

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

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HOUSE COMMITTEES ON WAYS AND MEANS,
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FINANCE, APPROPRIATIONS, AND GOVERNMENTAL AFFAIRS

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INTRODUCTION

The Internal Revenue Service Restructuring and Reform Act of 1998¹ (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 each taxpayer. The second goal is to provide top quality service to all 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

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 20, 2003. 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.

⁷ The first, second, third, and fourth joint reviews were held on May 25, 1999, May 3, 2000, May 5, 2001, and May 14, 2002 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); Joint Committee on Taxation, *Strategic Plans and Budget of the Internal Revenue Service, 2002*, May 14, 2002 (JCS-4-02).

⁸ Sec. 8022(3)(c). The previous four 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; *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.

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-53-03), May 19, 2003.

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. Recently published opinion surveys show that taxpayer service is improving. Overall, 44 percent of the public has a favorable opinion of the IRS as compared with most other Federal agencies based on a survey conducted in August 2002. The American Customer Satisfaction Index survey for 2002 reports a satisfaction rate for all individual filers of 62 out of 100 points. The satisfaction rate for electronic filers was 78 out of 100 points, in contrast with 53 points for paper tax filers. Last year's survey showed a satisfaction rate of 77 points for electronic filers and 52 points for paper filers.

The 2003 filing season

Acting Commissioner Wenzel testified that the 2003 tax filing season has been "smooth, with returns being processed on time, electronic filing increasing, and improved accessibility and accuracy of telephone service." The General Accounting Office, in its preliminary review of the IRS's performance during the 2003 filing season, agreed that the filing season so far has been smooth, electronic filing has continued to grow, telephone service has improved, and the IRS website has seen increased use.

The IRS projects that net collections for calendar year 2003 will be approximately \$1.74 trillion compared with approximately \$2 trillion last year. During calendar year 2003, the IRS also projects that it will receive 175 million returns, including over 132 million individual returns, and the IRS expects to issue over 104 million individual refunds. As of March 28, 2003, the IRS reported that the average dollar amount per refund was up almost 2.33 percent from last year, and the average refund as of that date was \$2,010. The IRS website recorded 3.11 billion hits and more than 437 million forms and publications were downloaded in fiscal year 2002.

Acting Commissioner Wenzel testified that electronic filing by individuals has increased by 10 percent this year and that electronic filing will constitute about 41 percent of individual returns filed. As of April 3, 2003, the number of taxpayers filing electronically using an IRS authorized Electronic Return Originator increased 8.51 percent over last year for a total of \$31 million taxpayers. The number of taxpayers filing electronically from their home computer using a third party transmitter constituted 9.2 million taxpayers. Almost 27 million individual taxpayers have chosen to use their personal identification numbers instead of a written statement when e-filing on-line. In addition, 3.4 million taxpayers filed their returns over the telephone using the TeleFile system. The IRS also reported that nearly 30 million taxpayers have chosen direct deposit for their Federal tax refund, a 12.6 percent increase from the year before. The IRS reported that over 18 million taxpayers chose to file both their Federal and State tax returns simultaneously in a single electronic transaction, an increase of 16 percent from last year. The IRS states that 119 out of 127 individual tax forms may be filed electronically.

The General Accounting Office found that the IRS's filing season performance through mid-March 2003 has improved compared to recent years. The General Accounting Office notes that although electronic filing is growing, growth is at a slower rate than projected. To help increase electronic filing, the IRS contracted with the Free File Alliance, a consortium of 17 tax preparation companies, to provide free online tax preparation and filing services for at least 60 percent of all taxpayers through the IRS website. As of March 26, 2003, approximately 2.1 million returns were filed through the consortium, the goal being 2.5 million. The IRS also is undertaking a number of initiatives to expand electronic filing for individual and business taxpayers.

On telephone service, the IRS notes that through March 22, 2003, approximately 83.8 percent of taxpayers who wanted to speak with a customer service representative got through, compared to 69.4 percent in 2002. Telephone correct response rates for tax law and tax account questions have fallen slightly from last year and are at 81.1 percent and 87.9 percent, respectively (compared to 83.5 percent and 88.4 percent over the same period last year). The IRS notes that better service is being provided to taxpayers by screening tax law questions to identify the right customer service representative to handle a call. As a result, the call abandon rate was reduced from 13.8 percent to 7.8 percent, and the transfer rate was reduced from 21.6 percent to 17.5 percent. Also, 26.7 million taxpayers (a 5.5 percent increase since last year) used automated services, including refund status, to obtain information.

The General Accounting Office found that this filing season, taxpayers are spending less time waiting to talk to an assistor. The General Accounting Office confirms that the rate at which callers receive accurate information from an assistor is down slightly, due in part to assistors having difficulty in adapting to a change in the guide used to for calls. However, the General Accounting Office notes that IRS officials said that because taxpayers with simple questions about their refund now are using the website and not calling the IRS, assistors generally are handling more complex questions. The General Accounting Office also reports that the toll-free telephone lines have improved over the last year.

The IRS Oversight Board reports that the IRS has improved its accuracy in correctly answering questions concerning tax law and taxpayer accounts on its toll-free telephone lines. The National Taxpayer Advocate indicates that, although access to toll-free service has improved (bumping the issue from #1 to #18 of the most serious problems faced by taxpayers), the problem has shifted to the handling of calls once the taxpayer reaches the menu system. The Treasury Inspector General for Tax Administration reports that the IRS has taken significant actions to be able to record calls to its toll-free telephone system in time for the 2004 filing season.

Walk-in service is available numerous locations throughout the United States. As of March 22, 2003, the IRS estimates that it had served over 4.53 million taxpayers at all Taxpayer Assistance Centers, with 3.15 million served this filing season. The IRS stated that the customer satisfaction rate is at 88 percent satisfied and 7 percent dissatisfied. According to the General Accounting Office, the quality of assistance at the IRS's walk-in sites has improved compared to last year, and service to taxpayers through community based coalitions has increased. As of February 2003, the Treasury Inspector General for Tax Administration reports that the accuracy

of tax law assistance has increased to 73 percent, an increase of 27 percentage points over the same period last year.

Other service issues

The IRS sought to improve the Employer Identification Number assignment process by consolidating Employer Identification Number services into three sites (from ten), offering telephone service at consistent times, revising the application form to improve third party authorization, installing a fax file server allowing for the receipt of multiple faxes, and developed an Employer Identification Number Internet application to provide taxpayers with the ability to request and receive such numbers online.

On refunds, the IRS has introduced a new refund information service on its website. For fiscal year 2002, the IRS averaged 15 days to issue a refund from an electronic return and 30 days to issue a refund from a paper filed return. 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); in 1999, 14 days (electronic) and 35.09 (paper); and in 2001, 14.6 (electronic) and 28 (paper).

Regarding efforts to reduce the taxpayer burden, 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. The IRS Oversight Board notes that as taxpayer demand for help continues to grow with increased tax code complexity, significant burdens are imposed on taxpayers to comply and the IRS to enforce tax laws. The IRS Oversight Board estimates that over the past five years, 19 public tax laws were passed, 293 tax code provisions were changed, and 414 alterations were implemented to forms and instructions.

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. According to a survey performed by the IRS Oversight Board, it was "very important" to taxpayers that the IRS ensure that other taxpayers honestly pay what they owe. However, despite the importance of the compliance function, finding resources to meet compliance needs is difficult. As the IRS Oversight Board notes, from 1992 to 2002, workload (measured by returns filed) at the IRS increased by 16 percent while full time equivalent employees decreased by 16 percent. The result of the conflicting trends in workload and resources has led to a "compliance gap" -- more taxpayers who do not file or report honestly and less IRS capacity for audit and enforcement. Former Commissioner Rossotti noted that during the 1992-2002 period, field compliance personnel decreased 28 percent, and concluded starkly that the "IRS is simply outnumbered when it comes to dealing with compliance risks." Between 1992-2001, coverage of all types fell dramatically: (1) document matching decreased from 33.1 percent of cases to 9.1 percent; (2) correspondence exams (not including the earned income credit) decreased from 4 to 1.2 percent; (3) in-person exam of individuals fell from 5.8 percent to 1.5 percent; and (4) exams of pass-thru

entities decreased from 5.1 percent to 2.9 percent. The Commissioner's report also found that 60 percent of known tax debts are not pursued, 75 percent of non-filers are not identified or pursued; 79 percent of taxpayers who underreport by using abusive devices are not identified or pursued; and 78 percent of underreported tax found by document matching is not pursued.

Enforcement activity

The IRS's goal in fiscal year 2002, like the year before, was to stop the long-term decline in compliance and also to focus resources on the principal areas of noncompliance. The Commissioner cites six of the most serious compliance areas: (1) tax shelter promoters; (2) abuse of trusts and offshore accounts to hide or improperly reduce income; (3) abusive corporate tax shelters; (4) underreporting by high-income individuals; (5) accumulation and failure to pay large amounts of employment taxes by some employers; and (6) the high rate of erroneous earned income credit payments.

As to tax shelter promoters, the Commissioner highlights that the IRS's efforts are showing results: 27 promoter injunctions granted and 27 pending, 372 civil promoter field investigations, 464 ongoing criminal investigations, and leads on 80 offshore promoters from the recently concluded Offshore Voluntary Compliance Initiative. The IRS reports that to identify tax shelter promoters, the IRS established a Lead Development Center in April 2002, which is leading to quicker injunctions and investigations. In addition, the IRS states that summonses to financial and commercial businesses to obtain information on U.S. residents with credit, debit, or other payment cards issued by offshore banks is helping to identify promoters and participants. Under the Offshore Voluntary Compliance Initiative, the IRS offered taxpayers the opportunity to disclose improper activity to the IRS. Taxpayers coming forward are required to pay back taxes, interest, and certain accuracy penalties, but do not have to face civil fraud and information return penalties, or criminal prosecution (based upon the application of the voluntary disclosure practice). The IRS's initial report on the initiative is that 1,253 taxpayers from 46 States and 48 countries applied, at least \$50 million in uncollected tax has been identified, and 80 new promoter cases (of the first 229 cases reviewed) have been identified.

With respect to the earned income credit, the IRS has requested an additional \$100 million (and 650 full time equivalent employees) in the fiscal year 2004 budget for a reform initiative.

The IRS lists progress on enforcement in several other areas, including two recent lawsuits on slavery reparations; tax shelters (35 promoter suits); legal action against websites that permitted tax shelters; early detection of \$350 million in fraudulent refund claims; conviction of 227 non-filers in fiscal year 2002; conviction of 41 taxpayers in employment tax withholding cases in fiscal year 2002; convictions of 26 taxpayers in abusive trust schemes in fiscal year 2002; and 254 investigations for return preparer fraud in fiscal year 2002. In addition, the IRS notes that publicity and media outreach sends the IRS message on tax shelters to up to 10,000 media outlets, and the public affairs office of the IRS Criminal Investigation division has significantly increased publicity of legal actions taken.

Levies, liens, and seizures all increased significantly from fiscal years 2000 and 2001. However, although total liens in fiscal year 2002 nearly reached fiscal year 1997 levels, levies

and seizures are still far below fiscal year 1997 levels (e.g., levies were approximately 36 percent of 1997 levels, liens approximately 79 percent, and seizures approximately 3 percent). Enforcement revenue increased slightly above fiscal year 2001 levels (from \$33.8 billion to \$34.1 billion), still below the \$37.2 billion collected in fiscal year 1997.

The IRS Oversight Board endorses the following IRS responses to the compliance gap: (1) focus compliance resources on key areas, such as tax shelter promotions and the use of off-shore accounts; (2) tailored examinations, such as the Limited Issue Focused Examination program, under which the IRS and large and mid-size business taxpayers agree on a dollar threshold below which issues will not be raised; (3) reorganization of paper processing centers and encouragement of electronic filing; (4) investments in pre-filing taxpayer education; (6) measuring compliance through the National Research Program; and (7) improvement of tax debt collection, including through the use of carefully monitored private debt collection agencies.

Audit activity

In fiscal year 2002, the number of individual returns audited (including service center or correspondence audits) was approximately 744,000, an increase of 12,000 returns over fiscal year 2001. 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. In comparing the audit rate for all taxpayers (including correspondence audits) from 1993 through 2002, the rate dropped 38 percent (from .92 to .57 percent) even though it rose significantly between 1993 and 1995. The audit rate for large corporations has declined significantly since fiscal year 1997 (12,972 closures) to fiscal year 2002 (8,443 closures), and the decrease for small corporations is more dramatic, from fiscal year 1997 (56,323 closures) to fiscal year 2002 (14,665 closures). In 2002 the IRS implemented a K-1 matching program as a means of ensuring that Schedule K-1 income of pass-through entities is properly reported. The initial launch of the program resulted in 65,000 notices being sent to taxpayers, at least 25 percent of which were erroneous. The IRS has since revised the K-1 matching program to improve the screening of information received and announced on March 10, 2003, that notices inquiring about 2001 tax returns will be sent out later in the year.

Technical staffing levels for audit activity have declined, from 13,647 revenue agents in 1998 to 11,176 in 2002, and from 2,113 tax compliance officers in 1998 to 1,212 in 2002. The decline in staffing levels is attributed to an increased workload and unbudgeted costs.

Measuring compliance -- National Research Program

The IRS has acknowledged 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 has developed a new program, the National Research Program, to measure filing compliance, payment compliance, and reporting compliance. The data gathered through the National Research Program will be used to update the formulas used for selecting returns for audit and for identification purposes in areas of noncompliance.

Private collection agencies

An Administration budget proposal would permit the IRS to use private debt collection companies to locate and contact taxpayers owing outstanding tax liabilities of any type and to arrange payment of those taxes by the taxpayers. The proposal specifies several procedural conditions under which the proposal would operate. First, provisions of the Fair Debt Collection Practices Act would apply to the private debt collection company. Second, taxpayer protections that are statutorily applicable to the IRS would also be made statutorily applicable to the private sector debt collection companies. Third, the private sector debt collection companies would be required to inform taxpayers of the availability of assistance from the Taxpayer Advocate.

The proposal creates a revolving fund from the amounts collected by the private debt collection companies. The private debt collection companies would be paid out of this fund. Their compensation would be “based upon a number of factors, including quality of service, taxpayer satisfaction, and case resolution, in addition to collection results.”

The Treasury Inspector General for Tax Administration reports that the IRS’s preliminary planning approach for the use of private collection agencies has been good, despite the fact that improvements are needed to ensure that: taxpayer rights are protected; private data is adequately secured; projects are appropriately managed; and the backgrounds of contractor employees are adequately investigated. The IRS Oversight Board notes that the private collection agencies would allow the IRS to concentrate its resources on more complex cases. The National Taxpayer Advocate reports that its focus is placed on preserving taxpayer rights and developing processes to afford taxpayers the same procedural and statutory protections in dealing with private contractors, and will continue to monitor the implementation phase.

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 workplace characterized by equal opportunity, recognition of employee performance, and no artificial barriers to advancement. For 2002, the IRS’s annual survey of employee satisfaction showed an increase of 4 percent from 2001, which the IRS Oversight Board says may indicate an upward trend, reflective of employee adjustments to IRS restructuring. The IRS Oversight Board notes that many IRS employees are nearing retirement age and that the IRS must be prepared to train and invest in new employees, especially as modernized technology becomes the norm.

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 March 31, 2003, there were 490 substantiated violations of section 1203. Of the 490 substantiated violations, 386 were for failure to file a Federal tax return. Of the 3,970 completed section 1203 inquiries, 2,446 inquires found that the allegation was not substantiated; 1,034 inquires were found to constitute

non-section 1203 misconduct. Eighty-one employees have been removed for section 1203 violations, 60 of whom were removed for willful failure to timely file a Federal tax return.

In this year's budget request, the IRS requested that two section 1203 violations be eliminated. 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, and that the IRS wants the Commissioner be able to establish guidelines that outline specific penalties, including termination, for the types of wrongful conduct listed under section 1203. According to the IRS, such changes are necessary because section 1203 is negatively affecting employee morale and effectiveness. Notwithstanding section 1203, the incidence of serious employee misconduct remains at the low levels reported prior to its enactment. The General Accounting Office reports that known problems, such as lengthy investigations and conflicts of interest during investigations, may have reduced the effectiveness of the section 1203 procedure, as well as the morale and productivity of enforcement personnel.

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 executives, including the Commissioner, Deputy Commissioner, and Treasury officials interview Streamlined Critical Pay candidates. 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. The IRS Oversight Board finds that critical pay "has helped provide needed talent and should continue." 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 \$1,693,572 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 \$3,623,979 on executive searches, of which \$1,881,553 is directly attributable to 26 critical pay hires (with two searches currently in progress).

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 General Accounting Office reports that the IRS has made progress in revamping its performance management system to better utilize available resources, but additional work is required to design and implement performance measures for supporting ongoing business operations, modernization efforts, and budget requests. The IRS Oversight Board finds that the IRS has made progress in measuring its performance over the past five years and that IRS decision-makers now have a much better sense of assessing the IRS's performance. However, the IRS Oversight Board believes that the IRS has to establish standards for measuring long-term strategic goals, especially to assess levels of compliance.

D. Organizational and Technological Modernization

Organizational modernization

The IRS has reorganized into 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 key IRS offices, including Chief Counsel, Appeals, the Taxpayer Advocate Service, Criminal Investigation, and Communications and Liaison and functional units.

A year ago, a number of commentators noted that the transition to the restructured IRS was awkward, resulting in “chaos and confusion.” This year, as the new structure has solidified, there appear to be fewer concerns with the aftermath of restructuring. The National Society of Accountants remarks on a disconnect between the national office and the field offices regarding communication of new policies and procedures, with the result that under the new structure, only simple problems are being resolved. The IRS Oversight Board stresses that alongside restructuring, the IRS should emphasize employee training to ensure that employees are engaged in the new system.

Technology modernization

At present, the IRS relies on computer systems developed in the 1960’s and 1970’s to maintain taxpayer records. Modernization of such systems is a large-scale 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 (typically one to three years) for a single Operating Division that are directed toward updating software and coordinating old computer systems with new technology as improvements are made by Business Systems Modernization.

In January and April 2003 reports, the General Accounting Office noted that the IRS has made “important progress.” Areas of progress include establishing the infrastructure systems needed to run new business applications, completion of certain modernization projects that already are providing benefits, and improvement of management controls needed to acquire and implement information technology systems. However, the General Accounting Office concludes that business systems modernization remains at “high risk” because the scope and complexity of the program is growing as projects move from the design to development stages, and management capacity is still somewhat immature. In the General Accounting Office’s view, such weaknesses lead to cost increases, delays, and deficient performance.

An October 31, 2002 audit report by the Treasury Inspector General for Tax Administration offered a mixed assessment of business systems modernization. From 2001, the Treasury Inspector General for Tax Administration found that business systems modernization had increased the capacity of the IRS’s telephone systems, improved the IRS’s ability to receive,

route, and respond to taxpayer telephone calls, and enabled taxpayers to receive refund information via the Internet. However, business systems modernization continues to have difficulty meeting original cost, schedule, and functionality estimates as described in the spending plans that are submitted to Congress -- a majority of projects cost more money and take more time to deliver fewer features than originally planned. On the whole, however, cost increases and schedule delays are decreasing over time, as projects move from design to development. Of the projects planned for completion by the 2002 filing season, just 46 percent of features were fully or partially delivered, 14 percent of features were suspended, with the remainder in progress. Whether business systems modernization continues to have significant cost and schedule delays is, in the view of Treasury Inspector General for Tax Administration, a matter of whether the Business Systems Modernization Office and the PRIME contractor implement improvements in the cost and schedule estimating process.

Four business systems modernization projects have been implemented, though only one of the four is fully operational. The Customer Relationship Management Exam project (a software package that computes complex taxes) is complete. Customer Communications (routing of routine taxpayer inquiries to an automated menu and the Internet Refund Fact of Filing project), the Enterprise Systems Management project (helping the IRS to monitor all the IRS computer systems and networks), and the Security and Technology Infrastructure Release (providing secure technical infrastructure that supports and enables delivery of new business systems) have been implemented but are not fully operational.

In progress is the Customer Account Data Engine, which is a critical project that will replace the existing tape-based master files and information processing system, and 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 will be deployed in two Phases. Phase 1 will process all individual taxpayer accounts over five Releases scheduled for deployment through 2006. Phase 2 will process business accounts. Dates for development and implementation of Phase 2 have not been established.

Also in progress are the e-Services project (to support the IRS's ability to conduct most transactions with taxpayers and their representatives electronically), the Integrated Financial System (to provide core financial capabilities and financial reporting and a framework for retirement of current financial systems), the Custodial Accounting Project (to provide the IRS with the control and reporting capabilities mandated by Federal financial management laws), the Enterprise Data Warehouse (to provide the foundation for certain data mining and decision analytic tools), and Filing and Payment Compliance (to use technology to improve IRS communications with taxpayers on compliance issues and also protect taxpayer rights).

E. IRS Budget Request for Fiscal Year 2004

In general

For fiscal year 2004, the IRS budget request totals \$10.437 billion and 100,043 full-time equivalent positions. The request reflects a \$521 million increase (or 5.3 percent) over the fiscal year 2003 and an increase of 888 full-time equivalent employees. The budget request has six building blocks: (1) mined resources; (2) compliance and customer service enhancements; (3)

internal services and support reinvestments; (4) modernization investments; (5) earned income credit reform initiative; and (6) maintenance of current levels of operations and non-recurs.

The IRS Oversight Board recommends a budget that provides \$287 million more than the Administration's recommended budget and includes an additional 2,120 full-time equivalent employees.

Mined resources (internal improvements)

For fiscal year 2004, the IRS estimates that internal productivity growth will make available \$166 million and 2,145 full-time equivalents (mined resources) from its current programs, which will be reinvested to offset funding increases elsewhere. Thus \$454 million in program increases and \$232 million requested to maintain current operations will be offset by \$166 million of mined resources, resulting in the \$521 (rounded) million funding increase.

Funding for compliance and customer service enhancements

The IRS requests an increase of \$204 million to fund initiatives to enhance compliance efforts and an increase of 2,371 full-time equivalents. Of these amounts, \$24 million and 258 full-time employees will be used for increased exam capacity for cases involving flow-through entities and corporate transactions.

Funding for internal services and support reinvestments

To provide internal services and support reinvestments, the IRS requests \$102 million and 12 full-time equivalents to annualize rent costs, increase training of personnel, install web-based applications, replace certain hardware and software, and expand a private network service.

Funding to support IRS modernization

The IRS requests an increase of \$49 million for Business Systems Modernization. Near-term improvements include: a secure self-service Internet product for taxpayers to check their refund status and fact-of-filing; an Internet product for tax practitioners, taxpayers, State tax representatives, and the Department of Education to perform electronic taxpayer account resolution, taxpayer identification matching, transcript delivery, and disclosure authorization.

Funding for earned income credit compliance initiative

To fund an earned income credit reform initiative, the IRS requests \$100 million and 650 full-time equivalents. The requested resources will be used to preclude payments to ineligible taxpayers, reduce the occurrence of erroneous claims, and ensure that eligible taxpayers receive their tax benefits.

Funding for maintenance of current levels of operations and non-recurs

The IRS requests a net total increase of \$232 million to maintain current operating levels.

General Accounting Office findings

The General Accounting Office reports that some of the mined resources listed in the 2004 budget request are not well defined and therefore may not result in the savings promised. The General Accounting Office notes that just 38 percent of dollar savings and 56 percent of full-time equivalent savings that were pledged in fiscal year 2003 will actually be achieved. The General Accounting Office also reports that in recent years budget requests have made increased staffing for compliance a priority, yet staffing still has declined. The General Accounting Office attributes the decline to increased workload, such as for processing returns, issuing refunds, and answering taxpayer mail, and unfunded costs.

Financial audit of IRS fiscal year 2002 financial statements

Like fiscal years 2001 and 2000, the General Accounting Office expressed an unqualified opinion on all IRS financial statements. The General Accounting Office rendered unqualified opinions for each year 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. 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

The IRS Oversight Board focused on four critical issues now facing the IRS: closing the compliance gap, continuing and implementing Business Systems Modernization, replenishing human capital, and modernizing facilities. On the compliance gap, the IRS Oversight Board estimated that the amount of assessed but uncollected taxes is \$280 billion and growing. The IRS Oversight Board was disappointed in the performance of Business Systems Modernization but emphasized that the program is a major long-term program that will require significant ongoing and growing investment. The IRS Oversight Board found that the IRS must assess its human capital needs and cope with an aging workforce, build new skills in employees so that they can work effectively in a modernized environment, develop an agency-wide approach to training using modernized technology, and improve internal communications. The IRS Oversight Board also found that the IRS is dependent on aging facilities to process paper returns.

The IRS Oversight Board’s recommended budget for the IRS for fiscal year 2004 is \$287 million higher than the Administration’s recommended IRS budget. Specifically, the IRS Oversight Board recommends \$172 million more than the Administration for taxpayer assistance, including an additional \$45.6 million to improve telephone services to small businesses as well as individual taxpayers, and an additional \$38 million in pre-filing services to determine the needs and values of taxpayers. Also, the IRS Oversight Board recommends \$71 million more than the Administration for Business Systems Modernization funding, and \$44 million more than the Administration in funding tax law enforcement.

The IRS Oversight Board met six times as a full board in fiscal year 2002 and conducted other meetings at the committee level. In fiscal year 2002, the IRS Oversight Board published three reports for the Congress, coordinated with the Treasury Department a search for the new IRS Commissioner, conducted a review of the performance evaluations and proposed bonuses of 13 top IRS executives, participated in six IRS Nationwide Tax Forums, and evaluated a number of IRS programs, including the IRS employee survey conducted by Gallup, the electronic filing program, the K-1 matching program, the closing of the Brookhaven pipeline for paper return processing, and the reengineering of certain compliance strategies.

National Taxpayer Advocate

The National Taxpayer Advocate's annual report for fiscal year 2002 focused on protecting taxpayer rights. The National Taxpayer Advocate's Report identified six main areas for legislative action: attorney fees in nonphysical personal injury cases, married couples as business co-owners, math error authority, the Office of Taxpayer Advocate, the regulation of Federal tax return preparers, and children's income. The National Taxpayer Advocate made several detailed proposals for each area. The National Taxpayer Advocate's Report also identified and discussed 22 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 2002, the Taxpayer Advocate Service independently reviewed and took action to resolve over 244,000 cases. The Report listed the top sources of Taxpayer Advocate Service casework processing of claims or amended returns as Earned Income Credit examinations due to the Revenue Protection Strategy, refund inquiry, initial processing of returns, penalties, problems with payments/credits, levies, lost/stolen refunds, and underreporter process.

Treasury Inspector General for Tax Administration

The Treasury Inspector General for Tax Administration's semiannual report to the Congress for the period April 1, 2002, through September 30, 2002, reports that the Treasury Inspector General for Tax Administration issued 118 audit reports during the six-month period. Financial results due to audit reports totaled \$54 million and an additional \$237.6 million in increased revenue and protected revenue. The Treasury Inspector General for Tax Administration closed nearly 2,430 investigations of criminal wrongdoing and administrative misconduct during the reporting period. Investigations recovered approximately \$3.1 million.

The Treasury Inspector General for Tax Administration reports that the IRS has improved security over information systems but nevertheless concludes that the overall level of security is not yet adequate. The Treasury Inspector General for Tax Administration also reports that the IRS has made progress in modernizing its technology systems. The IRS has installed an upgraded toll-free telephone system that improves its ability to respond to taxpayer calls and provide capacity to route taxpayers' calls to the appropriate IRS employee. The IRS also has released an update to its Enterprise Architecture, which serves as a roadmap for current and future modernization projects. 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, cost increases, performance-based contracting technique problems, and maintaining a consistent strategic direction.

The Treasury Inspector General for Tax Administration reports that, although the IRS made “some progress” in improving customer services, additional improvements are necessary. The Treasury Inspector General for Tax Administration noted that IRS assistance generally is better by phone than at a walk-in site. The Treasury Inspector General for Tax Administration reports that the IRS’s volunteer income tax assistance and tax counseling for the elderly (VITA/TCE) program suffers from inadequate controls and a lack of accountability over the computers the IRS provides to the program.

The Treasury Inspector General for Tax Administration reports that the IRS does not impose available penalties on employers who file inaccurate name and social security number combinations on Form W-2 (Wage and Tax Statement), and has not developed a regularly scheduled program for administering the information return penalty.

The Treasury Inspector General for Tax Administration reports that, while the IRS has made progress in implementing the taxpayer rights provisions of the IRS Reform Act, significant improvements are needed in the suspension of interest provision.

Taxpayer Rights

The IRS estimates that in fiscal year 2002 it undertook 528,020, 1.3 million, and 296 liens, levies, and seizures, respectively. According to the IRS, a significant percentage of the taxpayer collection due process cases (five percent, or 906 out of a total of 18,600 cases in inventory) advance arguments that are frivolous or otherwise without merit. The IRS asserts that frivolous cases consume a disproportionate amount of time as the claims often are voluminous. The IRS maintains a list of frivolous arguments on its website. A proposal in the Administration’s budget for fiscal year 2004 would 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 proposal would permit the United States Tax Court to be the exclusive venue for suits to obtain judicial review of an Appeals determination resulting from a collection due process hearing.

According to an August 2002 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. The Treasury Inspector General for Tax Administration found the IRS’s continued compliance with the notice of levy provisions of the IRS Reform Act to be attributable to consistency of legal provisions and internal seizure procedures, technical expertise and assistance, and continued emphasis on employee training.

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 mail lien notices in a timely manner (1 to 17 days late), which may have resulted in taxpayers not being aware of appeal rights. The Treasury Inspector General for Tax Administration estimates that taxpayer rights could have been affected for 14,695 notice of Federal tax liens prepared between August

1, 2001, and June 30, 2002. The IRS attributed the delays due to printer problems, management turnover, and staffing issues.

The Treasury Inspector General for Tax Administration found that the IRS took appropriate action to protect taxpayer rights to an appeal in 91 percent (30 of 33) of the cases identified in its fiscal year 2000 and 2001 reviews.

The IRS has faced many difficulties in implementing the innocent spouse provisions, resulting in a significant backlog of cases. However, the IRS has taken several steps to improve the program. According to the National Taxpayer Advocate, the steps are showing positive results. The National Taxpayer Advocate attributes improvements in the program to: the implementation of a new tracking system to gain control over inventory (the Innocent Spouse Tracking System), development of software to speed processing and improve accuracy, automated decision-making tools, revision of the innocent spouse claim form, instructions, and publication, centralization of the operation in Cincinnati, and stable staffing levels at the centralized site. The National Taxpayer Advocate reports that in fiscal year 2002, 49,800 cases were closed and that inventories have dropped substantially. In addition, the success of centralization permitted the IRS to reduce staffing levels elsewhere.

The IRS reports that the average processing time for innocent spouse claims (from initial receipt of a claim to delivery of a determination letter to the taxpayer) improved between fiscal year 2002 and fiscal year 2003. For example, the average number of days to issue a determination in response to a meritorious claim was 259 days in fiscal year 2003 compared to 283 days in fiscal year 2002. The IRS made a determination that an innocent spouse claim did not qualify in an average of 78 days in fiscal year 2003 compared to 106 days in fiscal year 2002.

With respect to the offer in compromise program, the IRS Oversight Board reports that approximately 80 percent of the offers in compromise can not be processed when they are first received and that the program is confusing and subject to abuse. The IRS Oversight Board recommends improvements to the offer in compromise program to include: educating taxpayers, simplifying paperwork, imposing criminal penalties, and legislative alternatives.

With regard to the length of time to process an offer in compromise, the IRS is processing more offers within six months today than the IRS did in fiscal years 2000 through 2002, but is processing far fewer offers within six to 12 months. Offers that take more than a year to process have decreased. Average processing time has decreased from an average of 317 days in fiscal year 2002 to an average of 272 days for the first six months of fiscal year 2003.

As part of this year's budget request, the Administration proposes to permit the IRS to enter into installment agreements for amounts less than the full liability owed by taxpayers. The Administration 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. The Administration requests that an opinion of IRS Chief Counsel no longer be mandatory for compromises of \$50,000 or more (including penalties and interest). In addition, the IRS is considering a proposal that would require taxpayer representatives to sign offers in compromise submitted on behalf of their clients.

The IRS attributes this year's decrease in average processing time in part to the fact that newly established centralized offer in compromise sites have matured and processes to improve workflow were implemented. The automated offer in compromise program has reduced various labor-intensive procedures and established connectivity with other IRS computer systems. Further, the IRS reports that it has successfully tested an automated tool for calculating "reasonable collection potential" and is in the process of making refinements.

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. Overall, 44 percent of the public has a favorable opinion of the IRS as compared with most other Federal agencies based on a survey conducted in August 2002.¹¹ The American Customer Satisfaction Index survey for 2002 reports a satisfaction rate for all individual filers of 62 out of 100 points.¹² The satisfaction rate for electronic filers was 78 out of 100 points, in contrast with 53 points for paper tax filers.¹³

¹⁰ IRS Strategic Plan at 4, 25. To carry out the IRS strategic goals, the IRS has developed five 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; and (5) insist on total integrity. IRS Performance Plan at SC-2. 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. *Id.*

¹¹ See George Guttman, *How Well Did the IRS Perform in 2002*, 2003 Tax Notes 28-8 (February 11, 2003) at 2.

¹² Special Report: Government Satisfaction Scores (December 16, 2002), available at <http://www.theacsi.org/government/govt-02.html>.

¹³ *Id.*

The prior year's {on, the 2001 survey} survey showed a satisfaction rate of 77 points for electronic filers and 52 points for paper filers.¹⁴

Certain information concerning performance measures for customer satisfaction and the quality and accuracy of services is summarized in the table below.

¹⁴ 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 14, 2002, at 16.

**PROGRAM PERFORMANCE ANNUAL PERFORMANCE GOALS, MEASURES,
INDICATORS, AND INFORMATIONAL TABLE**

| Performance Measures | FY 2000 | FY 2001 | FY 2002 | | FY 2003 | FY 2004 |
|--|-------------|-------------|---------|-------------|-----------|-----------|
| | Performance | Performance | Target | Performance | Target | Proposed |
| Percent of individual returns filed electronically | 28% | 31% | 35% | 36% | 41% | 44% |
| Information returns filed electronically (thousands) | 219,739 | 330,239 | 474,700 | 376,063 | TBD | TBD |
| Information returns filed electronically (%) | 17% | 22% | 34% | 26% | TBD | TBD |
| IRS Digital Daily hits (billions) | 1.56 | 2.60 | 3.00 | 3.11 | 4.00 | 4.70 |
| Teletax and toll-free automated calls (thousands) | 49,700 | 76,117 | 75,000 | 63,796 | 50,000 | 50,000 |
| Assistor calls answered (thousands) | 32,300 | 32,091 | 33,750 | 30,525 | 33,700 | 35,000 |
| Toll-free customer satisfaction (% satisfied) | 58% | 59% | N/A | 56% | 56% | 57% |
| Toll-free customer satisfaction (% dissatisfied) | 2% | 2% | N/A | 2% | 2% | 2% |
| Toll-free level of service | 59.0% | 56.4% | 71.5% | 68.0% | 72.0% | 73.0% |
| Toll-free tax law quality | 73% | 76% | 78% | 81% | 86% | 88% |
| Toll-free account quality | 60% | 70% | 72% | 74% | 77% | TBD |
| Customer satisfaction (walk-in) (% satisfied) | 91% | 90% | N/A | 86% | 88% | 88% |
| Customer satisfaction (walk-in) (% dissatisfied) | 6% | 6% | N/A | 8% | 7% | 7% |
| Payment received electronically (thousands) | 63,380 | 64,366 | 67,438 | 66,029 | 66,200 | 67,100 |
| IRS Digital Daily downloads (millions) | 149 | 317 | 473 | 438 | 496 | 579 |
| Tax law contacts | N/A | 1,787,338 | N/A | 1,843,000 | 1,900,000 | 2,000,000 |
| Customer accounts correspondence quality | 78% | 79% | 85% | 75% | 79% | TBD |
| Accounts contacts | N/A | 3,000,000 | N/A | 3,110,000 | 3,300,000 | 3,600,000 |
| Toll-free tax law accuracy | N/A | N/A | N/A | N/A | 87% | 89% |
| Toll-free accounts accuracy | N/A | N/A | N/A | N/A | 91% | 93% |

Source: IRS Fiscal Year 2004 Performance Plan at PA-6, PA-7, (February 3, 2003).

B. The 2003 Filing Season

Overview

Acting Commissioner Wenzel testified that the 2003 tax filing season has been “smooth, with returns being processed on time, electronic filing increasing, and improved accessibility and accuracy of telephone service.”¹⁵ The General Accounting Office, in its preliminary review of the IRS’s performance during the 2003 filing season, agreed that the filing season so far has been smooth, electronic filing has continued to grow, telephone service has improved, and the IRS website has seen increased use.¹⁶ However, the General Accounting Office reports that staff resources for compliance continues to be a problem, but that potential exists for a reallocation of resources to compliance as the IRS’s modernization process proceeds.¹⁷

The IRS projects that net collections for calendar year 2003 will be approximately \$1.74 trillion compared with approximately \$2 trillion last year.¹⁸ During calendar year 2003, the IRS also projects that it will receive 175 million returns, including over 132 million individual returns, and the IRS expects to issue over 104 million individual refunds.¹⁹ As of March 28, 2003, the IRS reported that the average dollar amount per refund was up almost 2.33 percent from last year, and the average refund as of that date was \$2,010.²⁰ Acting Commissioner Wenzel testified that electronic filing by individuals has increased by 10 percent this year and that electronic filing will constitute about 41 percent of individual returns filed.²¹

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

¹⁵ Statement of Robert E. Wenzel, Acting Commissioner of Internal Revenue, before the Subcommittee on Oversight of the House Committee on Ways and Means (April 8, 2003) (hereinafter “Wenzel April 8, 2003, Testimony”) at 1.

¹⁶ Statement of James R. White, Director, Tax Issues, before the Subcommittee on Oversight of the House Committee on Ways and Means *Internal Revenue Service Assessment of Fiscal Year 2004 Budget Request and 2003 Filing Season Performance to Date* (April 8, 2003) (hereinafter “GAO April 8, 2003, Statement”) at 2, 12.

¹⁷ *Id.* at 17.

¹⁸ Wenzel, April 8, 2003, Testimony at 1.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.* at 2.

their tax refunds faster than taxpayers who file paper returns and, in general, electronic filing is more accurate than paper filing.

During the filing season, individual electronic filing increased by 10 percent and electronic filing on-line grew by 27 percent.²² For calendar year 2003, the IRS projected that electronic filing will constitute approximately 41 percent of the individual returns filed.²³ The IRS attributes the surge in the number of electronically filed returns to the Free File program.

As of April 3, 2003, the number of taxpayers filing electronically using an IRS authorized Electronic Return Originator increased 8.51 percent over last year for a total of \$31 million taxpayers. The number of taxpayers filing electronically from their home computer using a third party transmitter constituted 9.2 million taxpayers. Almost 27 million individual taxpayers have chosen to use their personal identification numbers instead of a written statement when e-filing on-line. In addition, 3.4 million taxpayers filed their returns over the telephone using the TeleFile system. The IRS also reported that nearly 30 million taxpayers have chosen direct deposit for their Federal tax refund, a 12.6 percent increase from the year before. The IRS reported that over 18 million taxpayers chose to file both their Federal and State tax returns simultaneously in a single electronic transaction, an increase of 16 percent from last year's 16.2 million.²⁴ The IRS states that 119 out of 127 individual tax forms may be filed electronically, and that the projected increase in the number of electronic returns is expected to rise from 54,310 in 2003 to 76,502 in 2007.²⁵

The General Accounting Office found that the IRS's filing season performance through mid-March 2003 has improved compared to recent years.²⁶ The General Accounting Office reported that through March 28, 2003, the IRS "smoothly processed" 67 million individual income tax returns of which 26 million were filed on paper and 41 million were filed electronically.²⁷ The General Accounting Office notes that although electronic filing is growing, growth is at a slower rate than projected. To help increase electronic filing, the IRS contracted with the Free File Alliance, a consortium of 17 tax preparation companies, to provide free online tax preparation and filing services for at least 60 percent of all taxpayers through the IRS

²² Wenzel, April 8, 2003, Testimony at 2.

²³ *Id.*

²⁴ *Id.*

²⁵ Appendix at 39-40.

²⁶ GAO April 8, 2003, Statement at 12.

²⁷ *Id.* at 12-13.

website.²⁸ As of March 26, 2003, approximately 2.1 million returns were filed through the consortium, the goal being 2.5 million.²⁹

Unlike last year, this year's annual report by the National Taxpayer Advocate did not list the cost of electronic filing for low-income taxpayers as one of the most serious problems encountered by taxpayers.³⁰

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 2003 filing season, the IRS added 7 additional forms to the individual e-filing program.

- Form 970 - Application to Use LIFO Inventory Method
- Form W-2G - Guam Wage and Tax Statement
- Form 1099G - Certain Government and Qualified State Tuition Program Payments
- Form 1310 - Statement of Person Claiming Refund Due to a Deceased Taxpayer
- Form 8594 - Asset Allocation Statement Under Sections 338 and 1060
- Form 8880 - Credit for Qualified Retirement Savings Contributions
- Form 8885 - Health Insurance Credit for Eligible Recipients³¹

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. For the 2003 filing season, taxpayers can sign their e-filed return in one of two ways, by using a Self-Select PIN or a Practitioner PIN both of which require entry of a five-digit number.³²

The Self-Select PIN program began in 2001, and by 2002, the 9.8 million taxpayers utilized the self-selected personal identification number option. The program authenticates taxpayers by requiring entry of the date of birth and the prior year's original adjusted gross income.³³

²⁸ *Id.*

²⁹ *Id.* at 14.

³⁰ Internal Revenue Service, *National Taxpayer Advocate Annual Report to Congress for Fiscal Year 2002*, Publication 2104 (December 31, 2002) (hereinafter "National Taxpayer Advocate FY 2002 Report").

³¹ Wenzel, April 8, 2003, Testimony at 3.

³² *Id.* at 6.

³³ *Id.*

The Practitioner PIN is an additional electronic signature option for taxpayers who use an Electronic Return Originator. Taxpayers must complete Parts I and II of Form 8879, IRS e-file Signature Authorization. In 2002, Practitioner PINS were used in filing 14.9 million returns. Thus far this filing season 18.4 million taxpayers have used the Practitioner PIN.³⁴

Expanded payment options.—Taxpayers who file electronically may pay their taxes electronically by authorizing a withdrawal of funds (on a date chosen by the taxpayer) from a checking or savings account. The IRS reported that in 2002, 454,278 taxpayers paid their taxes through electronic funds withdrawal, an increase of 24 percent over the prior year. So far this filing season, 207,688 taxpayers have paid their taxes through electronic funds withdrawal, an increase of 48.7 percent over the same period in 2002.³⁵

Paper and electronic filers may pay their taxes using a credit card. The IRS reported that in 2002, 313,385 taxpayers paid by credit card, an increase of 10 percent over the prior year. Thus far, this filing season, 116,810 taxpayers have used the credit card option.³⁶ The IRS does not charge a fee for credit card payments; however, the credit card companies do impose a “convenience” fee, which appears on the cardholder’s credit card statement.

Electronic filing for business taxpayers

The IRS states that it recognizes that electronic filing for businesses is very important for reducing the tax payment burden. For 2003, the IRS projects that over 4 million taxpayers will make tax payments using the Electronic Federal Tax Payment System (which now includes an online option). This compares to over 3.2 million taxpayers using the system in fiscal year 2002. Also in 2003, for the first time tax professionals are able to file employment taxes for business clients as part of a new Employment Tax e-filing system.

The IRS reports that it is upgrading electronic filing options for small business taxpayers to allow for more flexible filing (e.g., allowing Forms 940 and 941 to be filed in a single transmission), faster acknowledgements, integrated payment options, and more specific error information. Online applications for employer identification numbers will soon be possible.³⁷

Refund status

The IRS reports that taxpayers have several options for checking on the status of a refund, including a new service on the IRS website called “Where’s My Refund?” The IRS reports that the program provides refund information quickly, efficiently, and securely.³⁸ For the

³⁴ *Id.*

³⁵ *Id.* at 5.

³⁶ *Id.*

³⁷ *Id.* at 8.

³⁸ *Id.* at 3.

2003 fiscal year, the IRS expects 15 million hits on the “Where’s My Refund?” icon. The program is accessible to visually impaired taxpayers.

Alternatively, taxpayers without access to the Internet can obtain refund information by calling the toll-free IRS TeleTax System approximately four weeks after a return is filed (three weeks for e-file and six weeks for paper on average). For the 2002 fiscal year, more than 27 million taxpayers used the TeleTax system to check on the status of their refunds. As of March 22, 2003, it is estimated that 15.2 million taxpayers have checked on the status of their refunds using TeleTax, 3.9 million fewer from this time last year.³⁹

Another option allows Form 1040-type individual filers and joint filers to access the IRS refund hotline, an automated self-service device.⁴⁰

IRS website

Since its launch in January 2002, the revamped IRS website (www.irs.gov) continues to be extremely popular with taxpayers.⁴¹ The site was designed to make it easier for taxpayers to find information and to be more focused on: taxpayers as customers. The website is divided into categories of taxpayers, for example, the Small Business/Self-Employed Community, which compiles relevant information for the kind of taxpayer and thus makes the site easier to use. The new website 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. The website is in the process of being enhanced with registered user capability, electronic transcripts, and greater information availability.⁴²

As of March 15, 2003, the IRS website was listed as second in the Lycos search engine’s Top 50 searches.⁴³ In fiscal year 2002, the website recorded 3.11 billion hits and more than 437 million forms and publications were downloaded. For fiscal year 2002, the IRS answered 183,882 questions with an average response time of 2.5 days.⁴⁴ For fiscal year 2003 through

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.* at 6.

⁴² IRS Performance Plan at PA-2.

⁴³ Wenzel, April 8, 2003, Testimony at 6.

⁴⁴ Appendix at 5.

March 30, website hits totaled 2.4 billion, a more than 24.5 percent increase on the same period last year.⁴⁵

Braille tax material

A variety of Braille material may be ordered by phone at no charge or may be downloaded from the “Accessibility” portion of the IRS website. Included in the offering of accessible materials are 50 of the most popular individual tax forms in PDF format, i.e., “Talking Forms” that may be opened, filled-in, and printed for filing purposes by blind taxpayers using screen readers.⁴⁶

Tax materials and assistance in Spanish

Tax materials in Spanish are available in the form of recorded tax topics, free tax publications, toll-free telephone assistance, and TeleTax (toll-free automated service).⁴⁷ Taxpayers may also speak to a Spanish-speaking representative by calling a toll-free number between the hours of 7:00 a.m. and 10:00 p.m. on weekdays and 10:00 a.m. and 3:00 p.m. on Saturdays through April 13.⁴⁸ The IRS website has a special Spanish section.

Telephone and walk-in service

Telephone service

Assistors are available on weekdays from 7 a.m. to 10 p.m. Monday through Friday local time. During the filing season (January 25, through April 12, 2003), assistors also were available on Saturdays from 10 a.m. to 3 p.m., and on Sunday, April 13.⁴⁹

The IRS states that it has diligently worked to ensure the publication of local telephone numbers and addresses of IRS offices in the government blue pages telephone directories.⁵⁰ The IRS states that it has included contact information on its website called “How to contact my local office.” However, the IRS notes that multiple telephone and address listings have been difficult to implement because it does not have the resources to ensure publication in every local directory.

⁴⁵ Wenzel, April 8, 2003, Testimony at 6.

⁴⁶ *Id.* at 13.

⁴⁷ *Id.* at 12.

⁴⁸ *Id.*

⁴⁹ *Id.* at 10.

⁵⁰ Appendix at 11.

The IRS notes that through March 22, 2003, approximately 83.8 percent of taxpayers who wanted to speak with a customer service representative got through, compared to 69.4 percent in 2002.⁵¹ Telephone correct response rates for tax law and tax account questions have fallen slightly from last year and are at 81.1 percent and 87.9 percent, respectively (compared to 83.5 percent and 88.4 percent over the same period last year).⁵² The IRS notes that better service is being provided to taxpayers by screening tax law questions to identify the right customer service representative to handle a call. As a result, the call abandon rate was reduced from 13.8 percent to 7.8 percent, and the transfer rate was reduced from 21.6 percent to 17.5 percent.⁵³ Also, 26.7 million taxpayers (a 5.5 percent increase since last year) used automated services, including refund status, to obtain information.⁵⁴

The General Accounting Office found that this filing season, taxpayers are spending less time waiting to talk to an assistor. The General Accounting Office confirms that the rate at which callers receive accurate information from an assistor is down slightly, due in part to assistors having difficulty in adapting to a change in the guide used to query calls.⁵⁵ However, the General Accounting Office notes that IRS officials said that because taxpayers with simple questions about their refund now are using the website and not calling the IRS, assistors generally are handling more complex questions.

The General Accounting Office reports that the toll-free telephone lines have improved over the last year.⁵⁶ The IRS attributes improvements in telephone service to lower than expected call demand as a result of the new refund status check feature on the IRS's website and more effective call routing system to refer calls to an assistor trained in the pertinent topic.

The IRS Oversight Board reports that the IRS has improved its accuracy in correctly answering questions concerning tax law and taxpayer accounts on its toll-free telephone lines. The IRS Oversight Board notes that increased efficiencies have helped improve customer service, but additional resources are required to provide an appropriate level of service for taxpayers. For example, only seven out of 10 callers to the toll-free service were provided

⁵¹ Wenzel, April 8, 2003, Testimony at 10. The IRS noted that the increase in assistor service is attributable to a decrease in demand as well as the implementation of new lines and less complicated scripts. Appendix at 3.

⁵² Wenzel, April 8, 2003, Testimony at 11.

⁵³ *Id.* at 10.

⁵⁴ *Id.* at 11. The total automated call completed volumes reflect a 28% change for fiscal year 2003 (23,345,108) when compared to fiscal year 2002 (32,430,667). The IRS attributes the decline to the success of the electronic refund status feature. Appendix at 3.

⁵⁵ GAO April 8, 2003, Statement at 15.

⁵⁶ *Id.*

assistance.⁵⁷ The IRS Oversight Board notes that while this is an improvement over previous years, it falls short of taxpayer needs and expectations.

The National Taxpayer Advocate indicates that, although access to toll-free service has improved (bumping the issue from number 1 to number 18 of the most serious problems faced by taxpayers), the problem has shifted to the handling of calls once the taxpayer reaches the menu system.⁵⁸ The National Taxpayer Advocate indicates that many taxpayers call expecting live assistance, but 22 percent receive automated help instead.

The Treasury Inspector General for Tax Administration reports that the IRS has taken significant actions to be able to record calls to its toll-free telephone system. The IRS plans to implement a call recording system that can both capture the voice and screen data. The targeted implementation date is September 30, 2003, in time for the 2004 filing season.⁵⁹

Walk-in service

Walk-in service is available at numerous locations throughout the United States. At many walk-in sites, service was offered on 12 Saturdays through April 12, 2003. As of March 22, 2003, the IRS estimates that it had served over 4.53 million taxpayers at all Taxpayer Assistance Centers, with 3.15 million served this filing season.⁶⁰ For fiscal year 2001, the IRS estimated the number of tax law contacts (1,782,253) and account contacts (2,597,439). In fiscal year 2002, the number of tax law contacts and account accounts increased slightly to 1,869,831 and 3,183,665, respectively.⁶¹ The IRS stated that the customer satisfaction rate is at 88 percent satisfied and seven percent dissatisfied.⁶²

Taxpayers utilizing walk-in service can receive help with IRS notices, payment plans, tax liens and levies, innocent spouse claims, and offers in compromise. Courtesy return preparation is available for taxpayers with incomes of \$35,000 or less, thus ensuring assistance for taxpayers that qualify for the earned income credit. Free tax preparation and e-file are also available in many communities through the Volunteer Income Tax Assistance (“VITA”) and Tax Counseling for the Elderly (TCE) programs. As of March 22, 2003, the IRS estimated that return

⁵⁷ Internal Revenue Service Oversight Board Annual Report (April 2003) (hereinafter “IRS Oversight Board Report”) at 6.

⁵⁸ National Taxpayer Advocate FY 2002 Report at 125.

⁵⁹ Treasury Inspector General for Tax Administration, *The Internal Revenue Service has Made Substantial Progress Toward Recording Calls as Part of the Quality Assurance Monitoring of its Toll-Free Telephone Assistance*, Ref. No. 2003-30-043 (January 2003) at 1-2.

⁶⁰ The IRS does not currently measure the wait time at Taxpayer Assistance Centers. Appendix at 5.

⁶¹ Appendix at 4.

⁶² Wenzel, April 8, 2003, Testimony at 11.

preparation at VITA and TCE sites had increased approximately 28 percent over the same period in 2002.⁶³

According to the General Accounting Office, the quality of assistance at the IRS's walk-in sites has improved compared to last year, and service to taxpayers through community based coalitions has increased.⁶⁴ As of February 2003, the Treasury Inspector General for Tax Administration reports that the accuracy of tax law assistance has increased to 73 percent, an increase of 27 percentage points over the same period last year. The Treasury Inspector General for Tax Administration attributes the increased accuracy to IRS actions, including revising the guidelines used by walk-in staff, certifying staff proficiency, conducting monthly reviews of tax law accuracy, and taking immediate action to address review information relating to any incorrect answers or improper referrals found during the IRS or Treasury Inspector General quality reviews.⁶⁵

C. Other Service Issues

Employer identification numbers

The IRS acknowledges customer service shortcomings in the Employer Identification Number assignment process.⁶⁶ The National Taxpayer Advocate's Annual Report ranks "Obtaining Employer Identification Numbers" as of the most serious problems encountered by taxpayers because taxpayers who are unable to obtain Employer Identification Numbers within the specified timeframes have problems filing Federal and State returns and conducting their business.⁶⁷ The main issues are processing requests by third parties, handling bulk requests, and responding to requests when the IRS's computers are temporarily shutdown each year. Despite these issues, the National Taxpayer Advocate notes that in fiscal year 2002, the IRS implemented a number of improvements to reduce the burden of applying for an Employer Identification Number. The IRS consolidated Employer Identification Number services into three sites (from 10), now offers telephone service at consistent times, revised Form SS-4 (Application for Employer Identification Number) to improve third party authorization, installed a fax file server allowing for the receipt of multiple faxes, and developed an Employer Identification Number Internet application to provide taxpayers with the ability to request and receive such numbers online.

⁶³ *Id.*

⁶⁴ GAO April 8, 2003, Statement at 16.

⁶⁵ *Id.* (citing the findings of the Treasury Inspector General for Tax Administration).

⁶⁶ National Taxpayer Advocate FY 2002 Report at 135.

⁶⁷ *Id.*

Refunds

For fiscal year 2002, the IRS averaged 15 days to issue a refund from an electronic return and 30 days to issue a refund from a paper filed return. 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); in 1999, 14 days (electronic) and 35.09 (paper); and in 2001, 14.6 (electronic) and 28 (paper).⁶⁸

Burden reduction

One of the 10 major strategies included in the IRS Strategic Plan is to “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 returns and pay taxes owed. The IRS Oversight Board notes that as taxpayer demand for help continues to grow with increased tax code complexity, significant burdens are imposed on taxpayers to comply with and in the IRS to enforce the tax laws.⁶⁹ The IRS Oversight Board estimates that over the past five years, 19 public tax laws were passed, 293 tax code provisions were changed, and 414 alterations were implemented to forms and instructions.⁷⁰

The National Taxpayer Advocate has identified misplaced or lost payments by the IRS as an additional burden for taxpayers, requiring taxpayers to substantiate their payment, for example, by submitting a copy of a cancelled check.⁷¹ The IRS is in the process of developing an initiative called the Remittance Transaction Research to scan payments received at various processing centers and lockboxes in an effort to alleviate taxpayer burden. The initiative will be piloted in August 2003 and is tentatively scheduled for implementation in late 2003.

⁶⁸ Appendix at 6.

⁶⁹ IRS Oversight Board Report at 6.

⁷⁰ *Id.* at 9.

⁷¹ National Taxpayer Advocate FY 2002 Report at 147.

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, generally is not reported and often requires in-person auditing to verify. Also, business income generally can be verified only by auditing.⁷² The IRS estimated 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.⁷³

For a tax system that is based on voluntary collections, ensuring taxpayer compliance is critical. According to a survey performed by the IRS Oversight Board, it was "very important" to taxpayers that the IRS ensure that other taxpayers honestly pay what they owe. According to the survey, 83 percent of taxpayers ascribe such importance to ensuring that corporations pay tax honestly. The figure is 77 percent with respect to high-income taxpayers, 68 percent with respect to small business taxpayers, and 56 percent with respect to low-income taxpayers.⁷⁴ However, despite the importance of the compliance function, finding resources to meet compliance needs is difficult. As the IRS Oversight Board notes, from 1992 to 2002, workload (measured by returns filed) at the IRS increased by 16 percent while full time equivalent employees decreased by 16 percent. "As more resources were needed for the IRS to perform essential services, such as processing returns and answering correspondence, resources were shifted from discretionary operations, including compliance activities."⁷⁵

The result of the conflicting trends in workload and resources has led to a "compliance gap" -- more taxpayers who do not file or report honestly and less IRS capacity for audit and

⁷² Internal Revenue Service Accountability Report Fiscal Year 2001, Publication 3385 (Revised March 2002) at 8. The K-1 matching program is intended to verify income reported by pass-thru corporations, partnerships, and trusts.

⁷³ Internal Revenue Service Progress Report, From the Commissioner of the Internal Revenue Service (December 2001) at 25.

⁷⁴ IRS Oversight Board Report at A-2.

⁷⁵ *Id.* at 4.

enforcement. Former Commissioner Rossotti noted that during the 1992-2002 period, field compliance personnel decreased 28 percent, and concluded starkly that the “IRS is simply outnumbered when it comes to dealing with compliance risks.”⁷⁶ Between 1992-2001, coverage of all types fell dramatically: (1) document matching decreased from 33.1 percent of cases to 9.1 percent; (2) correspondence exams (not including the earned income credit) decreased from 4 to 1.2 percent; (3) in-person exam of individuals fell from 5.8 percent to 1.5 percent; and (4) exams of pass-thru entities decreased from 5.1 percent to 2.9 percent.⁷⁷ The Commissioner’s report also found that 60 percent of known tax debts are not pursued, 75 percent of non-filers are not identified or pursued; 79 percent of taxpayers who underreport by using abusive devices are not identified or pursued; and 78 percent of underreported tax found by document matching is not pursued.⁷⁸

The IRS is working to close the compliance gap by shifting resources, eliminating some processing centers, encouraging electronic filing, and using competitive sourcing for some services.⁷⁹ A new matching program will capture the data from over 16 million K-1 forms, which are used to report income, credits, and deductions of partners, shareholders and beneficiaries of passthru entities, and match it to individual taxpayer returns. Credit card summonses, the Offshore Voluntary Compliance Initiative, publicity campaigns, and a shift in emphasis are showing some results in combating tax abusive schemes and shelters. In addition, the IRS proposes to use private debt collection agencies to collect known tax debts and has developed the National Research Program to measure compliance. Nevertheless, although such efforts are critical, to close the compliance gap, former Commissioner Rossotti called for “a steady and consistent budget,” one that provides for a steady growth in staff of about 2 percent a year and steadily increased funding for modernization.⁸⁰

B. Enforcement Activity

The IRS’s goal in fiscal year 2002, like the year before, was to stop the long-term decline in compliance and also to focus resources on the principal areas of noncompliance. The Commissioner cites six of the most serious compliance areas: (1) tax shelter promoters; (2) abuse of trusts and offshore accounts to hide or improperly reduce income; (3) abusive corporate tax shelters; (4) underreporting by high-income individuals; (5) accumulation and failure to pay

⁷⁶ Commissioner Charles O. Rossotti, *Report to the IRS Oversight Board: Assessment of the IRS and the Tax System* (September 2002) at 15.

⁷⁷ *Id.*

⁷⁸ *Id.* at 16.

⁷⁹ IRS Oversight Board Report at 5.

⁸⁰ Commissioner Charles O. Rossotti, *Report to the IRS Oversight Board: Assessment of the IRS and the Tax System* (September 2002) at 18.

large amounts of employment taxes by some employers; and (6) the high rate of erroneous earned income credit payments.⁸¹

As to tax shelter promoters, the Commissioner highlights that the IRS's efforts are showing results: 27 promoter injunctions granted and 27 pending, 372 civil promoter field investigations, 464 ongoing criminal investigations, and leads on 80 offshore promoters from the recently concluded Offshore Voluntary Compliance Initiative.⁸²

The IRS reports that to identify tax shelter promoters, the IRS established a Lead Development Center in April 2002. The Lead Development Center centralizes the receipt and development of leads on promoters received from practitioners and taxpayers, authorizes and monitors promoter investigations, and promotes and effects the coordination of a parallel investigation within IRS Criminal Investigation. As of April 1, 2003, about 1,100 leads had been received and, as of March 1, 2003, 267 investigation referrals were being worked in the field. The IRS attributes the new procedure for processing and referring promoter leads to quicker injunctions by the Justice Department and reports 22 granted injunctions arising from the new procedures as of April 1, 2003. In addition, the IRS is conducting extensive training of personnel in conducting promoter investigations.⁸³

In addition, the IRS states that summonses to financial and commercial businesses to obtain information on U.S. residents with credit, debit, or other payment cards issued by offshore banks is helping to identify promoters and participants. After culling the information received from the summonses, the IRS revised downward an early estimate of 1-2 million cardholders involved in schemes, to hundreds of thousands of taxpayers. From the information, the IRS has developed over a thousand cases for civil audits or potential criminal investigation and is increasing resources to work these cases.⁸⁴ As of March 13, 2003, the Justice Department had filed seven summons enforcement petitions against individual taxpayers related to the offshore credit card project.⁸⁵

Under the Offshore Voluntary Compliance Initiative, the IRS offered taxpayers the opportunity to disclose improper activity to the IRS. Taxpayers coming forward are required to pay back taxes, interest, and certain accuracy penalties, but do not have to face civil fraud and information return penalties, or criminal prosecution (based upon the application of the voluntary

⁸¹ Statement of Mark W. Everson, Commissioner of Internal Revenue, before the House Appropriations Subcommittee on Transportation, Treasury and Independent Agencies (May 7, 2003) at 3.

⁸² *Id.* at 4.

⁸³ Statement of Dale Hart, Deputy Commissioner, Small Business/Self-Employed Operating Division, before the Senate Committee on Finance (April 1, 2003) at 13-14.

⁸⁴ *Id.* at 15-16.

⁸⁵ *Id.* at 19.

disclosure practice).⁸⁶ The Offshore Voluntary Compliance Initiative opened in January 2003 and ended on April 15, 2003. The IRS's initial report on the initiative is that 1,253 taxpayers from 46 states and 48 countries applied, at least \$50 million in uncollected tax has been identified, and 80 new promoter cases (of the first 229 cases reviewed) have been identified.⁸⁷

With respect to the earned income credit, the IRS has requested an additional \$100 million (and 650 full time equivalents) in the fiscal year 2004 budget to start a new strategy for improving the earned income credit program. The approach would require that the IRS gather certain eligibility criteria before paying the earned income credit refund. The IRS aims to minimize taxpayer burden by using existing databases and other sources to establish eligibility in advance.⁸⁸ The General Accounting Office notes that many details about the implementation of this initiative have not been determined and stresses that success will depend on careful planning and attention by IRS management.⁸⁹

The IRS lists progress on enforcement in several other areas, including slavery reparations (two recent lawsuits); tax avoidance schemes (successful suits asking for injunction against 35 promoters in the past two years); shut-down of or lawsuits against eight websites that permitted tax shelters; early detection of \$350 million in fraudulent refund claims by the Criminal Investigation fraud detection centers in calendar year 2002; conviction of 227 non-filers in fiscal year 2002 (out of 503 non-filer investigations and 233 indictments); conviction of 41 taxpayers in employment tax withholding cases in fiscal year 2002 (out of 92 investigations and 55 indictments); convictions of 26 taxpayers in abusive trust schemes in fiscal year 2002 (out of 108 investigations and 44 indictments), up from 79 investigations and 32 indictments in fiscal year 2001; and 254 investigations for return preparer fraud in fiscal year 2002 (more than double from the year before).⁹⁰

The IRS notes that it listed the "dirty dozen" tax shelters and schemes on the IRS website and is working to combat those and other shelters in many ways. Publicity and media outreach sends the IRS message on tax shelters to up to 10,000 media outlets, and the public affairs office of the IRS Criminal Investigation division has significantly increased publicity of legal actions taken. The IRS has been using the Internet as well, by establishing links between the IRS website and websites of the Departments of Treasury and Justice on tax shelters. The IRS is working with the private sector to fight tax schemes, for example, the American Bar Association

⁸⁶ *Id.* at 17-18.

⁸⁷ Statement by Treasury Assistant Secretary for Tax Policy, Pam Olson, (May 1, 2003) IR-2003-58.

⁸⁸ Statement of Dale Hart, Deputy Commissioner, Small Business/Self-Employed Operating Division, before the Senate Committee on Finance (April 1, 2003) at 18.

⁸⁹ General Accounting Office, *Compliance and Collection: Challenges for IRS in Reversing Trends and Implementing New Initiatives* (May 7, 2003) GAO-03-732T at 12.

⁹⁰ Statement of Dale Hart, Deputy Commissioner, Small Business/Self-Employed Operating Division, before the Senate Committee on Finance (April 1, 2003) at 19-24.

website informs taxpayers of their rights and responsibilities. The IRS comments that the publicity works, as inquiries on Internet search engines such as Google typically result in referral to the IRS or a newspaper article.⁹¹ Other forms of outreach include development of educational programs to refute tax schemes that are sent to external stakeholders and high-profile seminars and speeches.

Enforcement actions increased in fiscal year 2002. For example, levies, liens, and seizures all increased significantly from fiscal years 2000 and 2001. Levies (which tripled in 2001) doubled in fiscal year 2002, to 1,321,795; liens (which doubled in 2001) increased approximately 23 percent in fiscal year 2002, to 528,020; and seizures (which jumped from 74 to 234 in 2001) increased to 296 in fiscal year 2002.⁹² Total liens in fiscal year 2002 nearly reached fiscal year 1997 levels, while levies and seizures are still far below fiscal year 1997 levels (e.g., levies were approximately 36 percent of 1997 levels, liens approximately 79 percent, and seizures approximately 3 percent).⁹³ Enforcement revenue increased slightly above fiscal year 2001 levels (from \$33.8 billion to \$34.1 billion), still below the \$37.2 billion collected in fiscal year 1997.⁹⁴

The IRS Oversight Board reports that enforcement activity generated \$371 million more in fiscal year 2002 than in fiscal year 2001 and the IRS launched several new initiatives aimed at improving overall compliance. However, the IRS Oversight Board notes that the gap between new delinquent accounts and delinquent accounts closed grew once again.⁹⁵ The IRS Oversight Board endorses the following IRS responses to the compliance gap: (1) focus compliance resources on key areas, such as tax shelter promotions and the use of off-shore accounts; (2) tailored examinations, such as the Limited Issue Focused Examination program, under which the IRS and large and mid-size business taxpayers agree on a dollar threshold below which issues will not be raised; (3) reorganization of paper processing centers and encouragement of electronic filing; (4) investments in pre-filing taxpayer education; (6) measuring compliance through the National Research Program; and (7) improvement of tax debt collection, including the use of carefully monitored private debt collection agencies. The IRS Oversight Board also notes that the IRS needs to improve implementation of programs, such as the K-1 matching and offer in compromise programs, to succeed in closing the compliance gap.⁹⁶

⁹¹ Statement of Dale Hart, Deputy Commissioner, Small Business/Self-Employed Operating Division, before the Senate Committee on Finance (April 1, 2003) at 8-11.

⁹² Appendix at 55 (showing a table reflecting these numbers).

⁹³ *Id.*

⁹⁴ *Id.* at “Appendix IV” of the Appendix.

⁹⁵ IRS Oversight Board Report at 6.

⁹⁶ *Id.* at 7-8.

C. Audit Activity

An important role of audits is to verify major categories of income and deductions. In fiscal year 2002, the number of individual returns audited (including service center or correspondence audits) was approximately 744,000, an increase of 12,000 returns over fiscal year 2001. 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.⁹⁷ The audit rate for high-income individuals (\$100,000 and over) decreased from approximately 4 percent in 1993 to about .8 percent today. The audit rate for middle-income taxpayers (\$25,000 to \$100,000) increased from about .8 percent in 1993 to 2 percent in 1996 and then fell back to about .8 percent in 2002. The audit rate for low-income taxpayers (below \$25,000, mostly earned income credit claims) decreased from about .8 percent in 1993 to approximately .4 percent in 2002. In comparing the audit rate for all taxpayers (including correspondence audits) from 1993 through 2002, the rate dropped 38 percent (from .92 to .57 percent) even though it rose significantly between 1993 and 1995.⁹⁸ It is estimated that the average completion cycle for individual audits by a revenue agent in fiscal year 2002 is 313 days, down from 377 days in fiscal year 2001 but above 299 days in fiscal year 1997.⁹⁹

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 2001.¹⁰⁰ The audit rate for all large corporations has declined significantly since fiscal year 1997 (12,972 closures) to fiscal year 2002 (8,443 closures), and the decrease for small corporations is more dramatic, from fiscal year 1997 (56,323 closures) to fiscal year 2002 (14,665 closures).¹⁰¹

Further, technical staffing levels for audit activity have declined, from 13,647 revenue agents in fiscal year 1998 to 11,598 in 2001, and 11,176 in 2002, and from 2,113 tax compliance

⁹⁷ Appendix at 42.

⁹⁸ General Accounting Office, *Compliance and Collection: Challenges for IRS in Reversing Trends and Implementing New Initiatives* (May 7, 2003) GAO-03-732T at 3-5.

⁹⁹ Appendix at 42.

¹⁰⁰ Internal Revenue Service Progress Report, From the Commissioner of the Internal Revenue Service (December 2001) at 25.

¹⁰¹ Appendix at 42. 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 still reflect a decrease. For example, in fiscal year 1997 the Automated Underreporter Program closed 1,598,471 cases and sent 3,500,804 letters compared to 1,491,139 cases and 2,895,927 letters in fiscal year 2002. For the Automated Substitute for Return Program, in fiscal year 1997, 392,598 cases were closed and 525,432 letters were sent compared to 242,637 cases closed and 162,918 letters sent in fiscal year 2002. *Id.* at 8.

officers in fiscal year 1998 to 1,420 in 2001, and 1,212 in 2002.¹⁰² The decline in staffing levels is attributed to an increased workload and unbudgeted costs.

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 .39 percent.¹⁰³ In 2001, these entities filed over 23 million Schedule K-1 forms reporting over \$1 trillion of income.

In response to this concern, in 2002 the IRS implemented a K-1 matching program as a means of ensuring that Schedule K-1 income is reported.¹⁰⁴ The intent of the program is to match items that are reported by the business entity on Schedule K-1 with the reporting of such items by individual taxpayers. The initial launch of the program resulted in 65,000 notices being sent to taxpayers, at least 25 percent of which were erroneous. Complaints from taxpayers led the IRS to stop sending notices, and the matching program ceased in August 2002.¹⁰⁵ The IRS has since revised the K-1 matching program to improve the screening of information received and announced on March 10, 2003, that notices inquiring about 2001 tax returns will be sent out later in the year. The IRS has implemented measures to ensure that notices are not sent to taxpayers erroneously and includes a longer-term plan to revise Schedule K-1 and Schedule E, Supplemental Income.¹⁰⁶

D. Measuring Compliance -- National Research Program

The IRS has acknowledged 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.¹⁰⁷ Because reliable and timely financial, operational, and

¹⁰² *Id.* at 43. Former IRS Commissioner Rossotti highlighted the need to increase staffing levels at an annual rate of two percent to address compliance and collection performance.

¹⁰³ Internal Revenue Service Progress Report, From the Commissioner of the Internal Revenue Service (December 2001) at 25.

¹⁰⁴ Internal Revenue Service, *IRS Issues Tips on Completing Schedules K-1; Matching Program Resumes with Improvements*, IR-2003-27 (March 10, 2003).

¹⁰⁵ Treasury Inspector General for Tax Administration, *The Internal Revenue Service Could Reduce the Number of Unnecessary Notices Sent to Taxpayers Regarding Unreported Income from Schedules K-1*, Ref. No. 2003-30-071 (March 14, 2003) at 2.

¹⁰⁶ Internal Revenue Service, *IRS Issues Tips on Completing Schedules K-1; Matching Program Resumes with Improvements*, IR-2003-27 (March 10, 2003).

¹⁰⁷ Internal Revenue Service Accountability Report Fiscal Year 2001, Publication 3385 (Revised March 2002) at 9.

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 \$283 billion in fiscal year 1998.¹⁰⁸ The IRS notes that this estimate is based on compliance data related to 1988 and earlier. The relative 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. Without a means to measure noncompliance, the total tax gap is difficult to estimate.

To address these concerns, the IRS has developed a new program, the National Research Program, to measure filing compliance (percentage of taxpayers filing timely returns), payment compliance (percentage of tax payments paid in a timely manner), and reporting compliance (percentage of tax liability accurately reported). Unlike its predecessor (the Taxpayer Compliance Measurement Program), the National Research Program will not rely heavily on time-intensive, line-by-line audits for establishing a baseline measure of reporting compliance. Rather, the National Research Program's components include: (1) a random sample of individual tax returns; (2) specially trained examiners; (3) tools to verify many items reported on a tax return without the need to contact a taxpayer; (4) classification measures for determining the level of a particular audit and which items must be verified; and (5) structured procedures and managerial reviews for examinations.¹⁰⁹

The National Research Program is designed to review approximately 49,000 individual tax returns randomly selected from a population of over 129 million returns.¹¹⁰ One of the guiding principles of the National Research Program is to lessen taxpayer burden while still obtaining a sample sufficient to catch tax cheating and to help reduce audits of compliant taxpayers. 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 and for identification purposes in areas of noncompliance. The General Accounting Office states that if the National Research Program is implemented as planned (the initial launch was scheduled for October 2002), it should provide valuable data.¹¹¹

¹⁰⁸ Appendix at Appendix IV.

¹⁰⁹ General Accounting Office, *New Compliance Research Effort is on Track, but Important Work Remains* (June 2002) GAO-02-769 at 7.

¹¹⁰ *Id.* at 2.

¹¹¹ General Accounting Office, *Major Management Challenges and Program Risks* (January 2003) GAO-03-109 at 10.

E. Private Collection Agencies

In fiscal years 1996 and 1997, the Congress earmarked \$13 million for the IRS to test the use of private debt collection companies. There were several constraints on this pilot project. First, because both IRS and Office of Management and Budget considered the collection of taxes to be an inherently governmental function, only government employees were permitted to collect the taxes. The private debt collection companies were utilized to assist the IRS in locating and contacting taxpayers, reminding them of their outstanding tax liability, and suggesting payment options. If the taxpayer agreed at that point to make a payment, the taxpayer was transferred from the private debt collection company to the IRS. Second, the private debt collection companies were paid a flat fee for services rendered; the amount that was ultimately collected by the IRS was not taken into account in the payment mechanism.

The pilot program was discontinued because of disappointing results. General Accounting Office reported that IRS collected \$3.1 million attributable to the private debt collection company efforts;¹¹² expenses were also \$3.1 million. In addition, there were lost opportunity costs of \$17 million to the IRS because collection personnel were diverted from their usual collection responsibilities to work on the pilot.

The IRS has in the last several years expressed renewed interest in the possible use of private debt collection companies; for example, IRS recently revised its extensive Request for Information concerning its possible use of private debt collection companies.¹¹³

In general, Federal agencies are permitted to enter into contracts with private debt collection companies for collection services to recover indebtedness owed to the United States.¹¹⁴ That provision does not apply to the collection of debts under the Internal Revenue Code.¹¹⁵

On February 3, 2003, President Bush submitted to the Congress his fiscal year 2004 budget proposal,¹¹⁶ which proposed the use of private debt collection companies to collect

¹¹² General Accounting Office, *Issues Affecting IRS' Collection Pilot* (July 18, 1997) GAO/GGD-97-129R.

¹¹³ TIRNO-03-H-0001 (February 14, 2003), at www.procurement.irs.treas.gov. The basic request for information is 104 pages, and there are 16 additional attachments.

¹¹⁴ 31 U.S.C. sec. 3718.

¹¹⁵ 31 U.S.C. sec. 3718(f).

¹¹⁶ See Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2004* (H. Doc. 108-3). In general, the tax provisions are described in *Analytical Perspectives* (Vol. III), pp. 66-81.

Federal tax debts.¹¹⁷ Shortly thereafter, the Department of the Treasury released its explanation of the President's revenue proposals.¹¹⁸

The budget proposal permits the IRS to use private debt collection companies to locate and contact taxpayers owing outstanding tax liabilities¹¹⁹ of any type¹²⁰ and to arrange payment of those taxes by the taxpayers. Several steps are involved. First, the private debt collection company contacts the taxpayer by letter.¹²¹ If the taxpayer's last known address is incorrect, the private debt collection company searches for the correct address. The private debt collection company is not permitted to contact either individuals or employers to locate a taxpayer. Second, the private debt collection company telephones the taxpayer to request full payment.¹²² If the taxpayer cannot pay in full immediately, the private debt collection company offers the taxpayer an installment agreement providing for full payment of the taxes over a period of as long as three years. If the taxpayer is unable to pay the outstanding tax liability in full over a three-year period, the private debt collection company obtains financial information from the taxpayer and will provide this information to the IRS for further processing and action by the IRS.

The proposal specifies several procedural conditions under which the proposal would operate. First, provisions of the Fair Debt Collection Practices Act would apply to the private debt collection company. Second, taxpayer protections that are statutorily applicable to the IRS would also be made statutorily applicable to the private sector debt collection companies. Third, the private sector debt collection companies would be required to inform taxpayers of the availability of assistance from the Taxpayer Advocate.

¹¹⁷ *Budget* (Vol. 1), p. 274.

¹¹⁸ See Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals* (February 2003) at 98.

¹¹⁹ There must be an assessment pursuant to section 6201 in order for there to be an outstanding tax liability.

¹²⁰ The proposal generally applies to any type of tax imposed under the Internal Revenue Code. The Treasury anticipates that the focus in implementing the proposal will be: (a) taxpayers who have filed a return showing a balance due but who have failed to pay that balance in full; and (b) taxpayers who have been assessed additional tax by the IRS and who have made several voluntary payments toward satisfying their obligation but have not paid in full. The Treasury anticipates that the IRS will commence implementation of the proposal with debts owed by individuals.

¹²¹ Several portions of the proposal require that the IRS disclose confidential taxpayer information to the private debt collection company. Section 6103(n) permits disclosure for "the providing of other services ... for purposes of tax administration." Accordingly, no amendment to 6103 appears to be necessary to implement the proposal.

¹²² The private debt collection company is not permitted to accept payment directly. Payments are required to be processed by IRS employees.

The proposal creates a revolving fund from the amounts collected by the private debt collection companies. The private debt collection companies would be paid out of this fund. Their compensation would be “based upon a number of factors, including quality of service, taxpayer satisfaction, and case resolution, in addition to collection results.”¹²³

The Treasury Inspector General for Tax Administration reports that the IRS’s preliminary planning approach for the use of private collection agencies has been good, despite the fact that improvements are needed to ensure that: (1) taxpayer rights are protected; (2) private data is adequately secured; projects are appropriately managed; and (3) the backgrounds of contractor employees are adequately investigated.¹²⁴

The IRS Oversight Board notes that the private collection agencies would allow the IRS to concentrate its resources on more complex cases.¹²⁵ The IRS Oversight Board supports the use of private collection agencies and, if the proposal is enacted, intends to monitor the initiative to ensure that taxpayers’ rights and confidentiality are maintained. In the interim, the IRS Oversight Board expects the IRS to continue to research ways to manage this initiative.

The General Accounting Office reports that the use of private collection agencies would require the IRS to monitor: (1) the capacity to fulfill responsibilities under proposed contracts; (2) delinquent debts with the highest probability of resolution; (3) referral rate of cases that are transferred back to the IRS; (4) resources needed to administer contracts and oversee the private collection agency’s performance; (5) factors in determining the level of private collection agency employee compensation; and (6) funding mechanisms.¹²⁶

The National Taxpayer Advocate reports that its focus is placed on preserving taxpayer rights and developing processes to afford taxpayers the same procedural and statutory protections in dealing with private contractors, and will continue to monitor the implementation phase.¹²⁷

¹²³ Treasury *General Explanations*, at 99.

¹²⁴ Statement of Pamela Gardiner, Acting Inspector General for Tax Administration, before the Subcommittee on the Departments of Transportation and Treasury, and Independent Agencies (March 12, 2003) at 3.

¹²⁵ IRS Oversight Board Report at 8.

¹²⁶ GAO May 7, 2003, Statement at 19-21.

¹²⁷ National Taxpayer Advocate FY 2002 Report at 397.

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 workplace 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 2000.¹²⁸ This number decreased to 51 percent in 2001, a 14 percent decrease from fiscal year 2000.¹²⁹ For 2002, the IRS's annual survey of employee satisfaction showed an increase of 4 percent from 2001, which the IRS Oversight Board says may indicate an upward trend, reflective of employee adjustments to IRS restructuring.¹³⁰ By contrast, a year ago, the IRS Oversight Board explicitly noted that IRS employee morale and job satisfaction were not adequate.¹³¹ Employee morale also may be affected by the use of performance agreements, which link individual employee performance expectations to agency-wide goals. The IRS Oversight Board states that the IRS has implemented such performance agreements at the executive level and for senior managers, and is implementing a similar performance management system and pay banding for front-line managers, and expresses support for the effort.¹³²

This year, IRS Oversight Board focused on the issue of human capital management. The IRS Oversight Board notes that many IRS employees are nearing retirement age and that the IRS must be prepared to train and invest in new employees. The IRS Oversight Board stresses that the IRS must implement a systemic approach to agency-wide training, especially as modernized technology becomes the norm.

¹²⁸ Internal Revenue Service Progress Report, From the Commissioner of the Internal Revenue Service (December 2001) at 39.

¹²⁹ *Id.* 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.

¹³⁰ IRS Oversight Board Report at 13.

¹³¹ *Id.* at 9.

¹³² *Id.* at 13.

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;¹³³
- (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;
- (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.¹³⁴

¹³³ 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).

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.¹³⁵ 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 exist 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 March 31, 2003, there were 490 substantiated violations of section 1203.¹³⁶ Of the 490 substantiated violations, 386 were for failure to file a Federal tax return.¹³⁷ Of the 3,970 completed section 1203 inquiries, 2,446 inquiries found that the allegation was not substantiated; 1,034 inquiries were found to constitute non-section 1203 misconduct.¹³⁸ Eighty-one employees have been removed for section 1203 violations, 60 of whom were removed for willful failure to timely file a Federal tax return.¹³⁹

¹³⁴ IRS Reform Act, sec. 1203(b).

¹³⁵ *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.*

¹³⁶ “Appendix I.b” of the Appendix.

¹³⁷ *Id.*, *see* “Appendix I.a-d” of the Appendix for a more detailed breakdown of section 1203 violations.

¹³⁸ “Appendix I.b” of the Appendix.

¹³⁹ *Id.*

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 1203.¹⁴⁰

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.¹⁴¹

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.¹⁴² Thus, 75 percent of tax compliance cases result in mitigation, half of all cases involve refund returns, and 74 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 enable the IRS to address the most significant problems of section 1203. 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.¹⁴³

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."¹⁴⁴ In addition, the IRS notes that focus groups and surveys consistently report that

¹⁴⁰ See Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals* (February 2003) at 86.

¹⁴¹ Appendix at 29.

¹⁴² *Id.*

¹⁴³ *Id.* at 30.

¹⁴⁴ *Id.* at 32.

there is a link between section 1203 and a decline in enforcement activity.¹⁴⁵ 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 states that procedures other than section 1203 affect the termination of IRS employees. For example, the implementing regulations of the Office of Personnel Management, Treasury, and the IRS provide for termination of employment “for such cause as will promote the efficiency of the Federal service.”¹⁴⁶ The process for imposing a particular penalty is prescribed by the Office of Personnel Management. Under the procedure, an employee is given written notice of the charges and is permitted to respond to the notice before receiving a determination. The employee is given the opportunity to appeal an adverse decision.

The General Accounting Office reports that known problems, such as lengthy investigations and conflicts of interest during investigations, may have reduced the effectiveness of the section 1203 procedure, as well as the morale and productivity of enforcement personnel.¹⁴⁷ The General Accounting Office reports that although the IRS and the Treasury Inspector General for Tax Administration have taken steps to improve the section 1203 process, the extent of the progress cannot be measured because their uncoordinated approaches to reform have not been based on consistent types of results-oriented goals, measures, and performance data. The General Accounting Office concluded that the section 1203 process needs evaluation and identified three guidelines: (1) results-oriented goals for processing section 1203 cases; (2) performance measures that are balanced and can be used to assess progress towards these goals; and (3) methods for collecting and analyzing performance data related to the goals and measures.¹⁴⁸

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.

¹⁴⁵ See, e.g., General Accounting Office, *IRS and TIGTA Should Evaluate Their Processing of Employee Misconduct Under Section 1203* (February 14, 2003) GAO-03-394.

¹⁴⁶ Appendix at 31.

¹⁴⁷ General Accounting Office, *IRS and TIGTA Should Evaluate Their Processing of Employee Misconduct Under Section 1203* (February 14, 2003) GAO-03-394 at 19.

¹⁴⁸ *Id.* at 24.

- 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.
- 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

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 as of March 31, 2003, five Streamlined Critical Pay 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.¹⁴⁹ The IRS Oversight Board finds that critical pay “has helped provide needed talent and should continue.”¹⁵⁰

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 the contributions of critical pay personnel to Business Systems Modernization, the launching of the new IRS website, development of a backup to the master file as a response to the September 11 terrorist attacks, implementation of a modernized help desk and an automated inventory database, the Internet Refund/Fact of Filing Program, development of strategic alliances between the IRS and external stakeholders, development of pre-filing education initiatives, an initiative to combat abusive corporate tax shelters, and implementation of an electronic crimes unit within Criminal Investigations.¹⁵¹

In recruiting critical pay personnel, the IRS spent \$1,693,572 for moving expenses. The moving expense program for critical pay personnel is the same as for career personnel except the IRS Reform Act covers an executive’s first move prior to government service) the IRS spent \$3,623,979 on executive searches, of which \$1,881,553 is directly attributable to 26 critical pay hires (with two searches currently in progress).¹⁵²

In contrast to a year ago, the IRS states that if more IRS employees were eligible for Streamlined Critical Pay positions, more would not be accomplished.¹⁵³

Loss of Streamlined Critical Pay executives

From the passage of the IRS Reform Act in July 1998 through March 31, 2003, the IRS has hired 49 Streamlined Critical Pay executives, 32 of which currently are working for the IRS.¹⁵⁴ Through March 31, 2003, 17 Streamlined Critical Pay executives have left the IRS. The

¹⁴⁹ Appendix at 32.

¹⁵⁰ IRS Oversight Board Report at 13.

¹⁵¹ For additional details on these and other contributions by critical pay executives, *see* Appendix at 36-38.

¹⁵² *Id.* at 33.

¹⁵³ *Id.* at 38.

¹⁵⁴ *Id.* at 34-35.

average tenure of the executives who have left is 21 months, with some staying as few as five months and others as long as 42 months. Six departed executives stayed more than two years.¹⁵⁵

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 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.¹⁵⁶ 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.¹⁵⁷ 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.¹⁵⁸

In September 1999, a balanced measures regulation was issued to formally establish the new performance management system.¹⁵⁹ The IRS implemented the balanced measures system for the Examination, Collection, and Customer Service Divisions in 1999.¹⁶⁰ 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.¹⁶¹

The General Accounting Office reports that the IRS has made progress in revising its performance management system to better utilize available resources, but that additional work is required to design and implement performance measures for supporting ongoing business operations, modernization efforts, and budget requests.¹⁶² The General Accounting Office

¹⁵⁵ For a table showing current and departed executives, as well as salaries prior to and during IRS service, *see id.*

¹⁵⁶ 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).

¹⁵⁷ IRS Strategic Plan at 91.

¹⁵⁸ *Id.*

¹⁵⁹ *Id.* at 88.

¹⁶⁰ *Id.* at 93.

¹⁶¹ *Id.*

¹⁶² General Accounting Office, *Major Management Challenges and Program Risks* (January 2003) GAO-03-109 at 12-13.

recommends that the IRS take steps to: (1) ensure that its organizational performance measures are objective and reliable, consistent over time, and limited to key performance indicators; (2) improve its ability to measure program performance, utilize resources, and improve service and compliance; (3) better link budget requests with program results; and (4) better manage human capital.

The IRS Oversight Board finds that the IRS has made progress in measuring its performance over the past five years and that IRS decision-makers now have a much better sense of assessing the IRS's performance. However, the IRS Oversight Board believes that the IRS has to establish standards for measuring long-term strategic goals, especially to assess levels of compliance. The IRS Oversight Board says that to this end, the IRS has established an Executive Steering Committee to develop long-term goals in consultation with the public, and finds that the National Research Program (discussed at Part II.D. of this Report), will help to measure compliance.¹⁶³

¹⁶³ IRS Oversight Board Report at 14.

IV. ORGANIZATIONAL AND TECHNOLOGICAL MODERNIZATION

A. Overview

Modernization is a massive project that touches the IRS at every level. Structurally, the IRS Reform Act mandated a complete reorganization of the IRS, to shift its focus from geography to function. Mechanically, the goal set in 1998 was to modernize dated technology, upgrade computer systems from the 1960's into the 21st century, and improve management processes and performance measures. As the General Accounting Office recently stated, the many components of modernization are interrelated, "for example, new technology will support revamped practices, and performance measures will be used to ensure accountability. Each component, by itself, is a major effort. Because the components are interrelated, IRS must make progress on all of the components in a coordinated fashion."¹⁶⁴ In general, modernization of the IRS is very much a work still in progress. As described below, technical modernization continues to present many challenges while organizational modernization is largely complete, though the aftereffects are still being felt.

B. 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 10 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.¹⁶⁵

The IRS has now reorganized into 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 key IRS offices, including Chief Counsel, Appeals, the Taxpayer Advocate Service, Criminal Investigation, and

¹⁶⁴ General Accounting Office, *Major Management Challenges and Program Risks* (January 2003) GAO-03-109 at 4.

¹⁶⁵ IRS Reform Act sec. 1001.

Communications and Liaison. 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. The Wage and Investment Division has three organizational offices: one designed to assist taxpayers in understanding their tax obligations (Communications, Assistance, Research and Education), one designed to work with taxpayers during the filing process (Customer Account Services), and one focused on compliance (Compliance), especially exemptions for dependents, credits, filing status, and deductions.

The Small Business and Self-Employed Division (assets under \$10 million) serves approximately 45 million taxpayers, including about seven million small businesses and about 33 million taxpayers who are fully or partially self-employed. 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 routine transactions with the IRS each year. The Small Business and Self-Employed Division carries out its functions through three organizations: Taxpayer Education and Communication, Customer Account Services, and Compliance. The IRS notes that it intends to develop criteria over time to help better categorize businesses as small or large, because the \$10 million asset test is not always the best indicator of whether a taxpayer is better served by the Small or Large Business Division. Some small businesses that require technical expertise of the Large and Mid-Size Business Division often are serviced there.¹⁶⁶

The Large and Mid-Size Business Division serves C corporations, S corporations, and partnerships with assets greater than \$10 million. These taxpayers employ many workers, have complicated tax and accounting issues, and operate in a global environment. The Large and Mid-Size Business Division is organized into five industries (Communications, Technology and Media; Financial Services; Heavy Manufacturing and Transportation; Natural Resources and Construction; and Retailers, Food, Pharmaceuticals, and Healthcare) and one examination function.

The Tax-Exempt and Government Entities division serves three distinct taxpayer segments: employee plans, exempt organizations, and government entities. Over three million entities are covered, including local community organizations, municipalities, universities, pension funds, State and local governments, and Indian tribal governments. This division also handles tax-exempt bond issues. The division serves four basic customer needs: education and communication; rulings and agreements; examination; and customer account services.

¹⁶⁶ Information is available at the IRS website, www.irs.gov.

IRS functional units

The Chief Counsel is appointed by the President and advises the Commissioner on all matters pertaining to the interpretation, administration, and enforcement of the tax laws. The Chief Counsel also provides guidance and interpretive advice to the IRS, the Treasury, and taxpayers.

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 which 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].”¹⁶⁷ The new Appeals unit has a headquarters and two Operating Units -- the Large Business & Specialty Programs, which handles appeals from the Large and Mid-Size Business division, and the General Appeals Programs, which handles appeals from the other divisions. Each Operating Unit has developed a Fast Track Mediation Program designed to expedite disputes in certain audits, offers-in-compromise, and trust fund recovery penalties.

The Taxpayer Advocate Service was formally established on March 12, 2000. The Taxpayer Advocate Service assists taxpayers in resolving problems with the IRS (that may or may not involve a hardship) and, through its advocacy function, recommends changes to prevent such problems. Unlike other parts of the IRS, the Taxpayer Advocate Service is organized geographically, thus taxpayers in a certain geographic area will go to the same advocate office. See Part VI.B. of this Report for a discussion of the National Taxpayer Advocate’s annual report to Congress.

Criminal Investigation is the investigative arm of the IRS and investigates potential criminal violations of the Code and related financial crimes, including money laundering and Bank Secrecy Act violations. Criminal Investigation has approximately 2,900 agents who are specially trained to recover encrypted information from computers. The Criminal Investigation strategic plan has three parts: 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).

Communications and Liaison coordinates communication between IRS employees and legislative, executive, State, business, and professional stakeholders. The National Public Liaison works to provide opportunities to partner with the private sector and generally manages interaction with business professionals that have a stake in the tax system.

Challenges facing the new IRS organizational structure

A year ago, a number of commentators noted that the transition to the restructured IRS was awkward, resulting in “chaos and confusion.”¹⁶⁸ Problems cited that resulted from the new

¹⁶⁷ *Id.*

¹⁶⁸ Testimony of Bryan E. Gates, National Council of Taxpayer Advocacy, before the IRS Oversight Board (January 29, 2002).

structure included: 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.¹⁶⁹ In addition, some noted that centralization of human resources management, information systems, and facilities led to a reduction in support staff and an increase in administrative burden as routine functions once carried out by administrative staff had to be performed by first-line managers.¹⁷⁰

This year, as the new structure has solidified, there are still some, albeit apparently fewer, concerns with the aftermath of restructuring. The National Society of Accountants finds that the reorganization has broken longstanding relationships between practitioners and IRS management, and that many IRS employees do not know the extent of their authority or their role or who in the IRS has authority to solve taxpayer problems. The National Society of Accountants also remarks on a disconnect between the national office and the field offices regarding communication of new policies and procedures, with the result that under the new structure, only simple problems are being resolved.¹⁷¹ The IRS Oversight Board stresses that alongside restructuring, the IRS should emphasize employee training to ensure that employees are engaged in the new system.¹⁷²

C. 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 former Commissioner Rossotti observed: "constitutes an insurmountable barrier to efficient service and compliance operations and is a very serious risk to the whole tax system."¹⁷³ 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

¹⁶⁹ 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.

¹⁷⁰ George Guttman, *IRS Organizational Modernization Not Standing Tall*, *Tax Notes* (February 25, 2002) at 958.

¹⁷¹ Statement of William Stevenson, National Society of Accountants, before the Committee on Ways and Means Subcommittee on Oversight (April 8, 2003) at 2.

¹⁷² Statement of Karen Hastie Williams, IRS Oversight Board, before the Committee on Ways and Means Subcommittee on Oversight (April 8, 2003) at 4.

¹⁷³ 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.

gains in worker productivity. In short, technological modernization is a large-scale 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.¹⁷⁴ Business Systems Modernization is the more significant, involving the long-term reconstruction of the IRS's business technology and processes. Business Systems Modernization programs are IRS-wide and typically have long implementation timeframes. At this time, Business Systems Modernization consists of 17 ongoing 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. One significant example, the Customer Account Data Engine (discussed below, with other projects), will transfer individual filers from the 1960's 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 involves shorter-term projects (typically one to three years) for a single Operating Division that are directed toward updating software and coordinating old computer systems with new technology as improvements are made by Business Systems Modernization. Tier B projects in fiscal year 2002 facilitated electronic capture of tax form images and data, allowed for electronic availability of 90 percent of Form 1040 tax forms and schedules, and enabled field staff to process cases electronically. Tier B projects funded for fiscal year 2003 are designed to centralize appeals case data electronically, establish a database that will track taxpayer cases meeting Taxpayer Advocate Service criteria, provide a centralized system for processing employee plan and exempt organization determination letters, provide IRS attorneys with better computer tools and systems access, and establish a system to monitor tax examination progress and results. Planned Tier B projects for fiscal year 2004 include: establishing an automated proof-of-claim computation and an electronic claim for filing in court; establishing an on-line system to screen and categorize taxpayer needs during registration at Taxpayer Assistance Centers; providing caseworkers on-line access to taxpayer payment data; providing a web-based database for managing case information; and recording telephone calls of taxpayers.¹⁷⁵

The IRS's Business Systems Modernization Office manages the modernization effort and oversees the "PRIME Alliance," a group of technology and management companies 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 that lists

¹⁷⁴ The IRS's fiscal year 2004 budget calls for an appropriation of \$429 million for the Business Systems Modernization program, including Tier B projects. IRS Budget in Brief: Fiscal Year 2004 (hereinafter "IRS FY 2004 Budget in Brief") at 1. For a discussion of the IRS budget request for modernization, see Part V.E. of this Report.

¹⁷⁵ IRS FY 2004 Budget in Brief at 7-8.

each project and the estimated costs and delivery dates. There have been five such spending plans requesting a total of \$968 million between April 1999 and December 2001.¹⁷⁶

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 eight 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 the 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.¹⁷⁷ The General Accounting Office reported that the 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 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.¹⁷⁸ But, 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.¹⁷⁹ As a result,

¹⁷⁶ Treasury Inspector General for Tax Administration, *Analysis of Business Systems Modernization Cost, Schedule, and Functionality Performance* (October 31, 2002) Ref. No. 2003-20-007.

¹⁷⁷ General Accounting Office, *Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected If Modernization Is to Succeed* (July 1995) GAO/AIMD-95-156.

¹⁷⁸ General Accounting Office, *IRS Continues to Face Management Challenges in its Business Practices and Modernization Efforts* (April 15, 2002) GAO-02-619T at 29.

¹⁷⁹ 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.

the IRS scaled back on modernization projects, and gave priority to implementing management capacity.

In March 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 inadequate and 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.¹⁸⁰ By April 2002, however, the General Accounting Office reported that the IRS had issued an updated version of its enterprise architecture, thus giving a high-level roadmap to guide and constrain business and technological change.¹⁸¹ Nevertheless, the General Accounting Office found that the IRS was proceeding with building systems before: (1) fully implementing mature software acquisition management processes, (2) developing and deploying a human capital management strategy, and (3) establishing effective cost and schedule estimating practices.¹⁸² The General Accounting Office concluded that the answer lies in a more modest scope and pace of systems projects until management capacity is brought up to the level needed.¹⁸³

Recent developments

In January and April 2003 reports, the General Accounting Office noted that the IRS has made "important progress."¹⁸⁴ Areas of progress include establishing the infrastructure systems needed to run new business applications, completion of certain modernization projects (discussed below) that already are providing benefits, and improvement of management controls needed to

¹⁸⁰ General Accounting Office, *Business Systems Modernization: Results of Review of IRS's March 2001 Expenditure Plan* (June 2001) GAO-01-716 at 4.

¹⁸¹ General Accounting Office, *IRS Continues to Face Management Challenges in its Business Practices and Modernization Efforts* (April 15, 2002) GAO-02-619T at 29.

¹⁸² *Id.* at 31. In a March 2002 audit report, the Treasury Inspector General for Tax Administration found that the IRS's management processes were immature and noted failures that would lead to future delays and cost increases, including: 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. 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.

¹⁸³ General Accounting Office, *IRS Continues to Face Management Challenges in its Business Practices and Modernization Efforts* (April 15, 2002) GAO-02-619T at 33.

¹⁸⁴ General Accounting Office, *Major Management Challenges and Program Risks* (January 2003) GAO-03-109 at 16-19; General Accounting Office, *Internal Revenue Service, Assessment of Fiscal Year 2004 Budget Request and 2003 Filing Season Performance to Date* (April 8, 2003) GAO-03-641T at 9-10.

acquire and implement information technology systems. However, the General Accounting Office concludes that business systems modernization remains at “high risk” because the scope and complexity of the program is growing as projects move from the design to development stages, and management capacity is still somewhat immature, especially relating to configuration management, human capital management, and cost and schedule estimate validation. In the General Accounting Office’s view, such weaknesses lead to cost increases, delays, and deficient performance. The General Accounting Office notes that although the IRS has acknowledged the problems and is taking initiative to address them, the timing is critical now that projects are in the development stage.

An October 31, 2002, audit report by the Treasury Inspector General for Tax Administration offered a mixed assessment of business systems modernization.¹⁸⁵ From 2001, the Treasury Inspector General for Tax Administration found that business systems modernization had increased the capacity of the IRS’s telephone systems, improved the IRS’s ability to receive, route, and respond to taxpayer telephone calls, and enabled taxpayers to receive refund information via the Internet. However, business systems modernization continues to have difficulty meeting original cost, schedule, and functionality estimates as described in the spending plans that are submitted to Congress -- a majority of projects cost more money and take more time to deliver fewer features than originally planned.¹⁸⁶ Of the 20 projects initiated since 1999, there has been a cost increase of \$75 million (or 24 percent) above projections. On the whole, however, cost increases and schedule delays are decreasing over time, as projects move from design to development.¹⁸⁷ For example, of eight projects that have completed planning and design, there was a cost increase of \$52 million (or 89 percent). But once the development phase is reached, cost estimates are more reliable.¹⁸⁸ The Treasury Inspector General for Tax Administration notes that although only nine percent of large companies with computer modernization projects complete the project on time and within the budget and 53 percent of all such projects cost 189 percent over original estimates, the extent of the cost overruns for business systems modernization is still unexplained.¹⁸⁹ Of the projects planned for completion by the 2002 filing season, just 46 percent of features were fully or partially delivered, 14 percent of features were suspended, with the remainder in progress.¹⁹⁰ Whether business systems modernization continues to have significant cost and schedule delays is, in the view of Treasury Inspector General for Tax Administration, a matter of whether the Business Systems

¹⁸⁵ Treasury Inspector General for Tax Administration, *Analysis of Business Systems Modernization Cost, Schedule, and Functionality Performance* (October 31, 2002) 2003-20-007.

¹⁸⁶ *Id.* at 2.

¹⁸⁷ *Id.* at 3.

¹⁸⁸ *Id.* at 5. A similar pattern prevails for schedule estimates, with greater delays at the planning and design phases. *Id.* at 6.

¹⁸⁹ *Id.* at 5, Appendix XI.

¹⁹⁰ *Id.* at 7.

Modernization Office and the PRIME contractor implement improvements in the cost and schedule estimating process.¹⁹¹

Modernization programs that are operational

Four business systems modernization projects have been implemented, though only one of the four is fully operational. The other three still have aspects yet to be completed.

The Customer Relationship Management Exam project is complete. The project is a software package that computes complex taxes, and has been distributed to Large and Mid-size Business Revenue Agents.

Customer Communications has been implemented. It routes routine taxpayer inquiries to automated menu-driven information services, thereby freeing IRS customer service representatives to answer complex or less common inquiries. The project also increased the capacity of the IRS's telephone system, and permits taxpayers to access refund and filing information by Internet (the Internet Refund Fact of Filing project) and telephone. However, originally planned features, such as systems management, administrative, and management information systems capabilities have been delayed.

The Enterprise Systems Management project helps the IRS to monitor all the IRS computer systems and networks to ensure that they are consistently available to IRS employees. The project also consolidates 19 computer help desks into a single help desk.

Security and Technology Infrastructure Release provides secure technical infrastructure that supports and enables delivery of new business systems, such as Internet Refund Fact of Filing, Internet Employer Identification Number, and the first release of "e-Services."

Key modernization programs in progress

IRS Master File/Customer Account Data Engine

The Customer Account Data Engine (often referred to as CADE) is a critical project that 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 1960's 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 employees to post transactions and update taxpayer account and return data from their desks. The Customer Account Data Engine will be deployed

¹⁹¹ *Id.* at 8.

in two Phases. Phase 1 will process all individual taxpayer accounts over five Releases scheduled for deployment through 2006. Phase 2 will process business accounts. Dates for development and implementation of Phase 2 have not been established.¹⁹²

The CADE project began in 1999. The design phase was completed in June 2001. The five scheduled Releases for Phase 1 will convert individual taxpayer data in groups, beginning with the Form 1040-EZ. Originally scheduled for January 2002, there have been significant delays in deploying the initial release, delays the Treasury Inspector General for Tax Administration attributes to the PRIME contractors failure to finalize a contract for improved software and PRIME's underestimate of the complexity involved.¹⁹³ At the time of the Treasury Inspector General for Tax Administration's audit report, Release 1 was scheduled for April of this year. The IRS now says the Release will occur in July.¹⁹⁴ To prepare for Release 1, the Business Systems Modernization Office and the PRIME contractor developed a pilot program to test capabilities. The Treasury Inspector General for Tax Administration criticized the plan for the pilot program as not thorough enough to ensure success.¹⁹⁵

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 registration of electronic return originators, electronic taxpayer identification number matching, electronic transcript delivery, electronic account resolution, secure e-mail, and bulk matching of taxpayer identification numbers.

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. The IRS has scheduled deployment of the first release for October 2003 and predicts that the project will be the most work-intensive project for fiscal year 2003.¹⁹⁶

¹⁹² Treasury Inspector General for Tax Administration, *Improvements in the Customer Account Data Engine Pilot Plan Need to Be Considered to Help Ensure the Pilot's Success* (November 5, 2002) 2003-20-018 at 1-2.

¹⁹³ *Id.* at 2.

¹⁹⁴ Wenzel, April 8, 2003, Testimony at 20.

¹⁹⁵ Treasury Inspector General for Tax Administration, *Improvements in the Customer Account Data Engine Pilot Plan Need to Be Considered to Help Ensure the Pilot's Success* (November 5, 2002) 2003-20-018.

¹⁹⁶ IRS FY Budget in Brief at 7.

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.¹⁹⁷ 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. The first release of the project is scheduled for deployment in the first quarter of fiscal year 2004.

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.

¹⁹⁷ 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 2004

A. In General

Fiscal year 2004 IRS budget request

For fiscal year 2004, the IRS budget request totals \$10.437 billion and 100,043 full-time equivalent positions.¹⁹⁸ The fiscal year 2004 budget request reflects a \$521 million (or 5.3 percent) increase over the fiscal year 2003 appropriated level of \$9.916 billion and an increase of 888 full-time equivalent employees from the fiscal year 2003 estimated operating level of 99,155 full-time equivalent employees.¹⁹⁹

The IRS proposes to allocate the \$521 million to Compliance and Customer Service Enhancements (\$134 million), Counterterrorism (\$6 million), Modernization (\$49 million), Earned Income Credit Initiative (\$100 million), and Maintenance of Current Levels of Performance and Non-Recurs (\$232 million).²⁰⁰

The IRS Oversight Board recommended a budget that provides \$287 million more than the Administration's recommended budget of \$10.437 billion, and includes an additional 2,120 full-time equivalents.²⁰¹ The IRS Oversight Board believes its budget provides the stable, additional, and sustained funding to meet the IRS's growing workload.²⁰²

IRS objectives and summary of the fiscal year 2004 budget request

The IRS fiscal year 2004 budget request has six building blocks: (1) mined resources; (2) compliance and customer service enhancements; (3) internal services and support reinvestments; (4) modernization investments; (5) earned income credit reform initiative; and (6) maintenance of current levels of operations and non-recurs.²⁰³

¹⁹⁸ IRS FY Budget in Brief at 1.

¹⁹⁹ IRS Fiscal Year 2004 Congressional Justification (February 3, 2003) (hereinafter "IRS FY 2004 Justification")

²⁰⁰ *Id.* at SD-8-9.

²⁰¹ Statement of Nancy Killefer, Chair, Internal Revenue Service Oversight Board, before the Subcommittee on Transportation, Treasury, and Independent Agencies of the House Committee on Appropriations (May 7, 2003) (hereinafter "Killefer, May 7, 2003, Testimony") at 5.

²⁰² IRS Oversight Board Report at iii.

²⁰³ IRS FY 2004 Budget in Brief at 1.

For fiscal year 2004, the IRS estimates that internal productivity growth will make available \$166 million and 2,145 full-time equivalents (mined resources) from its current programs, which will be reinvested to offset funding increases elsewhere.²⁰⁴ Thus, \$454 million in program increases and \$232 million requested to maintain current operations will be offset by \$166 million of mined resources, resulting in the \$521 (rounded) million funding increase.

The IRS requests an increase of \$204 million (2,371 full-time equivalents) to fund initiatives to enhance compliance efforts.²⁰⁵ Of these amounts, \$24 million and 258 full-time employees will be used for increased exam capacity for cases involving flow-through entities and corporate transactions.

To provide an earned income credit reform initiative, the IRS requests \$100 million and 650 full-time equivalents. The requested resources will be used to preclude payments to ineligible taxpayers, reduce the occurrence of erroneous claims, and ensure that eligible taxpayers receive their tax benefits.

The IRS requests an increase of \$49 million to maintain the momentum of Business Systems Modernization.²⁰⁶ Near-term improvements include: a secure self-service Internet product for taxpayers to check their refund status and fact-of-filing; an Internet product for tax practitioners, taxpayers, State tax representatives, and the Department of Education to perform electronic taxpayer account resolution, taxpayer identification matching, transcript delivery, and disclosure authorization.

To maintain current levels of operations, the IRS requests a net total increase of \$232 million.²⁰⁷

B. Mined Resources (Internal Improvements)

The IRS budget request takes into account projected cost savings of \$166 million from internal improvements and efficiencies. For example, the IRS expects savings of \$26 million (394 full-time equivalents) from improvements to examination work processes that will improve operational efficiency and workload selection, and reduce taxpayer burden. The IRS reports that the improvements will enable the IRS to increase the level of reporting and filing compliance, reduce “no-change” rates, and focus available resources on abusive trusts, shelters, and complex tax issues.²⁰⁸

²⁰⁴ *Id.*; IRS FY 2004 Justification at SD-9.

²⁰⁵ IRS FY 2004 Budget in Brief at 2.

²⁰⁶ *Id.*

²⁰⁷ *Id.*

²⁰⁸ *Id.*

The IRS expects savings of \$10.3 million by reducing contractor support for end-user equipment and services. The IRS reports that such a reduction will be possible because of organizational changes and the deployment of a new infrastructure²⁰⁹ In addition, the IRS expects savings of \$6.9 million (203 full-time equivalents) from improvements in processing centers and savings of \$6.6 million (163 full-time equivalents) from increases in electronic filing.

C. Funding for Compliance and Customer Service Enhancements

The IRS budget request includes \$204 million (2,371 full-time equivalents) in increased funding to strengthen customer service and compliance, especially for high-risk, high-income taxpayers and businesses, and abusive schemes. The IRS states that the funding will increase both field examination and field collection, the automated collections system and service center compliance programs. The IRS plans to deliver the following initiatives.²¹⁰

- Address complex enforcement issues (\$66.5 million and 887 full-time equivalents)
- Increase exam capacity for flow-through entities and abusive corporate transactions (\$24.1 million and 258 full-time equivalents)
- Reduce filing season details of compliance staff (\$13.7 million and 164 full-time equivalents)
- Improve telephone service to small business and self-employed taxpayers (\$11.4 million and 184 full-time equivalents)
- Counter increasing levels of fraudulent returns (\$11.6 million and 185 full-time equivalents)
- Combat abusive tax schemes (\$10.7 million and 125 full-time equivalents)
- Augment tax collection by reducing delinquencies (\$6 million and 100 full-time equivalents)
- Expand treaty-based exchanges of information (\$5 million and 2 full-time equivalents).

D. Funding for Internal Services and Support Reinvestments

To provide internal services and support reinvestments, the IRS requests \$102 million and 12 full-time equivalents to annualize rent costs, increase training of personnel, install web-based applications, replace certain hardware and software, and expand a private network service.

²⁰⁹ *Id.*

²¹⁰ *Id.* at 4-5.

E. Funding to Support IRS Modernization

In general

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. Tier B projects are more limited in scope and typically improve existing systems or coordinate current systems with modernization projects. Tier B projects are of a shorter duration (approximately one to three years).²¹¹

The IRS indicates that Business Systems Modernization and Tier B projects will increase productivity in four distinct ways: (1) cost reduction; (2) cost avoidance; (3) burden reduction; and (4) increased tax collection.²¹²

The IRS has requested \$429 million for Business Systems and Tier B Modernization, an increase of \$49 million from fiscal year 2003.²¹³

Business systems modernization

The IRS notes that it 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.²¹⁴

The IRS states that the \$49 million increase will fund the contract, equipment, and software costs needed to improve the speed, timeliness and accuracy of tax administration.²¹⁵ The increase does not fund any full-time equivalents. The IRS plans to deliver the following project related benefits in fiscal year 2003.²¹⁶

- Implement 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 and quicken the refund process.

²¹¹ IRS FY 2004 Budget in Brief at 7.

²¹² *Id.* at 5-6; IRS FY 2004 Justification at SD-5.

²¹³ IRS FY 2004 Budget in Brief at 1-2.

²¹⁴ *Id.* at 6.

²¹⁵ IRS FY 2004 Justification at BSM-3.

²¹⁶ *Id.* at 7-8; IRS FY 2004 Budget in Brief at 6-7.

- Continue the *Custodial Accounting Project*, which will create a repository for modernized Individual Master File data and address documented financial material weaknesses.
- Continue the *Enterprise Architecture and Tax Administration Vision and Strategy*, which creates long-term vision of tax administration processes and building systems.
- Continue *e-services*, to provide registration of electronic return originators, taxpayer identification number matching, electronic account resolution, transcript delivery, and secure e-mail.
- Modernize *e-file*, which will provide additional forms (Forms 1120 and 990) to be accessed electronically.
- Implement *Internet Employer Identification Number*, which will automate entry of requests over the Internet.
- Establish the *Integrated Financial System*, which will provide core financial capabilities and financial reporting and will permit retirement of current financial systems.
- Continue the *Infrastructure Shared Services*, which provides the basic secure infrastructure necessary to support the modernization effort for e-services and other Internet applications.
- Continue *Integrated Tax Administration Business Solution*, which provides an understanding of requirements needed to effectively integrate business processes in IRS functions.

The IRS plans to deliver the following project related benefits in fiscal year 2004.²¹⁷

- Continue the *Customer Account Data Engine*, which will provide electronic processing of selected Form 1040 Wage & Investment returns
- Continue the *Custodial Accounting Project*, which will provide an integrated enterprise data warehouse to support organizational data needs, performance measurement, and tax operations process improvements.
- Continue modernized *e-file*, which will provide a new tax return database.
- Continue *e-services*, which will provide support for the 2004 filing season as well as implement support structures for modernized *e-file*.
- Continue the *Integrated Financial System*, which will provide detailed functional requirements to support internal management requirements for financial and management planning, execution, and reporting.
- Continue the *Infrastructure Shared Services*.

²¹⁷ *Id.* at 7.

Tier B modernization

The IRS states that the Tier B projects funded in fiscal year 2003 will support the following objectives.²¹⁸

- Establish a centralized database system to receive taxpayer appeals case data electronically and reduce the response time to taxpayers, and provide appeals case data to the operating divisions
- Provide a database that tracks the status and progress of taxpayer cases meeting the Taxpayer Advocate Service criteria mandated by the IRS Reform Act
- Provide a centralized, automated system for processing employee plans and exempt organization determinations utilizing commercial-off-the-shelf products
- Provide computer-based tools to IRS attorneys for preparation and circulation of tax briefs, electronic reference of documents, interface capability with U.S. Court systems, and access to secure communication systems within and outside of the IRS
- Provide a system to capture tax examination progress and results (e.g., examination planning data, audit results and timekeeping data)

The IRS states that the Tier B projects funded in fiscal year 2004 will provide the following benefits.²¹⁹

- An automated proof-of-claim computation and electronic claim for filing in court
- An on-line system to facilitate workload and resource distribution by screening and categorizing taxpayer needs at the point of registration
- Online access to caseworkers of all taxpayer payment data and images processed by IRS systems and deposits at lockbox banks
- Information to states and support applications to Federal agencies in the area of fuel tax compliance and tools for conducting tax research, determining and improving case classification, and monitoring Excise programs
- Internet-based centralized database for managing case information for tracking, planning, and reporting purposes
- Customer call recording mechanism and customer feedback based on actual events

F. Funding for Earned Income Credit Compliance Initiative

The IRS requests \$100 million to apply an integrated approach to strengthening the administration of the earned income credit.²²⁰ A large portion of the request will be used for the development of information technology and business processes, and the remainder will be used to implement a certification plan to determine whether a taxpayer claiming an earned income credit for a child satisfies eligibility requirements without requiring additional actions by the

²¹⁸ *Id.* at 8; IRS FY 2004 Justification at IS-14.

²¹⁹ *Id.*

²²⁰ IRS FY 2003 Budget in Brief at 8.

claimant. The initiative aims to reduce the number of claimants who are required to certify residency by approximately 80 percent.²²¹

G. Funding for Maintenance of Current Levels of Operations and Non-recurs

The IRS requests \$267 million to maintain current operations. This amount will fund the estimated cost of statutory pay increases and inflation at a level that will maintain the current level of services.²²² The \$267 million is offset by \$35 million that is being non-recurred from the fiscal year 2003 base for Health Insurance Tax Credit Administration, resulting in a total increase of \$232 million.

H. General Accounting Office Findings

The General Accounting Office reports that some of the mined resources listed in the 2004 budget request are not well defined and therefore may not result in the savings promised.²²³ For example, the IRS currently is reviewing its procedures to improve tax-return processing but has not identified operational areas that will be reengineered to achieve the improvements.²²⁴

The General Accounting Office also reports that in recent years budget requests have made increased staffing for compliance a priority, yet staffing still has declined.²²⁵ The General Accounting Office attributes the decline to increased workload, such as for processing returns, issuing refunds, and answering taxpayer mail, and unfunded costs.²²⁶ The General Accounting Office estimates that for fiscal year 2002, unbudgeted cost increases of \$106 million resulted in delayed hiring of revenue agents and officers, tax compliance officers, and tax specialists.²²⁷ The General Accounting Office notes that just 38 percent of dollar savings and 56 percent of full-time equivalent savings that were pledged in fiscal year 2003 will actually be achieved. The IRS attributes the shortfall to a delay in modernization projects and less-than-anticipated workload decreases.²²⁸

²²¹ *Id.* at 9.

²²² IRS FY 2004 Justification at SD-10.

²²³ GAO April 8, 2003, Statement at 5.

²²⁴ *Id.*

²²⁵ *Id.* at 6.

²²⁶ *Id.*

²²⁷ *Id.*

²²⁸ *Id.* at 6-7.

I. Financial Audit of IRS Fiscal Year 2002 Financial Statements

The General Accounting Office recently presented the results of its audit of the IRS's principal financial statements for fiscal year 2002. Like fiscal years 2001 and 2000, the General Accounting Office expressed an unqualified opinion on all IRS financial statements.²²⁹ The General Accounting Office rendered unqualified opinions for each year due to the "extraordinary efforts of IRS senior management and staff to compensate for serious internal control and system deficiencies."²³⁰ 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.

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) inability to identify and collect outstanding tax revenues and issue refunds, (4) inability to timely report IRS property and equipment balances, and (5) weaknesses in computer security.²³¹ In addition to the material weaknesses identified, the General Accounting Office reports significant deficiencies in design or operation of internal controls in budgetary activity and controls over hard-copy tax receipts and taxpayer data.²³²

²²⁹ 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 2002 and 2001 Financial Statements* (November 15, 2002) GAO-03-243 at 1.

²³⁰ *Id.*

²³¹ *Id.* at 9.

²³² *Id.* at 10.

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. 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.²³³ 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.²³⁴ 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.

The IRS Oversight Board notes that since the passage of the IRS Reform Act, the IRS:

has refocused, redefined, and rebuilt itself, with dramatic changes in its mission, organization, management processes, and governance. Yet the American tax system is still plagued with two long-term conflicting trends: a steadily increasing demand on the administration service, and a steady real decline in IRS resources due to budget constraints.²³⁵

The IRS Oversight Board summarized the current state of the IRS and identified and discussed four critical issues now facing the IRS: closing the compliance gap, continuing and implementing Business Systems Modernization, replenishing human capital, and modernizing facilities.²³⁶

²³³ Sec. 7802(c) and (d).

²³⁴ Sec. 7802(d)(4).

²³⁵ IRS Oversight Board Report at i.

²³⁶ Statement of Karen Hastie Williams, Member, Internal Revenue Service Oversight Board, before the Subcommittee on Oversight of the House Committee on Ways and Means (April 8, 2003) (hereinafter "Williams April 8, 2003, Testimony") at 2.

On the compliance gap, the IRS Oversight Board found that there is mounting evidence that some taxpayers are not reporting and paying what they legally owe, estimating that the amount of assessed but uncollected taxes is \$280 billion and growing.²³⁷ The IRS Oversight Board also noted that the number of promoted abusive tax shelters are rising and that a significant number of potential examination and collection cases are not being pursued because the IRS has failed to assign resources to more than 20 to 30 percent of identified cases. The IRS Oversight Board recognizes that the IRS cannot and should not add the resources in a single year to work all identified cases but recommends adopting former Commissioner Rossotti's suggestion to grow staff gradually over time. The IRS Oversight Board believes that such an approach will increase in productivity and help to close the compliance gap.²³⁸

The IRS Oversight Board was disappointed in the performance of Business Systems Modernization, which it describes as "plagued with delays in schedule and cost overruns."²³⁹ However, the IRS Oversight Board emphasized that Business Systems Modernization is a major long-term investment that will require significant ongoing and growing investment and that Business Systems Modernization should be implemented as quickly as possible to lower the program's ultimate cost and risk.²⁴⁰

The IRS Oversight Board found that the IRS must assess its human capital needs. Major challenges are: coping with an aging workforce; building new skills in employees so that they can work effectively in a modernized environment; developing an agency-wide approach to training using modernized technology; and improving internal communications.²⁴¹

The IRS Oversight Board found that the IRS is dependent on aging facilities to process paper returns.²⁴² For example, existing facilities average over 35 years in age and are in need of substantial repair.²⁴³ The IRS wants to upgrade facilities (83 buildings at 10 campuses at a capital cost of \$2 billion) over the next 15 years and requested that the IRS Oversight Board include \$72 million in the fiscal year 2005 budget for this purpose.²⁴⁴ The IRS Oversight Board recognizes the need to update facilities but stresses that budget restraints will require some tradeoffs.

²³⁷ *Id.*; Killefer, May 7, 2003, Testimony at 2-3.

²³⁸ Williams April 8, 2003, Testimony at 2; Killefer, May 7, 2003, Testimony at 3.

²³⁹ Williams April 8, 2003, Testimony at 3; Killefer, May 7, 2003, Testimony at 3.

²⁴⁰ Williams April 8, 2003, Testimony at 4; Killefer, May 7, 2003, Testimony at 4.

²⁴¹ Williams April 8, 2003, Testimony at 4; Killefer, May 7, 2003, Testimony at 4.

²⁴² Williams April 8, 2003, Testimony at 4; Killefer, May 7, 2003, Testimony at 4.

²⁴³ Williams April 8, 2003, Testimony at 5; Killefer, May 7, 2003, Testimony at 4.

²⁴⁴ Williams April 8, 2003, Testimony at 5; Killefer, May 7, 2003, Testimony at 5.

The IRS Oversight Board's recommended budget for fiscal year 2004 is \$287 million higher than the Administration's recommended IRS budget of \$10.4 million.²⁴⁵ Specifically, the IRS Oversight Board recommends \$172 million more than the Administration for taxpayer assistance, including an additional \$45.6 million to improve telephone services to small businesses as well as individual taxpayers, and an additional \$38 million in pre-filing services to determine the needs and values of taxpayers.²⁴⁶ Also, the IRS Oversight Board recommends \$71 million more than the Administration for Business Systems Modernization funding, and \$44 million more than the Administration in funding tax law enforcement. The IRS Oversight Board's budget provides for the following pre-filing and account services: (1) higher level of assistor service answering an additional 1.7 million phone calls; (2) face-to-face assistance to an additional 492,000 taxpayers through outreach programs and pre-filing compliance alternative treatment initiatives; (3) indirect assistance to an additional 138,000 taxpayers through established partnerships with practitioner groups as well as the Volunteer Income Tax Assistance program; and (4) an additional 38 staff-years of education and out-reach services.²⁴⁷

The IRS Oversight Board's budget recommendation also provides for the following: (1) a five year plan to close the compliance gap; (2) an adequate full time equivalent level for the IRS to rebuild human capital; (3) full funding of the IRS's efforts to modernize its processes and information technology; (4) increased level of telephone service to taxpayers; (5) additional taxpayer outreach and pre-filing assistance to help taxpayers file correctly and prevent problems before they occur; and (6) additional funding for counter terrorism activities. The IRS Oversight Board also recommended that the filing deadline for electronic filers be extended to April 30th, and that the processing, assistance, and management account is funded adequately.²⁴⁸

The IRS Oversight Board met six times as a full board in fiscal year 2002 and conducted other meetings at the committee level. In fiscal year 2002, the IRS Oversight Board published three reports for the Congress, coordinated with the Treasury Department a search for the new IRS Commissioner, conducted a review of the performance evaluations and proposed bonuses of 13 top IRS executives, participated in six IRS Nationwide Tax Forums, and evaluated a number of IRS programs, including the IRS employee survey conducted by Gallup, the electronic filing program, the K-1 matching program, the closing of the Brookhaven pipeline for paper return processing, and the reengineering of certain compliance strategies.²⁴⁹ The IRS Oversight Board held a public meeting on January 27 and January 28, 2003. The meeting consisted of four panels and the panel topics included: (1) the future direction of electronic tax administration; (2) the IRS's enforcement challenges; (3) effective collection strategies (such as the offer in

²⁴⁵ Williams April 8, 2003, Testimony at 6; Killefer, May 7, 2003, Testimony at 5.

²⁴⁶ Williams April 8, 2003, Testimony at 7-8; Killefer, May 7, 2003, Testimony at 7.

²⁴⁷ Williams April 8, 2003, Testimony at 8.

²⁴⁸ *Id.* at 7, 9.

²⁴⁹ IRS Oversight Board Report at C-2 and C-3.

compromise program); and (4) the IRS workforce empowerment (i.e., human capital issues that affect taxpayer service).²⁵⁰

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
- (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.²⁵¹ 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

²⁵⁰ See George Guttman, *Oversight Board Concerned about IRS Budget Situation*, 2002 *Tax Notes* 242-52 (December 17, 2002).

²⁵¹ Sec. 7803(c)(2)(C)(i).

taxpayers served by the office.²⁵² 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.²⁵³

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.²⁵⁴ 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 provided the guidelines for issuing Taxpayer Assistance Orders.²⁵⁵

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.²⁵⁶ 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.²⁵⁷

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.²⁵⁸ 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

²⁵² Sec. 7803(c)(2)(C)(iii).

²⁵³ Sec. 7803(c)(2)(C)(ii).

²⁵⁴ 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).

²⁵⁵ Internal Revenue Service, *IRS Expands Authority for Taxpayer Advocate Service*, IR-2001-12 (January 24, 2001).

²⁵⁶ Sec. 7803(c)(2)(B).

²⁵⁷ Sec. 7803(c)(2)(B)(iii).

²⁵⁸ Sec. 7803(c)(2)(B)(ii)(I) through (XI).

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 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 for fiscal year 2002 focused on protecting taxpayer rights. In the preface to her report, the National Taxpayer Advocate wrote,

The concept of “access” is fundamental to universal achievement of taxpayer rights. For taxpayers to feel that they should comply with their tax obligations and tax responsibilities, taxpayers must feel that they have - access to information, access to the IRS, access to the Taxpayer Advocate Service, access to representation, and access to return preparation.²⁵⁹

Legislative proposals

In general

The National Taxpayer Advocate’s Report identified six main areas for legislative action: attorney fees in nonphysical personal injury cases, married couples as business co-owners, math

²⁵⁹ National Taxpayer Advocate FY 2002 Report at v.

error authority, the Office of Taxpayer Advocate, the regulation of Federal tax return preparers, and children's income. The following paragraphs summarize the Taxpayer Advocate's primary legislative proposals.

Attorney fees in nonphysical personal injury cases

The National Taxpayer Advocate's Report recommended three legislative alternatives relating to attorney fees in nonphysical personal injury cases. The National Taxpayer Advocate indicated that the adoption of any one of the proposals, described below, would eliminate the unequal treatment under current law of legal fees in cases involving nonphysical personal injury.²⁶⁰ The National Taxpayer Advocate prefers the second alternative.

- (1) Exclude from gross income legal fees agreed upon or awarded in nonphysical personal injury settlements and judgments (sec. 104(a)(2)).
- (2) Include legal fees agreed upon or awarded in nonphysical personal injury settlements and judgments in gross income, and allow an adjustment to income for such fees in calculating adjusted gross income (sec. 62).
- (3) Include legal fees agreed upon or awarded in nonphysical personal injury settlements and judgments in gross income but allow an itemized deduction (and a deduction for AMT purposes) that is not subject to the two percent floor.

Married couples as business co-owners

The National Taxpayer Advocate's Report states that anecdotal evidence suggests that many unincorporated businesses owned jointly by a married couple do not file the required partnership income tax return (Form 1065, U.S. Return of Partnership Income).²⁶¹ The Report finds that many file Form 1040 instead and report the results of the business operations on Schedule C (Profit or Loss From Business (Sole Proprietorship)).

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

- (1) Allow a married couple operating a business as co-owners to elect out of subchapter K of the Code and file one Schedule C (or one Schedule F in the case of a farming business) and two Schedules SE if: (1) all of the capital and profits interests in the partnership are owned by two individuals who are married to each other; (2) the couple makes an election; and (3) the couple files a joint return for all taxable years that includes the items of the partnership, provided that the couple maintains adequate records to substantiate their respective interests in the partnership (sec. 761(a)).

²⁶⁰ *Id.* at 162.

²⁶¹ *Id.* at 172.

- (2) Require each spouse who operates an unincorporated business solely with his or her spouse as co-owners to file separate Schedules SE (sec. 6017).²⁶²

Math error authority

The Code authorizes the IRS to assess and collect an addition to tax, without issuance of a notice of deficiency or opportunity for review by the U.S. Tax Court, where the adjustment is the result of a mathematical or clerical error on the tax return (sec. 6213(b)). The National Taxpayer's Advocate Report recommends repeal of the math error assessment authority for entries on a return with respect to a qualifying child for purposes of the Earned Income Credit, where the taxpayer has been identified as the non-custodial parent of the child by the Federal Case Registry of Child Support Orders (sec. 6213(g)(2)(M)). In addition, the report recommends that the definition of a mathematical error be limited to: (1) inconsistent items in which the inconsistency is determined from the face of the return; (2) omitted items, including schedules, that are required to be included with the return; and (3) items reported on the return that are numerical or quantitative and that can be verified by a government entity that issues or calculates such information.²⁶³

The Office of the Taxpayer Advocate

To strengthen the independence of the Office of the Taxpayer Advocate and the ability of the National Taxpayer Advocate to protect rights and taxpayer confidences both within the IRS and in Federal courts, the National Taxpayer Advocate recommends legislative changes²⁶⁴ to:

- (1) Provide for the position of Counsel to the National Taxpayer Advocate, who would advise the National Taxpayer Advocate on matters pertaining to taxpayer rights, tax administration, and the Office of Taxpayer Advocate, including commenting on rules, regulations, and significant procedures, and the preparation of amicus briefs (sec. 7803(c)(3)).
- (2) Authorize the National Taxpayer Advocate to intervene as amicus curiae in any Federal litigation, excluding litigation before the United States Supreme Court, that raises issues relating to taxpayer rights under the Internal Revenue Code (sec. 7803(c)(3)).
- (3) Provide the National Taxpayer Advocate with the non-delegable authority to issue a Taxpayer Advocate Directive to the IRS with respect to any program, proposed program, action or failure to act that may create a significant hardship for a taxpayer segment or taxpayers at large (sec. 7811).

²⁶² *Id.* at 174.

²⁶³ *Id.* at 186.

²⁶⁴ *Id.* at 198-99.

- (4) Include “impairment of taxpayer rights” as a definition of “significant hardship” for purposes of issuing a Taxpayer Assistance Order or Taxpayer Advocate Directive (sec. 7811).
- (5) Clarify that Local Taxpayer Advocates have the discretion to withhold from the IRS the fact that a taxpayer contacted the Taxpayer Advocate Service or any information provided by a taxpayer to the Taxpayer Advocate Service (sec. 7803(c) (4)(A)(ii)).
- (6) Provide that in litigation before a Federal court, Local Taxpayer Advocates shall not be required to disclose through discovery or compulsory process the fact that the taxpayer contacted the Taxpayer Advocate Service or any information provided by the taxpayer to the Taxpayer Advocate Service, unless the court determines that such testimony or disclosure is necessary to: (1) prevent a manifest injustice; (2) help establish a violation of law; or (3) prevent harm to the public health or safety, of sufficient magnitude in the particular case to outweigh the integrity of the Taxpayer Advocate Service in general by reducing the confidence of taxpayers in future cases that their communications will remain confidential (sec. 7803(c)(4)(A)).

Regulation of tax return preparers

Paid return preparers include attorneys, certified public accountants, and enrolled agents who are subject to some form of regulation or oversight by the IRS or State licensing agencies. Unenrolled return preparers are not required to demonstrate a minimum degree of competency in the field of taxation, nor must they satisfy any continuing education requirements in order to prepare Federal tax returns.

The National Taxpayer Advocate recommends that a Federal tax return preparer who prepares more than five Federal tax returns in a calendar year must satisfy certain registration, examination, and certification requirements, and the IRS should be authorized to enforce such requirements.²⁶⁵

Children’s income

The taxation of investment income of children under the age of 14 is known as the “kiddie tax”.²⁶⁶ The National Taxpayer Advocate reports that the kiddie tax rules are unnecessarily complex because of the interrelationship between the child’s tax return and the parent’s tax return.

The National Taxpayer Advocate’s Report recommends making the standard deduction for dependent children equal to the standard deduction for a single taxpayer.²⁶⁷ The report also

²⁶⁵ *Id.* at 217-18.

²⁶⁶ Sec. 1(g).

²⁶⁷ Sec. 63.

recommends repealing the rules governing the taxation of investment income of children under age 14 and instead tax children on their investment income at either: (1) tax rates applicable to estates and trusts or (2) the child's own income tax rate up to a specified threshold, with investment income above that threshold at a higher tax rate.²⁶⁸

Most serious problems faced by taxpayers

The National Taxpayer Advocate's Report identified and discussed 22 of the most serious problems identified by individual taxpayers. The top 10 are:

- Navigating the IRS
- Processing of offers-in-compromise
- Math error authority
- IRS informational reporting program
- Processing claims for refunds
- Determining Earned Income Credit eligibility
- Procedures for examining Earned Income Credit claims
- Response time during Earned Income Credit examinations
- IRS oversight of Earned Income Credit tax return preparers
- Length of Earned Income Credit audits²⁶⁹

Most litigated tax issues

The National Taxpayer Advocate's Report identifies the top 11 most litigated issues by taxpayers as:

- Nonfiler/Unreported and Underreported Income
- Collection Due Process
- Trade and Business Expenses
- Valuation
- Earned Income Credit
- Abusive Trusts
- Itemized Deductions
- Capital Gains
- Civil Fraud Penalty
- Joint and Several Liability
- Barred Refunds²⁷⁰

²⁶⁸ *Id.* at 234.

²⁶⁹ *Id.* at 7, 15, 25, 32, 42, 47, 55, 64, 69, 75.

²⁷⁰ *Id.* at 256.

Taxpayer Advocate Service activities

The National Taxpayer Advocate's Report states that during fiscal year 2002, the Taxpayer Advocate Service independently reviewed and took action to resolve over 244,000 cases.²⁷¹ The National Taxpayer Advocate's Report listed the top sources of Taxpayer Advocate Service casework processing of claims or amended returns as Earned Income Credit examinations due to the Revenue Protection Strategy, refund inquiry, initial processing of returns, penalties, problems with payments/credits, levies, lost/stolen refunds, and underreporter process.²⁷²

Approximately 234,327 of the cases originated as Applications for Taxpayer Assistance Orders. Relief was granted in approximately 161,611 cases, including the issuance of 12 Taxpayer Assistance Orders.²⁷³ In 69 percent of these cases, the National Taxpayer Advocate was able to provide relief, partial relief, or appropriate assistance to the taxpayer.²⁷⁴

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).²⁷⁵ 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.²⁷⁶

²⁷¹ *Id.* at 389.

²⁷² *Id.*

²⁷³ *Id.* at 390. Of the 12 Orders issued, four were Direct Taxpayer Assistance Orders and eight were Review Taxpayer Assistance Orders.

²⁷⁴ *Id.*

²⁷⁵ Treasury Order 115-01(b) (January 14, 1999).

²⁷⁶ Sec. 7803(d)(3)(A).

Organizational structure

The Treasury Inspector General for Tax Administration strategic goals are improving the economy, efficiency, and effectiveness of tax administration and detecting and deterring fraud in IRS programs and operations.

Office of Audit

The Office of Audit is organized around the IRS's core business activities, comprising Headquarters Operations and Exempt Organizations; Small Business and Corporate Programs; Wage and Investment Income; and Information Systems.

The Office of Audit identifies opportunities to improve tax-law administration by conducting performance and financial audits of IRS programs and operations. The Office of Audit was established to assess the efficiency, economy, and effectiveness of program accomplishments, ensure compliance with applicable laws and regulations, and to prevent, detect, and deter fraud, waste, and abuse.

Office of Investigations

The Office of Investigations administers investigative programs and is charged with detecting and preventing fraud and other misconduct within the IRS. 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 Investigations is organized around 11 field offices and has four divisions: (1) Operations Division; (2) Special Inquiries and Intelligence Division; (3) Strategic Enforcement Division; and (4) Technical and Forensic Support Division.

The Operations Division provides guidance concerning all investigative matters, including: responding to congressional inquiries; liaising with Federal law enforcement agencies; preparing statistical reports for internal and external use; and managing complaints.

The Special Inquiries and Intelligence Division conducts complex, investigations involving IRS senior management, the IRS Oversight Board, IRS Office of Chief Counsel, and employees of the Treasury General for Tax Administration. Within the Special Inquiries and Intelligence Division are two sections that focus on procurement fraud and counter-terrorism.

The Strategic Enforcement Division is responsible for executing a program to detect: fraud in IRS operations, unauthorized access 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. Between April and October 2002, the Strategic Enforcement Division analyzed 1,206 leads of

potential unauthorized access to tax information by IRS employees, resulting in 174 referrals to field special agents.²⁷⁷

The Technical and Forensic Support Division is responsible for implementing programs concerning technical services and the Forensic Science Laboratory. Each of the programs provides technical expertise throughout the development and adjudication process of investigations.

Semiannual report

In general

The Treasury Inspector General for Tax Administration's semiannual report to the Congress for the period April 1, 2002, through September 30, 2002, reports that the Treasury Inspector General for Tax Administration issued 118 audit reports during the six-month period.²⁷⁸ Financial results due to audit reports totaled \$54 million and an additional \$237.6 million in increased revenue and protected revenue. The Treasury Inspector General for Tax Administration closed nearly 2,430 investigations of criminal wrongdoing and administrative misconduct during the reporting period. Investigations recovered approximately \$3.1 million.²⁷⁹

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.²⁸⁰ Nevertheless, despite such progress, the overall level of security is not yet adequate. Weaknesses include perimeter security, infrastructure security, and application security.²⁸¹ 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.²⁸²

²⁷⁷ TIGTA Semiannual Report to Congress, April 1, 2002, through September 30, 2002, at 29.

²⁷⁸ *Id.* at 3.

²⁷⁹ *Id.*

²⁸⁰ *Id.* at 10.

²⁸¹ *Id.*

²⁸² *Id.* at 10-11.

Business systems modernization

The Treasury Inspector General for Tax Administration reports that the IRS has made progress in modernizing its technology systems. The IRS has installed an upgraded toll-free telephone system that improves its ability to respond to taxpayer calls and provide capacity to route taxpayers' calls to the appropriate IRS employee.²⁸³ The IRS has installed: an Internet application that allows taxpayers to check the status of their returns and refunds, an IRS-wide secure technology environment, and a system designed to improve the availability and performance of modernized systems.²⁸⁴ The IRS also has released an update to its Enterprise Architecture, which serves as a roadmap for current and future modernization projects.²⁸⁵

However, the Treasury Inspector General for Tax Administration reports that certain issues pose potential barriers to the success of Business Systems Modernization.²⁸⁶ These issues include delays, cost increases, performance-based contracting technique problems, and maintaining a consistent strategic direction.²⁸⁷ The IRS generally agreed with most of the recommendations and has taken or planned appropriate action.

Customer service

The Treasury Inspector General for Tax Administration reports that, although the IRS made "some progress" in improving customer services, additional improvements are necessary.²⁸⁸ The Treasury Inspector General for Tax Administration noted that IRS assistance generally is better by phone than at a walk-in site and will provide future recommendations to improve walk-in site service. The Treasury Inspector General for Tax Administration recommends that the IRS correct deficiencies in its program to publish its telephone numbers and addresses in local telephone books and also recommends improving the quality measurement system for the IRS's Internet site to reflect the new organizational structure.²⁸⁹ The IRS agreed with the recommendation and will conduct a study to determine the feasibility of implementing the recommendation.

²⁸³ *Id.*

²⁸⁴ *Id.*

²⁸⁵ *Id.* at 12.

²⁸⁶ *Id.*

²⁸⁷ *Id.*

²⁸⁸ *Id.* at 13.

²⁸⁹ *Id.* at 14.

Returns processing

The Treasury Inspector General for Tax Administration reports that each year the IRS is unsuccessful at processing an estimated 46,000 tax returns for S Corporations (Form 1120S) because the IRS does not have on file the taxpayers' election to be treated as an S corporation, resulting in hours of wasted effort by small businesses.²⁹⁰ Further, the IRS does not consistently process Forms 1120S to determine the correct taxes due from small businesses. The Treasury Inspector General for Tax Administration recommends the development of procedures to improve and simplify the process for approving, recording, and controlling elections, and the related notification process.²⁹¹

Integrating performance and financial management

The Treasury Inspector General for Tax Administration reports that the IRS's volunteer income tax assistance and tax counseling for the elderly ("VITA/TCE") program suffers from inadequate controls and a lack of accountability over the computers the IRS provides to the program.²⁹² The Treasury Inspector General for Tax Administration reported that the IRS cannot physically account for the computers it provides to volunteers and did not ensure that only authorized software was loaded on volunteer computers.²⁹³ Further, the IRS did not ensure that sensitive taxpayer e-file data was removed from volunteer computers at the end of the 2001 filing season.

The Treasury Inspector General for Tax Administration recommends that the IRS perform a physical inventory of all computers in the VITA/TCE program.²⁹⁴ The Treasury Inspector General for Tax Administration also recommends the development of procedures to ensure that property records are updated for all computer equipment obtained from external agencies, that e-filed taxpayer data is erased from volunteer computers at the conclusion of tax filing season, and that only authorized software is loaded onto volunteer computers.²⁹⁵ The IRS agreed with the recommendations and is taking corrective action.

Compliance

The Treasury Inspector General for Tax Administration reports that the IRS does not impose available penalties on employers who file inaccurate name and social security number combinations on Form W-2 (Wage and Tax Statement), and has not developed a regularly

²⁹⁰ *Id.* at 15.

²⁹¹ *Id.* at 16.

²⁹² *Id.* at 20.

²⁹³ *Id.*

²⁹⁴ *Id.*

²⁹⁵ *Id.*

scheduled program for administering the information return penalty.²⁹⁶ The Treasury Inspector General for Tax Administration apprised the IRS of this concern through a memorandum issued during the audit and recommends that the IRS ascertain whether certain penalties may be assessed before the expiration of the three-year statute of limitations.²⁹⁷ The IRS disagreed with the specific recommendation of assessing penalties before the expiration of the three-year statute of limitations because of taxpayer rights due process procedures, but agreed with the recommendations to develop a program for information return penalties and is taking corrective action.

Erroneous payments

The Treasury Inspector General for Tax Administration reports that some corporations electing subchapter S status (S corporations) try to avoid paying FICA tax by paying very small amounts as salaries to officers while passing through income to officers that is not in the form of a salary and so not subject to FICA.²⁹⁸ The Treasury Inspector General for Tax Administration recommends that IRS management improve its technical guidelines to ensure that examiners are aware of the requirements to search for non-compliance by S corporations and to increase educational outreach through its taxpayer education and communication function.²⁹⁹ Additionally, the Treasury Inspector General for Tax Administration recommends programming changes to computer systems in order to enhance the IRS's ability to identify non-compliant S corporations.³⁰⁰ The IRS agreed with the recommendations and is taking corrective action.

Protecting taxpayer rights

The Treasury Inspector General for Tax Administration reports that, while the IRS has made progress in implementing the taxpayer rights provisions of the IRS Reform Act, significant improvements are needed in the suspension of interest provision. The Treasury Inspector General for Tax Administration recommends that the IRS develop procedures to identify all taxpayers with an applicable under-assessed interest, provide a systemic reminder about the suspension of interest when an audit is closed, update computer programming to consider weekends and holidays in the calculation of the suspension of interest notification period, and adjust applicable taxpayer accounts with incorrectly suspended earned income credit interest amounts.³⁰¹ The IRS agreed with the recommendations and is taking corrective action.

²⁹⁶ *Id.* at 21-22.

²⁹⁷ *Id.* at 22.

²⁹⁸ *Id.* at 24.

²⁹⁹ *Id.* at 25.

³⁰⁰ *Id.*

³⁰¹ *Id.* at 26-27.

Other significant audit results

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

- The Internal Revenue Service Needs to Simplify Filing Requirements and Clarify Processing Procedures for Small Business Corporate Returns
- The Internal Revenue Service Successfully Processed Schedules K-1 for Its Matching Program, However, Tax Form Changes Would Reduce Unnecessary Notices to Taxpayers
- Although the 2002 Filing Season Was Completed Timely, Customer Service Can Be Improved During Error Processing
- Outreach Initiatives to Ensure Taxpayers Receive the Benefit of the Child Tax and Additional Child Tax Credits
- Computers Used to Provide Free Tax Help and That Contain Taxpayer Information Cannot Be Accounted For
- Criminal Investigation's Use of Confidential Funds for Undercover Operations Is Appropriate; However, Certain Aspects of Undercover Operations Need Improvement
- The Internal Revenue Service Does Not Penalize Employers that File Wage and Tax Statements with Inaccurate Social Security Numbers
- The Large and Mid-Size Business Division's Program Controls Could Be Improved to Ensure More Timely and Accurate Examinations of Large Corporations
- The Internal Revenue Service Does Not Always Address Subchapter S Corporation Officer Compensation During Examinations
- Despite Some Problems, the Internal Revenue Service Properly Identified Returns With Rate Reduction Credit Errors During the 2002 Filing Season

Audit reports with significant unimplemented corrective actions

The Treasury Inspector General for Tax Administration reports that there are about 95 significant recommendations for corrective action, contained in 41 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.³⁰²

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

³⁰² *Id.* at 43-57.

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.³⁰³ 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.

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.³⁰⁴

According to the IRS, a significant percentage of due process cases (five percent, or 906 out of a total of 18,600 cases in inventory) advance arguments that are frivolous or otherwise without merit.³⁰⁵ The IRS asserts that frivolous cases consume a disproportionate amount of

³⁰³ Secs. 6320 and 6330.

³⁰⁴ 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.*

³⁰⁵ Appendix at 22.

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.³⁰⁶ 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.³⁰⁷ The IRS maintains a list of frivolous arguments on its website called “The Truth About Frivolous Tax Arguments” which is a 36-page document listing frivolous arguments.³⁰⁸ The IRS estimates that in fiscal year 2002 it undertook 528,020, 1.3 million, and 296 liens, levies, and seizures, respectively.³⁰⁹

A proposal in the Administration’s budget for fiscal year 2004 would 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 withdraw.³¹⁰ The Administration’s budget proposal would permit the United States Tax Court to be the exclusive venue for suits to obtain judicial review of an Appeals determination resulting from a collection due process hearing.³¹¹ The Administration’s budget proposal would require the IRS to publish (at least annually) a list of positions, arguments, requests, and proposals determined to be frivolous.

According to an August 2002 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.³¹² The Treasury Inspector General for Tax Administration found that all 73 seizures reviewed were compliant with the law. In two cases, the inspectors did not initially follow internal guidelines. Nevertheless, the Treasury Inspector General for Tax Administration concluded that the errors were identified and corrected and that taxpayer rights were not violated. The Treasury Inspector General for Tax Administration found the IRS’s continued compliance with the notice of levy provisions of the IRS Reform Act to be attributable to consistency of legal provisions and internal seizure procedures, technical expertise and assistance, and

³⁰⁶ *Id.*

³⁰⁷ *Id.*

³⁰⁸ http://www.irs.gov/pub/irs-utl/friv_tax.pdf. See Appendix at 23.

³⁰⁹ Appendix at 55.

³¹⁰ Department of the Treasury, *General Explanations of the Administration’s Fiscal Year 2004 Revenue Proposals* (February 2003) at 87.

³¹¹ *Id.* at 91.

³¹² Treasury Inspector General for Tax Administration, *The Internal Revenue Service Continues to Comply With The Law When Seizing Taxpayers’ Property* (August 2002), Ref. No. 2002-40-155 at 3.

continued emphasis on employee training. In an earlier 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 hardship³¹³ and that IRS was closing some cases that should not be closed.³¹⁴

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 mail lien notices in a timely manner (1 to 17 days late), which may have resulted in taxpayers not being aware of appeal rights.³¹⁵ The Treasury Inspector General for Tax Administration estimates that taxpayer rights could have been affected for 14,695 notice of Federal tax liens prepared between August 1, 2001, and June 30, 2002. The IRS attributed the delays due to printer problems, management turnover, and staffing issues.³¹⁶

The Treasury Inspector General for Tax Administration found that the IRS took appropriate action to protect taxpayer rights to an appeal in 91 percent (30 of 33) of the cases the Treasury Inspector General for Tax Administration identified in its fiscal year 2000 and 2001 reviews.³¹⁷ The IRS advised the Treasury Inspector General for Tax Administration that the corrected lien notices either have been issued or will be issued for the remaining three cases. Additionally, none of the 33 taxpayers affected had their right to appeal the notice of federal tax lien improperly denied.³¹⁸

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.³¹⁹ The IRS Reform Act generally made innocent spouse relief easier to obtain. It eliminated all of the understatement

³¹³ 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.

³¹⁴ *Id.* at 8-9.

³¹⁵ Treasury Inspector General for Tax Administration, *Fiscal Year 2003 Statutory Review of Compliance with Lien Due Process Procedures* (February 2003), Ref. No. 2003-40-066 at 3.

³¹⁶ *Id.*

³¹⁷ Treasury Inspector General for Tax Administration, *Taxpayer Rights to Appeal Federal Tax Liens Were Protected* (November 2002), Ref. No. 2003-40-025 at 2.

³¹⁸ *Id.*

³¹⁹ Sec. 6015.

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.³²⁰

After passage of the IRS Reform Act, the IRS 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.³²¹ 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.³²² 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 took 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.³²³

Last year, the National Taxpayer Advocate reported that a taxpayer's learning the status of an innocent spouse claim was among the most serious problems faced by taxpayers (ranked #22).³²⁴ 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 expected their claims to be handled promptly and many did not comprehend that legal requirements may add additional days to the process.

³²⁰ Sec. 6015(f).

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

³²² Statement of David C. Williams, Inspector General, Treasury Inspector General for Tax Administration, before the Senate Committee on Finance (February 2, 2000) at 3.

³²³ Statement of Charles O. Rossotti, Commissioner of Internal Revenue, before the Senate Committee on Finance (February 2, 2000) at 7.

³²⁴ National Taxpayer Advocate FY 2001 Report at 67-69.

However, the National Taxpayer Advocate now reports that the IRS has taken a number of positive steps to address the innocent spouse issue including: the implementation of a new tracking system to gain control over inventory (the Innocent Spouse Tracking System), development of software to speed processing and improve accuracy, automated decision-making tools, revision of the innocent spouse claim form, instructions, and publication, centralization of the operation in Cincinnati, and stable staffing levels at the centralized site. The National Taxpayer Advocate reports that in fiscal year 2002, 49,800 cases were closed and that inventories have dropped substantially. In addition, the success of centralization permitted the IRS to reduce staffing levels elsewhere. The National Taxpayer Advocate now concludes that the program is highlighted not as a problem for taxpayers, but rather, as an IRS success story.³²⁵

The IRS reports that the average processing time for claims (from initial receipt of a claim to delivery of a determination letter to the taxpayer) improved between fiscal year 2002 and fiscal year 2003. For example, the average number of days to issue a determination in response to a meritorious claim was 259 days in fiscal year 2003 compared to 283 days in fiscal year 2002. The IRS made a determination that an innocent spouse claim did not qualify in an average of 78 days in fiscal year 2003 compared to 106 days in fiscal year 2002.³²⁶

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.³²⁷

In last year's report, the General Accounting Office found that between fiscal years 1997 and 2001, the inventory of unresolved offers nearly tripled to approximately 95,000.³²⁸ 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. The IRS Oversight Board reports that approximately 80 percent of the offers in compromise can not be processed when they are first received and that the program is confusing and subject to abuse.³²⁹ The IRS Oversight Board recommends improvements to the offer in

³²⁵ National Taxpayer Advocate FY 2002 Report at 150-153.

³²⁶ Appendix at 18-19.

³²⁷ Sec. 7122(c) and (d).

³²⁸ General Accounting Office, *IRS Should Evaluate the Change to Its Offer in Compromise Program* (March 2002) GAO-02-311 at 2.

³²⁹ Internal Revenue Service Oversight Board, *IRS Oversight Board Releases Annual Report, 2003 Tax Notes* 88-23 (May 7, 2003) at 12.

compromise program to include: educating taxpayers, simplifying paperwork, imposing criminal penalties, and legislative alternatives.

With regard to the length of time to process an offer in compromise, the IRS is processing more offers within six months today than the IRS did in fiscal years 2000 through 2002, but is processing far fewer offers within six to 12 months. Offers that take more than a year to process have decreased. For example, the IRS reports that in fiscal years 1999, 2000, 2001, and 2002 the total offers processed within six months of submission were 52 percent, 39 percent, 32 percent, and 38 percent, respectively. Through six months of fiscal year 2003, the IRS reports that 53 percent of offers are processed within six months. The percentage of offers processed between six and 12 months in fiscal years 1999, 2000, 2001, and 2002 are 40 percent, 45 percent, 43 percent, and 36 percent, respectively, with a 29 percent rate through the first six months of fiscal year 2003. 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, 26 percent in fiscal year 2002, and 18 percent through the first six months of fiscal year 2003.³³⁰ Average processing time has decreased from an average of 317 days in fiscal year 2002 to an average of 272 days for the first six months of fiscal year 2003. Further, the average age of open inventory decreased from 265 days in fiscal year 2002 to 240 days at the end of March 2003.³³¹

As part of this year's budget request, the Administration proposes a modification of the rules to permit the IRS to enter into installment agreements for amounts less than the full liability owed by taxpayers.³³² The Administration believes such a change would increase the number of installment agreements and reduce the number of offers in compromise. The Administration 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.³³³ In addition, the Administration requests that an opinion of IRS Chief Counsel no longer be mandatory for compromises of \$50,000 or more (including penalties and interest).³³⁴ The Administration believes that such a change would permit better allocation of resources without undermining the quality of the review process. In addition, the IRS is considering a proposal that would require taxpayer representatives to sign offers in compromise submitted on behalf of their clients.³³⁵ The IRS also has drafted instructions to guide telephone assistants in determining whether a caller is an offer in compromise candidate.

³³⁰ Appendix at 19.

³³¹ *Id.* at 21.

³³² Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals* (February 2003) at 89.

³³³ *Id.* at 87.

³³⁴ *Id.* at 93.

³³⁵ Appendix at 20-21.

The IRS attributes this year's decrease in average processing time in part to the fact that newly established centralized sites have matured and processes to improve workflow were implemented. The automated offer in compromise program has reduced various labor-intensive procedures and established connectivity with other IRS computer systems. Further, the IRS reports that it has successfully tested an automated tool for calculating "reasonable collection potential" and is in the process of making refinements.³³⁶

³³⁶ *Id.*

APPENDIX



DEPUTY COMMISSIONER

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

May 7, 2003

MAY 07 2003

Ms. Mary Schmitt
Acting Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington, D.C. 20515-1102

Dear Ms. Schmitt:

I am responding to your April 2, 2003, request for information in connection with the Annual Joint Congressional Review of the strategic plans and budget of the Internal Revenue Service. I apologize for the late response. However, we wanted to make sure we provided you with thorough and accurate answers to your important questions.

I hope this information is helpful. If you have any questions, please contact Floyd Williams at (202) 622-4725.

Sincerely,

A handwritten signature in cursive script that reads "Bob Wenzel".

Bob Wenzel

Enclosures

Questions for the Internal Revenue Service

Many of the requests below are requests for data. For purposes of answering these data requests, a history of data for each year for Fiscal Year 1997 through Fiscal Year 2002 should be provided. If there is insufficient data, or if 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"), the IRS changed its mission to emphasize serving the public and meeting the needs of taxpayers. Please describe how customer service has improved, providing (where applicable) annualized data on customer service before the Act through Fiscal Year 2002 in the following areas:

- (1) Telephone Service for Taxpayer Questions. Please provide data showing the number of answers to taxpayer calls. 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.

Prior to FY 1999, our call sites operated under a regional alignment and in a semiautonomous fashion. Call data was reported on a site-by-site basis rather than on the enterprise approach used in 2000. Measures under the enterprise management approach reflect a more accurate customer experience. Moving to an enterprise-operating environment has substantially changed our telephone assistance practices. In 2000, we operated as a fully integrated network using dynamic call routing and centralized data capture and reporting, which is more accurate. As a result of the implementation of dynamic call routing, a substantially higher number of calls were offloaded to automation. FY2001 brought the Advanced Tax Credit that created heavy demand on the toll-free lines. This resulted in an increase to calls answered as well as busy signals in addition to the elevated demand. While we have been able to service more callers through automation, the nature of these calls is less complex leaving calls requiring higher skills and additional resolution time for live assistance. For many of the reasons stated above FYs subsequent to RRA 98 cannot be compared to FYs prior to RRA 98. We have however provided the 1997,1998 and 1999 data for informational purposes.

| MEASURE | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 W/O Advanced Tax Credit | FY 2001 WITH Advanced Tax Credit | FY2002 |
|-------------------------|---------|---------|---------|---------|--|---|--------|
| QUANTITY | | | | | | | |
| Total Number of Calls | 198.2M | 140.6M | 155.3M | 119.7M | 174.7M | 185.8M | 142.9M |
| Assistor Calls Answered | 59.7M | 56.5M | 37.8M | 32.3M | 30.1M | 32.0M | 30.5M |
| Customer Busies | 45.7M | 8.8M | 40.6M | 20.1M | 36.5M | 38.9M | 18.1M |

Total Calls Attempted and Answered represent demand on the 1040, 8815, 4262 and TeleTax Telephone lines.

| MEASURE | FY 2000 | FY 2001 W/O Advanced Tax Credit | FY 2001 With Advanced Tax Credit | FY2002 |
|---------------------------|---------|--|---|--------|
| QUANTITY | | | | |
| Automated Calls Answered | 49.9M | 66M | 76M | 46.8M |
| Assistor Level of Service | 61% | 62% | 59% | 70% |

| Quality Rates | FY97 | FY98 | FY99 | FY00 | FY01 | FY02 |
|---------------|------|------|------|------|------|-------|
| Accounts | 91% | 87% | 82% | 88% | 89% | 90.3% |
| Tax Law | 96% | 81% | 74% | 78% | 79% | 84.3% |

Accuracy rates shown by percentage rather than calls answered correctly. Tax Law Accuracy for FY98 was reported only during filing season. The reporting period was 02/07/98 through 04/25/98.

Full implementation of Centralized Quality Review Staff occurred during FY99. This applied uniform standards to quality reviewing of calls. FYs 1997 & 1998 Accuracy Rates were determined using Test Calls while FYs 1999 and subsequent were determined by monitoring actual customer calls. Data therefore is not directly comparable.

| | FY97 | FY98 | FY99 | FY00 | FY01 | FY02 |
|------------------------------|------|------|----------------|----------------|----------------|----------------|
| Average Speed of Answer | *N/A | *N/A | 3.9 (234) | 4.1 (246) | 5.2 (312) | 3.9 (234) |
| AHT - (Excludes Screener) | *N/A | *N/A | 6.4 (386.0) | 9.6 (577.1) | 9.6 (578.4) | 9.4 (566.1) |

Average speed of answer (ASA) and average handle time (AHT) is shown in minutes and (seconds)
ASA Time from taxpayer dialing to connection with an assistor, AHT average time for call to be handled by an assistor
***Average speed of answer and average handle time is not comparable FY97 and 98 to 99-02 due to major systems changes and move to corporate management.**

FY 03 is showing significant improvement in the customer experience over FY 02 with improvements in almost every category.

| <i>As of : (April 5, 2003)</i> | 2002 | 2003 | % Change |
|--|------------|------------|----------------|
| Telephone: | | | |
| Total Assistor Calls Answered ¹ | 11,876,766 | 12,012,570 | 1.14% |
| Assistor Level of Service ¹ | 70.03% | 84.32% | 20.41% |
| Total Automated Calls Completed ² | 32,430,667 | 23,345,108 | -28.02% |
| Telephone Quality Rates:³ | | | |
| Tax Law Quality | 80.26% | 81.25% | 1.23% |
| Accounts Quality | 72.90% | 69.06% | -5.27% |
| Tax Law Customer Accuracy Rate | 83.39% | 82.46% | -1.12% |
| Accounts Customer Accuracy Rate | 89.37% | 87.64% | -1.94% |

Telephone Measures

- Assistor level of service, at 84.32%, is up 20.4% over last year. The increase in Assistor LOS this year is attributable to a decrease in demand as well as the implementation of new lines and less complicated scripts. For the filing season, net attempts and primary abandons are down from the prior year. All of this is an indication that callers are getting in and getting service.
- Assistor calls answered this filing season are up about 1.1% over last year, with fewer secondary abandons this year compared to last, also indicating more customers are getting where they need to be.
- The total Automated Call completed volumes continue to be lower than the volumes experienced in FY 2002, down about 28%. A possible reason for this continued decline in completed automated services could be attributed to the success of the Internet Refund Fact of Filing (IRFOF) application. More than 10 million customers have used this application since January 10, 2003, when it was updated for the 2003-filing season. The combined automated assistance provided by IRFOF and the Toll-Free automated system exceeds the planned automated services to customers for the filing period. IRFOF went online in August of 2002; therefore, there is no filing season comparative data available for the 2002-filing season.

- The average speed of answer for Accounts and Tax Law calls combined for the 2002 and 2003 filing seasons is 194 and 152 seconds, respectively.

Telephone Quality Rates

- While telephone quality rates are currently below established fiscal year goals, incremental improvements have been made. Weighted accounts quality has improved each month during the rating period. Tax law quality is currently above last year's rate for the same time period, and tax law customer accuracy continues to improve.

- (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.

The new Field Assistance organization stood up in FY 2001. The following chart provides data for the FY 2001 and FY 2002 periods:

Number of Taxpayers Receiving Service (2001 & 2002):

| Measure | FY 2001 | Rate/hr | FY 2002 | Rate/hr |
|----------------------------------|------------------|------------|------------------|------------|
| Total Return Prepared (Contacts) | 1,008,292 | 3.6 | 886,781 | 1.9 |
| Tax Law Contacts | 1,782,253 | 4.6 | 1,869,831 | 4.6 |
| Account Contacts | 2,597,439 | 4.2 | 3,183,665 | 4.2 |
| Total Contacts | 9,680,715 | 4.2 | 9,683,126 | 4.2 |

Data for FY 1997 through FY 2000 is provided for informational purposes. Prior to FY 2001, Tax Law Contacts and Account Contacts were not tracked as line items by the Customer Service organization where "Walk-In" was housed.

Number of Taxpayers Receiving Service (1997 - 2000):

| Measure | FY 1997 | FY 1998 | FY 1999 | FY 2000 |
|----------------------------------|------------------|------------------|-------------------|------------------|
| Total Return Prepared (Contacts) | 620,588 | 654,382 | 892,968 | 1,092,377 |
| Total Contacts | 7,123,306 | 7,713,379 | 10,263,158 | 9,926,252 |

Accuracy of Service

TIGTA began conducting bi-monthly reviews of the quality of services in the Taxpayer Assistance Centers in January 2001. The results of the first review, covering the period January 29 through February 9, 2001, found that employees correctly answered tax law questions 75% of the time. For the period January through February 2002 the tax law accuracy rate was 61% and 72% for the period January through February 2003.

Wait Time

Wait time at the Taxpayer Assistance Centers is not currently measured because we concluded that measuring how long customers wait for service tends to adversely affect the thoroughness and quality of answers. Our past experiences have shown that employee reaction to timeliness measures tend to increase the likelihood of inaccurate or incomplete answers. Our current focus is devoted to improving the accuracy of answers to tax law questions and the quality of work.

- (3) Internet Service for Taxpayer Questions. Please provide data on the Electronic Tax Law Assistance Program, through which taxpayers can make inquiries on the IRS website. If available, show the number of queries, number of responses, and average time of response.

| Electronic Tax Law Information for 1998 – 2002 | | |
|---|-----------------|---|
| <i>FY 1998</i> | | |
| Received | Answered | Average Response (Work Days) |
| 73,900 | 73,037 | 1.7 |
| <i>FY1999</i> | | |
| 246,571 | 245,674 | 3.2 |
| <i>FY 2000</i> | | |
| 303,801 | 304,738 | 3.1 |
| <i>FY 2001</i> | | |
| 264,393 | 256,761 | 4.4 |
| <i>FY 2002</i> | | |
| 176,522 | 183,882 | 2.5 |

Difference between received and answered is rollover between fiscal years (more answered than received) or reductions for duplicate inquiries (less answered than received)

- (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 return and paper returns.

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 | 35.1 | 14 |

Information is calculated on Fiscal Year basis using sample data. This average data included direct deposit and mailed and the entire 1040 family of returns (1040, 1040A, 1040EZ). FY 2002 was impacted by taxpayer errors made on the Advanced Tax Credit.

| Fiscal Year | Average Number of Days Originating from a Paper Return | Average Number of Days Originating for an Electronic Return |
|-------------|--|---|
| 2001 | 28 | 14.6 |
| 2002 | 30 | 15 |

- (5) Audit data. 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.

**Examination Closures
FY 1997 through FY 2002**

| All Individuals | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 | FY 2002 |
|--|----------------|----------------|----------------|----------------|----------------|----------------|
| Field | 715,615 | 567,759 | 384,484 | 251,108 | 202,515 | 205,134 |
| Service Center | 803,628 | 625,021 | 715,789 | 366,657 | 529,241 | 538,747 |
| Total Return Closures | 1,519,243 | 1,192,780 | 1,100,273 | 617,765 | 731,756 | 743,881 |
| | | | | | | |
| | | | | | | |
| Corporations < \$10 Million* | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 | FY 2002 |
| Field | 55,021 | 40,735 | 27,484 | 17,580 | 13,169 | 12,713 |
| Service Center | 1,302 | 1,083 | 784 | 1,043 | 1,163 | 1,942 |
| Total Return Closures | 56,323 | 41,818 | 28,268 | 18,623 | 14,332 | 14,655 |
| | | | | | | |
| | | | | | | |
| Corporations \$10 Million & Over* | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 | FY 2002 |
| Field | 12,706 | 11,464 | 10,287 | 8,978 | 8,465 | 8,211 |
| Service Center | 266 | 366 | 250 | 234 | 253 | 232 |
| Total Return Closures | 12,972 | 11,830 | 10,537 | 9,212 | 8,718 | 8,443 |
| | | | | | | |
| | | | | | | |
| Grand Total | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 | FY 2002 |
| Field | 915,420 | 728,545 | 505,847 | 342,660 | 280,111 | 281,808 |
| Service Center | 812,702 | 634,098 | 722,559 | 373,255 | 534,946 | 545,171 |
| Total Return Closures | 1,728,122 | 1,362,643 | 1,228,406 | 715,915 | 815,057 | 826,979 |

*Does not include form 1120 F or 1120 S. However, examinations for these returns and forms 1065 are included in the grand total.

Hours per Return

| Individuals | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 | FY 2002 |
|---------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Revenue Agent | 22 | 22 | 25 | 28 | 29 | 28.4 |
| Tax Auditor | 4.3 | 4.5 | 5.7 | 7.1 | 8.3 | 9.4 |
| Service Center (Non-IRP) | 0.8 | 0.9 | 1.1 | 1.8 | 1.7 | 1.7 |
| | | | | | | |
| Corps. < \$10 M | 43 | 45 | 51 | 58 | 64 | 56 |
| Corps. \$10 M & Over | 140 | 138 | 154 | 174 | 194 | 232 |

| 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 (actual) | FY 2003 (projected) |
| Cases Closed | 1,598,471 | 1,726,098 | 1,770,695 | 1,353,545 | 1,161,901 | 1,491,139 | 1,528,119 |
| Letters Sent | 3,500,804 | 3,208,770 | 3,350,891 | 2,735,345 | 2,576,375 | 2,895,927 | 3,056,238 |
| Avg. Hours per Case | 1.0 | 0.9 | 0.8 | 1.1 | 1.4 | 1.0 | 1.0 |
| | | | | | | | |
| ASFR | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 | FY 2002 (actual) | FY 2003 (projected) |
| Cases Closed | 392,598 | 426,495 | 584,142 | 332,427 | 333,770 | 242,637 | 200,000 |
| Letters Sent | 525,432 | 628,541 | 467,254 | 228,203 | 393,751 | 162,918 | 140,000 |
| Avg. Hours per Case | 2.0 | 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) Statistics for ASFR cases do not include any SFRs manually generated by exam or correspondence audits.
- 4) Projections through 2007 are not available b/c audit plans are only done 1 year in advance.

(6) Limited Issue Focused Examination. This new targeted audit program for the largest businesses involves agreements between taxpayers and the IRS that limit the issues to be addressed in exchange for limits on claims. Please describe the status of this program and the IRS’s goals for the program.

The Limited Issue Focused Examination (LIFE) process aligns with the Large and Mid-Size Business (LMSB) Division Strategic Initiative Issue Management Strategy and is intended to focus examinations on the most significant compliance risks. It incorporates “best practices” identified from internal and external sources with process requirements intended to increase communication between the examination team and the taxpayer. It was implemented in November 2002. All LMSB technical personnel

completed training by December 2002. A public release announcing the LIFE process was issued in December 2002.

The goal of LIFE is to improve the post-filing process by streamlining the examination of a taxpayer's return(s) in appropriate situations. This approach will enable LMSB to more effectively utilize resources on some examinations thus allowing them to be redirected to other areas of compliance risk, such as tax shelters. This process will create an atmosphere where the examination process is less difficult, less time consuming, less expensive, and less contentious for both parties.

To assist with the identification of those issues on a return representing greater compliance risk, revenue agents employ materiality concepts. This culminates in the establishment of thresholds below which the Service agrees it will not select areas for examination. While these thresholds are the province of the revenue agents, the taxpayer does have input, as he or she must agree not to file claims for issues reducing tax liability that fall below these thresholds. The taxpayer must also work with the examination team to resolve issues as they occur and timely respond to information requests.

LMSB is presently conducting an interim review of the process. The review consists of interviews with agents and managers who are currently utilizing the process and focus group sessions with LMSB front-line employees and managers. We are also gathering feedback from the Managers Advisory Group. Externally, we have solicited and received specific feedback on the process from the Tax Executives Institute, the American Institute of Certified Public Accountants and the American Bar Association.

- (7) Taxpayer complaints. Please show the number of telephonic and written taxpayer complaints against the IRS.

Because of the potential for duplication on taxpayer complaints tracked in the various management information systems, the IRS is unable to report on the total number of taxpayer complaints received. However, the National Taxpayer Advocate, in her FY 2002 Annual Report to Congress, provides a list and detailed discussion of, "The Most Serious Problems Encountered By Taxpayers." The problems listed in the report are as follows:

- Navigating the IRS
- Processing of Offer-In-Compromise Cases
- Math Error Authority
- IRS Information Reporting Program
- Processing Claims for Refund
- EITC Eligibility Determination can be Made Less Burdensome

- Procedures for Examining EITC Claims Cause Hardship and Infringe on Appeal Rights
- Lack of Response During EITC Exams
- IRS Oversight of EITC Return Preparers Can Be Improved
- The Length of EITC Audits Contributes to Taxpayer Concerns
- EITC Recertification Compounds Taxpayer Burden
- Language & Cultural Barriers Impact Taxpayer Compliance
- Free U.S. Individual Income Tax Return Preparation
- Access to ACS (Automated Collection System)
- Collection Due Process
- Awareness and Understanding of Federal Tax Deposits
- Toll-Free Accuracy
- Refund Inquiries
- Obtaining Employer Identification Numbers (EINS)
- Delay in Receiving Requested Documents
- Misapplied/Lost Payments
- Relief From Joint & Several Liability

(8) Please comment on progress in providing local telephone numbers and addresses of IRS offices in the local telephone book as required by section 3709 of the Act.

IRS has diligently worked at ensuring that local telephone numbers and addresses are in the local telephone books as required by section 3709 of the Act. We believe we have met this obligation and now have provided this important information to the public. The numbers and office addresses are placed in local telephone directories through GSA and are published in the government blue pages. In addition IRS has included this information on the IRS.GOV web page with a link under individuals for “How I contact my local office”. The taxpayer can access their state and determine the nearest local office offering assistance as well as providing phone number and address.

Field Assistance:

- **§ 3709 RRA 98 Directive to Publish Local IRS Telephone Numbers**
- As of March 22, 2003, we received 346,353 calls on the 3709 phone lines compared to 68,845 for the same period last year.
- All local telephone lines identified for the Section 3709 Program are operational at this time.

- **Field Assistance continues to track the publication of local numbers on a monthly basis. However, several phenomena in the telephone industry have complicated the this project.**

For example, in any city, multiple telephone directories are available – versus the one directory that most users expect. IRS contracts with only one directory (funds are not available to contract with all issuers).

- **In some cases, numbers are published in the government blue pages. In cases of some small markets that do not have blue pages the contract requested that numbers be included in white pages under U.S. Government.**
- (9) **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.**

Customer service can be improved with the implementation of a number of initiatives that are under consideration:

- **Embedded Quality – Targets opportunities for improvement in servicing taxpayers in the areas of tax law and account work.**
- **Q-Matic Networking/Enhanced Functionality – Improves transactional and non-transactional data from our management information system.**
- **Desktop Integration – Provides a user-friendly system that allows one stop service and gives employees centralized access to taxpayer information and history across systems; Integrated Case Processing (ICP), Reasonable Cause Assistant (RCA), Automated Underreported (AUR), Automated Collection System (ACS), Report Generation System (RGS), Correspondence Imaging, and Notice Viewing.**
- **Taxpayer Assistance Center (TAC) Model – Addresses privacy and security issues in TACs and allows traffic to be more effectively controlled.**
- **Section 3709 Telephone Lines System – Allows customers to push a numeric selection on their phone for routing to the appropriate toll-free number rather than hanging up and dialing the appropriate number. This reduces the time frame to resolve customer issues and it also provides Field Assistance with an automated reporting mechanism to track telephone volume and issue tracking.**

In addition, to improve customer service, we plan to reduce our number of seasonal staffing and increase our permanent workforce. This will allow us to have a stable workforce and provide consistent service year round.

II. Business Systems Modernization

- (1) 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. According to some reports, CADE is significantly over-budget and behind schedule. Specifically, the first release reportedly has been trimmed back in functionality from what was originally promised (in addition to being late and over- budget). Is this true? Please describe the current status of CADE, the plan for the first and future releases, development and testing of software, and the effectiveness of the PRIME contractor with respect to CADE. When will CADE permit employees directly to make adjustments to taxpayer’s returns?

CADE R1 is significantly behind schedule, but not over budget. In the spring of 2002, the contract with the prime was converted to a price fixed at the level of their proposal for this release. Other releases of CADE are also delayed and the financial implications are being determined, but the cost will definitely increase as we better understand the complexity of CADE.

The functionality planned for the first release is less than planned back several years ago and as late as the Summer of 2001. However, the functionality (1040EZ single filers, paper and electronic, no balance due – about 6 million returns) has been the planned functionality since November 2001.

The complexity of this first release of CADE is enormous because it has to both download tax account information from the legacy Individual Master File (IMF) as well as be able to place information back to the MF, as well as recreate a number of other complex interfaces, such as the Financial Management Service to pay refunds. Though the tax processing aspect of Release 1 is not overly complex, the applications infrastructure is enormously complex and has proven to be much more difficult than estimated. Later releases will have greater applications functional complexity and less infrastructure complexity.

The delays in CADE have been partly due to the infrastructure complexities noted above. In addition, we encountered several issues during the initial CADE development that have now been resolved. The Prime has been working to fully understand current IRS business processes, which is critical to estimating the complexity of the balancing and reconciliation function. Second after initial difficulty, PRIME is doing a better job of designing the business process aspects

of CADE. Third, PRIME is now creating operational documentation deemed adequate by the IRS.

CADE is currently in the second phase of a three-phase Pilot, along with other systems integration testing. To date, the testing has stayed on schedule for the last couple of months, as long a stable period as we have seen on CADE in the last year. In the third phase of the Pilot (which was not in the initial plans, but which will give us great confidence before we turn it on) the IRS will fully operate CADE on real taxpayer data under typical loads.

To determine the functionality of future releases of CADE, we are currently working with our stakeholders to finalize a release strategy, which will delineate not only the functionality of the system for each release, but the taxpayer population involved. We believe that the next release will be in January 2004 and will mainly reflect filing season changes for the 2004 filing season. The release after that, Release 2, will address the first set of 1040 filers, likely in January 2005.

CADE alone will not enable employees to make adjustments to taxpayer accounts. CADE is dependent on the Customer Account Management (CAM) Project (see #2 below). CAM along with CADE's database will provide a modernized customer interface, which will allow on line posting and adjustments to taxpayer account and return data. The schedules for CADE and CAM have to be closely aligned. And are currently being re-planned to adjust for the delivery delays of CADE and for the current stoppage of the CAM project, as explained below.

- (2) Success in implementing CADE depends on success with the Customer Account Management program, which allows the IRS to update data for CADE. Customer Account Management has two operating models: Individuals Assistance and Self-Assistance. Please explain the current status of both models.

Due to funding reductions and cost increases in projects under way, we have stopped the CAM project after completing the system requirements. This poses serious challenges in how to keep CADE going beyond Release 2, as we will need the new customer accounts management capability to support taxpayers who typically have complex tax returns and require customer service due.

We are looking into ways to do some work in the so-called self-assistance model, which tend to be simpler, web-based applications such as the Internet Refund Fact-of-Filing. However, we cannot complete the IMF replacement without building the CAM individual

assistance operating model (i.e., the software that supports customer service agents).

- (3) The Office of Management and Budget has cut funding for Modernization programs in part because the IRS significantly underestimates the cost of projects. Why does the IRS consistently have problems accurately projecting Modernization costs and what is being done?

The BSM Program is huge and complex. Although it has existed for five years, the first couple of years saw the IRS focused on organizational modernization, which realigned our business processes. Hence, by most measures this is still a program in its infancy and many lessons are being learned. There is probably no other civilian or private sector program that is so large and complex. Prior attempts to do this have met with failure.

Further, the BSM Program has progressed through several distinct levels of complexity, with lessons learned (often the hard way) at each step. First, the new applications had to interact with legacy systems. Next, they had to interact with legacy systems and new modernized infrastructure, such as the new secure online environment that we have deployed. Now we are going through the stage in which the applications are beginning to interact with each other, such as using e-Services to register users for Modernized e-file. We have yet another level of complexity around the corner when multi-release systems like CADE have one release in operation while another is being constructed.

The fact that we are making clear progress is itself a good sign. Indeed, compared to other systems projects in this size range, the IRS's record for cost and schedule estimation, while not what we want them to be, are nevertheless better than reported elsewhere (e.g., in the most recent report of hundreds of projects by the Standish Group).

We are working very hard to do better by: carefully analyzing the causes for poor estimates and correcting systematic errors; establishing contracting methods that have the PRIME accept more of the financial risk; increasing safety margins; and better controlling scope. Although it is hard to generalize across so many varied projects, cost increases (and schedule slippage) are attributable to misestimates or changes in requirements. The latter, caused by the IRS, is very hard to estimate, and is due to such things as legislative changes or changes in legacy systems to which the modernized systems interface.

- (4) How will the recent retirement of key IRS employees affect Business Systems Modernization?

The key executives that have left (Reece, Kehoe, Rossotti) or that will leave in the near future (Langdon, Mader, Wenzel) were strong supporters of the BSM program and they will be missed. However, we have built very close relationships broadly across the IRS executive team, especially with the Deputy Commissioners (Duder, Hart, Nolan, and Morgante) and the CFO (Grams, Powell), so there is still a large degree of continuity across the executive level. These key players are formally involved with the program by playing leadership roles on key BSM governance bodies, as well as generally participating in other aspects of the program, such as the business case development and the BSM budgeting process.

- (5) The TIGTA has found that cost and schedule performance of Business Systems Modernization is improving. Although the Software Engineering Institute's favorable review of the IRS's management framework for acquiring modernized business solutions is welcome news, why was such favorable review not obtained earlier? Please explain how this framework will assist modernization; will it help with the problem of cost overruns? Is the framework appropriate for the tasks ahead?

Both the PRIME and IRS received favorable reviews by SEI last year – PRIME attaining SA-CMM Level 3 certification and the BSM Program attaining Level 2. Both the PRIME and BSM Program are acquisition organizations – BSM acquiring solutions via the PRIME and the PRIME mostly acting as an acquirer of solutions via subcontracting (see #6 below). In addition the PRIME performs engineering and integration services. Software Acquisition – Capability Maturity Model (SA-CMM) is the appropriate management framework for us both. We are currently looking at a new framework from SEI called CMMi, which is tailored for the integration role that PRIME performs, but that is quite new.

The management disciplines are directly relevant to the improved management of the BSM Program. The so-called “key process areas” are things like risk management, cost and schedule estimation, acquisitions management, configuration management, and so forth. These are the same areas in which TIGTA and GAO had been expressing concerns in audits over the prior couple of years.

There are two reasons that it took so long to attain these ratings. First, it is hard. As of last summer, PRIME is the only organization in the world to achieve Level 3. BSMO is the first civilian agency to achieve Level 2 (only the second in the US government) and the first multi-

project organization to achieve Level 2. It took a huge, concentrated effort on both our parts to accomplish this.

Second, PRIME would not have been eligible to achieve an SA-CMM rating for the program until they had enough demonstrable history to show that they were applying these management disciplines across the entire life cycle. Hence, they likely would not even have been eligible had they applied much sooner.

- (6) **Please explain the contractual relationship between the IRS and the PRIME, and the relationship between the PRIME and PRIME's contractors?**

This is a complex question to answer. First, while the PRIME is the main organization that we directly contract with to achieve the BSM program, it is not the only one. The Custodial Accounting Project (roughly \$50 million in FY2003) is led by Northrop Grumman Mission Systems (formerly TRW), the HR Connect Project has also been led by NGMS under leadership from Treasury, and IBM leads the Modernized e-file project.

The IRS has a number of different contracting arrangements with PRIME. For example, for CADE Release 1, we have a fixed price agreement (the contract was initially cost plus fixed fee, but was converted to fixed price under a renegotiation about a year ago that set the price to PRIME's proposal the previous year). For the IFS project, we have a cost plus incentive fee contract, in which PRIME's fee varies from 2% to 12% based on cost control, delivery timeliness, and quality. E-Services has been on a cost plus fixed fee basis, but was recently converted to cost plus incentive fee.

The PRIME works largely via subcontracting to its Alliance partners and others to execute the BSM projects. For example, of the almost \$100 million in IFS work in FY2003, CSC directly gets only about a third of that, with the other two thirds split between BearingPoint, SAP, and direct government purchases of hardware and systems software infrastructure. We do not have deep visibility into the specific contracts that CSC has with its Alliance partners, although we do have visibility into the subcontractor rates and expenses.

Other parts of the project, such as program management and administrative support are typically on a "level of effort" basis, in which we pay a standard price with some profit for every hour of work. Typically, these tasks do not have specific deliverables in the normal sense of a systems project. Also, much of the systems engineering work and the enterprise architecture work is level-of-effort.

Going forward, we are moving to where all new application projects will be on some type of fixed price or incentive fee basis.

III. Taxpayer Protection and IRS Oversight

- (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? The IRS's innocent spouse determinations were 7 percent less than planned in Fiscal Year 2002 and the IRS has lowered the case closure target from 65,000 in Fiscal Year 2002 to 51,500 in Fiscal Year 2003. Last year, the IRS stated that reduction of staffing for field examiners on innocent spouse claims was justified because of efficiencies achieved from deployment of the Integrated Case Processing computer application. Have these efficiencies in fact been achieved?

| | |
|--|--------------------------------------|
| Number of Pre-notification cases | 18,027 |
| Of the Pre-notification total, the number of new receipts (February) | 4,540 |
| Backlog Not considered backlogged if received date is Dec or later. It takes a minimum of 75 days to drop down to Stage 05 from the received date. This time is required to contact the requesting, non-requesting spouse, and secure the administrative file. | 9,547 |
| Average processing time of full scope cases CCISO SB/SE Total Average computed as follows: SB/SE hours 54,054 closures 3,003 CCISO hours 23,451 closures 9,318 Total hours 77,505 closures 12,321 | 2.6 hrs. 18.0 hrs. 6.3 hrs |
| Average processing days of full scope cases with determination issued in FY 2003 | 258.6 days |
| Average processing time of non-qualifying cases CCISO only. SB/SE does not differentiate | .5 hrs. |
| Average processing days for non-qualifying cases in FY 2003 (to date) | 77.9 days |

The efficiency of ICP (Integrated Case Processing) can be measured by the improvement in the average processing days this fiscal year compared to FY'2002.

Average processing days of full scope cases with determination issued in FY 2002 – 282.6 days (decrease of 24 days)

Average processing days for non-qualifying cases in FY 2002 – 105.7 days (decrease of 27.8 days)

- (2) Offers in Compromise. Please show the percentage of offers in compromise completed within one year of submission and within six months of submission.

| Percentage of Offers in Compromise Closed by Time to Close and Fiscal Year | | | | | |
|---|-----------------|-----------------|-----------------|-----------------|---|
| | FY 1999* | FY 2000* | FY 2001* | FY 2002# | FY 2003# (6 Months Year to Date) |
| Within 6 Months | 52% | 39 % | 32 % | 38 % | 53 % |
| Over 6 Months, Within 12 Months | 40% | 45 % | 43 % | 36 % | 29 % |
| Over 12 Months | 8% | 17 % | 25 % | 26 % | 18 % |

Sources: * C108 Report

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

| Offers in Compromise Returned to Taxpayers by Fiscal Year | | | | | |
|--|---------|---------|---------|---------|---------------------------------------|
| | FY 1999 | FY 2000 | FY 2001 | FY 2002 | FY 2003 (6 Months Year to Date) |
| Not Processable | 22,342 | 13,694 | 16,185 | 32,897 | 17,011 |
| Returned | 0* | 13,555 | 27,751 | 50,492 | 23,055 |

*** 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 Returned was created for the other situations where the offer could not otherwise be processed.**

The IRS Oversight Board recently stated its concern that almost 80 percent of offers received cannot immediately be processed. What steps are being taken? Are legislative changes necessary?

The proliferation of the electronic media marketing by firms promising settlement of IRS taxes for “pennies on the dollar” has given taxpayers an unrealistic expectation about the offer program. Many taxpayers seek refuge in the offer program to circumvent imminent or ongoing collection action. Under current policy, the mere act of submitting a processable offer (without any supporting financial documentation) is sufficient to stay collection. Despite the fact that the latest revision (5-2001) of the offer in compromise package, Form 656, includes specific instructions to attach certain financial documentation when submitting an offer, we receive relatively few complete submissions. Furthermore, many taxpayers lose interest when they realize that they must submit substantiation of their finances to enable the Service to evaluate their offers.

We believe the high number of incomplete offers could be reduced if the pending legislation regarding penalties for frivolous submissions is enacted. We also are in the early stages of considering a proposal that

would require representatives to sign offers in compromise submitted on behalf of their clients.

In addition, we have drafted instructions to guide telephone customer service representatives when taxpayers raise the topic of offers. This guidance directs them to discuss offers in the context of the overall collection program, probing to determine if the caller is indeed an offer candidate, or more suited to other avenues (e.g., full pay, installment agreement). Under development is the offer in compromise portion of a website which will show how offers fit into the overall collection strategy.

Please update your discussion of processing time, automation, and centralization of the process.

Processing time has declined from an average of 317 days during FY 2002 to an average of 272 days for the first 6 months of FY 2003. In addition, the average age of open inventory dropped from 265 days at the end of FY 2002 to 240 at the end of March 2003. This is due in part to the continuing maturation of the Centralized Offer in Compromise (COIC) sites. Last summer we also implemented COIC process changes to improve workflow. One such change provided for early screening of offer submissions for which the taxpayers' own financial information indicated they had the ability to pay their tax liabilities completely. Another limited the type of supporting documentation we required from taxpayers who submit offers.

To address delays in field offer specialist inventories, we continue to transfer work between geographic locations to balance workload with existing staff.

Regarding automation, our efforts continue with the Automated Offer in Compromise database to increase productivity by automating labor-intensive procedures and establishing connectivity with other IRS computer systems. We have successfully tested an automated tool for calculating "Reasonable Collection Potential" in COIC and are refining it for distribution to the field. While further efforts are "in the works," we currently are redirecting programming resources to handle system needs related to the user fee implementation.

After a challenging first year that included higher than expected attrition losses and a steep learning curve, the COIC sites have greatly contributed to program improvements. Both sites are fully staffed and the majority of employees, having successfully completed their first year on the job, have been promoted to the journey level in their positions.

- (3) Collection Due Process. The IRS has reported that the due process provision of the Act slow and lengthen the overall compliance cycle and that the process was open to abuse by taxpayers seeking to delay collection activities by filing frivolous claims. This year, the Administration's Fiscal Year 2004 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.

The collection due process (CDP) provisions require that taxpayers be given 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.

There are approximately 18,600 CDP cases currently in inventory in Appeals. About 5% or 906 cases involve frivolous issue taxpayers. 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/Settlement officer, they insist on being provided certain documents, such as a copy of the Appeals/Settlement 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 some 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. Collection action is also suspended on these accounts while the case is pending in Appeals. A legislative change pending in Congress, which would permit 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.

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

We are considering rules that would, where appropriate, require taxpayers to identify with greater specificity the reasons supporting the taxpayer's request for a CDP hearing. Claims with frivolous positions will be examined 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 passed; only federal employees owe taxes; etc. Others use popular terminology which is common among frivolous claims.

The Service currently maintains a list of frivolous arguments on its Internet site. Under the heading, "The Truth About Frivolous Tax Arguments," is a 36-page document explaining why various shop-worn arguments are frivolous. The link is: http://www.irs.gov/pub/irs-utl/friv_tax.pdf.

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

Of the more than 38,000 CDP determinations issued during the fiscal years 1999, 2000, 2001 and 2002, only 35 determinations, or 0.09 percent, were overturned or conceded on appeal. That represents 3.23 percent of the 1,085 cases disposed of by the courts. For this purpose, we have counted as "losses" cases that were returned to the Office of Appeals because of a procedural error in the conduct of the CDP proceeding. In such cases the collection action may ultimately be sustained in further proceedings. In addition to cases involving errors in the CDP process, "losses" also include cases in which an error was detected in the assessment process, or in the underlying liability. We are aware of no cases in which the appeals officer's judgment concerning the appropriateness of the collection action at issue, alone, was overturned.

- (4) Tax Preparer Registration. Please comment on the National Taxpayer Advocate's proposal to require tax preparers to register with the IRS, to require the IRS to develop a series of exams to test that technical knowledge and competency of tax preparers, and a requirement that the IRS annually certify paid preparers.

Below is an IRS Position paper which addresses the question.

REGULATION OF FEDERAL TAX RETURN PREPARERS

IRS Position Paper – April 2003

Introduction

The Internal Revenue Service is aware of concerns that have been raised about the quality of the services provided by paid tax preparers. At a Senate Finance Committee hearing on April 1, 2003, the GAO said that a small percentage of the more than 71 million taxpayers that use paid preparers receive poor service because of problem performance by preparers. The National Taxpayer Advocate (NTA) has also identified this issue in the 2002 NTA Report to Congress and has recommended a legislative solution that would require Federal regulation of tax preparers.

National Taxpayer Advocate's Proposal

The proposal would require the establishment of a Federal Tax Return Preparers (FTRP) program which would regulate the registration, examination, certification and enforcement of any person, other than an attorney, certified public accountant or enrolled agent, who prepares more than five federal tax returns in a calendar year. These persons would have to complete the following requirements:

- Register with the IRS
- Pass an initial examination testing technical knowledge and competency
- Pass an annual refresher examination (including tax law updates) in each succeeding year
- Display his or her FTRP registration card

In addition, the legislative proposal would authorize the IRS to:

- Design, administer and certify FTRPs on an initial and annual basis
- Conduct a public information and consumer education campaign to inform taxpayers that paid preparers must sign the return and display their registration card
- Maintain a public list of registered and certified FTRPs, those who are registered but not certified and FTRPs whose registration has been revoked
- Notify applicable taxpayers that his or her return was prepared by an unenrolled return preparer who is not registered or registered but not certified

IRS Position

The IRS believes that all taxpayers should be able to receive accurate return preparation assistance. However, while problems exist with some paid preparers, we cannot support a legislative remedy such as that proposed by the National Taxpayer Advocate.

In listing the most serious problems encountered by taxpayers, the National Taxpayer Advocate's 2002 Report to Congress says that oversight of Earned Income Tax Credit return preparers could be improved. The IRS agreed and also expressed initial support for establishing standards and procedures for registering and certifying all tax return preparers. However, this initial statement of support did not take into account many of the issues that we now are considering; issues we believe are significant enough to caution against such a legislative solution at this time. There should be thorough consideration of these issues (as outlined below), as well as more information about the scope of the problem before determining whether legislation establishing federal regulation would provide any real benefits to taxpayers.

Issues

- **Federal vs. State Role** - Historically, licensing of professionals has been a states' rights issue. Currently, the IRS regulates practice before the IRS, a representational activity that is relevant to Federal oversight. The Tax Reform Act of 1976 established the definition of and penalties on "income tax preparers" but explicitly recognized the rights of states and localities to regulate them independent of the Federal government. Only California and Oregon have established entry requirements for the field of tax return preparation. The IRS has contacted these states to discuss the effectiveness of their programs. Preliminarily, neither state had data on the effectiveness of their program and California specifically noted the difficulty in identifying unregistered preparers. IRS will continue dialogue with these states as their experience could provide important information to guide future Federal action in this area.
- **Public Perception** - As early as 1953, the House Ways and Means Committee recognized that "the mere fact that a taxpayer's representative is a Treasury enrollee is no assurance of fair treatment for either the taxpayer or the Government, and that a requirement compelling all such representatives to be Treasury enrollees does not stop the unscrupulous from working undercover or through others." Despite that official notation, many taxpayers may incorrectly view the registration of a tax preparer by the IRS as an endorsement by the agency and mislead them into thinking they will get better service and somehow have recourse to the IRS should their "certified" preparers make errors or take advantage of the taxpayer.

- **Resources** - IRS does not have sufficient current resources to administer a Federal regulation of tax preparers program as outlined in the proposed legislation. While specific costs have not yet been projected, we can make some assumptions on the scope of resources that might be required by looking at existing procedures that govern practice before the IRS as well as other areas that require high volume processing of information. In addition to monitoring all attorneys, certified public accountants and enrolled agents who practice before the IRS, the IRS also monitors the enrolled agent examination processes and the renewal applications for each of these individuals. Currently, there are approximately 40,000 enrolled agents. The National Taxpayer Advocate estimates that there are up to 600,000 return preparers who might be covered by the legislative proposal. Assuming the program for regulation of return preparers has at least the same if not more processing and monitoring requirements, this could entail the creation of a new mini submission processing operation with operating systems to process applications, certification, test results, etc. Significant additional resources could be required.
- **Opportunity Costs** – Given the fact that funding does not always accompany legislative requirements, IRS would be faced with redeploying resources from other programs, which could have a negative impact on current enforcement, service improvement and revenue collection efforts.
- **Enforcement** - Without civil penalties or criminal sanctions for failure to register, it is likely that many of these preparers will simply ignore these provisions and continue their business. Many could go underground (making their detection extremely difficult) offering their services at a lower cost, not signing tax forms and evading any subsequent enforcement activities. This would make IRS enforcement that much more difficult and resource intensive.
- **Added Taxpayer Cost** – While it has been suggested that the primary cost of registration would be borne by the tax preparers, we believe businesses typically raise their fees to cover increased costs. Therefore, the cost of this program would likely be passed on to the taxpayer. This can have an unintended consequence of increasing the cost burden to the taxpayer without providing them any assurance that they are buying better or more accurate return preparation services.

Alternatives to Legislation Requiring Federal Regulation

The IRS Business Divisions and the IRS Chief Counsel believe there are productive alternatives to additional legislation requiring more Federal oversight. The IRS is actively engaged in the following initiatives, which are examples of ongoing efforts to provide education and information outreach to preparers and taxpayers who want to ensure good service.

- **Education** – The IRS is expanding preparer education activities through continuing professional education programs, on-line courses and tax forums. One of the Service’s most effective outreach programs to the tax professional

community is the IRS Nationwide Tax Forums. These forums include seminars and trade shows and offer information on tax law changes, how to save time by e-filing, ethics and how to become an Electronic Return Originator. This year, there are also advanced sessions focusing on abusive schemes, tax shelter reporting and compliance, and refund crimes. Additionally, through Tax Preparer Institutes, the IRS provides materials on high priority programs to educational institutions.

- **Outreach** – The IRS is increasing publicity on how to choose an income tax return preparer. The agency is working with the American Bar Association to further expand and publicize criteria for choosing a tax preparer. In addition, recent Criminal Investigation press releases have highlighted instances of fraud among tax return preparers. Both the ABA's web site and IRS press releases reference such criteria as avoiding anyone that bases fees on a percentage of the refund, refuses to sign the return, claims to know a special or secret way to avoid taxes, suggests taking unsubstantiated deductions and credits, asks customers to sign blank returns, or asks for the refund to be mailed directly back to them. Additionally, IRS envisions including reliable preparer criteria on irs.gov, in the IRS e-news subscription service, and in future filing season press releases. Also information can be included in IRS partnership outreach efforts with local community organizations that sponsor programs designed to enhance tax and financial literacy.
- **Testing** - The IRS recognizes that it faces a particular challenge in getting information to and identifying the needs of unenrolled tax return preparers. A current effort underway to test the effect of education materials on those preparers who prepare Earned Income Tax Credit (EITC) returns may provide a model of how to meet this challenge. This effort centers on a pilot that sends a brochure to three groups of EITC preparers and then compares their subsequent rate of errors over three years to groups with similar characteristics who did not get the brochure. The brochure, with a desired outcome of reducing errors and improving EITC compliance, includes material on tax law changes, due diligence and information on where to get further EITC information. In addition to identifying the impact of preparer education on EITC error rate, the brochure can be used for other outreach efforts such as the EITC booth at the Tax Forums.
- **Enforcement** – If additional resources are available, IRS would prefer to increase enforcement of the current return preparer penalty provisions, thus encouraging higher professional standards of practitioners and unenrolled return preparers. Paid returns preparers are currently subject to criminal and civil penalties for a wide range of inappropriate behavior. Criminal penalties may be asserted for willfully attempting to evade tax, willfully making false statements under penalties of perjury, and willfully aiding, assisting, counseling or advising in the preparation of any document in connection with the Internal Revenue laws that is false or fraudulent. Civil penalties may be asserted for willfully attempting to understate the tax liability of another person, or if the preparer negotiates a

check issued with respect to another person's taxes. Preparers are also subject to civil penalties for failing to (1) sign a return, (2) furnish their identifying number, (3) file a correct information return, (4) furnish the taxpayer with a copy of a return, (5) retain a copy of a return, or (6) be diligent in determining a taxpayer's eligibility for the Earned Income Tax Credit.

Conclusion

The IRS believes that all taxpayers should be able to receive accurate return preparation assistance. However, without knowing the full extent of the problem, whether the proposed legislative remedy would bring about the desired result and the impact on IRS resources, it is premature to consider a legislative solution. However, the IRS Business Divisions will continue to work with the National Taxpayer Advocate on a course of action that will better define the nature and scope of the problem, study the impact of current efforts to improve both preparer and taxpayer education and look at additional alternatives to foster better service by paid tax preparers.

- (5) Merger of TIGTA and Treasury Inspector General. Please comment on the Administration's proposal to merge the TIGTA and the Treasury Inspector General into a new Inspector General for Treasury. Is the TIGTA not operating as envisioned in the 1998 Act? Would the proposal increase the risk of disclosure of confidential tax return information?

TIGTA is operating as envisioned by the 1998 Act that established it. The Administration's proposal is in no way a reflection on how TIGTA operates. The processes developed by TIGTA to provide oversight and not to interfere with efficient tax administration would remain after merger. The Administration is dedicated to the protection of confidential tax return information and the merger, premised on administrative efficiency, should not increase the risk of disclosure of confidential information.

IV. 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 enumerated in section 1203? Have the procedures been effective in addressing employee misconduct?

See Appendix I for data on §1203 allegations, and the actions taken. As of March 31, 2003, there were 81 removals under Section 1203, 60 of which were based on failure to timely file a federal tax return. An additional 158 employees with substantiated §1203 violations resigned, retired, were separated during probation or were separated on other grounds. In 138 of those 158 cases, the §1203 issue was one of the tax compliance provisions.

There is no specific measure for the “effectiveness” of §1203. If effectiveness is measured in terms of modification of employee behavior, the data suggests that there has been significant behavior modification. 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 that were 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 7% 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. Seventy-five 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 74 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 2004 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?

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.

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

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 the cases to be submitted for 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.

The basic premise of §1203 is that certain offenses are so serious that termination of employment is presumed to be the appropriate sanction. The discretion of IRS managers to select an alternate penalty was eliminated, as was 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 Service. 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?

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 employee is given 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 consideration of the evidence, including any response from the employee, the employee is notified 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 regarding 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 all other aspects of the OPM prescribed process are followed.

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

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. The decline in the number of front-line enforcement personnel has only recently been addressed, and employee morale was seriously affected by the accusations and scrutiny of the IRS in 1997 and 1998.

Recognizing that there are a number of factors to be considered, the fear and anxiety associated with §1203 is frequently cited by front-line employees and managers as a major factor in their approach to enforcement activity. They believe the law reflects an assumption that certain egregious misconduct was not taken seriously by the IRS, and that a Draconian approach was needed 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 in them 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 employees taking appropriate enforcement actions were put at risk by the enactment of §1203. The most recent such survey is reported by the GAO in “IRS and TIGTA Should Evaluate Their Processing of Employee Misconduct Under Section 1203,” GAO-03-394, February 14, 2003. 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 that we can identify steps that can be taken to further address employee concerns about §1203.

(b) 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 Executives 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?

As of March 31, 2003, IRS has used the Streamlined Critical Pay authority to hire five executives with a base salary that could have been accommodated under the SES pay scale if pay had been the sole criteria used. The streamlined critical pay authority provides us with the ability to identify candidates to fill critical vacancies in an organization at a specific point in time. This four year term allows us to match organizational needs at a specific point in time with experienced executive talent. The four year term provides the organization with maximum flexibility for the future.

| Title | Initial CP Salary | Maximum SES at Time of Hire |
|---|-------------------|-----------------------------|
| Director, Communications (W&I) | \$125,000 | \$133,700 |
| Deputy Chief, C&L | \$133,000 | \$133,700 |
| Director, Security Modernization | \$130,000 | \$138,200 |
| National Director, Account Management Division (W&I) | \$105,000 | \$125,900 |
| Director, Product & Partnership Development (W&I) | \$125,000 | \$133,700 |
| Director, Infrastructure, Architecture, & Engineering | \$130,000 | \$138,200 |

- (2) How much (total and on a year-by-year basis) has the IRS spent on moving expenses for critical pay personnel? How does this compare to the number of critical pay hires in a year?

As of March 31, 2003, the IRS has spent a total of \$1,693,572 for moving expenses for critical pay personnel. (The total is less than reported in April 2002 due to actual expenses being less than estimated.) The benefits under this program are the same as for career individuals, with the one exception being that RRA 98 provides the additional authority to allow coverage of their first move prior to government service.

| Fiscal Year | Total Expenses | Executives Moved | Executives Hired |
|--------------|--------------------|------------------|------------------|
| 1998 | \$ 90,568 | 3 | 4 |
| 1999 | \$ 16,340 | 1 | 2 |
| 2000 | \$374,466 | 6 | 12 |
| 2001 | \$896,026 | 10 | 18 |
| 2002 | \$296,316 | 2 | 12 |
| 2003 | \$73,206 | 1 | 1 |
| Total | \$1,693,572 | 23 | 49 |

- (3) How much (total and on a year-by-year basis) 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, 2003, IRS has expended \$3,623,979 on 51 executive searches with five currently in progress. (This is less than reported in April 2002 due to actual expenses being less than anticipated for searches in progress at that time.) Of this amount, \$1,881,553 is directly attributable to 26 Critical Pay hires with two searches currently in progress.

- (4) Please show the prior salary and critical pay salary for each critical pay employee hired.

| CURRENT CP EXECUTIVES (AS OF March 31, 2003) | | | | |
|---|--------------------------------|-----------------------------|----------------------------|-----------------------|
| <u>NAME</u> | SALARY | | | |
| | <u>PRIOR to IRS</u> | 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 |
| CURRENT CP EXECUTIVES (AS OF March 31, 2003) | | | | |
| <u>NAME</u> | SALARY | | | |
| | <u>PRIOR to IRS</u> | CURRENT COMPENSATION | | |
| | | BASE | POTENTIAL BONUS | TOTAL COMP |
| 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 |
| Forman, Fred | \$622,700 | \$192,600* | \$0 | \$192,600 |
| Gaur, Prashant | \$255,000 | \$160,000 | \$30,000 | \$190,000 |
| Horse, 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 |
| Kist, Franklin | \$591,661 | \$155,000 | \$25,000 | \$180,000 |
| Leighty, Colleen | \$154,614 | \$140,000 | \$21,000 | \$161,000 |
| Liuzzi, John | \$195,000 | \$175,000 | \$17,600 | \$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 |
| Shultz, Paul | \$186,000 | \$165,000 | \$16,400 | \$181,400 |
| St. Jacques, Michael | \$65,400 | \$130,000 | \$20,000 | \$150,000 |
| 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 |
| Wisniewski, Brenda | \$363,600 | \$180,000 | \$12,600 | \$192,600 |

| SEPARATED CP EXECUTIVES (AS OF March 31, 2003) | | | | |
|---|--------------------------------|---|----------------------------|-----------------------|
| <u>NAME</u> | SALARY | | | |
| | <u>PRIOR to IRS</u> | <i>IRS COMPENSATION (at time of departure)</i> | | |
| | | 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 |
| SEPARATED CP EXECUTIVES (AS OF March 31, 2003) | | | | |
| <u>NAME</u> | SALARY | | | |
| | <u>PRIOR to IRS</u> | <i>IRS COMPENSATION (at time of departure)</i> | | |
| | | BASE | POTENTIAL BONUS | TOTAL COMP |
| Cunninghame, Donna | \$118,400 | \$147,500 | \$0 | \$147,500 |
| Eads, James | \$355,717 | \$192,600* | \$0 | \$192,600 |
| Kehoe, Joseph ** | \$1,000,000 | \$192,600* | \$0 | \$192,600 |
| LaFaver, John | \$90,000 | \$155,100* | \$0 | \$155,100 |
| Langdon, Larry ** | \$650,000 | \$192,600* | \$0 | \$192,600 |
| Liberti, Thomas | \$228,700 | \$181,400 | \$0 | \$181,400 |
| Matthews, Mark | \$185,000 | \$192,000* | \$0 | \$192,600 |
| 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 |
| Reece, John ** | \$219,811 | \$192,600* | \$0 | \$192,600 |
| Rinaldi, Jim | \$308,118 | \$186,300 | \$0 | \$186,300 |
| Rosenker, Heather | \$150,000 | \$135,000 | \$30,000 | \$165,000 |
| Yuckenber, Timothy | \$243,413 | \$175,000 | \$11,300 | \$186,300 |

*Current base salary includes annual salary increases since EOD.

**Joseph Kehoe and John Reece separated effective 4/19/2003.
Larry Langdon will separate 5/31/2003.

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

| | |
|-------------------------|-----------|
| Technology | 17 |
| 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?

As of March 31, 2003, 16 executives have left the IRS.

The average tenure of the executives who have departed is 21 months. Five of the executives were with the IRS for over two years and one for three and a half years.

(7) Please describe specific accomplishments made possible by the special pay provisions.

The streamlined Critical Pay executives have brought exceptional talent and an extensive range of skills to the Service. These are evidenced by the key and highly significant contributions they have made that enable the Service to successfully meet the massive challenges presented by the complete restructuring mandated by Congress. Below are some examples from the last half of fiscal year 2002:

Modernization

- **The Business Systems Modernization (BSM) Program established the foundation for better management of our massive business and technology improvement programs with the establishment of both a long-term vision and enterprise architecture. In fact, the Service is only the second agency in the federal government to obtain Level Two certification in the Software Engineering Institutions Capability Maturity Model.**
- **We launched the new IRS.gov website – Digital Daily – in January 2002 with enhanced search capabilities, receiving a positive response from the public and recognition with the E-gov Pioneer Award, the Forbes “Best of Web” Award, and a CIO Award.**

- We developed and executed an expanded master file backup and disaster recovery process/capability across all three IRS Computing Centers, in response to the 9/11/01 terrorist attacks. In addition, four Situation Awareness and Management Center (SAMC) locations were established.
- We implemented the first modernized Enterprise Help Desk (EHD) infrastructure and the automated inventory database, Integrated Asset Management System (ITAMS).
- We designed and implemented a process for converting SB/SE training courses to a technology enhanced learning (TEL) environment, thus reducing the administrative costs associated with training and delivery by 43%.

Customer Relations

- We launched the first account secure web application for taxpayers to access certain types of account information, enabling us to match the service provided by other companies. Usage of Internet Refund/Fact of Filing (IRFOF) has already exceeded our expectations, with over one million accesses to date.
- The Office of Taxpayer Burden Reduction produced tangible burden reduction results with significant time savings for taxpayers and practitioners.
- We developed and implemented 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.
- We developed strategic alliances between the IRS and external stakeholders to achieve mutual objectives (i.e., trade associations, practitioner and payroll organizations, educational and financial institutions, liaison groups, and Congressional staff offices.)
- We developed effective pre-filing educational initiatives and published guidance to clarify the tax law and reduce unnecessary controversy.

Compliance

- **We identified emerging issues within industries and the developed comprehensive profiles, tools, and techniques to assist agents in dealing with those issues.**
- **We implemented a successful initiative to combat abusive corporate tax shelters.**
- **We Implemented electronic crimes unit within Criminal Investigations.**

(8) Would more be accomplished if IRS employees were eligible for the special pay provisions?

No.

(c) Please show the number and kind of Equal Employment Opportunity Commission complaints and grievances. What percentage of complaints were settled? What was the type of remedy provided?

See Appendix II

(d) Please compare the average salary (adjusted for inflation in 2002 dollars) and average grade of all employees from 1997 through 2002.

See Appendix III a.

V. Revenue and Business Results

Please provide data for the following:

(1) *Total revenue collected; total enforcement revenue collected.*

See Appendix IV

(2) *Total number of returns filed.*

See Appendix IV

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

See answer to V (4) below.

- (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.

Revenue and Business Results - Automation History

(dollars in thousands / actual data)

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|----------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| FTE | 101,703 | 98,036 | 98,729 | 97,074 | 97,707 | 99,901 |
| Automation FTE | 0 | 0 | 133 | 107 | 156 | 176 |
| Total Obligations | 7,283,991 | 7,628,490 | 8,256,212 | 8,389,844 | 9,766,875 | 9,509,081 |
| Travel Budget | 111,928 | 136,561 | 163,161 | 178,406 | 182,022 | 192,279 |
| Outside Contract Expense: | | | | | | |
| Automation (BSM) | 0 | 0 | 25,818 | 167,818 | 298,307 | 271,119 |
| Other | 586,232 | 763,369 | 1,003,619 | 462,341 | 668,360 | 825,182 |
| Relocation Expenses | 19,907 | 37,565 | 28,353 | 39,282 | 35,458 | 19,314 |
| Space Rental | 509,634 | 497,629 | 526,098 | 504,342 | 587,548 | 589,452 |
| Automation Budget | 213,985 | 252,561 | 439,503 | 468,377 | 610,184 | 596,636 |

NOTE: Dollar data includes obligations of funds from all available sources; i.e., prior years and user fees.

- (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. What specific steps are being taken to increase electronic filing, including steps to ensure coordinated filing between the IRS and State governments?

119 individual tax forms and schedules out of a total of 127 can be filed electronically. This means that well over 90% of all individual taxpayers are eligible to file their tax returns electronically.

The percentage increase each year for electronic filing by individuals is as follows:

| Year | E-File Returns (In Thousands) | % Increase Over Prior Year |
|-------------|--|---------------------------------------|
| 1986 | 25 | |
| 1987 | 78 | 212% |
| 1988 | 583 | 647% |
| 1989 | 1,161 | 99% |
| 1990 | 4,204 | 262% |
| 1991 | 7,567 | 80% |
| 1992 | 11,045 | 46% |
| 1993 | 12,482 | 13% |
| 1994 | 14,021 | 12% |
| 1995 | 11,807 | -16% |
| 1996 | 14,968 | 27% |
| 1997 | 19,136 | 28% |
| 1998 | 24,580 | 28% |
| 1999 | 29,346 | 19% |
| 2000 | 35,381 | 21% |
| 2001 | 40,207 | 14% |
| 2002 | 46,891 | 17% |

Based on the more recent information available, the projected increase in electronic filing through FY2007 is as follows. Please note that these projections, which represent baseline extrapolations of current trends, existing marketing approaches, enacted legislation and confirmed IRS program changes, are subject to change.

| Year | E-File Returns (In Thousands) | % of Returns Filed Filed Electronically |
|-------------|--|--|
| 2003 | 54,310 | 41.2% |
| 2004 | 60,453 | 45.1% |
| 2005 | 66,592 | 48.8% |
| 2006 | 71,890 | 51.9% |
| 2007 | 76,502 | 54.4% |

Specific steps being taken to increase electronic filing:

- **On October 30, 2002, the IRS and the Department of Treasury announced a public-private partnership agreement that permits tax software companies to provide secure and free online tax return preparation and e-filing services to at least 60 percent (or 78 million) individual taxpayers. These free services are available throughout the 2003 Filing Season beginning January 16, 2003.**
- **A consortium of companies is offering the free services from the tax software industry. All members of this consortium are Authorized IRS e-file Providers. Taxpayers have the ability to file the same federal tax forms available in comparable paid online services.**
- **We developed legislative proposals to encouraging electronic filing. A current proposal is being considered in congress for an extended due date past April 15th for electronically filed returns.**
- **We are developing a comprehensive product line for businesses.**
- **We modernized infrastructure to make filing technically easier.**
- **We developed a set of tax data standards (xml) to simplify product development/modification and reduce software development costs.**
- **We developed a comprehensive strategy for practitioners/taxpayer representatives that would offer other electronic services in combination with electronic filing to encourage electronic filing growth. The initial rollout of these initiatives will begin this fiscal year.**
- **Currently Federal/State e-file is available in 37 states and the District of Columbia we continue to work closely with all states that have income tax for inclusion into the e-file federal program.**

(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 2002**

| All Individuals | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 | FY 2002 |
|---|------------------|------------------|------------------|----------------|----------------|----------------|
| Field | 715,615 | 567,759 | 384,484 | 251,108 | 202,515 | 205,134 |
| Service Center | 803,628 | 625,021 | 715,789 | 366,657 | 529,241 | 538,747 |
| Total Return Closures | 1,519,243 | 1,192,780 | 1,100,273 | 617,765 | 731,756 | 743,881 |
| | | | | | | |
| Corporations < \$10 Million | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 | FY 2002 |
| Field | 55,021 | 40,735 | 27,484 | 17,580 | 13,169 | 12,713 |
| Service Center | 1,302 | 1,083 | 784 | 1,043 | 1,163 | 1,942 |
| Total Return Closures | 56,323 | 41,818 | 28,268 | 18,623 | 14,332 | 14,655 |
| | | | | | | |
| Corporations \$10 Million & Over | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 | FY 2002 |
| Field | 12,706 | 11,464 | 10,287 | 8,978 | 8,465 | 8,211 |
| Service Center | 266 | 366 | 250 | 234 | 253 | 232 |
| Total Return Closures | 12,972 | 11,830 | 10,537 | 9,212 | 8,718 | 8,443 |
| | | | | | | |
| Grand Total | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 | FY 2002 |
| Field | 915,420 | 728,545 | 505,847 | 342,660 | 280,111 | 281,808 |
| Service Center | 812,702 | 634,098 | 722,559 | 373,255 | 534,946 | 545,171 |
| Total Return Closures | 1,728,122 | 1,362,643 | 1,228,406 | 715,915 | 815,057 | 826,979 |

Cycle Days

| Individuals | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 | FY 2002 |
|---------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Revenue Agent | 299 | 286 | 311 | 360 | 377 | 313 |
| Tax Auditor | 205 | 217 | 244 | 267 | 252 | 262 |
| Service Center (Non-IRP) | 235 | 206 | 325 | 321 | 263 | 268 |
| | | | | | | |
| Corps. < \$10 M | 255 | 281 | 316 | 365 | 359 | 343 |
| Corps. \$10 M & Over | 466 | 447 | 466 | 511 | 565 | 567 |

No Change Rates

| Individuals | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 | FY 2002 |
|--------------------------|---------|---------|---------|---------|---------|---------|
| Revenue Agent | 10% | 12% | 12% | 13% | 14% | 16% |
| Tax Auditor | 14% | 15% | 15% | 15% | 17% | 16% |
| Service Center (Non-IRP) | 13% | 21% | 15% | 26% | 19% | 20% |
| | | | | | | |
| Corps. < \$10 M | 26% | 27% | 27% | 27% | 30% | 30% |
| Corps. \$10 M & Over | 18% | 19% | 21% | 20% | 20% | 20% |

Technical Staffing

| | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY 2001 | FY 2002 |
|-------------------------|---------|---------|---------|---------|---------|---------|
| Revenue Agents | 14,399 | 13,647 | 13,061 | 12,550 | 11,598 | 11,176 |
| Tax Compliance Officers | 2,318 | 2,113 | 1,930 | 1,702 | 1,420 | 1,212 |

Source: Table 37

- (7) The projected loss of revenue from non –filers; total tax gap.

See Appendix IV

- (8) Total number of the Senior Executive Service, GS-15s, and 14s; average age of IRS employees above GS-9, break out average age of revenue agents, revenue officers, tax auditors, chief counsel employees.

See Appendix III b-g

- (9) Total number of managers; ration of management staff to non –management staff; average number of employees managed by first line managers.

See Appendix III b-g

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

Below is a file with Appeals cumulative receipts and closed cycle times for FY'96 through FY'02.

Appeals does not maintain sustension rates since use of ROTER data is restricted for certain measurement purposes, and there is not sufficient business reason to track the data for all appeals. Manual extraction and calculation of rates would not be very meaningful because available data does not cover all issues and accuracy is subject to data input error.

| | FY'97 | FY'98 | FY'99 | FY'00 | FY'01 | FY'02 |
|---------------------------|--------|--------|--------|--------|--------|--------|
| Total Appeals Receipts | 76,684 | 65,434 | 58,679 | 55,370 | 68,123 | 76,397 |
| Appeals Cycle Time (Days) | 220 | 210 | 223 | 222 | 225 | 250 |

(11) Total number of trials; total docketed cases/dollar amounts; litigation sustention rate, and cycle time.

Fiscal Year 1997

| | <u>Total No. of Cases Closed</u> | <u>Defaults/Dismissals</u> | <u>Settled</u> | <u>Tried & Decided</u> | <u>Declaratory Judgment</u> |
|-----------------|----------------------------------|----------------------------|----------------|----------------------------|-----------------------------|
| Tax Court | 28,065 | 5,441 | 21,384 | 1,203 | 37 |
| District Court | 667 | 227 | 290 | 150 | |
| Ct. of Fed. Cl. | 118 | 17 | 52 | 49 | |
| Total | 28,850 | 5,685 | 21,726 | 1,402 | |

Tax Court Cases

| | <u>Tax & Penalty Disputed in Case</u> | <u>Tax & Plty Determined</u> | <u>Ovrpymnt In Dispute</u> | <u>Ovrpymnt Determined</u> |
|---------------------|---|----------------------------------|----------------------------|----------------------------|
| Defaults/Dismissals | 153,551,089 | 131,744,849 | 226,778 | 102,868 |
| Settled | 2,753,312,744 | 660,176,842 | 65,883,680 | 57,790,932 |
| Tried and Decided | 689,825,678 | 232,640,118 | 17,605,416 | 3,468,081 |
| Total | 3,596,689,511 | 1,024,561,809 | 83,715,874 | 61,361,881 |

| | <u>Sustention Rate</u> | <u>Avg. Cycle Time in Days</u> |
|----------------------|------------------------|--------------------------------|
| Defaults/Dismissals | | 194 |
| Settled | | 395 |
| Tried and Decided | 90% | 1,042 |
| Declaratory Judgment | 95% | 1,488 |
| All cases | | 383 |

- Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

District Courts

| | <u>Overpayment Disputed in Case</u> | <u>Overpayment Determined</u> | <u>Sustention Rate</u> | <u>Avg. Cycle In Days</u> |
|---------------------|---|-----------------------------------|------------------------|-------------------------------|
| Defaults/Dismissals | 36,810,367 | 13,086,698 | | 551 |
| Settled | 179,331,186 | 33,811,809 | | 845 |
| Tried and Decided | 65,358,885 | 9,110,883 | 71% | 945 |
| All Cases | 281,500,438 | 56,009,390 | | 767 |

* Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

Court of Federal Claims

| | <u>Overpayment Disputed in Case</u> | <u>Overpayment Determined</u> | <u>Sustention Rate</u> | <u>Avg. Cycle In Days</u> |
|---------------------|---|-----------------------------------|------------------------|-------------------------------|
| Defaults/Dismissals | 12,376,115 | 249,045 | | 682 |
| Settled | 318,713,774 | 34,131,085 | | 1427 |
| Tried and Decided | 31,792,639 | 8,138,241 | 94% | 1241 |
| All Cases | 362,882,528 | 42,518,371 | | 1242 |

* Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

Fiscal Year 1998

| | <u>Total No. of Cases Closed</u> | <u>Defaults/ Dismissals</u> | <u>Settled</u> | <u>Tried & Decided</u> | <u>Declaratory Judgment</u> |
|-----------------|--------------------------------------|---------------------------------|----------------|--------------------------------|---------------------------------|
| Tax Court | 26,423 | 5,309 | 20,035 | 1,053 | 26 |
| District Court | 635 | 223 | 268 | 144 | |
| Ct. of Fed. Cl. | 139 | 46 | 56 | 37 | |
| Total | 27,197 | 5,578 | 20,359 | 1,234 | 26 |

Tax Court Cases

| | <u>Tax & Penalty Disputed in Case</u> | <u>Tax & Plty Determined</u> | <u>Ovrpymnt In Dispute</u> | <u>Ovrpymnt Determined</u> |
|---------------------|---|--------------------------------------|--------------------------------|--------------------------------|
| Defaults/Dismissals | 160,401,932 | 135,281,291 | 319,116 | 161,618 |
| Settled | 3,715,728,589 | 913,606,314 | 170,989,852 | 74,197,442 |
| Tried and Decided | 2,887,113,294 | 505,812,212 | 333,680,735 | 259,035,876 |
| Total | 6,763,243,815 | 1,554,699,817 | 504,989,703 | 333,394,936 |

| | <u>Sustention Rate</u> | <u>Avg. Cycle Time in Days</u> |
|----------------------|------------------------|------------------------------------|
| Defaults/Dismissals | | 220 |
| Settled | | 396 |
| Tried and Decided | 90% | 949 |
| Declaratory Judgment | 69% | 434 |
| All cases | | 383 |

- Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

District Courts

| | <u>Overpayment Disputed in Case</u> | <u>Overpayment Determined</u> | <u>Sustention Rate</u> | <u>Avg. Cycle In Days</u> |
|---------------------|---|-----------------------------------|------------------------|-------------------------------|
| Defaults/Dismissals | 692,242,661 | 41,727,902 | | 695 |
| Settled | 82,615,233 | 33,308,792 | | 801 |
| Tried and Decided | 44,389,460 | 18,406,196 | 75% | 962 |

| | | | |
|-----------|-------------|------------|-----|
| All Cases | 281,500,438 | 56,009,390 | 800 |
|-----------|-------------|------------|-----|

* Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

Court of Federal Claims

| | <u>Overpayment Disputed in Case</u> | <u>Overpayment Determined</u> | <u>Sustention Rate</u> | <u>Avg. Cycle In Days</u> |
|---------------------|---|-----------------------------------|------------------------|-------------------------------|
| Defaults/Dismissals | 47,276,952 | 33,622 | | 873 |
| Settled | 94,781,750 | 41,439,275 | | 936 |
| Tried and Decided | 44,393,158 | 10,172,553 | 84% | 996 |
| All Cases | 186,451,860 | 51,645,450 | | 931 |

* Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

Fiscal Year 1999

| | <u>Total No. of Cases Closed</u> | <u>Defaults/ Dismissals</u> | <u>Settled</u> | <u>Tried & Decided</u> | <u>Declaratory Judgment</u> |
|-----------------|--------------------------------------|---------------------------------|----------------|--------------------------------|---------------------------------|
| Tax Court | 23,290 | 4,593 | 17,778 | 902 | 17 |
| District Court | 548 | 204 | 224 | 120 | |
| Ct. of Fed. Cl. | 137 | 65 | 39 | 33 | |
| Total | 23,975 | 4,862 | 18,041 | 1,055 | 17 |

Tax Court Cases

| | <u>Tax & Penalty Disputed in Case</u> | <u>Tax & Plty Determined</u> | <u>Ovrpymnt In Dispute</u> | <u>Ovrpymnt Determined</u> |
|---------------------|---|--------------------------------------|--------------------------------|--------------------------------|
| Defaults/Dismissals | 314,237,176 | 222,823,330 | 1,271,402 | 515,963 |
| Settled | 5,451,034,314 | 1,118,894,459 | 730,613,985 | 355,905,321 |
| Tried and Decided | 672,308,057 | 211,584,359 | 76,335,988 | 54,976,799 |
| Total | 6,437,579,547 | 1,553,302,148 | 808,221,375 | 411,398,083 |

| | <u>Sustention Rate</u> | <u>Avg. Cycle Time in Days</u> |
|----------------------|------------------------|------------------------------------|
| Defaults/Dismissals | | 218 |
| Settled | | 438 |
| Tried and Decided | 92% | 958 |
| Declaratory Judgment | 82% | 563 |
| All cases | | 415 |

- Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

District Courts

| | <u>Overpayment Disputed in Case</u> | <u>Overpayment Determined</u> | <u>Sustention Rate</u> | <u>Avg. Cycle In Days</u> |
|---------------------|---|-----------------------------------|------------------------|-------------------------------|
| Defaults/Dismissals | 50,473,593 | 1,764,675 | | 480 |
| Settled | 44,670,772 | 8,254,380 | | 593 |
| Tried and Decided | 157,732,080 | 8,848,280 | 76% | 977 |
| All Cases | 252,876,445 | 18,867,335 | | 635 |

- * Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

Court of Federal Claims

| | <u>Overpayment Disputed in Case</u> | <u>Overpayment Determined</u> | <u>Sustention Rate</u> | <u>Avg. Cycle In Days</u> |
|---------------------|---|-----------------------------------|------------------------|-------------------------------|
| Defaults/Dismissals | 19,961,771 | 845 | | 2537 |
| Settled | 44,014,851 | 9,380,546 | | 1464 |
| Tried and Decided | 111,978,530 | 39,660,801 | 72% | 1427 |
| All Cases | 175,955,152 | 49,042,192 | | 1964 |

- * Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

Fiscal Year 2000

| | <u>Total No. of Cases Closed</u> | <u>Defaults/Dismissals</u> | <u>Settled</u> | <u>Tried & Decided</u> | <u>Declaratory Judgement</u> |
|-----------------|----------------------------------|----------------------------|----------------|----------------------------|------------------------------|
| Tax Court | 19,149 | 4,418 | 13,819 | 893 | 19 |
| District Court | 569 | 251 | 193 | 125 | |
| Ct. of Fed. Cl. | 59 | 25 | 17 | 17 | |
| Total | 19,777 | 4,694 | 14,029 | 1,035 | 19 |

Tax Court Cases

| | <u>Tax & Penalty Disputed in Case</u> | <u>Tax & Plty Determined</u> | <u>Ovrpymnt In Dispute</u> | <u>Ovrpymnt Determined</u> |
|---------------------|---|----------------------------------|----------------------------|----------------------------|
| Defaults/Dismissals | 479,303,806 | 413,165,654 | 1,888,468 | 398,270 |
| Settled | 5,021,522,539 | 932,781,391 | 251,218,284 | 226,976,321 |
| Tried and Decided | 1,290,910,342 | 577,902,407 | 44,183,365 | 24,530,657 |
| Total | 6,791,736,687 | 1,923,849,452 | 297,290,117 | 251,905,248 |

| | <u>Sustention Rate</u> | <u>Avg. Cycle Time in Days</u> |
|----------------------|------------------------|--------------------------------|
| Defaults/Dismissals | | 237 |
| Settled | | 426 |
| Tried and Decided | 90% | 995 |
| Declaratory Judgment | 79% | 925 |
| All cases | | 413 |

- Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

District Courts

| | <u>Overpayment Disputed in Case</u> | <u>Overpayment Determined</u> | <u>Sustention Rate</u> | <u>Avg. Cycle In Days</u> |
|---------------------|-------------------------------------|-------------------------------|------------------------|---------------------------|
| Defaults/Dismissals | 27,395,124 | 2,026,548 | | 567 |
| Settled | 49,374,530 | 11,265,487 | | 744 |

| | | | | |
|-------------------|-------------|------------|-----|-----|
| Tried and Decided | 102,392,923 | 14,320,911 | 76% | 839 |
| All Cases | 179,162,577 | 27,612,946 | | 687 |

* Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

Court of Federal Claims

| | <u>Overpayment Disputed in Case</u> | <u>Overpayment Determined</u> | <u>Sustention Rate</u> | <u>Avg. Cycle In Days</u> |
|---------------------|---|-----------------------------------|------------------------|-------------------------------|
| Defaults/Dismissals | 247,849,009 | 1,788,484 | | 1105 |
| Settled | 43,649,566 | 1,888,233 | | 1012 |
| Tried and Decided | 8,764,124 | 8,186 | 94% | 4034 |
| All Cases | 300,262,699 | 3,684,903 | | 1922 |

* Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

Fiscal Year 2001

| | <u>Total No. of Cases Closed</u> | <u>Defaults/ Dismissals</u> | <u>Tried & Settled</u> | <u>Declaratory Decided</u> | <u>Judgment</u> |
|-----------------|--------------------------------------|---------------------------------|--------------------------------|--------------------------------|-----------------|
| Tax Court | 13,609 | 3,126 | 9,703 | 762 | 18 |
| District Court | 361 | 148 | 159 | 54 | |
| Ct. of Fed. Cl. | 107 | 37 | 42 | 28 | |
| Total | 14,077 | 3,311 | 9,904 | 744 | 18 |

Tax Court Cases

| | <u>Tax & Penalty Disputed in Case</u> | <u>Tax & Plty Determined</u> | <u>Ovrpymnt In Dispute</u> | <u>Ovrpymnt Determined</u> |
|---------------------|---|--------------------------------------|--------------------------------|--------------------------------|
| Defaults/Dismissals | 350,846,504 | 284,068,075 | 2,373,277 | 279,238 |
| Settled | 1,973,117,576 | 404,581,588 | 142,281,089 | 19,691,318 |
| Tried and Decided | 954,735,502 | 147,907,348 | 38,732,406 | 17,322,474 |
| Total | 3,278,699,582 | 836,557,011 | 183,386,772 | 37,293,030 |

| | <u>Sustention Rate</u> | <u>Avg. Cycle Time in Days</u> |
|----------------------|------------------------|------------------------------------|
| Defaults/Dismissals | | 239 |
| Settled | | 415 |
| Tried and Decided | 93% | 1171 |
| Declaratory Judgment | 67% | 1029 |
| All cases | | 417 |

* Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

District Courts

| | <u>Overpayment Disputed in Case</u> | <u>Overpayment Determined</u> | <u>Sustention Rate</u> | <u>Avg. Cycle In Days</u> |
|---------------------|---|-----------------------------------|------------------------|-------------------------------|
| Defaults/Dismissals | 34,439,920 | 625,663 | | 590 |
| Settled | 203,563,195 | 23,886,737 | | 809 |
| Tried and Decided | 16,547,888 | 6,200,066 | 65% | 835 |
| All Cases | 254,551,003 | 30,712,446 | | 723 |

* Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

Court of Federal Claims

| | <u>Overpayment Disputed in Case</u> | <u>Overpayment Determined</u> | <u>Sustention Rate</u> | <u>Avg. Cycle In Days</u> |
|---------------------|---|-----------------------------------|------------------------|-------------------------------|
| Defaults/Dismissals | 135,323,029 | 26,657 | | 916 |
| Settled | 444,643,194 | 97,809,715 | | 1450 |
| Tried and Decided | 85,589,226 | 2,701,449 | 79% | 1519 |
| All Cases | 665,555,449 | 100,537,821 | | 1283 |

* Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

Fiscal Year 2002

| | <u>Total No. of Cases Closed</u> | <u>Defaults/ Dismissals</u> | <u>Settled</u> | <u>Tried & Decided</u> | <u>Declaratory Judgment</u> |
|-----------------|--------------------------------------|---------------------------------|----------------|--------------------------------|---------------------------------|
| Tax Court | 15,658 | 4,038 | 10,826 | 778 | 16 |
| District Court | 328 | 129 | 122 | 77 | |
| Ct. of Fed. Cl. | 246 | 179 | 38 | 29 | |
| Total | 16,232 | 4,346 | 10,986 | 884 | 16 |

Tax Court Cases

| | <u>Tax & Penalty Disputed in Case</u> | <u>Tax & Plty Determined</u> | <u>Ovrpymnt In Dispute</u> | <u>Ovrpymnt Determined</u> |
|---------------------|---|--------------------------------------|--------------------------------|--------------------------------|
| Defaults/Dismissals | 926,534,353 | 164,802,929 | 289,552,313 | 755,266 |
| Settled | 3,929,763,988 | 649,802,087 | 740,764,168 | 218,979,982 |
| Tried and Decided | 1,840,219,246 | 326,083,138 | 87,289,374 | 28,893,546 |
| Total | 6,696,517,587 | 1,140,688,154 | 117,605,855 | 248,628,794 |

| | <u>Sustention Rate</u> | <u>Avg. Cycle Time in Days</u> |
|----------------------|------------------------|------------------------------------|
| Defaults/Dismissals | | 228 |
| Settled | | 402 |
| Tried and Decided | 90% | 990 |
| Declaratory Judgment | 81% | 703 |
| All cases | | 386 |

- Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

District Courts

| | <u>Overpayment Disputed in Case</u> | <u>Overpayment Determined</u> | <u>Sustention Rate</u> | <u>Avg. Cycle In Days</u> |
|---------------------|---|-----------------------------------|------------------------|-------------------------------|
| Defaults/Dismissals | 48,993,742 | 13,598,117 | | 581 |
| Settled | 1,441,137,384 | 15,633,334 | | 807 |
| Tried and Decided | 50,925,619 | 6,399,927 | 69% | 1190 |
| All Cases | 1,541,056,745 | 35,631,378 | | 808 |

* Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

Court of Federal Claims

| | <u>Overpayment Disputed in Case</u> | <u>Overpayment Determined</u> | <u>Sustention Rate</u> | <u>Avg. Cycle In Days</u> |
|---------------------|---|-----------------------------------|------------------------|-------------------------------|
| Defaults/Dismissals | 276,409,571 | 270,771 | | 1420 |
| Settled | 69,616,687 | 15,302,191 | | 1518 |
| Tried and Decided | 357,048,792 | 2,035,999 | 90% | 1011 |
| All Cases | 703,075,050 | 17,608,961 | | 1387 |

* Sustention Rate is equal to 100-(# of reported losses/# of cases tried and decided)

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

| Collection Case Dispositions | | | | | | |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <u>Total Dispositions</u> | <u>FY 1997</u> | <u>FY 1998</u> | <u>FY 1999</u> | <u>FY 2000</u> | <u>FY 2001</u> | <u>FY 2002</u> |
| TDA (Modules) | 5,012,662 | 4,288,695 | 2,954,434 | 2,771,870 | 3,040,809 | 3,013,769 |
| TDI (Taxpayers) | 1,647,848 | 1,381,025 | 1,748,164 | 1,445,593 | 1,086,236 | 905,872 |
| OIC (Taxpayers) ¹ | 117,173 | 99,154 | 71,393 | 83,208 | 113,209 | 143,102 |

Source: CAR NO 5000-2, 5000-4, 5000-108 reports

¹ Includes cases closed as Not Processable because the taxpayer is either in bankruptcy or not in filing compliance.

| Enforcement Activity | | | | | | |
|-----------------------------|----------------|----------------|----------------|-----------------|----------------------|----------------------------|
| <u>Action</u> | <u>FY 1997</u> | <u>FY 1998</u> | <u>FY 1999</u> | <u>FY 2000</u> | <u>FY 2001</u> | <u>FY 2002²</u> |
| Liens | 543,613 | 382,755 | 167,867 | 287,517 | 428,376 | 528,020 |
| Levies ³ | 3,659,417 | 2,503,409 | 504,403 | 219,778 | 674,080 ⁴ | 1,321,795 |
| Seizure | 10,030 | 2,307 | 161 | 74 ⁵ | 234 ⁵ | 296 ⁵ |

Source: CAR NO 5000-23 for SBSE and CSAR reports for ACS all BODs

| Collection Staffing in Full Time Equivalents (FTE) Realized | | | | | | |
|--|--------------------|----------------|----------------|----------------|----------------|----------------|
| <u>Location</u> | <u>FY 1997</u> | <u>FY 1998</u> | <u>FY 1999</u> | <u>FY 2000</u> | <u>FY 2001</u> | <u>FY 2002</u> |
| CFf * | 7,225 | 6,665 | 6,399 | 5,696 | 5,879 | 5,329 |
| ACS | 2,647 ⁶ | 2,242 | 2,124 | 2,375 | 2,617 | 2,753 |
| CSCO# | 3,078 | 2,721 | 2,811 | 2,505 | 2,712 | 2,624 |
| COIC ⁷ | | | | | | 643 |

Source: AFS payroll data for PAC 7D and 7C. For Compliance Services, PAC 7C is split between the offices according to the proportion reflected in WP&C data for the same period.

Compliance Services Collection Operations

² All counts are from C-23 report for SBSE CFf and from CSAR report for ACS all BODs.

³ These are notices of levy issued in Collection Field function (CFf) and Automated Collection System (ACS) offices. Excluded are systemically issued levies such as the Federal Payment Levy Program (FPLP), State Income Tax Levy Program (SITLP), and Alaska Permanent Fund Levy Program (AKPFD).

⁴ Counted for SBSE CFf from C-23 report but ACS information is from the CSAR report.

⁵ The FY 2000, FY 2001 and FY2002 figures are different than the C-23 report. These figures reflect a physical count (originally conducted in December 2001 and annually thereafter) of seizures done during these years.

* Shows Revenue Officer staffing levels

⁶ The 1997 ACS FTEs cannot be compared to other years, because Nashville's FTEs in 1997 included both ACS and Taxpayer Service staffing. The ACS staffing cannot be backed out from the total.

⁷ Centralized Offer in Compromise offices at Brookhaven and Memphis began operations in August 2001.

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

The IRS has approximately 79,000 email accounts. As of April 2003, over 41,000 were enrolled in secure email (also called Secure Messaging). To date, Appeals, Chief Counsel and Taxpayer Advocate email users are completely enrolled. TIGTA and Criminal Investigations e-mail users will be enrolled by June 2003 when additional security devices are installed on their computers. Users in other business units are being enrolled as their computers are replaced with a newer model. The IRS has slowed the computer replacement program due to a funding shortfall.

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

See Appendix V

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

| FISCAL YEAR | SQUARE FOOTAGE |
|--------------------|-----------------------|
| 1997 | 34,985,517 |
| 1998 | 34,321,000 |
| 1999 | 33,626,842 |
| 2000 | 29,610,961 |
| 2001 | 30,275,349 |
| 2002 | 31,103,453 |

Summary of §1203 Allegations Recorded In ALERTS as of March 31, 2003

| 1203 Violation | 1203 Section | Completed Inquiries | Inquiry In Progress | 1203 Inquiry Deferred | Total |
|---|--------------|---------------------|---------------------|-----------------------|--------------|
| Seizure Without Approval | (b)(1) | 16 | 1 | 0 | 17 |
| False Statement Under Oath | (b)(2) | 21 | 0 | 1 | 22 |
| Constitutional & Civil Rights Issues | (b)(3) | 280 | 12 | 13 | 305 |
| Falsifying or Destroying Records | (b)(4) | 68 | 14 | 7 | 89 |
| Assault or Battery | (b)(5) | 12 | 0 | 1 | 13 |
| Retaliate or Harass | (b)(6) | 1,765 | 14 | 30 | 1,809 |
| Misuse of 6103 | (b)(7) | 3 | 0 | 1 | 4 |
| Failure to File Federal Tax Return | (b)(8) | 998 | 78 | 42 | 1,118 |
| Understatement of Federal Tax Liability | (b)(9) | 722 | 190 | 26 | 938 |
| Threat to Audit for Personal Gain | (b)(10) | 85 | 7 | 5 | 97 |
| Totals | | 3,970 | 316 | 126 | 4,412 |

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 1,780 taxpayer complaints alleging §1203 issues based on the constitutionality of the nation's tax laws. These complaints were not recorded in ALERTS.
 - b) As of March 31, 2003, the DCRU had received a cumulative total of 1,136 Section 1203(b)(3)(B) cases for review. 986 cases have been reviewed and closed.

Source: Automated Labor and Employee Relations Tracking System (ALERTS).

Extract Date: Tuesday, April 01, 2003

Summary of Completed §1203 Inquiries Recorded In ALERTS as of March 31, 2003

| 1203 Violation | 1203 Section | Substantiated Misconduct | | Allegation Not Substantiated | Total |
|---|--------------|--------------------------|---------------------|------------------------------|--------------|
| | | 1203 Misconduct | Non-1203 Misconduct | | |
| Seizure Without Approval | (b)(1) | 1 | 2 | 13 | 16 |
| False Statement Under Oath | (b)(2) | 1 | 3 | 17 | 21 |
| Constitutional & Civil Rights Issues | (b)(3) | 1 | 14 | 265 | 280 |
| Falsifying or Destroying Records | (b)(4) | 10 | 22 | 36 | 68 |
| Assault or Battery | (b)(5) | 1 | 6 | 5 | 12 |
| Retaliate or Harass | (b)(6) | 6 | 126 | 1,633 | 1,765 |
| Misuse of 6103 | (b)(7) | 0 | 0 | 3 | 3 |
| Failure to File Federal Tax Return | (b)(8) | 386 | 362 | 250 | 998 |
| Understatement of Federal Tax Liability | (b)(9) | 71 | 476 | 175 | 722 |
| Threat to Audit for Personal Gain | (b)(10) | 13 | 23 | 49 | 85 |
| Totals | | 490 | 1,034 | 2,446 | 3,970 |

Source: Automated Labor and Employee Relations Tracking System (ALERTS).

Extract Date: Tuesday, April 01, 2003

Summary of Substantiated §1203 Allegations Recorded In ALERTS as of March 31, 2003

| 1203 Violation | Removals | Resigned / Retired | Probation Separation | Removed On Other Grounds | Penalty Mitigated | In Review Board Process | Total |
|---|-----------|--------------------|----------------------|--------------------------|-------------------|-------------------------|------------|
| Seizure Without Approval | 0 | 0 | 0 | 0 | 0 | 1 | 1 |
| False Statement Under Oath | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Constitutional & Civil Rights Issues | 0 | 0 | 0 | 1 | 0 | 0 | 1 |
| Falsifying or Destroying Records | 3 | 5 | 1 | 0 | 0 | 1 | 10 |
| Assault or Battery | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Retaliate or Harass | 1 | 4 | 0 | 1 | 0 | 0 | 6 |
| Misuse of 6103 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Failure to File Federal Tax Return | 60 | 92 | 13 | 15 | 175 | 31 | 386 |
| Understatement of Federal Tax Liability | 11 | 16 | 1 | 1 | 18 | 24 | 71 |
| Threat to Audit for Personal Gain | 5 | 4 | 2 | 1 | 1 | 0 | 13 |
| Totals | 81 | 122 | 17 | 19 | 194 | 57 | 490 |

Notes:

1. The cases reported as "Removals" and "Penalty Mitigated" do not reflect the results of any third party appeal.

Unsubstantiated §1203 Allegations with Other Proven Misconduct In ALERTS as of March 31, 2003

| 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) | 1 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 3 |
| Constitutional & Civil Rights Issues | (b)(3) | 0 | 1 | 0 | 1 | 2 | 1 | 6 | 2 | 1 | 14 |
| Falsifying or Destroying Records | (b)(4) | 1 | 1 | 0 | 7 | 3 | 1 | 3 | 1 | 5 | 22 |
| Assault or Battery | (b)(5) | 0 | 1 | 0 | 0 | 1 | 0 | 1 | 1 | 2 | 6 |
| Retaliate or Harass | (b)(6) | 2 | 6 | 0 | 13 | 20 | 8 | 36 | 19 | 22 | 126 |
| Misuse of 6103 | (b)(7) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Failure to File Federal Tax Return | (b)(8) | 6 | 51 | 24 | 15 | 38 | 56 | 98 | 17 | 57 | 362 |
| Understatement of Federal Tax Liability | (b)(9) | 4 | 17 | 1 | 15 | 47 | 95 | 188 | 19 | 90 | 476 |
| Threat to Audit for Personal Gain | (b)(10) | 1 | 2 | 0 | 4 | 5 | 1 | 6 | 1 | 3 | 23 |
| Totals | | 15 | 80 | 25 | 55 | 116 | 162 | 339 | 62 | 180 | 1,034 |

Source: Automated Labor and Employee Relations Tracking System (ALERTS).

Extract Date: Tuesday, April 01, 2003

Appendix II

| Fiscal Year | Number of Complaints Filed | Bases of Complaints (not listed in any specific order) | Major Issues (not listed in any specific order) | Percentage of Complaints Settled (cases settled/all cases closed)* |
|---|-----------------------------------|---|--|---|
| 1997 | 763 | reprisal, race, color, national origin, gender, disability, age, and religion | working conditions, appointment/hire, promotion/nonselction, harassment (nonsexual), harassment (sexual), training, time and attendance, duty assignment, reassignment, disciplinary action, appraisal/awards | 28% |
| 1998 | 806 | reprisal, race, color, national origin, gender, disability, age, and religion | working conditions, appointment/hire, promotion/nonselction, separation/retirement, harassment (nonsexual), harassment (sexual), training, time and attendance, duty assignment, reassignment, disciplinary action, appraisal/awards | 32% |
| 1999 | 842 | reprisal, race, color, national origin, gender, disability, age, and religion | working conditions, promotion/nonselction, harassment (nonsexual), training, time and attendance, duty assignment, reassignment, disciplinary action, appraisal/awards | 28% |
| 2000 | 766 | reprisal, race, color, national origin, gender, disability, age, and religion | working conditions, promotion/nonselction, harassment (nonsexual), training, time and attendance, duty assignment, reassignment, disciplinary action, appraisal/awards | 22% |
| 2001 | 715 | reprisal, race, color, national origin, gender, disability, age, and religion | working conditions, promotion/nonselction, harassment (nonsexual), training, time and attendance, duty assignment, reassignment, disciplinary action, appraisal/awards | 21% |
| 2002 | 763 | reprisal, race, color, national origin, gender, disability, age, and religion | working conditions, appointment/hire, promotion/nonselction, harassment (nonsexual), training, time and attendance, duty assignment, reassignment, disciplinary action, appraisal/awards | 23%** |
| * -- Typical remedies in settlement agreements are as follows: back pay, compensatory damages, attorney's fees, promotions, reassignments, negative documents pulled from EPFs/OPFs, details, restoration of sick leave, restoration of annual leave, priority consideration, no negative comments on an SF-50, updated appraisal, cash awards or bonuses, changes in duty hours, within grade increases, new posts-of-duty | | | | |
| ** -- As indicated in the heading for the column, the 23% is a fraction of the cases settled (178) and all cases closed (772) for FY 2002, i.e., 178/772 = 23%. | | | | |

Appendix III a.

| AS OF SEPTEMBER 30 | | | | | | | | | | | | | |
|--------------------|-----------------|--------|-------------|--------|-------------|--------|-------------|--------|-------------|--------|-------------|--------|-------------|
| YEAR | TOTAL EMPLOYEES | AVG_GD | AVG_SAL | 98 INC | 98 SAL | 99 INC | 99 SAL | 00 INC | 00 SAL | 01 INC | 01 SAL | 02 INC | 02 SAL |
| 1997 | 115509 | 08 | \$38,170.83 | 2.50% | \$39,125.10 | 3.60% | \$40,533.60 | 5.60% | \$42,803.48 | 4.90% | \$44,900.85 | 2.80% | \$46,158.07 |
| 1998 | 113491 | 08 | \$39,498.89 | | | 3.60% | \$40,920.85 | 5.60% | \$43,212.42 | 4.90% | \$45,329.83 | 2.80% | \$46,599.06 |
| 1999 | 112969 | 08 | \$41,039.76 | | | | | 5.60% | \$43,337.99 | 4.90% | \$45,461.55 | 2.80% | \$46,734.47 |
| 2000 | 114014 | 08 | \$43,004.78 | | | | | | | 4.90% | \$45,112.01 | 2.80% | \$46,375.15 |
| 2001 | 115571 | 08 | \$44,796.33 | | | | | | | | | 2.80% | \$46,050.63 |
| 2002 | 119150 | 08 | \$46,811.69 | | | | | | | | | | \$46,811.69 |

Appendix III b.

AS OF SEPTEMBER 30, 1997

| | TOTAL |
|----------|--------------|
| GD-14-15 | 6269 |
| SES | 256 |

| | AVG_AGE |
|--------------------------|----------------|
| OTHER | 44 |
| REVENUE AGENT | 44 |
| REVENUE OFFICER | 44 |
| TAX EXAMINER | 46 |
| GD-14-15 OTHER | 47 |
| GD-14-15 REVENUE AGENT | 49 |
| GD-14-15 REVENUE OFFICER | 47 |
| SES OTHER | 50 |
| SES REVENUE AGENT | 48 |
| CHIEF CONSEL | 43 |

| | TOTAL |
|---------|--------------|
| MGR | 43854 |
| NON-MGR | 8259 |

Appendix III c.

AS OF SEPTEMBER 30, 1998

| | TOTAL |
|----------|--------------|
| GD-14-15 | 6589 |
| SES | 263 |

| | AVG_AGE |
|--------------------------|----------------|
| OTHER | 45 |
| REVENUE AGENT | 45 |
| REVENUE OFFICER | 45 |
| TAX EXAMINER | 46 |
| GD-14-15 OTHER | 48 |
| GD-14-15 REVENUE AGENT | 50 |
| GD-14-15 REVENUE OFFICER | 48 |
| SES OTHER | 50 |
| SES REVENUE AGENT | 49 |
| CHIEF COUNSEL | 43 |

| | TOTAL |
|---------|--------------|
| MGR | 42321 |
| NON-MGR | 8354 |

Appendix III d.

AS OF SEPTEMBER 30, 1999

| | TOTAL |
|----------|--------------|
| GD-14-15 | 6963 |
| SES | 264 |

| | AVG_AGE |
|--------------------------|----------------|
| OTHER | 45 |
| REVENUE AGENT | 46 |
| REVENUE OFFICER | 46 |
| TAX EXAMINER | 47 |
| GD-14-15 OTHER | 48 |
| GD-14-15 REVENUE AGENT | 50 |
| GD-14-15 REVENUE OFFICER | 48 |
| SES OTHER | 50 |
| SES REVENUE AGENT | 48 |
| CHIEF COUNSEL | 44 |

| | TOTAL |
|---------|--------------|
| MGR | 41765 |
| NON-MGR | 8462 |

Appendix III e.

AS OF SEPTEMBER 30, 2000

| | TOTAL |
|----------|--------------|
| GD-14-15 | 7397 |
| SES | 256 |

| | AVG_AGE |
|--------------------------|----------------|
| OTHER | 45 |
| REVENUE AGENT | 47 |
| REVENUE OFFICER | 47 |
| TAX EXAMINER | 47 |
| GD-14-15 OTHER | 48 |
| GD-14-15 REVENUE AGENT | 50 |
| GD-14-15 REVENUE OFFICER | 50 |
| SES OTHER | 51 |
| SES REVENUE AGENT | 49 |
| CHIEF COUNSEL | 45 |

| | TOTAL |
|---------|--------------|
| MGR | 42216 |
| NON-MGR | 8701 |

Appendix III f.

AS OF SEPTEMBER 30, 2001

| | TOTAL |
|----------|--------------|
| GD-14-15 | 6463 |
| SES | 311 |

| | AVG_AGE |
|--------------------------|----------------|
| OTHER | 46 |
| REVENUE AGENT | 47 |
| REVENUE OFFICER | 48 |
| TAX EXAMINER | 47 |
| GD-14-15 OTHER | 48 |
| GD-14-15 REVENUE AGENT | 50 |
| GD-14-15 REVENUE OFFICER | 53 |
| SES OTHER | 51 |
| SES REVENUE AGENT | 50 |
| CHIEF COUNSEL | 45 |

| | TOTAL |
|---------|--------------|
| MGR | 42274 |
| NON-MGR | 7373 |

Appendix III g.

AS OF SEPTEMBER 30, 2002

| | TOTAL |
|----------|-------|
| GD-14-15 | 6667 |
| SES | 323 |

| | AVG_AGE |
|--------------------------|---------|
| OTHER | 46 |
| REVENUE AGENT | 48 |
| REVENUE OFFICER | 48 |
| TAX EXAMINER | 47 |
| GD-14-15 OTHER | 49 |
| GD-14-15 REVENUE AGENT | 51 |
| GD-14-15 REVENUE OFFICER | 48 |
| SES OTHER | 51 |
| SES REVENUE AGENT | 48 |
| CHIEF CONSEL | 45 |

| | TOTAL |
|---------|-------|
| MGR | 43799 |
| NON-MGR | 7225 |

Congress of the United States

JOINT COMMITTEE ON TAXATION

Washington, DC 20515-6453

Honorable Bob Wenzel
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Room 3000
Washington, D.C. 20224

APR 2 2003

Dear Acting Commissioner Wenzel:

SUBJECT: JOINT REVIEW OF THE IRS STRATEGIC PLANS AND BUDGET

We are writing to request information in connection with the annual joint Congressional review of the strategic plans and budget of the Internal Revenue Service ("IRS"). Section 8022(f)(3) of the Internal Revenue Code requires the Joint Committee on Taxation to report, for each calendar year after 1998 and before 2004, on (1) the strategic and business plans for the IRS, (2) the progress of the IRS in meeting its objectives, (3) the budget for the IRS and whether it supports its objectives, (4) the progress of the IRS in improving taxpayer service and compliance, (5) the progress of the IRS on technology modernization, and (6) the annual filing season. The report is prepared for the Committees on Ways and Means, Appropriations, and Government Reform of the House of Representatives and the Committees on Finance, Appropriations, and Governmental Affairs of the Senate to assist these committees in the annual joint review of the IRS.

To assist us in preparing our report, we require certain information from the IRS. Attached is a list of questions covering a variety of topics that are of interest to the relevant committees. So that we may complete our report in sufficient time for the joint review, a response is required by April 30. Due to the time-sensitive nature of our inquiry, we would appreciate your forwarding responsive information as soon as it becomes available.

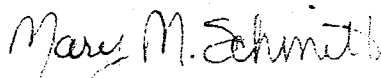
This document is a record of the Joint Committee on Taxation ("Joint Committee") and is entrusted to the recipient for your use only in handling this matter. Additionally, any documents created by the recipient in connection with a response to this Joint Committee document, including (but not limited to) any replies to the Joint Committee, are records of the Joint Committee and shall be segregated from agency records and remain subject to the control of the Joint Committee. Accordingly, the aforementioned documents are not "agency records" for purposes of the Freedom of Information Act. Absent explicit Joint Committee authorization, access to this document and any responsive documents shall be limited to appropriate personnel who need such access for the purposes of providing information or assistance to the Joint Committee.

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515-6453

Honorable Bob Wenzel, Acting Commissioner

Should you have any questions regarding this letter or the attached questions, please contact Roger Colinvaux of my staff at (202) 224-7640.

Sincerely,



Mary Schmitt
Acting Chief of Staff

cc: Floyd Williams, National Director
Legislative Affairs

Questions for the Internal Revenue Service

Many of the requests below are requests for data. For purposes of answering these data requests, a history of data for each year from Fiscal Year 1997 through Fiscal Year 2002 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"), the IRS changed its mission to emphasize serving the public and meeting the needs of taxpayers. Please describe how customer service has improved, providing (where applicable) annualized data on customer service before the Act through Fiscal Year 2002 in the following areas:

- (1) Telephone Service for Taxpayer Questions. Please provide data showing the number of answers to taxpayer calls. 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.
- (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.
- (3) Internet Service for Taxpayer Questions. Please provide data on the Electronic Tax Law Assistance Program, through which taxpayers can make inquiries on the IRS website. If available, show the number of queries, number of responses, and average time of response.
- (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.
- (5) Audit data. 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.
- (6) Limited Issue Focused Examination. This new targeted audit program for the largest businesses involves agreements between taxpayers and the IRS that limit

the issues to be addressed in exchange for limits on claims. Please describe the status of this program and the IRS's goals for the program.

- (7) Taxpayer complaints. Please show the number of telephonic and written taxpayer complaints against the IRS.
- (8) Please comment on progress in providing local telephone numbers and addresses of IRS offices in the local telephone book as required by section 3709 of the Act.
- (9) 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.

II. Business Systems Modernization

- (1) 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. According to some reports, CADE is significantly over-budget and behind schedule. Specifically, the first release reportedly has been trimmed back in functionality from what was originally promised (in addition to being late and over-budget). Is this true? Please describe the current status of CADE, the plan for the first and future releases, development and testing of software, and the effectiveness of the PRIME contractor with respect to CADE. When will CADE permit employees directly to make adjustments to taxpayer's returns?
- (2) Success in implementing CADE depends on success with the Customer Account Management program, which allows the IRS to update data for CADE. Customer Account Management has two operating models: Individual Assistance and Self-Assistance. Please explain the current status of both models.
- (3) The Office of Management and Budget has cut funding for Modernization programs in part because the IRS significantly underestimates the cost of projects. Why does the IRS consistently have problems accurately projecting Modernization costs and what is being done?
- (4) How will the recent retirement of key IRS employees affect Business Systems Modernization?
- (5) The TIGTA has found that cost and schedule performance of Business Systems Modernization is improving. Although the Software Engineering Institute's favorable review of the IRS's management framework for acquiring modernized business solutions is welcome news, why was such favorable review not obtained earlier? Please explain how this framework will assist modernization; will it help with the problem of cost overruns? Is the framework appropriate for the tasks ahead?

- (6) Please explain the contractual relationship between the IRS and the PRIME, and the relationship between the PRIME and PRIME's contractors?

III. Taxpayer Protection and IRS Oversight

- (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? The IRS's innocent spouse determinations were 7 percent less than planned in Fiscal Year 2002 and the IRS has lowered the case closure target from 65,000 in Fiscal Year 2002 to 51,500 in Fiscal Year 2003. Last year, the IRS stated that reduction of staffing for field examiners on innocent spouse claims was justified because of efficiencies achieved from deployment of the Integrated Case Processing computer application. Have these efficiencies in fact been achieved?
- (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. The IRS Oversight Board recently stated its concern that almost 80 percent of offers received cannot immediately be processed. What steps are being taken? Are legislative changes necessary? Please update your discussion of processing time, automation, and centralization of the process.
- (3) Collection Due Process. The IRS has reported that the due process provisions of the Act slow and lengthen the overall compliance cycle and that the process was open to abuse by taxpayers seeking to delay collection activities by filing frivolous claims. This year, the Administration's Fiscal Year 2004 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.
- (4) Tax Preparer Registration. Please comment on the National Taxpayer Advocate's proposal to require tax preparers to register with the IRS, to require the IRS to develop a series of exams to test the technical knowledge and competency of tax preparers, and a requirement that the IRS annually certify paid preparers.
- (5) Merger of TIGTA and Treasury Inspector General. Please comment on the Administration's proposal to merge the TIGTA and the Treasury Inspector General into a new Inspector General for Treasury. Is the TIGTA not operating as envisioned in the 1998 Act? Would the proposal increase the risk of disclosure of confidential tax return information?

IV. 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 enumerated in section 1203? Have the procedures been effective in addressing employee misconduct?
- (2) The Administration's Fiscal Year 2004 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?
- (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?
- (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?
- (5) Please discuss whether section 1203 has had an impact on the number of seizures, levies, face-to-face audits, and job performance.

(b) 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?
- (2) How much (total and on a year-by-year basis) has the IRS spent on moving expenses for critical pay personnel? How does this compare to the number of critical pay hires in a year?
- (3) How much (total and on a year-by-year basis) has the IRS spent on search firms to recruit critical pay personnel and how much of this amount is attributable to personnel actually hired?
- (4) Please show the prior salary and critical pay salary for each critical pay employee hired.
- (5) How many of those hired work in automation, administration, and general business respectively?

- (6) How many hired pursuant to the special pay provisions have since left the IRS? What is the average tenure?
- (7) Please describe specific accomplishments made possible by the special pay provisions.
- (8) Would more be accomplished if IRS employees were eligible for the special pay provisions?

(d) Please show the number and kind of Equal Employment Opportunity Commission complaints and grievances. What percentage of complaints were settled? What was the type of remedy provided?

(e) Please compare the average salary (adjusted for inflation in 2002 dollars) and average grade of all employees from 1997 through 2002.

V. Revenue and Business Results

Please provide data for the following:

- (1) Total revenue collected; total enforcement revenue collected.
- (2) Total number of returns filed.
- (3) Total number of full time equivalent employees; number of employees involved in automation.
- (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.
- (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. What specific steps are being taken to increase electronic filing, including steps to ensure coordinated filing between the IRS and State governments?
- (6) Total number of audits, percent of "no change audits"; average cycle time per audit; number of employees conducting audits.
- (7) The projected loss of revenue from non-filers; total tax gap.

- (8) Total number of the Senior Executive Service, GS-15s, and 14s; average age of IRS employees above GS-9, break out average age of revenue agents, revenue officers, tax auditors, chief counsel employees.
- (9) Total number of managers; ratio of management staff to non-management staff; average number of employees managed by first line managers.
- (10) Total number of appeals; Appeals sustention rate; and cycle time.
- (11) Total number of trials; total docketed cases/dollar amounts; litigation sustention rate, and cycle time.
- (12) Total number of collections, seizures, liens, and levies; number of employees involved in collection activities.
- (13) What is the latest status of the Enterprise Wide Security Mail system (i.e., secure e-mail for sensitive data)?
- (14) Number of criminal cases; number of criminal convictions, percentage of tax verses non-tax.
- (15) Total square footage of building space the IRS occupies.