMS system was implemented late in Fiscal Year 1996, and the partial year data for that year is combined in that data file. The data on specific issues should not be added, since correspondents often raise more than one issue in their letters.

	FY 96/97	FY 98	FY 99	FY 2000	FY 2001	FY 2002
All Taxpayer Complaints	981	2053	1976	2653	2124	840
Audit Issues	551	361	272	252	137	53
General Customer Service Issues	Data Not Reported	877	584	567	275	113
Form Simplification	12	28	28	91	48	8
Innocent Spouse	0	0	0	24	40	17
Installment Agreements	102	107	69	38	29	14
Levies	460	228	92	68	85	53
Liens	261	158	119	112	61	41
Offers in Compromise	173	139	180	125	144	80
Refund	426	343	459	428	414	117
Refund Offset	69	22	70	88	52	6
Tax Forms and Publications	119	54	43	43	38	26
Taxpayer Walk-In Service	39	14	5	3	3	3
Toll-Free Number`	68	40	7	30	26	6

The IRS has had other headquarters level reports regarding taxpayer complaints, which have evolved to respond to changes in the law and the IRS organization. For example, the Customer Feedback System was developed in July, 1996, to provide information about taxpayer allegations of inappropriate behavior by IRS employees and the disposition of those allegations. The Customer Feedback System was terminated in December, 2000, after it became apparent that it was no longer producing meaningful information. Almost 75% of the complaints recorded in the Customer Feedback System resulted in findings that the employee behavior was appropriate, or the information provided with the complaint was not sufficiently complete to permit meaningful follow-up. The most serious allegations of misconduct were by that time being captured in reports on §1203 allegations.

The IRS now uses data on §1203 complaints to monitor allegations of serious employee misconduct. This data is reported to Congress as part of the Treasury Inspector General for Tax Administration's Semiannual Report, and includes allegations from both taxpayers and IRS employees. During the most recent reporting period (October1, 2001 to March 31, 2002), the IRS completed 154 inquiries into §1203 allegations, and had 57 in progress. These numbers exclude cases based on the employee tax compliance provisions of §1203. The completed inquiries resulted in 6 findings of §1203 misconduct, 22 findings of other misconduct, and 126 unsubstantiated allegations.

7. **If there are other areas of customer service that should be highlighted (whether or not they have shown improvement or worsened), please comment. If customer service could be improved with increased staff, increased equipment or software, or a legislative, regulatory or other change, please comment as appropriate.**

Answer:

To improve customer service, and based on an AT&T usage study, the IRS aligned its toll-free service hours last year to meet customer demand. Beginning October 7, 2001, IRS assistors are available 7 a.m. to 10 p.m. Monday through Friday local time. During the filing season (January 2 through April 15, 2002), assistor services are available on Saturdays from 9 a.m. to 5 p.m. Assistor services are also available on President's Day and Sunday April 7 and April 14, 2002. IRS automated assistance systems continue to be available 24 hours a day, 7 days a week.

Primarily because of increased calls concerning refunds and the rate reduction credit, the total volume of incoming calls on our toll-free lines for the fiscal year through March 30 has been up 13 percent over last year, totaling 51.1 million calls for the first half of the fiscal year.

Despite this substantial increase in the volume of calls, for the first half of the year through March 30, 2002 approximately 66 percent of taxpayers who wanted to talk to a customer service representative got through, compared to 68 percent last year. In the last four weeks, service improved further, with 74 percent of taxpayers getting through to customer service representatives. We have set a goal for the whole year of 71 percent.

In addition, 45.3 million taxpayers used our automated services to get information, including refund status, an increase of 8 percent since last year, and the upward trend continues.

Once connected, taxpayers must get prompt, accurate and courteous answers to their account and tax questions. Here too we have made substantial progress towards providing better service to taxpayers. The telephone correct response rates for tax law and tax account questions showed a marked improvement in FY 2002. They were up to 83 percent and 89 percent respectively as compared to 75 percent and 88 percent over the same period last year.

We established a special telephone line for victims of the terrorist attacks and since then, we have provided over 90 percent level of service on this line.

II. Taxpayer Protection

The Act made a number of significant changes to the rights of taxpayers. Please comment on whether any of the taxpayer rights provisions should be revisited or strengthened. Please identify any provisions that are proving difficult to administer. In addition, we specifically would like to measure progress in the following areas:

1. **Innocent Spouse. Please show the number of innocent spouse cases, both new cases and total caseload. What is the current backlog of innocent spouse claims and the average processing time for such claims? Last year, the IRS reported that staffing for innocent spouse claims had increased to address the backlog. The IRS also reported that the implementation of an Integrated Case Processing computer**

application would increase productivity in innocent spouse cases. For Fiscal Year 2003, the IRS plans to cut funding for innocent spouse cases in order to increase funding for audits. Does the planned cut in funding accurately reflect improvements in addressing innocent spouse claims?

Answer:

The following table is a summary of the receipts, determinations, and inventories through 02/24/02.

			Ending Inventory	
			Modules*	Taxpayers*
Date	Modules Received	Total Determinations	Waiting Determinations	Waiting Determinations
09/30/00			40,158	21,136
09/30/01			28,187	14,835
10/28/01	3,586	5,494	26,279	13,831
11/23/01	2,894	4,373	24,800	13,053
12/24/01	3,019	4,000	23,819	12,536
01/27/02	2,309	4,021	22,107	11,635
2/24/02	4,234	4,840	21,354	11,239

A "determination" is made when the taxpayer is notified of IRS's decision

* There is an average of 1.9 modules per claim so the actual number of affected taxpayers is the total number of modules divided by 1.9

Our target for Modules Awaiting Determination at 9/30/03 is 14,271 (7,511 taxpayers).

The following table is a comparison of the lapse time between receipt of the claim and notification letter by determination type for the full history of receipts and for FY 2000 and FY 2001 receipts.

AVERAGE LAPSE TIME TO NOTIFY TAXPAYER OF DETERMINATION

	Full History	FY 2000 Receipts	FY 2001 Receipts

Type of Determination	Days			Days			Days		
	W&I	SBSE	IRS avg.	W&I	SBSE	IRS avg	W&I	SBSE	IRS Avg.
Non Qualifying Determinations	77	402	150	90	335	137	60	183	68
Basic Req Not Met Determinations	96	341	130	114	312	132	80	228	84
Merit Determinations	268	377	330	314	334	324	216	233	219

The IRS also reported that the implementation of an Integrated Case Processing computer application would increase productivity in innocent spouse cases. For Fiscal Year 2003, the IRS plans to cut funding for innocent spouse cases in order to increase funding for audits. Does the planned cut in funding accurately reflect improvements in addressing innocent spouse claims?

Answer:

The reduction in staffing for field examiners is the result of efficiencies achieved through centralizing processing of innocent spouse claims in Cincinnati and deployment of the Innocent Spouse Integrated Case Processing computer application.

2. **Offers in Compromise. Please show the percentage of offers in compromise completed within one year of submission and within six months of submission. Please also report on the number returned to taxpayers because they were incomplete or could not otherwise be processed. Last year, the IRS reported that the additional requirements to the offer in compromise process required by the Act increased the IRS's processing time and case inventory but also noted that automation could alleviate costs and processing time. One year later, has processing time improved? What specific steps are being taken to address the backlog? What steps are being taken to automate the process? Has centralization of the process helped?**

Answer:

Percentage of Offers in Compromise Closed by Time to Close and Fiscal Year

	FY 1999	FY 2000	FY 2001	FY 2002 (5 Months Year to Date)
Within 6 Months	52 %	39 %	32 %	33 %
Over 6 Months, Within 12 Months	40 %	45 %	43 %	40 %
Over 12 Months	8 %	17 %	25 %	26 %

Source: C108 Reports

Question:

a) Please also report on the number returned to taxpayers because they were incomplete or could not otherwise be processed.

Answer:

Offers in Compromise Returned to Taxpayers by Fiscal Year

	FY 1999	FY 2000	FY 2001	FY 2002 (5 Months Year to Date)
Not Processable	22,342	13,694	16,185	9,190
Returned	0 *	13,555	27,751	15,594

* Note: Beginning in FY 2000, the definition of Not Processable changed to include only those offers that could not be processed because the taxpayer was in bankruptcy or was not in filing compliance. A new category called Return was created for the other situations where the offer could not otherwise be processed.

Question:

Last year, the IRS reported that the additional requirements to the offer in compromise process required by the Act increased the IRS's processing time and case inventory but also noted that automation could alleviate costs and processing time. One year later, has processing time improved?

Answer:

Processing time has increased from an average of 311 days in FY 2001 to an average of 324 days for the first 5 months of FY 2002. This is due in part to the fact that we pulled many experienced Offer Specialists out of the field to assist with the training at the Centralized Offer in Compromise (COIC) sites. We also experienced a steeper than expected learning curve and a higher than expected turnover at both Brookhaven and Memphis which meant the Offer Specialists were kept longer doing training and on-the-job instruction (OJI).

Question:

What specific steps are being taken to address the backlog?

Answer:

To meet our processing time goals, and reduce the backlog, we:

- Centralized the receipt of new cases in two service center campuses, at Memphis, TN and Brookhaven, NY, where paraprofessional staff will resolve the less complicated cases before they become aged.
- Developed a plan to quickly resolve simple cases by streamlining the level of investigation. This will allow the professional staff in the field to focus on the more complex work or be available for reassignment to general collection program work.
- Are transferring work between geographic locations to balance workload with existing staff.
- Lowered the delegation authority for some types of offer decisions.
- Expanded the reasons why an offer may be returned without a full investigation to include:
  - estimated tax payments are not current
  - the offer is not significantly different from a previously rejected or defaulted offer
- Redefined the reasons why an offer may be returned because it was submitted solely to delay collection.
- Issued guidance from Chief Counsel to reduce the level of scrutiny in the review for legal sufficiency.
- Approved the use of overtime to work OICs.
- Submitted legislation to address frivolous OIC filers and remove the barriers to granting installment agreements for less than full payment. Both of these legislative proposals can assist in reducing inappropriate OIC receipts.
- Are developing additional process changes to speed case resolution in both the Centralized OIC sites and in the field. Examples include: 1) reducing levels of verification and associated taxpayer burden, where appropriate; and,
  2) maximizing the use of screening techniques to eliminate OIC cases that can be resolved as full pays or through Installment Agreements.

Question:

What steps are being taken to automate the process?

Answer:

We are taking a multi-tiered, multi-year approach to automation. Over the next year and a half, we anticipate making approximately twenty programming changes to the current system that have the potential to increase productivity and provide enhanced customer service. Many are directed at automating labor intensive procedures and should result in improved accuracy and reduced processing time. Our focus is on prioritizing the programming changes so that we move forward first with those enhancements that provide the highest potential of improvement. Connectivity with other IRS computer systems and an automated tool for calculating "Reasonable Collection Potential" are key areas to improvement.

Question:

Has centralization of the process helped?

Answer:

The first several months of FY 2002 were an implementation period for our centralized sites. The anthrax terrorist attack on our U. S. Postal system just weeks after start-up adversely affected mail handling and added additional stress to our already difficult inventory management situation. In addition, higher than expected attrition losses in the centralized sites extended the period of resource instability.

Neither COIC site is fully staffed. We have 154 Offer Examiners and 365 Process Examiners working inventory at the centralized sites. By April 2002, 82 additional Offer Examiners and by June 2002, 35 more Process Examiners will complete training which will fully staff the sites. We experienced a delay getting to full staffing because of a significant loss of trainees to higher graded positions in other service center program areas.

In addition, new employees are experiencing a steep learning curve. To date, the process examiners have mastered the initial case building actions, but the offer examiners are just starting to gain experience at accepting or rejecting offers. This has impacted the timely and efficient flow of casework through the centers.

We expect continued improvement in initial case processing timeframes, as we require taxpayers to submit offers on the most recent version of Form 656. Effective May 1, 2002, we will return offers submitted on obsolete versions of the form will be returned immediately to the taxpayer as not processable. When taxpayers provide all the documents necessary to verify their financial condition, less time is required to resolve the case.

3. Collection Due Process. Last year the IRS reported that the due

process provisions of the Act had slowed and lengthened the overall compliance cycle and that the process was open to abuse by taxpayers seeking to delay collection activities by filing frivolous claims. The year, the Administration's Fiscal Year 2003 budget proposals request that the IRS be permitted to dismiss requests for collection due process hearings if the request is based on frivolous arguments or is intended to delay or impede tax administration. Please update your assessment of how the collection due process provisions have affected the compliance cycle and discuss the likely effect of the Administration's proposal. Please describe how "frivolous" claims will be defined and distinguished from legitimate claims. Also provide the percentage of determinations by an Appeals' officer in collection due process hearings that have been overturned.

1. **Please update your assessment of how the collection due process provisions have affected the compliance cycle and discuss the likely effect of the Administration's proposal.**

Answer:

The collection due process (CDP) provisions require us to give taxpayers an opportunity to request a hearing with Appeals after the filing of a Notice of Federal Tax Lien and prior to proposed levy action. Some taxpayers use the hearing process to delay collection action by filing hearing requests that raise frivolous issues.
Appeals has approximately 20,000 CDP cases in inventory. About 4% or 800 cases involve frivolous issue taxpayers. The Area Appeals Office with the most cases has about 13% of non-filer/frivolous taxpayers. Sub-offices within that area have even more substantial percentages of taxpayers with frivolous claims.

However, the actual number alone does not account for the amount of time it takes for such cases. Frivolous claims occupy a disproportionate share of time over claims from taxpayers having substantive issues. Frivolous issue taxpayers frequently file voluminous claims. Most of these taxpayers request being able to record hearings via audio or stenographic recordings. This is often time-consuming to arrange. A larger percentage of the frivolous issue taxpayers go to court where they raise the same frivolous issues. Also some of the representatives of these claims file Sec. 1203 actions against IRS employees, which are very time-consuming, even when they are not sustained.

In addition to frivolous claims, taxpayers attempting to delay collection action have been taking an inordinate amount of time. They often tend to be non-responsive in Appeals. If they do respond, before agreeing to meet with the Appeals officer, they insist on being provided certain documents, such as a copy of the Appeals officer's delegation of authority or a copy of the notice and demand for payment, or they routinely ask for more time in producing necessary records or data. These are often the same taxpayers who will go to court and in many instances these taxpayers file in the incorrect court - even when Appeals has correctly advised them where to file. By statute, these taxpayers have another 30 days to file in the correct court after having been dismissed from the incorrect court; so it seems they are exploiting every delay the system allows them.

Time spent on these frivolous claims is time spent away from taxpayers who raise legitimate issues. We also suspend collection action on these accounts while the case is pending in Appeals. A legislative change, which would allow us to dismiss frivolous claims, would allow us to proceed with collection on these cases and enable Appeals to focus full efforts on taxpayers with legitimate claims.

2. Please describe how "frivolous" claims will be defined and distinguished from legitimate claims.

Answer:

We will ask taxpayers making a hearing request to state the grounds for appealing the filing of the notice of lien or proposed levy action. The IRS will examine claims with frivolous positions carefully to determine if real tax issues are present.

Frivolous claims are generally easy to spot. Many are similar to issues being thrown out of courts repeatedly, such as: taxes are voluntary so they chose to not pay; they are a citizen of the State of Virginia, not the United States, so they don't pay US taxes; the 16th amendment was never validly ratified; only federal employees owe taxes; etc. Others use popular terminology which is common among frivolous claims.

The IRS will establish a list of the known claims and terminology which we will treat as frivolous. We will update this list periodically. We maintain a list of frivolous arguments on our Internet site. Under the heading, "The Truth About Frivolous Tax Arguments," is a 32-page document explaining why various shop-worn arguments are frivolous. The link is: http://www.ustreas.gov/irs/ci/tax_fraud/frivolous.pdf.

1. Also provide the percentage of determinations by an Appeals' officer in collection due process hearings that have been overturned.

Answer:

Appeals officer determinations were overturned or conceded in less than 1%, or 5 cases, of approximately 750 court cases.

III. Employee Performance and Satisfaction

(a) Section 1203 of the Act provided that IRS employees could be terminated for certain proven violations.

1. How many employees have been terminated for each violation numerated in section 1203? Have the procedures been effective in addressing employee misconduct?

Answer:

No specific measure exists for the "effectiveness" of §1203. If effectiveness is measured in terms of modification of employee behavior, the data suggests significant behavior modification has occurred. Little of that modification has been productive. Since the enactment of §1203, employees have frequently reported that the fear of a §1203 allegation has caused reluctance to take otherwise proper enforcement actions. Managers and employees also report routine workplace disputes and rude or unprofessional interactions with taxpayers as potential §1203 violations to avoid a claim that they have covered up potentially serious misconduct. Taxpayers and practitioners have cited §1203 in correspondence about tax account issues, in an apparent attempt to delay IRS action on the case. Meanwhile, the incidence of serious employee misconduct remains at the very low levels reported prior to the enactment of §1203.

The overall objective of §1203 was to ensure that employees who commit serious misconduct are removed from Federal employment. The discretion of IRS managers was limited, as was the employee's ability to have a third party review the penalty determination. The §1203 penalties have been applied most frequently in cases involving employee tax compliance—fewer than 10% of the substantiated allegations involve the other eight §1203 provisions. However, the cases submitted to the Commissioner's §1203 Review Board include many where the penalty of removal is obviously too harsh. Sixty-eight percent of the tax compliance cases result in mitigation of penalty, and the cases warranting mitigation of penalty are readily identifiable. Half of the cases involve refund returns, and 73 percent of the employees are at grade 7 or below. The effectiveness of the law is compromised by overly broad language in the law that encompasses these cases.

2. **The Administration's Fiscal Year 2003 budget proposal requests that the late filing of refund returns and employee-against-employee actions be removed, and that the unauthorized inspection of return information be added to the list of violations. Are there other violations that should be removed or added? Please address the effect of the provisions that would terminate an IRS employee for harassment of a taxpayer.**

Answer:

Removing refund return cases and those involving employee-against-employee allegations, combined with the proposed authority of the Commissioner to set a penalty range for offenses, would enable the IRS to address the most significant problems with the current provisions of §1203. For example, the Commissioner could establish a range of penalties for late filed Federal tax returns that would take into account the grade, job duties, and common personal circumstances in these cases.

The Commissioner recommended that unauthorized inspection of taxpayer records be added to §1203 because of our experience in dealing with these cases. The IRS has attempted to implement a policy to the effect that removal is the appropriate penalty in these cases, absent mitigating factors. The qualifier "absent mitigating factors" is required by the case law on employee discipline, and has been interpreted inconsistently both within the IRS and by third parties reviewing employee appeals. The addition of this offense would permit greater consistency within the IRS, and would resolve the problem of third parties substituting their judgment for that of the IRS on the question of the seriousness of this offense. Traditional discipline processes appear to be adequate to address other categories of misconduct.

If an employee violates the Internal Revenue Code, Treasury Regulations, or IRS policy, including the Internal Revenue Manual, with the intent to harass a taxpayer, the employee is subject to removal under §1203. One removal has occurred under §1203 for harassing a taxpayer. The IRS found §1203 retaliation or harassment allegations substantiated in four other cases, but the employee resigned or retired before the personnel process was completed. Two of those cases involved taxpayer victims, and in the other two cases the misconduct was directed at other IRS employees. In an additional 113 cases, in which a §1203 retaliation or harassment allegation was not substantiated, the IRS found the employee had committed other misconduct. The IRS removed two employees based on non-§1203 misconduct, and suspended ten. Reprimands and counseling were imposed in most of the remaining cases for offenses such as rude and unprofessional behavior, the employees received reprimands and counseling.

3. Should mitigating factors be required to be considered in addition to relying on the discretion of the Commissioner? Should there be provision for an appeal of the ruling of the Commissioner and if not, why not?

Answer:

The legislative proposal includes a revision to §1203 that would permit consideration of mitigating factors in §1203 cases. This would allow the IRS to address some of the common fact patterns that routinely result in mitigation of penalty by the Commissioner, without requiring his personal review. Enactment of this part of the proposal would reduce the anxiety of employees who would otherwise face months of uncertainty as their case moves through the various stages of the personnel process.

Employees have the right to appeal the finding that a §1203 violation occurred, and many have done so. Findings have been reversed when a third party concluded that the IRS erred in finding that the misconduct was willful. We are waiting for the results of a review of a third party decision that the IRS used an incorrect definition of "threat" in a case where we found the employee threatened an audit for the purpose of extracting a personal gain (§1203(b)(10)). The employee does not have the right to appeal the Commissioner's decision on the penalty. Creating such an appeal right would undermine the basic premise of §1203.

The basic premise of §1203 is that certain offenses are so serious that termination of employment is the appropriate sanction. Section 1203 eliminated the discretion of IRS managers to select an alternate penalty and the authority of third parties to substitute their judgment for that of the IRS on the appropriateness of the penalty imposed. Vesting the authority to reduce the penalty in the Commissioner ensures consistency within the IRS. The Commissioner is also far removed from any possible bias for or against a particular employee, and in that sense is as independent and objective in his evaluation of the case as any third party would be. If Congress concludes that the Commissioner is not sufficiently independent and objective, and therefore an appeal to a third party should be available to the employee, the difference between the §1203 process and the regular discipline process would be substantially eliminated. The additional case processing time, and the resources committed to the Commissioner's review process, would not be justified by the marginal difference that would remain. A repeal of §1203 would be more efficient than the addition of an appeal right.

4 Are there procedures other than those in section 1203 (for example, in guidelines of the Office of Personnel Management) that affect termination of IRS employees?

Answer:

Title 5 of the United States Code, and OPM, Treasury and IRS implementing regulations, establish procedures for termination of employment "for such cause as will promote the efficiency of the Federal service." Other laws define specific conduct that warrants termination of employment, but the process for actually imposing the penalty is the one prescribed by OPM. The manager gives the employee written notice of the charges against him or her in a "proposal letter," which also advises the employee of his or her opportunity to respond to the proposal. After considering the evidence, including any response from the employee, the IRS notifies the employee of the findings and penalty in a "decision letter." The employee may appeal through channels established in a negotiated agreement, or through the Merit Systems Protection Board. Employees may also challenge the decision through the EEO process. As a general rule, managers have discretion about the level of penalty to include in the proposal letter, and in the penalty imposed by the deciding official. A law like §1203 limits that discretion in penalty setting, but follows all other aspects of the OPM prescribed process.

5. Please discuss whether section 1203 has had an impact on the number of seizures, levies, fact-to-face audits, and job performance.

Answer:

We cannot isolate the impact of §1203 from other factors that contributed to the decline in seizures, levies, face-to-face audits and job performance. Numerous other provisions of the Restructuring and Reform Act changed procedures and taxpayer rights. These changes had temporary effects as employees learned and adapted to the new procedures and rights, as well as continuing effects by making previously accepted enforcement activities more difficult to complete. We have only recently addressed the decline in the number of front-line enforcement personnel and how the accusations and scrutiny of the IRS in 1997 and 1998 seriously affected employee morale.

Recognizing we must consider a number of factors, front line employees and managers frequently cited, the fear and anxiety associated with §1203 as a major factor in their approach to enforcement activity. They believe the law reflects an assumption that the IRS did not take certain egregious misconduct seriously, and that it needed a Draconian approach in order to prevent this conduct from occurring. Notwithstanding the very low incidence of the prohibited behaviors, both before and after enactment of §1203, employees felt that the lack of confidence expressed through the enactment of §1203 could result in a lack of support for them in the event of an unfounded allegation.

Focus groups and surveys consistently report a view that the enactment of 1203 put employees taking appropriate enforcement actions at risk. That view will persist as long as the law remains in effect. The IRS will continue to monitor employee attitudes through surveys and focus groups, so we can identify other ways to further address employee concerns about §1203.

(b) The Act required the IRS to establish a new performance management system.

1. **Does the IRS now have a system that better evaluates and awards employees based on performance that is consistent with the IRS' mission? If, so how does such system work?**

Yes, the Internal Revenue Service (IRS) has implemented a new Performance Management System in compliance with the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA '98), codified as 5 USC Chapter 95, and the Service's adoption of balanced measures of performance. This system:

- Strengthens the linkage between an individual employee's performance, and the Service's mission, business goals and strategic plans
- Includes an employee retention standard for the fair and equitable treatment of taxpayers for all employees (as required by statute), and,
- Assures that employee performance awards are directly linked to employee performance results.

Additionally, RRA '98 allows the Secretary of Treasury to provide the IRS the authority to establish one or more payband systems covering all or any portion of the IRS workforce that is under the General Schedule. Subject to OPM guidelines and limited by the General Schedule salary ranges, IRS has the flexibility to develop paybands to meet the needs of our organization.

We used this authority to develop a Senior Manager Payband and a Department Manager Payband. These paybands are performance-based systems whereby movement through the band is contingent upon increasingly higher levels of performance

(c) The Act provides the IRS with certain personnel flexibilities to bring in experts and revitalize the IRS workforce. These personnel flexibilities include streamlined critical pay authority for up to 40 individuals, the ability to set the pay for certain positions at levels higher than under prior law, and the ability to offer recruitment, retention, and relocation incentives.

1. **How many critical pay hires could have been accommodated under the Senior Executive Service ("SES") pay scale? What level of pay would those hired under the critical pay provisions been eligible for without critical pay and how does such amount compare to the critical pay amount paid?**

Answer:

Since the implementation of the Streamlined Critical Pay authority, the IRS has hired five executives with a base salary that the SES pay scale could have accommodated. However, recruitment efforts under these traditional methods (i.e., SES) were unsuccessful in providing candidates with the required level of technical and leadership expertise. Through the critical pay authority and the use of a search firm, we were able to identify and hire executives with the appropriate background and expertise to fill these high-level critical positions. In all five cases, the critical pay executive's base salary was actually less than the maximum allowable under the SES pay scale. We should also note that Streamlined Critical Pay is not just about pay. Equally important is the streamlined aspect of the program. We are able to identify candidates for the positions and quickly bring them into the agency.

Title	Initial CP Salary	Maximum SES at Time of Hire
Director, Communications	$125,000	$133,700
Deputy Chief, C&L	$133,000	$133,700
Director, Security Modernization	$130,000	$138,200
National Director, Account Management Division	$105,000	$125,900
Director, Product & Partnership Development	$125,000	$133,700

2. **How much has the IRS spent on moving expenses for critical pay personnel?**

Answer:

As of March 31, 2002, the IRS has spent $1,822,759 for moving expenses for critical pay personnel. The benefits under this program are the same as for career individuals, with the exception that RRA 98 provides the additional authority to allow coverage of their first move prior to government service.

3. **How much has the IRS spent on search firms to recruit critical pay personnel and how much of this amount is attributable to personnel actually hired?**

As of March 31, 2002, IRS has spent $3,639,985 on executive searches.

4. **Please show the prior salary and critical pay salary for each critical pay employee hired.**

CURRENT CP EXECUTIVES (AS OF April 2002)

NAME	SALARY			
	PRIOR to IRS	CURRENT COMPENSATION		
		BASE	POTENTIAL BONUS	TOTAL COMP
Adams, Robert	$167,269	$175,000	$11,300	$186,300
Allen, Maureen	$80,000	$125,000	$25,000	$150,000
Ayres, James	$203,179	$170,000	$22,600	$192,600
Berg, Doug	$240,975	$181,400	$4,900	$186,300
Boswell, William	$500,000	$192,600*	$0	$192,600
Bratton, Delena	$92,016	$133,000	$20,000	$153,000
Chesman, Michael	$615,300	$186,300	$0	$186,300
Claytor, Paul	$197,000	$181,400	$4,900	$186,300
Dobbins, Tom	$149,537	$142,500*	$42,600	$185,100
Duder, John	$176,000	$176,000	$16,600	$192,600
Dunahoo, Carol	$334,000	$192,600*	$0	$192,600
Eads, James	$355,717	$192,600*	$0	$192,600
Forman, Fred	$622,700	$192,600*	$0	$192,600
Gaur, Prashant	$255,000	$160,000	$30,000	$190,000
Horsey, Daniel	$196,685	$165,000	$15,000	$180,000
Jakabcin, George	$109,201	$130,000	$10,000	$140,000
Jernigan, Cliff	$206,847	$181,400	$0	$181,400
Kehoe, Joseph	$1,000,000	$192,600*	$0	$192,600
Langdon, Larry	$650,000	$192,600*	$0	$192,600
Leighty, Colleen	$154,614	$140,000	$21,000	$161,000
Liuzzi, John	$195,000	$175,000	$17,600	$192,600
Matthews, Mark	$185,000	$192,000*	$0	$192,600
Meier, Kurt	$207,000	$181,400	$4,900	$186,300
Olson, Nina	$95,000	$135,000*	$0	$135,000
Porter, William	$107,346	$150,000	$30,000	$180,000
Pursley, Mark	$135,000	$125,500*	$40,000	$165,500
Ratcliffe, Wilbur	$342,341	$186,300	$0	$186,300
Reece, John	$219,811	$192,600*	$0	$192,600

CURRENT CP EXECUTIVES (AS OF April 2002)

NAME	SALARY			
	PRIOR To IRS	CURRENT COMPENSATION		
		BASE	POTENTIAL BONUS	TOTAL COMP
Rinaldi, Jim	$308,118	$186,300	$0	$186,300
Rosenker, Heather	$150,000	$135,000	$30,000	$165,000
Shultz, Paul	$186,000	$165,000	$16,400	$181,400
Stricklin, H. James	$125,000	$150,000	$15,000	$165,000
Terry, Thomas	$199,958	$186,300	$0	$186,300
Toder, Eric	$147,000	$150,000	$15,000	$165,000
Tootson, Jack	$205,016	$180,000	$12,600	$192,600
Warren, Margaret	$93,333	$125,000	$25,000	$150,000

SEPARATED CP EXECUTIVES (AS OF April 2002)

NAME	SALARY			
	PRIOR to IRS	*IRS COMPENSATION (at time of departure)*		
		BASE	POTENTIAL BONUS	TOTAL COMP
Conklin, Bert	$204,750	$181,400	$0	$181,400
Conti, Vincent	$160,000	$135,000	$0	$135,000
Cosgrave, Paul	$463,000	$181,400*	$0	$181,400
Cunninghame, Donna	$118,400	$147,500	$0	$147,500
LaFaver, John	$90,000	$155,100*	$0	$155,100
Liberti, Thomas	$228,700	$181,400	$0	$181,400
Mazei, Albert	$220,000	$160,000	$0	$160,000
Myers, Shelly	$115,529	$130,000	$0	$130,000
Oveson, Wilford	$85,107	$144,800*	$0	$144,800
Yuckenberg, Timothy	$243,413	$175,000	$11,300	$186,300

*Current base salary includes annual salary increases since EOD.

5. How many of those hired work in automation, administration, and general business respectively?

Technology	14
Administration	6
General Business	17

6. How many hired pursuant to the special pay provisions have since left the IRS? What is the average tenure?

Answer:

As of April 5, 2002, nine executives have left the IRS.

The average tenure of the executives who have departed is 17 months. Three of the executives were with the IRS for over two years with the longest being 29 months.

7. Please describe specific accomplishments made possible by the special pay provision.

Answer:

The streamlined Critical Pay executives brought exceptional talent and an extensive range of skills to the IRS. These talents are evidenced by the significant contributions they made that enable us to successfully meet the challenges of the congressionally mandated presented by the complete restructuring . For example:

- **Modernization**

- Transformation of the IRS into four new customer-based divisions with detailed organizational designs for the 11 organizational units and the national headquarters organization.

- Transformation of the National Taxpayer Advocate's office to a nationwide network to provide dedicated assistance to taxpayers in tax disputes with the IRS, and to champion taxpayer's rights and provide recommendations for improving tax legislation.

- Creation of the Tax Administration Visioning project -- a key element in defining the future Business Systems Modernization Program.

- Creation of a consolidated nationwide IS organization, where we directed nearly 100 percent of the IT resources, in accordance with industry standards.

- Completion of a nearly flawless Y2K conversion resulting in many areas of standardization and consolidation of our information systems operations.

- Establishment of the Business Systems Modernization program to replace IRS' outdated technology with modern systems, and the completion of the IRS Enterprise Architecture to clearly define improvements to our business operations and the modernization of the IRS using modern technology.

- Implementation of "CRM Exam", a tax computation software package for LMSB revenue agents and international examiners.

- **Customer Relations**

- Creation of new expanded annual report from the National Taxpayer Advocate to Congress providing the 20 most serious problems encountered by taxpayers, legislative recommendations for improvements, and assessments of IRS efforts to improve customer service and reduce taxpayer burden.

- Development and implementation of modernized business systems for improved customer communications, such as, 1) voice-activated programs that more accurately route taxpayer calls to the most appropriate IRS resource, 2) a new desktop interface applying industry best practices for agent desktop design and functionality, and 3) the SB/SE Community website.

- Development of effective pre-filing educational initiatives and publication of guidance to clarify the tax law and reduce unnecessary controversy.

- Development and implementation of the IRS's new approach to proactively partnering with external stakeholders to achieve mutual objectives (i.e., trade associations, practitioner and payroll organizations, educational and financial institutions, liaison groups, and Congressional staff offices.)

- **Compliance**

- Implementation of a successful initiative to combat abusive corporate tax shelters.

- Initiation of the largest criminal investigation in history, a combined domestic and international case against a ring of promoters of abusive trusts.

- Implementation of electronic crimes unit within CI and a compliance Council.

8. Would more be accomplished if IRS employees were eligible for the special pay provision?

Answer:

Yes. The IRS looses employees with special skills to the private sector regularly. Retaining these skills ,especially at the executive level is a continuing challenge the IRS faces.

(d) Please show the number and kind of Equal Employment Opportunity Commission complaints and grievances. What percentage of complaints were settled? What was the average amount of settlement?

Answer:

Number of Formal Complaints

Fiscal Year	Filed[1]	Closed [2]	Settled [2]	% Settled [3]
97	763	519	145	27.94%
98	806	532	167	31.39%
99	842	529	148	27.98%
00	766	727	157	21.60%
01	744	714	143	20.03%

[1] The number of complaints filed for Fiscal Years 97 through 00 is taken from the Department of the Treasury, Office of Equal Opportunity Program's report of Key EEO Complaint Statistics. The number of cases filed in Fiscal Year 2001 was taken from the Department of the Treasury Complaint Tracking System.

[2] Source: Complaints Tracking System.

[3] The % Settled computed by dividing the number of complaints settled by the number closed.

Bases of Formal Complaints [4]

Fiscal Year	Race & National Origin	Age	Gender	Reprisal	Religion	Disability
97	24.00%	13.00%	19.00%	27.00%	2.00%	15.00%
98	25.00%	14.00%	22.00%	22.00%	2.00%	15.00%
99	25.00%	13.00%	20.00%	25.00%	3.00%	14.00%
00	25.00%	15.00%	19.00%	24.00%	3.00%	14.00%
01	26.00%	14.00%	20.00%	22.00%	2.00%	16.00%

[4] The data for Fiscal Years 97 through 00 are taken from the Department of the Treasury Office of Equal Opportunity Program's report of Key EEO Complaint Statistics. The data for Fiscal Year 01 are from the Department of the Treasury Complaints Tracking System.

Fiscal Year 2001 Settlements

As shown above, the IRS settled143 formal complaints during Fiscal Year 2001. Based on a review of the Complaints Tracking System, the primary remedies provided in these settlements were:

Monetary Remedies

Type of Remedy	Number	Total Amount	Average Amount
Compensatory Damages	30	$270,714.00	$9,023.80
Backpay			
(with computed amount)	8	$47,660.00	$5,957.50
(without computed amount)	45		
Attorneys' Fees	11	$230,016.00	$20,910.55

(e) Please compare the average salary (adjusted for inflation in 2001 dollars) and average grade of all employees.

Answer:

Average Salary: $45,431 *

Average Non Supervisory Grade: 7.7

*Average salary is for all employees and is based on per annum salary, which includes locality pay rates.

Revenue and Business Results

Please provide data for the following:

1. Total revenue collected, total enforcement revenue collected

FiscalYear	Total Revenue Collected ($B)[a]	Net Revenue Collected ($B)[b]	Total Enforcement Revenue Collected ($B)
1997	1,623.3	1,505.0	37.2
1998	1,769.4	1,641.3	35.2
1999	1,904.1	1,746.1	32.9
2000	2,096.9	1,900.3	33.8
2001	2,128.8	1,902.1	33.8

a Before refunds
b After refunds

2. Total number of returns filed.

Calendar Year	1997	1998	1999	2000	2001
Grand Total	217,916,000	222,481,000	224,402,874	226,563,974	229,577,173

3. Total number of full time equivalent employees; number of employees involved in automation.

Answer:

The total projected FTE for FY 2003 is 101,080. The number of FTE for our business systems modernization effort (automation) is 176.

4. Total budget; travel expenses, outside contract expenses (split between automation and other and exclude payments to other government agencies), relocation expenses, space rental, and automation budget.

(See attachment 1)

5. Electronic Filing. The Act set a goal for the IRS to have at least 80 percent of all tax returns filed electronically by the year 2007. Please show the number of forms available for electronic filing (compared to the total number of forms), the number of taxpayers utilizing electronic filing, the number of taxpayers "eligible" to file 100 percent of their forms electronically, and the percentage increase each year in use of electronic filing. Please forecast the percentage of electronic filing through 2007. If the IRS is not on course to meet the Act's 80 percent goal, what are the obstacles to meeting the goal? What specific steps are being taken to increase electronic filing, including steps to ensure coordinated filing between the IRS and State governments?

Answer:

During the past several years, the IRS has made significant progress toward accomplishing the goal established by Congress. Approximately, one out of every four individual taxpayers file electronically. To date, 110 forms/schedules are electronically enabled. This leaves less than 1% of tax returns that cannot be filed electronically because digital versions of certain forms do not exist.

As of March 28, 2002, IRS has received over 37 million individual returns electronically, a 13 percent increase over the prior year and 26 percent increase over 2000.

The following chart summaries IRS' efforts with electronic filing since its inception in 1997.

Calendar Year	E-File Volume (thousands)	% of Increase
1997	19,135	
1998	24,580	28.46%
1999	29,329	19.32%
2000	35,402	20.71%
2001	40,206	13.57%

However, with this increase, our current projections show us falling short of the 80 percent goals established by Congress.

Calendar Year	E-File Projections (thousands)	% of Increase
2002	44,930	
2003	49,801	10.84%
2004	54,082	8.60%
2005	58,022	7.29%
2006	61,567	6.11%
2007	64,647	5.00%

In addition, we must overcome a number of significant challenges if the IRS is going to achieve the 80% goal. Some of the major impediments are:

- Product and service cost and complexity
- Technical infrastructure
- Taxpayer apprehension concerning security and privacy

We must make the e-file system less complex. To begin with, IRS e-file has not been completely paperless. Paper signature jurats and other paper forms and checks have been part of the system. In addition, taxpayers cannot file some forms and schedules electronically. These factors complicate the e-file system and drive up the costs for both taxpayers and practitioners. The IRS is taking a series of actions over the next several years to remove these barriers to make IRS e-file more convenient and cheaper to use. Some of these actions included expanding the use of electronic signatures through the self-selected PIN initiative, reinstating the practitioner PIN initiative, accepting 29 new forms electronically in 2002, exploring the feasibility of extending the return due date for electronically filed returns, and offering free Internet filing. The IRS will also continue working with Treasury and the private sector to develop a solution(s) that will provide a no cost option for taxpayers to file their tax returns online.

We must also ensure that our technical infrastructure can support a robust electronic tax administration program. Not only do we expect a significant increase in the number of Electronic Return Originators and returns that they submit electronically, but also in the many new products and services they use for transacting and communicating electronically with us. Return preparers now file over half of all tax returns and to receive all of those returns electronically, we must work with that community to convert their entire operation to an electronic environment. That community has assured us that if we provide the ability to file all returns, including business returns, electronically and accept all other communications electronically, they will fully support the program. Toward that end, we awarded a PRIME contract to Computer Sciences Corporation and a team of leading technology and consulting firms to be major partners in managing the modernization of IRS' core business and technology systems with a near term focus that will include value added e-services for third parties such as electronic disclosure authorization, transcript delivery, and communication.

Taxpayers also have concerns about the security and privacy of electronic transactions with the IRS. We must continue to demonstrate that the security and integrity of our electronic systems and the confidentiality of taxpayer information are among the most important responsibilities we have to the American people. We have strengthened our systems' security and must remain vigilant to keep the e-file process the safest possible.

6. Total number of audits, percent of "no change audits"; average cycle time per audit; number of employees conducting audits.

Answer:

Examination Closures
FY 1997 though FY 2001

All Individuals	**FY 1997**	**FY 1998**	**FY 1999**	**FY 2000**	**FY 2001**
Field	715,615	567,759	384,484	251,108	202,515
Service Center	803,628	625,021	715,789	366,657	529,241
Total Return Closures	1,519,243	1,192,780	1,100,273	617,765	731,756
Corporations < $10 Million	**FY 1997**	**FY 1998**	**FY 1999**	**FY 2000**	**FY 2001**
Field	55,021	40,735	27,484	17,580	13,169
Service Center	1,302	1,083	784	1,043	1,163
Total Return Closures	56,323	41,818	28,268	18,623	14,332

Corporations $10 Million & Over	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
Field	12,706	11,464	10,287	8,978	8,465
Service Center	266	366	250	234	253
Total Return Closures	12,972	11,830	10,537	9,212	8,718
Grand Total	**FY 1997**	**FY 1998**	**FY 1999**	**FY 2000**	**FY 2001**
Field	915,420	728,545	505,847	342,660	280,111
Service Center	812,702	634,098	722,559	373,255	534,946
Total Return Closures	1,728,122	1,362,643	1,228,406	715,915	815,057

Cycle Days

Individuals	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
Revenue Agent	299	286	311	360	377
Tax Auditor	205	217	244	267	252
Service Center (Non-IRP)	235	206	325	321	263
Corps. < $10 M	255	281	316	365	359
Corps. $10 M & Over	466	447	466	511	565

No Change Rates

Individuals	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
Revenue Agent	10%	12%	12%	13%	14%
Tax Auditor	14%	15%	15%	15%	17%
Service Center (Non-IRP)	13%	21%	15%	26%	19%
Corps. < $10 M	26%	27%	27%	27%	30%
Corps. $10 M & Over	18%	19%	21%	20%	20%

Technical Staffing

	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
Revenue Agents	14,399	13,647	13,061	12,550	11,598
Tax Compliance Officers	2,318	2,113	1,930	1,702	1,420

Source: Table 37

7. The projected loss of revenue from no non-filers; total tax gap.

Answer:

We have used compliance data to make estimates of the gross tax gap (tax liability that is not paid voluntarily and timely) for income and employment taxes for Tax Years 1985 and 1988. Because of the lack of compliance data since 1988, we have projected our estimates to Tax Years 1992 and 1998 based on the assumption of constant compliance rates. No other projections are available at this time.

Gross Tax Gap ($ in billions)

Component	Tax Year			
	1985	1988	1992	1998
Individual Income Tax	**74.4**	**85.8**	**101.7**	**166.4**
Nonfiling	9.8	11.2	13.8	22.6
Underreporting	53.5	58.5	73.1	119.6
Underpayment	11.1	16.1	14.8	24.2
Corporation Income Tax	**16.5**	**22.9**	**24.5**	**40.5**
Nonfiling	0.0	0.0	0.0	0.0
Underreporting	15.5	21.4	22.5	37.5
Underpayment	1.0	1.5	2.0	3.0
Employment Taxes	**20.7**	**32.1**	**48.3**	**65.5**
Nonfiling	0.0	0.0	0.0	0.0
Underreporting	15.8	26.2	41.0	55.3
Underpayment	4.9	5.9	7.3	10.2
TOTAL	**111.6**	**140.8**	**174.5**	**272.4**
Nonfiling	9.8	11.2	13.8	22.6
Underreporting	84.8	106.1	136.6	212.4
Underpayment	17.0	23.5	24.1	37.4

8. Number of the Senior Executive Service; GS-15s and 14s.

Answer:

Currently on rolls :

Senior Executives (SES) : 312
Supervisors at grades 14 and 15: 2263
Pay Banded Senior Managers (formerly grades 14 and 15) : 1702
Non supervisor grades 14 and 15 : 4415

9. Total number of managers; ratio of management staff to non-management staff; average number of employees managed by first line mangers.

Answer:

Currently on rolls:
Total number of Managers: 10:484
Ratio of Managers to Non Managers: 1to 10.9

We determine the ratio of managers to non managers by dividing the total number of non supervisory employees (management officials included) by the number of supervisors. The IRS employee database does not identify front line managers.

10 Total number of appeals; Appeals sustention rate; and cycle time.

ANSWER:

NATIONAL APPEALS						
	FY 1997	**FY 1998**	**FY 1999**	**FY 2000**	**FY 2001**	**FY 2002 YTD Mar.**
Closed Cycle Time:						
Field	342	326	365	408	441	436
Office	230	230	256	282	309	331
Collection	220	222	235	263	272	298
Service Center	117	101	109	121	142	171
CE	878	822	725	752	773	846
Inventory: (excludes cases in Counsel jurisdiction)						
Field	21,784[1]	18,411	13,629	10,664	9,713	9,514
Office	14,188	10,011	5,807	4,334	4,386	4,337
Collection	5,230	5,004	8,306	9,863	14,869	16,280
Service Center	8,744	8,070	10,270	12,141	22,229	26,410
CE	N/A	1,070	963	1,065	1,085	1,060
Total Inventory	49,946	42,566	38,975	38,067	52,282	57,601

[1] This amount includes both Field and CE cases for the fiscal year 1997 since we are unable to separate those categories for that year.

Collection Due Process (CDP) Activity:						
Receipts			5,365	6,892	19,119	12,412
Disposals			557	4,145	8,065	8,633
Inventory			4,808	6,541	17,109	20,076
Cycle Time			N/A	262	280	278

- Closed cycle time and inventory for all sources (other than CDP) is National from ACDS (Appeals Centralized Database System) reports.
- CDP data for FY'00 through March FY'02 is National from D&BAM (Diagnostics and Balanced Appeals Measures) reports.
- CDP data for FY'99 is from Appeals National database ACCESS report.

General Appeals stopped systemically collecting sustention rate information several years ago and therefore, does not collect for our programs. This is due in part to systems issues and to the designation of sustention rates as ROTERS (Records of Tax Enforcement Results). The IRS has established regulations containing rules to ensure that ROTORS are not used in a way as to improperly influence the handling of taxpayer cases.

APPEALS LMSB		
	FY 2001	**FY 2002 YTD February**
Closed Cycle Time: *		
Field	532	569
CEP	773	859
Inventory: (excludes cases in Counsel urisdiction)		
Field	3,649	3,059
CEP	1,085	1,083
Total Inventory	4,734	4,142
*Closed cycle time and inventory data include Field cases for Appeals LMSB and **all** CEP for Appeals Nationwide.		
Fiscal Year 2001 Only	**RecoveryRate**	**Sustention Rate**
Field (Only Activity Codes 219 and above)	11%[2]	34%
CEP	23%	

[2] The Recovery Rate shown for Field Exam cases for these limited activities codes is skewed by one case in which, 98% of the amounts were conceded. That one case represented 37% of the total proposed dollars for this category.

Recovery rate is the ratio of tax sustained by Appeals, to *total tax* proposed by Compliance plus amounts of claims disallowed by Compliance. The recovery rate for FY 2001 is comparable to earlier studies of Recovery rates. In 1993 and 1995 studies, recovery rates were 23% and 14% respectively for a statistical sample of CEP cases.

Sustention rate is the ratio of adjustments to taxable income sustained by Appeals (dollars) to Compliance proposed adjustments to taxable income (dollars). It also includes, the percentage of tax credits sustained to the tax credits disallowed by Compliance. The sustention rate for FY 2001 is comparable to earlier studies of Sustention rates. In 1993 and 1995 studies, recovery rates were 35% and 33% respectively for a statistical sample of CEP cases.

The earlier studies noted that the recovery rates are affected by significant factors beyond the control of either Compliance or Appeals. These include, Loss Carrybacks, Carryover Adjustments from prior periods, New Issues Raised during appeal, Technical Advice issued during the appeal, Supreme Court Decisions issued during the appeal, Change is Service position and TEFRA Flow Through Adjustments. The studies estimated the effect of these at between 18% and 31%.

11. Total number of trials; total docketed case/dollar amounts; litigation sustention rate and cycle time.

Answer:

For FY01, 762 cases that went to trial were closed.

For Tax Court as of September 2001:
- 18,300 Dockets
- $29.8 Billion
- 80.97 % sustention rate

For District Courts
- 900 dockets
- $3 Billion
- 98% sustention rate

Court of Federal Claims
- 600 Dockets
- $2 Billion
- 99% sustention rate

IRS does not capture cycle time.

12. Total number of collections; seizures, liens, and levies; number employees involved in collection activities

Answer:

Collection Closures

Total Dispositions	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
TDI (Taxpayers)	1,647,848	1,381,025	1,748,164	1,445,593	1,086,236
TDA (Modules)	5,012,662	4,288,695	2,954,434	2,771,870	3,040,809

Source: NO-5000-4
NO-5000-2

Enforcement Statistics

Action	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
Liens	543,613	382,755	167,867	287,517	428,376
Levies[3]	3,659,417	2,503,409	504,403	219,778	674,080[4]
Seizures	10,030	2,307	161	74[5]	234[5]

FTE Collection Activities

Location	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
Service Center Control Branch	3,078.0	2,721.2	2,810.8	2,505.2	2,712.0
Automated Collection System	2,647.0[4]	2,241.8	2,124.1	2,375.2	2,616.5
Collection Field function	11,075.0	10,448.0	9,981.0	8,448.0	7,926.0

[3] These are the figures for notices of levy issued in CFf and ACS. They do not include systemic levy programs, such as SITLP (State Income Tax Levy Program), FPLP (Federal Payment Levy Program), and AKPFD (Alaska Permanent Fund Levy Program)

[4] This figure includes the number of levies issued by SB/SE CFf from the C-23 report and ACS information from the CSAR report.

[5] The FY 2000 and 2001 figures are different then the C-23 report. These figures reflect a physical count (conducted in December 2001) of seizures done during these two years.

[4] The 1997 ACS FTSs cannot be compared to the other years, because Nashville's FTEs in 1997 included both ACS and Taxpayer Service staffing. The ACS and Taxpayer Service staffing. The ACS staffing can not be backed out from the total.

13. What is the status of the Enterprise Wide Security Mail system (i.e.,secure e-mail for sensitive data)?

Answer:

IRS deployed an Enterprise Email System during second quarter FY2000. At the end of FY2000, IRS had completed the expansion of the email infrastructure to add a Secure /Multipurpose Internet Mail Extensions (S/MIME) security enhancement (email and attachment encryption) for transporting Sensitive But Unclassified (SBU) data across the IRS. During FY2001, we completed operational testing and began piloting the capability with small groups of users. However, we postponed full deployment to end users pending the completion of the deployment of a standard software suite for IRS end user computers (desktop and laptops). During first Quarter 2002, we began an annual hardware refreshment program to upgrade end user computers. We deployed refreshed systems with standardized software products to give us a stable baseline for managing end user systems. Additionally, each new system had an engineered software image to improve overall security assurance for systems at the IRS. We aligned desktop delivery of the secure email capability with the refreshment project and a parallel effort to deliver software upgrades to non-refreshed systems. Although we planned deployment activities to minimize impact to the 2001 Filing Season, IRS leaders recently reaffirmed their resolve to complete the secure email deployment to all email users before the end of first Quarter 2003. Providing continued resource availability and timely completion of employee education and the electronic enrollment process, we will achieve our goal. Currently, 3555 users have the secure email system enhancement.

14. Number of criminal cases; number of criminal convictions, percentage of tax verses non-tax

Answer:

Criminal Cases	FY01	FY00	FY99	FY98	FY97
# of Cases Initiated	3284	3372	3952	4655	5335
# of Cases Convicted	2251	2249	2713	3000	3110

Attached are program area summary reports for each of the fiscal years that provide additional and more complete information. Also attached is Criminal Investigation's (CI) special agent on-roll report showing a decrease in agent-resources of approximately 18% from FY97 to FY01. (attachment #2 and #3)

The following table shows the extent to which CI's initiated cases and sentenced cases involve tax administration:

Criminal Cases	FY01	FY00	FY99	FY98	FY97
% of Initiated Cases that include Tax Violations	56.4%	52.9%	48.5%	52.9%	57.2%
% of *Sentenced Cases that include Tax Violations	40.5%	45.8%	44.6%	49.8%	49.3%

Attached is a chart that provides additional and more complete information.

*Generally speaking, a case sentenced during a particular fiscal year was most likely initiated and worked during preceding fiscal years. Therefore, this statistic is not a strong indicator of CI's current emphasis on tax administration. (attachment #4)

15. Total square footage of building space the IRS occupies.

Answer:

The IRS currently occupies 31,059,028 square feet of space.

SQUARE FOOTAGE OCCUPIED

1997	1998	1999	2000	2001
34,985,517	34,321,000	33,626,842	29,610,961	30,161,707

Budget Breakdown by Appropriation Account and Automation

	2003		2002		2001		2000		1999		1998		1997	
Category	FTE	($000)	FTE	($000)	FTE	($000)	FTE	($000)	FTE	($000)	FTE	($000)	FTE	($000)
Automation	176	$531,164	176	$461,557	156	$293,310	107	$187,232	133	$37,400	*	*	*	*
PAM	44,356	$4,149,827	43,774	$3,982,971	42,387	$3,893,368	46,218	$3,339,463	43,183	$3,205,330	43,855	$2,964,215	31,280	$1,852,421
TLE	46,872	$3,988,358	46,275	$3,786,801	45,683	$3,648,438	41,451	$3,280,662	43,243	$3,131,812	44,590	$3,103,638	62,918	$4,108,806
ISY	7,499	$1,675,857	7,499	$1,620,905	7,441	$1,618,468	7,486	$1,498,590	9,917	$1,791,755	7,233	$1,360,906	7,505	$1,202,314
ITIA	-	$450,000	-	$391,593	-	$243,221	-	$175,432	-	$24,400	-	-	-	-
EITC	2,353	$154,346	2,353	$153,940	2,196	$149,308	1,919	$139,708	2,386	$140,490	2,358	$135,902	-	-

*When the Tax Systems Modernization (TSM) program failed, Automation work at the IRS was essentially halted until Congress launched IRS' ITIA (now BSM) initiative. ITIA/BSM funding began with an appropriation in late FY 1998; the actual work of this sweeping automation initiative began in late FY 1999. Hence, the timeline for current IRS Automation work reflects FY 1999 to present.

INTERNAL REVENUE SERVICE - CRIMINAL INVESTIGATION

SUMMARY BY PROGRAM AREA for FY01

	INITIATED	PROS RECS	INDICTED	CONVICTED	SENTENCED	DIT
FRAUD						
Legal	1020	535	560	548	548	39.15%
Illegal	1313	953	920	937	859	38.95%
TOTAL FRAUD	**2333**	**1488**	**1480**	**1485**	**1407**	**78.10%**
Fraud Sub-Program Area						
Healthcare	101	103	96	114	98	3.38%
Bankruptcy	40	16	22	20	15	1.40%
Insurance	42	26	30	29	39	0.71%
Excise Tax	11	18	21	14	8	0.41%
Financial Institutions	154	117	95	97	102	3.28%
For. & Dom. Trusts	79	30	32	45	26	4.82%
Telemarketing	64	74	75	68	64	1.52%
QRP	170	113	95	102	103	5.39%
Return Preparers	116	73	70	63	56	5.30%
General Fraud	1392	789	805	824	781	46.68%
Public Corruption	95	69	70	52	64	2.78%
Gaming	69	60	69	57	51	2.03%
TOTAL of SUB PROG.	**2333**	**1488**	**1480**	**1485**	**1407**	
Narcotics						
OCDETF	592	559	557	468	517	11.21%
OTHER	51	46	45	47	66	2.12%
HIDTA	28	13	11	16	21	1.40%
HIDTA/OCDETF	280	229	199	235	227	4.07%
TOTAL NARCOTICS	**951**	**847**	**812**	**766**	**831**	**18.80%**
Receipt of Info Items and Other						3.10%
TOTAL	3284	2335	2292	2251	2238	100.00%

Dit = Direct Investigative Time

CRIMINAL INVESTIGATION
SPECIAL AGENTS ON-ROLL
FY 1997 - FY 2002

Fiscal Year	Special Agent
1997	3326 [1]
1998	3144 [2]
1999	3044 [3]
2000	2842 [4]
2001	2741 [5]
2002	2835 [6]

The current number of Special Agents on-roll as of January 2002 is 2847.

1 Special Agents on board as of first pay period in fiscal year: October 1996.

2 Special Agents on board as of first pay period in fiscal year: October 1997.

3 Special Agents on board as of first pay period in fiscal year: October 1998.

4 Special Agents on board as of first pay period in fiscal year: October 1999.

5 Special Agents on board as of first pay period in fiscal year: October 2000.

6 Special Agents on board as of first pay period in fiscal year: October 2001.

IRS CRIMINAL INVESTIGATION
SPECIAL AGENT GAINS & LOSSES

Fiscal Year	Special Agent Gains	Special Agent Losses	Net Gain
2002	312 projected	150 projected	+162 projected
2003	150 projected*	150 projected*	0 projected*

- Decision pending

TAX AND NON-TAX COUNTS OF SUBJECT CRIMINAL INITIATIONS AND SENTENCINGS IN FY 1997 - 2001
COUNTS OF CONVICTIONS IN FY 1997 - 2001

	INITIATIONS			%	SENTENCED			%	CONVICTIONS
	TAX	NON-TAX	TOTAL	Tax	TAX	NON-TAX	TOTAL	Tax	TOTAL
FY 1997	3049	2286	5335	57.2%	1484	1525	3009	49.3%	3110
FY 1998	2461	2194	4655	52.9%	1482	1492	2974	49.8%	3000
FY 1999	1916	2036	3952	48.5%	1167	1452	2619	44.6%	2713
FY 2000	1785	1587	3372	52.9%	1134	1341	2475	45.8%	2249
FY 2001	1851	1433	3284	56.4%	906	1332	2238	40.5%	2251

TAX = Primary/Secondary violation is Title 26, 18-286, 18-287, 18-371K or 18-371m
For initiations use alleged violations
For sentenced use sentenced violations

NON-TAX = Neither the Primary nor Secondary violations are tax violations

AS OF 09/30/1997

AVERAGE SALARY: 38322
AVERAGE NONSUPV GRADE: 7.90
AVG NONSUPV GRADE IF WAGE GRADE EMPLOYEES EXCLUDED: 7.91

TOTAL NUMBER OF SES EMPLOYEES: 255
TOTAL NUMBER OF SUPERVISORY GRADES 14 AND 15: 3381
TOTAL NUMBER OF PAY BANDED SENIOR MANAGERS (FORMERLY GRADES 14 AND 15): 0
TOTAL NUMBER OF NON SUPERVISORY IN GRADES 14 AND 15: 2888

TOTAL NUMBER OF MANAGERS: 9199
RATIO OF MANAGERS TO NON MANAGERIAL: 1 TO 11.6

AS OF 09/30/1998

AVERAGE SALARY: 39646
AVERAGE NONSUPV GRADE: 7.89
AVG NONSUPV GRADE IF WAGE GRADE EMPLOYEES EXCLUDED: 7.89

TOTAL NUMBER OF SES EMPLOYEES: 261
TOTAL NUMBER OF SUPERVISORY GRADES 14 AND 15: 3459
TOTAL NUMBER OF PAY BANDED SENIOR MANAGERS (FORMERLY GRADES 14 AND 15): 0
TOTAL NUMBER OF NON SUPERVISORY IN GRADES 14 AND 15: 3129

TOTAL NUMBER OF MANAGERS: 9146
RATIO OF MANAGERS TO NON MANAGERIAL: 1 TO 11.4

AS OF 09/30/1999

AVERAGE SALARY: 41183
AVERAGE NONSUPV GRADE: 7.94
AVG NONSUPV GRADE IF WAGE GRADE EMPLOYEES EXCLUDED: 7.95

TOTAL NUMBER OF SES EMPLOYEES: 262
TOTAL NUMBER OF SUPERVISORY GRADES 14 AND 15: 3495
TOTAL NUMBER OF PAY BANDED SENIOR MANAGERS (FORMERLY GRADES 14 AND 15): 0
TOTAL NUMBER OF NON SUPERVISORY IN GRADES 14 AND 15: 3468

TOTAL NUMBER OF MANAGERS: 9335
RATIO OF MANAGERS TO NON MANAGERIAL: 1 TO 11.1

AS OF 09/30/2000

AVERAGE SALARY: 43146
AVERAGE NONSUPV GRADE: 7.92
AVG NONSUPV GRADE IF WAGE GRADE EMPLOYEES EXCLUDED: 7.93

TOTAL NUMBER OF SES EMPLOYEES: 254
TOTAL NUMBER OF SUPERVISORY GRADES 14 AND 15: 3753
TOTAL NUMBER OF PAY BANDED SENIOR MANAGERS (FORMERLY GRADES 14 AND 15): 0
TOTAL NUMBER OF NON SUPERVISORY IN GRADES 14 AND 15: 3642

TOTAL NUMBER OF MANAGERS: 9603
RATIO OF MANAGERS TO NON MANAGERIAL: 1 TO 10.9

AS OF 09/30/2001

AVERAGE SALARY: 44930
AVERAGE NONSUPV GRADE: 7.94
AVG NONSUPV GRADE IF WAGE GRADE EMPLOYEES EXCLUDED: 7.95

TOTAL NUMBER OF SES EMPLOYEES: 310
TOTAL NUMBER OF SUPERVISORY GRADES 14 AND 15: 2217
TOTAL NUMBER OF PAY BANDED SENIOR MANAGERS (FORMERLY GRADES 14 AND 15): 1620
TOTAL NUMBER OF NON SUPERVISORY IN GRADES 14 AND 15: 4245

TOTAL NUMBER OF MANAGERS: 9851
RATIO OF MANAGERS TO NON MANAGERIAL: 1 TO 10.7

AS OF 04/06/2002

AVERAGE SALARY: 45334
AVERAGE NONSUPV GRADE: 7.64
AVG NONSUPV GRADE IF WAGE GRADE EMPLOYEES EXCLUDED: 7.64

TOTAL NUMBER OF SES EMPLOYEES: 312
TOTAL NUMBER OF SUPERVISORY GRADES 14 AND 15: 2264
TOTAL NUMBER OF PAY BANDED SENIOR MANAGERS (FORMERLY GRADES 14 AND 15): 1714
TOTAL NUMBER OF NON SUPERVISORY IN GRADES 14 AND 15: 4425

TOTAL NUMBER OF MANAGERS: 10518
RATIO OF MANAGERS TO NON MANAGERIAL: 1 TO 10.9

Summary of §1203 Allegations Recorded
In ALERTS as of February 28, 2002

1203 Violation	1203 Section	Completed Inquiries	Inquiry In Progress	1203 Inquiry Deferred	Total
Seizure Without Approval	**(b)(1)**	13	1	0	**14**
False Statement Under Oath	**(b)(2)**	17	4	1	**22**
Constitutional & Civil Rights Issues	**(b)(3)**	244	6	6	**256**
Falsifying or Destroying Records	**(b)(4)**	58	8	6	**72**
Assault or Battery	**(b)(5)**	8	1	1	**10**
Retaliate or Harass	**(b)(6)**	1,564	60	24	**1,648**
Misuse of 6103	**(b)(7)**	2	1	0	**3**
Failure to File Federal Tax Return	**(b)(8)**	765	187	29	**981**
Understatement of Federal Tax Liability	**(b)(9)**	306	179	11	**496**
Threat to Audit for Personal Gain	**(b)(10)**	68	5	0	**73**
Totals		**3,045**	**452**	**78**	**3,575**

Notes:

1. This report includes all §1203 allegations recorded in ALERTS since enactment of the IRS Restructuring and Reform Act of 1998 (July 1998).

2. 1203 Inquiry Deferred = Inquiry was not completed to determine if §1203 was violated (e.g., Employee resigned before an inquiry could be completed).

3. In addition to the information above:
   a) CCPAG received and forwarded to the Frivolous Return Program 902 taxpayer complaints alleging §1203 issues based on the constitutionality of the nation's tax laws. These complaints were not recorded in ALERTS.
   b) Since the passage of RRA, the Office of EEO & Diversity, Discrimination Complaint Review Unit (DCRU) has received 781 EEO settlements and/or findings of discrimination for review of potential §1203(b)(3)(B) violations. As of December 31, 2001, the DCRU had reviewed 641 cases. No §1203(b)(3)(B) violations have been substantiated.

Source: Automated Labor and Employee Relations Tracking System (ALERTS).

Extract Date: Monday, March 04, 2002

Summary of Completed §1203 Inquiries Recorded In ALERTS as of February 28, 2002

1203 Violation	1203 Section	Substantiated Misconduct		Allegation Not Substantiated	Total
		1203 Misconduct	Non-1203 Misconduct		
Seizure Without Approval	**(b)(1)**	0	2	11	**13**
False Statement Under Oath	**(b)(2)**	1	2	14	**17**
Constitutional & Civil Rights Issues	**(b)(3)**	0	9	235	**244**
Falsifying or Destroying Records	**(b)(4)**	9	18	31	**58**
Assault or Battery	**(b)(5)**	1	4	3	**8**
Retaliate or Harass	**(b)(6)**	6	113	1,445	**1,564**
Misuse of 6103	**(b)(7)**	0	0	2	**2**
Failure to File Federal Tax Return	**(b)(8)**	282	271	212	**765**
Understatement of Federal Tax Liability	**(b)(9)**	15	182	109	**306**
Threat to Audit for Personal Gain	**(b)(10)**	13	19	36	**68**
Totals		**327**	**620**	**2,098**	**3,045**

Source: Automated Labor and Employee Relations Tracking System (ALERTS).

Extract Date: Monday, March 04, 2002

Summary of Substantiated §1203 Allegations Recorded In ALERTS as of February 28, 2002

1203 Violation	Removals	Resigned / Retired	Probation Separation	Removed On Other Grounds	Penalty Mitigated	In Personnel Process	Total
Seizure Without Approval	0	0	0	0	0	0	**0**
False Statement Under Oath	0	1	0	0	0	0	**1**
Constitutional & Civil Rights Issues	0	0	0	0	0	0	**0**
Falsifying or Destroying Records	2	5	1	0	0	1	**9**
Assault or Battery	1	0	0	0	0	0	**1**
Retaliate or Harass	1	4	0	0	0	1	**6**
Misuse of 6103	0	0	0	0	0	0	**0**
Failure to File Federal Tax Return	46	86	11	7	102	30	**282**
Understatement of Federal Tax Liability	0	6	0	0	0	9	**15**
Threat to Audit for Personal Gain	4	4	2	1	1	1	**13**
Totals	**54**	**106**	**14**	**8**	**103**	**42**	**327**

Notes:

1. The cases reported as "Removals" and "Penalty Mitigated" do not reflect the results of any third party appeal.

Source: Automated Labor and Employee Relations Tracking System (ALERTS) and 1203 Review Board records.

Extract Date: Monday, March 04, 2002

Unsubstantiated §1203 Allegations with Other Proven Misconduct In ALERTS as of February 28, 2002

1203 Violation	1203 Section	Removals	Resigned / Retired	Probation Separation	Suspension	Reprm'd	Admshm't	Counseling		Other	Total
								Written	Oral		
Seizure Without Approval	**(b)(1)**	0	0	0	0	0	0	0	2	0	**2**
False Statement Under Oath	**(b)(2)**	0	1	0	0	0	0	1	0	0	**2**
Constitutional & Civil Rights Issues	**(b)(3)**	0	0	0	0	2	1	4	2	0	**9**
Falsifying or Destroying Records	**(b)(4)**	1	0	0	6	2	1	3	1	4	**18**
Assault or Battery	**(b)(5)**	0	0	0	0	1	0	1	1	1	**4**
Retaliate or Harass	**(b)(6)**	2	6	0	10	17	7	33	19	19	**113**
Misuse of 6103	**(b)(7)**	0	0	0	0	0	0	0	0	0	**0**
Failure to File Federal Tax Return	**(b)(8)**	5	46	23	12	32	36	66	15	36	**271**
Understatement of Federal Tax Liability	**(b)(9)**	2	9	0	8	17	22	53	7	64	**182**
Threat to Audit for Personal Gain	**(b)(10)**	1	2	0	4	4	0	4	1	3	**19**
Totals		**11**	**64**	**23**	**40**	**75**	**67**	**165**	**48**	**127**	**620**

Source: Automated Labor and Employee Relations Tracking System (ALERTS).

Extract Date: Monday, March 04, 2002